



# National Reserve Bank of Tonga

*27*  
*Years of Service*

**ANNUAL**  
**2017** **REPORT**  
for the Year Ended 30 June 2017

**N R B T**

# **ANNUAL** **2017** **REPORT** for the Year Ended 30 June 2017

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# Contents

◇	<b>Governor's Foreword</b>	<b>7</b>
◇	<b>Functions and Objectives</b>	<b>9</b>
◇	<b>Governance</b>	<b>10</b>
◇	<b>Corporate Plan</b>	<b>14</b>
◇	<b>Economic Overview</b>	<b>16</b>
◇	<b>Financial Stability</b>	<b>22</b>
◇	<b>Financial Markets Operation</b>	<b>35</b>
◇	<b>Risk Management Operation</b>	<b>39</b>
◇	<b>Currency Management</b>	<b>41</b>
◇	<b>Corporate Services</b>	<b>43</b>
◇	<b>Financial Performance</b>	<b>47</b>
◇	<b>Financial Statements</b>	<b>49</b>

## **MISSION**

To formulate and implement sound monetary policy that is conducive to economic prosperity; promote stable and efficient financial system, external stability and effective payment systems through professionalism and independence

## **VISION**

To be an effective and dynamic central bank in promoting Tonga's economic prosperity

## **VALUE**

Integrity | Innovation | Team work | Excellence



## Governor's Foreword

I am pleased to present the National Reserve Bank of Tonga Annual Report for the financial year 2016/17 which attests to the Reserve Banks' work and provides an overview of the policies and operations in-line with the principal objectives and the functions outlined in the NRBT Act, as well as the audited Financial Statements for the year ended 30th June, 2017.

Macroeconomic activity continued to improve as the year progressed. The Tongan economy continued to grow for the fourth consecutive year. The Statistics Department recently released Tonga's 2016-17 Real Gross Domestic Product (GDP) of 5.0% reaching its highest growth since 1998-99. The growth was mainly driven by strong growths in the construction, trade, transport, communication and agricultural sectors.

At the end of June 2017, annual inflation was at 10.3% aided by the rise in imported food prices which also reflected the new government excise tax. Global oil prices also increased which transpired to higher domestic fuel and electricity prices. At the time of writing, the Bank projected that in the short term, inflation would fall close to the Bank's 5% inflation reference rate. The foreign reserves also continued to increase to end at a high of T\$407.9M and 7.4 months of imports.

The financial system continued to remain safe and

sound during the financial year. The commercial banks remained well capitalized with reasonable profits coupled with the continued improvement to the quality of assets. During the year, the commercial banks credit increased to a new record high of \$404.5 million and non-performing loans declined to \$16.9 million. The annual credit growth was due mainly to the increase in housing loans to individuals and business loans mainly to the wholesale and retail, services and manufacturing sectors. Lending activities in the non-bank financial institutions also increased to \$140.4 million reflecting lending to households. To maintain financial stability, the Bank formulated and issued policies and drafted legislations and regulations to protect the integrity of the financial system and the interest of depositors. Following continuous enhanced supervision and monitoring of the commercial banks, the Bank revoked one commercial bank license and conducted the payout of their customers' deposits. Due to concerns on high interest rates charged by the commercial banks and non-bank lenders, the Bank drafted legislations to regulate the non-bank financial institutions and introduced the Annual Percentage Rate (APR) calculator which includes all interest rates and fees and charges related to a loan, to ensure borrowers can compare and are cognizant of the total loan cost.

One of the Banks new initiatives was to promote finan-

cial inclusion by ensuring access to finance, particularly small and medium enterprises (SMEs). This initiative would support inclusive economic growth and measures to provide affordable financial services to remote areas. During the year, the NRBT Act was amended to expand the functions of the Bank to manage and promote financial inclusion initiatives and related activities. In recognition of its financial inclusion efforts, the Bank was also awarded the Alliance for Financial Inclusion Maya declaration award for clearly defined measurable targets and dedicated progress reporting.

In efforts to assist the development of the domestic market operations in the near future to be more market oriented, amendments to the NRBT Act approved in February 2017 allows the utilization of the excess balance in the Revaluation Reserve Account, above \$10 million, to cover the Reserve Bank's monetary policy costs. This amendment also allowed the excess balance in the Revaluation Reserve Account to be paid to the Government upon the request of its Minister and approved by the Reserve Bank Board.

Against this background, of macroeconomic and financial stability and a favorable outlook, the Reserve Bank maintained its accommodative monetary policy stance for the eighth consecutive year. The Bank's policies were mainly focused on encouraging the utilization of excess liquidity in the banking system, promote prudent credit to support economic growth, and strengthen the monetary policy transmission mechanism. At the same time, the Bank also remained vigilant for any signs of overheating risks in the economy. In addition, the Bank eased the exchange control policies in view of the high level of foreign reserves and the outlook for the foreign reserves to remain at comfortable levels and the current monetary policy stance. This also assisted the business community and the general public in making their overseas payments.

On the financial performance and operations, in accordance with the NRBT Act, the Reserve Bank's audited financial accounts were submitted to the Minister of Finance together with a summary of the Reserve Bank's

operations during the year. Overall, the Reserve Bank's total income for the year was T\$10.41 Million and the net profit available for distribution was T\$2.853 million of which T\$1.997 million will be transferred to the Government. The main contributor to the Reserve Bank's profit was the interest income from the investment of foreign reserves. This income was offset by operational costs for capital investments, cost of issuing currency, administration and staff costs. These expenses were measures to maintain the quality of currency in circulation at a high standard, modernize the IT and communications infrastructure, as well as train and retain professional staff.

Throughout the year, there were changes to the Governance composition of the Bank, the Board members welcomed one director and were deeply saddened by the passing of the late Director 'Uhila moe Langi Liava'a. The Directors also reviewed the NRBT Corporate Plan 2015-2017, after the second year of implementation and endorsed the NRBT Corporate Plan 2017/18 – 2018/19.

At the end of the financial year 2016/2017, the Bank has achieved its functions outlined in the NRBT Act and I would like to thank the Board of Directors for their support and the Staff for their efforts and dedication during the year which are outlined in this Annual Report. I acknowledge the support of the Ministry of Finance, Government Ministries and the financial institutions in pursuing our common goal of promoting macroeconomic stability and economic growth. The assistance throughout the year from the international organizations, development partners of Tonga and other central banks in the region are also acknowledged with appreciation.



Dr. Sione Ngongo Kioa  
Governor

# Functions and Objectives

The National Reserve Bank of Tonga (Amendment) Act, 2014, Section 4 sets out the principal objectives of the Bank. It states:

## Objectives of the Bank

- (1) The principal objectives of the Bank shall be to maintain internal and external monetary stability.
- (2) Without prejudice to its principal objective, the Bank shall-
  - (a) promote financial stability; and
  - (b) promote a sound and efficient financial system.
- (3) Subject to subsections (1) and (2), the Bank shall conduct its activities in a manner that supports macroeconomic stability and economic growth.

Maintaining internal monetary stability is pursued by the Reserve Bank through promoting low and stable inflation over the medium term. The Reserve Bank's inflation reference rate is 5% per annum.

Maintenance of external monetary stability is pursued through maintaining adequate amount of foreign currencies (foreign reserves) to meet the country's foreign currency demands to pay for imports, etc. As such, the Reserve Bank's monetary policies aim to ensure that Tonga always has foreign reserve holdings of at least three to four months of import cover.

The National Reserve Bank Act, Section 4A also sets out the Reserve Bank's functions:

*"The principal functions of the Bank shall be, to:*

- (a) issue currency;*
- (b) formulate and implement monetary policy;*
- (c) prescribe the regime for the determination of the external value of the Tongan currency in consultation with the Minister;*
- (d) determine the foreign exchange rate and implement foreign exchange policy;*
- (e) determine and implement financial stability policy, and oversee the maintenance of the stability of the financial system as a whole;*
- (f) regulate as required the supply, availability and international exchange of money;*
- (g) exclusively hold and manage the external reserves of the Kingdom;*
- (h) provide advisory services to the Minister on banking and monetary matters;*
- (i) be the principal banker, fiscal agent and depository of the Government;*
- (j) undertake banking business, in Tonga or elsewhere, subject to the provisions of this Act;*
- (k) regulate and supervise financial institutions, including non-bank financial institutions;*
- (l) oversee and promote the efficient, sound and safe functioning of the payment system;*
- (m) collect and produce statistics;*
- (n) cooperate with and participate in international councils and organisations, including public international financial institutions, and cooperate with domestic and foreign public entities, concerning matters related to its objectives and functions;*
- (o) regulate and supervise capital markets in Tonga;*
- (p) to manage and promote financial inclusion initiatives and related activities; and*
- (q) carry out any other function or any ancillary activities incidental to the exercise of its functions under this Act or any other Act;*

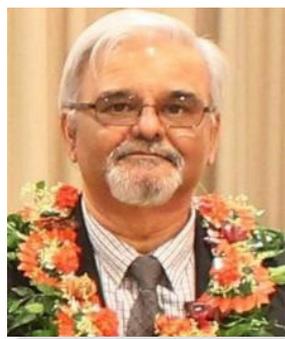
Details on how the Reserve Bank applied its functions to meet its objectives are outlined in this report and other publications.

# Governance

## Board of Directors



*Chairman*  
Mr. Steve Edwards



*Director*  
Mr. Richard Prema



*Governor*  
Dr. Sione Ngongo Kioa



*Director*  
Mrs. Sinaitakala Tu'itahi



*Director (Secretary  
for Finance)*  
Mr. Tatafu Moeaki  
*Resigned on 17 July 2016*



*Director*  
Mr. 'Uhila Liava'a  
*Up to 15 September 2016*



*Director (Secretary  
for Finance)*  
Mr. 'Aholotu Palu  
*From 18 July 2016 - 31 Decem-  
ber 2016*



*Director (Secretary  
for Finance)*  
Mrs. Balwyn Fa'otusia  
*Appointed on 3 January 2017*

## Key Decision Makers

The Board of Directors comprises of the Chairman (non-executive Director), the Governor, Secretary for Finance, and 4 other non-executive Directors. The Governor, who is the Chief Executive Officer of the Bank, is responsible to the Board for the management and execution of the Bank's policy. Under the NRBT Act and the Amendment Acts, the Directors are appointed for terms of up to five years by the Minister of Finance and may be reappointed. During the year, the Secretary of Finance Mr. Tatafu completed his Directorship after 2 years and 9 months of service. The Acting Secretary for Finance Mr. 'Aholotu Palu completed his Directorship after 5 months of service. The Directors also welcomed Mrs Balwyn Faotusia, Secretary for Finance to the Board. The Directors were saddened by the passing of Director 'Uhilamoe Langi Liava'a who served the Bank for 8 months (5 February – 4 October 2016). As at the end of June 2017, two director positions were vacant.

In accordance with the Act, the Board must meet at least 10 times during the calendar year to discuss and formulate the policies of the Bank and to monitor its operations. The Board Sub-Committee also met regularly to discuss and vet all Board matters well before every Board meeting and fulfil any requirements for further consideration at the Board. While the Board Sub-Committee met 18 times during the financial year, the Board met 16 times to formulate the policy of the Bank, monitor the Bank's operations and provide strategic direction and advice to the Governor. In line with Section 54D, the Board Audit Committee met to support the Board in considering the tender of the External Audit service and recommending the appointment of the external auditors and advising on the scope of external audits. The Audit Committee in their responsibility to oversee the internal audit function directed that, at this time, the Risk Management Office would undertake some internal audit functions and report directly to the Board.

The Board of Directors are responsible for the Reserve Bank's policy and affairs. This involves constantly reviewing the performance of the Reserve Bank in the conduct of its functions and its use of resources, and may give advice to the Governor not only to sustain the efficient and effective management of the Bank's opera-

tions but also to ensure that the Reserve Bank delivers its core functions in compliance with the NRBT Act and related Acts.

Section 9A of the NRBT Amendment Act 2014 specifies the powers and functions of the Board which may not be delegated. During the year, the Board of Directors diligently carried out these powers and functions and defined and adopted the accommodative monetary policy stance which was published in the bi-annual Monetary Policy Statements in August 2016 and February 2017. The Directors also approved the monthly economic review, data flashes and issued a press release on the Monetary Policy decisions and its implementation. The Directors also considered policy measures to stimulate economic growth by promoting financial inclusion initiatives and access to finance for Small and Medium Enterprises (SMEs). In recognition of its efforts to promote access to finance, the Bank won the Alliance for Financial Inclusion (AFI) Maya Award, for clearly defined measurable targets, and the most dedicated institution reporting progress on key financial inclusion indicators, financial inclusion policies, regulations, and outcomes. This is in line with its function to manage and promote financial inclusion initiatives and related activities.

The Directors also defined and adopted financial stability policies, foreign exchange policies and other policies of the Bank regarding the execution of its supervisory functions. These policies included the microfinance and money lender bill, the credit union bill, the foreign exchange control bill as well as the Banking Bill. The Directors endorsed amendments to the prudential statements which were updated to reflect best practice, and the exchange control guidelines to ease the foreign exchange payments. Noting the revocation of the credit bureau license in Fiji which serviced the Tongan banks, the Directors considered and endorsed a credit bureau licensing guideline to facilitate the set-up of a credit bureau in Tonga. The Directors also approved the increase in the banks Statutory Required Deposit ratio from 5% to 10% effective on the 1 July 2017.

During the year, to ensure financial stability was maintained and that depositors funds are protected at all times., the Board approved the revocation of the Pacific International corporation bank (PICB) license and con-

tinued to monitor closely the PICB court case for any reputational, legal or financial risks that may arise. The Directors were also kept apprised of the ongoing pay out of PICB depositors and the PICB court case. To ensure financial services to the outer islands was maintained, the Directors supported the opening of the BSP Vava'u branch as well as the sub branches in Ha'apai and Eua. The Directors also noted the progress on the 2 new bank license applications. The Directors discussed the commercial banks liquidity, capital, credit growth and profitability as well as their exchange rates, interest rates and fees & charges. To address the public concerns on interest rates and fees and charges, the Directors endorsed the standardized Annual Percentage Rate calculator for Banks to disclose the effective interest rates and all fees and charges related to a loan and assist the customer in their decision to borrow. The procedures to facilitate the payout of customers claims for money in deposit accounts that have been dormant and transferred to the Bank under Section 81 of the Financial Institutions Act was endorsed by the Board. The Directors supervised the implementation of the policies and the exercise of the functions of the Bank through management monthly updates at Board meetings. The implementation of the NRBT's functions by management was also discussed at the sub-committee meetings.

To ensure the operations of the Bank are carried out efficiently and effectively during the year, the Directors approved the review and changes to general policies

and internal rules applicable to the administration and operations of the Bank. The Directors also approved the review and amendments to the Reserve Bank's terms and conditions of employment. To retain a professional team, during the year, the Board also approved changes to the Staff Remuneration Policy through changes to the Provident Fund Scheme Rules, the Staff Loan Scheme, and the study leave policy. These changes contributed to strengthening the Bank's Corporate Plan strategic priority of positioning the Bank as the employer of choice while maintaining a high staff retention rate.

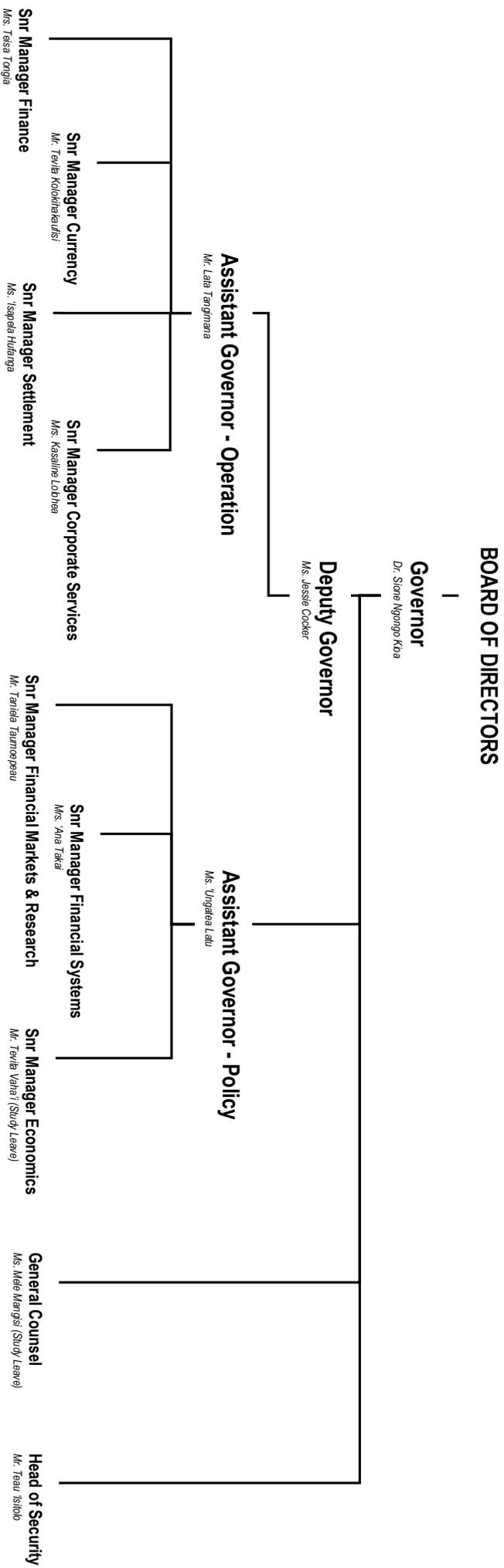
The Directors also endorsed the 2017/18 annual budget and the organization chart of the Bank as well as the Annual Report for 2015/16. Monthly financial statements comparing the actual financial outcomes against the budget were also approved by the Directors and transmitted to the Minister of Finance and the Prime Minister's Office to be published in the Government Gazette. To diversify the income of the NRBT and enhance the contribution to income from numismatic and currency bank notes and coins, facilitate as well as measures to fund the monetary policy costs, the Directors also endorsed the Amendments to the NRBT Act. The Directors also approved the new coin proposal for the Olympic Games 2018 – Luge. The Board also endorsed the recommendation of the audit committee to reappoint Price Waterhouse Coopers as the external auditors of the Bank subject to the Minister of Finance approval in accordance with section 53 of the National Reserve Bank Act.



*Left to Right: Mr. 'Aholotu Palu (Secretary for Ministry of Finance), Mr. 'Uhila Liava'a, Mr. Richard Prema, Mr. Steve Edward, Mrs. Sinaitakala Tu'itahi, Dr. Sione Ngongo Kioa (Governor), Ms. Jessie Cocker (Deputy Governor / Secretary to the Board)*  
*Absent: Mrs. Balwyn Faka'otusia*

# Organisational Chart

## National Reserve Bank of Tonga Organizational Structure – 30<sup>th</sup> June 2017



# Corporate Plan

In November 2014, the Board of Directors approved the Corporate Plan 2015-2017. The Corporate Plan is a three year rolling plan, from January 2015 through to December 2017, running on a calendar year thus overlapping with the Reserve Bank's financial year. Following the implementation of the NRBT Corporate Plan 2015-2017, at the end of December 2016, Management reviewed and assessed the Bank's performance and the level of achievement after the second year of implementing the Corporate Plan and its key Strategic Priorities.

With the assistance of an independent reviewer, the review of the Corporate Plan showed that overall the Bank has achieved 69% of the 215 Corporate Plan targets for 2015-2017 within the second year of implementation. This is slightly below the 73% achieved in the previous year. Some of the items that were not achieved were attributed to other priorities, capacity constraints and matters that were out of the NRBT's control such as the passing of the Non-bank supervision bills (microfinance, foreign exchange dealer, the drafting of a Payment System Act was delayed, the formulation of the Financial Inclusion National Strategy due to other priorities). Some of the unachieved items are work in progress such as continuous research into guidelines for banks to lend to MSMEs and developing the Financial Markets auction system. The remaining 31% was re-prioritised and scheduled for the third year of the Plan and to be completed by June 2017.

Management team also reviewed the targets and strategies and updated the Corporate Plan 2015-17 to Corporate Plan 2017/18 – 2018/19 to be reviewed in December 2017. The Corporate Plan for the FY 2017/18 targets has increased from 215 in 2015/16 to 400 targets in 2017/18. The increase in the corporate plan targets reflects the separation of the Settlements unit from the Accounts department as a new unit. The Risk Unit is now more pro-active with one staff to undertake some internal audit functions. The Financial Inclusion initiatives have also increased to reflect the NRBT Amendment Act 2017 Section 4. The development of the financial markets and the implementing of the IMF technical assistance recommendations to strengthen the monetary policy transmission mechanism are also some of the new targets. The implementing of the draft bills such as the Foreign Exchange Control bill, the microfinance bill and the money lender bill have also been included as targets in the corporate plan.

Management will continue to align staff behaviours with the Bank's values. This is not only in maintaining a culture of high performance that supports achieving the strategic priorities set out in the Corporate Plan but also in positioning the National Reserve Bank of Tonga as an effective and dynamic central bank in promoting Tonga's economic prosperity

# CORPORATE PLAN STRATEGIC PRIORITIES



## **STRATEGIC PRIORITY 1**

- Set a Platform for Tonga Becoming a High-Growth Economy

## **STRATEGIC PRIORITY 2**

- Develop Tonga's Financial Markets

## **STRATEGIC PRIORITY 3**

- Become the Employer of Choice

## **STRATEGIC PRIORITY 4**

- Modernize the Operations of the Bank

# Economic Overview

## Overseas Economies

The International Monetary Fund (IMF) reported in its April 2017 World Economic Outlook (WEO) that global growth is expected to improve in 2017 and 2018 than previously anticipated in the October 2016 WEO. More specifically, growth is expected to rise by 3.5% in 2017, an upward revision from 3.4% in 2016 and is expected to remain steady at 3.6% in 2018. These revisions stemmed from strong economic growth in a number of emerging markets and developing economies. This further reflects a pickup in confidence and other potential monetary policy easing for advanced economies which include the United States (US), Europe and Japan. Recovery in commodity prices have lifted global headline inflation and reduce deflationary pressures. The oil prices are expected to rise to an average price of US\$55 per barrel in 2017/18, compared with an average of US\$43 per barrel in 2016. This is due to further expectations of supply cuts in oil production and commitments by influential oil exporting countries such as Saudi Arabia to cut production beyond its initial indication in the OPEC agreement.



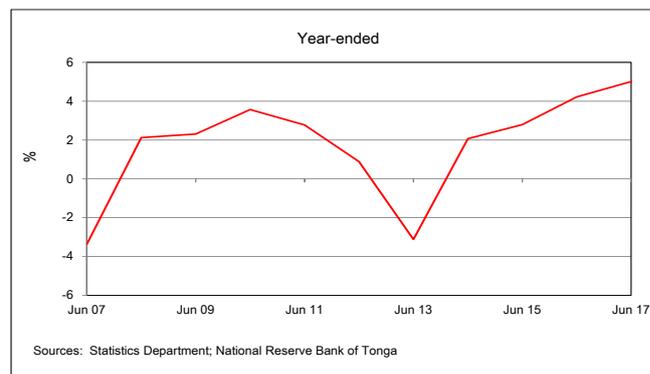
*Tongan squash at the Pack-House ready to export*

## Developments in the Domestic Economy

The Tongan economy continued to grow for the fourth consecutive year reaching its highest annual growth rate since 1998/99 (National Account Statistics 2016/17), which was a 5.0% growth in Real Gross Domestic Product (GDP). This follows an expansion of 4.2% in 2015/16. The growth was mainly driven by strong growths in the construction, trade, transport, communication and agricultural sectors. This official growth estimate is much higher than the forecast by the Reserve Bank and the IMF of 3.7% and 3.6% respectively.

The primary production grew by 1.3% in 2016/17 driven by activities in the agricultural sector. Total agricultural exports volume rose over the year by 2,875.9 tonnes (33.0%), attributed mainly to the favourable weather conditions which resulted in higher exported volumes of root crops, squash, watermelon, and breadfruit. The largest growth was recorded in exported root crops which increased by 2,992.7 tonnes (105.0%), followed by a 344.9 tonnes (9.2%) rise in the export of squash. This outweighed a decline in the export of kava-Tonga, coconuts, sandalwood, vanilla, onion, and Indian mulberry (nonu) juice over the year. Exported kava-Tonga declined by 81.3 tonnes (49.0%) largely as a result of the drought in 2015.

Figure 1: Real GDP Growth



The industry sector recorded a strong growth of 11.1% in 2016/17. The construction activities in the country contributed to a strong performance in the secondary production. A 16.4% growth in the construction sector in 2016/17 was supported by an increase in private household housing loans and an increase in business loans for construction, manufacturing and utilities. The developments in the construction sector are expected to also have spill over effects on the utilities sector, mining and quarry and other sectors of the economy such as trade and transport and communication.

In terms of tertiary production it grew by 3.4%. Partial indicators reflect further growth in consumption activities which support a 7.7% growth in the trade sector in 2016/17. The Recognized Seasonal Employees (RSE) together with the Seasonal Worker Program (SWP) schemes and the increase in banks' personal loans to private individuals contributed to higher consumer spending power which fuelled the expansion in trade. In the year ended June 2017, total number of container registrations rose by 987 containers (10.0%) which was driven by the 905 (21.3%) rise in private containers indicating a rise in the informal distribution sector. The large number of events and celebrations held during the year, and the increase in private construction supported this annual growth. In addition, there was an increase of 38 cargo ships docked and unloaded during the year to June 2017 compared to the previous year. Expansion in the trade sector may also indicate growth in the transportation sector. The upgrade and extension of the Fuaa wharf which is scheduled to be completed in 2018, will contribute significantly to improving the safety and quality of domestic inter-island transportation, and further support economic activity. Furthermore, there were 3,710 total vehicles registered in 2016/17, a 672 (22.1%) increase compared to the previous year. Banks' total vehicle loans to individuals increased by \$0.3 million (39.0%) over the year to June 2017.

Performance of the tourism industry grew by 3.7% in 2016/17 supported by events that took place during the year, the opening of the Tanoa International Dateline Hotel, increased cruise ship arrivals, and international games such as rugby and judo hosted domestically. Total international arrivals increased by 11,713 passengers (10.5%) in 2016/17 due mainly to an increase in cruise ship arrivals of 8,236 visitors (45.3%). This was due

to larger cruise ships arriving in Tonga, and 2 additional cruise ships arriving during the year. The visa waiver agreement between China and Tonga came into effect in December 2016 when a cruise ship Costa-Atlantica arrived in Tonga with about 2,000 Chinese tourists. Additionally, Tonga is now popular as a cruise destination and that Vuna Wharf is now a reliable port for international cruise liners. It supports the small tour and taxi operators as well as handicraft sellers.

## Monetary Policy Formulation

### Monetary Policy Actions

The Reserve Bank maintained its current monetary policy stance in 2016/17. During the 2016/17 financial year, the Reserve Bank revised its inflation reference rate from a range of 6%-8% to a rate of 5%. Despite the significant increase in the annual inflation rate in June 2017 up to 10.3%, the foreign reserves remained at comfortable levels above the minimum range of 3 – 4 months of import cover at around 7 months of import cover, exchange rates were competitive, the banking system remained sound with strong capital and liquidity position maintained and the domestic economy experienced favourable growth as projected.

The Reserve Bank continued to monitor the movements in inflation which included assessing the effects of exchange rate movements, new tax introduced and also the businesses' profit margins, on inflation, and projected that it was a temporary hike and that inflation will return below the reference rate in 2017/18.



*Ha'apai Agriculture Show, July 2016.*

The focus of the Reserve Bank's monetary policy actions was therefore to adopt measures, as outlined below, to encourage the utilization of the excess liquidity in the banking system to increase lending in order to support domestic economic growth, and strengthen the monetary policy transmission mechanism in the medium term. The Reserve Bank remained vigilant for any signs of overheating risks in the economy particularly risks attached to strong credit growth.

- Maintained the monetary policy rate (interest rate on banks' exchange settlement accounts or excess reserves) at 0% (zero interest rate policy).
- Maintained the minimum loans/deposit ratio at 80% to be achieved by June 2017, 85% by December 2017 and 90% by June 2018;
- Increased the Statutory Reserve Deposit ratio from 5% to 10% effective in July 2017;
- Maintained the inflation reference rate at 5% since November 2016;
- Eased the Exchange Control requirements effective in February 2017 to assist individuals and business in making foreign exchange payments and thereby provide an accommodative business environment;
- Continued to closely monitor the effects of the eased Foreign Exchange Control requirements and economic development on the foreign reserves;
- Engaged technical assistance from the IMF to consider using open market operation (such as the issuance of NRBT notes) to mop up the excess liquidity in the system and help develop the domestic market in order to be more market based and efficient in

the issuing of securities, which would in turn provide local investment opportunities and avoid pressure on the foreign reserves through outgoing capital investments;

- Continued with the financial inclusion initiatives to improve access to financial services and provide further protection to the consumers through the regulation of non-bank financial institutions, introduction of a financial consumer protection policy, and enhancement of consumers' financial literacy.
- Improved the transparency of monetary policy by announcing policy decisions approved by the Reserve Bank Board of Directors shortly after monthly Board meetings. This was effective since January 2017.

## Monetary Policy Outcomes

The headline inflation started rising in July 2016 and remained relatively high during 2016/17. The annual headline inflation edged higher in June 2017 rising by 10.3%, the highest headline inflation in 2016/17. The same period in 2016 recorded a very low annual inflation of 0.1%, which also had lower level of imported and local prices. Imported prices rose by 11.7% over the year to June 2017 contributing 6.5 percentage points to the annual headline inflation. The prices of all imported food categories rose, except for imported fruits and vegetables, and this was led by a 26.6% increase in price of meat, fish & poultry reflecting a rise of 41.5% and 33.5% in the price of mutton flap and chicken pieces respectively. This was followed by a 10.8% rise in the prices of other food components which included goods such as sugar whose price rose by 21.6%.

The higher prices of imported meat continued to reflect the excise taxes and custom duties imposed on various imported food in July 2016. Similarly, the price of Winfield blue tobacco rose by 29.2%. Additionally, the increase in world oil prices drove the price of fuel higher by 10.1%, diesel and petrol prices rose by 16.0% and 14.5% respectively. Furthermore, the price of fuel and power under the household operations increased by 10.8% which comprised of kerosene and liquid petroleum gas.

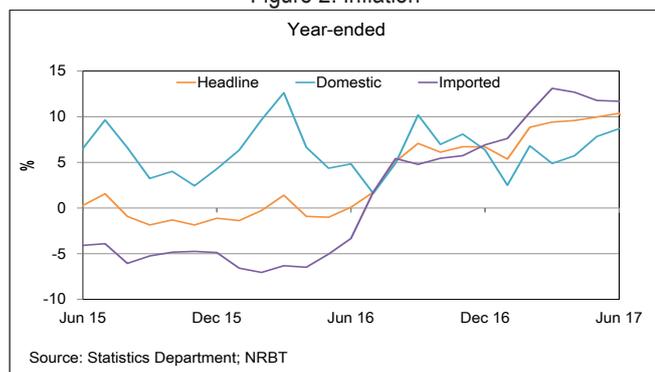
Domestic inflation rose by 8.7% over the year to June 2017 accounting for 3.8 percentage points of the headline inflation. This was driven by the seasonality of local food, rise in electricity price, and the continued short



*Harvesting of potatoes*

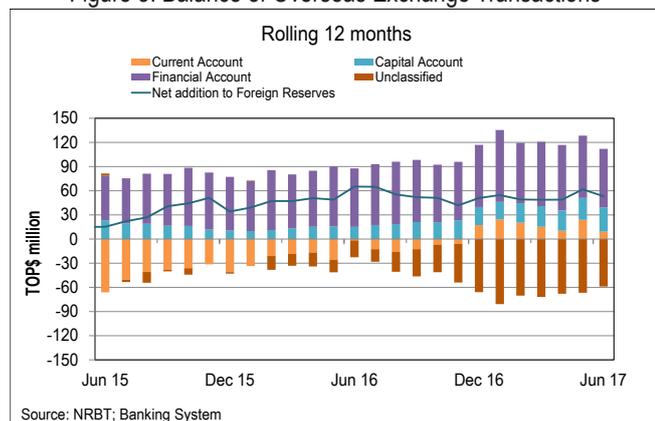
supply of kava-Tonga. The price of local food rose by 10.2% contributing 2.1 percentage points to the overall headline inflation due to the prolonged dry weather in 2017 for growing vegetables compared to the same period in 2016. The increase in oil prices drove the electricity price higher by 22.7%, and kava-Tonga price rose annually by 43.0%.

Figure 2: Inflation



Over the year to June 2017, total OET (Overseas Exchange Transactions) receipts rose by \$94.3 million (14.4%) to \$749.1 million driven by higher inflows of private remittances and travel receipts. The celebrations and annual events during the year supported the annual growth in remittances. Similarly, total OET payments continued to rise by \$68.2 million (12.0%) to \$636.9 million in the same period which was attributed to higher import and service payments, particularly payments for wholesale & retail goods and freight. The overall OET balance for the year ended June 2017 was therefore a surplus of \$53.0 million, equivalent to USD\$24.2 million which is more than the IMF’s projection of a surplus of USD\$3.5 million. Compared to June 2016, the overall balance was lower by \$12.2 million (18.6%) compared to a year ago.

Figure 3: Balance of Overseas Exchange Transactions



This contributed to the rise in the official foreign reserves to \$407.9 million in June 2017, sufficient to cover 7.4 months of imports, which is still above the Reserve Bank’s minimum range of 3 – 4 months. The level of foreign reserves at the end of June was equivalent to USD \$186.2 and was above the IMF’s projection of USD \$169.9 million by the end of 2016/17, but with lower months of import cover of 5.8 months. A monthly press release on the level of foreign reserves is posted on to the website for the awareness of the public.

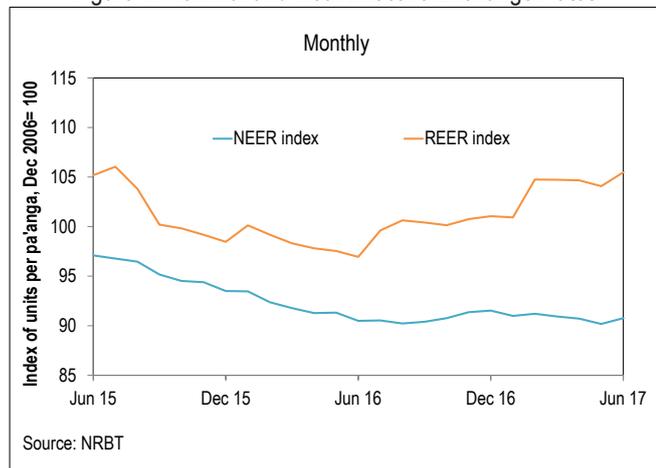
Majority of Tonga’s major trading currencies have strengthened against the Tongan Pa’anga over the year to June 2017, namely the Australian Dollar, New Zealand Dollar, Fijian Dollar and the Euro while the United States Dollar, Great Britain Pound, Japanese Yen and Chinese Yuan weakened against the Tongan Pa’anga. As a result, both the Nominal Effective Exchange Rate (NEER)



Young Kava-Tonga plants ready for cultivation

and the Real Effective Exchange Rate (REER) appreciated over the year by 0.3% and 8.8%, respectively. The rise in the REER index reflected Tonga's higher headline inflation rate relative to its trading partners, which may impact the international competitiveness of the Tongan exports of goods & services.

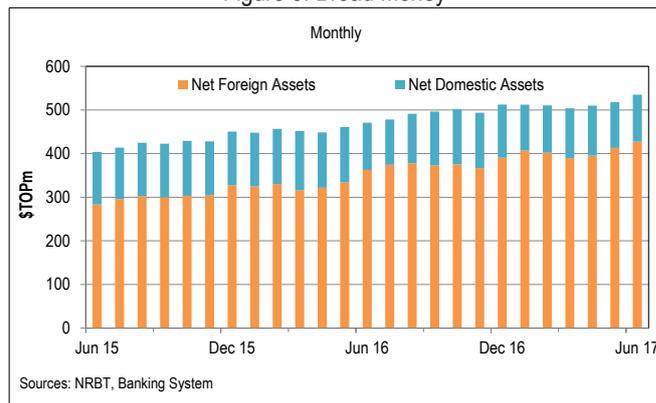
Figure 4: Nominal and Real Effective Exchange Rates



Over the year to June 2017, broad money increased by \$64.3 million (13.7%) to a new record high of \$534.9 million. This was solely a result of a significant rise in net foreign assets which increased by \$65.6 million (18.1%) outweighing a decline of \$1.4 million (1.3%) in net domestic assets. More specifically, foreign reserves continued to be the main contributor to the annual in-

crease in net foreign assets. This had offset the decline in net domestic assets. However, the annual increase in broad money was 13.7%, which was just below the Reserve Bank's forecast for June 2017 of 14.0% in its February 2017 Monetary Policy Statement (MPS). In addition, liquidity in the banking system (reserve money) increased over the year to June 2017 by \$27.2 million (10.6%) driven mainly by a \$16.2 million (9.6%) rise in banks' deposits to the Reserve Bank vault.

Figure 5: Broad Money



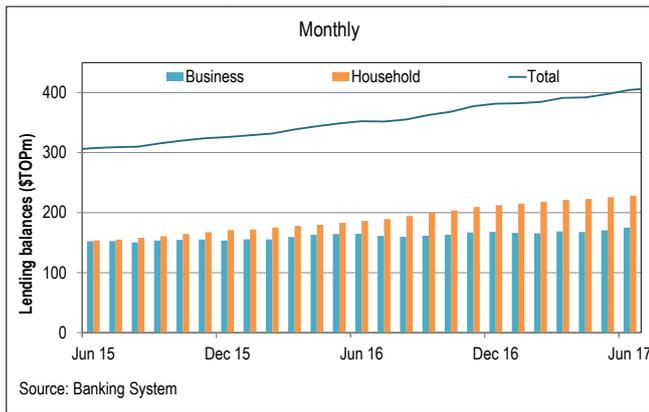
Total banks' lending increased over the year to June 2017 by \$52.2 million (14.8%) to a new high record of \$404.5 million. Housing loans continued to significantly drive higher lending to households over the year. Vehicle loans and other personal loans also contributed to the rise in lending to households. Lending to businesses rose driven by growth in loans to the wholesale & retail, services, and manufacturing sectors. This coincided and supported other evident increases in domestic economic activities throughout the year. The annual credit growth of 14.8% is very close to the Reserve Bank's estimated credit growth of 15.0% that was to be achieved at the end of 2016/17 in its February 2017 MPS. Lending activities in the non-bank financial institutions also increased over the year by \$16.5 million (13.3%) to \$140.4 million, largely reflecting an increase in household lending.

The weighted average interest rate spread widened over the year by 7.1 basis points from 5.63% to 5.70%. This was due to a decline in the weighted average deposit rate outweighing a decrease in the weighted average lending rate.



Construction of the St. George Palace, Nuku'alofa, Tonga.

Figure 6: Banks' Lending



Net credit to government declined over the year to June 2017 by \$40.5 million. This was due mainly to a rise in government deposits supported by the receipts of the budgetary support and government grant funds from development partners, as well as improved government revenue collection during the year.

## Economic Corporate Plan Targets

In April 2017, a review of the 2016 corporate plan was conducted which showed the Economics Department had achieved 20 out of its 23 targets. Over the year, some targets were revised and some were added on to enhance the timeliness of the release of reports and publications and responses to stakeholders and thereby improve communication and public awareness of the Reserve Bank's functions as well as economic developments, taking the total up to 35 measurable targets under the Corporate Plan for 2017. After the first 6 months of 2017, the Economics Department was able to achieve 23 targets while 7 are included in the department's work plan for the remainder of the year. The remaining 5 targets were not achieved during the first half of the year due mainly to delays in submission of data from stakeholders and shifts in work priorities.

# Financial Stability

## Financial Sector

The Reserve Bank continued to be responsible for the promotion of a sound and efficient financial system. This is pursued through the licensing, regulating and supervising of financial institutions, which are the banks and authorized restricted foreign exchange dealers. The NRBT (Amendment) Act 2014 extended the mandate of the Reserve Bank to the licensing and supervision of non-bank financial institutions (NBFIs), capital markets and credit information systems in Tonga. Separate legislations are still being processed for the licensing and supervision of the individual NBFIs. A Guideline for the licencing and supervision of credit information systems (credit bureaus) was issued in March 2017 and became effective on 1 May 2017.

As of June 2017, there were 4 banks licensed to operate in Tonga, declining from 5 banks reported in June 2016. The banking licence of Pacific International Commercial Bank (PICB) was revoked in July 2016.



*Bank of South Pacific increases the number of ATMs*

The Bank of South Pacific Tonga Limited has focused on building their outreach programs with rapid expansion on their number of access points. BSP's branch in Vava'u has undergone major renovations, including the installation of another ATM. The branches in the outer islands of Ha'apai and 'Eua that were previously closed by the former Westpac bank were re-opened by BSP during the financial year 2016/17, thereby the agency agreement with TDB in these two outer islands ended. The number of EFTPOS and in store facilities has increased from 250 in June 2016 to 334 in June 2017. The total number of ATMs also increased to 12 as at June 2017 from 8 last year.

Table 1: Banking Services in Tonga

Banks	ANZ	BSP	MBf	TDB
Branches (including Head Office at Nu-ku'alofa)	3	4	2	8
Sub-branches	1	16	-	-
Agents/Instore banking	-	-	-	-
ATMs	13	12	-	-
EFTPOS	200	334	-	-
Internet Banking	Yes	Yes	No	Yes
MoneyGram Agent	No	Yes	Yes	No

All banks maintained their head offices in Tongatapu. MBf Bank Limited and ANZ Bank also maintained their branches and sub-branches in Vava'u. Tonga Development Bank (TDB) continued to be the only bank serving all the outer islands of Ha'apai, Vava'u, 'Eua and the two Niua (Niuatoputapu and Niuafu'ou). TDB also continued to operate two other sub-branches in Tongatapu located in Tatakamotonga for the Hahake District and Nukunuku for the Hihifo District.

During the year, the banks maintained their current banking services and have also developed new banking services. BSP has set up a business center for its corporate clients in September 2016. TDB launched the 'Ave Pa'anga Pau Product in February 2017 following

the piloting mode and testing in January 2017. TDB has joined ANZ and BSP in the digitization of their products by launching its internet banking product as well as the 'Ave Pa'anga Pau product.

## Banking System Supervision and Regulation

During 2016/17 the Reserve Bank continued to focus its supervisory activities on ensuring prudent management of credit risks by banks particularly with the monetary policy stance to encourage lending by banks to support economic development. In addition, much emphasis was placed on compliance checks and enforcing the legal and prudential requirements to promote a safe and sound financial system, and also ensure a level playing field in the banking system.

In light of the Reserve Bank Board's decision in February 2017 to increase in the Statutory Reserve Deposit (SRD) Ratio from 5% to 10%, effective in the banks' balance sheet for July 2017, to encourage prudent practices whereby a portion of the liquidity is to be set aside as precaution against the increased loan portfolio, the Reserve Bank will closely monitor the implication of this decision on banks' liquidity. This is in addition to monitoring of banks' compliance with the minimum requirement on the loans to deposit ratio of 80% that was to be effective in June 2017, 85% by December 2017 and 90% by June 2018. As of June 2017, only one bank achieved this target.

The Reserve Bank continued to conduct compliance checks to verify banks' compliance with the legal and prudential requirements. In addition, enhanced monitoring of banks' reports to the Reserve Bank continued to ensure accuracy and timeliness of these reports to assist with the Reserve Bank's policy decisions. Administrative penalties were imposed on breaches of the prudential requirements as well as the reporting requirements. During the year approved a temporary breach of the single borrower limit for one loan subject to conditions. Trainings were conducted by the Reserve Bank for the banks to assist banks with their awareness and implementation of the prudential and reporting requirements.

The Reserve Bank revoked the banking license of Pa-

cific International Commercial Bank effective from 26th July 2016. This was after continuous enhanced supervision and monitoring of this commercial bank that was established in 2014 to ensure full compliance with the conditions of its licence. The Reserve Bank focused on protecting the interest of depositors and creditors by conducting the pay out of claims by PICB's customers. To date all claims have been met. Court proceedings are in progress.

Following the introduction of the Foreign Exchange Levy Act which came into effect on 1st June 2016, the Reserve Bank discussed with the banks to ensure they are compliant with the Foreign Exchange Levy Act. Furthermore, the Reserve Bank permitted banks to charge a fee to pass on the costs of the new foreign exchange levy to their customers. This was on a cost recovery basis and to ensure banks can adjust their systems to enable them to impose this new levy. The Reserve Bank later lifted this decision and commencing in January 2017, all banks have absorbed the foreign exchange levy in order to contribute to reducing customers' costs of foreign exchange transactions, similar to the Reserve Bank.

During 2016/17, the Reserve Bank received two new applications for banking license and meetings were held with the applicants to discuss the Reserve Bank's requirements. There is work in progress to improve the



*Economics update to Parliamentarians*

sources for background checks and verifying information submitted in bank license applications.

Work is in progress to amend the Financial Institutions Act to rename as Banking Act, given its focus on bank licensing and supervision, and also to strengthen the controllership and receivership provisions for the resolution of problem banks and update of provisions to be in line with international best practices.

Revisions were also made to 4 out of the 12 Prudential Statements which became effective in April 2017. This was mainly to align the requirements of these Prudential Statements with the Financial Institutions (Amendment) Act 2014 and international best practices. This also included a revision to the calculator for the Annual Percentage Rate (APR) to incorporate feedback from the banks as well as enable the calculation of APR for loans with interest rates that are on a straight line basis.

The Reserve Bank continues to explore solutions to setting up of a credit bureau in Tonga to collect the credit information from the domestic banks which would contribute to the enhancement of the credit environment and promoting financial stability. The credit bureau based in Fiji which had serviced the domestic banks had terminated its operations in June 2017.

Pursuant to the provisions of the Financial Institutions (Amendment) Act 2014, the Reserve Bank, on 30th June 2017, for the first time forfeited unclaimed monies totaling \$300,613.37 to the Government's account. These are unclaimed monies paid by the banks to the Reserve Bank for the years ending 2004 to 2011 and have remained unclaimed for more than 5 years after being paid to the Reserve Bank. Banks have been informed to advice customers of dormant accounts and any unclaimed money that has been paid to the Reserve Bank to encourage customers to make their claims prior to the due date for forfeiture of these unclaimed monies. Customers are also to claim their unclaimed money through banks in which banks are required to retain sufficient records to identify customers.

The Reserve Bank supported the Association of Banks to raise awareness and issue a public notice on safety measures to ensure they are protected from fraudulent activity or ATM skimming, particularly customers of the

two largest banks. All customers that were affected by these fraudulent acts were fully reimbursed.

The Reserve Bank continued the monthly bilateral meetings with the banks as well as bi-annual meeting with the Association of Banks in Tonga (ABT) were held during the year to obtain updates on the banks strategies in light of the market development to ensure that they continued to operate prudently and in compliance with the Reserve Bank's requirements. Furthermore, technical meetings were carried out on specific issues mainly on reporting requirements.

The Reserve Bank Board is informed of developments in the banking system through a monthly report on banking sector development as well as other updates in the Governor's update to the Board on a monthly basis.

## **Banking System Financial Performance**

### **Financial Position**

The total assets of the banking system reached \$769 million at the end of June 2017, a growth of \$84.4 million (12.3%) over the year 2016/17. This resulted mainly from credit growth of 14.8% (\$52.2 million) and a 14.6% (\$32.1 million) growth in banks' deposits with depositary institutions including their deposits with the Reserve Bank (Exchange Settlement Account and Statutory Reserve Deposit) which rose by \$19.1 million (10%). In addition, banks' demand and time deposit holdings abroad rose by \$8.9 million and \$4.0 million respectively.

About 80% of credit growth over the year to June 2017 was attributed to banks' lending to individuals (\$41.9 million). This consisted of mainly housing loans (\$41.0 million) which reflected competitive low interest rates and housing loan packages offered by banks during the year. Banks' lending to businesses also rose during the 2016/17 financial year by \$10.3 million (6.1%). Majority of loan beneficiaries were for businesses involved in retail & wholesale, manufacturing and construction indicating improvements in business confidence.

Government continued to offer its low interest rate loans through the Government Development Loan (GDL) scheme administered by TDB. The total outstanding loans under this scheme as of June 2017 was at \$9.1

million compared to \$6.6 million in June 2016. Of the total outstanding loan as of June 2017, 39.3% was lent to the agricultural sector followed by the fisheries and education sectors at 19.7% and 14.3% respectively.

Table 2: Financial Sector Deposit Accounts

	2015/2016	2016/2017
Demand Deposits		
Number of Accounts	27,731	17,162
Value of Deposits (\$m)	208,578	242,289
Saving Deposits		
Number of Accounts	42,600	46,354
Value of Deposits (\$m)	76,974	84,620
Time Deposits		
Number of Accounts	2,099	2,286
Value of Deposits (\$m)	182,772	209,861
Total Number of Accounts	72,430	65,802
Total Value of Deposits (\$m)	468.3	536.8

Total banks' liabilities rose over the year by \$79.3 million (14.6%). Total deposits continued to fuel rises in total liabilities. All deposit categories increased with demand deposits rising the fastest by \$33.7 million (16.2%), reflecting growth in private business deposits of \$16.6 million and Government deposits of \$15.9 million. Other liabilities increased by \$8.2 million (30.5%) underpinned by Government's transfer of funds to TDB to fund its development loan scheme. In addition, an increase of \$2.9 million (61.2%) in borrowings also contributed to the rise in total liabilities during the year.

The total number of deposit accounts reported by banks decreased over the year by 9.2% to 65,802 whilst the total value of deposits increased by \$68.5 million to \$536.8 million. This largely reflected some of the banks closing their dormant accounts which are mainly small valued accounts.

## Profitability

The profitability of the total banking system improved in 2016/17 compared to the previous financial year. An after-tax profit of \$18.317 million was recorded for the year ended June 2017, which is equivalent to 2.2% of average assets, compared to an after-tax profit of \$16.889 million for the previous year, which was equivalent to 2.6% of average assets. This reflected a strong growth

of 13.3% in total average assets over the year outweighing the improved profitability. The increase in profitability is attributed to a rise in both net interest income and non-interest income of \$2.4 million and \$1.9 million respectively, as well as a decline in provision expenses of \$0.8 million which outweighed an increase in non-interest expenses of \$3.8 million.

Table 3: Financial Performance

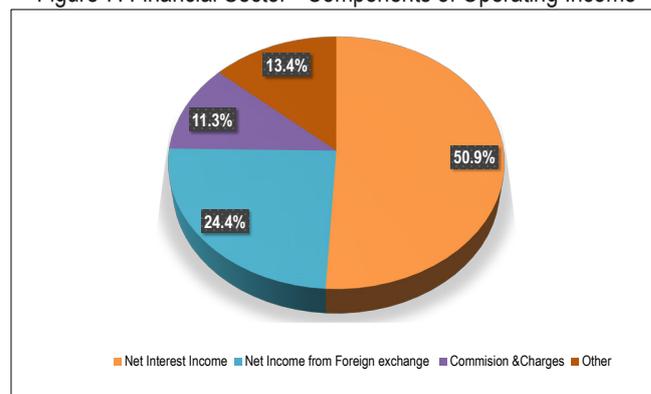
	2015/2016	2016/2017
Pre-tax Net Profit (% average total assets)	3.0%	3.2%
After-tax Net Profit (% average total assets)	2.2%	2.5%
Total Operating Income (% average total assets)	7.3%	7.0%
Net Interest Income (% average total assets)	3.7%	3.6%
Non-interest income (% average total assets)	3.6%	3.5%
Average Net Interest Margin (%)	3.7%	3.6%
Total Operating Expenses (% average total assets)	5.2%	5.4%
Consolidated Risk-weighted Capital Ratio (%)	34.0%	29.4%

Source: Licensed Financial Institution

1/Revised to reflect 12 months data

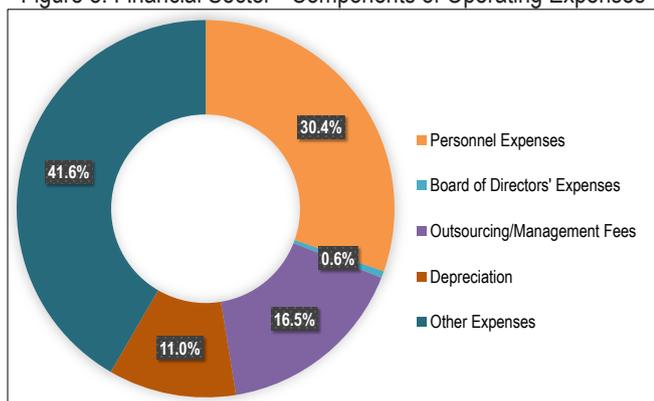
Total operating income of the banks was comprised mainly of net interest income at 50.9% followed by net income from foreign exchange at 24.4% compared with 50.5% and 25.9% respectively in June 2016. The growing net interest income is in line with the strong credit growth over the year for all banks.

Figure 7: Financial Sector - Components of Operating Income



Total operating expenses of the banks largely comprised of Other Expenses at 41.6% followed by Personnel Expenses at 32.8% and outsourcing & management fees at 16.5% compared with 40.9%, 32.8% and 13.4% respectively in the previous year. The increase in other expenses largely reflected the higher administrative expenses.

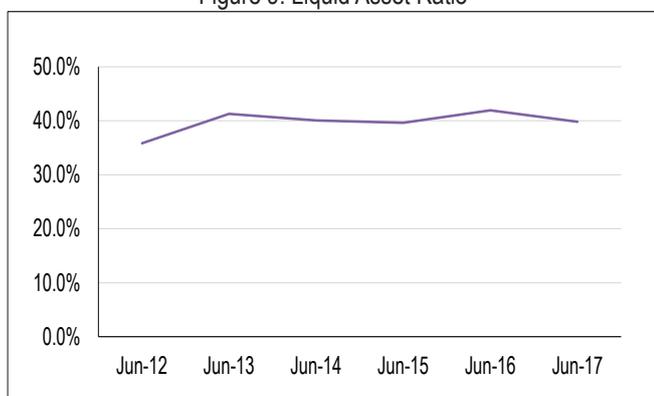
Figure 8: Financial Sector - Components of Operating Expenses



## Liquidity

The banking system's liquidity continued to remain high during 2016/17. The increase in eligible liquid assets by \$20.1 million over the year, mainly the higher Exchange Settlement Accounts contributed to the high liquidity which was in line with the higher foreign reserves despite the strong credit growth. Total loans as a proportion of deposits slightly increased to 75.4% in June 2017 from 75.2% that was recorded in June 2016. The Liquid Asset Ratio fell to 39.8% in June 2017 compared to 41.9% in June 2016 but continued to remain well above the Reserve Bank's minimum requirement of 5%.

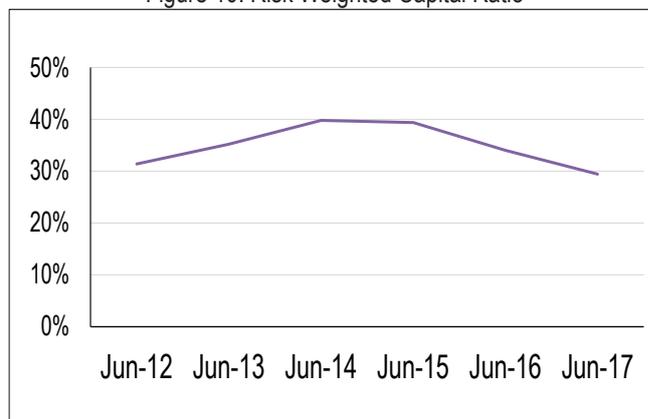
Figure 9: Liquid Asset Ratio



## Capital

The capital position of the banking system remained strong during 2016/17. Despite the decline in the risk-weighted capital ratio (RWCR) at the end of June 2017 to 29.4% from 34.0% in June 2016, it remained well above the statutory minimum requirement by the Reserve Bank of 15%. The fall in the RWCR is largely due to a \$67.4 million (18.0%) increase in risk-weighted assets reflecting the strong credit growth over the year (\$52.2 million).

Figure 10: Risk Weighted Capital Ratio



## Asset Quality

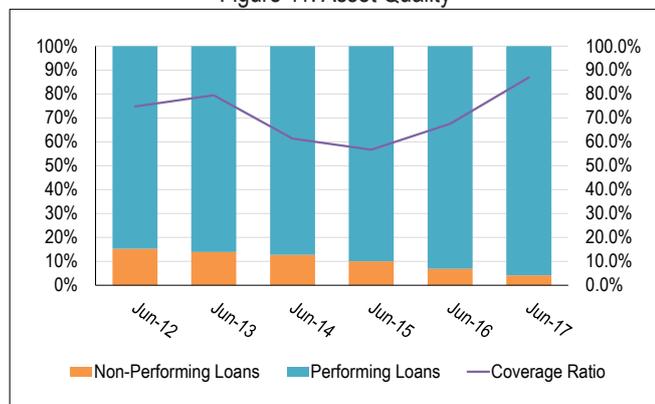
The overall quality of the banks' assets improved over the year to June 2017. Total non-performing loans decreased by \$7.3 million (30.1%) to \$16.9 million at the end of June 2017. This largely reflected loan write offs as well as loan settlements during the year. The ratio of non-performing loans to total loans therefore improved to 4.2% from 6.9% in June 2016.

Business loans accounted for 55.6% (\$9.5 million) of the total non-performing loans in June 2017 while the remaining 44.4% (\$7.6 million) was in household loans. Housing loans accounted for 28.6% (\$4.9 million) of total non-performing loans followed by non-performing loans from the tourism sector with 15.8% (\$2.7 million [2 accounts]) and personal loans with 15.7% (\$2.7 million).

The non-performing loans remained well covered by the provisions for loan losses although the total provisions fell over the year by \$1.5 million (9.1%) to \$14.8 million due mainly to the write off of a major loan. The coverage

ratio remained high at 87.6% increasing from 67.5% in June 2016. The Reserve Bank continued to work closely with banks to ensure adequate provisions are in place as well as the accurate reporting of security values is maintained.

Figure 11: Asset Quality



The Financial Institutions-Banks department committed to 55 targets in the 2016 corporate plan in which 30 were successfully achieved and 3 were partially achieved. During the review of the 2016 corporate plan in 2017, targets were removed and revised, and new targets were added to guide the department in delivering its expected output. This resulted in a total 32 targets for 2017.

## Non-Bank Financial Institutions Supervision

The supervision and oversight of all non-bank financial institutions remains work in progress. The legislations approved by Cabinet for the supervision of money lenders, credit union, microfinance institutions and foreign exchange dealers are still awaiting approval by the Legislative Assembly. The regulation of NBFIs is required to ensure the customers of these NBFIs are better informed of the risks associated with the NBFIs' products and that their interests are protected. This includes concerns with high interest rates charged by the informal lenders.

The Reserve Bank recognizes that regulation of NBFIs should be to a relatively lesser extent compared to bank supervision, as they are serving certain sectors of the economy or community whom are not serviced by the banks. The regulation of insurance companies, retirement funds and microfinance institutions are important

to minimize potential systemic risks. The draft Financial Consumer Protection policy for financial service provide is being finalized, to enhance the protection of financial consumers and thereby maintain confidence in the financial system.

The authorized restricted foreign exchange dealers continued to be affected by the banks' de-risking decisions which have resulted in the closing of some of these authorized restricted foreign exchange dealers' accounts due to elevated money laundering and terrorist financing risks associated with authorized restricted foreign exchange dealers. The Reserve Bank continues to work together with the authorized restricted foreign exchange dealers to strengthen their Anti-Money Laundering/Counter Terrorist Financing (AML/CFT) compliance status in order for the banks to retain their accounts. Furthermore, the Reserve Bank continues to liaise with the banks to encourage them to offer alternative products for de-risking with the aim of maintaining and reducing the cost of remittances to Tonga.

## Licensing and Supervision of Restricted Foreign Exchange Dealers

The licensing and supervision of foreign exchange dealers continue under the current Foreign Exchange Control Regulations, which are being amended to improve the Reserve Bank's regulatory and enforcement powers. During 2016/17, the Reserve Bank licensed one new authorized restricted foreign exchange dealer, taking the total number of licenced and registered authorized restricted foreign exchange dealers to 11.

In order to expedite the annual compliance checks of all authorized restricted foreign exchange dealers, all changes to the licensing/registration requirements were required to be submitted by the end of November, revised from end of December. The annual compliance checks found the majority of the foreign exchange dealers to be generally compliant with the conditions of the licensing / registration which formed the basis for the Reserve Bank's approval for these 11 authorized restricted foreign exchange dealers at the beginning of 2017 to continue their operations. Two of the commercial banks, namely BSP and MBf Bank continued to hold agency arrangements with MoneyGram. All banks are licensed as authorized dealers under their banking license.

Compliance spot checks, training of the authorized restricted foreign exchange dealers, stakeholder and quarterly meetings when required contributed to the improvement in the understanding and compliance with the conditions of license/ registration.

## Other Non-Bank Financial Institutions

The Reserve Bank is authorized under section 4A(k) of the National Reserve Bank of Tonga (Amendment) Act 2014 to regulate and supervise financial institutions including NBFIs such as Retirement Funds, Insurance Companies, Credit Unions, Cooperative Societies, Credit Institutions, Money Lenders, Microfinance Institutions, Foreign Exchange Dealers, and Investments companies.

During the year, the Reserve Bank continued to set up the regulatory framework for each NBFI while awaiting the approval of the separate laws for the licencing and supervision of these NBFIs. Meanwhile, South Pacific Business Development (SPBD), a microfinance institution, continued to voluntarily submit financial information on their lending activities to the Reserve Bank on a monthly and annual basis.

## Payment System

The Reserve Bank continued to explore ways to improve the efficiency and sound functioning of the payment system. Meanwhile, the manual settlement system, involving the inter-bank cheque clearance that is conducted by the Settlement Unit on a daily basis is operating well.

## Interbank Cheques Clearance

The Reserve Bank facilitates a daily clearance service for the commercial banks to ensure a safe and efficient clearing system in Tonga. The commercial banks in Tonga signed an interbank clearing agreement to guide them in ensuring all cheques are cleared in a timely manner. A total of 156,842 cheques were presented for clearance at the Reserve Bank during the financial year 2016/2017 an increase of 1.5% from the previous year. The increase in the number of cheques presented for clearance is attributed to higher level of economic activities over the year. The clearance of cheques in the centre is running well and all participants are committed to settle their dues on time.

During the year, Settlement Unit participated in the review of the 2016 Corporate Plan. The Unit was assigned three measurable targets for the calendar year 2016 which were all achieved. The review also added on ten new measurable targets for the 2017 calendar year. These new targets were related to promoting an efficient and secured payments system and the modernisation of the operations of the Reserve Bank.

## Settlement Corporate Plan Targets

The Financial Institutions-Non Banks department committed to 17 targets in 2016 corporate plan in which 12 were successfully achieved. The main reason for not achieving the remaining targets was the delay in the enactment of the laws for the licencing and supervision of NBFIs. During the review of the 2016 corporate plan in 2017, targets were revised and removed, and new targets were also added to be more practical and relevant. A total of 14 targets were approved in the 2017 corporate plan.

## Financial Inclusion

2016/17 was the Reserve Bank's year for financial inclusion. The Reserve Bank winning the Maya Declaration Award in September 2016 at the first Alliance for Financial Inclusion (AFI) Global Policy Forum (GPF) to be held in the Pacific, is a milestone to reminisce. This award recognizes the Reserve Bank out of more than 100 member institutions representing over 90 nations across



Tongan Culture Performance at AFI 8th Annual Global Policy Forum. Nadi, FIJI

the globe, as the institution with clearly defined measurable targets, and the most dedicated progress reporting via the AFI Data Portal. This is the AFI's integrated global database on financial inclusion policies, regulations, and outcomes, that allows members to track and view progress made against their Maya Declaration commitments as well as key financial inclusion indicators. The Maya Declaration is the first global commitment by policymakers from developing and emerging countries to unlock the economic and social potential of the poor through greater financial inclusion.

The Reserve Bank engaged relevant national and international stakeholders to support its financial inclusion journey. Coordinated efforts are being acknowledged and buy-in of important stakeholders such as the ministers, government officials as well as the private sectors will be crucial for the initiative to be effective. One-on-one consultations with key stakeholders were conducted with the assistance of the Pacific Financial Inclusion Program (PFIP) in the lead up to the formulation of a national financial inclusion strategy.

The Reserve Bank has made a commitment under the Maya Declaration to develop and improve access to finance for Micro Small and Medium Enterprises (MSMEs) by 20% in 2020, focusing on the agricultural, fisheries, tourism sectors, women and youth; and also to develop policies and regulations for MSME finance, consumer protection and financial literacy. In working towards achieving this commitment, the Reserve Bank has encountered a number of challenges which includes the lack of data or statistics on MSMEs and their access to finance. There was no uniform definition of MSMEs and therefore the data collected were not entirely

on consistent basis. The Reserve Bank recognized the importance of statistics in order to measure its progress with its Maya Declaration commitment which in turn reflects the progress of SMEs' access to finance. The Reserve Bank therefore adopted the definition used by the Ministry of Commerce Consumer Trade Innovation and Labour which is based on the number of employees and sales turnover.

Another challenge encountered by the Reserve Bank was the coordination of efforts towards developing SMEs and their access to finance. The Reserve Bank hosted a MSME Workshop in November 2016 with the objectives to identify the challenges faced by MSMEs in accessing finance as well as to develop strategies to address those challenges, using the outcome of an informal survey of MSMEs access to finance conducted by the Reserve Bank as a basis for these discussions. To confirm the strategies developed at this workshop, the Reserve Bank also conducted bilateral consultations with relevant stakeholders with the view of establishing a MSME working group to drive the implementation of these strategies. Work is still in progress to re-strategize and reconsider how to be more effective in driving this initiative given the current business, economic and political conditions.

In February 2017, the Reserve Bank's mandate under section 4 of the National Reserve Bank of Tonga Act was also extended to include promoting financial inclusion, as it recognizes that this supports its role of ensuring inclusive economic growth and macroeconomic stability, and that financial inclusion is not just about the availability and sustainability of financial services in the remote areas, but also the affordability and relevance of these



*NRBT workshop on improving MSME access to finance. Davina House, TONGA*



**THE 2016  
AFI GLOBAL  
POLICY FORUM**  
BUILDING THE  
PILLARS OF  
SUSTAINABLE  
FINANCIAL  
INCLUSION  
FIJI 7-9 SEPTEMBER



*Pacific Central Bank Governors at AFI 8th Annual Global Policy Forum*

services to the livelihood of the people of Tonga.

Data collected by the Reserve Bank shows that access to financial services has improved over the year with all core set of indicators increasing. The number of bank branches, ATMs and bank agents per 10,000 adults increased over the year resulted in increasing deposit accounts, percentage of administrative units with at least one access point and the overall number of access points per 10,000 adults at a national level.

Table 4: AFI Core Set of Indicators

	2016	2017
Number of access points per 10,000 adults at a national level	60	89
Number of commercial bank branches per 10,000 adults at a national level	2	3
Number of ATMs per 10,000 adults at a national level	3	4
Number of agents per 10,000 adults at a national level	2	3
Percentage of administrative units with at least one access point	65	76
Number of deposit accounts per 10,000 adults	8,797	10,157

Source: Banking System

The Financial Inclusion department committed to 8 targets in the 2016 corporate plan in which 5 were successfully achieved. The main reason for not achieving the remaining targets was the need to reconsider the department's role in light of the developments in the market and stakeholders. During the review of the 2016 corporate plan, targets were revised and removed, and new targets were added to be more focused and better guide the department in delivering its expected output. A total of 31 targets were approved in the 2017 corporate plan.

### Financial Intelligence Unit

The Transaction Reporting Authority is Tonga's Financial Intelligence Unit (FIU) responsible for administering the requirements of the Money Laundering and Proceeds of Crime (MLPC) Act. Amongst other anti-money laundering related functions, the FIU is responsible for receiving, analysing and dissemination of suspicious reports. The FIU is also responsible for the supervision of financial institutions and cash dealers in accordance with their obligations under the MLPC Act and Regulations. This in turn supports the Reserve Bank's objective of promoting a safe and sound financial system. The FIU's role and functions prescribed under the MLPC Act includes policy formulation and enforcement.

## Supervision & Compliance

During the year, the FIU continued with its supervision and reports analysis functions in accordance with the requirements of the MLPC Act and Regulations.

To complete the annual compliance check, the FIU together with the Financial Institutions, Non-Banks Division conducted compliance visits to 13 authorized restricted foreign exchange dealers during October 2016 – December 2016. The visits were to verify compliance of these entities with their licensing conditions which also includes Anti-Money Laundering/Counter Financing of Terrorism (AML/CFT) related requirements. The findings of these visits were generally compliant; further spot checks were conducted to riskier entities in March 2017 to follow up on issues of concerns identified in the annual compliance check that was completed in December 2016.

The annual compliance checks and vigilant monitoring of the AML/CFT compliance of the authorised restricted foreign exchange dealers also supported the Reserve Bank's efforts to improve their compliance status in light of the rising concerns of de-risking. The FIU shared compliance reports of its reporting entities with one of the banks, with the endorsement of relevant authorised restricted foreign exchange dealers, to assist in the bank's review of its banking relationship with its money remitter customers. This was part of the efforts to assure the banks that foreign exchange dealers are also being actively supervised and are in compliance with AML/CFT requirements and thereby to support the banks' decision to retain their bank accounts.

In October 2016, the FIU received technical assistance from the United Nations Office on Drugs and Crime (UNODC) under the Global Program on Money Laundering assistance to Pacific countries including Samoa, Cook Islands, Niue and Tonga. The UNODC advisor visited the FIU and other domestic law enforcement agencies in April and October 2016 basically to assist with providing AML/CFT advice, training and technical assistance to build AML/CFT capacity of relevant agencies and to support the coordination mechanisms to ensure the effective implementation of Tonga's AML/CFT regime. The FIU benefitted from this assistance through the success of the "Mystery Shopper Exercise" which anonymously

tested the effectiveness of the AML/CFT controls and practices in the domestic financial system in situations where criminals attempt to perform illegal transactions. Several weaknesses and breaches of the AML/CFT requirements were identified by this exercise, which assisted the FIU to address these issues and also strengthen its supervision and monitoring of the reporting entities. The FIU is looking into conducting targeted compliance visits to its reporting entities in their effort to increase its effectiveness. The Reserve Bank also benefitted from this exercise through the identification of a number of operations in Tonga who were conducting un-authorized foreign exchange dealing and required them to apply for a license from the Reserve Bank.

During the year, the FIU responded to a number of requests for financial information from Ministry of Revenue & Customs to assist with ongoing investigations and especially in relation to STRs disseminated to them. Information were collected from all the reporting entities in relation to these requests. The MLPC Act allows for collecting of any information relevant to serious offences and that FIU can instruct any financial institutions and cash dealers to take steps in relation to any information or report, to enforce compliance or to facilitate any investigation anticipated by the FIU or a law enforcement agency.

The FIU conducted its first biannual training for the year on AML/CFT requirements to all its reporting entities in February 2017. The training focused on enhancing the understanding of all reporting institutions on the obligation to identify and report suspicious activities. This was also an opportunity for the FIU to provide feedback to its reporting entities on the reports submitted by them.

In April 2017, the FIU contributed to the review of the Reserve Bank's Corporate Plan for 2017-19. The FIU contributes to the first strategic priority of the bank in setting a platform for Tonga becoming a high growth economy through the prevention of money laundering. For this calendar year, the FIU has a total of 17 targets to achieve. The FIU's targets are aimed at effectively supervising its reporting entities, ensuring a well-informed regime and to comply with global AML/CFT related requirements.

Throughout the year, the FIU also completed all due dil-

igence check requests from different departments within the Reserve Bank. These checks were commonly for applicants for exchange control transactions, numismatic coin collectors, suppliers and several others. The results of these checks were generally non-suspicious and were communicated to each requesting department.

## Reports & Statistics

Table 5: Number of Reports Received

Types of reports filed	2014/15	2015/16	2016/17
Suspicious Transaction Reports (STRs)	24	20	22
Currency Transaction Reports (CTRs)	4,138	7,087	8,668
Border Currency Reports (BCRs)	36	52	80

The FIU received 22 STRs from the commercial banks and authorized restricted foreign exchange dealers during the year, increasing by 2 reports from the previous year. The number of CTRs increased by 18% from the previous year totaling to 8,668 reports filed in 2016/17. Total BCRs also increased this year by 35% totaling to 80 reports filed by the Ministry of Revenue & Customs. The FIU retains the information obtained in these reports to assist in its analysis function

## Reports analysis & Information sharing

Figure 12: Suspicious Transactions Reports by Type



The dominant STR indicator continued to be significant transactions that were inconsistent with the customer's known background or the source of fund were undetermined. This included significant cash deposits or withdrawals as well as significant private telegraphic transfer transactions. The next dominant STR indicator was the use of personal accounts for conducting of business transactions. The remaining STRs were related to several indicators such as large and rapid movement of funds and structured payments.

Table 6: Number of STRs Disseminated

Law Enforcement Agencies	2014/15	2015/16	2016/17
Ministry of Police	5	2	1
Ministry of Revenue & Customs	6	13	8
Ministry of Foreign Affairs (Immigration)	0	0	1
MCCTIL	0	0	1

Following the analysis of the 22 STRs received, 8 STRs were disseminated to the Ministry of Revenue & Customs for further investigation of possible contravention of tax related requirements. 1 report was passed to Police for further investigation of possible serious offence, 1 report was referred to the Immigration Department given one of the issues was related to the validity of the travel documents submitted and 1 report was referred to the Ministry Commerce, Consumer, Trade, Innovation & Labour for further investigation given the involvement of some business license related issue. Given 11 out of the 22 STRs were filed by the FIU as they did not warrant any further investigation by the law enforcement authorities, this prompted the FIU to improve the effectiveness and relevancy of the trainings provided to the reporting entities, and provide more feedback to reporting entities on STR related issues to increase their awareness on suspicious indicators which will in turn raise the quality of the STRs submitted to the FIU.

Table 7: CTR Data Analysis

	2015/16 (TOP\$ million)	2016/17 (TOP\$ million)
Inwards	119.5	132.6
Outwards	59.6	68.7
Transaction purpose		
Business	83.5	91.6
Personal	95.6	109.7
Transaction type		
TT	34.5	25.2
Cash	72.2	103.6
Cheque	41.4	40.9
Other	26.8	25.6
Cash/ Cheque	4.2	6.0

From the 8,668 reports received this year, majority of the reports were for inward transactions which are classified into cash, cheque, telegraphic transfers and other deposits. Cash continues to be the dominant type of transaction reported over the year followed by the use of cheques and telegraphic transfers. This is similar to the one of the most common STR indicator of significant cash transactions.

Table 8: BCR Data Analysis

	2016/17 (TOP\$ million)
Inbound	0.6
Outbound	36.5
Purpose of funds	
Business	36.4
Personal	0.7

The FIU received 80 BCRs this year from the Ministry of Revenue & Customs. Majority of the reports were for outbound funds and were mostly shipments of currencies for authorised restricted foreign exchange dealers and commercial banks. A very few of the outbound fund reports were for individual travellers and these were mainly travellers carrying cash sourced from their businesses or bank accounts for overseas spending. All outbound funds for authorised restricted foreign exchange dealers and commercial banks received prior approval of the Reserve Bank and a few of the individual travellers without proper approval were dealt with by authorised

officers at the border. Inbound funds carried across the border were mostly for individual travellers returning or visiting Tonga. Funds of both inbound and outbound travellers who failed to make a declaration at the border were seized by the Ministry of Revenue & Customs and offending travellers were charged with penalties accordingly.

The FIU also conducted analysis of the notes conversion report from banks and authorized restricted foreign exchange dealers and making comparison with information reported from the Ministry of Revenue & Customs on the BCRs. The analysis was done on individuals converting notes/ buying Tongan Pa'anga with amounts exceeding the BCR declaration threshold of TOP\$10,000 but were not reported from the Ministry of Revenue & Customs as they were not declared at the border. These information were passed on to the Ministry of Revenue and Customs to assist with the profiling of travellers. With the Inter-agency MOU in place, the FIU was able to share 7 monthly reports during the year.

The FIU continued to disseminate on a monthly basis the terrorist list from the Office of Foreign Assets Control's (OFAC) of the United States Department of the Treasury of Specifically Designated Nationals (SDN) and the dissemination list of the Non-Cooperative Countries and Territories and countries that are subject to the Financial Action Task Force's public statements.

## FIU Corporate Plan Targets

In April 2017, the FIU contributed to the review of the Reserve Bank's 2016 Corporate Plan. The FIU contributes to the first strategic priority of the bank in setting a platform for Tonga becoming a high growth economy through the prevention of money laundering. For the previous year, the FIU had a total of 10 targets with 8 achieved and 2 targets partially achieved to be completed in 2017. Following the review and setting the corporate plan for 2017-19, 1 target was removed, 2 were revised and 8 targets were added on, therefore the FIU has a total of 17 targets to achieve. The FIU's targets are aimed at effectively implementing the Money Laundering & Proceeds of Crime Act and Regulations through improving awareness and enforcing compliance with the AML/CFT

requirements, improving capacity to share information with domestic and foreign counterparts, and enhanced risk based supervision. This would also contribute to addressing the de-risking and de-banking decisions by global banks due to elevated AML/CFT risks associated with smaller sized financial institutions such as money remitters, as well as banks outside of the US.

# Financial Markets Operations

## Domestic Market Operations

The Reserve Bank did not issue any Reserve Bank notes as it continued to encourage banks to use the excess liquidity in the banking system for lending to support economic growth.

As of the 30 June 2017, the banking system liquidity stood at \$209.5 million, an increase from \$192.3 million at the end of June 2016. The banking system liquidity comprised mainly of \$183.9 million in the banks' Exchange Settlement Accounts (ESA) held with the Reserve Bank and \$25.6 million of Government of Tonga's Bonds held by the banks. The higher liquidity was in line with the higher foreign reserves.

Due to the excess liquidity in the banking system, there was no activity in the inter-bank market and similarly there were no applications for repurchase agreements during the year. As a result of the growing excess liquidity, the Reserve Bank notified the banks of its intention to increase the statutory reserve deposits (SRD) rate from 5% to 10% in the 2017/18 financial year to encourage prudent practices whereby a portion of the excess liquidity is set aside as a precaution against the growth in credit and to strengthen the monetary policy transmission mechanism.

Figure 13: Banking System Liquidity



The Reserve Bank continued to publish financial information, such as comparisons of financial institutions' daily and weekly exchange rates and fees related to foreign exchange transactions, in its efforts to improve the public's understanding of financial indicators in order to make better financial decisions.

The Reserve Bank is also exploring other avenues and mechanisms in order to develop the domestic market operations in the near future to be more market oriented. Amendments to the NRBT Act approved in February 2017 allows the utilization of the excess balance in the Revaluation Reserve Account, above \$10 million, to cover the Reserve Bank's monetary policy costs. This enhances the Reserve Bank's ability to issue NRBT notes to implement the monetary policy and thereby develop the domestic market. This amendment also allowed the excess balance in the Revaluation Reserve Account to be paid to the Government upon the request of its Minister and approved by the Reserve Bank Board.

## Foreign Exchange Operations

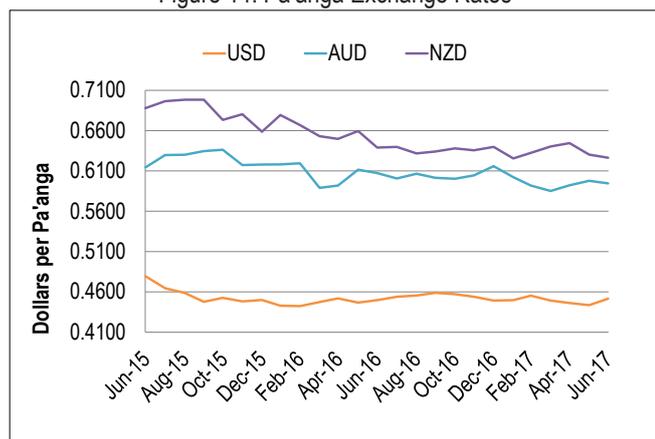
The Reserve Bank determines the rate at which the Tongan pa'anga is exchanged for foreign currencies on a daily basis by reference to a weighted basket of currencies of Tonga's major partners in foreign trade and foreign receipts and payments transactions. The exchange rates set on a daily basis generally form the basis of the commercial banks' publicly quoted foreign exchange dealing rates.

The Reserve Bank monitored the movement of the rate of exchange of the pa'anga against other currencies with a view to ensure that the country's balance of payments position and price stability are maintained at levels that are consistent with the achievement of macroeconomic stability. According to an evaluation by the IMF staff visit in March 2017, the value of the pa'anga is in line with fundamentals, and there are no signs of deteriorating competitiveness. However, should pressure on the for-

Foreign reserves emerge, the Reserve Bank should stand ready to depreciate the Pa'anga against the basket of currencies in order to safeguard external stability.

Over the year ended June 2017, Tongan pa'anga fluctuated against the US dollar (USD), Australian dollar (AUD) & New Zealand dollar (NZD) in narrower bands, compared to last year reflecting decreased volatility in all three currencies during the year. The USD weakened against the AUD and NZD. Uncertainties in the US political arena contributed to the declining USD while interest rate hikes by the Federal Reserve did very little to buy the currency due to its negative effects on US security yields. The AUD and the NZD also gained on the weak USD due to relatively stronger economic prospects in the respective countries. As such, the TOP appreciated against the USD while it depreciated against the AUD and NZD over 2016/17.

Figure 14: Pa'anga Exchange Rates



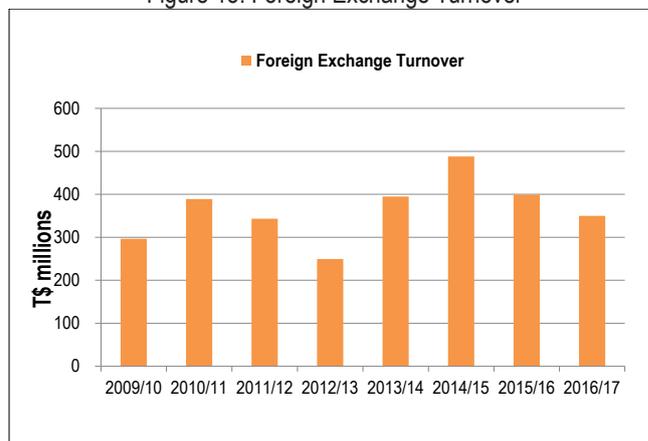
The Reserve Bank also continued to monitor the commercial banks' exchange rates spreads to ensure that they were in compliance with approved limits that were set by the Reserve Bank. Despite the introduction of the levy on foreign exchange transactions in June 2016, the spread limits were not revised. The Reserve Bank in collaboration with the Association of Banks in Tonga (ABT) also directed the banks not to pass on the levy burden to customers through an additional fee. These directives meant that the banks would absorb the levy burden within their own profit margin instead of passing it to the public. The Reserve Bank paid T\$0.482 million in levy to the Ministry of Finance during 2016/17.

## Foreign Reserves Management

### The Reserve Bank Portfolio

The gross official foreign reserves was maintained well above the minimum range of 3 to 4 months of import cover. The level of foreign reserves peaked at a record high of T\$412.1 million during June 2017 before settling at T\$407.9 million, equivalent to 7.4 months of import cover, by the end of the month compared to T\$354.9 million (7.2 months of import cover) as at 30 June 2016. The significant increase in the level of foreign reserves was attributed mainly to receipts of budget support for the Government. The Reserve Bank continues to monitor the banks' compliance with their respective nostro limits and that excess is sold to the Reserve bank as part of its foreign reserves management tools.

Figure 15: Foreign Exchange Turnover

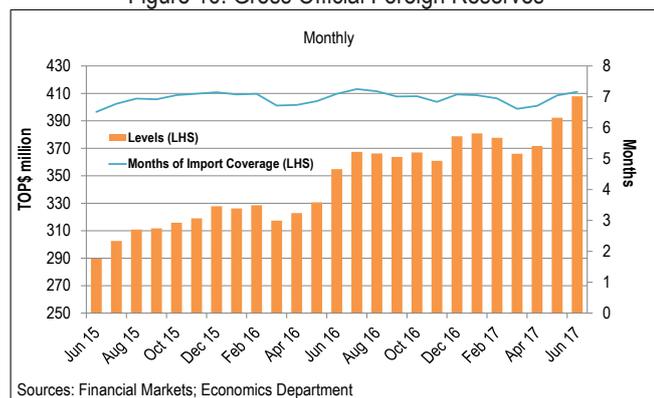


During the year, the Reserve Bank was a net purchaser in the spot foreign exchange markets. Foreign exchange purchases of T\$201.6 million exceeded sales of T\$148.3 million giving a total foreign exchange turnover for the year of T\$349.9 million. This is a decrease from T\$399.1 million last year due mainly to a fall in volume of foreign exchange transfers by the Reserve Bank. The Reserve Bank conducted foreign exchange operations for its customers, but especially the Government, and for its own account in a range of currencies.

The management of the foreign reserves during 2016/17 met the objectives of safety, liquidity and profitability. The currency composition of the foreign reserves was mainly in US dollar, Australian dollar and the New Zealand dollar.

The Reserve Bank's investment policy is to obtain the maximum income commensurate with safety, liquidity and the maintenance of the overall value which continued to be a challenge, given the uncertainty and volatility in the global financial markets and continued low interest rates in the trading partner countries. The currency composition therefore deviated from the benchmark portfolio but remained within the Board approved limit, in order to maximize income and maintain the value of the foreign reserves. The currency composition therefore exposed the Reserve Bank to exchange rate risk hence the Reserve Bank continued to closely monitor the implications of the movements of the exchange rates on the value of the foreign reserves. Despite lower interest rates in the global markets, the income on the investment of the foreign reserves increased by \$0.28 million in 2016/17 compared with the previous year, which was in line with the significant increase in the level of foreign reserves of \$53 million.

Figure 16: Gross Official Foreign Reserves



The Reserve Bank complied with all the Board approved risk parameters for the management of the foreign reserves during the year which included ensuring that investments were held with banks rated above the Board approved minimum "A" rating by international credit rating agencies and minimizing concentration of investments in one bank. In June 2017 the Board of Directors approved that the limit on total deposits or investments per bank be increased from T\$90 million to T\$130 million due to the increase in foreign reserves and to maximize income from banks with the best yields. The Reserve Bank secured technical assistance from the IMF to review and provide recommendation on how to improve the management of the foreign reserves, which is scheduled for August 2017.

## Exchange Control Operations

During 2016/17, the Reserve Bank completed the annual review of its Exchange Control policies and guidelines and eased the exchange control requirements to be in line with the very high level of foreign reserves and the outlook for the foreign reserves to remain at comfortable levels, the current monetary policy stance, as well as the need to improve the clarity of the requirements as per feedback received from banks, the authorized restricted foreign exchange dealers, and the general public. The revisions were as follows:

1. The delegated limit of T\$100,000 to the banks and authorized restricted foreign exchange dealers will now also apply to capital payments that previously had no delegated limit such as loan repayments, offshore investment, dividend payments to non-resident investors and migrant transfers (except for loans to residents controlled by nonresidents).
2. The monthly limit for gift payments of \$5,000 per month is removed. This means that anyone can send gift payments overseas for amounts up to \$50,000 per annum per remitter per beneficiary in any given time of the year.
3. The delegated limit of \$5,000 per transaction per remitter applicant without supporting documents previously removed is now reinstated.
4. The requirement to provide visas for payments for travel, education and medical expenses, and export of cash is removed.
5. The requirement to provide evidence of funds received from offshore for loan repayments and wages paid in foreign currency cash to foreign crew members is removed.
6. The requirement with regards to the overseas recipient of payments for education and medical expenses has been expanded to include third parties.

As such, the Reserve Bank processed 776 exchange control applications for current and capital payments of amounts above the delegated limit of \$100,000. The approved exchange control applications amounted to T\$223.5 million in 2016/17 (of which 14% were classified as capital transactions) compared to the 825 exchange control applications (8% capital transactions) processed in 2015/16 amounting to T\$198.4 million. The exchange control unit achieved its target for a half day turnaround time for processing and approval of applications, pro-

vided that all the submitted documents met the requirements. The exchange control data on foreign currency payments by large customers including the Government and large importers were key inputs to the Reserve Bank's foreign reserves forecast and monetary policy decisions.

The Reserve Bank also received 62 applications for the removal of cash (both Tongan pa'anga and foreign currency notes totaling T\$10,000 and above) across the border which were all approved and amounted to a total of T\$46.9 million. Last year, 67 applications were approved totaling T\$45.9 million. Despite the decrease in the number of applications the value of these transfers increased as banks and foreign exchange dealers preferred favorable exchange rates offered from overseas. The exchange control unit also notified the Ministry of Revenue and Customs of all approved applications for exports of cash, two (2) days before the date of travel, with some exceptions due to late submission of applications from banks, authorized restricted foreign exchange dealers, and individual applicants.

Quarterly spot checks were conducted during the year to ensure banks and authorized restricted foreign exchange dealers were compliant with the exchange control guidelines. Meanwhile, internal monitoring of compliance is also carried out through other reports such as the Overseas Exchange Transactions (OET), Foreign exchange transactions with value that is equivalent to T\$50,000 and above (FX above 50K), Forward exchange contracts (FEC) and the Foreign currency accounts (FCA). Press releases were posted on the website, and trainings with the banks and authorized restricted foreign exchange dealers were conducted to keep them informed of any revisions to the exchange

control guidelines and to also raise issues identified from the spot checks. The Reserve Bank still continued to issue the Gift list for those who have reached their annual delegated limit of T\$50,000 and a Caution list for those who had nearly exhausted their annual delegated limit for gift payments (T\$45,000 up to T\$50,000). In addition, a Travel list is also issued for those who have breached the delegated limit for Travel allowance of T\$20,000 per travel. In cases of breaches, customers will be referred to the Reserve Bank for approval and further monitoring to ensure they consistently comply with the exchange control requirements, and also ensure payments made are bona-fide transactions to help with anti-money laundering initiatives.

## Financial Market Corporate Plan Targets

At the end of the first half of 2016/17, a review of the 2016 corporate plan was conducted which showed the Financial Markets Department had achieved 30 out of the 39 targets, while only 9 were still outstanding. Due to recent global and domestic developments, some targets were revised and other targets were also added taking the total up to 42 targets for the financial markets department to implement in order to enhance the operations of the Reserve Bank. These include revisions to the Reserve Bank's budgeted income due to movements in global exchange rates and interest rates, revisions to the Reserve Bank's internal inflation reference rate to be in line with recent developments and the inclusion of recommendations by the IMF technical assistance mission on domestic market development in the corporate plan targets.

# Risk Management

The Reserve Bank commissioned an enterprise-wide risk assessment in 2013. External consultants carried out the project and the findings of the Report were implemented in silos by each Department. However, the Reserve Bank recognizes that risk management is an integral aspect of its daily operations and the implementation phase was not producing coordinated policy, comprehensive procedures and structured process outcomes.

## Risk Incident Reporting

In September 2016, a Risk Management Unit was established under the Governor's Office with a designated officer to identify and monitor the many risks the Reserve Bank faces – some general while others are unique to central banks. Extensive use of Management committees set up ensures that all risks are accounted for in the Bank.

The Reserve Bank adopted a standardized risk management framework that encompasses the governance role of the Unit, the strategic and operational functions of all departments and the supporting services and tools to manage and monitor known risks the Reserve Bank faces.

A preliminary status update exercise was carried out to review the progress since the commissioned enterprise-wide risk assessment. The result of this exercise, in addition to the 2016 Auditor's report, apportioned risk according to the Reserve Bank's risk appetite. Currency risk was identified as significantly high hence a risk based program was created to minimize the risk. The program included random security recording review of the vault activities; departmental reconciliation cross-check verification; spot check review of documentation maintenance; review of departmental procedures and processes and assisting with counting of the backlog of redeemed currency parcels.

The Unit also maintained a risk incident register to document events that occur and adversely affect the achievement of the Reserve Bank's strategic priorities, strategic goals, objectives, measurable targets and strategies.

Table 9: Risk Incidents Reported

Months	Policy	Operations	Total
Jul16	1	1	2
Aug16		1	1
Sep16		1	1
Oct16	1	5	6
Nov16	1	3	4
Dec16		3	3
Jan17	1	9	10
Feb17		8	8
Mar17	1	2	3
Apr17		9	9
May17		7	7
Jun17		6	6
TOTAL	5	55	60

A risk incident report is generated when a risk incident occurs and identify from the relevant department/unit. A catalog of the reported risk incidents is presented at the monthly meeting of the Risk Management Committee.

## Risk Management Corporate Plan Targets

In the approved three-year rolling corporate plan, the Risk Management Unit was allocated with eight specific measurable targets. A review of the calendar year corporate plan was carried out in March 2017 which revealed that the Unit achieved three targets while five targets were unrealized. By setting up the Unit, risk incidents were reported, compliance testing were carried out, monthly risk assessment were conducted, key control effectiveness were verified and complaints were lodged.

All these activities contributed to the Unit's unrealized measurable new targets.

## Delegation of Authority

Regular reviewing, updating and monitoring of the delegated authority list are assigned to the Risk Management Unit. The delegation list authorizes, with limited power or responsibility, an officer to act on behalf of the Reserve Bank. Currently, the Unit is updating the delegation of authority since its last review in 2012.

## Complaints Management

The Risk Management Unit is also tasked with facilitating the resolution of customer complaints in relation to the performance of the Reserve Bank's services and/or functions, as well as the services of the licenced banks and authorised foreign exchange dealers.

Customer complaints received are given due consideration in accordance with the legislative powers of the Reserve Bank. The Reserve Bank addresses the complaints in relation to its services or functions while complaints related to the services of the licenced banks and authorised foreign exchange dealers will be disseminated to the relevant licenced institutions.

Over the year, 3 complaints were lodged with the Reserve Bank of which all were about our services to the general public. As part of its efforts to resolve received complaints, the Reserve Bank continue with public awareness program through radio, television and on its website.

# Currency Management

The National Reserve Bank of Tonga is responsible for regulating the issue of currency in the Kingdom and maintaining an adequate supply of quality banknotes and coins in circulation to meet the public's currency needs.

The Reserve Bank also redeems any banknotes or coins that are mutilated or no longer fit for circulation and destroys them accordingly.

During the year, the Reserve Bank reviewed and proposed amendments to the NRBT Act Section 26 on the Power of Recall Currency to reflect the current practice used by other central banks on recalled currencies that are no longer legal tender. The proposed amendment is another income source from currency and provides that the Reserve Bank will no longer redeem nor accept any recalled coins for exchange after the expiration of the time limit specified in the recall notice.

## Currency in Circulation

As at 30 June 2017, total currency in circulation was T\$75.2 million. The value of banknotes in circulation as at 30 June 2017 rose by 12.3% to T\$71.8 million from the end of June 2016 (T\$63.9 million). There were 32.2 million coins, worth T\$3.3 million, in circulation at the end of June 2017. The value of coins in circulation increased by 13.3% from the end of June 2016 (T\$2.9 million).

## Note Processing Operation

As at 30 June 2017, T\$211.1 million returned banknotes were deposited for fitness sorting and authentication check. Of this, the Currency team managed to process T\$95.7 million: 1.6 million pieces (T\$74.4 million) were deemed fit for reissue while 1.2 million pieces (T\$21.2 million) were deemed unfit and subsequently destroyed. While on-going maintenance to the cobra machine was

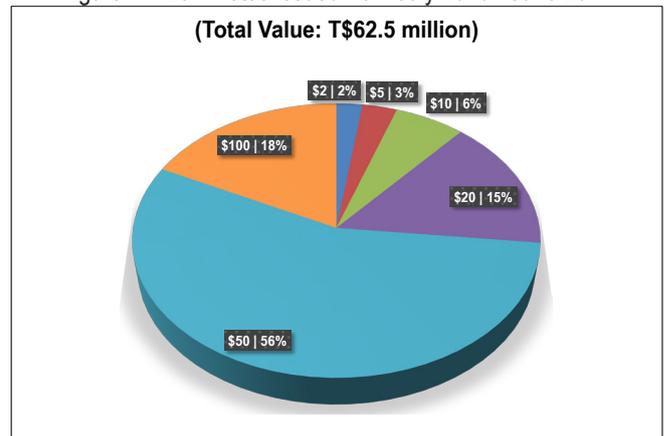
conducted, the team continued to manually process the currency until the upgrade works was complete. The cobra machine would expedite the process of authentication, counting, sorting and destruction process of re-deemed parcels from the commercial banks.

The old recalled (KTTIV Series) coins withdrawn from circulation during the year amounted to 2.0 million coin pieces. These coins consisted of 75/25 cupro nickel of a higher metal composition value and nickel plated steel which was separated and then melted down for recycling by the London Metals Limited, United Kingdom.

## Banking Transactions

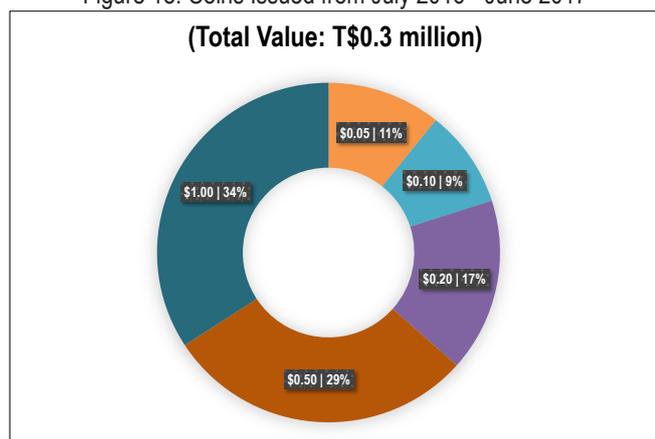
During the financial year 2016/17, the value of currency issued to the commercial banks and the general public was T\$62.9 million, of which T\$62.5 million was in banknotes and T\$0.3 million in coins.

Figure 17: Banknotes Issued from July 2016 - June 2017



The high percentage of T\$20, T\$50 and T\$100 banknote demonstrates the public's reliance on higher denominations for daily transactions and as a store of value.

Figure 18: Coins Issued from July 2016 - June 2017



## Numismatics

During the year, 3 new agreements were signed with the World Coin Association (WCA), Germany, for the minting and marketing of new coins:

- Coronation of HM King Tupou VI
- Olympic Games 2018 – Luge
- Kingdom of Tonga – Royal Palace

Numismatic income as at 30 June 2017 was T\$159,568.54.

## Counterfeit Notes

During the year, 23 counterfeit notes were received for assessment by the Reserve Bank.

Table 10: Counterfeit Notes Received

	July 2016 - June 2017	
\$20	40	2
\$50	1,050	21
Total	1,090	23

In relation to total currency in circulation, the total value of counterfeits was negligible at only 0.002%. However, to ensure that public confidence in our currency is maintained, the Reserve Bank continued to assist the Tonga Police with efforts to deter counterfeiting through media awareness programs on how to identify genuine banknotes both in the English and Tongan language.

## Currency Corporate Plan Targets

At the end of the first half of 2016/17, a review of the 2016 corporate plan was conducted which showed the Currency Division had achieved 2 out of the 4 targets, while 2 were still outstanding. While the team is currently working on renewal of the Cobra Machine and its ongoing support, the team is hopeful that the new machine will help speed up the counting/destruction process of redeemed parcels and also free up more time for the team to reach out and conduct the quarterly spot check of Note Trust Depot in the Outer Islands.

# Corporate Services

## Staffing

In 2016/17 financial year, the Reserve Bank continued to focus on promoting its strategic priority to position the Reserve Bank as the employer of choice. This is through implementing competitive attraction and retention strategies in a culture of high performance. The Reserve Bank's human resource policies, staff benefits, training and development, job description and the organizational structure were reviewed to facilitate the emerging changes in the organization.

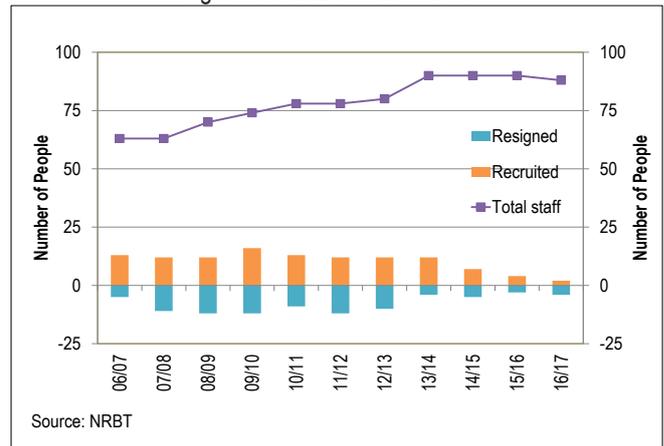
Investing on building the Reserve Bank's capacity, 2 professional staffs were recruited to the Economics and Security Units. Similar to the previous year and as part of the retention strategies and promoting a culture of high performance, the Bank continued to implement the Monthly awards for Employee of the Month, Health awards and Best Uniform awards to encourage continuous improvements on staff performance and conduct.

In the financial year 2016/17, the Reserve Bank achieved a 4.5% average rate of absenteeism, a 2.5% decline from last financial year 2015/16. This year the Reserve Bank focused on retaining its staff and promoting staff health in the workplace. To promote a healthy lifestyle and professional network with the community, the Bank encouraged staff participation in sports tournaments such as Inter-Organizational Netball Competition, Tonga Golf Club tournaments and various Health activities during the year. These initiatives also promoted staff morale, improve staff overall health and the staff work life balance.

To support the Bank long term succession plan and staff career developments, some staff were rotated to other departments to enhance their work experience and overall understanding of the Bank's function. With the support of the Human Resource team, the Executive Management continued to provide staff counseling and

mentoring during the year.

Figure 19: NRBT Staff Statistics



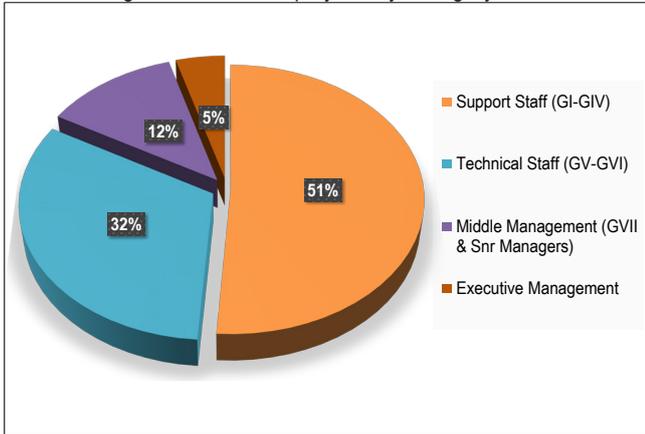
Through the commitment and support facilitated by 88 staff, the Reserve Bank was able to deliver on its core responsibilities effectively during the year. The staff turnover was 5% in 2016/17. A total of 5 staff where 3 migrated overseas, 1 terminated and 1 retired. This indicates that the Bank managed to maintain and retained its staff to remain within the annual Corporate Plan target of 5% benchmark. In June 2017, the Reserve Bank



Guard Commander retired from the Bank after 16 years of service

Guard Commander (Mr. Semisi Fonua Fifita) retired at the age of 70 from his service at the Bank after 16 years of service. With only 87 staff onboard, the Reserve Bank managed to meet the functions and objectives efficiently and effectively as outlined in the NRBT Act.

Figure 20: Total Employees by Category 2017



## Staff Development

The Reserve Bank continued to engage staff through training programs offered in-house, locally, online correspondence courses and internationally to strengthen the core competencies needed to deliver the Reserve Bank's functions. The Study Leave Policy were reviewed to facilitate and encourage staff development through further studies overseas. In 2016/17, the Reserve Bank completed 93% of the training programs scheduled on the Training Needs Analysis and had emerged during the year, an increase of 13% above the Corporate Plan target of 80%. This increase reflected the Bank's com-



NRBT Netball team at Inter-Organisational Netball Competition

mitment towards staff developments and trainings.

In 2016/17 financial year, the Reserve Bank continued to support its staff training through part time studies, short courses and take advantage of the Bank's financial support not only to further strengthen the competencies required for their job but also to build their career path at the Bank. During the year, 3 staff were on study leave with pay pursuing further studies overseas, 2 staff pursued postgraduate studies and 1 undergraduate. The 1 undergraduate staff successfully completed his Bachelor of Commerce in Economics and Accounting studies from the University of Auckland New Zealand and resumed work in June 2017. The Reserve Bank is grateful to the New Zealand Aid Scholarship Programme, Australian Awards Scholarship and Chevening United Kingdom Government Scholarship Programme for sponsoring and funding the Bank's employee's further studies.

The Reserve Bank acknowledges the technical support and advisory services provided through the IMF, Pacific Financial Technical Assistance Centre (PFTAC) and Alliance for Financial Inclusions (AFI) throughout the year 2016/17.

Table 11: Instance of Training by Financial Year

	Number of training events			Number of participants		
	14/15	15/16	16/17	14/15	15/16	16/17
In-house	5	3	3	23	90	35
Online	3	2	7	7	10	13
Local	5	7	4	14	29	15
Overseas	14	28	32	11	38	46

## Human Resource Corporate Plan Targets

In 2016/17 financial year, the Human Resource Unit reviewed its level of implementation and achievement of the Unit Corporate Plan targets and achieved a 76% (13 targets) out of the 18 targets. The remaining 24% (4 targets) were rolled over to the 2017/18 financial year. In addition, Human Resource team also added 2 new targets which focuses on Business Process Review and encouraging Staff developments through further studies.



Staff at the NRBT Golf day competition

## Information Technology

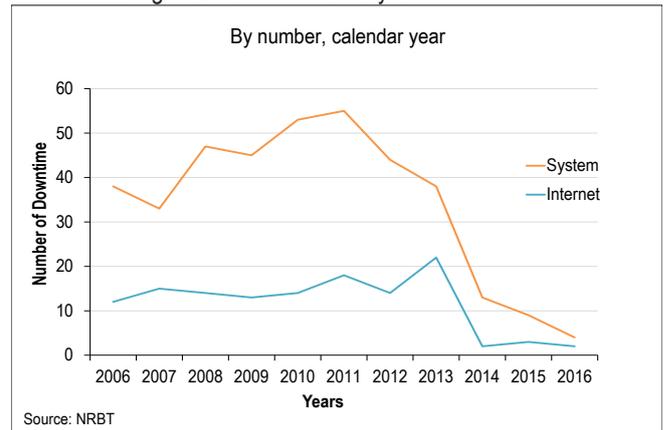
Providing highly accessible, uninterrupted and secured IT services to meet the Bank and the external stakeholders information and communication needs is always the main focus of the Information Technology Department this financial year, similar to previous years. The IT department provided maintenance of the IT infrastructure and provided solutions for all information technology and communications systems. System downtime instances continued to improve significantly over the past year. During the year, IT Department enforced the Bi-Annual Internal Audit of the Systems and network to ensure compliance and controls are in place and in accordance with the IT process and procedures. On the initial internal audit, the focus was on all access rights and controls, as well as checking against the approved access. The following internal audit focused on the compliance of the corporate servers with the Best Practice and IT standards.

To promote team discussions and a conducive work environment by enabling staff to be mobile and flexible to work from anywhere in the bank, the Bank replaced various desktop computers with laptops and smart devices. The Wireless network was also upgraded to a centralized wireless network environment for ease of management and enhance security controls. The Department also upgraded its ability to monitor the internet usage by implementing Web monitoring application and filtering.

In trying to meet the targets of disseminating Bank's

information on a timely manner while accessible and available to the stakeholder, the IT team upgraded the website and keeping up to date with security patches. Over the year, the IT team continued to upskills through on the job training, self-learning on online resources and Departmental team meetings. The team reviewed its processes and procedures and also assist other Departments and Units with their business process drawings (process mapping).

Figure 21: Instances of System Downtime



## Cyber Security

During the year, cybersecurity was one of IT main concern due to various forms of cyber-attacks on financial institutions globally. To mitigate the risks of cyber-attack, the IT Department continued to implement various security controls in the corporate network infrastructure to ensure systems, hardware and Corporate Network is safe and secured at all times. This includes vulnerability assessment and checks, deployment of hardware, software and security patches with the latest definition and in accordance with the IT standards and international best practices.

IT team continued to manage and monitor the SWIFT payment system to avoid disruption to Bank's inter-bank and payment process. This includes regular updates and security check of the SWIFT network. To ensure Bank's operation is not disrupted during unexpected and emergency situation, IT team reviewed the Bank's Business Continuity Plan and Disaster Recovery Plan along with emergency procedures.

The Bank also participated in the Tonga National initia-

tives for combatting cybercrime by being a member of the Tonga National Cyber Emergency Response Team (Tonga CERT). This membership build the team network locally and internationally as well as staying abreast with latest security threats, advices and cyber security news.

## IT Corporate Plan Targets

In 2016/17 financial year, the IT Department reviewed its level of implementation and achievement of the Department Corporate Plan targets and achieved a 75% (15 targets) out of the 20 targets. The remaining 25% (5 targets) were rolled over to the 2017/18 financial year. In addition, IT team also introduced 3 new targets which focuses on improving security in the SWIFT system, Corporate Email, management of Website and ongoing review and streamline of Business Process.

## Property, Security and General Administration

The Property Division in collaboration with Security and General Administration provide a safe and secure working environment for the Bank's staff, tenants and visitors for the year 2016/17. In achieving their corporate plan targets, the Property team proactively managed the Bank's Fixed Assets. The Property Division is responsible for regular services and maintenance of the Bank's critical plant and equipment while overseeing refurbishment projects to uphold the standard of the Bank's building and its facilities. The Security Division maintained secure working environment to staff and tenants. The General Administration is responsible for administrative

support, records management, transportation, corporate communications, and procurement. The Administration department arranges catering and logistical support for the Banks special functions. The corporate services projects completed during the year include:

1. Replacement of the Level 2 staff room balcony handrails with stainless steel.
2. Upgrading of the plumbing system.
3. Review of the Tenants' rental rate and Tenancy agreement.
4. Re-programming of the PABX system along with separate UPS's for unexpected power shut down.
5. Records management system upgrades by scanning of old files into electronic and disposing of archive file.

## Property, Security and General Administration Corporate Plan Targets

In 2016/17 financial year, the Property, Security and General Administration Department reviewed its level of implementation and achievement of the Department Corporate Plan targets and achieved above 60% of the targets and the remaining 40% were re-prioritized and rolled over to the 2017/18 financial year. In addition, the team also added new targets which focuses on safe guarding the NRBT Building premises and property, enhance the Records Management and upgrading of Bank's facilities and key plant and equipment.

# Financial Performance



*National Reserve Bank of Tonga Profit Transfer to Ministry of Finance and National Planning, Minister Dr. 'Aisake Valu Eke*

The gross income from operations for the year ended 30 June 2017 amounted to \$10.41 million, compared to \$12.144 million of the previous year. The 14% decline in gross income for 2016/2017 was significantly driven by the one-off sales of the bank's leased property to BSP last year, the 79% decrease in sales of numismatic currency, and the decline of income from foreign exchange dealings due to lower volume of transaction during the year.

Income from overseas investments however, continued to increase from last year, although at a slower pace. This is mainly due to the declining yields in NZD and AUD investments build up during the year which offset the anticipated hike in USD rates.

Total Expenses amounted to \$7.548 million compared to \$8.009 million in the previous year. The 6% decrease is mainly attributed to the lower cost of currency issued during the year. On the other hand, the administration

cost, staff cost and interest expense from foreign and domestic currency accounts increased during the year but was insignificant to offset the 42% drop in cost of currency issue.

The net profit for the year ending 30 June 2017 was \$2.853 million, compared to \$4.135 million of the previous year. The financial result for 2016/2017 surpassed the corporate plan's annual target of \$1 million net profit per year, reflecting the investment and income strategies implemented during the year coupled with the well managed bank expenses. The National Reserve Bank of Tonga in compliance with section 8(1) of the NRBT (Amendment) Act 2014, which indicates that 30 percent of the profit shall be transferred to the Bank's General Reserves and 70 percent of the profit for the year is payable to the Government. In this regard, T\$1.997 million will be transferred to the Ministry of Finance and National Planning account.

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National Reserve Bank of Tonga

# Financial Statements

YEAR ENDED 30 JUNE 2017

## INDEX

### *Page*

51 - 53	Directors' Report
54	Statement by Directors
55 - 57	Independent Auditor's Report
58	Balance Sheet
59	Statement of Comprehensive Income
60	Statement of Distribution
61	Statement of Changes in Equity
62	Statement of Cash Flows
63 - 82	Notes to and Forming of the Financial Statements

## DIRECTORS' REPORT

In accordance with a resolution of the Board of Directors, the directors herewith submit the Balance Sheet of the National Reserve Bank of Tonga (the "Bank") as at 30 June 2017, and the related Statements of Comprehensive Income, Distribution, Changes in Equity and Cash Flows for the year ended on that date and report as follows:

### 1. DIRECTORS

The following were directors of the Bank at any time during the financial year and up to the date of this report:

Mr Steve Edwards - Chairman  
 Mr Richard Prema  
 Dr Sione Ngongo Kioa - Governor  
 Mrs Sinaitakala Tu'itahi  
 Mrs Balwyn Fa'otusia (appointed on 3 January 2017)  
 Mr Tatafu Moeaki (resigned on 17 July 2016)  
 Mr. 'Uhila Liava'a (up to 15 September 2016)  
 Mr. 'Aholotu Palu (from 18 July 16 to 31 December 16)

### 2. PRINCIPAL ACTIVITIES

The National Reserve Bank of Tonga's (the Bank) principal objectives as a central bank, as defined in Section 4 of the National Reserve Bank of Tonga (NRBT) (Amendment) Act 2014, shall be, to:

- 1) maintain internal and external monetary stability;
- 2) without prejudice to its principal objective, the Bank shall-
  - a) promote financial stability; and
  - b) promote a sound and efficient financial system.
- 3) subject to subsections (1) and (2), the Bank shall conduct its activities in a manner that supports macroeconomic stability and economic growth.

The principal functions of the Bank shall be, to:

- a) issue currency;
- b) formulate and implement monetary policy;
- c) prescribe the regime for the determination of the external value of the Tongan currency in consultation with the Minister;
- d) determine the foreign exchange rate and implement foreign exchange policy;
- e) determine and implement financial stability policy, and oversee the maintenance of the stability of the financial system as a whole;
- f) regulate as required the supply, availability and international exchange of money;
- g) exclusively hold and manage the external reserves of the Kingdom;
- h) provide advisory services to the Minister on banking and monetary matters;
- i) be the principal banker, fiscal agent and depository of the Government;
- j) undertake banking business, in Tonga or elsewhere, subject to the provisions of this Act;
- k) regulate and supervise financial institutions, including non-bank financial institutions;
- l) oversee and promote the efficient, sound and safe functioning of the payment system;

- m) collect and produce statistics;
- n) cooperate with and participate in international councils and organisations, including public international financial institutions, and cooperate with domestic and foreign public entities, concerning matters related to its objectives and functions;
- o) regulate and supervise capital markets in Tonga;
- p) to manage and promote financial inclusion initiatives and related activities; and
- q) carry out any other function or any ancillary activities incidental to the exercise of its functions under this Act or any other Act.

### **3. TRADING RESULTS**

The net profit of the Bank for the year ended 30 June 2017 was \$2,852,592 (2016: \$4,135,199)

### **4. GENERAL RESERVES**

In accordance with Section 8(1)(b) of the National Reserve Bank of Tonga (Amendment) Act, 2014, the amount of \$855,778 (2016: \$1,240,560) being 30% of the current year profit, is transferred to the General Reserve at year end.

### **5. PAYABLE TO GOVERNMENT**

In accordance with Section 8(1) of the National Reserve Bank of Tonga (Amendment) Act, 2014, the amount of 91,996,814 (2016: \$2,894,639) is payable to the Government of the Kingdom of Tonga.

### **6. BAD AND DOUBTFUL DEBTS**

The directors took reasonable steps before the Bank's financial statements were made out to ascertain that all known bad debts were written off and adequate provision was made for doubtful debts.

At the date of this report, the directors are not aware of any circumstances which would render the amount written off for bad debts, or the amount of the provision for doubtful debts, inadequate to any substantial extent.

### **7. PROVISIONS**

There were no material movements in provisions during the year apart from the normal amounts set aside for such items as employee entitlements.

### **8. ASSETS**

The directors took reasonable steps before the Bank's financial statements were made out to ascertain that the assets of the Bank were shown in the accounting records at a value equal to or below the value that would be expected to be realised in the ordinary course of business.

At the date of this report, the directors are not aware of any circumstances which would render the values attributable to the assets in the financial statements misleading.

## 9. DIRECTOR'S BENEFIT

No director of the Bank has, since the end of the previous financial year, received or become entitled to receive a benefit by reason of contract made by the Bank with the director or with a firm of which the director is a member, or with a company in which the director has substantial financial interest other than what is disclosed in the financial statements.

## 10. BASIS OF ACCOUNTING

The directors believe the basis of preparation of the financial statements is appropriate and the Bank will be able to continue in operation for at least 12 months from the date of this report. Accordingly the directors believe the classification and carrying amounts of assets and liabilities as stated in these financial statements to be appropriate.

## 11. OTHER CIRCUMSTANCES

At the date of this report, the directors are not aware of any circumstances not otherwise dealt with in this report or financial statements which render any amounts stated in the financial statements misleading.

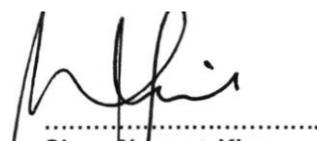
## 13. UNUSUAL TRANSACTIONS

The results of the Bank's operations during the financial year have not in the opinion of the directors been substantially affected by any item, transaction or event of a material and unusual nature other than those disclosed in the financial statements.

For and on behalf of the Board of Directors in accordance with a resolution of the Directors this 30th day of October, 2017 .



.....  
Mr Steve Edwards  
Chairperson



.....  
Sione Ngongo Kioa  
Governor

## STATEMENT BY DIRECTORS

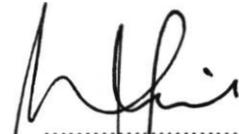
In the opinion of the Directors:

- (a) the accompanying balance sheet is drawn up so as to give a true and fair view of the state of affairs of the Bank as at 30 June 2017;
- (b) 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 30 June 2017;
- (c) the accompanying statement of distribution is drawn up so as to give a true and fair view of the distribution of operating profit of the Bank for the year ended 30 June 2017;
- (d) the accompanying statement of changes in equity is drawn up so as to give a true and fair view of the movement in equity for the year ended 30 June 2017; and
- (e) the accompanying statement of cash flows is drawn up so as to give a true and fair view of the cash flows of the Bank for the year ended 30 June 2017.

For and on behalf of the Board of Directors by authority of a resolution of the Directors this 30th day of October , 2017.



.....  
**Mr Steve Edwards**  
Chairperson



.....  
**Sione Ngongo Kioa**  
Governor



## Independent Auditor's Report

To the Board of Directors of National Reserve Bank of Tonga

### Report on the audit of the financial statements

#### *Opinion*

We have audited the accompanying financial statements of the National Reserve Bank of Tonga (the 'Bank'), which comprise the balance sheet of the Bank as at 30 June 2017, and the statement of comprehensive income, statement of distribution, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements are prepared, in all material respects, in accordance with the accounting policies described in Note 2 of the financial statements and in the manner required by the National Reserve Bank of Tonga Act, 1988, the National Reserve Bank of Tonga (Amendment) Act, 2007, and the National Reserve Bank of Tonga (Amendment) Act, 2014.

#### *Basis for Opinion*

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report.

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

#### *Emphasis of Matter*

We draw attention to Note 2(a) and (b) to the financial statements which refers to the reporting framework and the policy on the treatment of exchange gains and losses and its variance with IAS 21 "Effect of changes in Foreign Exchange Rates". Our opinion is not modified in respect of this matter.

#### *Independence*

We are independent of the Bank in accordance with the ethical requirements of the International Ethics Standards Board for Accountant's Code of Ethics for Professional Accountants (IESBA Code) that are relevant to our audit of the financial statements in Tonga, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

#### *Other Information*

Directors and Management are responsible for the other information. The other information comprises the information included in the Bank's Annual Report for the year ended 30 June 2017 (but does not include the financial statements and our auditor's report thereon).

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

*PricewaterhouseCoopers, Level 8 Civic Tower, 272 Victoria Parade, Suva, Fiji.*

*GPO Box 200, Suva, Fiji.*

*T: (679)3313955 / 3315199, F: (679) 3300981 / 3300947*

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In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

#### *Responsibilities of Directors and Management for the Financial Statements*

Directors and management are responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards and with the requirements of the National Reserve Bank of Tonga Act, 1988, the National Reserve Bank of Tonga (Amendment) Act, 2007, and the National Reserve Bank of Tonga (Amendment) Act, 2014 and for such internal control as the directors and management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors and management are responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors and management either intend to liquidate the Bank or to cease operations, or have no realistic alternative but to do so.

The directors and management are responsible for overseeing the Bank's financial reporting process.

#### *Auditor's Responsibilities for the Audit of the Financial Statements*

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with the ISAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors and management.



- Conclude on the appropriateness of the directors and managements use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represents the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the directors and management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

#### **Restriction on Use**

This report is made solely to the Board of Directors of the Bank, as a body. Our audit work has been undertaken so that we might state to the Board of Directors those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank and the Board of Directors as a body, for our audit work, for this report, or for the opinions we have formed.

*PricewaterhouseCoopers*

**PricewaterhouseCoopers  
Chartered Accountants**

*Kaushick Chandra*

**Kaushick Chandra**

**30 October 2017  
Suva, Fiji**

**BALANCE SHEET AS AT 30 JUNE 2017**

	Notes	2017	2016
		\$	\$
<b>ASSETS</b>			
<b>Foreign Currency Assets</b>			
Short Term Investments and Current Accounts	8	381,043,257	327,817,394
Accrued Interest		12,642,504	11,338,185
International Monetary Fund (IMF)	9		
- Reserve Tranche Position		10,464,778	10,558,012
- Special Drawing Rights		16,351,486	16,487,060
<b>Local Currency Assets</b>			
Cash on Hand	18	36,520	55,924
Accrued Interest		20,069	39,917
Other Assets	10	11,307,829	12,472,735
International Monetary Fund - Currency Subscription	9	32,089,040	32,447,402
Property, Plant and Equipment	11	9,067,277	9,267,684
<b>Total Assets</b>		<b>473,022,760</b>	<b>420,484,313</b>
<b>LIABILITIES</b>			
<b>Foreign Currency Liabilities</b>			
Accrued Interest		2,164	364
Demand Deposits	12(a)	47,411,769	33,927,546
IMF Special Drawing Rights Allocation	9	20,038,963	20,217,499
<b>Local Currency Liabilities</b>			
Payable to Government	13	1,996,814	2,894,639
Demand Deposits	12(b)	223,780,936	197,641,101
Accrued Interest		41,468	19,867
Other Liabilities	16	1,274,723	1,037,121
Currency in Circulation	14	75,218,625	67,344,536
Statutory Reserve Deposits	15	24,670,000	21,526,000
International Monetary Fund - Currency Subscription	9	32,089,040	32,447,402
Employee Provisions	17	132,711	101,147
<b>Total Liabilities</b>		<b>426,657,213</b>	<b>377,157,222</b>
<b>NET ASSETS</b>		<b>46,365,547</b>	<b>43,327,091</b>
<b>CAPITAL AND RESERVES</b>			
Authorised Capital		5,000,000	5,000,000
Paid up Capital		5,000,000	5,000,000
General Reserves	2(n)	12,474,557	11,618,779
Revaluation Reserve Account		28,890,990	26,708,312
<b>TOTAL CAPITAL AND RESERVES</b>		<b>46,365,547</b>	<b>\$43,327,091</b>

The above balance sheet should be read in conjunction with the accompanying notes.

**STATEMENT OF COMPREHENSIVE INCOME YEAR ENDED 30 JUNE 2017**

	Notes	2017	2016
<b>Income</b>		<b>\$</b>	<b>\$</b>
Interest Income	4	8,343,926	7,872,406
Other Income	5	2,056,338	4,271,844
<b>Total Operating Income</b>		<b>10,400,264</b>	<b>12,144,250</b>
<b>Expenses</b>			
Interest expense	6	123,428	49,024
Administration and other expenses	7	7,424,244	7,960,027
<b>Total Operating Expenses</b>		<b>7,547,672</b>	<b>8,009,051</b>
<b>Net profit for the period</b>		<b>2,852,529</b>	<b>4,135,199</b>
<b>Other comprehensive income</b>			
Net gains/(losses) arising from the translation of foreign currency balances to local currency	2(b)	2,182,678	15,434,839
<b>Total other comprehensive income for the period</b>		<b>2,182,678</b>	<b>15,434,839</b>
<b>Total comprehensive income for the period</b>		<b>\$5,035,270</b>	<b>\$19,570,038</b>

The above statement of comprehensive income should be read in conjunction with the accompanying notes.

**STATEMENT OF DISTRIBUTION YEAR ENDED 30 JUNE 2017**

	Notes	2017	2016
		\$	\$
<b>Net profit available for distribution</b>		\$ 2,852,592	\$ 4,135,199
<b>Distribution as follows:</b>			
Transfer to General Reserves as required under Section 8(1)(b) of the National Reserve Bank of Tonga (Amendment) Act, 2014	2(n)	855,778	1,240,560
Balance Payable to Government of Tonga as required under Section 8(1) of the National Reserve Bank of Tonga (Amendment) Act, 2014	13	1,996,814	2,894,639
		<b>\$ 2,852,592</b>	<b>\$4,135,199</b>

The above statement of distribution should be read in conjunction with the accompanying notes

**STATEMENT OF CHANGES IN EQUITY YEAR ENDED 30 JUNE 2017**

	Paid up Capital	General Reserves	Revaluation Reserve Account	Total
	\$	\$	\$	\$
<b>Balance 30 June 2015</b>	<b>5,000,000</b>	<b>\$10,378,,219</b>	<b>\$11,273,473</b>	<b>\$26,651,692</b>
<i>Other comprehensive income</i>				
Net gains arising from the translation of foreign currency balances to Tongan currency	-	-	15,434,839	15,434,839
Transfer to General Reserves (as provided for under Section 8(1)(b) of the National Reserve Bank of Tonga (Amendment) Act 2014, and approved by the Minister of Finance	-	1,240,560	-	1,240,560
<b>Balance 30 June 2016</b>	<b>\$5,000,000</b>	<b>\$11,618,779</b>	<b>\$26,708,312</b>	<b>\$43,327,091</b>
Net gains arising from the translation of foreign currency balances to Tongan currency	-	-	2,182,678	2,182,678
Transfer to General Reserves (as provided for under Section 8(1)(b) of the National Reserve Bank of Tonga (Amendment) Act 2014, and approved by the Minister of Finance	-	855,778	-	855,778
<b>Balance 30 June 2017</b>	<b>\$5,000,000</b>	<b>\$12,474,557</b>	<b>\$28,890,,990</b>	<b>\$46,365,547</b>

The above statement of changes in equity should be read in conjunction with the accompanying notes.

**STATEMENT OF CASH FLOWS YEAR ENDED 30 JUNE 2017**

	Notes	2017	2016
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		\$	\$
Interest received		7,059,455	5,321,256
Rental income		777,140	784,068
Numismatic sales		73,758	352,180
Other income		1,205,440	3,135,595
Purchase of currency		24,183	(3,178,087)
Interest paid		(100,027)	(37,632)
Payments to suppliers and employees		(5,343,089)	(5,396,305)
Net cash (outflow)/ inflow from operating activities		3,696,860	981,075
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchase of fixed assets		(387,549)	(498,935)
Net movement in IMF accounts		228,808	(1,071,330)
Net movement in staff loans		(72,687)	(393,111)
Net cash used in investing activities		(231,428)	(1,963,376)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Increase in currency in circulation		7,874,089	11,383,077
Increase in demand deposits		39,624,058	34,857,598
Increase in statutory deposits		3,144,000	3,414,000
Net movement in Government of Tonga account		(2,894,639)	(882,511)
Net movement in funds held for clearance		(10,622)	(260,672)
Net movement in IMF SDR Allocation		(178,537)	799,398
Net cash inflow from financing activities		47,558,349	49,310,890
<b>Net increase in cash and cash equivalents</b>		<b>51,023,781</b>	<b>48,328,589</b>
<b>Cash and cash equivalents at the beginning of the financial year</b>		<b>\$327,873,318</b>	<b>\$264,109,890</b>
<b>Net effect of change in exchange rates</b>	<b>2 (b)</b>	<b>2,182,678</b>	<b>15,434,839</b>
<b>Cash and cash equivalents at the end of the financial year</b>	<b>18</b>	<b>\$381,079,777</b>	<b>\$327,873,318</b>

The above statement of cash flows is to be read in conjunction with the accompanying notes.

## 1. GENERAL INFORMATION

The National Reserve Bank of Tonga's ("Bank") principal objectives as a central bank, as defined in Section 4 of the NRBT (Amendment) Act 2014, shall be, to:

- 1) The principal objectives of the Bank shall be to maintain internal and external monetary stability
- 2) Without prejudice to its principal objective, the Bank shall-
  - a) promote financial stability; and
  - b) promote a sound and efficient financial system.
- 3) Subject to subsections (1) and (2), the Bank shall conduct its activities in a manner that supports macroeconomic stability and economic growth.

The principal functions of the Bank shall be, to:

- a) issue currency;
- b) formulate and implement monetary policy;
- c) prescribe the regime for the determination of the external value of the Tongan currency in consultation with the Minister;
- d) determine the foreign exchange rate and implement foreign exchange policy;
- e) determine and implement financial stability policy, and oversee the maintenance of the stability of the financial system as a whole;
- f) regulate as required the supply, availability and international exchange of money;
- g) exclusively hold and manage the external reserves of the Kingdom;
- h) provide advisory services to the Minister on banking and monetary matters;
- i) be the principal banker, fiscal agent and depository of the Government;
- j) undertake banking business, in Tonga or elsewhere, subject to the provisions of this Act;
- k) regulate and supervise financial institutions, including non-bank financial institutions;
- l) oversee and promote the efficient, sound and safe functioning of the payment system;
- m) collect and produce statistics;
- n) cooperate with and participate in international councils and organisations, including public international financial institutions, and cooperate with domestic and foreign public entities, concerning matters related to its objectives and functions;
- o) regulate and supervise capital markets in Tonga;
- p) to manage and promote financial inclusion initiatives and related activities; and
- q) carry out any other function or any ancillary activities incidental to the exercise of its functions under this Act or any other Act.

These financial statements have been approved for issue by the Board of Directors on 30th October 2017.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS

### **a) Basis of accounting**

The financial statements of the Bank have been prepared in accordance with the National Reserve Bank of Tonga Act, 1988, the National Reserve Bank of Tonga (Amendment) Act, 2007, and the National Reserve Bank of Tonga (Amendment) Act, 2014. The Bank's accounting policies are based on International Financial Reporting Standards ("IFRS") except where the Act requires a different treatment, as noted in Note 2 (b), in which the Act takes precedence.

The financial statements are prepared on the basis of the historical cost convention, which has no regard to changes in the levels of prices. Unless otherwise stated, the accounting policies adopted are consistent with those of the previous year.

*New standards, amendments and interpretations issued but not yet effective and not early adopted*

A number of new standards and amendments to standards and interpretations are effective for accounting periods beginning on or after 1 July 2017. None of these is expected to be relevant to the Bank, except the following set out below:

Standard / Interpretation	Content	Applicable for financial years beginning on/ after
IFRS 9, 'Financial instruments'	IFRS 9, 'Financial instruments', addresses the classification, measurement and recognition of financial assets and financial liabilities. It replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the IAS 39 requirements. The Bank is in the process of evaluating the potential effect of this standard.	Annual periods beginning on or after 1 January 2018
IFRS 16: Leases	<p>IFRS 16, 'Leases', replaces the current guidance in IAS 17. Under IFRS 16, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Under IAS 17, a lessee was required to make a distinction between a finance lease (on balance sheet) and an operating lease (off balance sheet). IFRS 16 now requires a lessee to recognise a lease liability reflecting future lease payments and a 'right-of-use asset' for virtually all lease contracts. Included is an optional exemption for certain short-term leases and leases of low-value assets; however, this exemption can only be applied by lessees.</p> <p>The standard is effective for accounting periods beginning on or after 1 January 2019. Early adoption is permitted but only in conjunction with IFRS 15, 'Revenue from Contracts with Customers. The Bank is in the process of evaluating the potential effect of this standard</p>	Effective date: periods beginning on or after 1 January 2019
IFRS 15: Revenue from contracts with customers	IFRS 15, 'Revenue from contracts with customers' deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognised when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18 'Revenue' and IAS 11 'Construction contracts' and related interpretations. The standard is effective for annual periods beginning on or after 1 January 2018 and earlier application is permitted. The Bank is in the process of evaluating the potential effect of this standard.	Effective date: periods beginning on or after 1 January 2018

## **b) Foreign currencies**

Foreign currencies have been translated to Tonga currency at rates of exchange ruling at year end. Exchange gains and losses arising during the year from changes in the valuation of foreign currencies are taken to the Revaluation Reserve Account in accordance with the provisions of Section 33 of the National Reserve Bank of Tonga Act, 1988, the NRBT (Amendment) Act, 2007, the Miscellaneous Amendments (Privy Council) Act 2010 and NRBT (Amendment) Act 2014, and are not included in the computation of annual profits and losses of the Bank as required under International Accounting Standard 21, "The effects of changes in foreign exchange rates" (IAS 21). The impact of this in the statement of comprehensive income would be an increase in net profit by \$2,182,678 (2016: \$15,434,839).

Net losses arising from such changes are set off against any credit balance in the Revaluation Reserve Account; if such balance is insufficient to cover such losses, Cabinet shall cause to be transferred to the ownership of the Bank non-negotiable market interest bearing securities issued by the Government to the extent of the deficiency.

Any credit balance in the Revaluation Reserve Account at the end of each year may be used by the Reserve Bank for the costs of implementing the monetary policy subject to the approval by the Board or be paid to the Government upon the request of the Minister in writing to the Reserve Bank subject to the market conditions and approval by the Board. According to the National Reserve Bank of Tonga (Amendment) Act 2017, the Revaluation Reserve Account is to be maintained at a minimum balance of \$10,000,000 and any balance remaining in the Revaluation Reserves Account shall be carried forward to the next financial year.

## **c) Critical accounting estimates and judgements**

The preparation of the financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are categorised in the period in which the estimates are revised and in any future periods affected.

In particular, information about significant areas of estimation, uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts categorised in the financial statements are included in the following notes:

Note 2 (d) – Provisions for impairment of financial assets

Note 2 (i) – Depreciation

Note 2 (j) – Provisions for employee entitlements

## **d) Financial Assets and Liabilities**

### **i. Financial Assets**

The Bank classifies its financial assets in the following categories: Held to maturity investments and loans and receivables.

- **Held to Maturity Investments**

Held to Maturity Investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank's management has the positive intention to hold to maturity.

Held-to-maturity investments are carried at amortised cost. Any premium or discount on purchase is capitalised and amortised over the term of the investment on a constant yield to maturity basis.

All purchases and sale of investment securities are recognised at settlement date, which is the date that the asset is transferred to the Bank.

- **Loans and Receivables (Staff Loans)**

Loans and Receivables (Staff Loans) are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Loans are carried in the balance sheet at historical cost net of impairment provisions.

### **Impairment of Financial Assets**

For financial assets that are not classified as fair value through profit or loss, the Bank assesses as at each balance date whether there is objective evidence of impairment. This would include observable data that comes to the attention of the Bank such as significant financial difficulty of the issuer or counterparty; the disappearance of an active market for financial asset because of financial difficulties or a market downgrade in credit rating of the counterparty.

For loans and receivables an appraisal is carried out at the end of the financial year by management. The amounts of potential losses that have been identified are either written off against provisions in the year in which they are recognised or recognised as an expense in the income statement.

### **ii. Financial Liabilities**

Financial liabilities are recognised at fair value plus transaction costs. They are recognised when an obligation arises and derecognised only when the obligation is discharged, cancelled or expired.

Financial liabilities are recorded at trade date, the date on which the Bank commits to borrow or repay the relevant funds.

- **Demand Deposits**

Demand Deposits represent funds placed with the Bank by financial institutions and other organisations brought to account on a cost basis. These deposits are at call. Interest is paid on demand deposits of commercial banks held with the Bank.

### **e) Currency and Numismatics Inventory**

Currency and numismatics on hand are recognised in the statement of financial position at cost. Cost includes the cost of bringing currency to the Bank's premises. Currency issuances are determined on a first-in-first-out basis. When currency is issued the value is reduced and amortisation expense is recognised in the income statement.

#### **f) Currency in Circulation**

The face value of notes and coins on issue is taken up as a liability in the accounts. Where notes and coins on issue are no longer considered to be in circulation, either through their age or their numismatic value, they are written back to income.

#### **g) 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 issued for circulation as they are not issued for monetary purposes. In terms of Section 53(2) of the National Reserve Bank of Tonga Act, 1988 and the Miscellaneous Amendments (Privy Council) Act 2010, Cabinet has specified by notice in the Gazette that the Bank shall not be required to include in its financial statements the face value of these coins in circulation.

#### **h) Income tax**

The Bank is exempted from all Government taxes in accordance with Section 55 of the National Reserve Bank of Tonga Act, 1988.

#### **i) Depreciation**

Fixed assets are depreciated on a straight line basis so as to write off the cost of each fixed asset over its estimated useful life. The principal annual rates in use are:

Leasehold and buildings	1.01% - 2%
Furniture and fittings, computer and office equipment	6.67% - 25%
Motor vehicles	25%

#### **j) Employee Entitlements**

The Bank has its own Staff Provident Fund and all staff contribute to this scheme. The bank and staff contributions are based on the years of service. Staff who were previously members of the National Provident Fund Scheme have returned their contribution to the Bank's Staff Provident Fund in February 2016.

Liabilities for other employee entitlements which are not expected to be paid or settled within twelve months of the reporting date are accrued in respect of all employees at the present value of future amounts expected to be paid.

#### **k) Cash and cash equivalents**

For the purposes of the cash flow statement, cash and cash equivalents includes tellers cash, current accounts and short term deposits.

### **l) Revenue Recognition**

Interest income is brought to account on an accrual basis.

### **m) Provisions**

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount has been reliably estimated.

### **n) General Reserve and Distribution of Profits**

- Section 8(1) of the National Reserve Bank of Tonga (Amendment) Act 2014 states that:

The net profits of the Bank for any financial year, after meeting all current expenditure for that year and after making provision for bad and doubtful debts, depreciation in assets and any other purposes deemed necessary by the Board shall be allocated as follows:

a) where the General Reserve does not exceed 50% of the authorised capital of the Bank, 100% of the net profit be transferred to the General Reserve;

b) where the General Reserve exceeds 50% of the authorised capital of the Bank, 30% to be transferred to the General Reserve and the authorised capital of the Bank equal 10% of the total monetary liabilities of the Bank.

Provided that upon agreement between the Minister and the Bank the General Reserve may be increased.

- Section 8(2) states that subject to Section 8(1), the remainder of the net profits for the financial year shall be applied to the redemption of any securities issued under Section 6 held by the Bank.
- Section 8(3) states that the Board shall, with the approval of the Minister, subject to Section 8(1) and 8(2), allocate to the General Reserve and pay to Government's general revenue the remaining net profit.

### **o) Revaluation Reserve**

Unrealised exchange gains and losses arising from revaluation of foreign currencies are transferred to the Revaluation Reserve (refer Note 2(b)) and are not included in the computation of annual profits and losses of the Bank.

### **p) Segment Reporting**

The Bank presents financial assets and financial liabilities, and their associated income and expense streams, by distinguishing between foreign and local currency activities. The Bank considers that these reporting approaches provide appropriate segmental reporting of the Bank's activities.

### **q) Leases**

Where the Bank is the lessee, the lease rentals payable on operating leases are recognised in the Income Statement over the term of the lease.

Where the Bank is the lessor, the assets leased out are retained in Property, Plant & Equipment.

### **r) Functional and Presentation Currency**

The Bank's financial statements are expressed in Tonga Pa'anga. Amounts in the financial statements are rounded to the nearest dollar unless otherwise stated.

## **3. FINANCIAL RISK MANAGEMENT**

The majority of the Bank's financial risks arise from the foreign reserves management unit of the Bank's Financial Markets Department. The main financial risks to which the Bank is exposed include credit risk, liquidity risk and market risks and policies for managing these risks are outlined below.

### **(a) Credit Risk**

Credit risk relates to the risk of loss arising from the failure of counterparty to a transaction to perform according to the terms and conditions of the financial contract.

Credit risk or safety is a key criterion in the determination of the composition of the Bank's foreign currency assets. To manage this credit risk, the Bank prescribes minimum credit ratings acceptable for investment and specifies the maximum permissible credit exposure to individual banks and countries. In addition, the number of commercial banks, with whom the Bank may deal with in foreign exchange must have minimum credit ratings of A.

The NRBT uses Standard & Poor's credit ratings of assessing the credit risk of foreign counterparties. The credit ratings of counterparties are on "watch" all the time and are updated as new market information is available.

The concentration of credit risk in the Bank's investment portfolio is as follows.

	2017	2016
	\$	\$
<b>Foreign currency assets</b>		
Short Term Commercial Paper and current accounts	381,043,257	327,817,394
<b>Total financial investments</b>	<b>\$381,043,257,</b>	<b>\$327,817,394</b>

The Bank's end of year concentration of credit exposure, based on Standard & Pools credit rating of the foreign counterparties based on the country in which the counterparty is resident. N/R indicates the entity has not been rated by Standard & Poor's and includes exposure to Supernational.

	Ratings	2017	2016
		\$	\$
Australia	AAA	868,334	591,267
	AA-	159,063,481	131,290,559
	A+	74,871,442	91,339,996
New Zealand	AA	844,346	98,586
	AA-	129,005,315	91,705,636
United States of America	AA+	10,046,431	12,077,700
Switzerland	AAA	6,048,046	570,776
United Kingdom	AA	216,970	120,139
Fiji	B+	78,892	22,735
<b>Total financial investments</b>		<b>\$381,043,257</b>	<b>\$ 327,817,394</b>

**(b) Liquidity Risk**

Liquidity risk relates to the difficulty in raising funds at short notice to meet commitments. Liquidity is a key criterion in the determination of composition of the Bank's foreign currency assets.

To minimize liquidity risk, the Bank maintains an adequate level of reserves and taking into consideration the transaction demand on foreign exchange, ensures that an appropriate amount is maintained in current accounts at all times. The balances of the investible reserves are placed on term investments of up to 12 months. The composition of foreign currency assets is monitored daily. The Bank manages liquidity on a contractual maturity basis, which is consistent with the expected maturities of financial instruments.

The table below analyses the Bank's liabilities into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date.

## Maturity Analysis as at 30 June 2017

	0-3 Months	3-12 months	1-5 years	Over 5 Years	No Specific maturity	Total
<b>Liabilities</b>						
<b>Foreign Currency Liabilities</b>						
Accrued Interest	2,164	-	-	-	-	2,164
Demand Deposits	47,411,769	-	-	-	-	47,411,769
IMF Special Drawing Rights Allocation	-	-	-	-	20,038,963	20,038,963
<b>Local Currency Liabilities</b>						
Payable to Government	1,996,814	-	-	-	-	1,996,814
Demand Deposits	223,780,936	-	-	-	-	223,780,936
Accrued Interest	41,468	-	-	-	-	41,468
Other Liabilities	-	-	-	-	1,274,723	1,274,723
Currency in Circulation	-	-	-	-	75,218,625	75,218,625
Statutory Reserve Deposits	-	-	-	-	24,670,000	24,670,000
International Monetary Fund						
- Currency Subscription	-	-	-	-	32,089,040	32,089,040
Employee Provisions	-	69,365	4,503	58,843	-	132,711
<b>Total Liabilities (contractual maturity dates)</b>	<b>273,233,151</b>	<b>69,365</b>	<b>4,503</b>	<b>58,843</b>	<b>153,291,351</b>	<b>426,657,213</b>

## Maturity Analysis as at 30 June 2016

	0-3 Months	3-12 months	1-5 years	Over 5 Years	No Specific maturity	Total
<b>Liabilities</b>						
<b>Foreign Currency Liabilities</b>						
Accrued Interest	364	-	-	-	-	364
Demand Deposits	33,927,546	-	-	-	-	33,927,546
IMF Special Drawing Rights Allocation	-	-	-	-	20,217,499	20,217,499
<b>Local Currency Liabilities</b>						
Payable to Government	2,894,639	-	-	-	-	2,894,639
Demand Deposits	197,641,101	-	-	-	-	197,641,101
Accrued Interest	19,867	-	-	-	-	19,867
Other Liabilities	-	-	-	-	1,037,121	1,037,121
Currency in Circulation	-	-	-	-	67,344,536	67,344,536
Statutory Reserve Deposits	-	-	-	-	21,526,000	21,526,000
International Monetary Fund						
- Currency Subscription	-	-	-	-	32,447,402	32,447,402
Employee Provisions	82,377	-	9,720	9,050	-	101,147
<b>Total Liabilities (contractual maturity dates)</b>	<b>234,565,894</b>	<b>-</b>	<b>9,720</b>	<b>9,050</b>	<b>142,572,558</b>	<b>377,157,222</b>

### (c) Market Risk

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. In respect of the Bank, market risk comprises interest rate risk and foreign currency risk.

#### (i) Interest rate risk

Interest rate risk refers to the risk of loss arising from changes in interest rates. The Bank limits interest rate risk by modified duration targets. The benchmark modified duration for the total portfolio is capped at 36 months. The duration of the portfolio is re-balanced regularly to maintain the target duration.

#### (ii) Foreign exchange risk

Exchange rate risk relates to the risk of loss arising from changes in the exchange rates against the Tonga Pa'anga. The Bank has adopted a currency risk management policy, which maintains the Tonga Pa'anga value of foreign reserves and minimises the fluctuations in the Revaluation Reserve Account.

The value of the Tonga Pa'anga is determined by a basket of currencies. To minimise the exchange rate risk, the weights of the currencies in the exchange rate basket is the benchmark for the composition of the Bank's foreign currency assets.

The following tables show the currency concentration of the Bank's assets and liabilities as at 30 June 2017 and 2016 in Tonga Pa'anga equivalents.

<b>At 30 June 2017</b>	<b>USD</b>	<b>AUD</b>	<b>GBP</b>	<b>NZD</b>	<b>Other</b>	<b>Total</b>
<b>ASSETS</b>						
Short Term Investments and Current Accounts	172,421,666	62,587,707	221,656	145,733,336	78,892	381,043,257
Accrued Interest International Monetary Fund	1,337,807	2,157,371	-	9,139,813	7,513	12,642,504
- Reserve Tranche Position	-	-	-	-	10,464,778	10,464,778
- Special Drawing Rights	-	-	-	-	16,351,486	16,351,486
<b>Total Assets</b>	<b>173,759,473</b>	<b>64,745,078</b>	<b>221,656</b>	<b>154,873,149</b>	<b>26,902,669</b>	<b>420,502,025</b>
<b>LIABILITIES</b>						
Demand Deposits	44,499,194	180,883	-	2,731,692	-	47,411,769
Accrued Interest	-	-	-	-	2,164	2,164
IMF Special Drawing Rights Allocation	-	-	-	-	20,038,963	20,038,963
<b>Total Liabilities</b>	<b>44,499,194,</b>	<b>180,883</b>	<b>-</b>	<b>2,731,692</b>	<b>20,041,127,</b>	<b>67,452,896</b>
<b>NET POSITION</b>	<b>129,260,279</b>	<b>64,564,195</b>	<b>221,656</b>	<b>152,141,457</b>	<b>6,861,542</b>	<b>353,049,129</b>

At 30 June 2016	USD	AUD	GBP	NZD	Other	Total
<b>ASSETS</b>						
Short Term Investments and Current Accounts	148,584,667	52,205,581	125,008	126,879,403	22,735	327,817,394
Accrued Interest International Monetary Fund	1,201,295	849,402	-	9,286,547	-	11,337,244
- Reserve Tranche Position	-	-	-	-	10,558,012	10,588,012
- Special Drawing Rights	-	-	-	-	16,487,060	16,487,060
<b>Total Assets</b>	<b>149,785,962</b>	<b>53,054,983</b>	<b>125,008</b>	<b>136,165,950</b>	<b>27,067,807</b>	<b>366,199,710</b>
<b>LIABILITIES</b>						
Demand Deposits	33,109,757	296,961	-	359,732	161,097	33,927,547
Accrued Interest	-	-	-	-	24,918	24,918
IMF Special Drawing Rights Allocation	-	-	-	-	20,217,499	20,217,499
<b>Total Liabilities</b>	<b>33,109,757</b>	<b>296,961</b>	<b>-</b>	<b>359,732</b>	<b>20,403,514</b>	<b>54,169,964</b>
<b>NET POSITION</b>	<b>116,676,205</b>	<b>52,758,022</b>	<b>125,008</b>	<b>135,806,218</b>	<b>6,664,293</b>	<b>312,029,746</b>

*iii. Sensitivity to Foreign Currency Risk and Interest Rate Risk*

The sensitivity of the Bank's financial assets and liabilities to assumed across the board changes in exchange rate and the interest rates with all other variables held constant is shown below

Impact of:	2017	2016
Change in equity due to a +/-5% appreciation / depreciation of the Tonga Pa'anga	17,652,456	15,601,487
Change in profit/loss due to a rise/drop of +/-1 percentage point in interest rate	3,530,491	3,120,297

	2017	2016
	\$	\$
<b>4. INTEREST INCOME</b>		
Overseas investments	8,256,547	7,794,343
Staff loans	87,379	78,063
	\$ 8,343,926	7,872,406
<b>5. OTHER INCOME</b>		
Numismatic coins	72,660	351,610
Rental income	777,140	784,068
Gain on sale of assets	65,250	1,836,520
Forex sales/ purchases	1,062,815	1,221,645
Bank user fees	77,375	77,430
Information services – publications	-	35
Miscellaneous	1,098	536
	\$ 2,056,338	\$ 4,271,844
<b>6. INTEREST EXPENSE</b>		
Foreign currency accounts	43,888	15,881
Domestic currency accounts	79,540	33,143
	\$ 123,428	\$ 49,024
<b>7. ADMINISTRATION AND OTHER EXPENSES</b>		
Administration	2,079,444	1,715,849
Retirement fund	360,296	336,714
Staff costs	2,999,717	2,914,331
Audit fees	26,127	26,133
Currency issue (refer note 10)	1,370,703	2,347,379
Depreciation	587,957	619,621
	\$ 7,424,244	\$ 7,960,027
<b>8. SHORT TERM INVESTMENTS AND CURRENT ACCOUNTS</b>		
Current accounts	12,630,507	13,481,203
Short term investments	368,412,750	314,336,191
	\$381,043,257	\$ 327,817,394

## 9. INTERNATIONAL MONETARY FUND

(i) The Bank was designated to serve with effect from 1 July 1989 as the fiscal agent of the Kingdom of Tonga for the purposes of the International Monetary Fund (IMF) by virtue of Section 51(1) of the National Reserve Bank of Tonga Act, 1988, and assumed the financial obligations of the membership of the Kingdom of Tonga as from that date by virtue of section 36(1)(c) of the National Reserve Bank of Tonga Act, 1988.

(ii) As at 30 June 2017, Tonga's membership subscription to the International Monetary Fund was SDR13,800,000 (2016: SDR13,800,000). Of this total amount, SDR3,436,633 (2016: SDR3,436,633) had been paid in foreign currencies, shown in the Balance Sheet as Reserve Tranche Position, and the remaining balance representing the Currency Subscription portion was satisfied by crediting the demand deposit accounts of the International Monetary Fund with the Bank.

(iii) Special Drawing Rights holdings is an interest bearing international reserve asset created by the INiIF and is allocated to members on the basis of their quotas in the Fund. As at 30 June 2017, the Special Drawing Rights holdings had a balance of SDR5,369,828 (2016: SDR5,366,538).

## 10. OTHER ASSETS

	2017	2016
	\$	\$
Staff loans and advances	1,644,892	1,572,205
Currency and numismatics	3,555,381	4,950,267
Other assets	6,107,556	5,950,263
	\$ 11,307,829	\$ 12,472,735

The amount charged to the statement of comprehensive income for currency expense is based on the total cost of notes and coins issued for circulation.

## 11. PROPERTY, PLANT & EQUIPMENT

	Leasehold & Buildings	Computer and Office Equipment	Furniture and Fittings	Motor Vehicles	TOTAL
<b>At 30 June 2015</b>					
Cost	13,157,984	3,121,636	340,494	502,232	17,122,346
Accumulated Depreciation	(5,108,736)	(2,127,617)	(203,173)	(294,450)	(7,733,976)
Net Book Amount	8,049,248	994,019	137,321	207,782	9,388,370
<b>Year Ended 30 June 2016</b>					
Opening net book value	8,049,248	994,019	137,321	207,782	9,388,370
Additions	366,561	132,374	-	-	498,935
Transfers in/(out)	-	-	-	-	--
Depreciation	(439,973)	(89,745)	(8,504)	(81,399)	(619,621)
Closing net book value	7,975,836	1,036,648	128,817	126,383	9,267,684
<b>At 30 June 2016</b>					
Cost	13,524,545	3,254,010	340,494	502,232	17,621,281
Accumulated Depreciation	(5,548,709)	(2,217,362)	(211,677)	(375,849)	(8,353,597)
Net Book Amount	7,975,836	1,036,648	128,817	126,383	9,267,684
<b>Year Ended 30 June 2017</b>					
Opening net book value	7,975,836	1,036,648	128,817	126,383	9,267,684
Additions	64,178	188,994		134,378	387,549
Net Transfer/Disposal	306,693	(263,585)	(48,275)	5,167	-
Depreciation	(260,612)	(194,858)	(57,375)	(75,111)	(587,957)
Closing net book value	8,086,095	767,199	23,167	190,816	9,067,277
<b>At 30 June 2017</b>					
Cost	10,716,790	1,492,069	142,219	364,249	12,715,326
Accumulated Depreciation	2,630,696	(724,870)	(119,052)	(173,433)	(3,648,050)
Net Book Amount	8,086,095	767,199	23,167	190,816	9,067,277

	2017	2016
	\$	\$
<b>12. (a) FOREIGN CURRENCY DEMAND DEPOSITS</b>		
Government of Tonga	47,357,315	33,874,493
Other institutions	54,454	53,053
	<b>\$ 47,411,769</b>	<b>\$ 33,927,546</b>
<b>(b) LOCAL CURRENCY DEMAND DEPOSITS</b>		
International banks	363,821	131,374
Domestic banks	183,892,722	167,716,282
Government of Tonga	39,524,393	29,793,445
	<b>\$ 223,780,936</b>	<b>\$ 197,641,101</b>
<b>13. PAYABLE TO GOVERNMENT</b>		
Amount payable to government in accordance with Section 8(1) of the National Reserve Bank of Tonga (Amendment) Act 2014	\$ 1,996,814	\$ 2,894,639
<b>14. CURRENCY IN CIRCULATION</b>		
Notes	71,852,269	64,344,416
Coins	3,366,356	3,000,120
	<b>\$ 75,218,625</b>	<b>\$ 67,344,536</b>

The exclusive rights of national currency issue are vested with the Bank. Currency in circulation comprises bank notes and coins issued by the Bank.

#### 15. STATUTORY RESERVE DEPOSITS

The deposits represent the reserves required to be maintained by each financial institution under Section 39 of the NRBT Act 1988.

#### 16. OTHER LIABILITIES

	2017	2016
	\$	\$
Other creditors and accruals	947,112	882,848
Payable to the National Reserve Bank of Tonga Staff Provident Scheme – refer note below	327,611	154,273
	<b>\$ 1,274,723</b>	<b>\$ 1,037,121</b>

Funds belonging to the National Reserve Bank of Tonga Staff Provident Scheme are held with the Bank in this account.

## 17. PROVISION FOR EMPLOYEE ENTITLEMENTS

	2017	2016
	\$	\$
Opening balance	101,147	80,853
Entitlements during the year	264,635	195,270
Utilised/reversals	(233,071)	(174,976)
	\$ 132,711	\$ 101,147

## 18. CASH AND CASH EQUIVALENTS

Cash and cash equivalents included in the cash flow statement comprise the following items in the balance sheet:

	2017	2016
	\$	\$
Cash on hand	36,520	55,924
Short term investments and current accounts	381,043,257	327,817,394
	\$ 381,079,777	\$ 327,873,318

## 19. RELATED PARTIES

### *Identity of related parties*

The Bank's ultimate parent entity is the Government of the Kingdom of Tonga.

The Board of Directors during the financial year ended 30 June 2017 were Steve Edwards (Chairperson), Richard Prema, Sinaitakala Tu'itahi, Balwyn Fa'otusia and Sione Ngongo Kioa (Governor).

During the year, the following executives were identified as key management personnel of the Bank: Sione Ngongo Kioa (Governor), Jessie Cocker (Deputy Governor), Lata Tangimana (Assistant Governor-Operation) and 'Ungatea Latu (Assistant Governor-Policy).

### *Transactions with related parties*

In the normal course of operations, the Bank enters into transactions with related parties identified above.

The transactions with the Government of the Kingdom of Tonga include banking services, foreign exchange transactions and registry transactions.

The Bank contributes to the National Reserve Bank of Tonga Staff Provident Fund in accordance with the Provident Scheme Rules. The contributions in the current financial year were as follows:

	2017	2016
	\$	\$
Provident Fund payments made by the Bank	360,296	342,336
	\$ 360,296	\$ 342,336

The funds of the National Reserve Bank of Tonga Staff Provident Fund are invested within the Bank at an average rate of 3.80% (2016:3.96%) per annum. The total interest paid by the Bank for the financial year amounted to \$7,152 (2016: \$4,294). The Trustees of the Staff Provident Fund are indemnified by the Bank against all losses, damages or other costs which may be sustained or suffered by or made against a trustee as a result of any act or omission committed by the Trustee or Trustees which is not a breach of trust on the part of the Trustee.

Transactions with director related entities include purchases of goods and services and receipt of rental and utilities income as follows:

	2017	2016
	\$	\$
Purchase of goods	1,928	138

The Directors are paid fees and sitting allowances for services rendered. The Directors' entitlements to the retirement fund at year end amounted to \$196,059 (2016: \$183,653). The Bank also provides non-cash benefits to the Executive officers in addition to their salaries.

Total remuneration below is included in 'administrative costs'

	2017	2016
	\$	\$
Executive officers	311,633	311,633
Director's fees and allowances	115,730	114 213
	\$ 427,363	\$ 425,846

## 20. COMMITMENTS

### (a) Operating lease commitments

#### Lessee Disclosure

Operating lease expenditure and commitments contracted for are payable as follows:

Detail of the major operating lease as at year end is as follows:

- (i) On 28 July 1992 the bank entered into an agreement with His Majesty the King of Tonga to rent the property in Fasi Moe Afi for 100 years ending 27 July 2091. Under the agreement, rent is payable at \$3,000 per year.

Total commitments for future lease rentals which have not been provided for in the accounts are as follows:

	2017	2016
	\$	\$
Due not later than one year	3,000	3,000
Due later than one year but not later than five years	12,000	12,000
Due later than five years	210,370	213,370
	\$ 225,370	\$ 228,370

### **Lessor Disclosure**

The Bank leases its building premises under operating leases to tenants for a term of 2 to 3 years. The minimum lease payments receivable at balance date are as follows:

	2017	2016
	\$	\$
Due not later than one year	404,621	613,232
Due later than one year but not later than five years	134,934	369,263
	\$ 539,555	\$ 982,495

### **(b) Capital and other commitments**

	2017	2016
	\$	\$
Commitment not provided for in the financial statements are as follows:		
Capital commitment: approved and contracted	NIL	NIL

## **21. CONTINGENT LIABILITIES**

Contingencies not otherwise provided for in the accounts and which existed at 30 June 2017 comprise:

- (i) Contracts for foreign exchange transactions was nil (2016: \$nil)
- (ii) In accordance with the accounting policy in Note 2(e), numismatic coins are not brought to account in the determination of the Bank's liabilities but a liability may arise if such coins are en-cashed for their face value. The Bank is of the opinion that in the unlikely event of encashment as legal tender, no significant loss is expected to arise.

## **22. FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES**

The fair value of an instrument is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm length transaction.

Quoted market values represent fair value when a financial instrument is traded in an organised and liquid market that is able to absorb a significant transaction without moving the price against the trader.

## **Financial Assets and Liabilities**

The valuation of the Bank's financial assets and liabilities are discussed below:

### ***Short term investments and current accounts***

The reported value of short term investments and current accounts is considered to be its fair value due to the short term nature of the financial assets.

### ***Statutory Reserve Deposits***

The carrying value of statutory reserve deposits are considered to approximate their fair value as they are denominated in cash.

### ***Demand Deposits***

The carrying value of deposits are considered to approximate their fair value as they are payable on demand.

### ***Currency in Circulation***

The carrying value of Currency in Circulation is considered to be its fair value as reported in the accounts.

### ***Other Financial Assets and Liabilities***

The reported values of other financial assets and liabilities are considered to be its fair value.