CENTRAL BANK OF SOLOMON ISLANDS

The Governor

29th April, 2013

Hon. Rick Houenipwela, MP
Minister of Finance
Department of Finance and Treasury
P O BOX 26
HONAIRA

Dear Honourable Minister

In accordance with the provision of section 58(2) of the Central Bank of Solomon Islands Act, 2012. I submit to you the 2012 report on the operations and the audited financial statements of the Bank.

Yours sincerely

Denton Rarawa
Governor

Governor's Foreword

We are pleased to inform our readers that starting in this edition, the format and content of our annual reports have been changed and presented in accordance to the new CBSI Act 2012 with statutory reporting requirements for greater accountability and transparency of the Central Banks policies and operations.

2012 can be regarded as a year of two halves for the Solomon Islands economy. Most macroeconomic indicators reported strong performances during the first six months of the year then slowed down or fell in the second half. On the other hand, other indicators recorded opposite movements, where the second half of the year was stronger than the first half.

The contrasting performances reflected developments and events in the global economy during the year. The global economy grew by 3.2% in 2012, slightly lower than the 3.9% reported in the previous year. This was driven primarily by growth in emerging market and developing economies while growth in advanced economies remained sluggish.

In our region, growth was driven mainly by developing Asian economies, supported by monetary policy easing, strong employment growth and solid consumption. However, downside risks remain, including renewed tensions in the Euro area and fiscal uncertainties in the US.

Against this backdrop of global uncertainty and weak recovery, growth in the Solomon Islands economy slowed in 2012. All other sectors reported positive growth except for agriculture. The contribution of agriculture to growth fell due to weak commodity prices. Public investments in infrastructure projects helped to sustain activities in certain sectors in particular, construction and services industries.

With foreign reserves at comfortable levels, the focus of monetary policy in 2012 turned to containing inflationary pressures in the economy. This was done through active open market operations to absorb the high levels of free liquidity in the system and through exchange rate policy. Aided by easing international food and oil prices, these actions yielded positive results with domestic inflation falling to 4.6% at the end of 2012 from 10.1% at the end of 2011.

The **financial system in Solomon Islands** remained sound and profitable. The banks are well capitalized and non-bank financial institutions reported positive trading results for the year. Prudential supervision and regulatory oversight during the year focused on compliance to prudential guidelines for the banks and a review of the investment portfolio of the SI National Provident Fund (SINPF).

The Bank intensified its activities in the **financial inclusion** space during the year. These activities focused on financial education, review of the legal framework, guidelines on minimum "know your customer" (KYC) requirements, mobile phone banking, financial literacy training, community savings clubs as well as data measurement and reporting. This culminated in our commitments to the Maya Declaration at the Alliance for Financial Inclusion (AFI) Global Policy Forum in Cape Town.

Listed below are notable CBSI activities and events in 2012:

- The coin reform program which started in 2010 culminated in the launching of a new five-coin array in July 2012.

- To commemorate the visit of their Royal Highnesses, the Duke and Duchess of Cambridge to Solomon Islands in September, the Bank issued a special silver proof coin for sale to the public and collectors. The coin had to be approved by St James Palace.

- The Governor presented the Bank's commitments to the Maya Declaration at the AFI Global Policy Forum in Cape Town in September 2012. The Declaration committed the Bank to provide leadership, advice and support to the Solomon Islands National Financial Inclusion Taskforce in achieving its goal of an additional 70,000 unbanked and under-served citizens of the country to have access to financial services by 2015. The Bank also committed to embark on data improvements and produce measurable indicators, champion the integration of financial education into the national school curriculum and provide an enabling legal environment by implementing the recommendations of the regulatory review completed in 2011.

- A new Central Bank Act (CBSI Act 2012) was enacted in November 2012 and came into force on 1st January 2013. The new Act, among other things, brought the CBSI Act in line with international best practices for central banking and governance. The law also strengthened CBSI's autonomy and accountability and limited political influence into the operations of the Bank.

- The Bank completed its Rifle Range staff housing project. The estate currently houses some of the Bank's senior management staff.

- The CBSI Governor voted for the IMF Executive Board Resolutions on the following issues: Governance Reforms of the Executive Board, Election of Executive Directors, the use of Proceeds of IMF Gold sales, the Amendments of the Articles of Agreement of the IMF, the 14th General Review of IMF Quotas and the venue for the 2015 Annual Meetings of the Board of Governors of the World Bank Group and IMF.

- The CBSI Board held eight meetings during the year. Two of these meetings were held outside of Honiara; one at the Bank's recreational site on Guadalcanal and the other at Lata, Temotu province. The Board used the occasion of the Lata meeting to meet with the Temotu Provincial Premier and other leaders. Bank staff accompanying the Board also conducted public awareness programs on the roles and functions of the Central Bank, awareness on the new coins and financial literacy training. The Governor presented books and reading materials to the provincial library and two schools in the Temotu.

- The Bank signed a Memorandum of Understanding (MOU) with the International Finance Corporation (IFC) to collaborate on activities towards the national payment systems project. This project will conclude in the enactment of a National Payment Systems Act for the country.

More details of the Bank's operations and activities in 2012 are presented in the rest of the chapters of this report.

In closing, it would be remiss of me not to acknowledge those organizations and individuals that have contributed towards the Bank's achievements in 2012. Firstly, let me acknowledge the CBSI Board of Directors for their guidance, advice and direction during the year. I would like to pay special tribute to out-going Director Antonio Lee, who completed his term on the Board at the end of the year. Secondly, I acknowledge the assistance of Government ministries, agencies, business houses, civil society groups, and all other stakeholders that have provided information and other services to the Bank. Finally, to all CBSI staff, from cleaners to chief managers, let me thank you for your dedication and professional contribution to the activities of the Bank during the year.

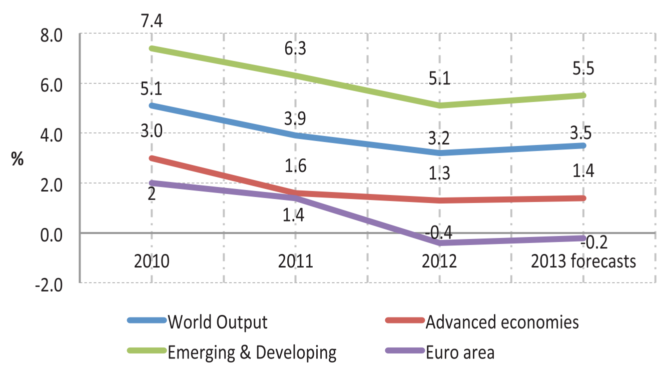
Denton Rarawa
Governor and Chairman of the Board

Chapter 1: Overview of Economic Developments in 2012

International Developments

The slow and protracted recovery in the advanced economies dented growth prospects for the global economy in 2012. According to the International Monetary Fund, world growth slowed down to 3.2% from 3.9% in 2011. Leading the growth were developing and emerging economies that grew 5.1%.

Figure 1: World GDP Growth



Source: IMF

Advanced economies posted a sluggish growth of 1.3% in 2012 as European countries slid into recession or struggled to shake off the aftermaths of the Euro crisis. This situation was further compounded by uncertainties that arose from the debt ceiling in the US economy. However, the US economy spurred by favourable labour market conditions and monetary policy loosening bounced back in the latter half of the year to post a moderate growth of 2.2%.

In the euro area, Germany and France grew 0.9% and 0.2% respectively but these were insufficient to offset the contractions in the periphery economies. Consequently, growth for the euro area remained negative at 0.4%.

The Solomon Islands major trading partners namely China, Australia and New Zealand recorded positive but slower growths against the previous year. The Chinese economy grew 7.8%, the lowest in more than a decade, on the back of weaker external and domestic demands. Australia, affected by the adverse commodity price movements, grew moderately by 3.3%. The New Zealand economy grew by 2% as a consequence of weak activities in manufacturing, exports and consumer spending.

Global inflation eased in 2012 in line with the weak demand conditions across major economies and plummeting commodity prices. Inflation in advanced economies was fairly flat at 2.0%. Average inflation in emerging and developing economies dropped further to 5.8%.

Similarly, average inflation in Solomon Islands' major trading partners fell further in 2012. Inflation in China decelerated to 3.0% while inflation in Australia and New Zealand dropped to 2.0% and 1.9% respectively.

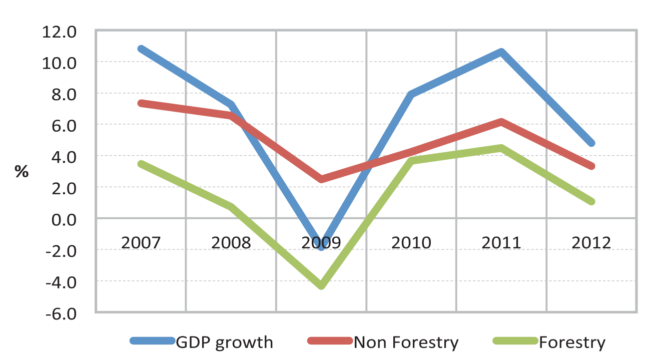
Domestic Developments

The Solomon Islands economy grew by 4.8% in 2012. All sectors except for agriculture contributed positively to the overall growth. However, the growth outturn was significantly lower than the 10.6% growth in 2011. The slowdown was due largely to the contraction in agricultural output combined with muted logging activities that were more or less sustained at the same level a year ago.

The balance of payments improved further, despite the fragile global conditions. Trade with other economies turned around from a deficit in 2011 to a trade surplus of $360 million in 2012 on the back of robust growth in exports. Sustained receipts from round log exports coupled with strong minerals and fisheries receipts outweighed the 30% fall in agricultural exports.

In line with the trade surplus, the current account deficit narrowed to $12 million and was financed mainly by capital inflows from donors and foreign direct investments. Gross foreign reserves increased to $3,652 million, equivalent to 10.5 months of import

Figure 2: Solomon Islands Economic Growth



Source: CBSI

cover.

In the real economy, performances by major commodities varied. Log production was sustained slightly above the previous year at 1.948 million cubic meters. Gold output rose to 67,819 ounces from 51,054 ounces in 2011. Output in the fishing industry increased on the back of strong prices and doubled throughput at the Noro cannery.

Agriculture, on the other hand, weakened as a result of low prices. This was evident when the combined export receipts for the three agricultural commodities namely palm oil, copra and cocoa contracted by 30%.

Domestic demand conditions remained upbeat. The manufacturing index[1] improved by 17%. Another indicator, lending for personal consumption grew by 21% over the year compared to subdued growth in imported consumables. The robust demand conditions could be attributed to several factors including the hosting of the 11th Festival of Pacific Arts (FOPA) in July 2012.

Proxy labour indicators showed there was a general growth in employment numbers. The average number of people that contributed[2] to the Solomon Islands National Provident Fund rose by 9% over the year to 48,332 people. The growth was consistent with other indicators such as advertised vacancies and reflected positive sentiments in both the private and public sectors.

Preliminary figures from the Government showed a fiscal surplus of $59 million in 2012, maintaining the positive trend seen in recent years. Nonetheless, expressing the surplus as a ratio of GDP, government finances weakened sharply from 6% in 2011 to 1% due to high expenditure growth. Expenditures relating to FOPA projects and constituency development funds recorded increases during the year.

Private sector credit from other depository corporations grew 4% to $1,271 million. Loans, the major credit facility, increased 20% to $1,094 million with most of the credit growth accounted for by personal, transport, communications, agriculture, construction and professional & other services. On the other hand, short term credit facilities dropped to around $155 million.

1 A composite index CBSI computed to measure manufacturing output in Solomon Islands.

2 Include active and slow active contributors that contributed within twelve months of the due date.

Liquidity levels at the commercial banks grew, albeit at a diminishing rate, to $1248 million. The primary sources of liquidity were foreign exchange inflows from donors, trade receipts and foreign direct investment.

Overall money supply increased by 17% to $3,065 million and was largely influenced by transferrable deposits and currency in circulation that increased by 34% and 11% respectively to outweigh other deposits which fell by 9% to $669 million. The growth in money supply in 2012 was dampened by the holdings of Central Bank Bokolo bills that increased to $356 million.

The interest rate margin remained around 10.5% for the second consecutive year despite falls in both the lending and deposit rates to 11.2% and 0.7% respectively. Similar trends were also depicted in the 91 day Treasury bills rate and the weighted average yield for Bokolo bills that declined to 0.34% and 0.47% respectively.

Headline inflation in the Solomon Islands, as measured by the three months moving average, slowed down to 4.6% in spite of the uptick in the final quarter. The overall slowdown reflected persistent deceleration in both imported and domestic components. Imported index eased to 2.4% due to easing food prices, moderate softening in energy prices in the second half of the year and downward pressures from miscellaneous items. The domestic component also subdued to 6.8% as a consequence of weaker growths in food and housing & utilities categories.

Outlook for 2013

The Solomon Islands economy is expected to grow by 4.0% in 2013, building on from the positive outcome in 2012. The growth is anticipated to come from non logging and non-mineral sectors on the assumptions that round log output would remain around the same level as in 2012 while mineral output may fall with the slow start at the beginning of the year.

On a positive note, exports in the first four months showed palm oil rebounded against last year. Processed sawn timber for the domestic and export markets is expected to rise further and boosting rural income. Ongoing capital and private sector projects will continue to be a stimulus to construction activities in the country. In the services sector, gradual improvements to transport and communication infrastructures helps to boost inter island trade linkages.

Government revenue is expected to increase strongly by 23% in 2013 to $3,607 million. Expenditure, on the other hand, is anticipated to increase slightly faster by 25% to $3,606 million to result in a smaller fiscal surplus of $0.7 million. About three quarter of budgeted revenue is represented by local sources. The remaining one quarter ($925 million) will be provided by Donors as budget support, of which 61% will go to recurrent budget and 39% towards capital expenditures. The Government remain committed to repaying its debt obligations in 2013 by allocating $134 million towards debt repayments.

Another trade surplus is expected for the year though at a reduced magnitude. This is on the grounds that imports are likely to expand much faster than the growth in exports. Weak commodity prices are major drivers behind this scenario. The smaller trade surplus combined with the likely deterioration in the primary account could reverse gains made in 2012 to the current account balance into a higher current account deficit. Despite these imbalances, gross foreign reserves will maintain the growth trend seen since 2010 on the back of ongoing donor support.

Large external inflows will continue to be the major source of monetary growth. However key monetary aggregates are likely to record slower growth momentum this year than in previous years. Structural liquidity levels in the banking system are anticipated to remain elevated but growth would be stifled as CBSI continues to issue Bokolo bills. Credit to private sector is bound to pick up modestly during the year in line with projected economic growth.

The CBSI projects inflation in 2013 to be within the 5% – 7% range on the back of weak import prices. There were, however, early pressures coming from oil and food price bumps which pushed inflation upward to 6.9% in February 2013. The latter was due to tight local supply conditions emanating from unfavourable weather patterns but considered as temporary. Despite high levels of liquidity in the banking system, the CBSI does not see this as a potential source of inflationary pressure because credit expansion is still conservatively low. Under the new CBSI Act 2012, price stability is becoming the primary policy objective of the Central Bank. To achieve this, the Central Bank will have to closely monitor the key macroeconomic aggregates and advise the Central Bank Board on the appropriate policy actions to take. The new Act ensures the CBSI is more accountable and transparent in terms of the conduct of the monetary policy.

Chapter 2: Board and Governance

(From L - R) **Front row - Mr. Leslie Teama - Director, Mrs Lilly Lomulo - Mrs Bella Simiha - Secretary to the Board, Mr. Katalulu Maepioh - Director, Mr Gane Simbe - Deputy Governor.**

Back row - Dr Steve Aumanu - Director, Mr Antonio Lee - Director, Mr Loyley Ngira - Director, Mr Denton Rarawa - Governor, Mr Shadrach Fanega - Ex-officio Director, PS Finance.

Section 7 of the Central Bank Act (CAP49) provides for the appointment of the Board of Directors. Those who are appointed as a director to the Bank must be 'persons of good repute and recognised experiences in financial matters, banking, public finance or have professional or academic experience'.

In 2012, the CBSI Board consisted of nine directors, two executive directors which include the Governor & Chairman; Mr Denton Rarawa, Deputy Governor & Deputy Chairman; Mr Gane Simbe, the Permanent Secretary of the Ministry of Finance; Mr Shadrach Fanega who is an ex-officio director, and six other non-executive directors; Dr. Steven Aumanu, Mr. Katalulu Maepioh, Mr. Leslie Teama, Mr. Loyley Ngira, Mrs Lilly Lomulo and Mr. Antonio Lee.

Directors Lee and Maepioh's term expired on 8th December 2012 and Directors Ngira and Lomulo's terms expired on 22nd December 2012. The Minister of Finance has renewed Director Maepioh's term for another two years and Directors Ngira and Lomulo's terms for another three years. Mr Lee decided to serve only one term. The CBSI Board and Staff are thankful to Mr Lee for the positive contributions he has made during his three year term as Director.

Board Meetings

Under the CBSI Act, the Board is required to hold a minimum of six meetings in a year. However during 2012 the Board held eight meetings, of which two meetings were held outside of Honiara - one was held at the CBSI Recreational site at Aruligo, West Guadalcanal and the other at Lata, Temotu Provincial capital. The Table below shows the numbers of meeting each Director attended in 2012.

Table 2.1: 2012 Board of Directors Meetings Attendance

Directors Names	Number of Meetings attended
Denton Rarawa	8
Gane Simbe	7
Shadrach Fanega	7
Dr. Steven Aumanu	8
Leslie Teama	6
Antonio Lee	5
Katalulu Maepioh	8
Loyley Ngira	6
Lilly Lomulo	5

Each year the Bank organises one provincial Board meeting. These provincial meetings provide the opportunity for the Board to interact and receive feedback from the communities on how national policies affect their development aspirations, especially issues related to access to financial or government services. The Board uses the opportunity to conduct awareness programs to explain the work of the Central Bank and answer questions they may have. In 2012, the Board travelled to Lata, Temotu province.

Corporate Governance

According to Section 38 of the CBSI Act 2012 "the operations and governance of the Central Bank shall be conducted and managed by the Board of Directors". Figure 4 below illustrates the corporate governance of the Central Bank, showing the flow of decision making and delegation of responsibilities from the Board through the Governor as Chief Executive Officer (CEO) of the Bank, and from Governor through to departments of the Bank. As the illustration shows many policy and administrative decisions made by the Bank are formulated at the departmental level, and passed on to various committees for critical scrutiny and evaluation. The conclusions and decisions of the various committees form the policy proposals that the Governor presents as recommendations to the Board for endorsement.

In 2012 a total of 47 Board papers were submitted to the Board for decision. Of the total, 25 papers were quarterly progress reports for noting; and the other 22 were policy papers for Board decisions. These policy papers included two bi-annual Monetary Policy Stance documents, the 2011 Annual Report and the 2011 Audited Financial Accounts, Gold investments,

Governor Rarawa presenting school materials to Temotu Province Premier, Fr. Brown Beu.

the installation of Bloomberg terminals, the draft CBSI Bill 2012, Review of the Training Policy, approval of the first PhD study leave by a senior staff, Internal Audit Charter, Security Audit of the Bank's Security System, Solomon Islands Coin withdrawal program, Review of the administration of the Exchange Rate, new $50.00 note design, Strategic Change Agenda 2013 - 2015, the 2013 Business Plan and 2013 Budget.

Board Committees

Another part of the Bank governance is channelled through, Committees of the Board established to deal with specific governance issues. Currently there are three such committees; the Board Audit Committee, the Board Staff Remuneration Committee and the Board Disciplinary Appeal Committee.

Audit Committee

The Board Audit Committee was established at the end of 2010. The Committee has four members; three non-executive Directors, the Deputy Governor and the Manager of Internal Audit Unit act as the Secretary to the Committee. One of the non-executive

Directors is the Chairman of the Committee.

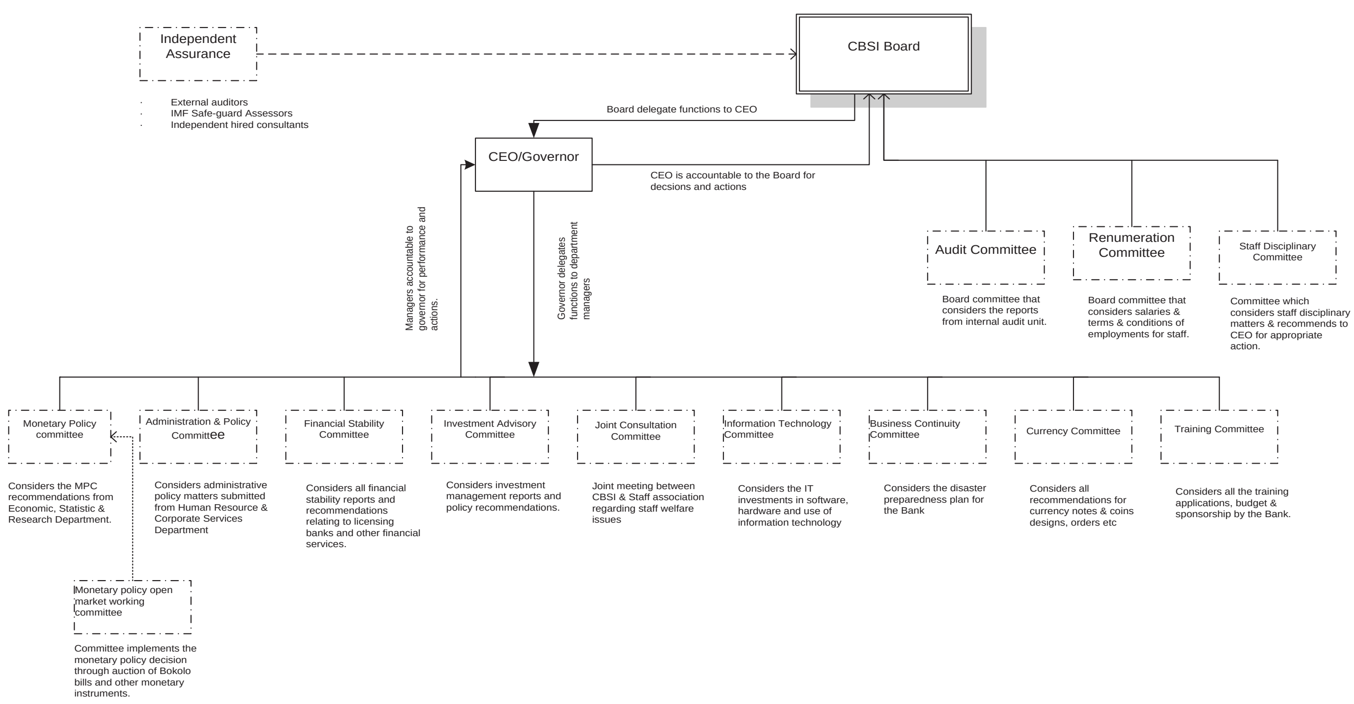
The Board Audit Committee was established to ensure that the Executives and Management comply with internal control rules and procedures designed to add value and improve operations. The independent evaluation and examination is to help CBSI accomplish its objectives by bringing a systematic disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes in the Bank. The Manager Internal Audit is responsible for carrying out independent evaluations and test compliance by the Management of the internal control procedures and rules and reports the findings directly to the Board Audit Committee. The Board Audit Committee also receives reports from the External Auditors, and directs management to take corrective steps to remedy any weaknesses identified in their independent audit. The Chairman of the Board Audit Committee reports the internal audit findings to the full Board, and directs the Governor to ensure that respective departments take appropriate remedial actions to correct the weaknesses identified.

In 2012, the Board Audit Committee met twice, less than the planned four meetings for the year under the Internal Audit Charter. The Board Audit Committee provided feedback to the IMF on their Safeguards Assessments during the year.

Board Staff Remuneration Committee

The Remuneration Committee of Board was established in 2012 to consider and determine all elements of the remuneration of executives, management and general staff. The subcommittee is chaired by a Non-executive Director, with two other non-executives as its members. The CBSI

Figure 3: Governance Framework of CBSI



Legal Officer is the Secretary to the Committee. In 2012 one of the main items dealt by the Committee was the revision of benefits for the Chief managers and managers. The Committee meets as and when there is a need to review the terms and conditions of executives, chief managers, managers and general staff. Under normal circumstances this happens after every two years. The establishment of the Committee allows for independent evaluation of the terms and conditions of employment of staff without due influence of the executives and staff.

Board Disciplinary Appeal Committee

As its name suggests, the Board Disciplinary Appeal Committee (BDAC) is set up to hear and review appeals by staff against any disciplinary actions that the Disciplinary Committee of the Bank may recommend against a staff. There are five members to the BDAC consisting of the Governor as the Chairman, one non-executive Board, two chief managers appointed by the Chair, one of whom must be from the department from which the staff is the subject of disciplinary action, and a member of the staff association. The Legal Officer and the Chief Manager of Human Resources & Corporate Services department are in attendance. As part of the natural justice to the staff, the BDAC reviews the appeal letter, questions the ground of disciplinary actions, and has the power to call the staff to appear in person to present his case as to why the disciplinary action against him should be reviewed. The BDAC considers all the submissions and makes its decision, which is taken as final.

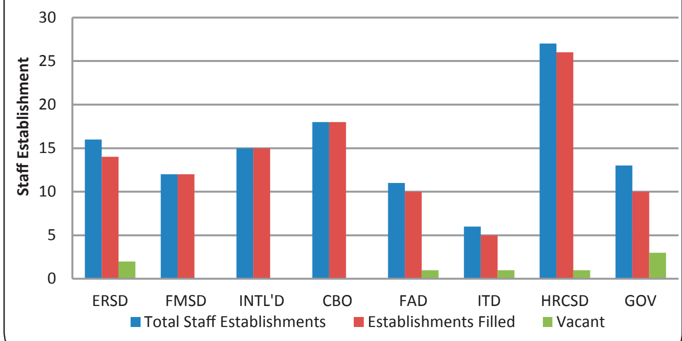
Organization Structure and Human Resources

CBSI uses its organizational capital to employ its human, information, physical and financial capital supported by its yearly business plan to achieve the mandates required under its legal charter. The Bank organizes its functions into eight (8) departments namely Economics, Research and Statistics; International; Currency and Banking Operations; Financial Market Supervision; Finance and Accounts; Information Technology; and Human Resources and Corporate Services. In addition to the departments there are three smaller units; the Internal Audit Unit, the National Financial Inclusion Unit and the Solomon Islands Financial Intelligence Unit (SIFIU). All the departments and smaller units must work together to achieve the mission of the Bank. With the exceptions of the Internal Audit unit which reports directly to the Board Audit Committee and the SIFIU which reports to the Anti-Money Laundering Commission (AMLC), all the departments and units report to the Governors' Office.

Human Resources

At the end of 2012, the total number of established positions in the Bank increased to 118 from 109 in 2011. However, only 110 positions were filled and 8 positions remain vacant pending recruitment in 2013. The Figure 5 below shows the level of staffing by departments as at end of 2012.

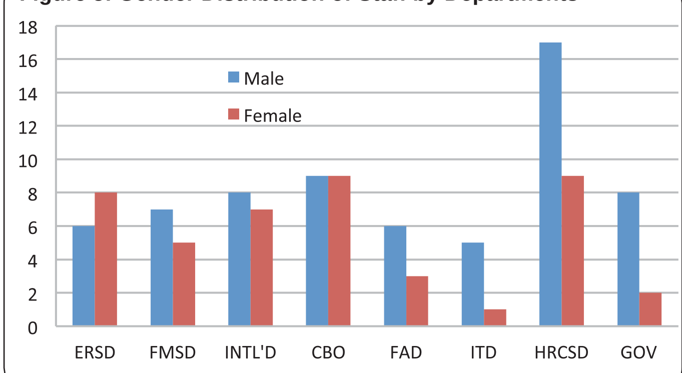
Figure 4: Staff Complements by Departments



Source: CBSI

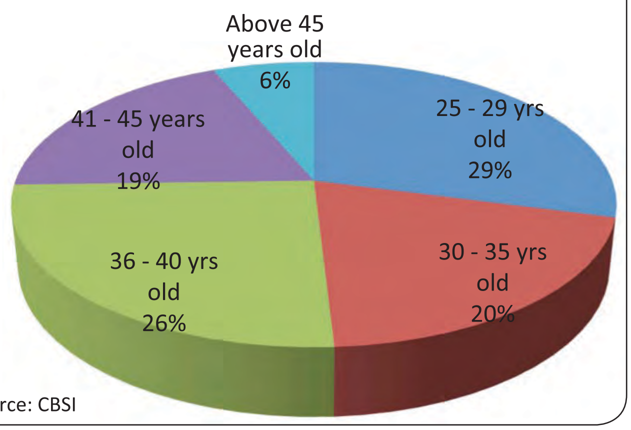
As a policy, the Bank promotes gender balance in its employment of human resources in recognition of the staff's appropriate technical and behavioural competencies. As at the end of the year, the composition of the human resource capital is 40% female and 60% male. Figure 6 shows the distribution of staff by gender in each department. Excluding the governors, 5 out of 15 management positions are filled by females. The Bank continues to scan the human resource market in Solomon Islands for qualified females to fill its technical and management positions.

Figure 5: Gender Distribution of Staff by Departments



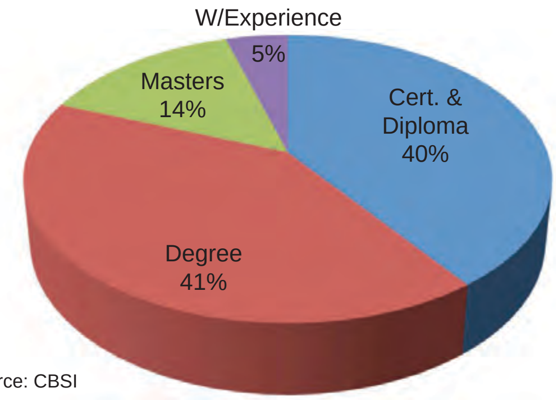
Source: CBSI

Figure 6: Age Composition of Staff



Source: CBSI

Figure 7: Academic Qualifications of Staff



Source: CBSI

The age profile of CBSI staff indicates that nearly half of the total staff in the Bank is young, at 35 years or below. Figure 7 below shows the age composition of the current staff establishment with almost 49% of the staff aged between 25 – 35 years. Only 6% of the staff is over 45 years.

Recruitment

In 2012, the Bank recruited seventeen (17) new officers for various positions within the Bank. Nine (9) positions were left vacant following internal staff transfers, promotions and staff early retirement while eight (8) positions were newly established. During the year, six (6) officers left the Bank following voluntary requests for early retirement and expiry of contracts. One officer was terminated.

Training & Staff Development

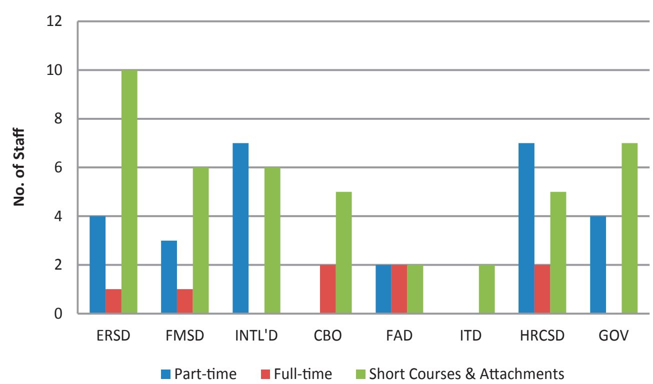
The Bank sees investment in the quality and caliber of its human capital as critical to enhance productivity and to position the Bank to meet its mandates. Consequently the Board sets aside on average $4 million of annual operational expenditure towards the training of staff. Apart from the Bank providing funds for training, bilateral partners particularly the International Monetary Fund (IMF), the Australian Prudential Regulation Authority (APRA), AusAid, Commonwealth Secretariat, Pacific Financial Technical Assistance Centre (PFTAC) and the Asian Development Bank (ADB) also provided funding assistance for technical training of officers in monetary policy analysis, economic forecasting, banking and financial services supervision, and economic statistics. Figure 8 below show the academic qualifications of staff working in the Bank in 2012.

As a policy objective, the Bank aims to increase the number of its staff with post-graduate qualifications at the masters' and doctorate levels especially in the areas of economics, accounting, finance, information technology, human resources and management.

Apart from sponsoring staff directly for post-graduate qualifications, the Bank encourages its officers to apply for Solomon Islands Government scholarships and attend relevant short term training offered by bilateral partners within and outside of Solomon Islands.

The Bank also assists staff pursuing further academic qualifications through full-time and part-time training sponsorship. Around 31% of staff undertook training in 2012. Most of these were to pursue higher qualifications while others enrolled in the Distance Flexible Learning (DFL) training for up skilling in a particular knowledge gap as identified in the annual performance assessment. As at year-end, four (4) officers graduated, one with a Masters Degree in Economics, another with a Bachelor's Degree in Accounting while two others graduated with a

Figure 8: Staff Training by Departments



Source: CBSI

Table 2.2: In-house Trainings and Seminars		
Training Topic	**Target Participants**	**Registered Participants**
Strategic Planning	Management & Senior Supervisors	20
First Aid Refresher	Floor Wardens (Former and New)	14
Computer literacy	General Staff	34
The Role of Financial Supervisors	General Staff	20
Customer Relations – CBSI Shared Experience	Public Servants	32
Appraisal Refresher Workshop	General Staff	15
Staff Handbook Refresher Workshop	General Staff	
First Aid Training	Floor Wardens (Former and New)	14
SysAid & Google Apps Training	General Staff	32
Economic Impact of FOPA 2012 on SI economy & Euro crisis and Solomon Islands – A preliminary study	General Staff	20

Certificate and Diploma from the Solomon Islands College of Higher Education.

During the year, CBSI staff participated in various short course trainings and attachments both aboard and locally. In 2012, 58 overseas short courses, attachments, workshops and seminars were attended representing almost 40% of Bank staff training during the year.

In-house trainings were also conducted for staff on topics aimed at sharing skills and knowledge and increasing awareness amongst employees within the Bank. The table below shows details of in-house training topics, targeted participants and the number of participants in these trainings.

Community Relations

In 2012, the CBSI continued its support to various communities; religious, social, educational related initiatives, activities and programmes. One of these support include the Pink Ribbon Charity fundraiser that focuses on women health issues. The Bank also assisted in providing refreshments for the school children rehearsing for the opening and closing ceremonies of the Festival of Pacific Arts.

Chapter 3: Monetary Policy Developments in 2012

Monetary Policy Stance

The main aim of the CBSI monetary policy is to ensure there is price stability in the economy. Considering the developments in the economy in 2012 however, the Board adopted a neutral monetary policy stance throughout the year. Inflation was projected in the range of 4% to 7% that is considered appropriate for the projected growth of the economy. By year-end the actual inflation outcome was 4.6%.

Despite taking the neutral stance, CBSI actively monitored developments in the domestic economy and where required took pre-emptive measures using the monetary policy instruments to influence the supply, availability, and cost of money, to achieve the objective above. The monetary policy instruments used during the year were:

- Cash reserve requirements;
- Open market operations; and
- Exchange rate

Cash reserve requirements

The cash reserve ratio remained unchanged at 7.5% during the year. Under this requirement commercial banks are required to set aside and hold 7.5% of their average total deposit liabilities as call deposits with the CBSI. This instrument has direct impact on the level of funds available for lending to the economy, and on domestic inflationary pressures. At the end of 2012 the total money held in reserve was $196.6 million and free liquidity on top of the reserved liquidity was $1.4 billion compared to $2.1 billion in 2011.

Open market operations

With the level of surplus liquidity remaining high in the economy, the Central Bank sold its Bokolo bills in open market operations to remove parts of the surplus liquidity from the system. By year end the total Bokolo Bills outstanding was $356 million, an increase from $250 million in 2011. In addition to Bokolo Bills, $40 million Government auction treasury bills was also sold in open market operations and has removed further excess liquidity from the financial system.

Exchange rate

The exchange rate is one key price that has a direct impact on price levels in Solomon Islands. In October 2012, the Bank reviewed the exchange rate regime and exchange rate policy and changed the arrangement from a "de facto" peg to the US dollar to an invoice-based basket of currencies. The change allowed flexibility in the management of the exchange rate and ensured an exchange rate more in line with economic fundamentals. Changes to the exchange rate can be used to affect the economy through impacting export and import prices. Given that a large share of Solomon Islands' output is traded internationally, changes in the exchange rate had a significant effect on trade, foreign reserves, and inflationary pressure.

Monetary policy processes

Monetary policy and changes to monetary policy instruments are discussed by the MPC[3]. For example, a change in the exchange rate policy, or the stock of Bokolo bills, or modification to the cash reserve ratio, must be approved by the MPC before presentation to the CBSI Board for final endorsement.

The MPC meets at least four times a year to monitor developments in the economy especially on key aggregates such as money supply, inflation trends, foreign reserves and monetary policy instruments. In addition, one of the main tasks of the MPC and the Board is to assess the bi-annual monetary policy stance, in March and September. The monetary policy stance sets the appropriate direction of the monetary policy instruments in relation to current inflation developments together with CBSI forecasts for the economy in the coming months.

Reserve management and Investments

The level of gross international reserves available and the price at which one unit of foreign currency is bought and sold in the economy is a key source of money that influences price stability in Solomon Islands. In 2012, the level of gross international reserves was stable and at a comfortable level. This provided the opportunity for the Board to diversify its investment portfolio to include gold as a reserve asset for the first time in Solomon Islands.

Section 17 of the CBSI Act 2012 allows the Bank to transact in and manage international reserves consistent with international best practice.

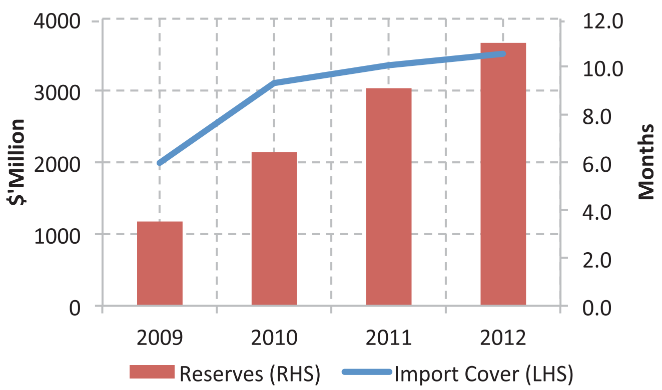
3 The Central Bank's Monetary Policy Committee is Chaired by the Governor, and includes the Deputy Governor, Chief Managers, Manager and Senior Research Analyst of the Economics, Research and Statistics Department.

The section specifies the asset types and portfolio mix of how the reserve can be held. The safety and security of the international reserves and availability of liquidity to meet international payment obligations of the country are the priority considerations during the placement of the reserves.

The Board approved the Investment and Reserve Management Policy Guidelines that allows the Investment Advisory Committee of the Bank to invest the reserves according to benchmark portfolio mix in terms of currencies, assets classes, maturity structure and approved institutions where reserves can be placed.

The approved reserves portfolio mix allows for three main asset classes - liquid assets, money market and marketable debt securities and gold - denominated in freely convertible foreign currencies issued or supported by foreign central banks and foreign reputable financial institutions with investment grades of ''A – AAA" ratings.

Figure 9: Gross Foreign Reserves



Source: CBSI

In 2012 the CBSI Board adopted a conservative approach considering the fragile global financial environment as potential risks to the international reserves and agreed to invest 10% of the total reserves in gold. The level of international reserves continued to grow steadily over the years. By the end of December 2012, the reserves reached $3,652 million or equivalent to USD 497.3 million. This is an increase of about 20% compared to 2011. The growth in the international reserves came from increases in inflows of donor funds, export receipts and other current and capital inflows from direct investments.

Measured in terms of import cover, the reserves level as at the end of the year is equivalent to 10.5 months of import cover, see chart below.

Liquidity Portfolio

The Bank held an equivalent of 2 months of import cover in liquid assets to meet normal demand for trading purposes and also as a buffer to counter financial market shocks, given the fragile global financial market conditions. With this strategic positioning, the Bank was able to meet all international payment obligations including international trade and debt settlements by the economy. On a monthly basis, the liquidity portfolio holds an average of USD144.1 million. By the end of December 2012, the liquidity portfolio held was USD$118.6 million or 23.8% of gross foreign reserves, equivalent to 2 months of imports.

Money Market Portfolio

Despite the current very low interest rates in the global financial markets, the Bank placed more than half of the gross foreign reserves in its Money Market portfolio. A total of 63.9% of gross foreign reserves was held in Money Market instruments in 2012 with maximum maturities of less than 12 months. Money Market portfolio investments are placed with reputable and "A-AAA" rated off-shore investment banks. The annualised return on investments in the money market portfolio including earnings from call accounts was 1.32%, reflecting the low demand for money and low growth in the international money markets.

Securities/Bond Portfolios

A total of three new investments in fixed income securities were contracted during 2012 totalling AUD 15.0 million. These are in Australian Commonwealth Government (ACG) Bonds. All ACG bonds are fully guaranteed by the Australian States and Commonwealth Governments. The average duration of the fixed income securities is 5 years.

Gold Investment

In 2012, the Bank diversified its portfolio mix by investing in gold as part of the gross international reserves. A Gold Investment Policy Guideline was approved by the Board in May 2011. However, the Bank was able to make its first purchase of gold in January and February of 2012. By December 2012, the Bank held a total of 17,681.963 ounces of gold. Of this, 6,030.585 ounces are held as physical gold bars - in 15 pieces of fine gold bars of approximately 400 ounces each with a purity level of 99.5%. The remaining 11,651.378 ounces are kept in paper gold (unallocated metal account) with a reputable international commercial bank.

In November 2012, the Bank officially verified and inspected the physical gold bars held overseas. Two Board Directors and the Chief Manager responsible for gold investments inspected and verified the CBSI physical gold holdings.

From Left: **CBSI Board of Directors, Mr Leslie Teama and Dr. Steve Aumanu with CBSI International Chief Manager, Raynick Aquilah.**

Chapter 4: Central Banking Operations

This chapter reports on various operational activities that the Bank undertook in 2012 through its different departments. These operational activities support the functions of the Bank and can also feed into the formulation of monetary policy or other policy actions of the Bank.

Economic Publications

As a service to its stakeholders, the Bank publishes regular economic reports. The publications include- an Annual Report, four Quarterly Reviews and twelve Monthly Economic Bulletins. Other publications include the Monetary Policy Statements (MPS) that are issued bi-annually in March and September each year. These publications can also be accessed from the CBSI website (www.cbsi.com.sb). In addition, the Bank provides updates on the state of the economy to the Government and other stakeholders in the form of presentations to national seminars or forums and through monthly briefing notes for the Ministry of Finance and Treasury.

Research

The Asian Development Bank sponsored a series of econometrics training for officials from the Ministry of Finance and Treasury, CBSI and Ministry of Development Planning and Aid Coordination. These trainings were conducted at the CBSI office from June 22-29 and November 17-24 by Professor Paresh Narayan of Deakin University. With these trainings, officials are expected to produce empirical papers for policy formulation purposes in the near term. The Bank is also encouraging officers to work on joint research papers within or across departments. These efforts yielded positive outcomes during the year when five research papers[4] were presented for discussion at the Monetary Policy Committee and to the Board of Directors in the second half of the year.

Macroeconomic Statistics

The CBSI signed up to participate in two other macroeconomic statistical projects spearheaded by the IMF and other development partners.

This was in addition to the ongoing Monetary Financial Statistics (MFS). The two new projects were improvement of Government Finance Statistics[5] (GFS) and External Sector Statistics (ESS). Two Technical Assistance missions from the IMF visited the Bank during the year - Mr. Marco Martinez (MFS TA) in August and Ms. Betty Gruber (GFS TA) in December. The MFS project is expected to end in 2013 while the other two projects will continue for the next three years. These projects will ensure the country's macroeconomic statistics are in compliance with international standards. Also in 2012, the Balance of Payments (BOP) unit in collaboration with the Ministry of Development Planning and Aid Coordination improved data compilation for donor inflows using the Development Assistance Database (DAD) software.

Operational management of gross international reserves

In line with the international best practice, the investment of the gross foreign reserves is handled by three units in the International department of the Bank. These units are the front office, middle office and back office.

The front office is responsible for selecting and contracting the financial products that the gross foreign reserves are to be placed. The front office use the Board approved investment guidelines in its selection of financial products, currency, maturity and financial institutions.

In 2012 the Bank subscribed to two Bloomberg financial services terminals to source the latest information and developments in the financial markets. Accessing the financial services enabled the front office to get "real time" financial market information which facilitated foreign exchange trading with offshore counter parties.

The back office is responsible for the settlement of payments and facilitation of the international exchange of money once the front office has secured the deal. The settlements are payments to commercial banks, payments on behalf of the SI Government and other international organizations.

All international payments and settlements are done within the international SWIFT standard jurisdiction.

4 The five papers are; Review of rejected loans applications; Euro Crisis and Solomon Islands – A Preliminary Study'; A Brief on the Economic Impact of FOPA on Solomon Islands; Review of the Administration of Exchange Rate in Solomon Islands; and the Impact of Westpac's withdrawal of financial Services to logging exporters.

5 Joint project between the Solomon Islands National Statistics Office and ERSD.

Accuracy and zero tolerance on errors and mistakes are the key standards observed when facilitating all international deals and settlements in the back office.

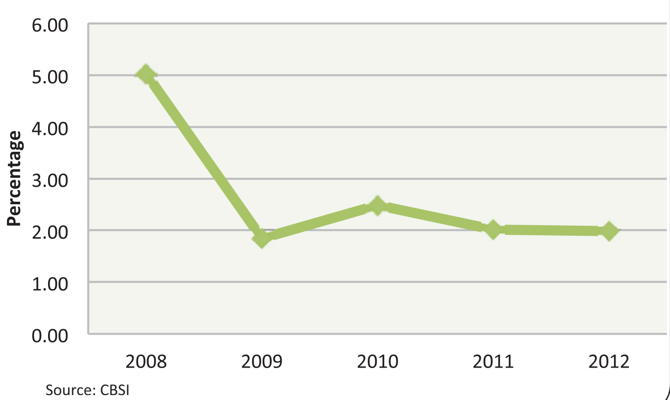
In February 2012 a major SWIFT System Upgrading was completed. This contributed to efficient and effective transmission of SWIFT messages between the CBSI and off-shore central banks and corresponding investment banks. In 2012, a total of 940 SWIFT messages were sent through the SWIFT system. A new officer was recruited as a SWIFT operator and is part of the back office team.

The middle office acts as an internal auditor for both the front and back offices to ensure that the investments contracted or payments for settlements are done in accordance with approved internal control guidelines and rules. The middle office roles and responsibilities includes identifying, analysing and monitoring financial market risks, investment risks and operations risks and advise the management to take appropriate actions to mitigate these risks. The middle office reports directly to the executive management of the Bank on any breaches or non-compliance with the rules and requirements stipulated in the approved Investment Policy Guidelines by the front and back office.

In 2012, the middle office continuously advised the front office team to maintain a conservative approach towards placement of funds in the European financial markets. This has resulted in the withdrawal of some investments in the European banks upon maturity.

As at the end of the year, total interest income from all foreign reserves investments reached $69.271 million. This was 16% higher than in 2011. The interest income included accrued interest income, and interest earned from call account holdings under a repurchase agreement with the Federal Reserve Bank of New York. This equated to an annualised averaged return on total reserves of 1.99% (see Figure 10).

Figure 10: Annualised Return on Investment



Exchange Controls

The Exchange Control regulation provides for the control and monitoring of all foreign exchange transactions between Solomon Islands residents and the rest of the world. The primary goal of Exchange Controls is to ensure that the country benefits from its resources and receives a fair share of all goods and services exported.

Under the Exchange Control regulations, commercial banks are appointed authorised dealers to process foreign exchange transactions as required under the regulations.

In 2012 the Bank lifted restrictions on the overnight limit of foreign exchange holdings by banks equivalent to $10.0 million. This was part of CBSI's gradual liberalisation of exchange controls. However, commercial banks are still required to maintain minimum foreign exchange holdings under Prudential Guidelines issued under the Financial Institutions Act 1998. The limits are not more than 15% and 25% of total bank's capital for any single currency holding and for all currency holdings respectively.

In terms of foreign exchange payments, CBSI assessment and approval is still required for all payments of more than $100,000 (for trade and services payments) and more than $30,000 (for travel, sustenance and personal transfers). Foreign exchange payments below $100,000 and $30,000 respectively can be assessed and facilitated by the authorised dealers (commercial banks) without the need for CBSI approval. Exchange control approval is still required for all capital payments such as capital transfers, loan repayments, equity proceeds, property proceeds etc, prior to commercial banks facilitating the payments.

During 2012 a total of 6,944 payments applications valued at $4,771.60 million (for trade and services, financial & capital payments, travel and personal remittances) above the authorised dealers' limits were received and assessed by the CBSI. This is 11.9% more than the previous year. Of the total applications received, 6,890 were approved, valued at $4,753.80 million. This is on average, 134 applications ($91.4 million) per week.

Applications for Temporary Resident (TR) Status

Under Exchange Controls, a Temporary Resident status can be granted to a non-resident who intends to reside in Solomon Islands for four years or less; or to a resident in the Solomon Islands who intends to reside permanently overseas in the next few years. Non-residents working in the country on contractual basis can also be granted Temporary Residents status for Exchange Control purposes. An Exchange Control permit granted by CBSI to such a person allows him to remit funds/payments abroad while residing temporarily in the country.

In 2012 the Bank received a total of 338 applications for Exchange Control permits for temporary resident status. Only 292 of the applications were approved as per Exchange Control requirement for Temporary Residents status.

Foreign Currency Account Facility

As part of its policy to encourage exporters, CBSI can allow resident exporters to open and operate foreign currency accounts (FCA) with banks on-shore or overseas. This facility requires Exchange Control approval. Under the current Exchange Control policy, the foreign currency facility is restricted to eligible exporters who has been in the exporting business for more than three years and with a clean record as a net exporter that promptly remits the full amount of export proceeds into a local bank account within the specified time frame as required under the Exchange Control regulation. Approval can also be granted on a case-by-case basis for specific purposes to NGO, institutions and other organisations.

In 2012 a total of 14 new applications seeking permission to open and hold foreign currency account facilities with banks on-shore and off-shore were received, of which, 11 were approved. In addition, the licenses of 14 other existing foreign currency account holders were renewed during the year. A total of 25 FCAs denominated in AUD, USD, JPY and PNG Kina are currently valid.

Foreign Exchange (FX) Restricted Classified Dealers

As part of its policy to promote financial services deepening in the country, the Bank has approved restricted foreign currency dealers licenses to eligible applicants. The Foreign exchange dealer's license allows successful applicants to operate as Money Changers and provide Money transfer services in the country.

In 2012, two new applications were received during the year. CBSI approved one Money transfer services provider - as an agent for Western Union Money Transfers services and one Money Changer services provider. As at the end of the year, a total of 10 authorised restricted foreign exchange dealers operated in the country.

Private Sector Offshore Borrowing

It is an Exchange Control requirement that all external borrowings by resident companies (including companies incorporated in Solomon Islands and the Solomon Islands branches of overseas incorporated firms) and individuals must first obtain Exchange Control approval from the Bank before entering into external loan agreements. This includes intercompany borrowings by existing resident companies or new companies incorporated in Solomon Islands. Without Exchange Control prior approval, future repayments or remittances of the loans and advances will not be considered for approval.

Table 4.1: Approved Foreign Exchange Restricted Classified Dealers License.

	2010	2011	2012
Money Transfer Service*	3	3	4
Money Changer Service	5	5	6
Total FX Classified Dealers	8	8	10

**As Western Union and Money Gram Agents*

In 2012 six (6) applications were received seeking Exchange Control approval for offshore borrowing and refinancing were approved with a combined loan amount of $997.2 million (USD133.1 million and AUD 0.8 million).

Administration of Round Log Exports

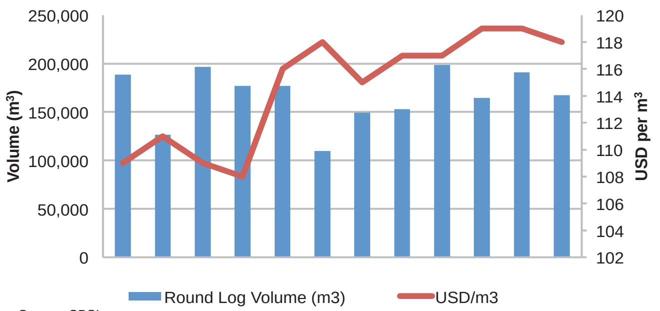
In terms of Exchange Control Regulations, the export of round logs is permitted under a Specific Authority to Export. The conditions for the Specific Authority to export round logs requires the exporter to have a Letter of Credit established with a commercial bank in Solomon Islands before an export permit is issued by CBSI. In addition to the letter of credit to guarantee the payment of the proceeds of log exports, round log exporters must present a certified copy of prices for the log species being exported from the Commissioner of Forest. This is a legal requirement under the "Specific Authority to export round logs" before shipments of round logs can be released by the Customs & Excise Division.

In 2012, a total of 890 Specific Authority applications were received. Of these, 24 were declined due to failure in meeting Exchange Control requirements. The total volume of log exports approved under Specific Authority applications amounted to 1,999,435 cubic metres, equivalent to $1,738.0 million.

Currency Administration and Management

One of the main operational activities of the Bank is the management of currency. The task requires

Figure 11: Specific Authority Approvals for Round Log Exports in 2012



Source: CBSI

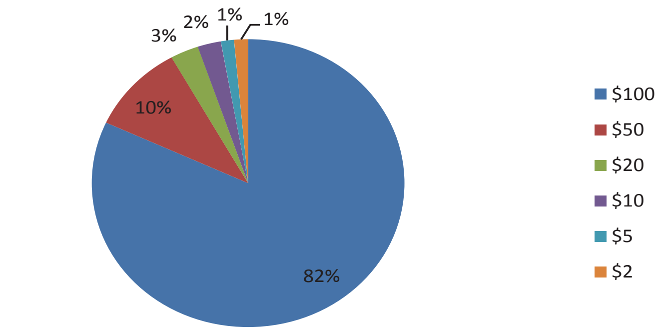
placing of new orders, issuing of notes and coins, receiving of notes and coins for deposits, destruction of soiled and mutilated notes, and surveillance of counterfeit notes.

Currency in Circulation

As at the end of 2012, the total value of currency notes and coins in circulation increased to $600 million from $527 million in the previous year. Currency notes accounted for $587 million of the total circulation and coins made up $13 million. The pie chart below shows the share of each note denomination in circulation at the end of the year.

Coins in circulation decreased for all denominations over 2012 except for the newly introduced $2 coin which increased by 284% to over $1 million since its introduction in July 2012. The decrease in almost all denomination coins was a direct result of the Central Bank nation-wide withdrawal of pre-2012 coins during the second half of the year 2012. The $1 and 50 cents coins accounted for 37% and 24% respectively followed by 20 cents at 18% and 10 cents at 13% compared to the new $2 coin at 7%.

Figure 12: Distribution by Denomination Notes in 2012



Source: CBSI

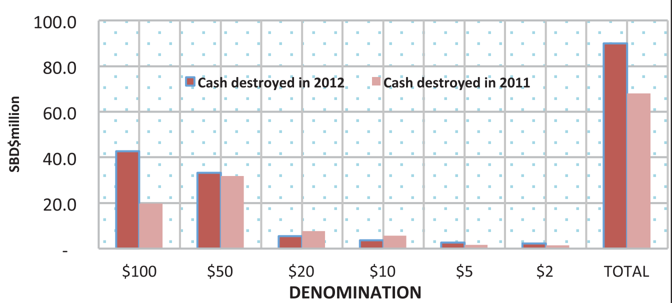
Cash Destruction

Total soiled notes returned from circulation for processing and destruction were $92.4 million at end 2012. Of the total received $90.0 million were destroyed and $2.4 million were retained as fit notes for re-issuable to commercial banks. The Chart below shows the trend in soiled and mutilated notes destroyed in 2012.

Cash Processing – Mechanization

The Central Bank invests in equipment to facilitate mechanization of the sorting and destruction of

Figure 13: Soiled Notes Destroyed in 2011-2012



Source: CBSI

soiled notes and increase the productivity of staff. In 2012, the Bank purchased an Off-line Currency Disintegration System (includes Off-line Banknote Shredder & Collection System) that was installed in February 2013. The new shredder is expected to greatly improve processing and destruction of soiled notes. This new acquisition is an addition to the Cobra Note Sorter and Shredder machines that the Bank had purchased some years back.

Counterfeit Banknotes

The Bank confiscated from circulation a total of 48 pieces of counterfeit notes in 2012 compared to only 6 pieces in 2011. Of the total counterfeit notes confiscated in 2012, 17 pieces were counterfeits of the $100 note, 29 pieces of the $50 note and a piece each of the $10 and $5 denominations. The Bank continued to conduct public awareness about the risks of circulating counterfeit notes through the radio and print media and encouraged the public to habitually check currency notes before accepting in exchange of goods and services.

Numismatic Operations

Total sales of uncirculated notes and coins and royalty receipts in 2012 increased by 14% to $1.16 million compared to $1.02 million in the previous year. Of the total income, 69% ($0.81 million) were for royalties from commemorative coin programs, 26% came from commission from sales of numismatic coins and 5% from sales of circulating notes and coins. In 2012, the Bank renewed running contracts in popular coin programs and participated in several new commemorative coin programs including the Royal Visit Coin Program commemorating the visit to the Solomon Islands of the Duke and Duchess of Cambridge, Diamond Jubilee of HM Queen Elizabeth II, the new Seven Wonders and Antique Seven Wonders of the World and the Year of the Snake. The Bank also released its own Silver Proofs and uncirculated coins.

Banking Services

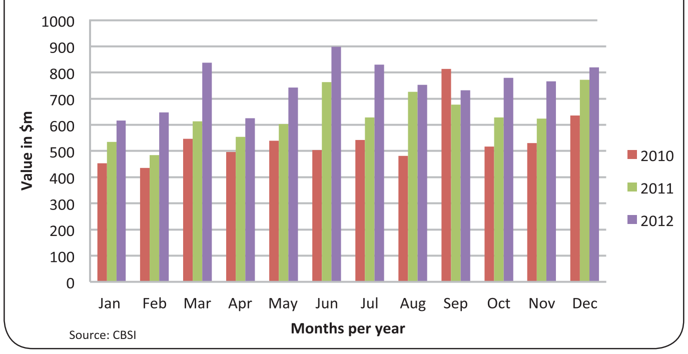
Under the provisions of the CBSI Act 2012 the Bank provides banking services only to financial institutions that are licensed by the CBSI, the Solomon Islands Government and other statutory authorities. The services offered by the Bank include, but are not limited to deposit, facilitating payments, providing account balances, daily monitoring of free liquidity of the commercial banks and the proper upkeep of records for audit requirements.

Clearing House Activities

The Bank supervises the Clearing House for cheques issued by the three commercial banks. The operation of the Clearing House is governed by the terms of an agreement known as the Record of Arrangements between Banks (RABB). In 2012, the monthly average number of cheques cleared through the clearing house was 22,000. Figure 15 show the monthly value of cheques cleared for the period 2010-2012.

As shown in the chart below, there was a peak movement in March when construction works at the main site and satellite venues for the 11th Festival of Pacific Arts (FOPA) commenced and, simultaneously in July 2012 when the country hosted the Festival. Overall there was an increase in both the value and volume of cheque transactions during the past three years.

Figure 14: Values of Cheques Cleared in 2010 - 2012



Administration of Government Debt Statistical Database

The Debt unit endeavors to maintain an accurate and reliable debt database on the CS-DRMS system for all government and private sector loans. To achieve this objective, officers in the Debt unit hold regular meetings with the Debt Management unit in the Ministry of Finance on administrative and technical issues including the use of the external debt reports on the CS-DRMS and the CS-SAS system for treasury bills auctions.

Project Support Services

The Project Support Services focused mainly on providing support to the Small Business Finance Scheme with the Sustainable Energy Financing Program terminated and the Rural Development Project- Supplemental Equity Financing Program drawing to a close. As required under the Memorandum of Understanding (MOU) signed with the Government in 2007, the Unit continued to monitor the Small Business Finance Scheme and reported loan data to the Solomon Islands Government on a quarterly and annual basis.

In 2012, eleven (11) nominations were submitted to the Bank for consideration under the Scheme. All 11 nominations were approved, which brought the total approved nominations to fifty-five (55) loans since the scheme was rolled out in August 2008. Of the 55 loans, thirty-six (36) nominations are current while nine (9) claims had been processed and paid to the banks as a result of defaults and, ten (10) guarantees cancelled as loans were fully serviced. As at end of 2012, the risk to the scheme was $3.954 million.

With regards to business location, a majority of the nominations came from Honiara with the majority of the loan applications being processed and approved were for transportation.

Administration of Bank Properties
The Bank's physical capital is represented by its fixed and moveable assets that support the achievements of its objectives. The fixed assets comprise of the office buildings, plants and equipment and housing for staff. In 2012 work started on designing a new air conditioning system for the vault areas to provide a healthy working environment for staff.

The lack of affordable housing or land for staff to build their own houses, has forced the Bank to take the strategic policy position to accommodate its staff where possible. The Rifle Range residential area housing estate was completed in 2012 with six executive houses, a multipurpose court, street lights and perimeter fencing. Major road improvement works commenced in 2012 at the Mbokona residential area, including tar sealing of the roads and proper drainage. Fencing of the area has commenced, and street lights have been installed. The Bank also has six vehicles that provide logistical support for its activities.

Security
The Security Unit plays a significant role in ensuring the safety and protection of all employees, properties and information of the Bank. The Security unit, after a security assessment, is now equipped with advanced security equipment to assist officers efficiently and effectively perform their day to day tasks. Security officers also perform the role of escorting visitors and contracted workers in the Bank.

As part of the Bank's evacuation preparedness procedures, the Security unit facilitated several emergency evacuation drills and first aid training for officers of the Bank to prepare them for emergency situations, which now seem to occur more frequently and unexpectedly.

Information Technology
The Bank information technology plays a key role in facilitating the flow of work and information within and to its customers outside the Bank. The Bank's local area network supports more than 150 network devices including the physical servers, staff workstations, network printers, wireless access router, ADSL modem, firewall, and CISCO switches that are housed within the Bank's main office. During the year, the Bank acquired an additional distribution layer network switch which also serves as a redundant distribution switch, a strategy for maintaining the reliability of the local area network whenever one of the network distribution switches fail to function. A network enhancement was performed for the Sun System which was migrated from a physical server to a virtual server during the year. The Bank's network also supported other services such as email, network printing, file storage, hosting database systems and software applications, backup, and internet access using network cable and wireless technology. Last year also saw the Bank introduce the wireless access connectivity to certain areas of the Bank to accommodate and ease administering of guests computers accessing the Banks local area networking resources.

In terms of hardware, the Bank standardized its hardware acquisition with the common brands (HP, Toshiba and Samsung). During the year, the Bank acquired 15 HP desktops, 23 Toshiba laptops, 3 HP network printers and 9 Samsung tablets. The desktops and laptops were issued either as replacements of aging equipment or as allocations for new officers.

The Bank also maintained its software ensuring that they function with genuine and valid license software. The Bank's financial and accounting software (Sun System), the statistical software (Eview), payroll software (MicrOpay Meridian), Anti-virus software (Symantec), Investment software (Bloomberg), and firewall software (Smoothwall) had their annual maintenance support renewed during the year. There were minor upgrades on the SWIFT application. The Bank signed an agreement with Bloomberg and acquired its license and uses some of its services primarily for sourcing market information. Maintenances on the Microsoft Access databases were performed in-house.

The Bank maintained its website (www.cbsi.com.sb) onshore in keeping with CBSI's status as the central bank of a sovereign nation. The content of the website are regularly updated and provides a range of information to the public.

IT Development Projects
During 2012, the Bank migrated its external emails to Google Apps with the goal of improving quality and accessibility to staff. With the Bank's increasing need for fast and reliable internet service, a proposal for alternative internet connectivity was presented and

approved by IT Committee and its implementation will depend on the availability of the undersea cable infrastructure.

To comply with SWIFT Upgrade requirements, the Bank acquired two new servers that were installed with Windows 2008 Server operating systems. The Bank also engaged a SWIFT consultant and completed the mandatory SWIFT upgrade from SWIFT Release 6 to SWIFT Release 7 applications for the SWIFT Production Server. Similar upgrade work on the SWIFT backup server was completed in-house in 2012.

Work continued with in-house system/database development. A working store system for currency stock management is progressively being implemented to provide proper, secure recordings and correct reporting of currency movements. A Foreign Exchange Transactions Ticketing database was upgraded to allow direct imports from the banks on Microsoft Excel spreadsheets. Work on the upgraded Export System was put on halt following the review of the IT System. The review recommended that the Export System requirements be analyzed.

The Bank is also working with the Reserve Bank of New Zealand on the installation of the Financial Sector Information System software to house all the financial and economic data of the Bank. This is part of a South Pacific Central Banks initiative and supported by IMF's Pacific Financial Technical Assistance Centre (PFTAC) based in Fiji. If the software is successfully piloted in Solomon Islands, it will be installed in the other central banks in the region.

IT System Review

The Bank engaged a New Zealand based IT consulting company to assess and review the appropriateness of the Bank's IT System during the year. The study recommended replacement of existing Microsoft access developed systems. Acquiring a new financially integrated system is important to meet the need for quality management information for decision making and accountability purposes. The consultants concluded that the hardware or networking infrastructure within the server room is still appropriate for the level of systems that the Bank requires. The recommendations from the report will be implemented as of 2013.

Budget and Financial Accounts

The Bank prepares its annual budget each year for its revenue, operational expenses and capital expenditure. In 2012, the Bank budgeted revenues of $88 million, operational expenses of $94 million and capital expenditure of $27 million.

CBSI's net asset at the year-end 2012 was $220 million. It has increased by $79 million from $141 million in 2011. This increase came mainly from unrealized revaluation gains on foreign currency assets, investment properties and property plant and equipment.

Total asset of CBSI at the end 2012 was $3,944 million. This comprised of total foreign currency assets of $3,660 million and total local currency assets of $285 million. Significant items of the foreign currency assets were, term deposit of $2,561 million, money at call $765 million, gold $219 million; and for local currency assets, property plant and equipment $140 million, loans and advances $88 million, other assets $46 million.

Total Liabilities at the end 2012 was $3,724 million; with local currency liabilities at $3,382 million and foreign currency liabilities $342 million. Significant items in local currency liabilities were demand deposits $1,722 million, fixed deposits $998 million and currency in circulation $600 million; and with foreign liabilities, IMF standby credit facility and special drawing rights at $253 million.

Total equity at the end of 2012 was $220 million. Paid up capital of $20 million, general reserve of $64 million, premises and equipment reserve $84 million and capital asset reserve $62 million, gold reserve ($2) million and foreign currency revaluation reserve ($7) million. Significant changes in equity for 2012 came from foreign currency revaluation reserve of $44 million and premises and equipment asset revaluation reserve of $32 million.

Statement of Comprehensive Income

Net loss of the CBSI in 2012 according to section 19 of CBSI Act (CAP 49) was ($0.7) million and under IFRS $49 million. The difference in the two net profits came from the deduction of revaluation gain on foreign currency and investment properties of $44 million and $6 million as required under section 45 of CBSI Act (CAP 49).

Total income for 2012 was $127 million. Interest income $64 million, fees and commission $10 million, other income $2 million, revaluation gain in investment properties $6 million, royalties and net gain on foreign currency exchange $1million and foreign currency revaluation gain of $44 million.

Total expenditure for 2012 was $78 million compared to $295 million 2011. In 2012, interest expense $5 million, administration expense $32 million, other operating expense $40 million and fees and commission $0.5 million. The significant decline in expenditure in 2012 resulted from the foreign currency revaluation gain of $44 million in 2012 as compared to the foreign currency revaluation loss of $245 million in 2011.

Total capital expenditure for 2012 was $18 million, this comprised of staff loans of $1 million and capital expenditure of $16 million.

Table 4.2: Summary of Financial Statement 2012

Profit and loss statement for period ending 31 December 2012			
($'M)	**2011**	**2012**	**change**
Revenue	71	127	56
Expense	295	78	217
Profit IFRS	-224	49	273
Add/deduct			
foreign currency reval'n gain/ loss	245	44	289
Investment property reval'n gain	0	-6	6
Profit distributable	21.0	-0.7	-21.7
Balance sheet as at 31 December 2012			
Assets	3282	3944	662
Liabilities	3141	3724	583
Equity	141	220	79

CHAPTER 5: FINANCIAL STABILITY REPORT

Overview of Financial System and Stability
The Solomon Islands financial system remained resilient despite the fragile international environment and subdued domestic economic activities. This reflects the fact that the local financial system only moderately relies on the international market for sustainability.

The financial market remains solid, showing no signs of distress. Credit growth continued to pick up modestly in the banking sector however, more aggressively for other providers of intermediated credit. Banks are continuing to compete for new customers in the corporate sector.

Non-performing loans slowly eased and this helped to bolster profitability of the financial sector. However, vulnerabilities in the economy remain, and a slowdown in some sectors of the economy could potentially place upward pressure on credit quality.

The domestic financial sector continued to accumulate excess liquidity. Excessive liquidity has helped banks to build strong capital buffers without relying on parent banks for further capital injection.

The Solomon Islands National Provident Fund (SINPF) also competed for credit and investment market share in 2012, reflected in the pickup in their investment portfolio by 8% to $1.3 billion. The income on investment was subdued in 2012 against 2011 but this is attributed to lower valuation gains from the financial assets placed overseas.

Insurance penetration in the local economy remained an issue in Solomon Islands in 2012, the total assets is $117.5 million, representing 2.2% of financial market share. The key focus of the insurance sector in Solomon Island is providing general insurance policies and the predominant classes of policies are fire, workers compensation and motor vehicles.

The challenges facing Credit Unions remained critical for the reputation of the financial system. From the 17 active Credit Unions, only 10 continue to provide financial reports to CBSI. The major critical issues facing credit unions are related to good governance and prudent financial management.

Regulatory and Supervisory Developments:
The role of CBSI towards achieving financial stability is now legally enshrined and articulated in Section 8 (2) of the CBSI Act 2012. The Act now provides the legal underpinning for CBSI to develop the regulatory and supervisory mechanisms to promote financial stability in Solomon Islands. While the pursuit of achieving the mandate is challenging, CBSI has already undertaken those roles through various on-going legislation and regulatory reforms in the financial sector.

As part of wider reforms in the financial sector to promote prudent management and stability, the CBSI is pursuing the review to modernise the current Financial Institutions Act [FIA] 1998 (as amended). A desk review of FIA has been completed by the IMF in 2012. The review is necessary to strengthen the protection of Solomon Island depositors, buttress the CBSI effective supervision and support the development of the financial system.

CBSI, in collaboration with the Ministry of Finance and the SINPF Board, have also intensified their efforts to reform the SINPF legislation. The review of the SINPF legislation is necessary to provide the legal underpinning and the legislative framework for CBSI to conduct prudential supervision of SINPF and exercise powers to protect the member's interest. In 2012, the task force has finalized the SINPF draft bill, which has now been approved by Cabinet for public consultations.

The review of the Credit Union Act was put on hold since 2011 awaiting the final outcome of an ADB review of laws and policies affecting financial inclusion. Following ADB's report in 2012, work has commenced and changes incorporated into the Credit Union bill. The revised legislation is expected to provide the legal underpinning for CBSI to license, supervise and regulate credit unions based on international best practice and standards. The draft bill will be submitted to Cabinet for endorsement.

Progress on the review of the Insurance legislation was slower than expected and little progress was witnessed in 2012. The insurance draft bill was, however, completed in 2008 through a desk review by the IMF. CBSI will continue to dialogue with the Economic Reform Unit to progress this important legislation.

CBSI had also reviewed the risk based capital calculations under Prudential Guideline No. 1 on the treatment of foreign denominated deposits held offshore. This is expected to be finalized in 2013. The new changes from the review will see the exclusion of deposits held with other branches other than Head Office in the capital calculation. Under the old capital regime, all branch deposits are deductible against capital.

CBSI have also done further work on a draft Disclosure Guideline in 2012 that is expected to be formalized in 2013. The new guideline will provide the mechanism for disclosures by financial institutions of interest rates, fees and charges on their products and services.

In 2012, the CBSI conducted four onsite examinations of the financial sector including an onsite on SINPF in April, Solomon Islands National Teachers Credit Union in May, the examination of Australia and New Zealand Banking Group Solomon Islands branch, with the assistance of the Australian Prudential Regulation Authority [APRA] in August and, the onsite review of the Credit Corporation of Solomon Islands in October with the assistance of PFTAC.

Ongoing offsite monitoring of the financial sector was undertaken in 2012. This was conducted through quarterly and half yearly visits as well as through submissions of regular reports by the financial institutions. During the year, CBSI also issued and implemented revised call reports to the banks and Credit Corporation, and implemented new reporting procedures for SINPF, which is purposely to enhance reporting for effective offsite surveillance. These new reporting also reflected the International Reporting Requirements for Monetary and Financial Statistics.

Solomon Islands Financial System

By year end 2012, Solomon Islands financial system remained unchanged with three commercial banks, one credit institution, seventeen credit unions, a superannuation fund, a development bank [currently under court administration by the Central Bank], and three insurance companies with seven intermediaries.

There are three foreign branch commercial banks with twenty representative offices operating in Honiara and the provinces, which comprised of thirteen branches and seven agencies. Electronic banking facilities expanded in 2012 with increase in Automatic Teller Machines [ATMs] to 38 and Electronic Funds Transfer at Point Of Sale [EFTPOS] to 224. The increase in electronic banking infrastructure was seen as an important part of banks' commitment to providing convenient banking services to customers. The rural banking services facilitated through the use of mobile bank vehicles remained at two in 2012.

Table 5.1: Number of Banking Infrastructure

	2010	2011	2012
Commercial Banks	3	3	3
Branches	14	13	13
Agencies	9	7	7
ATMs	35	36	38
EFTPOS	137	175	224
Superannuation funds	1	1	1
Credit institutions	1	1	1
Credit unions	17	17	17
General insurance companies	3	3	3
Insurance brokers	4	4	4
Insurance agencies	3	3	3

In terms of applications for a banking license, one application was received in 2012. The Central Bank following its assessment had reserved its decision until the applicant fully meets the licensing and regulatory requirements.

The only credit institutions licensed under the Financial Institutions Act [1998] is the Credit Corporation [SI] Limited, a subsidiary of Credit Corporation [PNG] Limited.

The number of credit unions actively operating in Honiara and in the provinces is seventeen, of which, ten consistently reported to the Registrar's office in 2012. Of the total active credit unions, three are rural based credit unions.

The insurance industry comprised of three companies of which two are general insurers, who also conduct business through their intermediaries. During the year, the number of intermediaries remained at seven comprising of four brokers and three agencies.

Table 5.2: Financial System Assets

($'million)	2009	2010	2011	2012
Commercial banks	2036.6	2364.0	2989.1	3457.9
SINPF	1050.0	1180.7	1324.9	1555.4
Insurance	102.5	110.7	120.3	117.5
Credit Corporation [SI] Ltd	27.2	32.5	69.3	87.1
Credit Unions	37.2	43.2	51.7	49.7
Total Assets	**3253.5**	**3731.1**	**4555.3**	**5267.6**

The combined financial assets of the supervised institutions grew by 16% to $5268 million in 2012 compared to $4555 million in 2011. Asset growth was fuelled by the expansion of investments from SINPF combined with increased participation of the banking sector in debt securities. Increased lending by Credit Corporation [SI] Limited during the year also contributed to the asset growth.

In terms of the market share, the banking industry and SINPF were of systemic importance to the stability of Solomon Islands financial system comprising 65.6% and 29.5% respectively of the market in 2012. Other supervised sectors accounted for 4.9% of the market share.

The Banking Sector

The banking sector, comprising of three commercial banks, performed strongly in 2012, with a solid measure of profitability (return on assets) and a strong capital position. The underlying reasons for the strong performance were due to strong revenue earnings from both sources of income and, declining non-performing loans. Commercial banks also maintained adequate levels of liquidity buffer.

Banks' profitability rose by 20.6% to $102.2 million in 2012, an upturn following a fall in profits recorded in 2011. The increase in profits was driven by the rise in total revenue to $304.8 million compared to $295.8 million in 2011. The growth in revenue was driven by both net interest and non-interest income. Despite the increase in after tax profits, the growth in average asset and average equity by 20.4% and 12.5% respectively resulted in the decline in return on asset to 4.8% and marginal increase in return on equity by 0.1% to 28.2%.

Operating expenses also rose by 8.2% to $154.0 million, largely underpinned by the rise in 'other expenses' and, administrative and occupancy expenses. However, these were offset by the recoveries from bad and doubtful debts, which resulted in the decline in total expenses for the year. The cost to income ratio therefore improved to 50.5% in 2012 from 54.8% in 2011.

The banking sector balance sheet expanded by 15.7% from $2989 million in 2011 to $3458 million in 2012. The upward movement was largely driven by a 41.3% growth in investment in CBSI debt securities and 19.8% in balances with Depository Institutions particularly demand balances held in call accounts with CBSI.

Table 5.3: Profit & Loss Statement

($' million)	2010	2011	2012
Net Interest Income	132.2	135.2	140.3
Non-Interest Income	168.8	160.6	164.6
Foreign exchange gains	110.6	104.0	111.9
Fees & Charges	27.2	31.6	33.3
Others	31.0	24.9	19.4
Operating Income	301.0	295.8	304.9
Operating Expenses	124.8	142.6	154.3
Provision for bad debts	4.9	19.6	(0.2)
Profit Before Tax	171.4	133.6	150.8
Profit After Tax	**108.2**	**84.7**	**102.2**

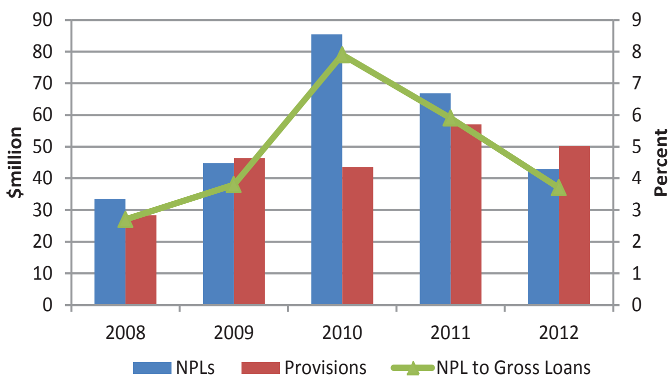
Commercial banks' lending portfolio recorded a pick-up in 2012 by 4.0% to $1169 million attributed to increases in loans to personal, communication, construction, tourism, and agriculture sectors together with increased credit to statutory corporations. This was mainly funded through loans comprising 87% of the portfolio and 13% in short term credit facilities, namely trade bills, overdrafts and lease financing.

In terms of liabilities, total deposit liabilities rose by 20.7% to $2674 million in 2012 driven by the growth in demand deposits whilst savings and time deposits declined over the year. The majority of deposit placements were held with non-financial corporations in particular, private sector non-financial corporations comprising 68% of deposit liabilities, 22% with financial corporations, and 10% for others including central government, local government and non-residents deposit accounts.

The banking sector recorded a strong capital position for 2012, supported by strong retained earnings allowing banks to register a consolidated balance of $536 million compared to $529 million in 2011. The capital adequacy ratio was in a healthy position and stood at 26.9%, well above the minimum prudential requirement of 15%. The Core Tier 1 capital measure registered a marginal decline from 24.8% in 2011 to 24.3% in 2012. This is however, significantly above the 7.5% minimum requirement.

Liquid assets increased with total broad liquid assets [marketable assets] reaching $2028 million at the end of 2012 compared to $1628 million a year ago. Consistent with the increase in liquid assets, commercial banks broad liquid assets to total assets ratio increased to 60.1% in 2012 from 56% in 2011. The ratio of core liquid assets to short term liabilities declined from 70.2% in 2011 to 62.4%, reflecting the growth in liabilities maturing within 3 months. This also indicates that banks are able to meet their near term obligations when due.

Figure 15: Commercial Banks Asset Quality



Source: CBSI

The quality of the loan portfolio, measured by non-performing loans [NPLs], improved further in 2012, following the downward trend in the previous year. Gross NPLs reduced by 36% to $43 million in 2012. The reduction in NPLs was due to improved serviceability of loan accounts combined with debt recovery of problem loans and debt restructuring particularly in the construction, personal, tourism and distribution sectors. The ratio of NPLs to gross loans improved from 5.9% in 2011 to 3.7% in 2012.

Table 5.4: Financial Soundness Indicators (2010 – 2012)

(in percent)	2010	2011	2012
Capital Adequacy:			
Regulated capital to risk weighted assets	22.7	24.6	26.9
Tier 1 Capital to risk weighted assets	22.7	24.6	24.3
Non-performing loans net of provisions to capital	15.0	6.7	4.3
Asset Quality:			
Non-performing loans to total gross loans	7.9	5.9	3.7
Sectoral Distribution of Loans:			
Personal	27.4	27.4	31.6
Distribution	16.6	15.2	13.3
Forestry	12.5	11.5	4.5
Telecommunication	8.1	8.0	9.2
Manufacturing	6.3	5.5	4.6
Construction	13.1	14.2	14.9
Tourism	6.3	7.0	6.7
Transport	3.0	3.8	3.4
Fishing	0.6	0.2	0.0
Professional Services	4.7	4.7	4.8
Agriculture	0.6	0.8	2.1
All Others	0.9	1.8	4.9
Earnings and Profitability:			
Return on Average Asset (before tax)	7.8	5.1	4.8
Return on Average Equity (before tax)	45.1	28.1	28.2
Interest Margin to gross Income	43.9	45.7	46.0
Non-interest expenses (incl. provisions) to gross income	43.1	54.8	50.5
Liquidity:			
Broad liquid Asset to total asset (Liquid asset ratio)	47.7	56.0	60.1
Core liquid asset to short term liabilities	65.2	69.4	60.3

Total provisioning [specific and general provisions], which refers to funds that the banks set aside to cushion bad debts, amounted to $50.6 million in 2012. This indicates more than 100% coverage whilst specific provisions to NPLs reported 42.7% coverage in 2012.

Credit Institutions

The Credit Corporation (SI) Limited performed strongly in 2012 with solid profits, improved loan quality and robust capital levels.

The unaudited after tax profit for 2012 reached a record high of $9.9 million, an increase from $5.3 million in 2011. This positive outcome was largely underpinned by the significant increase in the lending portfolio by $33.6 million to $80.7 million, which resulted in the rise in net interest earnings to $14.6 million in 2012 compared to $9.1 million in 2011. Profitability indicators showed improved returns on assets to 12.9% and returns on equity to 33.2%. The growth in the portfolio was led by lending to personal, fishing, professional services, distribution and statutory corporations.

The balance sheet expanded further by 25.7% to $87.1 million in 2012 compared to $69.3 million in 2011. With its strategy of continuing to grow the lending book, further growth in assets is expected for 2013. On the liabilities of CCSIL, total deposits increased by $9.7 million over the year to $50.4 million in 2012 with the bulk of deposit balances held with financial corporations.

The capital position remained strong at $30.7 million in 2012 compared to $27.2 million in 2011, which was attributed to an increase in retained earnings. Risk based capital ratio measures indicated an adequate capital level at 34.4%, well above the 15% minimum requirement. This was, however, a reduction from 45.2% in 2011 mainly due to an increase in risk weighted assets to $91.3 million in 2012.

Reported classified loans, measured by the ratio of non-performing loans to total loans, stood at 2.2%

in 2012. The increase in the ratio from 1.3% in 2011 was largely due to the increase in non-performing loans to $1.8 million indicating an increase in the deterioration in the performance of the loan portfolio.

Credit Unions

On a consolidated basis, credit unions' assets in 2012 stood at $49.7 million compared to $51.7 million for the previous year. This was largely due to the reduction in their lending portfolio by $2.7 million to $34.6 million, which reflected the sudden withdrawal of some members from one of the credit unions. Similarly, on the liabilities of credit unions, members' deposits fell by $2.9 million to $36.1 million, whilst members' share capital fell from $42.7 million in 2011 to $38.2 million in 2012.

Table 5.5: Credit Unions Financial Statements Summary			
($'million)	2010	2011	2012
Net interest Income	4.6	4.7	5.4
Non-Interest Income	0.1	0.6	0.4
Operating Income	**4.7**	**5.3**	**5.8**
Operating Expenses	**2.4**	**2.2**	**2.5**
Net Surplus	**2.3**	**3.1**	**3.3**
Total Assets	43.2	51.7	49.7
Total Loans	31.1	37.3	34.6
Members Share Capital	36.8	42.7	38.2
No. of Members	4,138	6,320	5,649

Despite the fall in lending, the consolidated revenue earned showed increase in operating income to $5.8 million. The profitability performance for the credit unions however, showed a marginal $0.2 million increase to a net surplus of $3.3 million in 2012 attributed to the increased operating expenses by 13.6% to $2.5 million. Consistent with the rise in net profits, credit unions' return on asset and equity improved to 7% and 9% respectively whilst the self-sufficiency ratio that gauges the effectiveness of the sector in covering its operational costs indicated 232% and, maintained surplus revenue.

As part of its supervisory mandate to ensure registered credit unions operate in a prudent manner, the Central Bank conducted one onsite examination and twelve visits during the year. A full scope review was conducted on the operations of the Solomon Islands National Teachers Association Credit Union Limited. Follow up visits made in the first and second halves of the year to credit unions included, Solomon Islands Public Employees Credit Union, Royal Solomon Islands Police Force Credit Union, Solomon Islands National Teachers Association Credit Union, Solomon Islands Health Workers Credit Union, Solomon Islands Nurses Credit Union and Bokolo Credit Union Limited. It was noted that the major critical issues facing the credit unions in the country are related to good governance and prudent financial management.

CBSI in showing its commitment to the sector continues to support the Solomon Islands Credit Union League (SICUL) through the provision of a 3-year financial subvention. During 2012, SICUL conducted trainings and technical support to Board and management on leadership, financial management and financial planning. In addition, SICUL in liaison with 'Live and Learn' conducted financial literacy training to savings clubs. SICUL also provided assistance to credit unions to update their financial accounts and preparation of financial reports for submission to the Registrars' Office.

In 2012, the International Credit Union Day was celebrated with the credit union members in Choiseul Province. SICUL conducted various presentations in Taro and a training session held with the members of the Bosa Credit Union Limited on the issues relevant for credit unions.

Solomon Islands National Provident Fund [SINPF]

SINPF continued to cope with the relatively uncertain international environment and subdued domestic economy in 2012. The weak conditions in the global economy impacted on the SINPF offshore investments, while the subdued domestic environment constrained investment opportunities.

SINPF total assets rose by 16% to $1.5 billion in 2012 fuelled by the rise in investment portfolio, which accounts for 82% of total balance sheet assets, of which term deposits and financial assets constitute 36% and 26% of the total investment portfolio respectively.

Table 5.6: SINPF Classes of Investments			
Investment Assets ($'million)	**2010**	**2011**	**2012**
Term Deposits	436.0	460.4	466.6
Assets Held to Maturity (Securities)	128.3	130.3	106.4
Financial Assets (equities)	313.6	300.7	333.7
Investment Properties	124.1	187.2	265.4
Loans and Advances	91.7	98.9	109.1
Total Investment	**1,093.7**	**1,177.5**	**1,281.2**

This increase in investment assets in 2012 was driven primarily by a loan of $15 million to Tavanipupu Island Resort, the purchase of $6.1 million shares in the newly established Solomon Oceanic Cable Company (SOCC), an additional loan of $2 million to Sasape International Shipyard Limited (SISL), and further share purchase of $2 million into SolTuna Limited. The refurbishment of Sasape slipway and the construction of its executive apartments also contributed to the increase in investments in 2012.

Table 5.7: SINPF Profitability [Audited]			
For period ending June ($'million)	2010	2011	2012
A: Investment Income	**55.3**	**129.4**	**125.0**
Interest	35.5	35.1	29.0
Dividend	32.0	52.6	67.4
Rentals	11.4	14.5	16.9
Net gains (loss) in changes in fair value	(23.5)	27.2	11.8
B: Other Income	**9.0**	**6.1**	**12.9**
Surcharges	5.3	4.5	4.2
Sundry	3.6	1.3	8.7
Gains on sale of fixed assets	0.2	0.2	0.0
C: Total Income	**64.4**	**135.5**	**137.9**
D: Operating Expenditure	**31.5**	**47.6**	**49.3**
Gross Surplus	32.9	87.9	88.6
Appropriation to Members	39.7	78.9	64.0
E: Net Surplus	**(6.8)**	**9.0**	**24.6**

The Fund reported an improved level of income in 2012, increasing modestly from $135.5 million in 2011 to $137.9 million in 2012. The increase was driven by the significant increase in the dividend payout, primarily from the SINPF investment in South Pacific Oil Limited (SPOL) and Solomon Telekom Company Limited). SINPF operating expenses also rose during the year to $49.3 million, giving SINPF an operating surplus of $88.6 million.

Total members' contributions rose by 16% to $1.4 billion in 2012. This reflects a positive net contribution inflow during the year. Total contributions paid in 2012 were $197.9 million compared to a contribution payout of $78.8 million. The number of contributors in the Fund increased in 2012 by 9% to 46,332.

SINPF also provides a special insurance cover to members in the case of death, where the beneficiary receives a sum of $6000 as a special death benefit. This is paid out of the special death benefit reserve which is replenished yearly through an annual deduction of $5.00 from individual member's contributions. The level of special death benefit reserves stood at $2.3 million in 2012 compared to $2.4 million in 2011.

Table 5.8: SINPF Balance Sheet			
Summary of NPF's Financial Position as at December			
($'million)	**2010**	**2011**	**2012**
Total Assets	**1,180.7**	**1,324.9**	**1,555.4**
Cash	37.6	91.2	209.2
Term Deposit	436.0	460.4	466.6
Debt Securities	128.3	130.3	106.4
Loans and advances	91.7	98.9	109.1
Equity Shares	313.6	300.7	333.7
Property Investments	124.1	187.2	265.4
Other Assets	49.4	56.2	65.0
Liabilities	**1,180.7**	**1,324.9**	**1,555.4**
Contributions	1,037.2	1,213.6	1,402.4
Capital	119.7	86.8	110.7
Others	23.8	24.5	42.3

Insurance Industry

Year-to-date after tax profits for the insurance industry declined by 23% to $12.3 million in 2012. The reduction was largely underpinned by the fall in gross premium income to $48.7 million due to non-renewal of policies of some major projects in the middle of 2012 and high cancellation of policies.

Net premium income earned for the year was $35.9 million down from $45.9 million in 2011. Despite the reduction in total income, expenses were managed by

Figure 16: Insurance Policies By Class

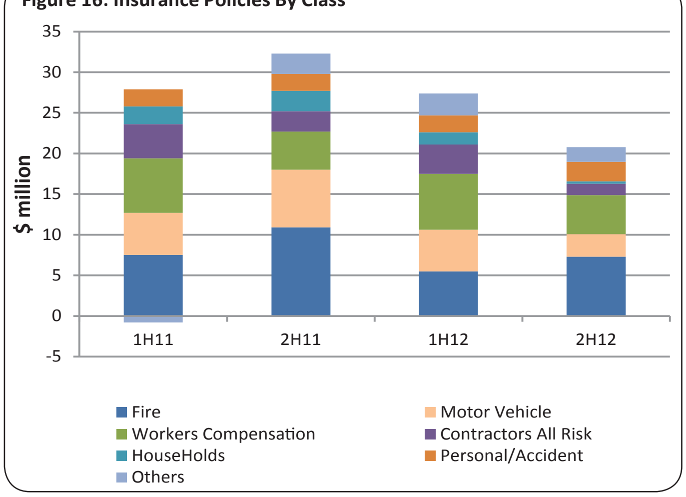


Table 5.9: Insurance Industry's Financial Statement Summary			
Income Statement ($'Million)	**2010**	**2011**	**2012**
Gross premium	60.6	60.0	48.7
Re- Insurance	16.0	14.4	9.0
Premium reserve	1.6	(0.3)	3.8
Net Earned Premium	43.0	45.9	35.9
Total Premium Expense (Inc. Claims)	12.5	15.3	10.8
Underwriting Income	30.4	30.6	25.1
Management Expense	5.8	6.6	6.2
Non- Underwriting income	2.0	1.3	(0.06)
Net Profit Before Tax	26.6	25.3	18.9
Net Profit After Tax	16.8	16.0	12.3
Balance Sheet ($'Million)			
Total Assets	110.7	120.3	117.5
Total Liabilities	45.2	38.7	50.4
Net Assets	65.5	81.6	67.1

the industry reflecting the decline in both premium and management expenses to $10.8 million and $6.2 million respectively. In addition, re-insurance for the year reduced by $5 million to $9.0 million due to lower reinsurance payments, with fire accounting for 72% and Contractors All Risk 18%.

Major policy covers underwritten by the industry in 2012 included fire, which accounted for 26% of total insurance policies, workers compensation policies at 24%, motor vehicle policies at 16% and other statutory liability products (personal, public, and general liability products) at 15%, contractors all risk [CAR] at 11% and others 8%.

Net claims paid fell from $9.8 million in 2011 to $5.8 million in 2012. The majority of claims were for motor vehicle and workers' compensation, which accounted for more than 50% of total claims in 2012. Other major claims were for personal liability and contractors all risk.

The combined assets of the insurance industry declined in 2012 by $2.8 million to $117.5 million. The decline was mainly due to a decrease in balances due from head offices to $1.5 million combined with the decline in debt securities investments. Liabilities, however, increased by 30% to $50.4 million largely driven by the increase in provisions to $7.4 million combined with increases in borrowings from head office. Despite these movements, the industry maintained positive net assets of $67.1 million.

Financial Inclusion

Achieving the objectives of financial inclusion in Solomon Islands progressed slowly in 2012 (see Box 1 on Key Objectives for National Financial Inclusion). The National Financial Inclusion Taskforce (NFIT), a national body approved by Cabinet and established in 2011 was tasked to coordinate stakeholder activities and efforts to achieve the national goal of giving an additional 70,000 people (30,000 are women) access to affordable and appropriate financial services in Solomon Islands.

Progress in 2012

As at the end of 2012 the following are key achievements made during the year:

- Progress was made in incorporating financial education in the Solomon Islands education curriculum. The Curriculum Division of the Ministry of Education and Human Resources Development is the key stakeholder facilitating this project with support from the NFIT.
- The Anti Money Laundering Commission (AMLC) through the Solomon Islands Financial Intelligence Unit (SIFIU) issued guidelines on minimum "know your customer" (KYC) requirements to open new accounts with licensed financial institutions in Solomon Islands.
- The adults' financial competency survey facilitated with the assistance of the Pacific Islands Financial Inclusion Program (PFIP) was completed in 2012, with recommendations from the study to be used as base line for financial education and financial literacy for adults in Solomon Islands.
- A commercial bank piloted its in-store bank and mobile phone banking using the banking model towards the last quarter of the year. ADB completed a review of existing legislations and policies affecting financial inclusion in Solomon Islands.
- A new microfinance institution, the South Pacific Business Development Ltd established its operations in the country.

The year also saw the notable growth in Community-based Saving Clubs supported by NGOs which combined provision of savings and credit products with financial literacy and trainings to members. In 2012, the number of savings club accounts opened by NGOs totalled 4340. The savings clubs are located in the rural and remote locations around Solomon Islands.

Adult financial literacy training reported some progress as measured by the number of people that attended the trainings. In 2012, 8,367 people, half of whom are women, attended some form of financial literacy training conducted by stakeholders namely NGOs, the commercial banks and CBSI. CBSI alone continued to promote adult financial literacy through its weekly "Money Matters" radio program, "Money Smart Day" annual event; in 2012 the event was held at Lata in Temotu Province. Eight workshops on financial literacy and management training were held, attended by 840 participants.

Despite the positive progress made, there are major gaps to be addressed in the pursuit of the financial inclusion agenda in Solomon Islands. First, is to agree on indicators to measure the progress in achieving the goal of adding 70,000 new people to access financial services in Solomon Islands. From consultations with stakeholders in the country, it was agreed that one indicator should be the access to financial services (or the supply of financial services and products) and another should be on usage (or the demand for financial services and products). However, how the data to be used in the calculation of the indicators would be collected is yet to be determined and agreed to.

Consumer protection and empowerment, another key area of the financial inclusion agenda has not really progressed in Solomon Islands. There is a need to review and amend existing applicable laws to empower and protect the rights of users of financial services. To meet our commitment in the Maya Declaration, a study of the demand for micro insurance products and services targeting the poor would be conducted to allow providers of micro insurance products to determine the commercial viability of providing such services and products in the country.

Overall, 2012 has seen mixed results in the development and promotion of financial inclusion activities in the country. **Solomon Islands Financial Intelligence Unit (SIFIU)**

The SIFIU carried out its functions as mandated by the Money Laundering and Proceeds of Crime Amendment Act 2010 (MLPCA). The Unit is manned by two officers, a CBSI seconded officer and a seconded officer from the Royal Solomon Islands Police Force. In terms of operational functions, the SIFIU reports to the Anti-Money Laundering Commission (AMLC), established under the MLPCA. SIFIU is a member of the Asia Pacific Group (APG) on Anti Money Laundering and also a member of the EGMONT Group. As a member of these international and regional organizations, the SIFIU and AMLC are committed to meeting international AML/CFT standards and requirements.

Despite resource constraints, the Unit was able to perform its tasks in line with international standards on anti-money laundering and combating financing of terrorism activities. The Unit worked closely with the commercial banks AML/CFT reporting officers during the year to address deficient areas highlighted in the World Bank/APG Mutual Evaluation report of 2009 and outstanding issues in Solomon Islands progress reports. Generally, the SIFIU has seen great improvements in banks' collation and safe keeping of customer's identification documents and other related information. The information is paramount to the AML/CFT regime and its work.

Another area the SIFIU has been involved in is on "financial scams". The Unit attended to numerous enquiries from the public during the year about financial schemes and purported lottery wins. The Unit was able to advise and assist people seeking advice prior to making contact with or payments to perpetrators of schemes. Unfortunately, other people sought advice after they have already paid money to perpetrators.

The Unit continued to carry out its functions of receiving, analysing and disseminating intelligence reports to law enforcement agencies. During the year, the Unit also received requests from the Government for background checks on companies and individuals interested in investing in the country. SIFIU assisted the Police on some cases they investigated during the year.

Table 5.10: Types of Reports Received in 2012

Type of Report	Received	Disseminated
Suspicious Transaction Report (STR)	49	14
Cash Transactions Report (CTR)	22,707	-
Electronic Funds Transfer Report (EFTR)	11,563	-
Border Currency Report (BCR)	10	-

Box 1: National Financial Inclusion Key Outcomes

The following summarizes the outcomes of National Financial Inclusion Agenda.

The overall goal is to give additional 70,000 people (of which 30,000 women) access to affordable financial services by 2015.

To achieve this overall national goal, the following sub goals must be achieved as well by 2015:

1. Establishment of a Secretariat to assistance the National Financial Inclusion Task force
2. Increase women participation in financial literacy and access affordable financial services.
3. Review regulatory laws affecting financial inclusions in Solomon Islands
4. Develop a minimum KYC to encourage more Solomon Islanders to use the formal banking services.
5. Develop innovate distribution channels for financial services products.
6. Conduct a national financial competency survey
7. Establish and collect data on financial Inclusion in Solomon Islands
8. Incorporate financial education in National School Curriculum and coordinate financial literacy activities provided by various stakeholders.
9. Share global best practice and information to stakeholders.

Source: National Financial Inclusion Unit, CBSI

Box 2: The Maya Declaration

Commitment by the Central Bank of Solomon Islands

AFI Global Policy Forum
27 September 2012
Cape Town, South Africa

The Central Bank of Solomon Islands (CBSI) hereby commits to provide leadership, advice and support to the Solomon Islands National Financial Inclusion Taskforce in achieving its goal set in 2011 to enable an additional 70,000 (of which 30,000 are women) unbanked and under-served citizens of our nation have access to financial services through coordinated effort by year 2015.

We commit to embark on an inclusive data improvement on financial inclusion through a financial competency survey by 2012, to measure the current level of financial literacy and competency in Solomon Islands, and to collect data to produce measurable indicators in the AFI network by 2013.

We commit to champion financial education through close collaboration with the Government in our effort to integrate financial education into the existing Solomon Islands national school curriculum from Class 1 to Form 3 by year 2013.

Finally, we commit to ensure the provision of an enabling legal environment by implementing the recommendations of the regulatory review completed in 2011, in order to provide for and encourage new innovative financial models such as mobile money services, village based savings and microfinance institutions, with the view to encourage expansion and diversification of financial services and products in the country.

Thank you.

Denton Rarawa
Governor

Calendar of Events

January

23rd Anti-money Laundering Commission (AMLC) meeting

26th Extractive Industry Transparency Initiative (EITI) Workshop at Heritage Park hotel

February

2nd Meeting with Deputy US Ambassador to Solomon Islands

8th Meeting with ANZ CEO, Mr Mike Smith with PM and Minister of Finance

9th Governor officially welcomed all staff to the New Year 2012

17th Meeting with Indian High Commissioner to Solomon Islands

20th Briefing of Australian Trade Mission

March

1st First CBSI Board meeting

7th National Financial Inclusion Taskforce (NFIT) meeting

19th Meeting of the Core Economic Working Group (CEWG)

23rd IMF/Pacific Islands Conference in Apia, Samoa

30th Striking of first coins at the Royal Australian Mint in Canberra.

April

4th Second CBSI Board Meeting

5th Handover of Rifle Range management houses

23rd Draft CBSI Act consultations with stakeholders at Mendana hotel

26th Third CBSI Board meeting

30th Submit audited financial accounts for 2011 to the Minister of Finance

May

3rd Asian Development Bank (ADB) annual meetings in Manila

8th IMF review mission on the Standby credit facility

11th Launching of the CBSI 2011 annual report

23rd De Le Rue conference in Auckland

31st Fourth CBSI Board meeting at Aruligo recreational site

June

13th Q2 NFIT meeting

24th Bank for International Settlements (BIS) annual meeting in Basel

July

5th Launching of the new five-coin array

11th Review of the Honiara Club agreement

18th CBSI hosts Bank of England/PFTAC training

25th Fifth CBSI Board meeting held at Lata, Temotu province

August

1st IT Review underway

2nd Road works at Mbokona commenced

September

11th AMLC meeting

12th NFIT meeting

20th Sixth CBSI Board meeting

26th AFI Global Policy Forum in Cape Town

October

14th IMF & World Bank Group annual meetings in Tokyo

19th Australia-Solomon Islands Business Forum, Brisbane

23rd CEWG meeting

24th Seventh CBSI Board meeting

November

1st Association of Financial Supervisors of Pacific Countries, Annual Meeting Port Villa

14th NFIT meeting

19th Review of Security System

30th Eighth CBSI Board meeting on 2013 Business Plan and Budget

December

7th South Pacific Governors meeting in Sydney

14th AMLC meeting

15th CBSI Staff Christmas Party

31st Old coins demonetized and cease to be legaltender

Press Releases in 2012

Jan 23rd	Pess Release: Counterfeit notes in circulation
Jan 27th	Press release on New Coins for the Solomon Islands
Mar 26th	Central Bank visits Selwyn College
Mar 27th	Solomon Islands New Coins Revealed
Apr 13th	Statement from the Central Bank of Solomon Islands: Monetary Policy Stance
Jun 21st	CBSI Celebrates 36th Anniversary
July 3rd	Solomon Islands New Coins set for launch
July 20th	Press release: CBSI clarifies misinformation by Malaita Ma'asina Forum (MMF)
July 24th	CBSI conducts nation-wide literacy program
July 30th	Temotu Provincial Library receives support from CBSI
July 30th	CBSI applauds Westpac Bank
Aug 20th	Press release: CBSI hosts Pacific Islands Bank Supervisors
Sept 7th	New Counterfeit notes emerge
Oct 8th	CBSI announces commitment to Maya Declaration
Oct 30th	Press release: CBSI Monetary Policy Stance for second half of 2012
Oct 31st	Press release: CBSI Warns the Public of Forged Documents
Dec 11th	Press release on CBSI Investment in Gold

2012 Flashback

2012 Flashback

2012 Flashback

Central Bank of Solomon Islands

ANNUAL STATEMENT OF ACCOUNTS
FOR THE YEAR ENDED 31 DECEMBER 2012

CONTENTS

Solomon Islands Office
of the Auditor- General

Independent Auditor's Report

To the Board of the Central Bank of the Solomon Islands

Scope

I have audited the accompanying financial statements of Central Bank of Solomon Islands which comprise the statement of financial position as at 31 December 2012, the statement of comprehensive income, the statement of transfers to the Solomon Islands Government, the statement of changes in equity and the statement of cash flows for the year then ended and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Report

The Board and management of the Bank are responsible for the preparation and fair presentation of these financial statements in accordance with the requirements of the Central Bank of Solomon Islands Act (Cap 49) and International Financial Reporting Standards. The responsibilities of the Board and management of the Bank include implementing and maintaining internal controls relevant to the preparation and fair presentation of the fi nancial statements that are free from material misstatements, whether due to fraud or error, selecting and applying appropriate accounting policies, and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement in the 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 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 estimates made by the Board and management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Audit Opinion

In my opinion, the financial statements presents fairly in all material respects, the financial position of Central Bank of Solomon Islands as at 31 December 2012 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on other Legal and Regulatory Requirements

The financial statements of Central Bank of Solomon Islands are in accordance with the provisions of the Central Bank of Solomon Islands Act (CAP 49) and International Financial Reporting Standards.

Mr. Edward Ronia
Auditor-General

Office of the Auditor-General
Solomon Islands

29 April2013

CENTRAL BANK OF SOLOMON ISLANDS

STATEMENT BY DIRECTORS

In the opinion of the Directors:

a) The accompanying statement of comprehensive income is drawn up so as to give a true and fair view of the results of the Bank for the year ended 31 December 2012;

b) The accompanying financial position is drawn up so as to give a true and fair view of the state of affairs of the Bank as at 31 December 2012;

c) The accompanying statement of changes in capital and reserve is drawn up so as to give a true and fair view of the movement in equity for the year ended 31 December 2012;

d) The accompanying statement of cash flows is drawn up so as to give a true and fair view of the cash flow movement of the Bank for the year ended 31 December 2012;

e) The financial statements have been properly prepared in accordance with International Financial Reporting Standards except as noted in note 3(b) to the financial statements. In accordance with the provisions of the section 45 CBSI Act (CAP 49) of 1976, foreign exchange gains and losses are credited or charged directly to the 'Foreign Exchange Revaluation Reserve account' and are not included in the annual profits or losses of the Bank for distribution.

This is at variance with International Financial Reporting Standard lAS 21, " Effects of Changes in Foreign Exchange Rates" which requires that exchange gains and losses be credited or charged to the profit and loss.

In the opinion of the Directors, the accounting treatment adopted is appropriate in view of the requirement of the CBSI Act (CAP 49) of 1976.

For and on behalf of the Board of Directors

Gane Simbe
Deputy Governor

Mr Katalulu Maepioh
Director

Date: 29/4/2013

Date: 29/4/2013

STATEMENT OF COMPREHENSIVE INCOME – FOR YEAR ENDED 31 DECEMBER 2012

	Note	2012 ($000's)	2011 ($000's)
Income			
Interest income	22(a)	64,131	52,171
Fees and commissions	22(b)	9,771	14,021
Royalties		807	831
Other income	22(c)	1,966	1,268
Net gain on foreign currency exchange		492	2,256
Changes in fair value of investment properties	9	5,682	-
Net unrealised foreign exchange revaluation gain		43,833	-
Total Income		**126,682**	**70,547**
Expenses			
Interest expense	22(d)	5,480	3,026
Fees and commissions	22(e)	540	224
Administrative expenses	22(f)	31,944	27,511
Other operating expense	22(g)	39,937	18,815
Net unrealised foreign exchange revaluation loss		-	245,344
Total expense		**77,901**	**294,920**
Net Profit/(Loss)		**48,781**	**(224,373)**
Other Comprehensive Income			
Gains/(losses) on:			
Gold		(2,122)	-
Properties, plant and equipment		32,360	-
		30,238	**-**
Total Other Comprehensive Income		**79,019**	**224,373)**
NET PROFIT DISTRIBUTION ACCORDING TO CBSI ACT			
Net Operating profit/(loss) in terms of IFRS		48,781	(224,373)
Add: (IFRS required items not included in CBSI Law):			
Net unrealised (gain)/loss on foreign exchange revaluation		(43,833)	245,355
Changes in fair value in investment properties		(5,682)	-
Net Operating Profit according to CBSI ACT		**(734)**	**20,971**
Net (Loss)/Profit transferred to General Reserve according to section 20(1) of CBSI ACT (CAP 49)		(734)	10,486
Transfer to Other Reserves according to section 20(2) of the CBSI ACT (CAP 49)		-	5,243
Due to Solomon Islands Government, according to section 20(2) of the CBSI ACT (CAP 49)		-	5,243

This statement of comprehensive income is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 49-72

STATEMENT OF TRANSFERS TO GOVERNMENT OF SOLOMON ISLANDS - FOR THE YEAR ENDED 31 DECEMBER 2012

	Note	2012 ($000's)	2011 ($000's)
Appropriation of profits according to Section 20 (2) of the CBSI Act (CAP 49)		-	5,243
Total transfer to Solomon Islands Government		**-**	**5,243**

The statement of transfers to Government of Solomon Islands is to be read in conjuction with the notes to and forming part of the financial statements set out on pages 49-72

STATEMENT OF FINANCIAL POSITION – AS AT 31 DECEMBER 2012

	Note	2012 ($000's)	2011 ($000's)
ASSETS			
Foreign Currency Assets		764,448	954,458
Money at call	4	764,448	954,458
Accrued Interest		9,593	9,922
Term Deposits	4	2,560,720	1,958,415
International Monetary Fund			
- Holding of Special Drawing Rights	5	106,087	104,741
Gold Investment	10	218,628	-
		3,659,476	3,027,536
Local Currency Assets			
Cash on Hand		456	98
Loans and Advances	7	87,174	107,828
Property, Plant and Equipment	8	139,787	93,240
Investment Properties	9	11,323	5,641
Other Assets	11	45,747	47,552
		284,487	254,359
Total Assets		**3,943,963**	**3,281,895**
LIABILITIES			
Foreign Currency Liabilities			
Demand Deposits	12	86,103	11,332
International Monetary Fund			
- Standby Credit Facility	13	141,630	141,942
- Special Drawing Rights Allocations	5	111,807	112,110
- Capital Subscription	5	915	919
- Extended Credit Facility	13	1,676	-
Total - Foreign Currency Liabilities		**342,131**	**266,303**
Local Currency Liabilities			
Demand Deposits	14	1,721,457	1,487,5 I 3
Currency in Circulation	15	599,669	527,702
SIG Monetary Operations Account	16	37,906	37,547
Fixed Deposits	17	997,811	797,146
Provision for transfer to SIG Consolidated Fund		480	5,243
Other Liabilities	18	24,485	19,430
Total Local Liabilities		**3,381,308**	**2,874,582**
Total Liabilities		**3,723,939**	**3,140,885**
NET ASSETS		**220,024**	**141,010**

STATEMENT OF FINANCIAL POSITION – AS AT 31 DECEMBER 2012

	Note	2012 ($000's)	2011 ($000's)
Capital and Reserves			
Authorized Capital		50,000	50,000
Paid up Capital		20,000	20,000
Gold Revaluation Reserve	10	(2,122)	-
General Reserve	19	63,652	58,707
Foreign Exchange Revaluation Reserve	20(a)	(7,169)	(7,169)
Premises and Equipment Assets Revaluation Reserve	20(c)	83,788	51,428
Capital Asset Reserve	21	61 875	61.877
TOTAL CAPITAL AND RESERVES		**220,024**	**141,010**

Gane Simbe
Deputy Governor

Emmanuel Gela
Chief Mnager

The statement of financial position is to read in conjunction with the notes to and forming part of the financial statement set out on pages 49-72

STATEMENT OF CHANGES IN CAPITAL AND RESERVES – FOR THE YEAR ENDED 31 DECEMBER 2012

	Issued & Paid up Capital	Gold Revaluation Reserve	General Reserve	Foreign Exchange Assets Revaluation Reserve	Premises & Equipment Asset Revaluation Reserve	Capital Assets Reserve	Total
	($000's)	($000's)	($000's)	($000's)	($000's)	($000's)	($000's)
Balance as at 1 January 2011	20,000	-	48,221	194,343	51,428	56,634	370,625
Transfer of net operating profit according to Section 20(1) and 20(2) of CBSI Act CAP(49)	-	-	10,486	-	-	5,243	15,729
Transfer of Foreign Exchange Revaluation Gains/ (Losses) for the year according to CAP(49) section 45 (1) of CBSI Act	-	-	-	(245,344)	-	-	(245,344)
At 31 December 2011	20,000	-	58,707	(51,002)	51,428	61,877	141,010
Transfer of net operating profit/ (loss) according to Section 20(1) and 20(2) of CBSI Act CAP(49)	-	-	(734)	-	-	-	(734)
Loss on Revaluation of Gold		(2,122)	-	-	-	-	(2,122)
Property Revaluation Gain	-	-	-	-	32,360	-	32,360
Changes in fair value – Investment Properties	-	-	5,682	-	-	-	5,682
Transfer of Foreign Exchange Revaluation Gains for the year according to CAP(49) section 45 (1) of CBSI Act	-	-	-	43,833	-	-	43,833
Others	-	-	(3)	-	-	(2)	(5)
At 31 December 2012	**20,000**	**(2,122)**	**63,652**	**(7,169)**	**83,788**	**61,875**	**220,024**

The statement of changes in equity is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 49-72

CASH FLOW STATEMENT – FOR THE YEAR ENDED 31 DECEMBER 2012

	Note	2012 ($000's)	2011 ($000's)
Cash flows from operating activities			
Interest received		64,131	52,171
Cash received from other income		13,171	18,448
Interest paid		(5,480)	(3,026)
Cash payments in course of operations		(61,621)	(36,175)
Net cash inflow from operating activities		**10,201**	**31,418**
Cash received in placement of deposits		434,605	1,027,606
Increase on IMF Allocation of SDR		-	(10,396)
Decrease in government finance provided		20,654	12,976
Net cash provided by operating activities	6	**465,461**	**1,061,604**
Cash flows from investment activities			
Payments for Premises, plant and equipment		(18,360)	(28,446)
Proceeds from sale of Premises, plant and equipment		99	159
Increase in foreign and domestic investments		(590,232)	(1,136,412)
Cash flows from financing activities		**(608,493)**	**(1,164,699)**
Net movement in issue of circulating currency		71,968	91,131
Net movement in foreign currency loan		75,828	14,767
Solomon Islands Government Monetary Operations		359	(406)
Dividend paid		(4,765)	(2,452)
Net cash provided by financing activities		**143,390**	**103,038**
Net increase/(decrease) in cash held		358	(57)
Cash at the beginning of the financial year		98	155
Cash at the end of the financial year		**456**	**98**

The statement of cash flows is to be read in conjunction with the notes to and forming part of the financial statementset out on pages 49-72

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

1. THE LEGAL FRAMEWORK

The Central Bank of Solomon Islands (CBSI) operates under the Central Bank of Solomon Islands Act (CAP 49) (1996 as amended). The CBSI is an independent legal entity wholly owned by, and reporting to, the Government of the Solomon Islands. The CBSI is responsible for ensuring:

- Regulation of the issue, supply, availability and international exchange of the currency of the Solomon Islands;
- Advising the Solomon Islands Government on banking and monetary matters;
- Promoting monetary stability;
- Supervision and regulation of banking business;
- Promoting a sound financial structure;
- Fostering economic conditions conducive to the orderly and balanced economic development of the Solomon Islands.

Section 19 of the CBSI Act states that the Board shall determine the net profit of the Bank for the current financial year after meeting current expenditures and making such provisions as it views appropriate for bad and doubtful debts, depreciation in investments and other assets; contribution to staff and pension funds, and such other purposes as the Board may deem necessary. Section 43 states that any capital profit or loss resulting from the sale or maturity of Central Bank investments in securities, shall represent an accrual or charge against the General Reserve, as the case may be, and shall not be deemed a profit or loss for the purposes of the calculation of net profits of the Central Bank in accordance with Section 19. Section 45 requires that gains arising, other than from normal trading activity shall be allocated to a Revaluation Reserve Account and neither, they nor similar losses (other than from trading activity) shall be included in the computation of annual profits and losses of the Central Bank.

The Board is also aware, in terms of current best Central Bank practice, and International Financial Reporting Standards (IFRS), that there is a need to harmonise the CBSI Act (CAP 49) with current best practice. Accordingly, as from 2013 financial year, the CBSI Act 2012 will replace CBSI (CAP 49) and becomes the basis to publish the financial accounts of the Bank.

The net profit will be determined in terms of IFRS and Section 54(1) of CBSI Act 2012 and distributable earnings will be determined under Section 54(2) which requires adjustments for unrealized and realized income, CBSI Act 2012.

2. BASIS AND FORMAT OF PRESENTATION

a) Basis of preparation

The financial statements of the Bank are based on IFRS adopted by the International Accounting Standards Board (IASB), interpretations issued by the Standing Interpretations Committee of the IASB except where the Central Bank of Solomon Islands Act (CAP 49) requires different treatment in which case the CBSI Act takes precedent. They are prepared under the historical cost basis and do not take into account changing money values except where stated.

The accounting policies have been consistently applied over the reporting and comparative years with the exception of Solomon Islands notes and coins. Up until 2008, the production costs of Solomon Islands notes and coins are initially capitalized under Other Local Currency Assets and later expensed when issued into circulation. As from 2009, the production cost of Solomon Islands notes and coins will be treated as an expense under Other Operating Expenses, as per note 3 (i). This has been possible with the accounts full compliance to IFRS since 2006.

The financial statements are expressed in the Solomon Islands dollar (SBD), rounded to the nearest thousand.

b) Comparatives

All necessary information has been classified and presented to achieve consistency in disclosure with current financial year amounts and other disclosures.

3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

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

c) Revenue recognition and Income presentation

Operating revenue

Operating revenue is generally recognized on an accrual basis and includes interest income, fees and commissions, and profit on foreign exchange dealing with commercial banks and sundry income.

Income presentation

As Discussed in Note 1, the Legal Framework, the Profit and Loss Statement continue to include income calculated on the basis of IFRS until 2013 when CBSI Act 2012 becomes effective. As an additional disclosure, CBSI presents net income restated in terms of the CBSI Act, which continues to be the basis for Central Bank profit distribution.

d) Foreign currency assets and liabilities

Foreign currencies

Transactions in foreign currencies are converted to Solomon Islands dollars at the rates of exchange prevailing on transaction dates. Year-end assets and liabilities denominated in foreign currencies are converted at the rates of exchange ruling at the year-end.

All unrealized gains and losses, arising from the conversion of foreign currencies are taken to the Foreign Exchange Asset Revaluation Reserve Account in accordance with the provisions of Section 45 of the CBSI Act (CAP 49). These amounts are not included in the computation of the annual profits or losses of the Bank, calculated in terms of the CBSI Act.

Net losses arising from the conversion of foreign currencies and net adverse changes in the fair value of securities are set off against any credit balance in the Foreign Exchange Asset Revaluation

Reserve Account, on the basis set out in the previous paragraph. If the balance of this account is insufficient to cover such losses, they are set off against any net profit remaining after the transfer to the General Reserve Account has been made in terms of Section 20 of the CBSI Act (CAP 49). If these transfers are not adequate to cover such losses, the Government is required to transfer to the ownership of the Bank non-negotiable non-interest bearing securities to the extent of the deficiency in terms of Section 44 of the CBSI Act (CAP 49).

Any credit balance in the Foreign Exchange Asset Revaluation Reserve Account at the end of each year is applied first to the redemption of any non-negotiable non-interest bearing securities previously transferred to the Bank by the Government to cover losses, in terms of Section 45 (3) of the CBSI Act.

As at 31 December 2012, there was a net revaluation gain of $43.8 million (2011: $245.3 million loss).

c) Impairment of other tangible and intangible assets

At each reporting date, the reviews the carrying amount 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 estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

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.

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.

d) Foreign currency assets and liabilities

Treasury notes, bonds and bills

At present CBSI holds foreign currency denominated interest bearing fixed bank deposits, and bonds denominated in foreign currencies which are re-valued at fair value ('market value') on a weekly basis. In terms of IAS 39, as a Central Bank, the CBSI would classify such portfolios within the residual "fair value option" through profit and loss category. Central banks do not actively trade in such securities for profit maximization purposes; activity reflects monetary policy considerations.

Under Section 43 (2) of the CBSI Act (CAP 49), such associated net unrealized gains and losses must accrue to the General Reserve. Section 19 also states that depreciation of such investments would accrue to profit and loss. In terms of IFRS, unrealized amounts would be accumulated in an appropriate Foreign Investments Asset Revaluation Reserve, prior to conformity with the existing dated legislation

e) Gold

The Bank has diversified its portfolio to include Gold in 2012, it includes physical gold bars and paper gold. The Board approved that gold bars are valued using the cost model which does not change with changing market price and paper gold using the revaluation model-available-for sale (AFS) which fluctuates with market price. Revaluation gains and losses are transferred to the Gold Revaluation Reserve.

f) Coins sold as numismatic items

The Bank sells, or receives royalties on, coins which are specially minted or packaged as numismatic items. These coins have not been accounted for as currency in circulation as they were not issued for monetary purposes.

g) Non-current assets

The carrying amounts of all non-current assets are reviewed to determine whether they are in excess of their recoverable amount at balance date. If the carrying amount of a non-current asset exceeds the recoverable amount, the asset is written down to the lower amount. In assessing recoverable amounts the relevant cash flows have not been discounted to their present value.

h) Property, plant and equipment

Acquisitions

Items of property, plant and equipment are recorded at cost and depreciated as outlined below. All items of property, plant and equipment are carried at the lower of cost less accumulated depreciation, and any recoverable amount.

Investment property

Investment property, which is property held to earn rentals and/or for capital appreciation, is measured initially at its cost, including transaction costs. Subsequent to initial recognition, investment property is measured at fair value. Gains or losses arising from changes in the fair value of investment property are included in profit or loss in the period in which they arise, but excluded from distributions.

Where the property is held to earn rentals and/or for capital appreciation, the property are retained in Land and Buildings.

Disposal of assets

The gain or loss on disposal of assets is calculated as the difference between the carrying amount of the asset at the time of disposal and the proceeds on disposal, and is included in the result in the year of disposal.

Depreciation

Depreciation is charged on a straight line basis over the estimated useful lives of the assets. The rates of depreciation used are based on the following estimated useful lives:

- Central Bank buildings - 4 - 55 years
- Computers - 3 - years
- Furniture, Plant and Equipment - 3 - 5 years
- Motor vehicles - 4 - years

Assets are depreciated from the date of acquisition. Expenditure on repairs or maintenance of property, plant and equipment incurred which does not add to future economic benefits expected from the assets is recognised as an expense when incurred.

Periodic revaluations

The Board has determined that apart from land and buildings, the remaining fixed assets of the Bank are recorded at values approximating recoverable market values. The Board approved a three year periodical revaluation of its land and buildings which was firstly done in 2006 and recently in 2012. This included a review of the asset classes, estimated useful lives and depreciation rates, and current market values where deemed appropriate. The basis of this valuation is the open market value, that is, the highest and best value the property would expect to be realized if put for sale on private treaty. The Board approved to have such assets revaluation every three years. The next revaluation will be done in 2015.

i) Notes and coins

The printing and minting production cost of Solomon Islands notes and coins, plus all other related costs are expensed as and when it is incurred.

j) Income Tax

The Bank is exempted from income tax under the Income Tax (Central Bank of Solomon Islands) (Exemption) Order of 21st June 1976 as provided for under Section 16 (2) of the Income Tax Act (CAP 123).

k) Employee entitlements

Employee remuneration entitlements are determined by the Board in terms of Section 14 of the CBSI Act.

A liability is recognised 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 Bank in respect of services provided by employees up to reporting date.

l) Solomon Islands Pension /Provident Fund

The Bank and its employees make contributions to the Solomon Islands National Provident Fund (Fund). The Bank had contributed to the Fund on behalf of its staff at the rate of 7.5% per cent of salaries and other staff entitlements/incomes. This amounts to $0.83 million (2011; $0.69 million) in this financial year. CBSI staff in respect of income received, also contributed $0.56 million (2011; $0.49 million) to the Fund at the range of 5% to 7.5%. The legal minimum employee's contribution rate is 5%.

m) Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents comprise cash held at the Bank as till money.

n) Solomon Islands Government bonds

Solomon Islands Government bonds are valued at cost. Due to the present very thin secondary market for such securities in the Solomon Islands, they are held to maturity by the Central Bank. Accordingly in terms of IAS 39, they are classified as "held to maturity" and recorded at cost in the Bank's accounts.

o) Allowance for Bad and Doubtful Debts

Any allowance for bad and doubtful debts is established when there is objective evidence that the Bank will not be able to collect all amounts due according to the original terms of the receivable.

Objective evidence that receivables are impaired includes observable data that come to the attention of the Bank about the following events:

- Significant financial difficulty to the debtor
- A breach of contract, such as default or delinquency in payments
- It becoming probable that the debtor will enter bankruptcy or other financial reorganization

The amount of allowance is the difference between the carrying amount and the recoverable amount of the asset being the present value of expected cash flows discounted at the market rate of interest for similar borrowers. The amount of the provision is recognized as a charge in the statement of comprehensive income.

4. EXTERNAL ASSETS

Section 30 of the CBSI Act requires the Bank to maintain a reserve of external assets, and lists the various ranges of assets which can be held. For a central bank, such assets would include all internationally recognised reserve assets. In these financial statements, external assets also include fully convertible foreign currency balances.

5. INTERNATIONAL MONETARY FUND

(a) The Solomon Islands is a member of the International Monetary Fund (IMF) and the Central Bank of Solomon Islands has been designated as the Government of the Solomon Island's fiscal agency (through which the Government deals with the IMF) and as the depository for the IMF's holding in Solomon Island dollars.

(b) The Solomon Islands subscription to the IMF has been met by:

(i) payment to the IMF out of Central Bank external assets which have been reimbursed by the Government of the Solomon Islands by issue of non-interest bearing securities;

(ii) the funding of accounts in favor of the IMF in the books of the Central Bank by the Government of the Solomon Islands.

(c) The liabilities to the IMF include subscriptions which are maintained in the IMF No.1 and IMF No. 2 accounts. The IMF maintains such balances in their accounts in both Special Drawing Rights (SDR) and Solomon Islands dollar equivalents; the Central Bank balances are maintained only in Solomon Islands dollars.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

6. RECONCILIATION OF OPERATING PROFIT TO NET CASH PROVIDED BY OPERATING ACTIVITIES

For the purpose of the statement of cash flows, cash and cash equivalents includes cash on hand at Bank (till money).

	2012 ($ 000's)	2011 ($000's)
Operating (loss)/profit	(734)	20,971
Non-cash items:		
Depreciation	3,940	6,095
Net (increase)/decrease in:		
Other receivables	22,593	12,947
Accrued expenses	439,662	1,021,591
Net cash provided by operating activities	**465,461**	**1,061,604**

7. LOANS AND ADVANCES

a) Loans and Advances to Solomon Islands Government

	2012	2011
Loans and advances	2,402	10,240
Development bonds	27	27
Treasury bills	40	20
Other securities	4,936	4,940
Amortizing bonds	74,691	88,029
Total Loans and Advances to Solomon Islands Government	**82,096**	**103,256**

b) Staff Loans

	2012	2011
Staff housing loans	3,887	3,532
Management car loans	348	212
Personal loans	843	828
Total Staff Loans	**5,078**	4,572
Total Loans and Advances	**87,174**	**107,828**

8. PROPERTY, PLANT AND EQUIPMENT

At 31 December 2011	**Land & buildings ($ 000's)**	**Equipment & furniture ($000's)**	**Computer ($ 000's)**	**Work in progress ($000's)**	**Total ($ 000's)**
Cost	48,481	21,854	4,609	37,653	112,597
Accumulated depreciation	(2,603)	(14,148)	(2,606)	-	(19,357)
Net book amount	**45,878**	**7,706**	**2,003**	**37,653**	**93,240**
Year ended December 2011					
Opening net book amount	53,026	10,635	380	12,719	76,760
Additions	-	1,100	2,412	24,934	28,445
Disposals	-	(220)	(10)	-	(230)
Depreciation charge	(1,507)	(3,809)	(779)	-	(6,095)
Transfer to investment property	(5,641)	-	-	-	(5,641)
Closing net book amount	**45,878**	**7,706**	**2,003**	**37,653**	**93,240**
At 31 December 2012					
Cost	123,302	24,721	5,406	6,343	159,772
Accumulated depreciation	-	(16,329)	(3,656)	-	(19,985)
Net book amount	**123,302**	**8,392**	**1,750**	**6,343**	**139,787**
Year ended December 2012					
Opening net book amount	45,878	7,706	2,003	37,653	93,240
Additions	-	3,642	797	13,921	18,360
Disposals	(167)	(66)	-	-	(233)
Depreciation charge	-	(2,890)	(1,050)	-	(3,940)
Internal Transfer	45,231	-	-	(45,231)	-
Revaluation increment	32,360	-	-	-	32,360
Closing net book amount	**123,302**	**8,392**	**1,750**	**6,343**	**139,787**

The Land and Buildings valuations was undertaken by a registered valuer, Pacific Architect Ltd on the 21st November 2012. It was carried out based on the market value of the properties. These valuations have been incorporated into the financial statements and effective as at 31 December 2012.

Similar valuation on Land & Buildings will occur again in 2015 in compliance with IAS16. The periodical (3 year period) revaluation of Land & Building was approved by the Board of Directors on the 7th of September 2006.

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

	2012 ($ 000's)	2011 ($ 000's)
Land and Buildings	90,942	51,519
	90,942	**51,519**

9. INVESTMENT PROPERTIES

Balance at beginning of financial year – at fair value	**5,641**	**6,148**
Change in fair value	5,682	-
Transferred from Office & Other Building and Residences – Accumulated Depreciation	-	(507)
Balance at end of financial year – at fair value	**11,323**	**5,641**

10. GOLD INVESTMENT

Gold investment consists of the following:

a) **Gold Bullion at cost**	75,308	-
b) **Unallocated Gold at fair value**	143,320	-
	218,628	-

The Board resolved that gold bullion (commodity) be valued at cost, therefore, no revaluation was carried,and unallocated gold or paper gold be recognized as a financial instrument- available-for-sale valued at fair value with revaluation done on weekly basis. The net unrealized revaluation loss at the end of the year was $2.1million and transferred to the Gold revaluation reserve.

11. OTHER LOCAL CURRENCY ASSETS

Sundry debtors & other cheques held	45,540	46,543
Advances and prepayments	207	1,009
	45,747	**47,552**

12. FOREIGN CURRENCY DEMAND DEPOSITS

Demand Deposits	**86,103**	**11,332**

Demand deposit of international organizations such as the Asian development Bank (ADB), European Development Bank (EDB), International Fund for Agricultural Development (IFAD), International Development Association.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

13. IMF STANDBY CREDIT FACILITY

IMF standby credit facility	**141,630**	**141,942**
IMF Extended credit facility	**1,676**	-

IMF Assistance to Solomon Islands Economic Reform Program.

Standby Credit Facility (SCF) with IMF commenced in 2010 with 1st disbursement on the 23 June 2010, 2nd on the 30th November 2010, 3rd on the 8th July 2011 and the final disbursement was transacted on the 1st December 2011.

Final disbursement of review of program

Extended Credit Facility (ECF) with IMF approved for its disbursement on the 11th December 2012 under the agreement.

14. LOCAL CURRENCY DEMAND DEPOSITS

Commercial banks	1,446,496	1,125,909
Solomon Islands Government	265,088	332,868
Financial Corporations	8,369	28,362
Other	1,504	374
	1,721,457	**1,487,513**

15. CURRENCY IN CIRCULATION

Notes	583,107	515,271
Coins	16,562	12,431
	599,669	**527,702**

16. SIG MONETARY OPERATIONS ACCOUNT

SIG Securities	**37,906**	**37,547**

17. FIXED DEPOSITS

(a) Solomon Islands Government (SIG)	629,923	555,833

This deposit represents funds received by SIG under the Stabex scheme of the European Community, Asian Development Bank, Republic of China, Australia, New Zealand and Papua New Guinea Government. The SIG draws on these deposits as and when it is ready to use the funds in a manner approved by the funding agencies.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

(b) Central Bank of Solomon Islands (CBSI) Securities	367,888	241,313
	997,811	**797,146**

18. OTHER LOCAL CURRENCY LIABILITIES

Unpresented bank cheques	6,963	6,495
Provision for employee entitlements	5,974	6,736
Other liabilities	11,548	6,199
	24,485	**19,430**

19. GENERAL RESERVE AND DISTRIBUTION OF PROFITS

The general reserve is maintained to cover net losses incurred by the Bank and unforeseen events and contingencies.

The requirements of Section 19 and 20 of the CBSI Act are:

(a) When the Central Bank determines net profit for the year after meeting all current expenditures, and making allowance for bad and doubtful debts, depreciation in investments, and contribution to staff and pension funds; and such other purposes as the Board may deem necessary.

(b) The net profit shall then be allocated to a General Reserve each year until such time as the General Reserve is equal in amount to half the authorized capital of the Central Bank. After which, half of the net profit shall be allocated to this General Reserve until the General Reserve is equal to twice the authorized capital of the Central Bank.

(c) After such allocations, the Board, with the Minister's approval, may then direct such part of remaining net profit as it considers appropriate, be allocated to one or more Special Reserves, and after such allocations, the remainder of the net profit shall be transferred to the Solomon Islands Government Consolidated Fund.

(d) If there is a net loss in any year that exceeds the amount of the General Reserve at end year, then such excess shall be paid to the Bank from the Consolidated Fund.

(e) With approval of the Minister, the Board may direct that a proportion, not exceeding half, of the General Reserve may at any time after the General Reserve has reached an amount equal to half the authorized capital of the Central Bank be converted into issues and fully-paid capital; provided such amounts do not cause paid up capital to exceed authorized capital.

20. REVALUATION RESERVE ACCOUNTS

a) Foreign Exchange Revaluation Reserve

Under Section 45 of the CBSI Act, gains arising from any change in the valuation of the Central Bank's assets or liabilities in, or denominated in, gold, foreign currencies or other units of account as a result of alterations of the external value of the currency of the Solomon Islands, or any change in the values, parities or exchange rates of such assets and liabilities with respect to the currency of the Solomon Islands other than gains arising from normal trading activity of the Central Bank, shall be credited to a Foreign Exchange Revaluation Reserve Account. Losses arising from any change other than losses from normal trading activity of the Central Bank shall be included in the computation of the annual profits or losses of the Central Bank. As discussed in the Notes, such treatment is inconsistent with IFRS. The CBSI provides additional disclosures in a profits distribution reconciliation statement accompanying the profit and loss account, which links IFRS net profit to profit distributable under the CBSI Law.

The losses arising from any such valuation changes other than losses arising from normal trading activity shall be set off against any credit balance in the Foreign Exchange Asset Revaluation Reserve Account and, notwithstanding any other provision of the Act, if such balance is insufficient to cover such losses, the Government shall issue to the Central Bank non-negotiable non-interest bearing securities to the extent of the deficiency. Any credit balance at the end of each financial year in the Foreign Exchange Asset Revaluation Reserve Account shall be applied first, on behalf of the Government, to the redemption of all securities issued and outstanding under this Section of the CBSI Act.

a) Foreign Exchange Revaluation Reserve (Cont'd)

In addition, under Section 44, if at any time the total assets of the Central Bank shall be less than its total liabilities, notwithstanding any other provisions of this Act, the Government shall cause to be transferred to the Central Bank non-negotiable non-interest bearing securities issued by the Government to the extent of the deficiency.

b) Foreign Investment Revaluation Reserve

As discussed in Note 3 (b) the CBSI does not presently hold foreign currency denominated investments other than fixed term bank deposits. In addition, because of the very limited market for Solomon Islands Government securities, holdings of such assets are recorded at cost. Accordingly, there are currently no amounts to be recorded in such an asset revaluation reserve(s) covering foreign and domestic Central Bank investments.

Under Section 43 (2) of the CBSI Act, any valuation changes in the Central Bank's holdings of securities, together with any capital profit or loss resulting from sale or maturity of such assets shall represent an accrual to, or a charge against the General Reserve and shall not be deemed profit or loss for the purpose of calculating net profits under the CBSI Act.

Section 43 is not consistent with current IFRS, specifically IAS 39, which would require such valuation changes to be included in the profit and loss account.

c) Property, Plant and Equipment Asset Revaluation Reserve

Following the first major revaluation of the Central Bank's land and premises assets in 2006, the CBSI has established an appropriate Premises and Equipment Assets Revaluation Reserve. (Refer also Notes 3(g)).

21. CAPITAL ASSET RESERVE

Other retained earnings reserves can be established under the CBSI Law (Section 20(2)) out of net profits, with the approval of the Minister. These reserves included, as at end 2005, a capital asset replacement reserve, small business finance scheme reserve, early retirements and gratuity reserve.

With the separate establishment of provision accounts in 2006 to meet IFRS requirements in relation to early retirement and gratuity payments, the Board has determined that the relevant reserve balances be transferred to the capital asset replacement reserve to strengthen the Central Bank's equity position in relation to future major capital investment in buildings and equipment.

	2012 ($ 000's)	2011 ($ 000's)
Capital Asset Reserve	**61,875**	**61,877**

	2012 ($ 000's)	2011 ($ 000's)
22. INCOME AND EXPENSES		
a) Interest income		
Interest received from foreign investments	62,010	49,644
Interest received from local investments	2,121	2,527
	64,131	**52,171**
b) Fees and commissions received		
Fees and commissions – foreign dealings	9,244	13,708
Fees and commissions – local dealings	527	313
	9,771	**14,021**
c) Other income		
Gain from disposal of fixed assets	134	72
Rent received	1,028	896
Sale of numismatic coins	355	191
Others	449	109
	1,966	**1,268**
d) Interest expenses		
Interest expense on foreign liabilities	179	520
Interest expense on local liabilities	5,301	2,506
	5,480	**3,026**
e) Fees and commissions paid	**540**	**224**
f) Administration expenses		
Staff costs	21,554	17,794
Others	10,390	9,717
	31,944	**27,511**
g) Other operating expenses		
Board of directors remunerations and expenses	403	186
Currency expenses	34,083	10,164
Depreciation	3,940	6,316
Auditors remuneration (Note 21)	641	413
Others	870	1,736
	39,937	**18,815**

23. AUDITOR'S REMUNERATION

	2012 ($ 000's)	2011 ($ 000's)
Amounts received or due and receivable by the External Auditors of the bank for:		
- Auditing the financial statements	641	413
	641	**413**

24. RELATED PARTIES DISCLOSURES

Related Party Disclosures requires the disclosure of information relating to aggregate compensation of key management personnel. The key management personnel of the Bank are members of the CBSI Board and senior staff who have responsibility for planning, directing and controlling the activities of the Bank. In 2012, this group comprises 14 in total (14 in 2011), including the two Governors, 7 non-executive CBSI Board of Directors and 7 Chief Managers. . Fees of the non-executive members of the CBSI Board are determined by the Minister of Finance. The Governor and Deputy Governor contracts are subject to mid-term review by the Minister of Finance and annually in terms of CBSI policies. The CBSI Board of Directors determines the remuneration of the Chief Managers.

The remuneration of the CBSI's key management personnel was as follows:

	2012 ($ 000's)	2011 ($ 000's)
Total remuneration is included in 'personnel expenses' as follows:		
Short-term employee benefits	2,158	1,366
Post-employment benefits	-	-
Other long-term benefits	-	-
Total Compensation	**2,158**	**1,366**

Short-term benefits include cash salary, and in the case of staff, annual leave, motor vehicle benefits, health benefits and the fringe benefits tax paid or payable on these benefits.

Post-employment benefits include superannuation benefits and in the case of staff, health benefits. Other long-term benefits include long service leave. The components of remuneration are reported on an accrual basis.

As at 31 December 2012 loans by the Bank to key management personnel are as follows:

Housing loan	3,887	3,532
Personal loan	843	828
Management car loan	348	212
Total loans	**5,078**	**4,572**

There were no other related party transactions with Board members; transactions with director-related entities which occurred in the normal course of the Bank's operations were conducted on the terms no more favorable than similar transactions with other employees or customers.

25. EMPLOYEES

The number of full time permanent Central Bank employees as at 31st December 2012 was 109 (2011: 100)

26. CONTINGENT LIABILITIES

The Bank has guaranteed staff housing loans with the commercial banks to the sum of $0.8 million as at 31 December 2012 (2011:$0.8 million). The guarantee is valid until the date the staff ceases employment with the Bank.

In 2007 the Solomon Islands Government introduced and provided $10 million for the establishment of the Small Business Finance Guarantee Scheme to be administered by CBSI. As at 31 December 2012 a total of 36 loans with a net guarantee of $3.95 million (2011: $1.87 million) have been administered under the scheme.

27. FINANCIAL INSTRUMENTS

Exposure to operational, credit, liquidity, interest rate, and currency risk arises in the normal course of the Bank's operations. The structure of the CBSI's balance sheet is primarily determined by the nature of its statutory functions, rather than commercial considerations. At the same time, CBSI continually manages its exposure to risk, through a variety of risk management techniques. Risk management of the CBSI is regulated by internal instructions and closely monitored by the Board.

Operating loss is the risk of loss from breakdown of internal controls. The CBSI is in the process of establishing an internal audit function (either internally or outsourced) which will exercise monitoring and control over accounting policies and procedures, and the effective functioning of the system of internal controls at the CBSI. Operating risk relating to the activities of foreign currency reserves management is controlled by a number of internal instructions, and there is clear segregation of front office and back office activity. The latter is one of the mechanisms for managing operating risk.

The material financial instrument to which the Bank has exposure includes:

(i) External assets

(ii) Other liabilities.

Credit risk

CBSI takes on exposure to credit risk which is the risk that a counter party will be unable to pay amounts in full when due. CBSI's maximum credit risk, excluding the value of collateral, is generally reflected in the carrying of financial assets. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant. The Bank does not require collateral in respect of financial assets except in respect of loans to staff.

Management has a credit policy in place. Credit risk on transactions in foreign currency reserves is managed through the approval of transactions and placement of funds, the establishment of limits restricting risk and constant monitoring of positions. Counter party limits are set based on credit ratings and are subject to regular review. Currency risk and the exposure in the local currency portfolio is also monitored and managed.

Credit risk on financial assets is minimized by dealing with recognized monetary institutions.

At balance sheet date, there were no significant concentrations of credit risk.

Liquidity risk

Liquidity risk is defined as the risk of loss arising due to the mismatch of the maturities of assets and liabilities. The maturities of assets and liabilities is the ability to replace, at an acceptable cost, interest bearing liabilities as they mature, are important factors in assessing the liquidity of the CBSI and its exposure to changes in interest and exchange rates.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

The table below shows financial assets and liabilities at 31 December 2012 (and 2011 comparatives) grouped by remaining contractual maturity.

2012 Maturity Analysis

	On Demand (SBD 000's)	0-3 Months (SBD 000's)	3-6 Months (SBD 000's)	6-12 Months (SBD 000's)	Over 1 year (SBD 000's)	Undefined Maturity (SBD 000's)	Total (SBD000's)
Foreign Currency Financial Assets							
Money on Demand	764,448	-	-	-	-	-	764,448
Accrued Interest	-	-	9,593	-	-	-	9,593
Term Deposits	-	637,970	1,922,750	-	-	-	2,560,720
Holding of Special Drawing Rights	-	106,087	-	-	-	-	106,087
Gold Investment(Unallocated)	-	-	-	-	-	143,320	143,320
Total	**764,448**	**744,057**	**1,932,343**	**-**	**-**	**143,320**	**3,584,168**
Local Currency Financial Assets							
Cash on Hand	-	456	-	-	-	-	456
Loans and Advances	-	-	2,403	-	84,771	-	87,174
Total	**-**	**456**	**2,403**	**-**	**84,771**	**-**	**87,630**
Total Financial Assets	**764,448**	**744,513**	**1,934,746**	**-**	**84,771**	**143,320**	**3,671,798**
LIABILITIES							
Foreign Currency Financial Liabilities							
Demand Deposits	-	86,103	-	-	-		86,103
IMF Standby Credit Facility	-	141,630	-	-	-	-	141,630
IMF Special Drawing Rights Allocations	-	-	-	-	-	111,807	111,807
IMF Extended Credit Facility	-	1,676	-	-	-	-	1,676
Capital Subscriptions	-	-	-	-	-	915	915
Total	**-**	**229,409**	**-**	**-**	**-**	**112,722**	**342,131**
Local Currency Financial Liabilities							
Demand Deposits	-	-	-	-	-	1,721,457	1,721,457
Currency in Circulation	-	-	-	-	-	599,669	599,669
SIG Monetary Operations Account	-	37,906	-	-	-	-	37,906
Fixed Deposits	-	-	216,806	62,219	-	718,786	997,811
Provision for transfer to SIG Consolidated Fund	-	-	-	-	-	480	480
Total	**-**	**37,906**	**216,806**	**62,219**	**-**	**3,040,392**	**3,357,323**
Total Financial Liabilities	**-**	**267,315**	**216,806**	**62,219**	**-**	**3,153,114**	**3,699,454**
Net Liquidity Gap	**764,448**	**477,198**	**1,717,939**	**(62,219)**	**84,771**	**(3,009,794)**	**(27,656)**

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

2011 Maturity Analysis

	On Demand (SBD 000's)	0-3 Months (SBD 000's)	3-6 Months (SBD 000's)	6-12 Months (SBD 000's)	Over 1 year (SBD 000's)	Undefined Maturity (SBD 000's)	Total (SBD000's)
Foreign Currency Financial Assets							
Money on Demand	954,458	-	-	-	-	-	954,458
Accrued Interest	-	-	9,922	-	-	-	9,922
Term Deposits	-	752,441	1,205,974	-	-	-	1,958,415
Holding of Special Drawing Rights	-	104,741	-	-	-	-	104,741
Total	**954,458**	**857,182**	**1,215,896**	**-**	**-**	**-**	**3,027,536**
Local Currency Financial Assets							
Cash on Hand	-	98	-	-	-	-	98
Loans and Advances	-	-	-	10,240	97,587	-	107,827
Total	**-**	**98**	**-**	**10,240**	**97,587**	**-**	**107,925**
Total Financial Assets	**954,458**	**857,280**	**1,215,896**	**10,240**	**97,587**	**-**	**3,135,461**
LIABILITIES							
Foreign Currency Financial Liabilities							
Demand Deposit							11,332
IMF Standby Credit Facility	-	-	-	-	-	11,332	141,942
IMF Special Drawing Rights Allocations	-	-	-	-	-	112,110	112,110
Capital Subscriptions	-	-	-	-	-	919	919
Total	**-**	**-**	**-**	**-**	**141,942**	**124,361**	**266,303**
Local Currency Financial Liabilities							
Demand Deposits	-	-	-	-	-	1,487,513	1,487,513
Currency in Circulation	-	-	-	-	-	527,702	527,702
SIG Monetary Operations Account	-	12,602	24,945	-	-	-	37,547
Fixed Deposits	-	199,853	7,815	5,045	27,050	557,383	797,146
Provision for transfer to SIG Consolidated Fund	-	-	-	-	-	5,243	5,243
Total	**-**	**212,455**	**32,760**	**5,045**	**27,050**	**2,577,841**	**2,855,151**
Total Financial Liabilities	**-**	**212,455**	**32,760**	**5,045**	**168,992**	**2,702,202**	**3,121,454**
Net Liquidity Gap	**954,458**	**644,825**	**1,183,136**	**5,195**	**(71,405)**	**(2,702,202)**	**14,007**

Interest rate risk

The Bank's exposure to interest rate risk and the effective interest rates of financial assets and liabilities at the balance sheet date are as follows:

Financial assets:

Cash and current accounts	-	floating interest rates.
Short term deposits	-	fixed interest rates, maturing in 90 days or less.
Treasury notes and bonds	-	fixed interest rates, maturing in 9 years or less.
Solomon Islands Government bonds	-	fixed interest rates, maturing as detailed in note 3 (m)
Staff loans	-	fixed interest rates, maturing in 20 years or less.
Statutory bodies/banks	-	fixed interest rates, maturing in 30 days or less.
Solomon Islands Government	-	fixed interest rates, payable in 30 days or less
	-	Account No.1
	-	Redemption of bonds.

Financial liabilities:

Domestic Institutions	-	fixed interest rates, payable in 30 days or less.

All other financial assets or financial liabilities are non-interest bearing.

a) Foreign Exchange Risk

Foreign exchange risk (currency risk) that arises from the loss of foreign reserves from changes in exchange rates against the Solomon Islands dollar. The Central Bank of Solomon Islands has adopted a currency risk management policy, which always maintains the Solomon Islands dollar value of foreign reserves and manages the fluctuations in the Revaluation Reserve Account – Foreign Currency.

Concentration of foreign exchange

The CBSI's net holdings of foreign exchange (excluding its holding of Special Drawing Rights) were distributed as follows as at 31 December 2012:

	% of foreign exchange	
	2012	**2011**
US Dollar	42	50
Australian dollar	36	30.2
Euro Dollar	7	11.4
Sterling Pound	8	3.2
New Zealand dollar	5	5
Singapore dollar	2	0.2
Total foreing exchange	**100**	**100**

Sensitiviy to foreign exchange rate risk

	2012 ($000's)	**2011 ($000's)**
Change in profit/equity due to a 2 per cent appreciation in the reserves – weighted value of the Solomon Islands dollar	-65	-54
Change in profit/equity due to a 2 per cent depreciation in the reserves-weighted value of the Solomon Islands dollar	66	56

b) Interest Rate Risk

Interest rate risk relates to the risks that the fair value or cash flows of financial instruments will fluctuates because of a change in market interest rates. The Central Bank of Solomon Islands is exposed to interest rate risk because most of its assets are financial assets such as domestic and foreign securities, which have a fixed income stream. The price of such securities increases when market interest rates decline, while the price of a security will fall if market rates rises.

Sensitivity to interest rate risk

The figures show the effect on the profit and equity of a movement of +/-1 percentage point in interest rates.

The valuation effects shown are generally reflective of the bank's exposure over the financial year.

	2012 (SBD000's)	**2011 (SBD000's)**
Change in Profit/Equity due to movements of +/-1 percentage point across yield curves:	**+/-36**	**+/-33**
Foreign Reserves		
Securities market	+/-24	+/-20
Money market	+/-10	+/-11
Commodities market	+/-2	-

Currency risk

Currency risk is the risk the value of financial instruments will fluctuate due to changes in foreign exchange rates.

The Bank incurs foreign currency risk on holdings of financial assets (principally external assets) that are denominated in a currency other than the Solomon Islands dollar. The currencies giving rise to this risk are primarily Australian dollars, New Zealand dollars, British pounds, Euro and United States dollars.

The Bank does not hedge its exposure to exchange fluctuations in these currencies.

In accordance with the CBSI Act, the task of maintaining the safety and liquidity of foreign reserve assets, as well as the returns from reserves asset management, are achieved through diversification of investment by entering into transactions in international capital and money markets. Analysis of risks is the process of managing the currency reserves by comparing factual risk levels with set limits. Credit risk is additionally limited by the separate minimum acceptable credit ratings and operational limits.

2012 Foreign Currency Risk

	Fixed Coupon 0-1	1-3 Months	3-12 Months	Over 1 Year	Non – Interest Bearing	Total
Foreign Currency Financial Assets	(SBD) (000's)	(SBD) (000's)	(SBD) (000's)	(SBD) (000's)	(SBD (000's)	(SBD) (000's)
Money on Demand	235,682	528,766	-	-	-	764,448
Accrued Interest	-	-	-	-	9,593	9,593
Term Deposits	-	225,868	2,334,852	-	-	2,560,720
Holding of Special Drawing Rights	-	-	-	-	106,087	106,087
Gold Investment (Unallocated)	-	-	-	-	143,320	143,320
Total Foreign Currency Financial Assets	**235,682**	**900,076**	**2,334,852**	**-**	**259,000**	**3,584,168**
LIABILITIES						
Foreign Currency Financial Liabilities						
Deman Deposits	-	-	-	-	86,103	86,103
IMF Standby Credit Facility	-	-	-	141,630	-	141,630
IMF Extended Credit Facility	-	-	-	1,676	-	1,676
IMF Special Drawing Rights Allocations	-	-	-	111,807	-	111,807
Capital Subscriptions	-	-	-	-	915	915
Total Foreign Currency Financial liabilities	**-**	**-**	**-**	**255,113**	**87,019**	**342,131**
Net liquidity gap	**235,682**	**900,076**	**2,334,852**	**(255,113)**	**171,981**	**3,242,037**

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

2011 Foreign Currency Risk

Foreign Currency Financial Assets	Fixed Coupon 0-1 (SBD (000's)	1-3 Months (SBD) (000's)	3-12 Months (SBD) (000's)	Over 1 Year (SBD) (000's)	Non Interest Bearing (SBD) (000's)	Total (SBD) (000's)
Money at call	77,163	877,295	-	-	-	954,458
Accrued Interest	-	-	-	-	9,922	9,922
Term Deposits	-	752,441	1,205,974	-	-	1,958,415
Holding of Special Drawing Rights	-	-	-	-	104,741	104,741
Total	**77,163**	**1,629,736**	**1,205,974**	**-**	**114,663**	**3,027,536**
LIABILITIES						
Foreign Currency Financial Liabilities						
Demand Deposits		-	-	-	11,332	11,332
IMF Standby Credit Facility	-	-	-	141,942	-	141,942
IMF Special Drawing Rights Allocations	-	-	-	-	112,110	112,110
Capital Subscriptions	-	-	-	-	919	919
Total	**-**	**-**	**-**	**141,942**	**124,361**	**266,303**
Net liquidity gap	**77,163**	**1,629,736**	**1,205,974**	**(141,942)**	**(9,698)**	**2,761,233**

28. GOING CONCERN

In the face of the backdrop of the global uncertainty and slow recovery, and the slow growth in the Solomon islands economy in 2012, the country's foreign reserves position remains at comfortable level, upon which safe and secured facilitation of the Bank's operations and the ongoing facilitation of all international payments obligations including the external debts that are fall due will be comfortable met in the next twelve months.

29. EVENTS AFTER THE REPORTING PERIOD

There has not been any matter or circumstance that has arisen since the end of the financial year that has significantly affected, or may significantly affect, the operations of the Bank, the results of those operations, or the state of affairs of the Bank in future financial years.