



National Reserve Bank of Tonga

Annual Report for the year ended 30 June 2013

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Governor's Foreword

The developments in the global and domestic economy during 2012/13 continued to contribute to the difficulty in achieving the desired outcome of the Reserve Bank's monetary policy. The Reserve Bank's target was for the Kingdom's foreign exchange reserves to remain above three to four months of import cover and for the inflation to remain below 6% per annum. Throughout the 2012/13 financial year, the level of official foreign reserves remained above 8.5 months of import cover and the overall inflation remained well below 6%. The Banking sector liquidity continued to increase and have helped to reduce the banks' lending rates, but more recent increases have been less effective. To help reduce the interest rates further while strengthening the banks' incentive to lend, the Reserve Bank removed all interest payments on the banks' Exchange Settlement Accounts (ESA) in November 2012. Since then some banks have indeed offered loans at lower rates. A detailed rationale behind the Reserve Bank's monetary policy decisions is published in the Reserve Bank's semi-annual Monetary Policy Statements.

On the domestic economy, the Reserve Bank estimated that the real Gross Domestic Product (GDP) growth during the 2012/13 financial year to be similar or slightly lower than the outcome of the previous year, owing mostly to a fall in construction activity. Against this background of subdued economic outcomes, the Reserve Bank continued to implement its expansionary monetary policy through leaving as much liquidity as possible in the banking system targeted at strengthening banks' individual incentives to increase lending. The level of the liquidity in the banking system continued to be very high by international standards and remained

significantly in excess of the banks' actual and precautionary liquidity needs during the year.

The lending rates fell over the 2012/13 financial year and growth in bank lending fell reflecting the settlement of major loans as banks continued to clean up their loan portfolio. Increased competition between banks, as a result of the excess liquidity in the financial system and the decline in deposit rates, resulted in lower cost of funds as well as the anticipated competition from a new bank. This contributed to the decline in lending rates. The decline in interest rates has not resulted in a corresponding increase in the banks' lending and economic activity as anticipated. Ongoing domestic and global economic uncertainties continued to weigh on the bank's appetite to lend and the Reserve Bank will continue its regular dialogue with the banks on ways to encourage prudent lending of their surplus liquidity.

In terms of financial stability, Tonga's banking system remained strong and sound during the year. Levels of capital adequacy and liquidity remained high and earnings increased, partly through an improvement in asset performance and cost savings as some banks ceased their more costly operations. Despite, the improvement in the level of non-performing loans, the main risk to the banking system continued to be the credit exposures and the slow rate of recovery in non-performing loans which were affected by the weak domestic and global economic conditions. While the banks showed adequate profits during the financial year, the increased competition between banks may exert downward pressures on the banks' profits in the medium term. The Reserve Bank will continue to discuss with the banks their

credit risk management systems, credit strategies and asset recovery processes.

The Reserve Bank continued working towards maintaining the quality of notes and coins in circulation at a high standard. During the year, the Reserve Bank issued new currency notes and coins, and progressed on the development of a new family of coins to replace Tonga's existing coins in circulation.

The Reserve Bank was able to carry out its responsibilities through the commitment and dedication of its 83 staff and the technical assistance received throughout the year. The Reserve Bank embarked on a major organisational change program throughout the year and actively pursued policies to strengthening staff capacity, with staff receiving training on-the-job, in house, at local institutions and abroad. Courses covered a range of central banking functions and served to enhance the staff's capacity while assisting the Reserve Bank to carry out its core responsibilities effectively.

In accordance with the Reserve Bank Act, the Reserve Bank financials were audited by Pricewaterhouse Coopers, Fiji and to be submitted to the Minister of Finance together with a summary of the Bank's operations during the year. The size of the Reserve Bank's balance sheet reached T\$295 million at the end of June 2013, a growth of T\$20.2 million over the year. The growth owed mostly to the rise in foreign reserves, reflecting the continued strong support from Tonga's development partners. The rise in foreign reserves increased the Reserve Bank's interest income at the same time the Bank's interest expense also decreased on the decision to maintain an expansionary monetary policy. Overall, the National Reserve Bank of Tonga's net profit available for distribution rose by

\$748,863 to \$2,720,446 from \$1,971,583 last year. Given that the Reserve Bank's overall capital has been built up to twice the amount of paid up capital, the entire net profit for the financial year will be transferred to the Government as required by the NRBT (Amendment) Act 2007.

I would like to thank the Board of Directors for their direction and support during the year. I acknowledge the support received from the Ministry of Finance, Government and the domestic banks in pursuing our common goal of promoting macroeconomic stability and economic growth. The assistance from the international organisations, development partners of Tonga and other central banks in the region is acknowledged with appreciation. I would also like to thank the staff of the Reserve Bank for their commitment and hard work during the year which contributed to the Reserve Bank in achieving its objectives in 2012/2013 which are presented in this Annual Report.

Finally, I would like to thank the former Governor Mrs Siosi C. Mafi, for her 20 years of commitment, devoted service and contribution to the Reserve Bank.



Sione Ngongo Kioa
Governor

Functions and Objectives

The *National Reserve Bank of Tonga (Amendment) Act, 2007*, sets out the principal objectives of the Bank. It states:

- (1) "The principal objectives of the Bank shall be, to-
 - (a) maintain internal and external monetary stability; and
 - (b) promote a sound and efficient financial system.
- (2) Subject to subsection (1), 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 benchmark inflation is to average between 6% and 8%.

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 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) regulate as required the supply, availability and international exchange of money;
- (d) hold and manage the external reserves of the Kingdom;
- (e) provide advisory services to the Minister on banking and monetary matters;
- (f) be the principal banker, fiscal agent and depository of the Government;
- (g) undertake banking business, in Tonga or elsewhere, subject to the provisions of this Act;
- (h) regulate and supervise financial institutions; and
- (i) oversee and promote the efficient, sound and safe functioning of the payment system."

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



Back row: Mr Richard Prema, Mrs Siosi C. Mafi (Governor), Mrs Sinaitakala Tu'itahi, Dr Sione Ngongo Kioa

Front row: HRH Princess Salote Pilolevu Mafile'o Tuita, Mr Steve Edwards (Chairman)

Absent : Mrs Pilimilose Balwyn Fa'otusia (Acting Secretary for Finance)

Key Decision Makers

The Reserve Bank has a Board of Directors that is responsible for the Reserve Bank's policy and affairs. The Board is to constantly review 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 operation but also to ensure that the Reserve Bank delivers its core functions in compliance with the NRBT Act and related Acts. The Board must meet at least once every month to discuss and formulate the policies of the Bank and to monitor its operations.

The Board of Directors' capacity was further strengthened by the recruitment of 2 Directors to fill in the 2 vacancies during the 2012 financial year. Towards the end of the year, the Board set up the Finance and Audit Committee (FAC). With 7 Directors through 13 board meetings and 4 FAC meetings, the Board of Directors continued to provide strategic direction and advice to the Governor.

In April 2013, the Governor's position was advertised both locally and internationally for 6 months. A Board Sub Committee was established to process the recruitment of the Governor.

The Board comprises of the Governor, Secretary for Finance, and 5 other non-executive directors. 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.

The Governor, who is the Chief Executive Officer of the Bank, is responsible to the Board for the execution of its policy and the management of the Bank. Mrs. Siosi Cocker Mafi was reappointed in

May 2008 for a second term as Governor and her contract ended on the 5th July 2013.

Board of Directors



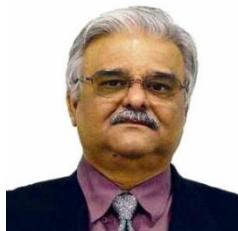
Mr. Steve Edwards

Chairman



**HRH Princess Salote
Pilolevu Mafile'o Tuita**

Director



Mr. Richard Prema

Director



Mr. Tiofilusi Tiueti

Director
(Secretary for Finance, Director ended 14 May 2013)



Dr. Sione Ngongo Kioa

Director



Mrs. Sinaitakala Tu'itahi

Director



**Mrs. Pilimilose Balwyn
Fa'otusia**

Director

(Acting Secretary for Finance,
Director commenced 14 May 2013)

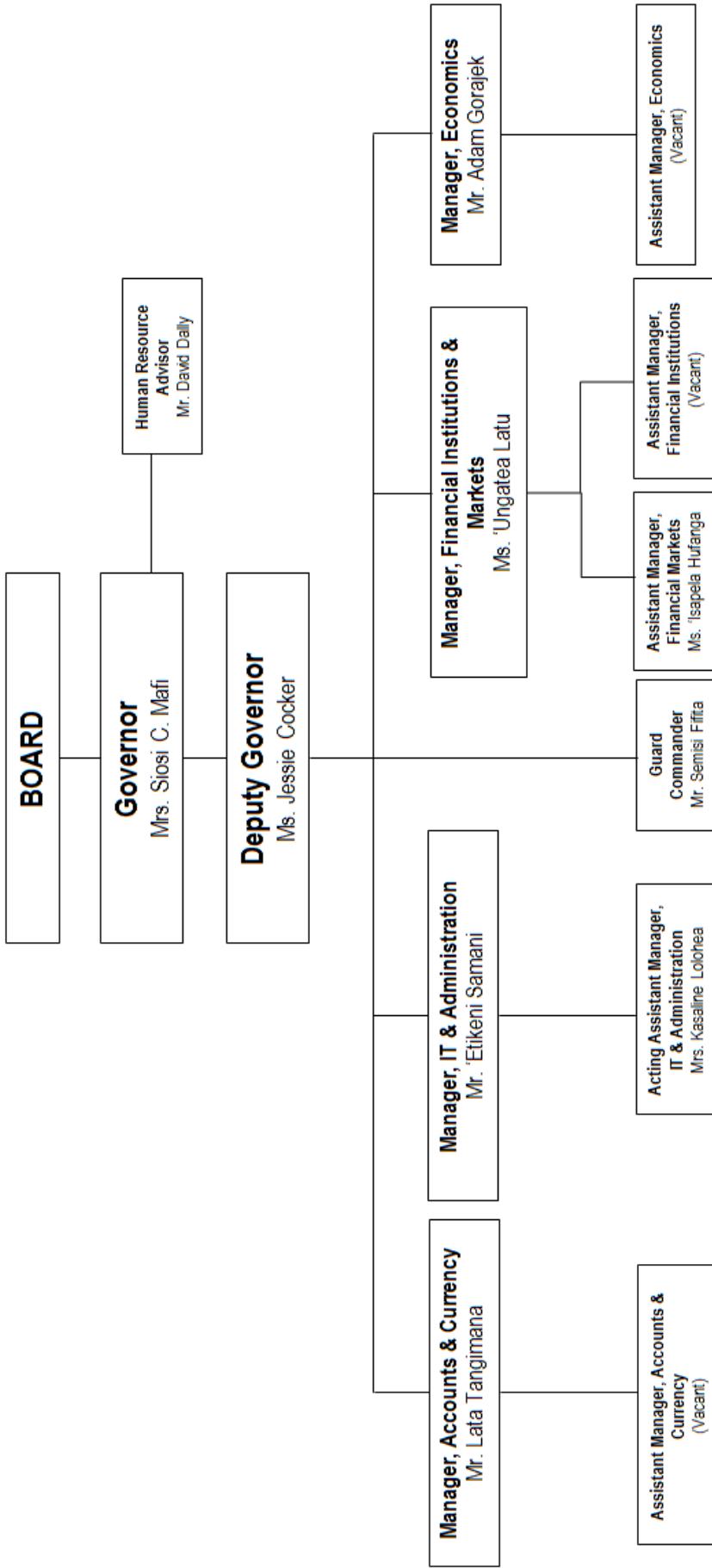


Mrs. Siosi Cocker Mafi

Governor

Organization Chart

June 2013



Accountability

Relationship with Government

The National Reserve Bank of Tonga Act specifies the relationship between the Government and the Reserve Bank. It requires the Reserve Bank to provide advice and statistics when requested by the Minister of Finance, and to inform the Minister on economic developments that are relevant to the achievement of the Reserve Bank goals. The Reserve Bank undertakes the role of being the principal banker, fiscal agent and depository for the Government.

Over the 2013 financial year, regular discussions between the Chairman of the Reserve Bank Board, the Governor and the Minister served to keep the Minister informed, as did the provision of various reports. Among the reports provided were the Reserve Bank's weekly foreign reserves and liquidity report, monthly statement of assets and liabilities, monthly monetary policy data, six monthly monetary policy statements, the operations summary together with the audited annual accounts and the annual report for the 2012 financial year.

Other forms of accountability

The Reserve Bank also seeks to ensure a high degree of public accountability for its decisions and processes, which necessitates a high degree of public transparency. The transparency in the 2013 financial year was achieved through regular public communication, in both written and verbal forms.

In written forms, the Reserve Bank published two Monetary Policy statements, which detailed the rationale behind its monetary policy decisions. The Reserve Bank also published its Annual Report for the financial year 2011/12, containing its audited

financial statements, a summary of its operations, and a detailed assessment of the condition of Tonga's financial system. It disseminated quarterly economic statistics in its quarterly Bulletin publication as well. All the Bank's publications are also posted on the Bank's website.

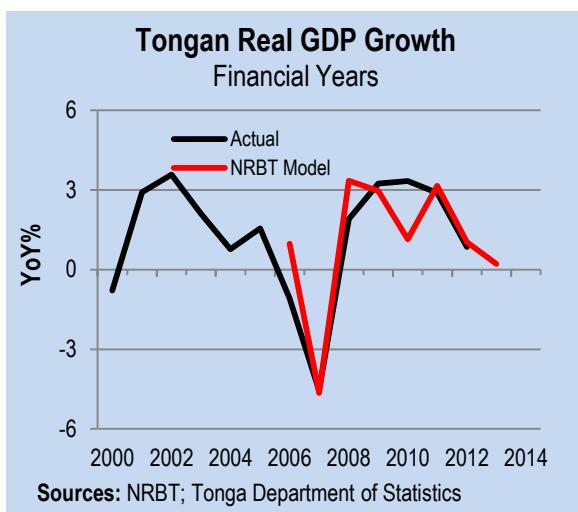
In verbal forms, the Governor made several public addresses over the 2013 financial year. In September 2012, for instance, the Governor presented at the Inaugural Conference of the Asia and Pacific Policy Society, Australian National University (ANU) regarding the challenges Tonga faces of declining remittances and tourism. The Governor also attended the 2013 Pacific and PNG Update at ANU in June 2013 for which she spoke about the economy in Tonga. The Chairman and the Governor held a press conference in November 2012 on the release of the Bank's Monetary Policy Statement for September 2012 and in May 2013 on the Monetary Policy Statement for February 2013. This followed the bi-annual meeting of the Association of the Banks in Tonga (ABT) which comprises of the Governor and the General Managers of the banks in Tonga.

The Bank enhanced its public communication and awareness during the year which included the establishment of the Complaints Unit. This unit was effective in early May 2013 where the customers of the banks in Tonga were notified to lodge complaints against the licenced financial institutions, foreign exchange dealers and the Reserve Bank. The public was to lodge complaints to the Complaints Unit regarding the products and services of the Reserve Bank and the banks. The Complaints may be lodged regarding bank products and services such as interest rates, exchange rates, fees and charges and complaints against the Bank regarding its services.

Economic Overview

Most central banks overseas maintained expansionary monetary policies in the financial year 2012/13, because inflation pressures were moderate. World GDP growth was also slower than had originally been anticipated.

For Tonga, the Reserve Bank estimates that real GDP growth was approximately 0.2% over the 2013 financial year. The figure is lower than the outcome of the previous year, owing mostly to a fall in construction activity.



The agriculture industry is the largest and accounts for 14% of GDP. Growth is unusually difficult to estimate for 2013 because the available data on domestic sales look questionable. Nevertheless, liaison with growers has indicated that steady rains supported large harvests, and export volumes grew by 4 – 6%, depending on the measure taken. We estimate growth in the sector to have been roughly 7.5% over the financial year. The outcome will have a very important bearing on overall growth.

The public administration industry is the second largest industry in Tonga. The government budgeted an almost 10% increase in the level of wages and salaries for the 2013 financial year, but

the staff headcount was reportedly little changed. The Reserve Bank and the Ministry of Finance estimate that value added in the industry increased only slightly.

NRBT Production Estimates for FY 2013

	Real Growth	Share of Production
Total	0.2	100.0
Agriculture	7.5	14.3
Utilities	1.3	2.6
Construction	-11.0	9.7
Distribution	1.0	10.0
Hotels, restaurants	-0.4	2.9
Finance, insurance	-2.0	5.5
Public admin	0.6	11.8
Dwellings	1.1	9.3
Other industries*	0.1	33.8

*Includes industries such as manufacturing, fishing, mining, transport and communication, education, health and social work.

The distribution industry (also known as wholesale and retail trade) makes up a further 10% of GDP. Imports, which account for most of the distributed goods, fell slightly in the first half of the 2012/2013 financial year in nominal terms. The Department of Statistics has not yet released data for the second half, though information from import payments made through the banking system suggests that volumes recovered. Data on container registrations were little changed over the year, as were consumption taxes in real terms. The Reserve Bank expects activity in the sector to have increased a little over the 2012/2013 financial year, with much of the growth generated by less formal parts of the sector, such as the Saturday morning fairs.

The construction industry has recorded unusually fast growth over the past five years. In 2008 it accounted for 6% of GDP, whereas in the

Statistics Department's latest release, for the 2012 financial year, it accounted for 10%. Much of the growth stemmed from public sector construction activity that was funded by development partners and large foreign loans. The major construction projects included the Vaiola Hospital, CBD reconstruction, and various road works. The largest projects had mostly finished by the 2012/2013 financial year and, although construction approvals for non-civil works have been little changed, we expect overall construction activity to have contracted by 11% in real terms.

The finance and insurance sector most probably contracted, following ongoing falls in bank lending. The Reserve Bank estimates that the finance component alone would have contracted by 4% in real terms.

Tourism activity was mixed in the 2012/2013 financial year. Data from the Department of Statistics show that air visitor arrivals were approximately 14% higher in the first half of the financial year than in the same half the year before. The rises were likely supported by positive economic growth and falls to unemployment in New Zealand and the US. Visitor data have not yet been released for the second half, but anecdotal information suggests that the numbers were low. Tonga might have initially benefitted from some destination substitution from Fiji and Samoa, after cyclone Evan hit in December, but tourist operators in the outer islands reported a slow stream of tourists during the June quarter. The slowdown probably stems from recent disruptions to the reliability of Tonga's domestic airline services and concerns overseas about the safety of Real Tonga's new Xian MA60 aircraft. Overall we expect tourism activity in Tonga to have contracted slightly in the 2012/2013 financial year as a whole.

With economic outcomes subdued, the Reserve Bank implemented expansionary monetary policy, supporting an elevated level of Exchange Settlement Account balances (domestic liquidity). The level of the balances was very high by international standards, even compared with developed countries that are pursuing the most expansionary monetary policies. The balances are significantly in excess of the banks' actual and precautionary liquidity needs.

Consistent with the elevated levels of Settlement Account balances, and a removal of interest payments on the balances in November 2012, lending rates fell over the year to June 2013. Growth in bank lending also improved, to become less negative in year ended terms. Still, the contraction in lending would have contributed to Tonga's slower economic growth outcome.

The balance of foreign exchange transactions was in slight surplus over the financial year. The surplus was narrower in size to the surplus recorded over the previous year, owing to a wider current account deficit.

Overall, gross official foreign reserves increased by 7% over the year, to \$263.3 million, or 8.8 months of imports. Reserves are well in excess of the Reserve Bank benchmark of 3 months of imports.

Consumer prices were broadly unchanged over the 2012/2013 financial year, leaving inflation well below the Reserve Bank reference range of 6 to 8%. The more subdued global growth outcomes over financial year 2012/2013 helped to prevent large increases in world oil and food price increases, thereby limiting local price increases.

Monetary Policy Indicators

	Sep 2012	Dec 2012	Mar 2013	Jun 2013
Foreign Reserves (\$TOP millions)	247.9	257.3	244.8	263.3
Foreign Reserves (months of import cover)	8.5	9.0	8.2	8.8
Nominal trade-weighted exchange rate index	101.9	101.5	102.1	101.6
Weighted average term deposit rate (%)*	3.8	3.8	3.3	3.2
Weighted average lending rate (%)*	10.1	10.1	10.0	9.7
Consumer price inflation (year-ended, %)	-0.8	2.5	0.8	0.2
Domestic items	-1.1	2.8	-1.0	0.5
Imported items	-0.6	2.3	2.2	0.0
Bank lending growth (year-ended, %)	-6.7	-5.9	-4.5	-3.7

*The banks changed their reporting methodology in January 2012, which resulted in a large series break.

Source: Banking system; NRBT; Tonga Department of Statistics

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 (banks).

There are 4 banks licensed to operate in Tonga.

Banking Services in Tonga

Banks	ANZ Bank	Westpac Bank of Tonga (WBOT)	MBf Bank	Tonga Development Bank (TDB)
Branches (including Head Office at Nuku'alofa)	3	5	2	6
ATMs	10	8	-	-
Instore Facilities	147	11	-	-
Internet Banking	Yes	Yes	No	No
Eftpos	Yes	Yes	No	No
MoneyGram Agent	No	Yes	Yes	No
Money Transfer Card	Yes	Yes	No	No
Other Services	Insurance Agent (NPI)	Mobile banking	-	Microfinance

The Westpac Bank of Tonga (WBOT) and the Tonga Development Bank (TDB) maintained their head offices and branches in Tongatapu, as well as branches in the islands of Vava'u, Ha'apai, and 'Eua. The MBf Bank Limited maintained its head office in Tongatapu and a branch in the island of Vava'u. The ANZ Bank also maintained its head office in Tongatapu and a sub-branch in Vava'u. TDB continued to be the only bank serving the outermost islands of Niuatoputapu and Niuafo'ou.

During the year, the banks continued with their current banking services, introduced some new banking services, and at the same time ceased their more costly operations. WBOT continued to

launch mobile banking services and Instore banking during the year, mainly to cater for customers' banking needs in remote areas. Instore banking facilities have been developed to provide banking services via Eftpos machines in various merchant locations and small shops for customers living in rural areas and outer villages.

On the other hand, WBOT has discontinued operations on Saturdays in the outer island of Vava'u in an attempt to reduce their costs of operations, during the year. TDB continued to offer a 50% reduction in loan repayment to assist their customers in this current economic environment.

TDB has been collaborating with the International Finance Corporation (IFC) to establish a strategic business unit within the existing organization structure to undertake commercial banking operations while continuing its development banking mandate. This will assist TDB in playing a key role in addressing the gap in banking services to the Small and Medium Enterprises and rural segments and facilitate the graduation process of micro businesses and retail customers.

WBOT continued to roll out its Financial Education Programs. These programs included Financial First Steps Program, Women in Business Program, Business Basics Program, Financial Management and Money Basics Program.

Supervision and Regulation of Licensed Financial Institutions

During the year 2012/13, Tonga's banking system remained strong and sound despite the weak economy. The banking system maintained a strong capital and liquidity position and profitability as well as improved asset quality over the year.

In 2012/13, the Reserve Bank's main supervisory concern continued to be the credit risks associated with the high non-performing loans. Although the level of non-performing loans has improved compared to the previous year, it continued to remain at high levels and the Reserve Bank continued to discuss with banks their credit risk management systems and recovery process. The weak economic conditions contributed to the slow recovery of non-performing loans in the banking system as a result of imperfect securities, lack of buyers and thin market conditions. These factors continued to affect the growth of credit to the private sector both on the supply and the demand sides.

The Reserve Bank received an application for a banking licence in February 2013 from the Pacific International Commercial Institution. The processing of the licence was assisted by an expert funded by the International Monetary Fund (IMF)/Pacific Financial Technical Assistance Centre (PFTAC), and the Bank's legal advisor.

The Reserve Bank continued to monitor the movements in interest rates. Increased competition between banks, excess liquidity in the financial system as well as the banks' reduced cost of funds as some deposits that were locked in high interest rates matured during the year, have contributed to the decline in banks' lending interest rates during the year. Lending interest rates fell by up to 5.0% compared to a reduction of up to 2.5% in the previous year, mainly personal loans interest rates. Deposit rates also fell by up to 2.0% during the year, mainly the time deposit rates, compared to a reduction of up to 0.8% last year. The decline in deposit rates was driven by the high level of liquidity in the banking system. Unfortunately, the decline in interest rates has not resulted in a corresponding increase in credit and economic activity as anticipated.

The continued stagnant credit growth is attributed to factors such as highly indebted borrowers therefore their borrowing capacity is very low, as well as the weak economic conditions and low borrower confidence in taking out further loans. The two largest banks offered competitive packages for housing loan customers however; these were available only to the good customers with acceptable credit risk. This has resulted in loan refinancing between banks and marginal loan growth is expected in the coming year. Furthermore, the proposed entrance of the new bank, Pacific International Commercial Institution, will provide competition and is expected to also contribute to credit growth. The Reserve Bank will closely monitor these developments to ensure financial stability is maintained.

Another area of focus is the banks' fees and charges. As a result of customers complaints as well as the need to update the requirements on fees and charges to be in line with best practices that have been taken on by regional central banks, proposed revisions to the disclosure requirements in Prudential Statement No. 4 will become effective in the next financial year.

Payments System

In April 2013, the World Bank / IFC conducted a workshop on the National Payment System for the staff of the Reserve Bank. The purpose of the training workshop was to develop a plan for the reform of Tonga's payment system to meet international best practices, which would therefore enhance the Reserve Bank's payment system oversight role. A stakeholder session was also slotted into the agenda which was to gauge the respective roles of the stakeholders in the national payment system. This would assist in developing the legislation as well as the framework for the oversight of the payment system as part of the

reform plan. The Board has approved the development of the new legislation on the national payment system.

Onsite/Offsite Monitoring

Onsite examination of banks remains an integral part of the Reserve Bank's supervisory framework. Three onsite examinations of three banks were conducted during the year with the assistance of an expert funded by IMF. The examination scope was extended to include market risk (interest rate and foreign exchange) and operational risk. Thus full scope examinations were conducted on all three banks including the verification of compliance with the Reserve Bank's reporting requirements as well as conducting internal control testing of banks' processes and procedures. The Reserve Bank examination team also completed a follow up visit to one bank in May 2013 to confirm the status of addressing the recommendations raised in the onsite visit in August 2012. The Reserve Bank will continue its onsite examination cycle of one bank every 2 years in the next financial year.

The Reserve Bank continued to enhance the enforcement of the Prudential Statements by conducting annual compliance checks as well as spot checks of compliance with the disclosure requirements on effective interest rates under Prudential Statement No. 4.

The Reserve Bank met with the Association of Banks in Tonga (ABT) to discuss issues that would continue to strengthen the soundness and stability of the financial system. Furthermore, the Reserve Bank continued to hold regular bilateral meetings with the banks in order to discuss their operations and get updates on their plans and strategies in light of the market developments to ensure they continue to operate prudently and in compliance with the Reserve Bank's requirements.

Financial Performance

The total assets of the financial system increased by \$17.1 million to \$521 million in 2012/13, an increase of 3.4%. The increase in the banks' assets was mainly due to a \$27.2 million in the Exchange Settlement Accounts (ESA). The increase in ESA largely reflected a major receipt by a private company as well as significant overseas development assistance received by the Government during the year. This was partially offset by a \$9.6 million (3.7%) decrease in total gross loans, which reflected the settlement of major loans as well as the write off of provisioned loans during the year.

At the end of the 2013 financial year, the banks' outstanding loans portfolio comprised of loans to industries and businesses, including agriculture (40.4%), private individuals (53% of which 34.9% was for housing) and statutory non-financial corporations (6.6%).

Financial Sector Deposit Accounts

	2011/12	2012/13
Demand Deposits		
Number of Accounts	14,852	17,104
Value of Deposits (\$m)	109.5	130.1
Saving Deposits		
Number of Accounts	30,335	31,760
Value of Deposits (\$m)	48.5	48.6
Time Deposits		
Number of Accounts	2,430	2,321
Value of Deposits (\$m)	156.2	146.7
Deposit by Other Banks		
Value of Deposits (\$m)	17.4	14.2
Total Number of Accounts	47,617	51,185
Total Value of Deposits (\$m)	331.7	339.6

Total liabilities increased by \$8.9 million (2.2%) to \$415 million. This was due mainly to a \$7.9 million (2.4%) increase in total deposits, compared with a decrease of \$9.2 million (2.7%) in 2011/12. The increase in total deposits largely reflected the increase in demand deposits. On the other hand, total provisions fell by \$2.5 million (8.1%),

reflecting the clearance of provisioned loans during the year.

The total number of accounts reported by banks increased by 8% to 51,185 and the total value of deposits increased by 2.4% to \$339.6 million.

Profitability

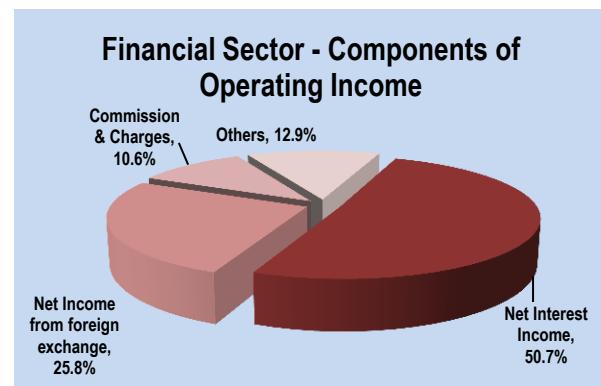
The profitability of the total financial sector decreased in the year ended June 2013 from the previous year. The total financial sector as a group showed an after-tax profit of \$8.9 million for the year ended June 2013, which is equivalent to 1.7% of average assets, compared with a profit of \$12.5 million for the previous year, which is equivalent to 2.4% of average assets. The decline in profitability compared to the year ended June 2012 was attributed mainly to an increase in provision expenses to 0.5% of average total assets compared to 0.2% the previous year. This reflects some loan downgrades and less loan recoveries during the year.

Financial Performance

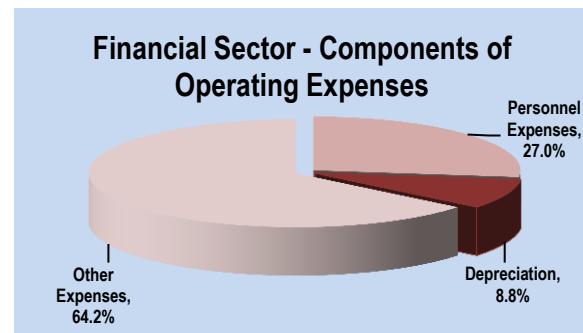
	2011/12	2012/13
Pre-tax Net Profit (% average total assets)	3	2.5
After-tax Net Profit (% average total assets)	2.4	1.7
Total Operating Income (% average total assets)	8.5	8.1
Net Interest Income (% average total assets)	3.9	4
Non-interest Income (% average total assets)	3.9	3.8
Total Operating Expenses (% average total assets)	5.2	5.1
Consolidated Risk-weighted Capital Ratio (%)	31.4	35.2

Total operating income decreased to 8.1% of average assets from 8.5% in 2011/12. The decrease in operating income was attributed mainly to a decrease in net interest income reflecting mainly the reduction of banks' lending interest rates as well as the continued decline in credit growth during the year. The bulk of banks' operating income was derived from the extension

of loans. The proportion of total operating income from net interest income decreased to 50.7% in 2012/13 compared with 54.4% in 2011/12 and similarly the proportion of operating income from commission and fees fell to 10.6% from 13.3% in the previous year. On the other hand, net income from other non-interest income increased to 12.9% from 7.1% in the previous year.

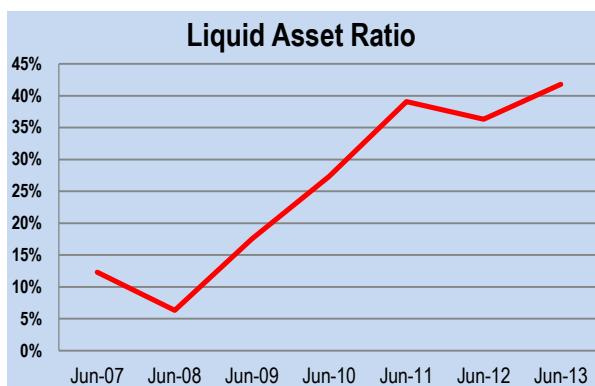


Total operating expenses slightly decreased to 5.1% of average assets in 2012/13, compared with 5.2% in 2011/12. This was mainly due to the increase in average assets which offset the increase in operating expenses over the year. About 27.0% of administrative expenses of the banks were taken up by employees' remuneration, a decrease from 30.5% in the previous year reflecting the reduction in number of staff. Depreciation and amortisation accounted for 8.8% of total administrative expenses and the balance of 64.1% was made up of the purchase of various goods and services necessary for the operations of the banks.



Liquidity

Liquidity in the banking system continued to increase during 2012/13, underpinned by major receipts by a private company and the Government coupled with the continued decline in loans. Net loans as a proportion of deposits¹ fell to 66.0% from 69.7% in June 2012. Furthermore, the Liquid Asset Ratio increased to 41.8% from 36.3% in 2011/12, which was well above the minimum Reserve Bank requirement of 5%.



Capital

The capital position of the banking industry remained strong and above the minimum ratio required by the Reserve Bank. The consolidated risk weighted capital ratio for all the banks increased to 35.2% at the end of June 2013, compared with 31.4% at the end of June 2012, and this is the highest level since June 2008. The higher capital position was mainly attributed to the increase in the banks' accumulated profits.



¹ Deposits = non-financial sector deposits + TDB promissory notes

Asset Quality

The overall quality of the banks' assets improved over the year ended June 2013 but still remains a concern. Total non-performing loans decreased by \$4.9 million (12.3%) to \$34.9 million, representing 14% of total loans for the year ended June 2013. The improvement over the year reflected the clearance of provisioned loans during the year. The total non-performing loans comprised of loans to businesses (72%), mainly the hotels and restaurants and wholesale and retail sectors, as well as housing for private individuals (17%).

Total provisions against loans fell by \$2.0 million (6.8%) to \$27.8 million which is slower than the rate non-performing loans declined over the year. The coverage ratio of the non-performing loans by total loan loss reserves improved to 79.5%, compared with 74.8% in June 2012.



Transaction Reporting Authority (TRA)

The Reserve Bank is the TRA under the Money Laundering and Proceeds of Crime Act 2000 (MLPC Act). The TRA's functions ensure the financial system is protected from money laundering and terrorist financing activities. This in turn supports the Reserve Bank's objective of promoting a safe and sound financial system.

The TRA's role and functions under the MLPC Act includes policy formulation and enforcement.

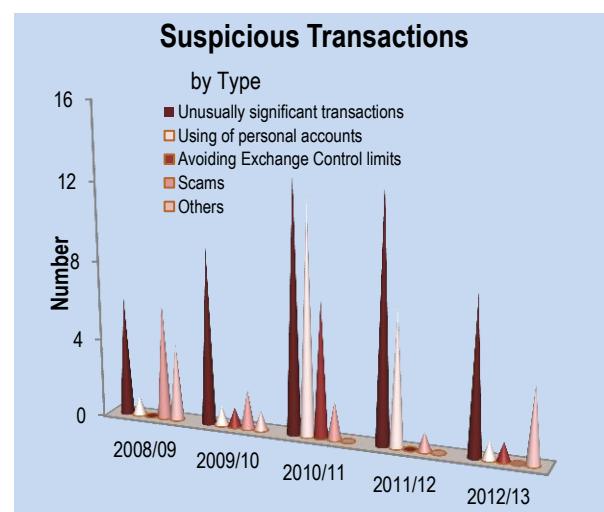
During the year, the TRA continued to implement the requirements of the MLPC 2010 legislative amendments and the recommendations from the 2009 Mutual Evaluation Report. The TRA issued to all reporting entities, the Currency Transaction Report (CTR) form for all transactions above T\$10,000 and collaborated with the Ministry of Revenue and Customs to issue the Border Currency Report (BCR) forms which came into effect in March 2013. These reports would assist with the monitoring and analysis of transactions. With the assistance of the Australian Transaction Reports and Analysis Centre (AUSTRAC), the TRA developed an Anti-Money Laundering/Combating Financing of Terrorism (AML/CFT) Guide for the authorized restricted foreign exchange dealers. This AML/CFT Guide has been issued to the Association of Banks in Tonga for their comments on whether the Guide would meet the banks' requirements and to address the proposed discontinuation of banking relationships with foreign exchange dealers due to their high AML risks. The TRA also provided training to banks and foreign exchange dealers on their obligations under the MLPC Act and Regulations to raise awareness and enhance compliance with the requirements of the Act.

The TRA and the members of the Sub Committee on Money Laundering and Terrorist Financing compiled Tonga's third detailed progress report which was discussed at the Asian Pacific Group (APG) on Money Laundering and Terrorist Financing 16th annual meeting in July 2013. Tonga was placed on "enhanced follow-up" due to its non-compliance with core recommendations on AML/CFT.

Number of Suspicious Transactions Reported (STR) to the TRA

	2008/09	2009/10	2010/11	2011/12	2012/13
STRs	17	14	34	21	14

The TRA received 14 STRs from the commercial banks and authorized restricted foreign exchange dealers during the year, representing a decrease of 20% from the previous year. Improved awareness through the training provided by the TRA contributed to the decrease in STRs being reported as reporting entities were more mindful of the elements and indicators of suspicious transactions.



The dominant STR indicator continued to be unusual significant cash deposits; withdrawals or telegraphic transfers that were inconsistent with the customer's profile or the sources of funds were undetermined. Only one STR was related to the usage of personal account for conducting of business transactions compared to seven reports that were received last year. The remaining reports were related to depositing of foreign currencies, attempted fraud and several remitters sending funds to the same recipients to avoid the Reserve Bank exchange control requirements. There were no scam related STRs filed this year.

Subsequent to the analysis of these STRs, 7 of the 14 STRs were reported to the Police (TCU) for

further investigations of possible money laundering and other serious offences. The remaining 7 STRs were to be disseminated to other law enforcement authorities such as the Ministry of Revenue for possible tax evasion and Immigration for possible breach of immigration laws. However, this awaits the signing of a Memorandum of Understanding between the members of the Cabinet Committee on AML/CFT. The dissemination of STR information and the sharing of information with other law enforcement agencies would improve and assist with the enforcement of AML/CFT related laws and regulations.

STRs Disseminated to Law Enforcement Agencies					
Law Enforcement Agencies	2008 /09	2009 /10	2010 /11	2011 /12	2012 /13
Police	11	8	32	16	7
Ministry of Revenue	0	2	14	14	0
Ministry of, Commerce, Tourism & Labour (MCTL)	0	0	1	0	0
Total STRs	11	10	32	16	7

The TRA also continued to disseminate 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.

The TRA and the Foreign Exchange Dealer Unit conducted onsite visits to 8 authorised restricted foreign exchange dealers in the process of the annual review of their licenses. All reporting entities were compliant with the AML requirements.

Interbank Cheques Clearance

The Reserve Bank facilitates a daily clearance service for the commercial banks to ensure a safe and efficient clearing system. The commercial banks operating in Tonga have signed an interbank clearing agreement to the clearance of cheques on a daily basis. A total number of 132,855 cheques were presented for clearance at the Reserve Bank during the financial year 2012/13, a decrease of 1% from the previous year. The decrease in the number of cheques being cleared may be attributed to the introduction of internet banking, eftpos and other forms of electronic payments by the commercial banks. The weak economic conditions during the 2012/13 year could also be a contributing factor. The clearance of cheques in the center is running well and all participants are committed to settle their dues on time. Reflecting the high level of liquidity available in the domestic market, there were no special cheque clearances between the banks during the year.

Financial Markets Operations

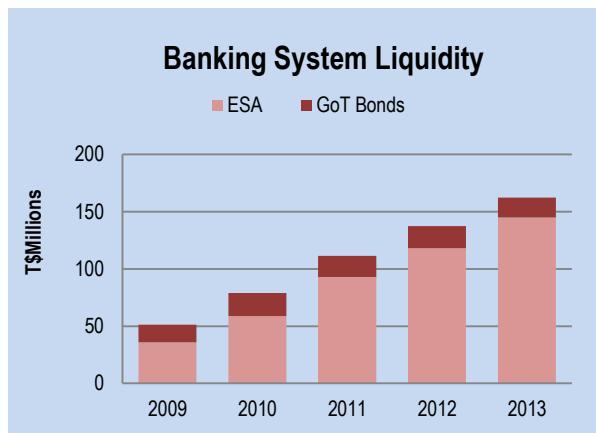
Monetary Policy Formulation

As detailed in recent Monetary Policy Statements, the Reserve Bank's policy target was to maintain the country's foreign reserves above three to four months of import cover and to promote inflation to remain below 6% per annum. Throughout the 2013 financial year, the level of official foreign reserves remained above eight months of import cover and overall inflation remained well below 6%. The Reserve Bank therefore continued to retain its highly accommodative policy stance. It made no changes to monetary policy throughout the year.

Domestic Market Operations

The Reserve Bank's accommodative monetary policy stance remained unchanged during the financial year 2012/13 and therefore did not issue any Reserve Bank notes. This is to continue to leave excess liquidity in the system to encourage banks to lend and support economic growth.

As of the 30 June 2013, the banking system liquidity stood at \$162.2 million, and increased from \$137.5 million at the end of June 2012. The banking system liquidity is comprised mainly of \$144.9 million in the banks' Exchange Settlement Accounts (ESA) held with the Reserve Bank and \$17.3 million of Government of Tonga Bonds held by the banks. This is compared with total liquidity of \$137.5 million at the end of June 2012. The higher liquidity this year was in line with the higher level of foreign reserves, the continued weak growth in credit as well as deferred import payments.



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.

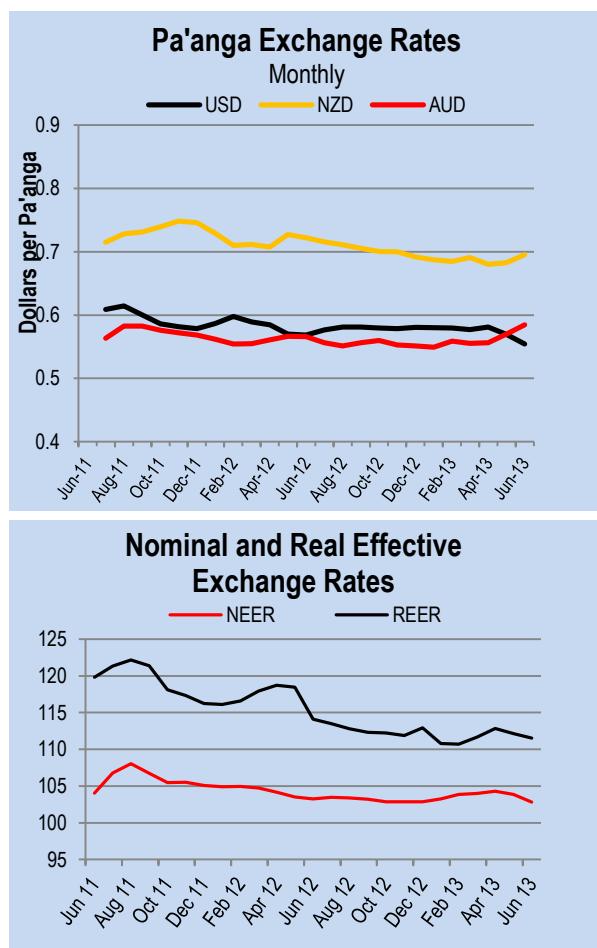
Foreign Exchange Operations

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 rate currency basket is reviewed annually however, the 2013 review has been deferred pending the finalization by the Economics Department of incorporating the foreign exchange dealers' transactions in the overall Overseas Exchange Transactions (OET) data. The exchange rate is set on a daily basis. These rates 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. Given the high and stable level of foreign

reserves, the Bank continued to make adjustments to the exchange rate during 2012/13 to maintain price stability. The Nominal Effective Exchange Rate (NEER) decreased by 0.4% over 2012/13 which reflected the weakening of the Tongan pa'anga against the currencies of its major trading partners. The Real Effective Exchange Rate (REER) fell by 1.3% over the same period as Tonga's inflation was lower than its trading partners during the year. The IMF's Article IV mission assessed Tonga's exchange rate as being broadly in line with its medium-term fundamentals. Work is in progress to finalise the methodology for calculating the NEER and the REER.

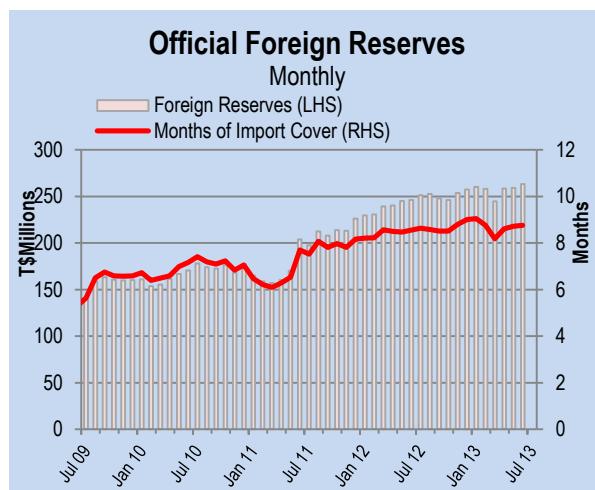
The pa'anga fluctuated against the USD and the NZD in narrower bands in 2012/13 compared to last year reflecting reduced volatility in the USD and NZD during the year. Meanwhile, the pa'anga against the AUD remained unchanged in 2012/13 compared to the previous year.



Foreign Reserves Management

The Reserve Bank Portfolio

The gross official foreign reserve was maintained well above the benchmark of 3 to 4 months of imports. The foreign reserves ranged between 8.2 months and 9.0 months of import cover during the year. The level of gross external reserves peaked at a record high of T\$263.3 million which was equivalent to 8.8 months of import coverage as at the end of June 2013. This compares with T\$246.1 million and 8.5 months of import as at 30 June 2012. The significant increase in the level of foreign reserves was attributed mainly to significant receipts by a private company and overseas development assistance for the Government, remittances as well as deferred import payments as a result of the weak economy.



During the year, the Reserve Bank was a net purchaser in the spot foreign exchange markets. Foreign exchange purchases of T\$133.0 million exceeded sales of T\$116.2 million giving a total foreign exchange turnover for the year of T\$249.2 million, a decrease from T\$343.2 million last year. The Reserve Bank also conducted foreign exchange operations for its other customers mainly the Government, and for its own account, in a range of currencies.



The management of the foreign reserves met the objectives of safety, liquidity and profitability although this continued to be a challenge given the global economic and financial crisis, the volatile exchange rates and the exceptionally low international interest rates. Nevertheless, the income on the investment of foreign reserves increased as a result of the higher level of foreign reserves over the year and the deviation from the currency benchmark portfolio. The currency composition of the foreign reserves was mainly in US dollars, Australian and the New Zealand dollars. The currency composition 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 exposes the Bank to exchange rate risk. The Reserve Bank therefore monitors closely the implications of the movements of the exchange rates on the value of the foreign reserves.

The Reserve Bank complied with all the Board approved risk parameters for the management of foreign reserves during the year and ensured that investments were held with banks rated above the Board approved minimum "A" rating by international credit rating agencies. The risk parameters are being reviewed for the Board's approval in September 2013. This will cater for the expected increase in the foreign reserves in 2013/14.

Exchange Control Operations

During 2012/13, the Reserve Bank processed 597 exchange control applications for payments of amounts above the delegated limit and all capital payments as stipulated in the Exchange Control guidelines. The approved exchange control applications amounted to T\$190.3 million in 2012/13 (of which 11% were classified as capital transactions) compared to the 648 exchange control applications (11% capital transactions) processed in 2011/12 amounting to T\$184.4 million. The decrease in the number of exchange control applications while the total amount of the applications increased reflects fewer larger valued applications were processed during the year. The exchange control data on foreign currency payments by large importers were key inputs to the Reserve Bank's foreign reserves forecast and monetary policy decisions. The Reserve Bank also received 41 applications for the removal of foreign currency cash over T\$10,000 across the border, of which all applications were approved totaling T\$16.6 million. This is an increase from 33 applications totaling T\$11.0 million in 2011/12 which was mainly due to favorable exchange rates offered overseas.

Spot checks were undertaken during the year to ensure banks and licenced foreign exchange dealers were compliant with the exchange control guidelines. The Reserve Bank conducted training with the banks and foreign exchange dealers to improve their understanding of its exchange control requirements.

Export Proceeds

The Reserve Bank continued to analyse the export trade data received from Tonga Customs and data on export proceeds to better understand the proportion of export proceeds being remitted back and the lag period between the shipment of export and the receipt of the export proceeds. This would assist the Bank's work towards setting up a framework for the return of export proceeds to Tonga. The analysis has shown that the data issues reported to the Board in 2011 have not changed. The Customs and Quarantine export data are understated and similarly for the export proceeds reported by the banks therefore more work needs to be done to improve the quality of the exports data. The Reserve Bank has included in its workplan the review of the Foreign Exchange Control Act and Regulations to incorporate a legal framework to facilitate the establishment of an export proceeds monitoring regime. These legal amendments are mandatory to be addressed to force the relevant stakeholders to improve the valuation of exports and the quality of export data.

Licensing Authorised Restricted Foreign Exchange Dealers

As at 30 June 2013, the Reserve Bank had licenced 4 and registered 6 authorized restricted foreign exchange dealers.

All foreign exchange dealers generally complied with the conditions of the licence/registration. This formed the basis for the Reserve Bank's approval of the applications for the renewal of all 10 authorised restricted foreign exchange dealers in January 2013. This included the renewal of Mana Money Transfer's licence which was later revoked in March 2013.

The Commercial Banks are licenced as authorised dealers under their banking licence. Two of the

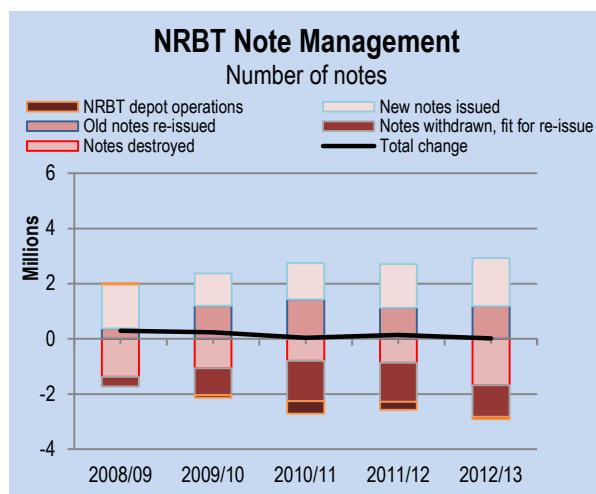
commercial banks, namely WBOT and MBf Bank currently have agency arrangements with MoneyGram.

During the year, the coordinated efforts of the Reserve Bank and the Ministry of Commerce, Tourism and Labour enhanced compliance with the requirement for businesses that were conducting foreign exchange business without a licence to apply for a licence and to facilitate procedures for licensing. The proposed review of the Foreign Exchange Control Act and Regulations would also include the strengthening of the Reserve Bank's powers to licence the authorised restricted foreign exchange dealers.

Compliance spot checks, quarterly meetings and training of the authorized foreign exchange dealers contributed to the improvement in the understanding and compliance with the conditions of licence/registration and the annual licence/registration renewal process.

Currency Management

The Reserve Bank is responsible for ensuring that there is an adequate supply of high-quality banknotes and coins in circulation to meet the public's currency needs.



During the 2013 financial year the amount of new notes issued by the Reserve Bank was valued at T\$25.1 million. This is an increase of T\$0.9 million or 215,000 pieces from the previous year (T\$24.2 million). However at the end of June 2013, the total value of notes on issue in Tonga was T\$36.6 million which is similar to that of the 2012 financial year.

In nominal terms the value of notes distributed by the Reserve Bank rose over the year, to its highest level on record of T\$42.9 million. The value of new notes issued rose particularly sharply during the Christmas celebrations. All currency notes of the Kingdom are printed by De La Rue Currency in the United Kingdom.

The Reserve Bank distributes almost all of its notes via the commercial banks, either by adding to their on-site stocks of notes or to their Note Trust Depots. The Depots hold the Reserve Bank's notes in custody of the commercial banks, ready for distribution via ATMs and tellers when

the need arises. The commercial banks have been reducing the amount of notes they hold in their Depots since the 2011 financial year, as they have become more averse to holding large amounts of cash on premises. This has increased the frequency of the commercial banks visits to the Reserve Bank vault. During the 2013 financial year, the Reserve Bank conducted surprise checks of the Depots, and found no discrepancies in the commercial banks' balances.

To maintain the quality of banknotes in circulation, the Reserve Bank destroyed almost 2.9 million pieces of unfit notes over the financial year, worth a total of T\$41.6 million. The amounts are much higher than that of previous years. This reflects the Reserve Bank's determination to improve the quality of notes that are out in circulation. There were also 9 counterfeits reported during the financial year down from 17 counterfeits the previous year. These counterfeits were 1 piece of \$20 pa'anga and 8 pieces of \$50 pa'anga note. The \$50 pa'anga counterfeits all shared the same serial number. All of the counterfeits were confirmed to be photocopied notes. The police was notified and an arrest was made. The Reserve Bank will continue to issue public notices and brochures on identifying counterfeit notes both in the English and Tongan language.

At the end of June 2013, the face value of coins on issue totaled \$1.97 million, compared with \$1.91 million of the previous year.

The Reserve Bank is still working on the development of a new family of coins to replace Tonga's existing coins in circulation.

Numismatic Notes and Coins

The Reserve Bank received royalty from the sale of numismatic coins directly to collectors and through agreements with specialised companies. Revenue from coin sales totaled \$31,289.21 over the 2013 financial year, which was higher than the previous year of \$23,500. The increase in income was mainly due to the sale of the Queen Elizabeth diamond jubilee numismatic coin. During the year, in consultation with World Coin Association, the Ministry of Finance and the Palace Office, two new numismatic coins were approved which the Reserve Bank anticipates will further increase royalty received from coin sales in the near future.

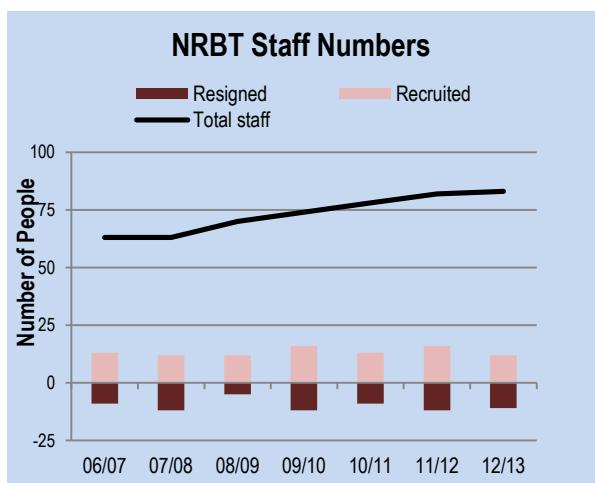
External Relations

Through participation in various international forums and bilateral relationships with other central banks, the Reserve Bank participates regularly in work aimed at addressing the ongoing challenges facing the global economy, the Pacific Region and Tonga. Particularly important relationships are those with other central banks in the South Pacific, and the IMF, which provides technical assistance to countries in the region and visits annually to complete comprehensive assessments of Tonga's economic and financial performance and policies. Often the participation in international forums requires senior officers of the Reserve Bank to travel overseas. For example, in October 2012, the Governor led the Tonga's delegation team to the IMF/World Bank annual meeting in Tokyo, Japan.

To support its routine analysis of Tonga's domestic economic and financial conditions, the Reserve Bank regularly meets with other stakeholders such as the banks, large private companies, development partners and their visiting delegations, as well as the Chamber of Commerce. The Reserve Bank also conducts surveys from large businesses around the country on a semi-annual basis.

Staffing

Embarking on a major organisational change program throughout the year, the Bank completed major reviews on the staff remuneration, corporate structure, process improvement as well as reviewing the vision, mission and values of the Bank. The reviews aimed at not only strengthening the transparency of the Bank's strategic direction but also at delivering greater efficiencies while enhancing staff professional growth and job satisfaction. Job titles were also reviewed to promote job ownership while reflecting the strategic significance of the roles. These job titles will be effective at the start of the next financial year. The Bank expects to complete the review of the staff loans policy in the next financial year.



Focusing on strengthening the Bank's capability, 11 people were recruited, mainly to fill vacant positions while strengthening the support needed at the Security and Human Resources Units. A New Zealand Volunteer under the Volunteer Support Abroad (VSA) was also engaged on a one year term to support facilitating the required human resources management programs. Through the quality support received from technical assistance and commitment from a total

of 80 staff and 3 daily note counters to the end of June 2013, the Reserve Bank continued to carry out its core responsibilities effectively.

Focusing on the institutional strengthening of the Bank's human resources, the Ministry of Education awarded one scholarship in Information System to the Bank commencing on the study program at the beginning of 2013.

Senior Management Training - NZIM



Back row: Tevita Kolokihakaufisi, Tupou 'Esau, Catherine Fonokalafi, Lu'isa Lapao'o, Netatua Afu, Sosefina Maileseni, Fe'ao Lasalo, 'Isapela Hufanga, Tevita Vahai
Front row: Lata Tangimana (Manager Accounts and Currency), 'Ungatea Latu (Manager Financial Institutions and Markets), Siosi Mafi (Governor), Jan Alley (NZIM), Jessie Cocker (Deputy Governor), 'Etikeni Samani (Manager IT and Administration), Adam Gorajek (Manager Economics)

Capitalizing on the value of its human capital, the Bank completed 85% of the training programs scheduled and emerged during the year. Staff professional development programs were carried out in various forms including on-the-job training, coaching, mentoring and through training providers locally and internationally. These programs aimed at strengthening the core competencies staff required to enhance performance. These include a Senior Management Training program conducted by the New Zealand Institute of Management (NZIM) where middle to senior staff of the Bank engaged and shared best strategies that would further strengthen their management capabilities. In April 2013, a change management workshop was facilitated by a former governor and current Advisor to Governor for

Reserve Bank of Fiji to initiate “new direction” where the Bank’s vision, mission and values were reviewed as mentioned earlier. This training program greatly assisted Management in implementing the change management initiatives scheduled for the year, while improving management and control required to deliver quality outputs. The Chairman of the Board, Governor and the Manager for Accounts and Currency attended a seminar with the Royal Australian Mint (RAM) on coinage reform and selection of good denominations, specifications and materials.

Change Management Workshop



Back row: 'Etikeni Samani (Manager IT & Administration), Kasaline Lolohea (Acting Assistant Manager IT & Administration), 'Ungatea Latu (Manager Financial Institutions and Markets), Lata Tangimana (Manager Accounts & Currency), 'Isapela Hufanga (Assistant Manager Financial Markets), Teau 'Isitolo (Assistant Guard Commander), Tupou 'Esau (Communication Officer)

Front row: Adam Gorajek (Manager Economics), Jessie Cocker (Deputy Governor), Siosi Mafi (Governor), Savenaca Narube (Former RBF Governor), Lorraine Seeto (Governor Advisor - Reserve Bank of Fiji), David Dally (HR Advisor-VSA)

Under the Bank’s financial support program, a senior officer of the Bank returned to work after successfully completing a postgraduate program in Information System from the University of New South Wales, Australia. Taking the initiatives to enhance career opportunities, some staff members chose to self-finance their tertiary studies.

Instances of Official Study

	by Financial Year			
	Completed		In Progress	
	2011/12	2012/13	2011/12	2012/13
Post Graduate	1	-	3	1
First Degree	-	-	2	2
Part time studies	-	-	3	0
Diploma	-	-	1	1
Certificate	-	-	1	1
Online courses	-	-	4	4

The Reserve Bank and its staff are grateful for the continued advisory and technical support from overseas organizations including the Asian Development Bank (ADB), the IMF, the Reserve Bank of Fiji and the University of Technology, Sydney.

The Financial Institutions Department also received technical assistance from the IMF & AUSTRAC to assist with the banking licence & offsite analysis as well as risk assessment and the development of supervision strategies for financial institutions and cash dealers. The TRA received technical assistance from the AUSTRAC on conducting a risk assessment of financial institutions and cash dealers and develop a risk-based supervisory strategy on a risk-based approach. Furthermore, AUSTRAC co-hosted with the APG and FATF (Financial Action Task Force) a Pacific regional workshop on Pacific Typologies & Revised FATF Standards in March 2013. This was the first workshop provided on Pacific specific typologies and the revised changes to the FATF 40 Recommendations. The TRA also participated on an attachment training program to Fiji Financial Intelligence Unit (FIU) in May 2013. These were rewarding training and capacity building opportunities for the TRA in enhancing their analysis and intelligence management skills.

Instances of Training

	by Financial Year*			
	Number of training events		Number of participants	
	2011/12	2012/13	2011/12	2012/13
In-house	6	3	98	37
External	10	1	23	16
Local	6	1	17	2
Overseas	4	16	6	17

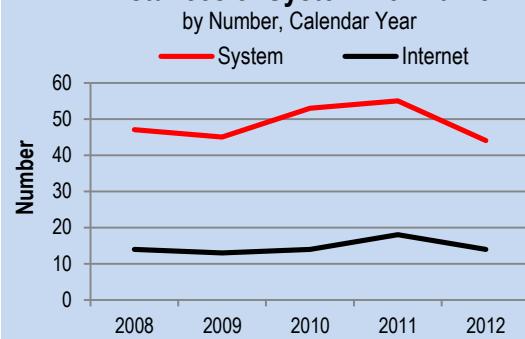
*Excluding official academic studies

Short Term Consultants and Technical Assistance (TA)

Descriptions	Department	Funding Source
Onsite visit examination & training- IMF	Financial Institutions	IMF
Remuneration Review-PwC, Fiji	Human Resource	NRBT
Review Vision, Mission & Values – Asian Development Bank (ADB)	Management	NRBT
Change Management Program - ADB	Management	NRBT
Process Review - RBF	All Departments	NRBT
Banking licence & offsite analysis-IMF	Financial Institutions	IMF
Payment system-World Bank	Financial Institutions	World Bank
Risk assessment and developing of supervision strategies for financial institutions and cash dealers-AUSTRAC	Financial Institutions	AUSTRAC
IT Auditors-PwC, Fiji	Information Technology	NRBT
Review the classification of OET CODES (Overseas Exchange Transaction) -IMF	Economics Department	IMF
Forecasting methods for inflation and interest rates-University of Technology, Sydney	Economics Department	University of Technology Sydney

To ensure that the Information Technology (IT) infrastructure of the Bank continue to support effective communication, security of information and operational efficiency, three IT staff attended computer training programs at Datec Training Center in Fiji. The training programs aimed at enriching and upgrading the staff knowledge and skills on updated technologies such as the servers, email system and virtualization. Attending these courses proved effective management of IT related risks that could adversely affect the delivery of the Bank's key outputs. Towards the end of the financial year, the IT Department completed a major IT Audit that helped identify key risk areas. In the next financial year, the IT Department will focus on mitigating the IT strategic and operational risks while ensuring the Bank is operating according to IT best practices and complying with international standards and frameworks.

Instances of System Downtime



Property

The Reserve Bank occupies 45% of the office space while other institutions rented the rest of its leased property of five storeys, at Salote Road in Fasi-mo-e-Afi.

The Security Unit contributed to the maximum physical security of the Bank, its assets, safety of the Bank's staff and tenants.

Through the Bank's structural review program during the year, the Building Unit was separated from the General Administration Department to be effective from 1 July 2013. A new position was also created to strengthen the management and control required to ensure routine maintenance is conducted to sustain business continuity while the Bank and its tenants operate efficiently and effectively in a safe and secured working environment. This was supported by the close collaboration between the staff from the Security Unit and the General Administration Department throughout the year.

With the assistance of the Security Unit, most of the major works completed include:

- a. Implementation of the Air Condition Project;
- b. Refurbishment of Standby Generator;
- c. Redesign of the Level 1 Training Room for staff training and meetings;
- d. Redesign of the Compactor Shed for storage;
- e. Construction of a Safe Cabinet for Backup Tapes offsite;
- f. Review of the electrical system;
- g. Refurbishment and improvement to Level 3 Suite 4 Office;
- h. Replacement and Re-modification of High Security Gate Motor;
- i. Replacement of NRBT Master Meter;
- j. Installation of Control Room UPS;
- k. Installation of Indicator Lights for Inner/Outer Mantrap Doors.

Some of the onsite works were supported by external technicians from Tonga Power Limited, Chubb NZ, Otis Elevator Company Ltd, Itrolect Limited, and Trade Air Engineering Ltd.

The Building Unit continued to assist the Bank's Emergency Team in providing guidelines for evacuation processes during natural disaster including hurricane, tsunami, earthquake and fire warnings.

NATIONAL RESERVE BANK OF TONGA

FINANCIAL STATEMENTS

YEAR ENDED 30 JUNE 2013

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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 2013, 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
HRH Princess Salote Mafile'o Pilolevu Tuita	
Mr Richard Prema	
Mrs Siosi C Mafi – Governor	- up to 5 July 2013
Mr Tiofilusi Tiueti	- up to 14 May 2013
Dr Sione Ngongo Kioa	- from 8 February 2013 and Governor from 21 August 2013
Mrs Sinaitakala Tu'itahi	- from 8 February 2013
Mrs Balwyn Fa'otusia	- from 14 May 2013

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 2007, shall be, to:

- a) maintain internal and external monetary stability; and
- b) promote a sound and efficient financial system

The principal functions of the Bank shall be, to:

- a) issue currency;
- b) formulate and implement monetary policy;
- c) regulate as required the supply, availability and international exchange of money;
- d) hold and manage the external reserves of the Kingdom;
- e) provide advisory services to the Minister on banking and monetary matters;
- f) be the principal banker, fiscal agent and depository of the Government;
- g) undertake banking business, in Tonga or elsewhere;
- h) regulate and supervise financial institutions; and
- i) oversee and promote the efficient, sound and safe functioning of the payment system.

3. TRADING RESULTS

The net profit available for distribution of the Bank for the year ended 30 June 2013 was \$2,720,446 (2012: \$1,971,583).

4. GENERAL RESERVES

In accordance with Section 8(1) (c) of the National Reserve Bank of Tonga (Amendment) Act, 2007, there is no amount transferred to the General Reserve at year end.

5. PAYABLE TO GOVERNMENT

In accordance with Section 8(3) of the National Reserve Bank of Tonga (Amendment) Act, 2007, subject to Section 8(1) and Section 8(2), the amount of \$2,720,446 (2012: \$1,971,583) is payable to the Government of the Kingdom of Tonga.

DIRECTORS' REPORT - Continued

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. DIRECTORS 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. EVENTS SUBSEQUENT TO BALANCE DATE

On 5 July 2013, Mrs Siosi C Mafi completed her contract as Governor of the National Reserve Bank of Tonga. On 21 August 2013, Dr Sione Ngongo Kioa was appointed Governor of the National Reserve Bank of Tonga.

Since the end of the financial year the directors are not aware of any matter or circumstances not otherwise dealt with in the report that has significantly affected the operations of the Bank, the results of those operations or the state of affairs of the Bank in subsequent financial years.

11. BASIS OF ACCOUNTING

The directors believe the basis of the preparation of financial statements is appropriate and the Bank will be able to continue in operation for at least 12 months from the date of this statement.

Accordingly the directors believe the classification and carrying amounts of assets and liabilities as stated in these financial statements to be appropriate.

12. 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 20th September, 2013.



Mr Steve Edwards
Chairperson



Dr 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 2013;
- (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 2013;
- (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 2013;
- (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 2013; 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 2013.

For and on behalf of the Board of Directors in accordance with a resolution of the Directors this 20th day of September, 2013.



.....
Mr Steve Edwards
Chairperson



.....
Dr Sione Ngongo Kioa
Governor

INDEPENDENT AUDITOR'S REPORT

To the Shareholder of the National Reserve Bank of Tonga

Report on the Financial Statements

We have audited the accompanying financial statements of the National Reserve Bank of Tonga (the 'Bank'). The financial statements comprise the balance sheet of the Bank as at 30 June 2013 and the statements of comprehensive income, distribution, changes in equity and cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes.

Directors' and Management's Responsibility for the Financial Statements

Directors and Management are responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting described in note 2 of the financial statements and in the manner required by the National Reserve Bank of Tonga Act, 1988, and the National Reserve Bank of Tonga (Amendment) Act, 2007. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

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

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

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

Emphasis of Matter

Without qualifying our opinion, attention is drawn to notes 2 (a) and (b) to the financial statements which refer to the reporting framework and the policy on the treatment of exchange gains and losses.

INDEPENDENT AUDITOR'S REPORT - Continued

Opinion

In our opinion, the accompanying financial statements have been prepared, in all material respects, in accordance with the basis of preparation and 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, and the National Reserve Bank of Tonga (Amendment) Act, 2007.

Restriction on Distribution or Use

This report is made solely to the Bank's shareholder. Our audit work has been undertaken so that we might state to the Bank's shareholder 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 Bank's shareholder as a body, for our audit work, for this report, or for the opinions we have formed.

20 September 2013

Suva, Fiji

PricewaterhouseCoopers

PricewaterhouseCoopers
Chartered Accountants

BALANCE SHEET
AS AT 30 JUNE 2013

NATIONAL RESERVE BANK OF TONGA

	Notes	2013	2012
		\$	\$
ASSETS			
Foreign Currency Assets			
Short Term Investments and Current Accounts	8	239,168,224	223,623,829
Accrued Interest		5,240,409	2,635,513
International Monetary Fund (IMF)	9		
- Reserve Tranche Position		4,684,272	4,525,735
- Special Drawing Rights		19,398,095	18,737,316
Local Currency Assets			
Cash on Hand	18	74,649	6,492
Accrued Interest		1,029	3,181
Other Assets	10	3,639,760	2,468,191
International Monetary Fund - Currency Subscription	9	13,444,187	13,734,172
Property, Plant and Equipment	11	<u>9,334,188</u>	<u>9,016,894</u>
Total Assets		<u>294,984,813</u>	<u>274,751,323</u>
LIABILITIES			
Foreign Currency Liabilities			
Accrued Interest		324	636
Demand Deposits	12(a)	8,773,231	6,977,278
IMF Special Drawing Rights Allocation	9	18,009,830	17,400,389
Local Currency Liabilities			
Payable to Government	13	2,720,446	1,971,583
Demand Deposits	12(b)	178,470,362	162,703,677
Accrued Interest		21,900	318,163
Other Liabilities	16	1,274,095	879,787
Currency in Circulation	14	38,540,418	38,480,984
Statutory Reserve Deposits	15	16,261,000	16,253,000
International Monetary Fund - Currency Subscription	9	13,444,187	13,734,172
Provisions for Employee Entitlements	17	<u>62,894</u>	<u>132,822</u>
Total Liabilities		<u>277,578,687</u>	<u>258,852,491</u>
NET ASSETS		<u>\$ 17,406,126</u>	<u>\$ 15,898,832</u>
		<u>=====</u>	<u>=====</u>
CAPITAL AND RESERVES			
Authorised Capital		5,000,000	5,000,000
		<u>=====</u>	<u>=====</u>
Paid Up Capital		5,000,000	5,000,000
General Reserves	2(n)	10,000,000	10,000,000
Revaluation Reserve Account	2(o)	<u>2,406,126</u>	<u>898,832</u>
TOTAL CAPITAL AND RESERVES		<u>\$ 17,406,126</u>	<u>\$ 15,898,832</u>
		<u>=====</u>	<u>=====</u>

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

STATEMENT OF COMPREHENSIVE INCOME

NATIONAL RESERVE BANK OF TONGA

YEAR ENDED 30 JUNE 2013

	Notes	2013	2012
		\$	\$
Income			
Interest income	4	6,192,434	5,535,690
Other income	5	<u>1,693,592</u>	<u>2,122,446</u>
Total Operating Income		<u>7,886,026</u>	<u>7,658,136</u>
Expenses			
Interest expense	6	569,965	1,156,802
Administration and other expenses	7	<u>4,595,615</u>	<u>4,529,751</u>
Total Operating Expenses		<u>5,165,580</u>	<u>5,686,553</u>
Net profit available for distribution		<u>2,720,446</u>	<u>1,971,583</u>
Net gains arising from the translation of foreign currency balances to local currency	2 (b)	<u>1,507,294</u>	<u>537,199</u>
Other comprehensive income		<u>1,507,294</u>	<u>537,199</u>
Total comprehensive income		\$ 4,227,740	\$ 2,508,782
		=====	=====

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

STATEMENT OF DISTRIBUTION

NATIONAL RESERVE BANK OF TONGA

YEAR ENDED 30 JUNE 2013

	Notes	2013	2012
		\$	\$
Net profit available for distribution		\$ 2,720,446	\$ 1,971,583
		=====	=====
Distribution as follows:	2(n)		
Transfer to General Reserves as required under Section 8(1)(c) of the National Reserve Bank of Tonga (Amendment) Act, 2007		-	-
Balance Payable to Government of Tonga as required under Section 8(3) of the National Reserve Bank of Tonga (Amendment) Act, 2007	13	<u>2,720,446</u>	<u>1,971,583</u>
		=====	=====
		\$ 2,720,446	\$ 1,971,583
		=====	=====

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

STATEMENT OF CHANGES IN EQUITY

NATIONAL RESERVE BANK OF TONGA

YEAR ENDED 30 JUNE 2013

	Paid up Capital	General Reserves	Revaluation		Total
			\$	\$	
Balance 30 June 2011	\$ 5,000,000	\$ 10,000,000	\$ 361,633	\$ 15,361,633	
Net gains arising from the translation of foreign currency balances to local currency	-	-	537,199	537,199	
Transfer to General Reserves (as provided for under Section 8(1)(c) of the National Reserve Bank of Tonga (Amendment) Act, 2007, and approved by the Minister of Finance)	-	-	-	-	
Balance 30 June 2012	\$ 5,000,000	\$ 10,000,000	\$ 898,832	\$ 15,898,832	
Net gains arising from the translation of foreign currency balances to local currency	-	-	1,507,294	1,507,294	
Transfer to General Reserves (as provided for under Section 8(1)(c) of the National Reserve Bank of Tonga (Amendment) Act, 2007, and approved by the Minister of Finance)	-	-	-	-	
Balance 30 June 2013	\$ 5,000,000	\$ 10,000,000	\$ 2,406,126	\$ 17,406,126	
	=====	=====	=====	=====	

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

	Notes	2013	2012
		\$	\$
CASH FLOWS FROM OPERATING ACTIVITIES			
Interest received		3,584,273	5,079,008
Rental income		858,276	1,014,670
Numismatic sales		35,191	25,814
Other income		653,567	1,083,276
Purchase of currency	(	1,894,392)	(376,643)
Interest paid	(	866,541)	(1,017,916)
Payments to suppliers and employees	(	(3,382,488)	(3,787,383)
Net cash (outflow) / inflow from operating activities	(	<u>1,012,114</u>	<u>2,020,826</u>
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of fixed assets	(	827,478)	(213,932)
Net movement in IMF accounts	(	819,316)	423,191
Net movement in staff loans		<u>21,905</u>	<u>375,566</u>
Net cash (outflow) / inflow from investing activities	(	<u>1,624,889</u>	<u>584,825</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
Net issue of currency in circulation		59,435	3,955,496
Net movement in demand deposits		26,759,870	26,114,548
Net movement in statutory deposits		8,000	369,000
Net movement in Government of Tonga accounts	(	11,179,898)	11,204,291
Net movement in funds held for clearance		485,413	(2,992,446)
Net movement in IMF SDR Allocation		<u>609,441</u>	<u>(328,132)</u>
Net cash inflow from financing activities		<u>16,742,261</u>	<u>38,322,757</u>
Net increase in cash and cash equivalents		14,105,258	40,928,408
Cash and cash equivalents at the beginning of the financial year		223,630,321	182,164,714
Net effect of change in exchange rates	2 (b)	<u>1,507,294</u>	<u>537,199</u>
Cash and cash equivalents at the end of the financial year	18	\$ 239,242,873	\$ 223,630,321
		=====	=====

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 principal objectives as a central bank, as defined in Section 4 of the NRBT (Amendment) Act 2007, shall be, to:

- a) maintain internal and external monetary stability; and
- b) promote a sound and efficient financial system.

The principal functions of the Bank shall be, to:

- a) issue currency;
- b) formulate and implement monetary policy;
- c) regulate as required the supply, availability and international exchange of money;
- d) hold and manage the external reserves of the Kingdom;
- e) provide advisory services to the Minister on banking and monetary matters;
- f) be the principal banker, fiscal agent and depository of the Government;
- g) undertake banking business, in Tonga or elsewhere;
- h) regulate and supervise financial institutions; and
- i) oversee and promote the efficient, sound and safe functioning of the payment system.

These financial statements have been approved for issue by the Board of Directors on 20th September 2013.

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 and the National Reserve Bank of Tonga (Amendment) Act, 2007. 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 2013. 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 2015

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS – continued

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 and the Miscellaneous Amendments (Privy Council) Act 2010, 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 \$1,507,294 (2012 \$537,199)

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 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. According to the National Reserve Bank of Tonga (Amendment) Act 2007, 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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS – continued

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)**

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS - continued

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 and staff make contributions to a staff provident scheme based on the years of service.

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS - continued

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 2007 states that:
 - 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, 50% of the net profit to be transferred to the General Reserve until the General Reserve is equal to the authorised capital of the Bank; and
 - c) where the General Reserve exceeds 100% but does not exceed 200% of the authorised capital of the Bank, 25% or a lesser sum to increase the General Reserve to twice the authorised capital 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.

	<u>2013</u>	<u>2012</u>
	\$	\$
Foreign currency assets		
Short Term Commercial Paper		
and current accounts	<u>239,168,224</u>	<u>223,623,829</u>
Total financial investments	<u>\$ 239,168,224</u>	<u>\$ 223,623,829</u>
	=====	=====

The Bank's end of year concentration of credit exposure, based on the country in which the counterparty is resident, is as follows:

	<u>2013</u>	<u>2012</u>
	\$	\$
Australia		
New Zealand	174,601,098	162,463,212
United States of America	46,913,403	45,734,026
Switzerland	16,521,265	14,305,475
United Kingdom	946,541	933,313
Fiji	142,603	134,826
	<u>43,314</u>	<u>52,977</u>
Total financial investments	<u>\$ 239,168,224</u>	<u>\$ 223,623,829</u>
	=====	=====

3. FINANCIAL RISK MANAGEMENT - Continued

The following table presents the Bank's financial assets based on Standard & Poor's 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 Supranational.

	<u>2013</u>	<u>2012</u>
	\$	\$
AAA	381,921	2,069,801
AA1	16,521,265	14,305,475
AA	409,569	81,781
A1	220,865,613	206,180,482
B	43,314	52,977
N/R	<u>946,542</u>	<u>933,313</u>
Total financial investments	\$ 239,168,224	\$ 223,623,829
	=====	=====

(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.

3. FINANCIAL RISK MANAGEMENT – Continued

(b) Liquidity Risk - continued

Maturity Analysis as at 30 June 2013

	0-3 months	3-12 months	1- 5 years	Over 5 Years	No Specific maturity	Total
Liabilities						
Foreign Currency Liabilities						
Accrued Interest	324	-	-	-	-	324
Demand Deposits	8,773,231	-	-	-	-	8,773,231
IMF Special Drawing Rights Allocation	-	-	-	-	18,009,830	18,009,830
Local Currency Liabilities						
Payable to Government	2,720,446	-	-	-	-	2,720,446
Demand Deposits	178,470,362	-	-	-	-	178,470,362
Accrued Interest	21,900	-	-	-	-	21,900
Other Liabilities	832,889	3,124	-	-	438,082	1,274,095
Currency in Circulation	-	-	-	-	38,540,418	38,540,418
Statutory Reserve Deposits	-	-	-	-	16,261,000	16,261,000
International Monetary Fund - Currency Subscription	-	-	-	-	13,444,187	13,444,187
Employee Provisions	42,931	-	2,402	17,561	-	62,894
Total Liabilities (contractual maturity dates)	190,862,083	3,124	2,402	17,561	86,693,517	277,578,687

3. FINANCIAL RISK MANAGEMENT - Continued

(b) Liquidity Risk - continued

Maturity Analysis as at 30 June 2012

	0-3 months	3-12 months	1- 5 years	Over 5 Years	No Specific maturity	Total
Liabilities						
Foreign Currency Liabilities						
Accrued Interest	636	-	-	-	-	636
Demand Deposits	6,977,278	-	-	-	-	6,977,278
IMF Special Drawing Rights Allocation	-	-	-	-	17,400,389	17,400,389
Local Currency Liabilities						
Payable to Government	1,971,583	-	-	-	-	1,971,583
Demand Deposits	162,703,677	-	-	-	-	162,703,677
Accrued Interest	318,163	-	-	-	-	318,163
Other Liabilities	438,544	1,151	-	-	440,092	879,787
Currency in Circulation	-	-	-	-	38,480,984	38,480,984
Statutory Reserve Deposits	-	-	-	-	16,253,000	16,253,000
International Monetary Fund - Currency Subscription	-	-	-	-	13,734,172	13,734,172
Employee Provisions	93,984	7,771	6,449	24,618	-	132,822
Total Liabilities (contractual maturity dates)	172,503,865	8,922	6,449	24,618	86,308,637	258,852,491

3. FINANCIAL RISK MANAGEMENT – Continued

(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 2013 and 2012 in Tonga Pa'anga equivalents.

At 30 June 2013	USD	AUD	GBP	NZD	Other	Total
ASSETS						
Short Term Investments and Current Accounts	108,361,771	90,460,890	147,118	40,155,131	43,314	239,168,224
Accrued Interest	283,937	3,730,191	1	1,225,405	875	5,240,409
International Monetary Fund						
- Reserve Tranche Position	-	-	-	-	4,684,272	4,684,272
- Special Drawing Rights	-	-	-	-	19,398,095	19,398,095
Total Assets	108,645,708	94,191,081	147,119	41,380,536	24,126,556	268,491,000
LIABILITIES						
Demand Deposits	8,604,197	169,034	-	-	-	8,773,231
Accrued Interest	-	-	-	-	324	324
IMF Special Drawing Rights Allocation	-	-	-	-	18,009,830	18,009,830
Total Liabilities	8,604,197	169,034	-	-	18,010,154	26,783,385
NET POSITION	100,041,511	94,022,047	147,119	41,380,536	6,116,402	241,707,615

3. FINANCIAL RISK MANAGEMENT - Continued

(c) Market Risk - continued

(ii) Foreign exchange risk – continued

At 30 June 2012	USD	AUD	GBP	NZD	Other	Total
ASSETS						
Short Term Investments and Current Accounts	95,065,454	89,607,130	139,246	38,684,825	127,174	223,623,829
Accrued Interest	347,915	1,664,934	1	621,179	1,484	2,635,513
International Monetary Fund						
- Reserve Tranche Position	-	-	-	-	4,525,735	4,525,735
- Special Drawing Rights	-	-	-	-	18,737,316	18,737,316
Total Assets	95,413,369	91,272,064	139,247	39,306,004	23,391,709	249,522,393
LIABILITIES						
Demand Deposits	5,943,094	1,034,184	-	-	-	6,977,278
Accrued Interest	-	-	-	-	636	636
IMF Special Drawing Rights Allocation	-	-	-	-	17,400,389	17,400,389
Total Liabilities	5,943,094	1,034,184	-	-	17,401,025	24,378,303
NET POSITION	89,470,275	90,237,880	139,247	39,306,004	5,990,684	225,144,090

(iii) Sensitivity to Foreign Currency Risk and Interest Rate Risk

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

Impact of:	2013	2012
Change in equity due to a +/-5% appreciation / depreciation of the Tonga Pa'anga	12,085,381	11,257,205
Change in profit/loss due to a rise/drop of +/-1 %age point in interest rate	2,431,871	2,127,160

4. INTEREST INCOME

	<u>2013</u> \$	<u>2012</u> \$
Overseas investments	6,187,018	5,516,478
Staff loans	<u>5,416</u>	<u>19,212</u>
	\$ 6,192,434	\$ 5,535,690
	=====	=====

5. OTHER INCOME

Numismatic coins	35,108	25,814
Rental income	1,010,249	1,013,355
Gain on sale of assets	19,971	-
Forex sales/ purchases	583,233	1,037,350
Bank user fees	21,676	15,597
Information services – publications	50	1,155
Miscellaneous	<u>23,305</u>	<u>29,175</u>
	\$ 1,693,592	\$ 2,122,446
	=====	=====

6. INTEREST EXPENSE

Foreign currency accounts	20,093	47,571
Domestic currency accounts	<u>549,872</u>	<u>1,109,231</u>
	\$ 569,965	\$ 1,156,802
	=====	=====

7. ADMINISTRATION AND OTHER EXPENSES

Administration	1,514,510	1,488,333
Retirement fund	135,605	201,108
Staff costs	1,567,193	1,504,090
Audit fees	15,393	15,345
Currency issue	852,730	908,195
Depreciation	<u>510,184</u>	<u>412,680</u>
	\$ 4,595,615	\$ 4,529,751
	=====	=====

8. SHORT TERM INVESTMENTS AND CURRENT ACCOUNTS

Current accounts	18,302,610	17,443,347
Short term investments	<u>220,865,614</u>	<u>206,180,482</u>
	\$ 239,168,224	\$ 223,623,829
	=====	=====

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 2013, Tonga's membership subscription to the International Monetary Fund was SDR6,900,000 (2012: SDR6,900,000). Of this total amount, SDR1,711,633 (2012: SDR1,711,633) 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 IMF and is allocated to members on the basis of their quotas in the Fund. As at 30 June 2013, the Special Drawing Rights holdings had a balance of SDR 7,088,064 (2012: SDR 7,086,453).

10. OTHER ASSETS

	<u>2013</u>	<u>2012</u>
	\$	\$
Staff loans and advances	37,380	59,285
Currency and numismatics	3,394,796	2,352.570
Other assets	<u>207,584</u>	<u>56,336</u>
	\$ 3,639,760	\$ 2,468,191
	=====	=====

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 & Office Equipment	Furniture & Fittings	Motor Vehicles	Work in Progress	TOTAL
At 30 June 2011						
Cost	11,907,453	2,220,058	254,147	176,640	51,715	14,610,013
Accumulated depreciation	(4,097,421)	(1,289,508)	(168,036)	(148,093)	()	(5,703,158)
Net book value	7,810,032	930,450	86,111	28,547	51,715	8,906,855
Year Ended 30 June						
2012						
Opening net book value	7,810,032	930,450	86,111	28,547	51,715	8,906,855
Additions	4,401	187,615	21,916	-	308,787	522,719
Transfer in/(out)	14,104	39,695	-	-	(53,799)	-
Depreciation	(205,000)	(169,008)	(111,643)	(27,029)	-	412,680
Closing Net book value	7,623,537	988,752	98,384	1,518	306,703	9,016,894
At 30 June 2012						
Cost	11,925,958	2,447,368	276,063	176,640	306,703	15,132,732
Accumulated depreciation	(4,302,421)	(1,458,616)	(179,679)	(175,122)	()	(6,115,838)
Net book value	7,623,537	988,752	98,384	1,518	306,703	9,016,894
Year Ended 30 June						
2013						
Opening net book value	7,623,537	988,752	96,384	1,518	306,703	9,016,894
Additions	480,055	250,939	-	96,484	-	827,478
Transfer in/(out)	247,748	37,721	21,234	-	(306,703)	-
Depreciation	(249,609)	(231,192)	(15,505)	(13,578)	()	(510,185)
Closing Net book value	8,101,731	1,045,920	102,113	84,424	-	9,334,188
At 30 June 2013						
Cost	12,653,761	2,736,028	297,297	273,124	-	15,960,210
Accumulated depreciation	(4,552,030)	(1,690,108)	(195,184)	(188,700)	()	(6,626,022)
Net book value	8,101,731	1,045,920	102,113	84,424	-	9,334,188

12. (a) FOREIGN CURRENCY DEMAND DEPOSITS

	<u>2013</u>	<u>2012</u>
	\$	\$
Government of Tonga	8,718,539	6,920,445
Other institutions	<u>54,692</u>	<u>56,833</u>
	\$ 8,773,231	\$ 6,977,278
	=====	=====

(b) LOCAL CURRENCY DEMAND DEPOSITS

International banks	29,688	32,435
Domestic banks	145,835,383	119,070,627
Government of Tonga	<u>32,605,291</u>	<u>43,600,615</u>
	\$ 178,470,362	\$ 162,703,677
	=====	=====

13. PAYABLE TO GOVERNMENT

Amount payable to government in accordance with Section 8(3) of the National Reserve Bank of Tonga (Amendment) Act 2007	\$ 2,720,446	\$ 1,971,583
	=====	=====

14. CURRENCY IN CIRCULATION

Notes	36,568,409	36,572,451
Coins	<u>1,972,009</u>	<u>1,908,533</u>
	\$ 38,540,418	\$ 38,480,984
	=====	=====

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

Other creditors and accruals	1,182,749	717,988
Payable to the National Reserve Bank of Tonga		
Staff Provident Scheme – refer note below	<u>91,346</u>	<u>161,799</u>
	\$ 1,274,095	\$ 879,787
	=====	=====

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

	<u>2013</u> \$	<u>2012</u> \$
Opening balance	132,822	115,330
Entitlements during the year	118,579	105,749
Utilised/reversals	<u>(188,507)</u>	<u>(88,257)</u>
	\$ 62,894	\$ 132,822
	=====	=====

18. CASH AND CASH EQUIVALENTS

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

	<u>2013</u> \$	<u>2012</u> \$
Cash on hand	74,649	6,492
Short term investments and current accounts	<u>239,168,224</u>	<u>223,623,829</u>
	\$ 239,242,873	\$ 223,630,321
	=====	=====

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 2013 were Steve Edwards (Chairperson), Siosi Mafi (Governor), HRH Princess Salote Pilolevu Tuita, Richard Prema Tiofilusi Tiueti, Sione Ngongo Kioa, Sinaitakala Tu'itahi and Balwyn Fa'otusia.

During the year, the following executives were identified as key management personnel of the Bank: Siosi C Mafi (Governor), Jessie Cocker (Deputy Governor), Lata Tangimana (Manager Accounts and Currency), 'Etikeni Samani (Manager Administration and Information Systems), 'Ungatea Latu (Manager Financial Institutions and Markets), and Adam Gorajek (Manager Economics).

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:

	<u>2013</u> \$	<u>2012</u> \$
Provident Fund payments made by the Bank	<u>135,605</u>	<u>201,108</u>
	\$ 135,605	\$ 201,108
	=====	=====

19. RELATED PARTIES - continued

The funds of the Provident Scheme are invested within the Bank at an average rate of 3.69% (2012: 3.98%) per annum. The total interest paid by the Bank for the financial year amounted to \$3,173 (2012: \$14,303). The Trustees of the Provident Scheme 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:

	<u>2013</u> \$	<u>2012</u> \$
Rental and utilities income invoiced to Tonga SAT	71,788	72,539
Purchase of goods	1,214	382

The Directors are paid fees and sitting allowances for services rendered.

The Directors entitlements to the retirement fund at year end amounted to \$256,475 (2012: \$193,469). The Bank also provides non-cash benefits to the Executive officers in addition to their salaries.

Total remuneration below is included in 'administrative costs.'

	<u>2013</u> \$	<u>2012</u> \$
Executive officers	368,549	352,483
Director's fees and remuneration	<u>66,594</u>	<u>55,872</u>
	\$ 435,143	\$ 408,355
	=====	=====

20. COMMITMENTS

(a) Operating lease commitments

Lessee Disclosure

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

Details of the major operating leases are 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-mo-e-Afi for 100 years ending 27 July 2091. Under the agreement, rent is payable at \$3,000 per year.
- (ii) On 6 April 1990 the bank entered into an agreement with His Majesty the King of Tonga to rent the property in Kolofo'ou for 100 years ending 5 April 2089. Under the agreement, rent is payable at \$2,000 per year.

20. **COMMITMENTS - continued**

(a) **Operating lease commitments - continued**

Lessee Disclosure - continued

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

	<u>2013</u>	<u>2012</u>
	\$	\$
Due not later than one year	5,000	5,000
Due later than one year but not later than five years	20,000	20,000
Due later than five years	<u>366,000</u>	<u>371,000</u>
	\$ 391,000	\$ 396,000
	=====	=====

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:

	<u>2013</u>	<u>2012</u>
	\$	\$
Due not later than one year	785,212	863,194
Due later than one year but not later than five years	<u>45,955</u>	<u>851,527</u>
	\$ 831,167	\$ 1,714,721
	=====	=====

(b) **Capital and other commitments**

	<u>2013</u>	<u>2012</u>
	\$	\$
Commitment not provided for in the financial statements are as follows:		
Capital commitment: approved and contracted	\$ 95,420	\$ 693,880

21. **CONTINGENT LIABILITIES**

Contingencies not otherwise provided for in the accounts and which existed at 30 June 2013 comprise:

- (i) Contracts for foreign exchange transactions was nil (2012: \$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.

23. EVENTS SUBSEQUENT TO BALANCE DATE

On 5 July 2013, Mrs Siosi C Mafi completed her contract as Governor of the National Reserve Bank of Tonga. On 21 August 2013, Dr Sione Ngongo Kioa was appointed Governor of the National Reserve Bank of Tonga.

No charge on the assets of the Bank has arisen since the end of the financial year to the date of this report to secure the liabilities of any other person.

No contingent liability has arisen since the end of the financial year to the date of this report.

No contingent or other liability has become enforceable or is likely to become enforceable within a period of twelve months after the date of this report which, in the opinion of the directors, will or may affect the ability of the Bank to meet its obligations as and when they fall due.

