
National Reserve Bank of Tonga

Annual Report for the Year Ended 30 June 2003

**PANGIKE PULE FAKAFONUA
‘O TONGA**

**NATIONAL RESERVE BANK
OF TONGA**

Private Bag No.25
Post Office
Nuku‘alofa, Tonga
South Pacific

1 October, 2003

Hon S T T ‘Utoikamanu
Minister of Finance
Ministry of Finance
Nuku‘alofa

Dear Mr Minister

In terms of section 54(1) of the National Reserve Bank of Tonga Act, Cap 102, I have the honour to transmit to you on behalf of the National Reserve Bank of Tonga the following:

- a) copy of the annual accounts for the year ended 30 June 2003, certified by the Auditors;
- b) report of the operation of the National Reserve Bank of Tonga for the year ended 30 June 2003.

Yours faithfully



HRH Prince ‘Ulukalala Lavaka Ata
Chairman

Board of Directors of the National Reserve Bank of Tonga



HRH Prince 'Ulukalala Lavaka Ata
Chairman



HRH Princess Salote Pilolevu Tuita



Hon. Siosiua T. T. 'Utoikamanu
Minister of Finance



Mr. Richard Prema



Mrs. Siosi Cocker Mafi
Governor

Principal purposes of the National Reserve Bank of Tonga

"The principal purposes of the National Reserve Bank of Tonga shall be:

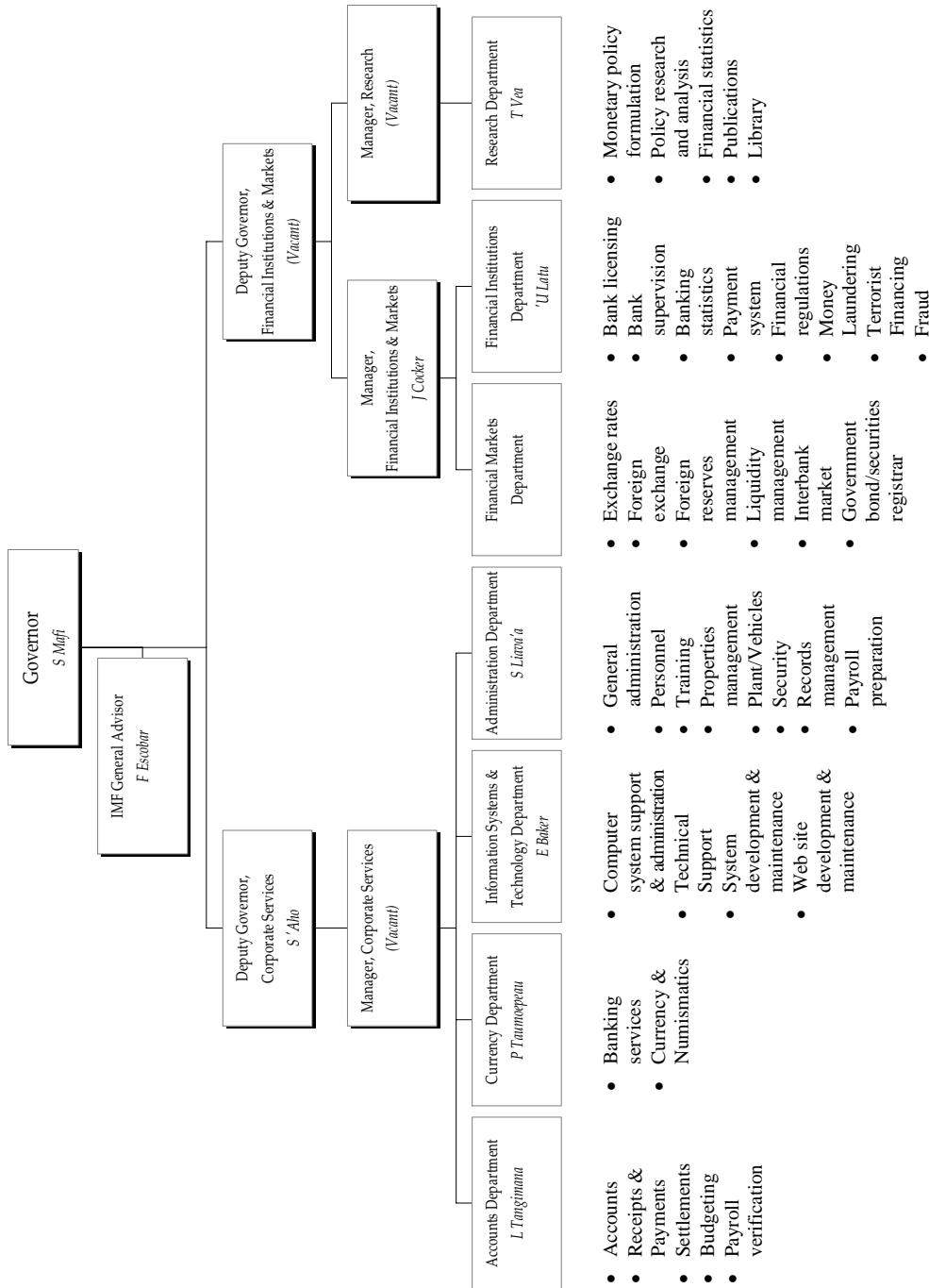
- (a) to regulate the issue of currency, and the supply, availability and international exchange of money;
- (b) to manage the external reserves of the Kingdom;
- (c) to promote monetary stability;
- (d) to promote a sound financial structure;
- (e) to foster credit and exchange conditions conducive to the orderly and balanced economic development of the Kingdom;
- (f) to provide advisory services to the Minister on banking and monetary matters;
- (g) to be the principal banker and fiscal agent of the Government;
- (h) to undertake banking business, in Tonga or elsewhere, subject to the provisions of this Act;
- (i) to undertake the licensing and supervision of financial institutions."

Section 4
National Reserve Bank of Tonga Act, Cap 102



National Reserve Bank of Tonga

June 2003



Contents

List of Figures and Tables	x
Economic Commentary	
Economic Overview	1
Monetary Policy Issues during 2002/03	8
Prices	9
Exchange Rates	9
The Financial System	12
Commercial Banks:	
Facilities and Operations	12
Financial Performance	13
Non Monetary Financial Institutions:	
Tonga Development Bank	15
Supervision of licensed financial institutions	16
Transaction Reporting Authority	17
Foreign Exchange Control	17
Corporate Services	
Currency Operation	18
Information Systems and Technology	18
Financial Results 2002/2003	19
External Relations	19
Board of Directors	19
Staff	20
Training	20
Attendance at Meetings	20
Acknowledgement	21
Senior Officers	22
Annual Accounts	
Approval of Accounts	23
Independent Audit Report	24
Profit & Loss Statement	25
Balance Sheet	26
Statement of Cash Flows	28
Notes to and Forming Part of the Accounts	30

List of Figures

Figure 1. Real GDP (annual percentage change)	3
Figure 2. Tourist Arrivals	4
Figure 3 CPI (percentage change on same period previous year)	4
Figure 4 Money Supply (M2) : Components	5
Figure 5 Banks' Credit	5
Figure 6 Gross Official Foreign Reserves and Import Coverage	8
Figure 7 US Dollar to Pa'anga Exchange Rate	10
Figure 8 Real Effective Exchange Rates (1991=100)	10
Figure 9 Commercial Banks - Components of Total Operating Income	14
Figure 10 Commercial Banks - Annual Net Interest Margin	14
Figure 11 Commercial Banks - Components of Total Operating Expenses	15
Figure 12 Commercial Banks - Non Performing Loans	15
Figure 13 Commercial Banks - Coverage Ratio	16

List of Tables

Table 1. International Economic Indicators	1
Table 2. Main Economic Indicators	2
Table 3 Overseas Exchange Transactions (OET): Annual Summary	7
Table 4 Commercial Banks' Accounts	12
Table 5. Financial Performance	13

Economic Overview

The signs of recovery experienced by the world economy in the second half of 2001/02 financial year were expected to continue into 2002/03 but the world economy began to weaken around the middle of 2002. Financial markets particularly equity and bond markets began to weaken in the second quarter of 2002 and economic indicators in the United States and the Euro area also pointed to a weaker and slower recovery than expected. These indicators included weaker consumer and business confidences thus the Consensus forecasted a slowdown in GDP growth for both the United States and the Euro area for the first half of 2002/2003. Furthermore, the likelihood and the actual occurrence of the Iraqi war exerted downward risks on confidence especially in the United States and the impact of the outbreak of SARS affected the global travel industry particularly in Asia.

Eventhough the IMF in its World Economic Outlook Report, September 2003, stated that there were signs of renewed recovery and projected global growth at 3.2 percent for 2003 and to pick up to about 4.0 percent in 2004, it was still unclear how broadbased and robust it would be. This recovery was

underpinned by marked strengthening in equity markets, accompanied by some pickup in business and consumer confidence, particularly in the United States

In terms of Tonga's trading partners, the **United States** economy grew by 2.4 percent in 2002 and was projected to reach 2.6 percent in 2003 and 3.9 percent in 2004. Inflation had fallen considerably amid weak demand and continued substantial excess capacity, with core CPI inflation still well below 2.0 percent.

In **Japan**, the economic growth forecast had been significantly revised upward to 2.0 and 1.4 percent for both 2003 and 2004, given the stronger-than-expected second quarter outturn, the stock market pickup, and heightened optimism about the United States recovery. However, the pace of recovery was expected to be moderate given deflation and corporate and banking system weaknesses in Japan.

After outperforming world economic growth, in 2001 and 2002, the pace of economic growth for **Australia** and **New Zealand**, were expected to slowdown in

Table 1. INTERNATIONAL ECONOMIC INDICATORS
Percentage change year on year

Country	Real GDP			Inflation			Current Account Balance		
	% change			% change			% of GDP		
	2002	2003	2004 ¹	2002	2003	2004 ¹	2002	2003	2004 ¹
United States	2.4	2.6	3.9	1.6	2.1	1.3	-4.6	-5.1	-4.7
Japan	0.2	2.0	1.4	-0.9	-0.3	-0.6	-0.7	-1.7	-1.1
Germany	0.2	-	1.5	1.3	1.0	0.6	2.3	2.4	2.1
United Kingdom	1.9	1.7	2.4	2.2	2.8	2.5	-0.9	-1.0	-0.9
Australia	3.6	3.0	3.5	3.0	2.9	2.3	-4.4	-5.2	-4.8
New Zealand	4.4	2.6	2.9	2.7	2.0	2.0	-3.7	-3.7	-4.1

¹ Forecasts

Source: IMF, World Economic Outlook, September 2003

2003, reflecting a number of factors, including the sizeable appreciation of the Australian and New Zealand dollars over the past two years, declining commodity prices and the lingering impact of drought. In Australia, economic growth is expected to slowdown to 3.0 percent and New Zealand to grow by 2.6 percent in 2003.

In terms of Tonga's economy, the Ministry of Finance projected a below average growth of 1.9 percent in real terms for 2002/03. This growth was supported mainly by the agricultural sector (both domestic and export); construction as a result of Waka rehabilitation project during 2002/03 and the finance sector.

The favourable weather conditions during the first half of the financial year had a favourable impact on agricultural production. Agricultural exports were led by squash, root crops (mainly cassava, taro

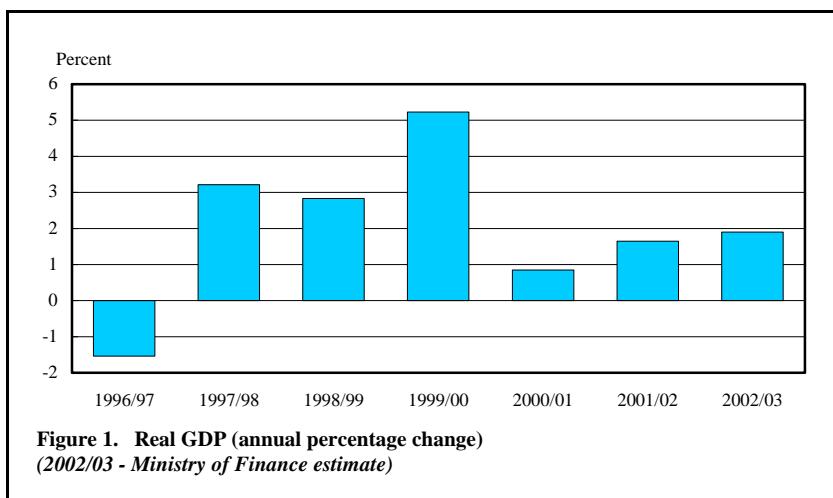


tarua, swamp taro, yams and giant taro), vanilla and kava. Vanilla exports during 2002/2003 increased by \$2.1 million compared with the previous year. Total



Table 2. MAIN ECONOMIC INDICATORS

Table 2. MAIN ECONOMIC INDICATORS						
						Est. 3/
						1999/2000 2000/01 2001/02 2002/03
Economic Activity (1995/96 base)						
Real GDP 1/		% change	5.2	0.8	1.6	1.9
Nominal GDP		% change	4.7	5.7	10.8	12.1
Tourist arrivals (numbers)	thousands		33.9	33.7	34.9	37.9
Money, Prices & Interest Rates						
CPI		% change	6.0	6.6	10.7	12.3
Money Supply (M2 - year end)	\$m pa'anga		97.9	123.5	133.5	151.6
Domestic Credit (year end)	\$m pa'anga		123.7	152.0	164.4	195.2
Short Term Deposit Interest Rate	% per annum		5.0	5.0	5.1	5.1
External Sector						
Merchandise exports fob 2/	\$m pa'anga		17.9	23.3	38.8	38.6
Merchandise imports fob 2/	\$m pa'anga		102.6	120.0	133.7	163.0
Official Foreign Reserves (year end)	\$m pa'anga		26.2	25.8	39.6	36.9
Import Coverage (year end)	months		2.6	2.3	2.5	2.4
Exchange Rate (period end)	US\$/T\$		0.5920	0.4644	0.4651	0.4664



agricultural exports increased by \$3.6 million (17.6 percent) during the year compared with \$10.8 million (112.6 percent) in the previous year. The warmer weather brought about by El Nino affected the activities in the fishing industry and resulted in a \$2.8 million (18.7 percent) decline in exports of fish and other marine products during the year compared with the \$3.3 million (28.0 percent) increase in 2001/02.



Despite the global effect on tourism of the US war against Iraq, the outbreak of SARS and the bombing in Bali, the total number of visitors that arrived into the Kingdom during 2002/03 peaked at 43,491, of which 85.0 percent arrived by air. This was an increase of 9.3 percent compared with the 5.1 percent increase during 2001/02.



Construction activities continued to increase during 2002/03, with various large projects completed and others, commencing. A survey conducted by the Reserve Bank of the eight major suppliers of construction materials indicated that sales increased by 6.0 percent during 2002/03 compared with a 25.1 percent increase during the year ended June 2002.

According to a survey conducted by the Reserve Bank (covering vehicle, supermarket and household goods), wholesale and retail sales only picked up by 1.6 percent compared with 19.5 percent in the previous year. This increase was mainly due to an increase in vehicle sales while sales reported for supermarkets and household goods declined. However, this survey only covered a limited number of

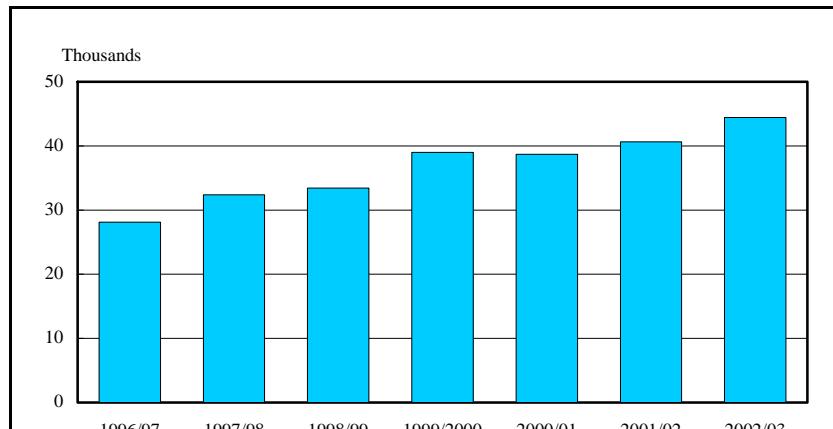


Figure 2. Tourist Arrivals

suppliers who have been consistently responded to the Reserve Bank survey. These included 2 vehicle dealers, 4 major supermarkets and one main household goods supplier.

Electricity consumption declined slightly by 0.7 percent during the year while the number of active consumers increased by 8.5 percent and the price of electricity rose by 21.3 percent during the year.

The average annual headline inflation rate

(measured by CPI) for the twelve months ended June 2003 increased by 12.3 percent, compared with 10.7 percent to the end of June 2002. This increase was mainly due to increases in import prices (which account for 66.2 percent of the total).

Import prices increased by 17.9 percent during the year ended 2002/03, higher than the 9.8 percent during the year ended 2001/02. Domestic prices increased at a

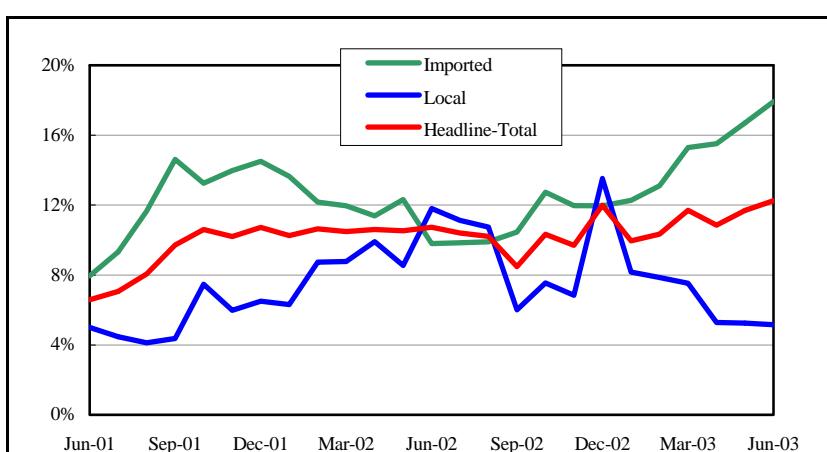


Figure 3. CPI (percentage change on same period previous year)

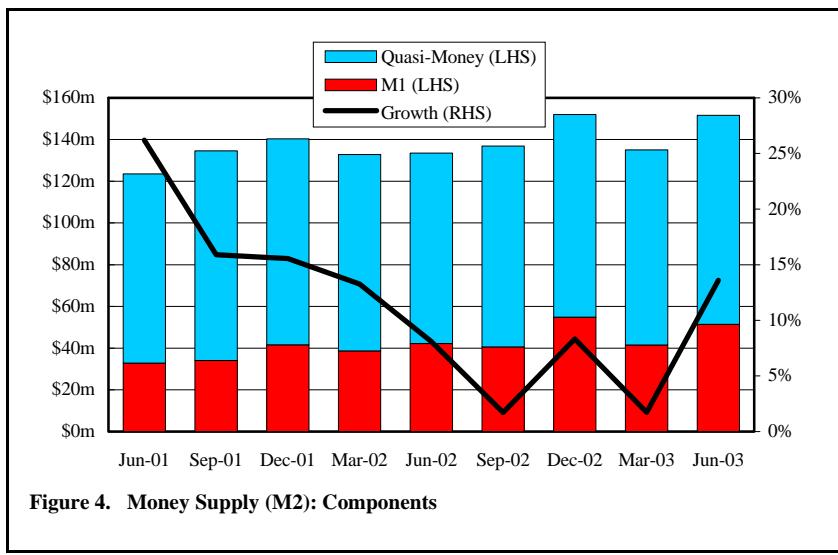


Figure 4. Money Supply (M2): Components

lower rate of 5.2 percent compared with 11.8 percent increase during the previous financial year.

Given the stagnant growth in total exports, the above activities continued to exert downward pressure on the country's official foreign reserves during the year thus the Reserve Bank continued its tight monetary policy stance with the introduction of individual bank credit ceiling. Despite this

measure, amongst other factors, the good return from the squash season of 2002/03, higher receipts from tourist related activities, higher private transfer receipts and the increased foreign currency deposits by customers expanded broad money by 13.6 percent during the year compared with 8.1 percent increase in the previous year. Subsequently, net domestic credit extended by the banking system rose by 18.8 percent compared with the

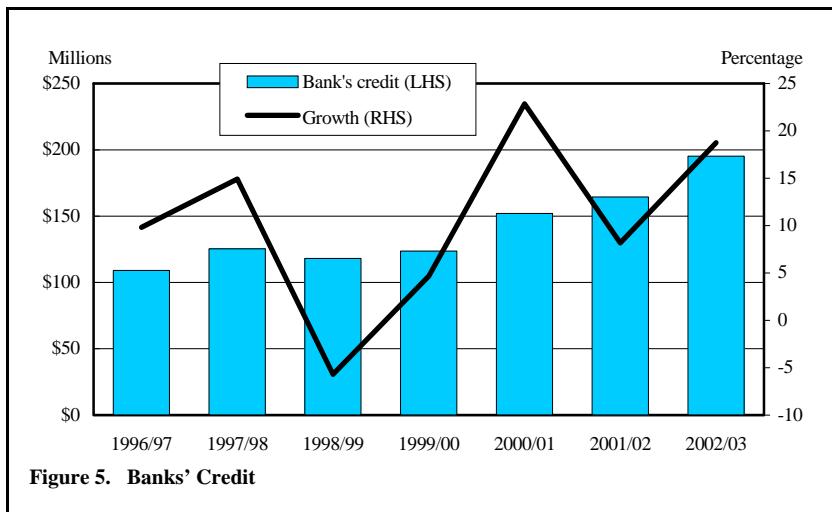


Figure 5. Banks' Credit

8.2 percent increase in 2001/02. The growth in net domestic credit was also supported by higher foreign currency borrowings by financial institutions.

Total credit extended to the private sector increased by 12.6 percent (14.6 percent in 2001/02) of which 62.9 percent of the increase went to the industrial sector mainly other services and the remaining 37.3 percent went to private individuals mainly housing. At the same time, government drew down much of its deposits with the banking system and also took out a foreign currency loan. This resulted in a decline in government's net credit position with the domestic banking system which fell by \$8 million during the year compared with an improvement of \$19 million in the previous year.

During 2002/03, the commercial banks' published deposit interest rates remained unchanged for all categories while the interest rates for the non-monetary financial institution's securities were revised upward for most categories. The average published lending rates charged by both commercial banks and non-monetary financial institutions remained largely unchanged over the year.

According to overseas exchange transactions data (oet), the overall external

balance recorded a deficit of \$2.6 million in 2002/03, compared with a surplus of \$13.8 million in 2001/02. The balance of trade recorded a deficit of \$124.4 million compared with \$94.9 million last year attributed to higher import payments which reached \$163.0 million in 2002/03, 21.9 percent higher than the previous year. At the same time, total exports slightly fell by \$0.2 million (0.5 percent). Exports receipts were led by squash, fish and other marine products and vanilla. The services balance also recorded a deficit of \$11.9 million. The higher net transfer inflow of \$128.9 million (11.1 percent) was not enough to finance the deficits in the trade, services and investment income accounts. Accordingly, the current account recorded a deficit of \$10.7 million, a significant change from the \$15.8 million surplus of last year. Due to lower official outflow in the 2002/03 year, the capital account recorded a surplus of \$17.4 million, a 10.2 percent increase from the \$15.8 million surplus recorded last year. According to oet, some net outflow of \$9.3 million was unaccounted for during the year. Consequently, the gross official foreign reserves fell to \$36.9 million at the end of June 2003 compared with \$39.6 million at the end of June 2002. This level of foreign reserves was equivalent to 2.4 months of imports of goods, still below the comfort level of 3 to 4 months of import cover.

Table 3. OVERSEAS EXCHANGE TRANSACTIONS (OET): Annual Summary

	1999/2000	2000/01	2001/02	2002/03
A. Merchandise trade balance	-84.7	-96.7	-94.9	-124.4
Exports, f.o.b.	17.9	23.3	38.8	38.6
Imports, f.o.b.	102.6	120.0	133.7	163.0
B. Services balance	3.2	-17.2	-4.1	-11.9
Receipts	30.0	23.0	36.2	54.8
Payments	26.9	40.2	40.3	66.7
C. Investment income balance	-0.8	-2.2	-1.2	-3.3
Receipts	3.6	3.2	5.0	4.7
Payments	4.3	5.4	6.2	8.1
D. Transfers balance	66.3	89.9	116.0	128.9
Receipts	79.4	107.0	143.7	151.4
<i>Private</i>	78.6	105.7	142.1	149.6
<i>Official</i>	0.7	1.3	1.6	1.8
Payments	13.1	17.1	27.7	22.6
<i>Private</i>	12.5	16.4	26.9	20.7
<i>Official</i>	0.6	0.7	0.8	1.8
E. Current account balance (A+B+C+D)	-16.0	-26.2	15.8	-10.7
F. Capital account balance	4.2	6.2	15.7	17.4
Official capital	5.1	5.2	11.2	16.9
<i>Inflows</i>	8.3	8.7	27.0	24.1
<i>Outflows</i>	3.1	3.5	15.8	7.2
Private capital	-1.0	1.0	4.5	0.5
<i>Inflows</i>	7.4	19.9	14.0	9.8
<i>Outflows</i>	8.4	18.9	9.5	9.3
G. Other items, net	3.9	19.5	-17.7	-9.3
H. Overall balance (E+F+G) 1/	-7.9	-0.4	13.8	-2.6

1/ Corresponds to changes in gross official foreign reserves.

Monetary Policy Issues during 2002/03

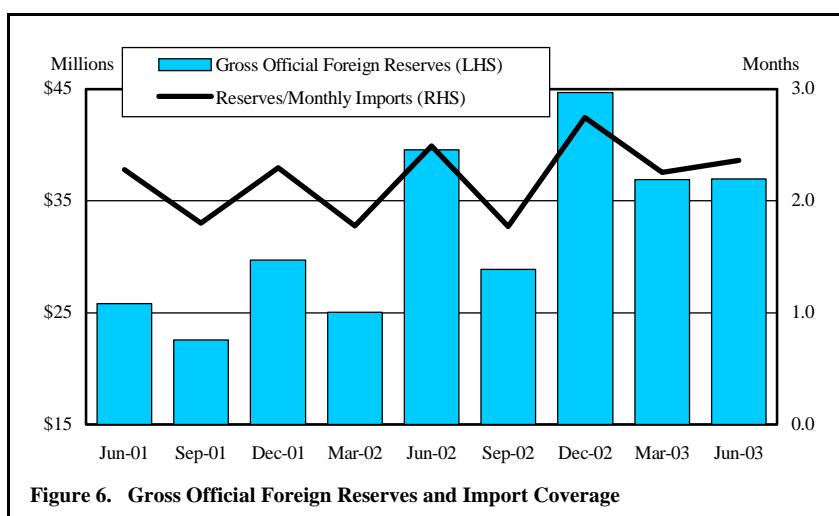
The monetary policy objectives of the National Reserve Bank continued to be: to maintain an adequate level of official foreign exchange reserves and to promote price stability. The Bank considers an external reserves level equivalent to at least 3 to 4 months of imports to be the adequate level.

The gross official foreign reserves continued to be under pressure during the financial year 2002/03. Despite the receipt of the first tranche of the government's loan from the Asian Development Bank (\$10.7 equivalent of USD5 million) in June 2002, the gross official foreign reserves remained under the comfort level throughout the year. In July 2002, the gross official foreign reserves fell to \$30.2 million (1.8 months of import) from \$39.6 million (2.5 months of import cover) in June 2002. It started to improve towards the end of the fourth quarter with the receipt of squash proceeds and it peaked at \$45.7 million (2.8 months of import cover) at the end of January 2003. By the end of June 2003, total gross official foreign reserves declined to \$36.9 million

(2.4 months of imports cover) compared with \$39.6 million (2.5 months of import cover) at the end of June 2002.

During the financial year 2002/03, the Reserve Bank continued with its tight monetary policy stance and imposed credit ceiling for each individual bank based on an overall credit ceiling for the banking system. Eventhough this overall credit ceiling was in line with the recommendations made by the IMF Article IV mission in May 2001, the same mission in November 2002 recommended that the credit ceiling should be strengthened by establishing and enforcing penalties for those banks that breach their ceilings. The Reserve Bank's minimum lending rate remained unchanged at 12 percent and the Statutory Reserves Deposit ratio remained unchanged at 15 percent.

Due to its balance sheet constraint, the Bank could not use open market operation, its preferred monetary policy instrument to manage the liquidity of the banking system. Therefore, at the end of 30 June



2003 there were no outstanding Reserve Bank Notes. However, the Bank has been encouraged by the indication received from the Ministry of Finance that it was considering the issue of Treasury Bills under the Public Finance Management Act to replace Reserve Bank Notes for open market operation purposes.

The Bank continued to provide temporary liquidity to the banking system through the use of repurchase agreements with the domestic banks. In 2002/03, \$12.6 million of repurchase agreement transactions were conducted with the banks. The interest rate on these transactions ranged from 17 percent to 19.5 percent per annum.

During the year, the domestic inter-bank market continued to develop. Total loans of \$26.6 million were made during the year for maturities ranging from overnight to over six months. The interest rate charged by the banks was 6 percent per annum for overnight loans.

The government did not issue any new bonds during the financial year to assist with the funding of its operations. It merely rolled over existing bonds that matured during the year. However, some investors redeemed their matured government bonds which the Reserve Bank was required to underwrite. The Reserve Bank and the Ministry of Finance are working together to reduce the Ministry's resorting to such financing.

Prices

The average annual headline inflation rate (measured by CPI) for the twelve months ended June 2003 increased by 12.3 percent, compared with 10.7 percent at the end of June 2002. The increase in the rate of

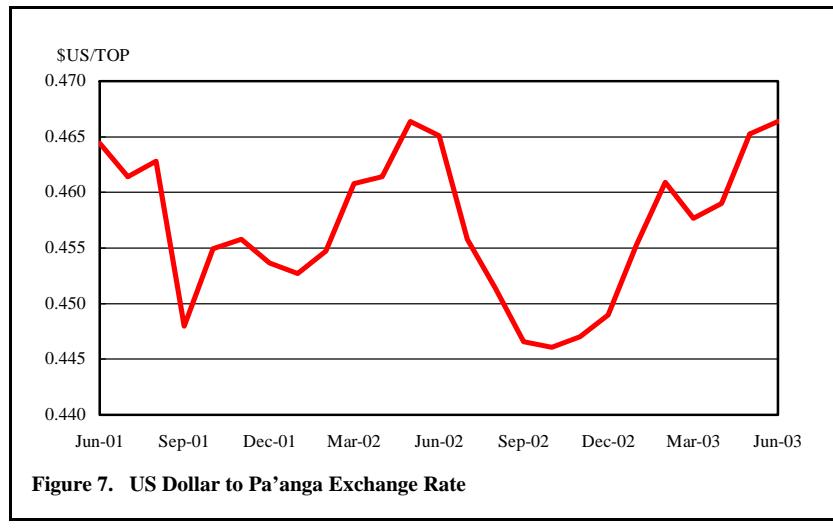
inflation was mainly due to increases in import prices (which account for 66.2 percent of the total).

Import prices increased by 17.9 percent during the year ended 2002/03, higher than the 9.8 percent during the year ended 2001/02. The increase in import prices during the year mainly reflected a rise of 26.0 percent in transportation prices. Other categories that contributed to the rise in import prices included; clothing and footwear (19.2 percent), tobacco and alcohol (16.9 percent), food (15.6 percent), household goods (15.2 percent), housing (10.8 percent) and miscellaneous goods and services (9.6 percent).

Domestic prices increased at a lower rate of 5.2 percent compared with 11.8 percent increase during the previous financial year. The increase in domestic prices reflected a rise of 19.1 percent in tobacco and alcohol prices, higher than the 3.1 percent increase during the year ended June 2002. Other categories that contributed to the rise in domestic prices included; clothing and footwear (14.9 percent); household goods (11.5 percent); miscellaneous goods and services (7.0 percent); food (3.4 percent) and transportation (1.6 percent).

Exchange Rates

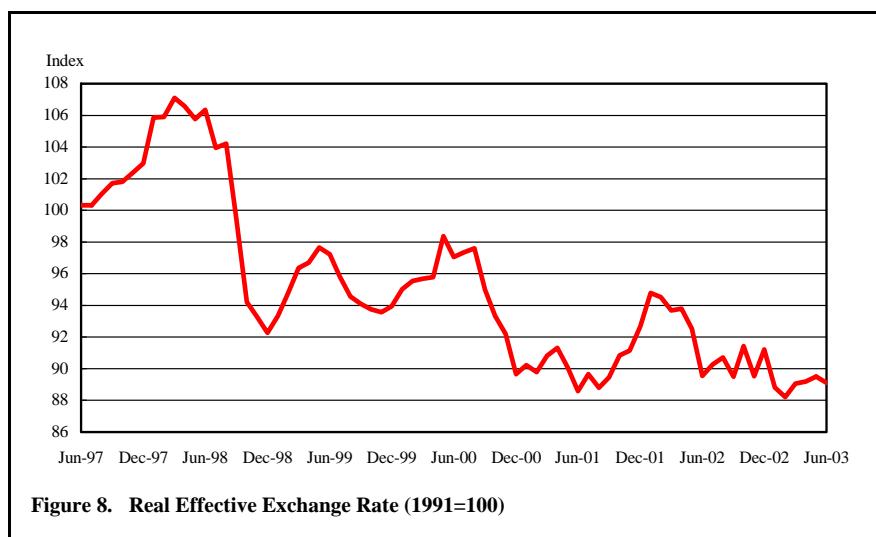
During the financial year, the value of the Pa'anga depreciated against the basket of currencies of its major trading partners by 10.1 percent (measured by nominal effective exchange rate index which represents movements in the average of bilateral exchange rates with the pa'anga, weighted by trade). Bilaterally, the Pa'anga significantly weakened against the Australian dollar by 16.2 percent, the New



Zealand dollar by 15.6 percent and the Fijian dollar by 12.8 percent. However, the Pa'anga slightly strengthened against the US dollar by 0.3 percent over the year after falling by 4.1 percent during the first four months of the 2002/03 financial year. It also strengthened slightly against the Japanese Yen by 0.4 percent during the financial year. These movements mainly reflected the continuing strengthening of the Australian and the New Zealand dollars against the US

dollar during this period. The real effective exchange rate index (a measure of external competitiveness of the Tongan economy against major trading partners) slightly fell by 0.5 percent during the financial year reflecting no change in the international competitiveness of Tonga.

The monetary policy objectives of maintaining adequate level of foreign reserves and promotion of price stability



were not achieved during the financial year. The following were contributing factors to the non-achievement of the Bank's objectives:

- structural weaknesses of the economy including a narrow production and export base, high dependence on external transfers, a tax system that depends heavily on relatively high tariffs, and a large share of the public sector in the economy;
- the inability of the Bank to undertake open market operation to manage the liquidity of the banking system due to its balance sheet constraint;
- the continued large demands on the

government budget and the banking system from different sectors;

- the limited ability of government to arrest expansionary macroeconomic policies which left the Bank with no choice but to rely on the exchange rate for ensuring external viability while compromising price stability;
- increased oil prices and tariff rates for imports of alcohol and tobacco which contributed to higher inflation.

The Reserve Bank and the Ministry of Finance are working on measures to address the above stated factors.

The Financial System

The National Reserve Bank of Tonga Act and the Financial Institutions Act authorise the Bank to undertake the prudential supervision of the licensed financial institutions. The primary concerns of the Bank are the stability of the financial system and the security of depositors' funds with licensed financial institutions.

The financial system in Tonga consists of three commercial banks, a development bank and the central bank. The total assets of the financial system, excluding the central bank, reached \$263.3 million at the end of June 2003, an increase of 12.0 percent from the previous year. The market share of the commercial banks dropped to 80.3 percent while that of the development bank rose to 19.7 percent in 2002/03 compared with 81.4 percent and 18.6 percent, respectively, for the previous year.

Commercial Banks: Facilities and Operations

The three commercial banks in operation in 2002/03 included two locally incorporated

banks and a foreign bank branch.

Commercial Banks in Tonga

<u>Bank</u>	<u>Headquarters</u>
Westpac Bank of Tonga	Nuku'alofa, Tonga
MBf Bank Limited	Nuku'alofa, Tonga
Australia and New Zealand Banking Group Limited	Melbourne, Australia

The Westpac Bank of Tonga maintained its head office and three branches on Tongatapu as well as branches on the islands of Vava'u, Ha'apai, and 'Eua. The MBf Bank Limited maintained its head office on Tongatapu and a branch on the island of Vava'u. The ANZ Bank operated its main branch and a sub-branch on Tongatapu and maintained a branch on Vava'u.

The total assets of the commercial banks reached \$211.3 million in 2002/03, an

Table 4. COMMERCIAL BANKS' ACCOUNTS						
	1997/98	1998/99	1999/2000	2000/01	2001/02	2002/03
Demand Deposits						
Number of Accounts	2,684	2,252	2,047	3,035	6,711	17,751
Value of Deposits (\$m)	20.4	23.6	27.4	40.4	46.5	57.4
Saving Deposits						
Number of Accounts	64,900	55,532	61,269	73,502	56,978	53,790
Value of Deposits (\$m)	22.3	24.0	24.6	31.2	36.8	36.9
Time Deposits						
Number of Accounts	2,376	1,246	2,357	3,413	4,505	5,546
Value of Deposits (\$m)	41.4	45.0	47.5	48.5	49.5	49.3
Total Number of Accounts	69,960	59,030	65,673	79,950	68,194	77,087
Total Value of Deposits (\$m)	84.1	92.5	99.4	120.2	132.8	143.5

Table 5. FINANCIAL PERFORMANCE						
	1997/98	1998/99	1999/2000	2000/01	2001/02	2002/03
Pre-tax Net Profit (% average total assets)	2.9	4.3	5.2	5.4	6.4	5.8
Total Operating Income (% average total assets)	9.0	9.3	9.9	10.4	11.5	11.6
Net Interest Income (% average total assets)	5.6	5.3	5.5	5.8	6.4	6.7
Non-interest Income (% average total assets)	3.4	4.0	4.4	4.6	5.1	5.0
Average Net Interest Margin (%)	6.7	6.4	6.7	7.0	7.8	8.1
Total Operating Expenses (% average total assets)	5.4	4.4	4.6	4.4	4.9	4.8
Consolidated Risk-weighted Capital Ratio (%)		33.4	25.0	23.6 ¹	24.3	19.8
¹ Revised						

increase of \$19.8 million (10.4 percent) over the previous year. Total loans by the commercial banks to the non-financial sector increased by 15.6 percent to \$155.7 million in 2002/03 compared with a 18.8 percent growth recorded in 2001/02. At the end of the 2002/03 financial year, the commercial banks' outstanding loans portfolio comprised: 38.0 percent for private individuals (of which 26.8 percent was for housing); 50.9 percent for industries and businesses including agriculture; and the remaining 11.1 percent was for other types of loans.

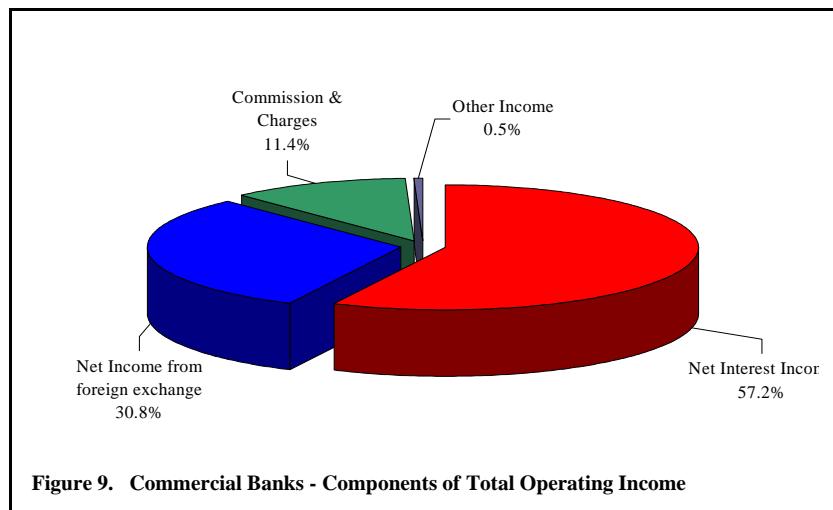
The total deposits by non-financial sector with the commercial banks grew by 8 percent to \$143.5 million in 2002/03 compared with a 10 percent growth recorded in 2001/02. The total number of accounts rose by 13 percent to 77,087 compared with a 15 percent decline in the previous year. The number of demand deposit accounts increased by 165 percent, savings accounts decreased by 6 percent and those of time deposits accounts rose by 23 percent. In terms of value, the total demand deposits increased by 23 percent, savings deposits increased by 0.1 percent and time

deposits decreased by 0.3 percent.

Financial Performance

The commercial banks as a group showed a pre-tax profit (as a percentage of average assets) of 5.8 percent in 2002/03, compared with 6.4 percent in 2001/02. This was due to a decrease in the banks' profitability over the year which was contributed mainly by an increase in loan loss provision expenses to cover the increase in non-performing loans during the year.

Total operating income was 11.6 percent of average assets, a slight increase from 11.5 percent in 2001/02. Net interest income was 6.7 percent of average assets. The bulk of commercial banks' operating income was derived from the extension of loans. Net interest income comprised 57.2 percent of total operating income in 2002/03 compared with 55.5 percent in 2001/02. Foreign exchange business made up 30.8 percent of total income compared with 35.3 percent in the previous year and the balance of 12.0 percent came from commission and charges plus other income



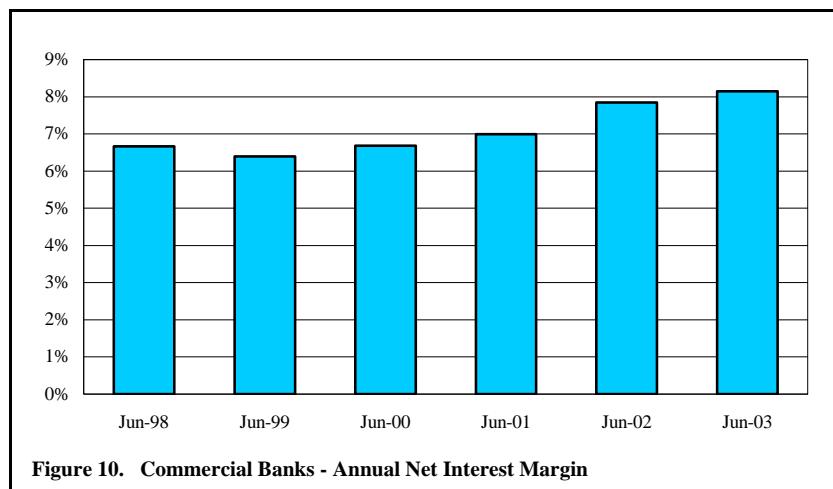
sources. Total non-interest income, as a percentage of average assets slightly declined to 5.0 percent from 5.1 percent in the previous year.

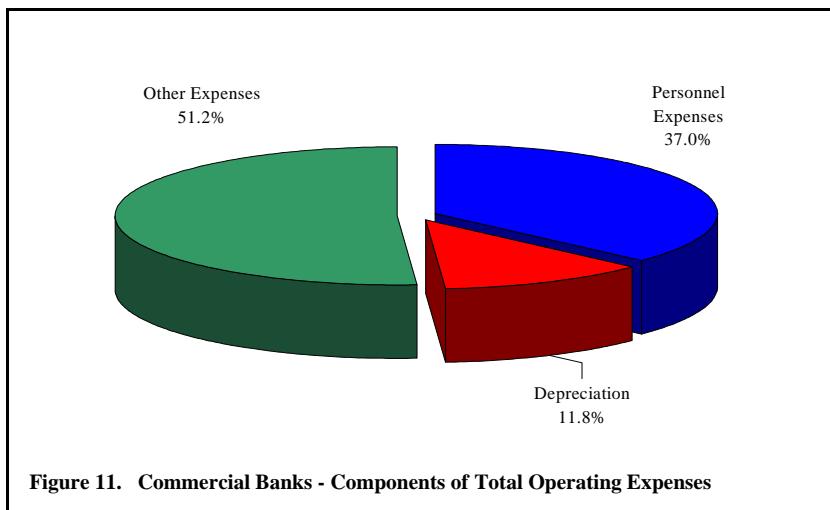
The average net interest margin (net interest income as a percentage of average earning assets) for the commercial banks increased to 8.1 percent in 2002/03 compared with 7.8 percent in 2001/02.

The operating expenses of the commercial banks slightly fell to 4.8 percent of average

assets in 2002/03 compared to 4.9 percent in 2001/02. About 37.0 percent of administrative expenses of the banks were taken up by employees' commercial remuneration compared with 39.8 percent in the previous year. Depreciation and amortisation accounted for 11.8 percent of total administrative expenses and the balance of 51.2 percent was made up of the purchase of various goods and services necessary for the operations of the banks.

The consolidated risk weighted capital





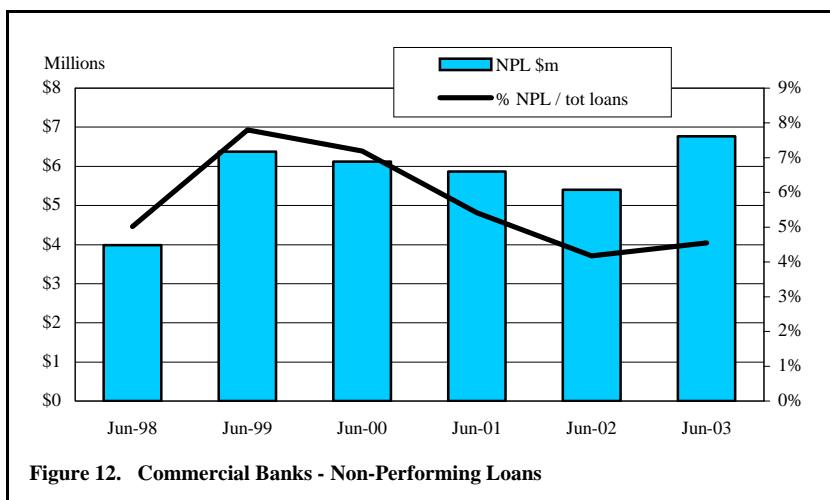
ratio for all the commercial banks decreased to 19.8 percent at the end of 2003 compared with 24.3 percent at the end of June 2002. This was above the 15 percent minimum ratio required by the Reserve Bank.

The overall quality of the commercial banks' assets slightly weakened as total non-performing loans rose to 4.5 percent of total loans compared with 4.2 percent at the end of June 2002. However, coverage of the non-performing loans by total loan loss

reserves slightly rose to 101.4 percent compared with 100.4 percent at the end of June 2002.

Non Monetary Financial Institutions: Tonga Development Bank

The Tonga Development Bank (TDB) was established in 1977 to provide short and long term finance to the private sector. Its main sources of funds were mainly provided by aid donors, particularly the



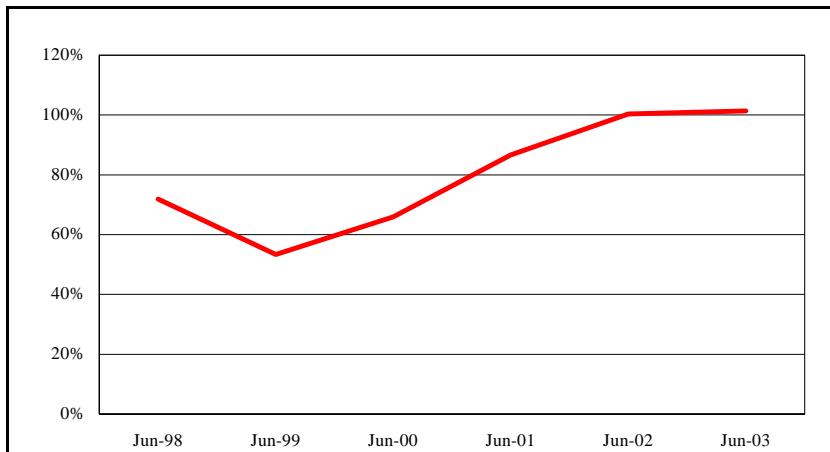


Figure 13. Commercial Banks - Coverage Ratio

Australian and New Zealand governments, and credit lines from multilateral lending agencies. However, TDB has been receiving less financial support from international financial institutions and resorted more to domestic financing through the sale of TDB bonds and promissory notes.

The TDB maintained its head office on Tongatapu, as well as branches on the islands of Vava'u, Ha'apai, 'Eua, Niuatoputapu and Niuafo'ou.

The TDB's total assets reached \$52.0 million at the end of June 2003, a \$8.3 million (19.1 percent) growth over the previous year. The outstanding loans to the non-financial sector increased by 17.6 percent to \$44.8 million at the end of June 2003 compared with a 9.3 percent growth in 2001/02. Again these figures do not reflect seasonal lending for squash exports by the TDB, which peaks in October before declining over the November to January period. TDB's outstanding loans portfolio at the end of June 2003 comprised: 32.2 percent for agriculture; 20.2 percent for

industries and manufacturing; 38.8 percent for private individuals; and 5.2 percent for fishing.

Total TDB bonds and promissory notes increased by 55.2 percent to \$22.6 million in 2002/03 compared with 17.7 percent growth in 2001/02. Total TDB promissory notes increased by \$7.4 million (70.3 percent) and the TDB bonds rose by \$0.6 million (14.8 percent). Total borrowing from international agencies, on the other hand, decreased by 14.7 percent to \$11.2 million in 2002/03 compared with 15.7 percent decline in the previous year.

Supervision of licensed financial institutions

During the year the Financial Institutions Department, which is responsible for administering the supervisory functions of the Bank, continued its supervisory activities. The Bank continued to monitor and evaluate the overall strategies, policies and performance of licensed financial institutions – where appropriate with reference to specific legal and/or

prudential criteria – and formed a view as to the soundness of the institution and the competence of those managing them. The Bank continued to administer its activities through the system of regular reports received from the financial institutions and onsite examinations throughout the year. The reports were analysed to ensure that the activities of the financial institutions complied with the terms and conditions of their licences and other specified regulatory and prudential standards such as capital adequacy, limits on credit exposures, asset quality, credit risk grading and provisioning. The reports were also analysed for any significant changes in their financial conditions.

The Bank conducted two on-site visits on licensed financial institutions during the year to review their risk management systems and their applications. These reviews focussed on credit risk management systems. The Bank also continued to hold regular meetings with licensed financial institutions to discuss their operations and compliance with the financial institutions regulations.

Transaction Reporting Authority

The Reserve Bank was appointed in 2001 as the Transaction Reporting Authority (TRA) by the Attorney General with the approval of Cabinet pursuant to section 11(1) of the Money Laundering and Proceeds of Crime Act 2000. The Financial Institutions department was also assigned with the functions of the TRA as stipulated under section 11(2) of the Money Laundering and Proceeds of Crime Act 2000. This department began to set up its framework to carry out these functions including requiring the licensed financial institutions and

authorised foreign exchange dealers to report suspicious transactions to the Reserve Bank.

The Reserve Bank supports the global movement towards combating of moneylaundering and financing of terrorism and is a member of a government committee on money laundering and terrorist financing activities. This committee was approved by Cabinet in February 2003, with the purpose of advising the Hon Attorney General, providing a clearing house for information and to coordinate the implementation of regulations. The committee should enhance the monitoring and surveillance of breaches of the appropriate legislations.

Foreign Exchange Control

The foreign exchange control authority over sending money and securities out of the Kingdom was transferred from the Minister of Finance to the Reserve Bank under the Foreign Exchange Control (Amendment) Regulations 2000. This authority includes licencing of foreign exchange dealers. During the financial year, the Reserve Bank licenced two authorised restricted foreign exchange dealers under the Foreign Exchange Control (Amendment) Act 2000. These authorised restricted foreign exchange dealers were the Fund Management Limited which operates Western Union and Rowena Financial Services Limited. Commercial banks are authorised dealers under their banking licence.

The Reserve Bank needs more resources in order to carry out the above extra responsibilities.

Corporate Services

Currency Operation

Circulation Currency

At the 30th June 2003, the face value of currency notes in circulation, both new and reissuable, totalled \$15,486,343. This was an increase of 13 percent over the previous year and was associated with events such as church conferences. Currency notes issued during the year totalled \$56,248,520.00 and currency redeemed totalled \$54,469,982 of which \$85,418.50 (28,729.5 pieces) were classified as unfit for reissue and were destroyed; the balance were retained for reissue.

Circulation Coins

At the end of June 2003 the face value of ordinary coins in circulation totalled \$1,501,658.98. During the year coins to a face value of \$156,026.51 (1,271,699 pieces) were issued.

Note Trust Depots

The Reserve Bank has Note Trust Depot (NTD) agreements with all commercial banks. During 2002/2003 the commercial banks lodged a total of \$30.5m (\$27.9m 2001/02) and withdrew \$30.9m (\$28.1m 2001/02) from the NTD's. Issues and lodgments increased by 10 percent compared with the previous year.

Counterfeits

The Bank verified three pieces of counterfeit notes during the year, same as that verified in the previous year. The three pieces of counterfeit notes verified in 2002/03 were all \$10 pa'anga notes. This is compared with two \$10 pa'anga pieces and

one \$5 pa'anga piece verified in the previous year.

Numismatic Coins

During the year numismatic coins were issued to collectors throughout the world. Production and marketing of coins of various denominations were made under agreements between the Bank and various producers.



Information Systems and Technology

The major tasks for the year focused on strengthening and managing information security and integrity by reviewing Information Technology (IT) strategy plan, computer network security policies, business continuity and backup procedures, systems procedures, legal software licenses and network management.

New IT developments included the formal launching online of the Bank's website in April 2003, via the new Tonfon wireless internet connection (ISP Provider); the segregation and continual maintenance of the accounting network to accommodate accounting and administration requirements; and the reviewing of switching to Satellite Communication.

Swift

The Bank established a new information system by installing the Society for Worldwide Inter-bank Financial Telecommunication (S.W.I.F.T) system to manage the Bank's financial payments, securities and treasury operations. The SWIFT production system went online via dial-up in November 2002 with ten banks providing bilateral key agreements. SWIFT supplies secure, standardised messaging services and interface software plus online swift support and training. This system has enhanced the security of the Bank's transactions and improved skills for system users. The Bank was fortunate to receive technical assistance from the Reserve Bank of New Zealand during the first month of setting up of SWIFT which made the task of learning how to use this new system a lot easier than otherwise.

Financial Results 2002/2003

Gross income from operations of the Bank for the year ended 30 June 2003 amounted to \$3.06 million (2002, \$2.46 million); cost of maintaining the currency issue was \$0.32 million (2002, \$0.22 million), and administration and other costs were \$2.02 million (2002, \$1.52 million). The net operating profit for the year was \$0.564 million (2002, \$0.404 million).

The greater portion of the Bank's income is the interest received from the investment of the external reserves and the investment on Tongan asset. The improvement in the Bank's gross income in 2002/03 was mainly due to higher than expected level of investible foreign reserves and higher level of investment in government bonds.

The Minister of Finance has accepted the

Bank's proposal to consider sharing the costs of operation through increasing the Bank's paid up capital and making resources available to meet the costs of liquidity management. The Minister of Finance has also approved that the net profit for the year ended June 2003 be transferred to the Bank's General Reserve account. This would improve the capital position of the Bank.

External Relations

During the year the Bank prepared regular briefing papers for the government on the level of the foreign reserves, interest rates and exchange rates. The Bank also conducted meetings with the domestic banks in order to review activities in the banking sector and to discuss policy issues. The Bank also met with representatives of international aid agencies and bilateral aid donors to discuss matters of mutual interest.

Board of Directors

During the year the Board of Directors met regularly to formulate the policies of the Bank and to monitor its operations. The death of Mr Albin Johansson in February 2003 was deeply felt by the Board of Directors of the Bank. When Mr Johansson died, he was the longest serving Director of the Bank having served the Board for nearly 14 years. The vacancy left by Mr Johansson on the Board was filled by Mr Richard Prema. Mr Prema's appointment will expire 21 April 2004. Mrs Siosi Cocker Mafi was appointed by His Majesty in Council to the position of Governor with effect from 2 May 2003 for a term of 5 years. As Governor Mrs Mafi became a member the Board of Directors.

Staff

Staff numbers decreased during the year to 52 from 55 the previous year. This decline mainly reflected staff that resigned from the Security Unit of the Bank.

During the year, the Bank received advisory services provided by the International Monetary Fund and the Pacific Financial Technical Assistance Centre based in Suva.



Training

The staff of the Bank attended various courses in specialised areas relevant to their functions. The courses attended included the Federal Reserve Bank of New York Central Banking Seminars; IMF courses on General Data Dissemination System held in Fiji and Monetary Operations held at the Singapore Training Institute; Secretariat of the Pacific Community workshop on internet website design held in Noumea; Accounting Software training held in Auckland; US/ Singapore sponsored workshop on counterterrorism finance held in Singapore; US sponsored conference on combating money laundering held in Bali; and regional workshop on the regulation and supervision of banks and financial institutions sponsored by the Pacific

Technical Assistance Centre in Fiji. A member of the staff also took study leave to complete her first degree study at the University of the South Pacific, Fiji. Six Security Guards participated in a short-term security training course held in Nuku'alofa that was organised by NZODA.

The Bank received a special training on the use of SWIFT by an Officer from the Reserve Bank of New Zealand in December 2002. A number of staff members also participated in a training on debt management systems arranged by the Ministry of Finance. The Bank continued to support staff development through financial assistance to staff undertaking approved part time and correspondence courses.



Attendance at Meetings

In July 2002 the Deputy Governor Corporate Services attended the Commonwealth Bank Governors meeting held in London and the Bank for International Settlements annual meeting held in Basle. In September 2002, the Acting Manager Financial Institutions and Markets attended the Commonwealth Finance Ministers' meeting in London and the World Bank/IMF annual meeting in Washington D.C. as part of Tonga's

delegation to these meetings. She also attended the Regional Heads of Supervision meeting held in Fiji in November 2002. The Deputy Governor Financial Institutions and Markets attended the conference on Transmission Mechanism of Monetary Policy arranged by the South East Asian Central Banks (SEACEN) Research and Training Centre held in Nadi in October 2002. She also attended the annual meeting of the South Pacific Governors held in Wellington in December 2002 and the South East Asian Central Bank Governors meeting held in Manila in February 2003. In June 2003 the Governor attended the Commonwealth Bank Governors meeting held in London and the Bank for International Settlements annual meeting held in Basle. Senior

officers of the Bank also visited various overseas financial institutions with which the Bank maintains a business relationship.

Acknowledgement

The directors and management of the Bank take this opportunity to record their appreciation of the services rendered by the staff during the year. The assistance from the International Monetary Fund, the Federal Reserve Bank of New York, the Reserve Bank of Australia, the Reserve Bank of New Zealand, Reserve Bank of Fiji, other regional central banks, Australian Prudential Regulation Authority, Pacific Technical Assistance Centre is also gratefully acknowledged.

Senior Officers

Senior Officers as at 30 June 2003

Governor	Siosi Cocker Mafi
Deputy Governor, Corporate Services	Seneti 'Aho
Acting Manager, Financial Institutions & Markets	Jessie Cocker
Assistant Manager, Currency	Paula Taumoepeau
System Analyst	Elizabeth Baker
Accountant	Lata Tangimana
Acting Assistant Manager, Administration	Suli Liava'a
Acting Assistant Manager, Financial Institutions	'Ungatea Latu
Acting Senior Research Officer	Talanaivini Vea

NATIONAL RESERVE BANK OF TONGA

**ACCOUNTS -
30 JUNE 2003**

APPROVAL OF ACCOUNTS

In the opinion of the directors, the accounts set out on pages 25 to 35 are drawn up so as to give a true and fair view of the state of affairs of the Bank as at 30 June 2003 and of its results for the year ended on that date.

The accounts are approved in accordance with a resolution of the Board of Directors of the National Reserve Bank of Tonga.

Signed on this **30th** day of **September 2003**.



HRH Prince 'Ulukalala Lavaka Ata

CHAIRMAN



Siosi C Mafi

GOVERNOR

Nuku'alofa
Tonga

NATIONAL RESERVE BANK OF TONGA

**ACCOUNTS -
30 JUNE 2003**

INDEPENDENT AUDIT REPORT

To the shareholder of the National Reserve Bank of Tonga.

Scope

We have audited the accounts of the National Reserve Bank of Tonga for the year ended 30 June 2003 as set out on pages 25 to 35. The Bank's directors are responsible for the preparation and presentation of the accounts and the information they contain. We have conducted an independent audit of these accounts in order to express an opinion on them to the Board of Directors of the Bank.

Our audit has been conducted to provide reasonable assurance as to whether the accounts are free of material misstatement. Our procedures included examination on a test basis, of evidence supporting the amounts and other disclosures in the accounts and the evaluation of accounting policies and significant accounting estimates. These procedures have been undertaken to form an opinion as to whether in all material respects, the accounts are presented fairly in accordance with the provisions of the National Reserve Bank of Tonga Act, 1988 so as to present a view which is consistent with our understanding of the Bank's financial position and the results of its operations.

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

Audit Opinion

In our opinion

- a) proper books of account have been kept by the Bank, so far as it appears from our examination of those books, and
- b) the accompanying accounts:
 - (i) are in agreement with the books of account;
 - (ii) to the best of our information and according to the explanations given to us:
 - (a) give a true and fair view of the state of affairs of the Bank as at 30 June 2003 and of the results of the Bank for the year ended on that date;
 - (b) are in accordance with the provisions of the National Reserve Bank of Tonga Act, 1988.

We have obtained all the information and explanations, which, to the best of our knowledge and belief, were necessary for the purposes of our audit.



LAUTOKA, FIJI

PricewaterhouseCoopers
Chartered Accountants

NATIONAL RESERVE BANK OF TONGA **PROFIT & LOSS STATEMENT FOR
THE YEAR ENDED 30 JUNE 2003**

2002		2003
\$		\$
INCOME FROM OPERATIONS:		
<u>2,139,532</u>	Net of Interest Paid \$149,133 (2002: \$321,922)	<u>2,909,681</u>
	Less:	
	OPERATING EXPENSES:	
218,406	Currency Issue	322,916
1,153,737	Administration	1,601,261
25,586	Audit Fees	31,139
<u>337,790</u>	Depreciation	<u>389,944</u>
<u>1,735,519</u>		<u>2,345,260</u>
404,013	OPERATING PROFIT for the year	564,421
<u>404,013</u>	TRANSFER TO GENERAL RESERVE	<u>2</u> <u>564,421</u>
BALANCE PAYABLE TO GOVERNMENT OF TONGA		
\$ -	In accordance with section 8(1)(b) of the National Reserve Bank of Tonga Act, 1988	\$ -
<u> </u>		<u> </u>

NATIONAL RESERVE BANK OF TONGA

2002		2003	
	\$	Notes	\$
CAPITAL & RESERVES			
2,000,000	Authorised Capital		2,000,000
<u>1,000,000</u>			<u>1,000,000</u>
707,994	Paid up capital		1,272,415
<u>1,707,994</u>	General Reserve	2	<u>2,272,415</u>
<u>1,147,958</u>			<u>2,963,170</u>
REVALUATION RESERVE			
CURRENCY ISSUE			
13,707,805	Notes		15,486,343
<u>1,453,910</u>	Coins		<u>1,501,659</u>
<u>15,161,715</u>			<u>16,988,002</u>
DEMAND DEPOSITS			
4,964,035	Banks		1,025,796
14,306,617	Government		17,798,753
14,278,319	International Agencies		15,664,058
7,836,651	Other foreign currency liabilities	7	4,369,106
<u>41,385,622</u>			<u>38,857,713</u>
<u>20,509,000</u>	STATUTORY RESERVE DEPOSITS		<u>21,081,000</u>
<u>816,147</u>	OTHER LIABILITIES		<u>1,263,874</u>
<u><u>\$80,728,436</u></u>			<u><u>\$83,426,174</u></u>

BALANCE SHEET
30 JUNE 2003

2002		2003	
	\$	Notes	\$
EXTERNAL RESERVES			
International Monetary Fund			
4,862,400	- Reserve Tranche	4	5,153,969
483,909	- Special Drawing Rights		612,692
<u>34,218,190</u>	Short term bills and current accounts	1(ii)	<u>31,181,327</u>
<u>39,564,499</u>			<u>36,947,988</u>
INTERNATIONAL MONETARY FUND			
<u>14,278,318</u>	Currency Subscription	4	<u>15,664,058</u>
CLAIMS ON GOVERNMENT OF TONGA			
5,335,832	Deposit with Treasury	5	-
<u>8,759,000</u>	Investment - Government of Tonga Bonds		<u>17,435,832</u>
<u>14,094,832</u>			<u>17,435,832</u>
<u>3,631,082</u>	ADVANCE BANKS		<u>3,815,541</u>
<u>7,758,190</u>	FIXED ASSETS	6	<u>7,591,756</u>
<u>1,401,514</u>	OTHER ASSETS	9	<u>1,970,999</u>
<u><u>\$80,728,436</u></u>			<u><u>\$83,426,174</u></u>

NATIONAL RESERVE BANK OF TONGA**STATEMENT OF CASH FLOWS**
YEAR ENDED 30 JUNE 2003

2002

2003

Notes

CASH FLOWS FROM OPERATING ACTIVITIES

270,008	Rental income	269,053
28,827	Numismatic sales	27,757
584,212	Other income	750,335
1,634,581	Interest receipts	1,715,152
(461,231)	Other interest payments	(182,190)
(8,720)	Currency expenditures	(1,211)
(1,167,995)	Administrative expenditures	(1,709,624)
879,683	Net cash inflows from operating activities	10
		869,272

CASH FLOWS FROM INVESTING ACTIVITIES

(145,891)	Purchase of fixed assets	(321,019)
450	Proceeds from sale of fixed assets	66,874
-	Purchase of currency stock	(614,721)
5,185,441	Net movement in repurchase advance	(184,459)
(414,788)	Net movement in IMF accounts	(420,352)
(23,768)	Net movement in staff loans	(19,129)
106,000	Net movement in Government of Tonga Bonds	(3,341,000)
4,707,444	Net cash inflows from investing activities	(4,833,806)

NATIONAL RESERVE BANK OF TONGA**CON'T STATEMENT OF CASH FLOWS
YEAR ENDED 30 JUNE 2003**

2002

2003

Notes

**CASH FLOWS FROM FINANCING
ACTIVITIES**

2,067,888	Net movement in currency in circulation	1,826,287
2,828,628	Net movement in demand deposits	(4,200,635)
2,162,000	Net movement in statutory deposits	572,000
(241,999)	Net movement in other liabilities	172,807
(3,881)	Net movement in other assets	8,929
6,812,636	Net cash inflows from financing activities	(1,620,612)
12,399,762	NET INCREASE/(DECREASE) IN CASH	(5,585,146)
20,878,037	CASH AT BEGINNING OF FINANCIAL YEAR	34,220,484
942,685	REVALUATION RESERVE	3 2,556,005
\$ 34,220,484	CASH AT END OF FINANCIAL YEAR	10 \$ 31,191,343

NATIONAL RESERVE BANK OF TONGA**NOTES TO AND FORMING
PART OF THE ACCOUNTS
YEAR ENDED 30 JUNE 2003****1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND
STATUTORY REQUIREMENTS**

The financial statements of the National Reserve Bank of Tonga have been prepared based on accounting principles approved by the Board of Directors in compliance with the National Reserve Bank of Tonga Act 1988.

The financial statements are prepared on the basis of historical cost convention, which has no regard to changes in the levels of prices.

ACCOUNTING POLICIES**(i) Foreign Currencies**

Foreign currencies have been translated to Tongan currency at rates of exchange ruling at the year ended. Realised and unrealised 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 and are not included in the computation of annual profits and losses of the Bank. 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, His Majesty in Council shall cause to be transferred to the ownership of the Bank non-negotiable non-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 is applied first, on behalf of the Government, to the redemption of any non-negotiable non-interest bearing notes previously transferred to the Bank by the Government to cover losses. Thereafter, one fifth of the remaining balance is paid to the Government, except that if the remaining balance does not exceed \$100,000 it shall be paid in full to the Government.

(ii) Securities

Short term bills are valued at cost.

Where foreign currency assets are the subject of a sale and repurchase agreement the asset is shown net of the repurchase liability.

(iii) Currency Issue

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.

NATIONAL RESERVE BANK OF TONGA**NOTES TO AND FORMING
PART OF THE ACCOUNTS
YEAR ENDED 30 JUNE 2003****(iv) 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, His Majesty in Council has specified by notice in the Gazette that the Bank shall not be required to include in its accounts the face value of these coins in circulation.

(v) Income Tax

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

(vi) 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 buildings	1.1%
Plant & equipment	10.0%
Carpets, drapes and security system	10.0%
Furniture & fittings, computer equipment and motor vehicles	25.0%

(vii) Cash Flows

Cash is defined as notes and coins held by National Reserve Bank of Tonga tellers cash, short term loans with maturity of twelve months or less in Tongan Pa'anga, and foreign currency cash and short term loans held by National Reserve Bank of Tonga in foreign currency.

(viii) Loans

Loans are carried in the balance sheet at historical cost net of specific provisions for bad and doubtful loans. The amount of potential losses that have been identified are recognized as an expense in the profit and loss statement.

NATIONAL RESERVE BANK OF TONGA**NOTES TO AND FORMING
PART OF THE ACCOUNTS
YEAR ENDED 30 JUNE 2003****2. GENERAL RESERVE**

2002	2003
\$	\$
303,981	Balance - 1 July 2002
404,013	Transfer to/(from) Net Operating Profit for the year (as provided for under Section 8(1)(a) of the NRBT Act, 1988, and approved by the Minister of Finance)
<hr/>	<hr/>
<hr/> \$ 707,994	Balance - 30 June 2003
<hr/>	<hr/>
	\$1,272,415

3. REVALUATION RESERVE ACCOUNT (Refer note 1 (i))

2002	2003
\$	\$
492,262	Balance - 1 July 2002
	1,147,958
	Net gains arising during the year from translation of foreign currency assets to Tongan currency
942,685	2,556,005
<hr/> 1,434,947	3,703,963
	Payable to the Government of Tonga in accordance with Section 33(3) of the National Reserve Bank of Tonga Act, 1988
286,989	740,793
<hr/> \$ 1,147,958	\$ 2,963,170
	<hr/>

4. INTERNATIONAL MONETARY FUND

- (i) The Bank was designated to serve with effect from 1 July 1989 as the fiscal agent of Tonga for the purposes of the International Monetary Fund 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 2003, Tonga's membership subscription to the International Monetary Fund was SDR 6,900,000 (2002: SDR 6,900,000). Of the total amount SDR 1,711,633 (2002: SDR 1,710,106) had been paid in foreign currencies, shown in the Balance Sheet as Reserve Tranche, and the balance representing the Currency Subscription portion was satisfied by crediting the demand deposit accounts of the International Monetary Fund with the Bank.

NATIONAL RESERVE BANK OF TONGA**NOTES TO AND FORMING
PART OF THE ACCOUNTS
YEAR ENDED 30 JUNE 2003****5. DEPOSIT WITH TREASURY**

Part of the assets of the Board of Commissioners of Currency, taken over by the Bank on 1 July 1989, comprised a deposit with the Treasury of \$5,906,215. An amount of \$570,383 was repaid by the Treasury on 14 July 1989 and the balance of \$5,335,832 has been converted into a bond issue. The Government of Tonga issued a government bond dated 20th June 2003 for the sum of \$5,335,832 at 6.7 percent interest payable annually. This government bond is due for repayment at par five years from the date of issue.

6. FIXED ASSETS

	2002	2003
	\$	\$
9,983,506	Leasehold land & buildings - at cost	9,829,957
<u>2,429,748</u>	Less : accumulated depreciation	<u>2,642,886</u>
<u>7,553,758</u>		<u>7,187,071</u>
845,502	Other fixed assets - at cost	1,166,000
<u>641,070</u>	Less : accumulated depreciation	<u>761,315</u>
<u>204,432</u>		<u>404,685</u>
10,829,008	Total - at cost	10,995,957
<u>3,070,818</u>	Less : accumulated depreciation	<u>3,404,201</u>
<u>\$ 7,758,190</u>		<u>\$ 7,591,756</u>

7. OTHER FOREIGN CURRENCY LIABILITIES

	2002	2003
	\$	\$
465,159	Accounts of International Organisations	232,235
3,064,860	Accounts of Domestic Organisations	2,306,899
4,306,632	Repurchase Agreements	1,829,972
<u>\$ 7,836,651</u>		<u>\$ 4,369,106</u>

NATIONAL RESERVE BANK OF TONGA

**NOTES TO AND FORMING
PART OF THE ACCOUNTS
YEAR ENDED 30 JUNE 2003**

8. COMMITMENTS AND CONTINGENCIES

Commitments and contingencies not otherwise provided for in the accounts and which existed at 30 June 2003 comprise:

- (i) Contracts for foreign exchange transactions \$1,461,090 (2002: \$1,383,365)
- (ii) In accordance with the accounting policy in Note 1 (iv) numismatic coins are not brought to account in the determination of the Bank's liabilities but a liability may arise if such coins are encashed 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.

9. OTHER ASSETS

	2002	2003
	\$	\$
417,491	Interest Receivable	726,445
558,962	Staff loans and advances	578,091
285,515	Currency and numismatic	573,842
139,546	Other assets	122,621
<hr style="border-top: 1px solid black;"/>		
1,401,514		2,000,999
<hr style="border-top: 1px solid black;"/>		
	Less: Provision for doubtful debts on staff loans and advances	(30,000)
<hr style="border-top: 1px solid black;"/>		
<u>\$ 1,401,514</u>		<u>\$ 1,970,999</u>

10. CASH BALANCES

	2002	2003
	\$	\$
2,295	Interest Receivable	10,017
<hr style="border-top: 1px solid black;"/>		
34,218,189	Short term bill and current accounts	31,181,327
<hr style="border-top: 1px solid black;"/>		
<u>\$ 34,220,484</u>		<u>\$ 31,191,344</u>

NATIONAL RESERVE BANK OF TONGA**NOTES TO AND FORMING
PART OF THE ACCOUNTS
YEAR ENDED 30 JUNE 2003****RECONCILIATION OF NET CASH PROVIDED
BY OPERATING ACTIVITIES TO NET PROFIT**

	2002	2003
	\$	\$
404,013	Net Profit	564,421
60	Increase (Decrease) in interest receivable	(299,878)
56,115	Increase (Decrease) in income accrued	3,362
(139,309)	Increase (Decrease) in other interest accrued	(32,958)
19,584	Increase (Decrease) in expenses accrued	(121,819)
(8,256)	Increase (Decrease) in expenses prepaid	14,495
-	Provisions for doubtful debts	30,000
337,790	Depreciation	389,945
209,685	Amortisation of currency stock	321,704
\$ 879,683	Net cash from operating activities	<u>\$ 869,272</u>

