



National Reserve Bank of Tonga

E BANK OF TONGA

26
Years of Service

**ANNUAL
REPORT**
2016 for the Year Ended 30 June 2016

ANNUAL REPORT

2016 for the Year Ended 30 June 2016

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Our Mission

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

Our Vision

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

Our Values

Integrity | Innovation | Team work | Excellence



Governor's Foreword

It is indeed my pleasure to present the National Reserve Bank of Tonga Annual Report and Financial Statements for the year ended 30th June, 2016. This Annual Report reviews the Reserve Bank's policies and operations during the financial year in-line with the principal objectives and the functions outlined in the NRBT Act.

During the 2015/16 financial year, the Tongan economy continued to grow at above 3% for the second consecutive year supported by the rebound in the agricultural and marine sectors, as well as growth in the trade, tourism and construction sector. Inflation remained low at 0.1% in the year ended June 2016 following two consecutive months of annual deflation. Total credit to businesses for construction and manufacturing as well as private individual housing loans grew by 14.5%, slightly exceeding the Reserve Bank's expectations of 14.4% growth and was supported by low interest rates and the persistently high liquidity in the banking system. Despite the challenges of de-risking by the foreign banks and the closing down of the foreign exchange dealers' accounts, remittances continued to remain above T\$200 million per annum, and the inflow of donor funds supported the increase in the foreign reserves to T\$354.9 million (9.4 months of imports) by the end of June 2016.

In terms of financial stability, the financial system remained strong and sound during the year. Levels of capital adequacy and liquidity in the banking system remained high, and earnings as well as non-performing loans improved. Due to major changes to the structure of the financial system during the year, the Reserve Bank ensured that the financial system continued to serve Tonga's financial needs and granted a new license to Bank South Pacific of Papua New Guinea on the 10th July 2015 as well as facilitate the de-licensing of Wespac Bank of Tonga which ceased its operations on the same day, closely monitored the Tonga Development Bank expansion of its services to include commercial banking and foreign exchange services, as well as address public concerns on banks' interest rates and fees and charges.

Against this background of a sound financial system, low inflation and high foreign reserves that is fundamental for macroeconomic stability, the Reserve Bank retained its accommodative monetary policy stance for the seventh consecutive year to maintain this positive trend in economic growth.

Similar to some economies in the region, the persistent high liquidity in the banking system reduced the effec-

tiveness of the monetary policy transmission mechanism and became the main concern for the Reserve Bank throughout the year. The Reserve Bank therefore pursued a mix of policies to strengthen the monetary policy transmission by implementing macro-prudential policies such as: setting a minimum loans to deposit ratio for banks; developing the financial markets to strengthen the monetary policy transmission mechanism; and drafted legislation to regulate non-banks to protect their customers and encourage access to finance. Acknowledging the contribution of the Micro, Small and Medium Enterprises (MSMEs) sector, to employment and inclusive economic growth, the Reserve Bank as a member of the Alliance for Financial Inclusion (AFI) network, committed to the Maputo Accord as well as other financial inclusion initiatives with the intention to formulate a national strategy to support access to finance particularly MSMEs for agriculture, fishing, tourism, youth and women.

On the financial performance and operations, in accordance with the NRBT Act, the Reserve Bank's financial accounts were audited by PricewaterhouseCoopers, Fiji and submitted to the Minister of Finance together with a summary of the Reserve Bank's operations during the year. Overall, the Reserve Bank's net profit available for distribution rose to T\$4.1 million of which T\$2.89 million will be transferred to the Government. The increase in net profit is attributed to interest income from the investment of foreign reserves as well as the gain on the sale of Reserve Bank assets. This income was offset by the increase in expenses for the issuing of the new currency to replace the currency that was recalled as well as administration and staff cost. These expenses were measures to maintain the quality of currency in circulation at a high standard, modernise the IT and communications infrastructure to prevent and manage operational risks, extensions to the Reserve Bank premises, as well as train and retain professional staff at the bank.

Throughout the year, there were changes to the Governance composition of the Reserve Bank, the longest serving Director of 19 years, HRH Princess Sālote Mafile'o Pilolevu Tuita resigned from the Board in February and the Board members welcomed Director 'Uhila Liaava'a as a new member. The Chairman and Directors acknowledge the invaluable contributions of HRH Princess Sālote Mafile'o Pilolevu Tuita as a Director and former Chairperson of the Board. The Directors also reviewed the Reserve Bank's Corporate Plan 2015-2017, after the first year of implementation and noted that 70% of the targets were achieved, some of the targets that were not achieved were due to matters that were beyond the Reserve Bank's control. The Directors also endorsed the Reserve Bank Corporate Plan 2016/17 – 2018/19.

I would like to take this opportunity 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, the non-bank financial institutions including the authorized foreign exchange dealers 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 Reserve Bank staff for their commitment and hard work during the year which contributed to the Reserve Bank achieving its objectives in 2015/2016 which are presented in this Annual Report.



Dr. Sione Ngongo Kioa
Governor

Functions and Objectives

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

Objectives of the Bank

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

Maintaining internal monetary stability is pursued by the Reserve Bank through promoting low and stable inflation over the medium term. The Reserve Bank's 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, Section 4A also sets out the Reserve Bank's functions:

“The principal functions of the Bank shall be, to:

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

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

Governance

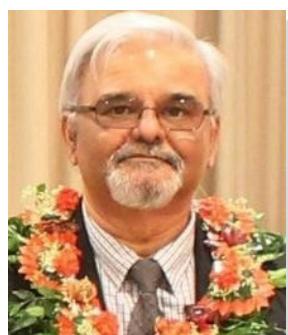
Board of Directors



Chairman
Mr. Steve Edwards



Director
HRH Princess Salote
Mafile'o Pilolevu Tuita
Resigned 1 February 2016



Director
Mr. Richard Prema



Director
Mrs. Sinaitakala Tu'itahi



Director
Mr. 'Uhila Liava'a
Appointed on 5 February 2016



Governor
Dr. Sione Ngongo Kioa



*Director (Secretary
for Finance)*
Mr. Tatafu Moeaki

Key Decision Makers

The Board of Directors comprises of the Chairman (non-executive Director), the Governor, Secretary for Finance, and 4 other non-executive Directors. The Governor, who is the Chief Executive Officer of the Bank, is responsible to the Board for the management and execution of the Bank's policy. Under the NRBT Act and the Amendment Acts, the Directors are appointed for terms of up to five years by the Minister of Finance and may be reappointed. During the year, one Director resigned and one new Director was appointed. As at the end of June 2016, one Director position remained vacant.

In accordance with the Act, the Board must meet at least 10 times during the calendar year to discuss and formulate the policies of the Bank and to monitor its operations. The Board Sub-Committee also met regularly to discuss and vet all Board matters well before every Board meeting and fulfill any requirements for further consideration at the Board. While the Board Sub-Committee met 13 times during the financial year, the Board met 16 times to formulate the policy of the Bank, monitor the Bank's operations and provided strategic direction and advice to the Governor.

The Board of Directors are responsible for the Reserve Bank's policy and affairs. This involves constantly reviewing the performance of the Reserve Bank in the conduct of its functions and its use of resources, and may give advice to the Governor not only to sustain the efficient and effective management of the Bank's operation but also to ensure that the Reserve Bank delivers its core functions in compliance with the NRBT Act and related Acts.

Section 9A of the NRBT Amendment Act 2014, which came into effect in October 2014, specifies the powers and functions of the Board which may not be delegated. During the year, the Board of Directors diligently carried out these powers and functions and defined and adopted the accommodative monetary policy stance which was published in the bi-annual Monetary Policy Statements in August 2015 and February 2016. The Directors also considered policy measures to stimulate economic growth in Tonga, they recognized the important role of Small and Medium Enterprises (SMEs) in job

creation, poverty alleviation, promotion of exports and investment. In this regard, the Directors endorsed the Reserve Bank's commitment to the Alliance for Financial Inclusion Maputo Accord 2015 to support the development of SMEs through access to finance. The Reserve Bank successfully applied and received grant funds for a project to enhance access to finance for SMEs by 20% in 2020.

To encourage banks to utilize the excess liquidity in the banking system to lend and thereby support economic development, the Directors also approved a new requirement for banks to maintain this loans/deposit ratio of 80% by December 2016, and progressively increase further.

The Directors also discussed the economic implications of the foreign exchange levy. The Directors then approved that the Reserve Bank absorb the foreign exchange levy and not pass it on to its customers. The Directors defined and adopted financial stability policies, foreign exchange policies and other policies of the Reserve Bank regarding the execution of its functions. These policies included the amendments to the Reserve Bank's Exchange Control Policy Guidelines as well as the Anti-money laundering Policy and Guidelines.

To ensure financial stability was maintained and the continuation of banking services to the people of Tonga the Directors also discussed the proposed changes to the payment system and reforms to implement an automated transfer system, reviewed the South Pacific Business Development (SPBD) Microfinance Ltd. operations, and considered ways to address de-risking by the commercial banks which had resulted in the closing of foreign exchange dealers accounts and some local bank's US dollar foreign correspondent bank accounts overseas. The Directors also continued to closely monitor one commercial bank and its compliance with the Reserve Bank directives, the Bank South Pacific (BSP's) compliance with the Reserve Bank requirements in its first year of operations, as well as the commercialization of the Tonga Development Bank and its new products. The Directors discussed the banking system developments which included the commercial banks liquidity, capital, credit growth and profitability as well as their exchange rates, interest rates and fees & charges. During the year,

the Board did not issue any new prudential statements to the banks. To monitor the implementation of the policies and the exercise of the functions of the Bank, the Directors were updated on the operations of the banks at the monthly Board meetings. The implementation of the Reserve Bank's functions by management was also discussed at the sub-committee meetings.

To ensure the operations of the Reserve Bank are carried out efficiently and effectively during the year, the Directors approved the review and changes to general policies and internal rules applicable to the administration and operations of the Reserve Bank. The endorsement of numismatic coin proposals to enhance the numismatic income of the Reserve Bank as well as the sale of the car park rental property to Bank South Pacific were approved by the Directors. During the year, the Board also approved changes to the Staff Remuneration Policy through changes to the Provident Fund Scheme Rules

and staff benefits including the Staff Loan Scheme Policy and Staff Travel Policy. These changes contributed to strengthening the Bank's Corporate Plan strategic priority of positioning the Reserve Bank as the employer of choice while maintaining a high staff retention rate.

The Directors also endorsed the 2016/17 annual budget of the Reserve Bank as well as the annual report for 2014/15. Monthly financial statements comparing the actual financial outcomes against the budget were also approved by the Directors and sent to the Minister of Finance and the Prime Minister's Office to be published in the Government Gazette. The Board also recommended the appointment of Price Waterhouse Coopers as the external auditors of the Bank to the Minister in accordance with section 53 of the National Reserve Bank Act. The Board met with the external auditor to discuss the external audit report and management letter for 2014/15 and monitored management's response and actions.



*From Left to Right: Ms. Jessie Cocker (Deputy Governor/Secretary to the Board), Mr. 'Uhila Liava'a, Mr. Richard Prema, Mr. Steve Edward, Mrs. Sinaitakala Tu'itahi, Dr. Sione Ngongo Kioa (Governor),
Absent: Mr. Tatafu Moeaki (Secretary for Finance)*

Organisational Chart

National Reserve Bank of Tonga Organizational Structure – 30th June 2016

BOARD OF DIRECTORS

–

Governor

Dr. Sione Ngongo Koa

Deputy Governor

Ms. Jessie Coker

Assistant Governor - Operation

Mr. La'ata Tangimana

Assistant Governor - Policy

Ms. Umgataea Atu

Head of Corporate Services

Mr. Elkeni Samani

Manager Accounts
Ms. Tersa Toiga

Manager Currency
Mr. Tevita Kolo'ihakauasi

Manager Corporate Services
Mrs. Kasaine Lohoe

Manager Financial Institutions
Mr. Tevita Vahai

Manager Financial Markets
Ms. 'Isapela Hulangi

Manager Economics
Ms. Aina Soakai

General Counsel
Ms. Meli Margis

Guard Commander
Mr. Semisi Fifita

Corporate Plan

The Reserve Bank for the first time launched its first Board Approved Corporate Plan in January 2015. In April 2016, the Directors reviewed this 3 year Corporate Plan after the first year of implementation and it was noted that 70% of the targets were achieved in its first year, some of the targets that were not achieved were due to matters that management could not control such as the request for Technical Assistance from the IMF to develop the Act and to supervise the non-bank financial institutions. The targets achieved are highlighted in this annual report. Revisions to the Corporate Plan were also approved and the Reserve Bank Corporate Plan 2016/17 – 2018/19 was reissued to Management .

The Corporate Plan 2016/17 – 2018/19 is a 3-year rolling plan, from January 2016 through to December 2019. This provides Management with the opportunity to assess the Plan and ensures there are sufficient resources budgeted in the Bank's budgeting cycle to implement the Plan. Management will update the Board at least once annually on the progress of implementing the Plan.

Our Mission

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

Our Vision

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

Our Values

We will pursue our mission with:

- Integrity – Being professional and exercising sound judgment;
- Innovation – Continually improving what we do;
- Team work – Working together for a more effective Bank;
- Excellence - Producing high quality work.

STRATEGIC PRIORITIES

Strategic Priority 1:

Set a Platform for Tonga Becoming a High-Growth Economy

Strategic Priority 2:

Develop Tonga's Financial Markets

Strategic Priority 3:

Become the Employer of Choice

Strategic Priority 4:

Modernize the Operations of the Bank

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

Economic Overview

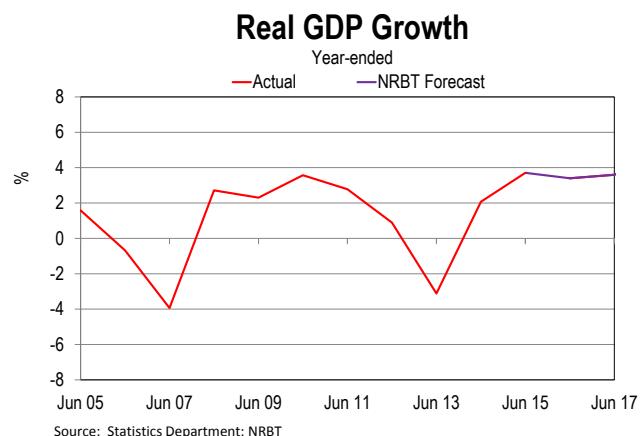
Overseas Economies

The International Monetary Fund (IMF) revised downwards its global economic growth forecast to 3.1% from 3.2%. This is due to the expected macroeconomic and political consequences of a sizeable increase in uncertainty of Britain leaving the European Union which is further expected to take a toll on confidence and investment thus affecting global financial markets. The U.S., China, Australia and New Zealand economies reportedly all experienced growth over the year ended June 2016 quarter. However GDP growth for U.S., Australia, New Zealand, and Japan are expected to slow down whilst China is expected to experience slight growth. Crude oil prices rose as a result of declines in excess oil supply.

Developments in the Domestic Economy

Domestically, real sector performances continued to support the National Reserve Bank of Tonga's (NRBT) estimated real GDP growth of 3.4% for 2015/16. This economic growth forecast, which is consistent with the IMF Article IV's projection of 3.1% growth, is supported by the rebound in the agricultural and marine sectors, and strong growth in the construction, trade, tourism and financial sectors.

Both the agricultural and marine exports have recovered during 2015/16. Total agricultural exports volume rose over the year by 379.8 tonnes (4.6%), attributed mainly to higher export volumes of squash, sweet potatoes, breadfruit and kava products. This outweighed a decline in the exports of taro, yam, coconut, watermelon, taro leaves and sandalwood. Squash exports increased the most by 1,568.7 tonnes (71.2%) followed by kava powder exports rising by 60.7 tonnes (29.7%) despite the current shortage in the supply of kava.



Higher exports of kava powder recorded in October 2015 was due to the re-opening of the market in Europe. In addition, the High Temperature Forced Air (HTFA) machine has resumed its operation at the airport thus also contributed to the rise in exports. Furthermore, the increase in the catch rate of tuna and snapper during the year contributed to a growth of marine export volumes by 723.7 metric tons (72.8%) in June 2016. The increase in the number of fishing vessels also supported the overall rise in marine exports. The continuous support from government through the Government Development Loans at Tonga Development Bank also supports the anticipated growth in the primary sector.



Local crops showcase during Agriculture Show 2016

Construction activities grew during the year with rises in individual housing loans and business loans for construction and manufacturing purposes, supporting a strong growth in the secondary sector.

The trade sector advanced over the year, supported by an increase in total number of containers registered by 1,389 registrations (16.4%). This reflected the events that occurred during the year, including the King's coronation, annual church conferences, reunions and the Tupou College Toloa 150th anniversary. Furthermore, the increasing number of imported second hand cars bought online from Japan contributed to the annual rise in vehicle registrations by 770 vehicles. The benefits of the fibre optic cable and the better internet connection facilitated the online purchasing and choice of vehicles. Fuel prices continued to decline over the year to June 2016 hence supporting the annual increase in vehicle registrations. The 5% increase in the Cost of Living Allowance (COLA) in the civil servants salaries in November 2015 also fueled strong consumer demand.

Likewise, the overall performance of the tourism industry in 2015/16 strengthened as expected by the Reserve Bank. In the year to June 2016, the total number of international arrivals increased by 13,785 passengers (14.2%). Air arrivals grew the most by 9,736 passengers (11.9%), followed by cruise ships arrivals rising by 4,022 visitors. The annual events and festivities during the year have contributed to this rise. Additionally, 14 cruise ships were recorded in 2015/16 compared to only 12 that ar-



Vava'u, Ha'apai and 'Eua Agricultural, Fisheries and Industrial Show 2016

rived in 2014/15. The introduction of the Air New Zealand Boeing 777 flights and the commencement of Fiji Airways direct flight from Fiji to Vava'u during the year also contributed to the increase.

Monetary Policy Formulation

Monetary policy actions

Over the year to June 2016, inflation remained low and foreign reserves were at a comfortable level well above the minimum range of 3-4 months of import cover; exchange rates were relatively stable and competitive; the financial system remained sound as it maintained strong capital and liquidity positions, weighted average interest rates narrowed; and the domestic economy grew strongly. Therefore the Reserve Bank maintained the current accommodative monetary policy stance.

The focus of the Reserve Bank's monetary policy actions was to consider measures to encourage the full utilization of the excess liquidity in the banking system for lending activities to support economic growth. However, as the 2016 IMF Article IV mission had recommended, the Reserve Bank will remain vigilant and will closely monitor early signs of vulnerabilities. The following policy actions are being taken by the Reserve Bank to enhance its role in promoting macroeconomic and financial stability:

1) Imposed a new requirement for banks to maintain a minimum loans/deposit ratio of 80% by December 2016, and progressively increase further. This is to encourage banks to utilize the excess liquidity in the banking system to lend and thereby support economic development.

2) Engaged technical assistance from the IMF to develop the domestic financial markets in order to be more market based, to improve the attractiveness of investments in local securities and also strengthen the monetary policy transmission mechanism. This includes considering interest rate as a new monetary policy tool.

3) Completed the amendment to the Foreign Exchange Control Act to improve the Reserve Bank's ability to protect the foreign reserves through the establishment of a framework for the return of proceeds of exports of goods and services rendered in Tonga, and requiring

residents' holdings overseas to be repatriated back to Tonga, and improvement to enforcement powers for the enforcement of exchange control requirements. The draft amendments are to be forwarded to the Minister of Finance for processing.

4) Completed the drafting of legislations for the supervision and regulation of microfinance institutions, money lenders, credit union. Other laws to be drafted are for the supervision of retirement funds, insurance companies, investment banks and capital markets. This would encourage improved access to finance but in a prudent way that would protect the interest of customers of the NBFI.

5) Financial inclusion initiatives to support inclusive economic growth. This includes developing strategies and policies to improve access to financial services, by the population at large throughout Tonga, as well as supporting the development of Small to Medium Enterprises (SMEs) and their access to finance.

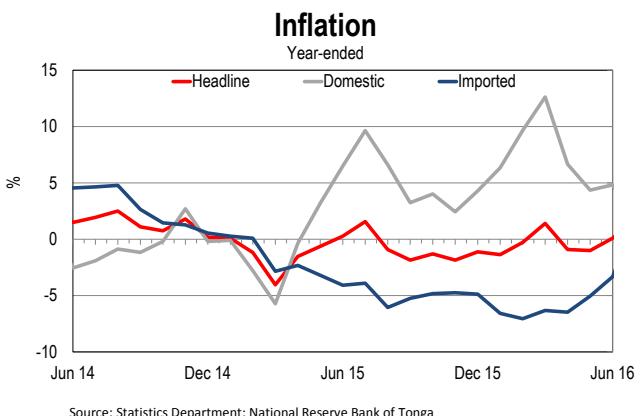
6) Amendment to the Financial Institutions Act to strengthen the controllership and receivership provisions and rename as the Banking Act as it focuses on bank supervision only.

Monetary Policy Outcomes

Headline inflation remained relatively low during 2015/16. Annual headline inflation increased by 0.1% in June 2016 following two consecutive months of deflation. A 4.8% rise in domestic prices outweighed a 3.3% decline in imported prices. High domestic prices reflected the hike in kava-Tonga prices, which has now increased by 137% over the year to \$80 per kilo. In addition, domestic food prices rose by 1.3%, reflecting high demand due to the annual church conferences and the special events that were held in June 2016 particularly the celebration of the Tupou College Toloa 150th anniversary. However, the decline in imported prices was due to a fall in prices of imported meat, fruits and vegetables.

Over the year ended June 2016, total OET (Overseas Exchange Transactions) receipts rose by \$135.9 million (26.2%) to \$654.8 million driven by higher receipts of remittances, budgetary support, government grants, interbank transfers, travel and other services. Similarly,

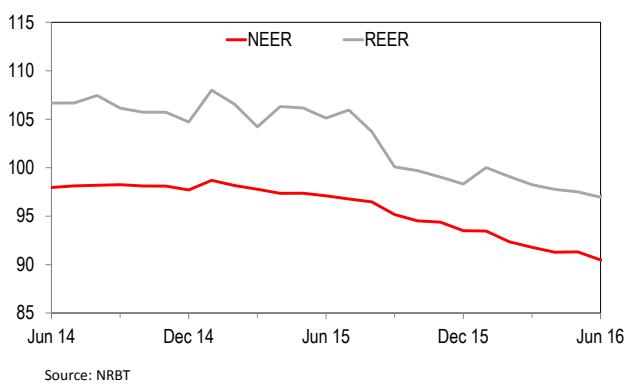
total OET payments continued to rise by \$62.5 million (12.4%) to \$568.7 million which is attributed to higher import, services and transfer payments. The overall balance for the year ended June 2016, which is equivalent to the net change to foreign reserves, was a surplus of \$65.2 million, equivalent to USD\$29.3 million which is more than the IMF's projection of USD\$16 million. Compared to June 2015, the overall balance is now \$50 million higher than it was a year ago.



Agriculture have recovered during 2015/16.

Nominal and Real Effective Exchange Rates

Monthly

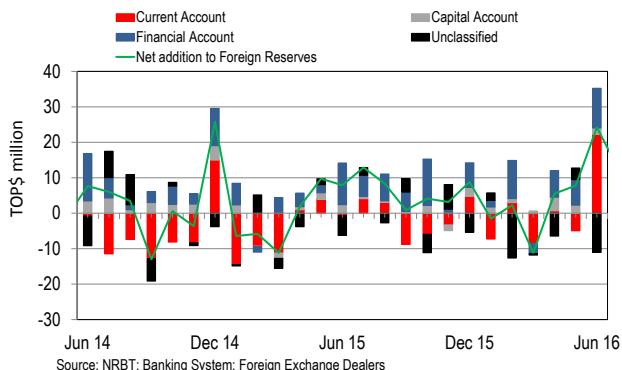


Source: NRBT

Foreign reserves rose to \$354.9 million in June 2016, sufficient to cover 9.4 months of imports, well above the Reserve Bank's minimum range of 3 – 4 months. The level of foreign reserves at the end of June was equivalent to USD \$159.7 and is close to the IMF's projection of USD \$158.6 million by the end of 2015/16, but with lower months of import cover of 6.2 months. The foreign reserves press release is posted on to the website every month for the awareness of the public.

Balance of Overseas Exchange Transactions

Monthly



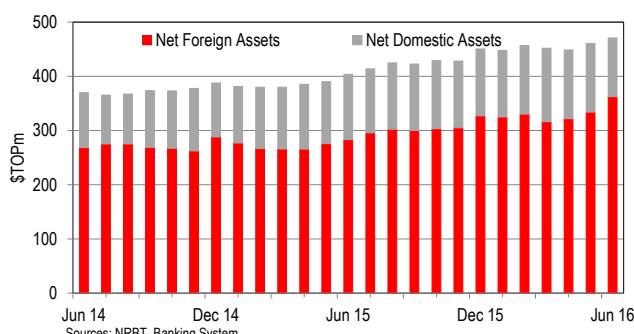
Source: NRBT; Banking System; Foreign Exchange Dealers

The majority of Tonga's major trading currencies have strengthened against the Tonga Pa'anga over the year ended June 2016, namely the U.S. dollar, Australian dollar, New Zealand dollar, Fijian dollar and the Japanese Yen. As a result, both the Nominal Effective Exchange Rate (NEER) and the Real Effective Exchange Rate (REER) depreciated over the year by 6.8% and 7.8% respectively. The lower REER indicates an improvement in Tonga's price competitiveness against that of its major trading partners.

Over the year to June 2016, broad money increased by \$67.2 million (16.7%) underpinned by a significant rise in net foreign assets of \$79.3 million (28%) which outweighed a \$12.2 million (10.1%) decline in net domestic assets. This is the highest annual growth recorded for net foreign assets which is attributed mainly to the continued increase in foreign reserves. Banking system liquidity also rose over the year by \$31.1 million (13.8%) due mainly to a \$15.9 million (10.5%) rise in banks' deposits to the Reserve Bank vault.

Broad Money

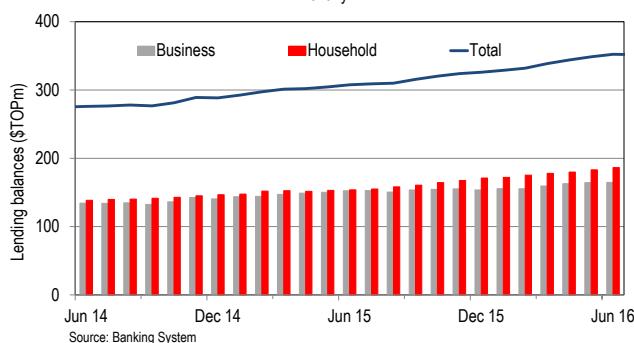
Monthly



In year ended terms, total bank lending rose to another record high of \$352.3 million in June 2016, increasing by \$44.7 million (14.5%) over the year ended June 2016. The increase in annual total bank lending slightly exceeded the Reserve Bank's forecast of 14.4% growth for 2015/16. Household loans remained as the main driver of the annual growth in credit. Lending activities in the non-bank financial institutions also increased over the year by \$15.2 million (14%) to \$124 million, reflecting rises in both household and business lending. Weighted average interest rate spread narrowed over the year by 27.1 basis points from 5.88%, due to declines in both the weighted average lending and deposit rates.

Banks' Lending

Monthly

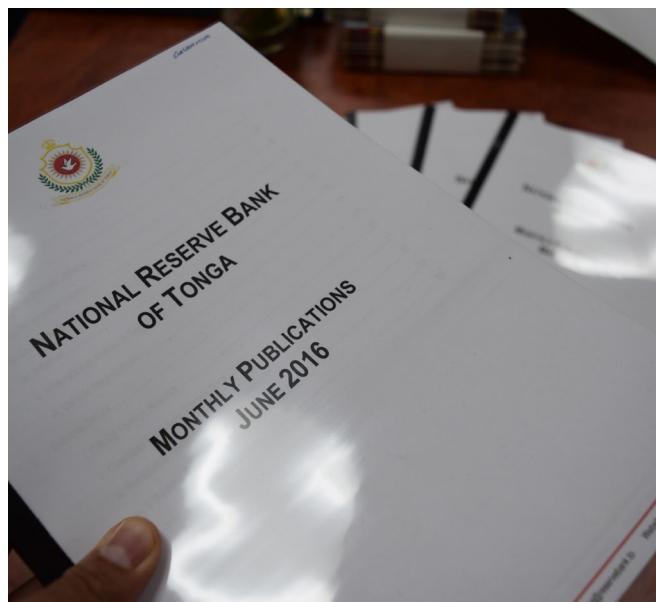


Source: Banking System

Net credit to government fell over the year by \$24.3 million due mainly to an increase in government deposits. This was due mainly to receipt of budgetary support and government grant funds during the year.



Governor's presentation during NRBT meeting with Parliamentarians



Economic monthly publications are sent to Privy Council and also posted to website

Financial Stability

Financial Sector

The Reserve Bank continued to be responsible for the promotion of a sound and efficient financial system. This is pursued through the licensing, regulating and supervising of financial institutions, which are the banks and authorised foreign exchange dealers. The NRBT (Amendment) Act 2014 extended the mandate of the Reserve Bank to the licensing and supervision of non-bank financial institutions (NBFIs). Separate legislations are being developed for the licensing and supervision of the individual NBFIs.

As of June 2016, there were 5 banks licensed to operate in Tonga.

Banking Services in Tonga

Banks	ANZ	BSP	MBf	TDB	PICB
Branches (including Head Office at Nuku'alo-fa)	3	2	2	8	1
ATMs	14	8	-	-	-
EFTPOS/ Instore Facilities	200	250	-	-	-
Internet Banking	Yes	Yes	No	No	No
Money-Gram Agent	No	Yes	Yes	No	No
Money Transfer Card	Yes	Yes	No	No	No
Other Services	*			**	

* Insurance Agent (NPI)

** Business advisory services, Microfinance

Bank of South Pacific of Papua New Guinea, as part of a regional purchase of Westpac operations in Tonga, Samoa, Solomon Island, Vanuatu and Cook Islands, was granted a new bank license to operate and took over Westpac Bank of Tonga's operations on 10th July 2015. On the same day, Westpac Bank of Tonga ceased its operations. Other banks maintained their head offices in Tongatapu. MBf Bank Limited maintained its branch in Vava'u. The ANZ Bank also maintained its sub-branch in Vava'u. Tonga Development Bank (TDB) continued to be the only bank serving all the outer islands of Ha'apai, Vava'u and 'Eua and the outermost islands of Niuatoputapu and Niuafo'ou. TDB also has two other branches in Tongatapu located in Tatakamotonga and Nukunuku. TDB continued to be an agent for Bank of South Pacific customers in Ha'apai and 'Eua.

During the year, the banks maintained their current banking services, and rolled out some new banking services. TDB continued implementing its expansion plans to commercial bank business during the year, its foreign exchange services (Telegraphic Transfer) commenced in September 2015 together with its cheque accounts and overdraft facilities as well as business advisory services to its customers. TDB also continued to offer deposits and withdrawal services on Saturdays, similar to Pacific International Commercial Bank (PICB). TDB continued to administer the Government Development Loan scheme during the year to support primarily the growth sectors and education.

Banking System Supervision and Regulation

In 2015/16, the Reserve Bank continued to focus its supervisory activities of banks on reducing the vulnerability of the banking system to credit risks and addressing public concerns with regards to the banks' interest rates and fees and charges. Whilst credit growth has continued to improve over the year, there was still excess liquidity in the banking system, fuelled by the higher foreign

reserves and deposits, and positive economic activities during the year. Non-performing loans also improved in 2015/16. The Reserve Bank therefore introduced a policy measure to encourage credit growth by setting minimum requirements on the banks' loans to deposit ratio in order to encourage the banks to utilize the excess liquidity in the banking system by prudently lending to support economic growth. The banks are expected to meet the minimum requirement of 80% loan to deposit ratio by December 2016, 85% by June 2017, and 90% by December 2017.

The Reserve Bank continued to monitor the movements in banks' interest rates and conducted spot checks to verify banks' compliance with the requirements of Prudential Statement 4 on Disclosure of Interest rates and Fees & Charges, as these are common issues which directly affect the public. Banks' interest rates have declined over the year, with the weighted average interest rate spread narrowing to a record low of 5.6% in June 2016 compared with 5.88% in June 2015. This decline largely reflected high liquidity in the banking system. In addition, banks continued to offer special rates to selective good customers while the published interest rates remained relatively stable over the year as banks maintained their base rates.

In addition, there were additional amendments to the Financial Institution Act as amended in 2014 that have been issued for consultation with stakeholders. This includes renaming the Financial Institutions Act as the Banking Act as it focuses on bank licensing and supervision only, and updating the provisions regarding the controllership and receivership of banks.

The Reserve Bank also focused on enhanced supervision of one bank. This included the issuance of directives in April 2016 under Section 37(1)(a) of the Financial Institutions Act and imposing of special requirements to address the high liquidity, operational, and governance risks of this bank.

Onsite examination of banks continues to be one of the core parts of the Reserve Bank's supervisory framework. The Reserve Bank examination team focused on conducting risk-based onsite visits to the one bank mentioned above. This was to verify the bank's ongoing compliance with the Reserve Bank's requirements.

Monthly bilateral meetings with the banks as well as bi-annual meeting with the Association of Banks in Tonga (ABT) were held during the year to obtain updates on the banks strategies in light of the market development to ensure that they continued to operate prudently and in compliance with the Reserve Bank's requirements. Furthermore, the meetings discussed issues which would support a sound and stable financial system such as issues relating to asset quality, profitability, interest rates and liquidity in the banking system.

Banking System Financial Performance

The total assets of the banking system increased by \$89.8 million (15.1%) to \$685 million in 2015/16. This was due mainly to a \$44.7 million (14.5%) growth in total loans and advances and an increase in the Exchange Settlement Account (ESA) of \$17.1 million (11.3%). In addition, total Nostro accounts and banks' Government bond holdings increased by \$10.1 million (325.8%) and \$6.4 million (33.1%) respectively over the year.

The credit growth over the year was attributed to lending to private sector businesses especially construction companies and retail and wholesale businesses indicating an improvement in business confidence. This was followed by an increase in private individual housing loans as banks compete by offering low interest rates and competitive housing loan packages during the year.



Two ATMs located at ANZ Ma'ufanga Branch

Government continued to offer the low interest lending scheme through the development loan scheme administered by TDB. The total outstanding loan under the managed funds as of June 2016 was at \$6.6 million compared to \$4.0 million in June 2015. Of the total outstanding loan as of June 2016, 45.1% was lent to the Agricultural sector followed by Education and Tourism at 16.4% and 10.6% respectively.

The banks' outstanding loans portfolio as at the end of June 2016, comprised of loans to private businesses (47.1%), including public enterprises, agriculture and fisheries private individuals (52.9% of which 36.8% was for housing) compared with 50% shares for both businesses and private individuals in June 2015. 32.7% of the 50% share of private individual loans were for housing loans.

Financial Sector Deposit Accounts

	2014/2015	2015/2016
Demand Deposits		
Number of Accounts	23,016	27,643
Value of Deposits (\$m)	162.0	204.789
Saving Deposits		
Number of Accounts	38,251	42,688
Value of Deposits (\$m)	62.6	80.763
Time Deposits		
Number of Accounts	2,062	2,099
Value of Deposits (\$m)	169.3	182.772
Total Number of Accounts	63,329	72,430
Total Value of Deposits (\$m)	393.9	468.3

Total liabilities increased by \$83.1 million (18.1%) to \$542 million. This reflected a significant growth in total deposits over the year of \$74.4 million (18.9%), which was largely attributed to a \$42.7 million (26.4%) rise in demand deposits, mainly private sector businesses' demand deposit of \$16.0 million. Time and Savings deposits also grew by \$13.5 million and \$18.7 million respectively mainly due to a rise in individuals' deposits.

The total number of deposit accounts reported by banks increased by 14.4% to 72,430 and the total value of deposits increased by 18.9% to \$468.3 million.

Profitability

The profitability of the total banking sector improved in the year ended June 2016 compared to the previous year. The total banking system showed an after-tax profit of \$16.889 million for the year ended June 2016, which is equivalent to 2.6% of average assets, compared with a profit of \$12.0 million for the previous year, which was equivalent to 2.1% of average assets. The increase in profitability is largely attributed to a decline in non-interest expense to 4.0% of average total assets compared to 4.7% in the previous year. This largely reflects the decline in outsourcing and management fees to 0.6% from 1.0% in the previous year. This reflected the takeover of Westpac by BSP with most of outsourcing services allocated to Westpac Hub in Fiji brought back to be under the local team's operation by BSP.

Financial Performance

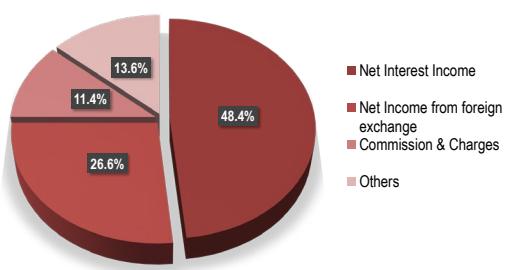
	2014/2015	2015/2016
Pre-tax Net Profit (% average total assets)	2.9	3.4
After-tax Net Profit (% average total assets)	2.1	2.6
Total Operating Income (% average total assets)	7.7	7.4
Net Interest Income (% average total assets)	3.7	3.4
Non-interest income (% average total assets)	3.7	3.7
Average Net Interest Margin (%)	6.4	6.0
Total Operating Expenses (% average total assets)	4.5	3.8
Consolidated Risk-weighted Capital Ratio (%)	39.4	34.0

Source: Licensed Financial Institutions

1/Revised to reflect 12 months data

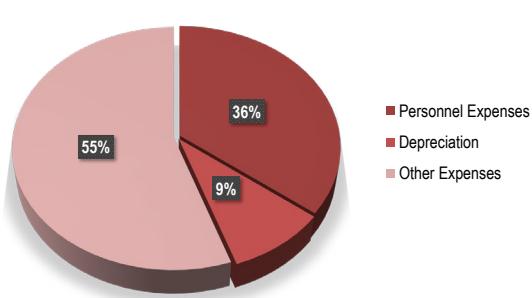
Total operating income as per revised table attached, operating income as percent of average assets fell to 7.4% from 7.7% in the previous year. This mainly reflects the fall in net interest income to 48.4% of total operating income in 2015/16 from 49.5% in 2014/15 as well as a decrease in other income to 13.6% of total operating income from 14.7%.

Financial Sector - Components of Operating Income



Total operating expenses decreased to 3.8% of average assets in 2015/16, compared with 4.7% in 2014/15. This was mainly due to a decrease in other operating expenses over the year. The operating expenses of the banks comprised mainly of 32.8% personnel expenses, an increase from 31.7% in the previous year reflecting an increase in operational cost and some staff recruitment during the year. Depreciation and amortization accounted for 8.6% of total operating expenses, decreasing from 11.9% last year, and the balance of 55.8% was made up of the banks' other expenses for the daily operation needs which increasing from 51.2% in the previous year due mainly to lower outsourcing and management fees.

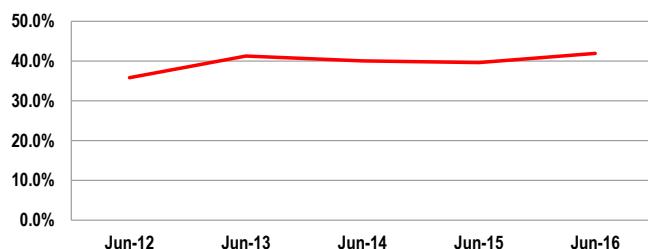
Financial Sector - Components of Operating Expenses



Liquidity

The banking system's liquidity continued to remain high during 2015/16. The increase in eligible liquid assets by \$45.7 million over the year, mainly the banks' Exchange Settlement Accounts, contributed to the high liquidity but was partially offset by an increase in credit growth. Gross loans as a proportion of deposits fell to 75.2% from 78.1% in June 2015. However, the Liquid Asset Ratio rose to 41.9% over the year compared to 40.1% in June 2015 and continued to remain well above the minimum Reserve Bank's minimum requirement of 5%.

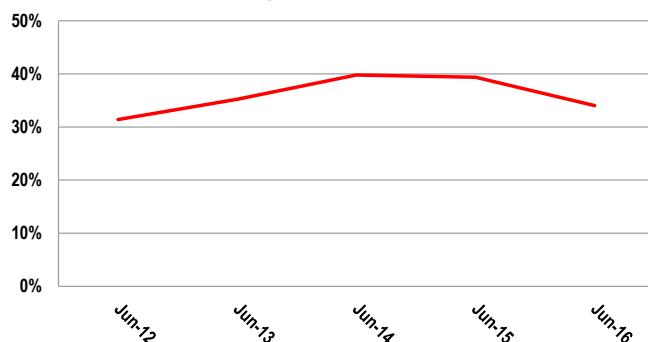
Liquid Asset Ratio



Capital

The capital position of the banking system remained strong as the risk-weighted capital ratio remained well above the minimum ratio required by the Reserve Bank of 15%. The consolidated risk weighted capital ratio for the banks fell to 34% at the end of June 2016, compared with 39.4% in the previous year. This was mainly attributed to the increased risk weighted assets outweighing the growth in banks' total capital, as total lending grew by 14.5% over the year.

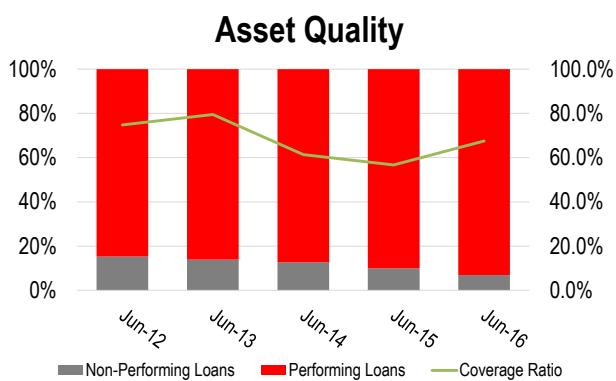
Risk Weighted Capital Ratio



Asset Quality

The overall quality of the banks' assets improved over the year to June 2016. Total non-performing loans decreased by \$6.5 million (21.3%) to \$24 million compared to \$30.7 million in June 2015. This largely reflected loan write offs as well as loan settlements during the year. The ratio of non-performing loans to total loans also improved to 6.9% from 10% in June 2015. The total non-performing loans comprised of loans to businesses (48.4%), mainly the hotels and restaurants and professional and other services, as well as housing for private individuals (20.2%).

Total provisions against loans fell by \$1.1 million (8.7%) to \$16.3 million however the coverage of the non-performing loans by total loan loss provisions, improved to 67.4% from 56.7% in June 2015. The Reserve Bank is working closely with banks to ensure that the adequacy of provisions as well as the accurate reporting of security values is maintained.



Non-Bank Financial Institutions Supervision

Following the amendments to the NRBT and Financial Institutions Act in 2014 to extend the NRBT's mandate to include the supervision and oversight of all non-bank financial institutions, work is still in progress to develop separate legislations for all the NBFIs. In addition, the Foreign Exchange Control Act (FEC Act), which enables the NRBT to regulate foreign exchange dealers, is being amended to strengthen the enforcement powers of the NRBT. Priority legislations to be processed in the 2016 parliamentary session includes the FEC (Amendment) Bill, Microfinance Bill, Money Lender Bill, and Credit

Union Bill. Other legislations that are being drafted include the legislations for the supervision of retirement funds, insurance companies, investment firms, and the capital markets. Furthermore, the Reserve Bank is developing a Consumer Protection policy pursuant to section 59B(2) of the NRBT (Amendment) Act 2014 to enhance the protection of financial consumers and thereby maintain confidence in the financial system. Surveys were conducted to stock take all the NBFIs operating in Tonga and their products, while awaiting the approval of the legislations.

The financial system is affected by the global and domestic banks' de-risking decisions which has resulted in the closing of some of the foreign exchange dealers' accounts and the difficulty in securing correspondent banks for some banks due to elevated money laundering and terrorist financing risks associated with foreign exchange dealers and the US banks tightening their standards on correspondent banks who trade in US dollar outside of the US. In recognition of the potential impact of these de-risking decisions on the cost and level of remittances and the economy as a whole, as well as encouraging illicit flows through more informal channels, the Reserve Bank has worked together with the foreign exchange dealers to improve their Anti-Money Laundering/Counter Terrorist Financing (AML/CFT) compliance status and required that their agents overseas are being licensed by another competent authority, in order for the banks to retain their accounts. The banks in Tonga were willing to retain some of the accounts as a result, however, the issue now is the overseas agents' banks are continuing to close their accounts in NZ and Australia, due to pressure from their correspondent banks in larger countries such as the US and UK to follow suit. This is a real problem and a growing one both regional and globally therefore regional efforts have been put forward to the regulators in Australia and NZ as well as the AML/CFT standard setters to reconsider their tight standards on lower AML/CFT risk countries such as Tonga and other Pacific Islands. To date, there has been no concrete solution from these efforts, however at the same time, the banks and money transfer operators are being encouraged to develop alternative ways of transferring remittance such as online-based or digitized products. Positive development however has been seen as the smaller banks have been successful in their applications to open USD correspondent bank accounts in one of the Australian banks.

Licencing and Supervision of Restricted Foreign Exchange Dealers

During 2015/16, the Reserve Bank licensed 4 and registered 7 authorized restricted foreign exchange dealers. Two registered authorized restricted foreign exchange dealers' ceased operation, while the license and registration of 2 authorized restricted foreign exchange dealers licenses were revoked during the year.

The requirement to renew the license/ registration for authorized restricted foreign exchange in 2016 was revised during the year to only submit changes to the licensing/ registration requirements if applicable. Majority of the foreign exchange dealers, except for the 2 mentioned above, generally complied with the conditions of the licensing /registration which formed the basis for the Reserve Bank's approval of 12 authorized restricted foreign exchange dealers at the beginning of 2016 to continue with their operations.

Two of the commercial banks, namely BSP and MB Bank continue to hold agency arrangements with MoneyGram. They are licensed as authorized dealers under their banking license.

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

Other Non-Bank Financial Institutions

The Reserve Bank is authorized under section 4A(k) of the National Reserve Bank of Tonga (Amendment) Act 2014 to regulate and supervise financial institutions including NBFI. Currently, the Reserve Bank is setting up the regulatory framework for each NBFI and during the year a survey was conducted to stock take and collect information on each type of NBFI operating in the financial system, including the types of products they offer and the nature of these products including the interest rate and fees charged. This will aid the Reserve Bank's work to develop relevant policies, prudential statements, reporting requirements guidelines and other supervisory mechanisms to promote a sound and efficient financial system.

The categories of NBFI are outlined in section 2(2) of the National Reserve Bank of Tonga (Amendment) Act 2014 which are; Retirement Funds, Insurance Companies, Credit Unions, Cooperative Societies, Credit Institutions, Money Lenders, Microfinance Institutions, Foreign Exchange Dealers, and Investments companies.

The preliminary result of the survey of NBFI showed that there are some money lenders operating in the financial system without a valid business license which warrant the need to formally supervise this sector in order to protect financial consumers.

The data collection will continue in the next financial year to ensure that the Reserve Bank have background information on the services and products as well as the operations of all non-bank financial institutions.

South Pacific Business Development (SPBD) as a microfinance institution continued to voluntarily submit financial information on their lending activities to the Reserve Bank on a monthly and annual basis.

Financial Inclusion

The Reserve Bank as a member of the Alliance for Financial Inclusion (AFI) network, in its efforts to promote financial inclusion in Tonga, committed to the Maputo Accord 2015 during the AFI's Global Policy Forum meet-



2016 is the NRBT year for promoting Financial Inclusion.

ing at Mozambique in September 2015. This commitment was to develop and improve the access of Small to Medium Enterprises (SMEs) to finance by 20% by 2020. The access to finance by SMEs would play an important role in job creation, poverty alleviation, and promotion of exports and investment which supports financial stability and promotes the Reserve Bank's vision of becoming an effective and dynamic central bank in promoting Tonga's economic prosperity.

The Reserve Bank through its membership of the AFI has received assistance to promote the access of SMEs to finance and this project is in progress. This includes participation in a knowledge exchange visit to Malaysia in May 2016, to learn and understand the landscape of SMEs formation and structure as well as the policies used in improving the SMEs and their access to finance in Malaysia. The Reserve Bank also participated in various AFI working group meetings abroad in the second half of 2015/16. This assisted with identifying and finding possible solutions to challenges in Tonga in terms of accessing finance at all levels of society.

A Supply Side Survey was conducted in 2015 to assess the availability of financial services to financial customers. In addition, a Demand Side Survey was conducted in February to March 2016 to identify the public's demand for financial services, and the outcome of this survey is still being finalised. The intention is to ensure that appropriate policies and products are being devel-



Training of enumerators for the Demand Side Survey

oped by the suppliers of financial services to meet the identified demand for financial services, which would improve the access to financial services and bring on-board those in the informal sector to the formal sector. The Reserve Bank intends to collaboratively develop a National Financial Inclusion Strategy to promote financial inclusion in Tonga.

Payment System

After numerous consultations with stakeholders and consideration of the implications of the proposed payment system reform to move to the Automated Transfer System, under the World Bank's Payments Remittances and Securities Settlement Initiative (PAPRI), the Reserve Bank withdrew its participation in this regional payment system reform. Meanwhile, the manual settlement system, involving the inter-bank cheque clearance that is conducted by the Settlement Unit on a daily basis is operating well. The Reserve Bank continued to explore ways to improve the efficiency and sound functioning of the payment system.

Financial Intelligence Unit

The Reserve Bank is the Transaction Reporting Authority (TRA) established under the Money Laundering and Proceeds of Crime Act 2000 (MLPC Act). The TRA is vested with the function of a Financial Intelligence Unit (FIU) in ensuring 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 FIU's role and functions prescribed under the MLPC Act includes policy formulation and enforcement.

Supervision & Compliance

During the year, the FIU progressed with its supervision and reports analysis functions and continued to implement the requirements of the MLPC Act and the recommendations from Tonga's 2010 Mutual Evaluation Report from the Asia Pacific Group on Money Laundering.

To progress with Tonga's membership application to the Egmont Group as targeted for in its Corporate Plan, and in response to the review of the Egmont Legal Working Group, the FIU developed proposed amendments to the

MLPC Act aimed at improving the operational independence of the FIU and address issues that were identified in the implementation of the MLPC Act. In August 2015, the FIU sought the assistance of the Attorney General's office in processing the draft amendments to the MLPC Act. The completion of Tonga's Egmont membership application awaits the completion of the proposed legislative amendments.

In 2015/16, the FIU assessed and confirmed seven cross border correspondent banking applications submitted from two of the commercial banks during the year. The MLPC Regulations require banks to seek the approval of the TRA prior to entering into a cross border correspondent banking relationship.

During the year, the FIU responded to a request for financial information from Tonga Police to assist in an ongoing investigation. Information were collected from all the reporting entities in relation to this request. The MLPC Act allows for the TRA to collect any information that the TRA considers relevant to serious offences and to instruct any financial institutions and cash dealers to take steps in relation to any information or report received by the TRA, to enforce compliance or to facilitate any investigation anticipated by the TRA or a law enforcement agency.

The FIU provided its six monthly training to the reporting entities in November 2015. AML training is provided to all reporting entities on a biannual basis aiming at enhancing awareness of their obligations under the AML legislations.

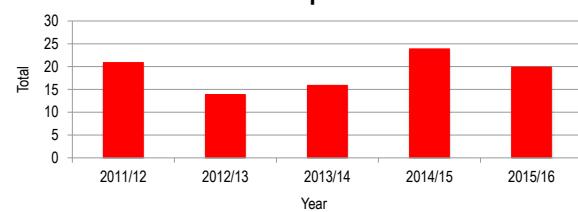
In January 2016, the FIU conducted spot check visits to all banks and authorized restricted foreign exchange dealers to review the entities' AML/CFT framework and information management system. This was on the back of a leak of a Reserve Bank confidential letter to the media in November 2015. The spot check visits to the reporting entities were inclined to accentuate the confidential nature of the FIU works and to stress the importance of maintaining an information system that supports this. The FIU detected no apparent threat in the reporting entities systems that may have caused this breach. The FIU also consulted with the Tonga Police and Attorney General's office on this matter.

During the year, the FIU completed all due diligence check upon request from different departments within the Reserve Bank. The checks completed were commonly for customers relevant to the respective departments. To assist these departments in their functions, the FIU conducted checks on applicants for exchange control transactions, numismatic coin collectors, suppliers and many others. The results of these checks were generally non-suspicious and were communicated to each requesting department. To assist in its due diligence and background check function, the FIU subscribed to an AML screening solution with Thomson Reuters Accelus for online screening. This solution is an online look- up tool that assists with due diligence checks on individuals and organizations giving access to the most comprehensive sanctions and Politically Exposed Persons data.

Reports & Statistics

1. Suspicious Transaction Reports

Total number of Suspicious Transactions Report



The FIU received 20 STRs from the commercial banks and authorized restricted foreign exchange dealers during the year, decreasing by 16% from the previous year. The decreasing trend may be a reflection of less suspicious activities occurring during the year. Reporting of STR is a statutory requirement for all financial institutions and cash dealers.

2. Currency Transaction Reports

Years	March 2013	2013/14	2014/15	2015/16
- June 2013				

Number of CTRs	1,004	3,986	4,138	7,087
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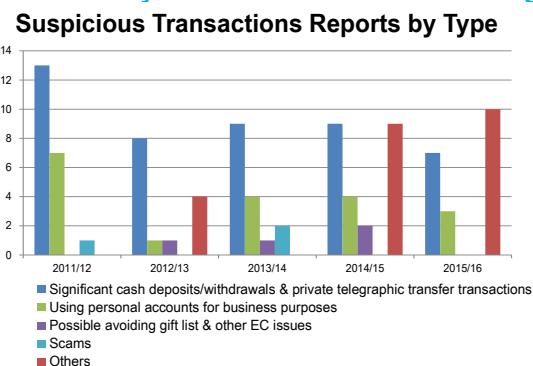
During the year, the FIU received 7,087 CTRs from the commercial banks and authorized restricted foreign exchange dealers representing around 70% increase from the previous year. The CTR data is kept for data analysis purposes.

3. Border Currency Reports

Years	March 2013	2013/14	2014/15	2015/16
	- June 2013			
Number of BCRs	15	20	36	52

The FIU received 52 reports from the Ministry of Revenue & Customs during the year representing around 40% increase from the previous year. The BCR data is also kept for analysis purposes.

Reports analysis & Information sharing



The dominant STR indicator continued to be unusual significant cash deposits and withdrawals; foreign currency conversion or telegraphic transfers that were inconsistent with the customer's known background or the sources of fund were undetermined. Three STRs were related to the usage of personal account for conducting of business transactions similar to the previous year. The remaining ten reports were related to several issues including large and rapid movement of funds, unusual business transactions and structured payments.

Years	2011/12	2012/13	2013/14	2014/15	2015/16
Total STR received	21	14	16	24	20
Total STR passed to TCU	16	7	11	5	2
Total STR passed to IRD	14	0	1	6	13
Total STR passed to Immigration	2	0	1	0	0
Total STR passed to MCTL	0	0	1	0	0
Total Scams	1	0	2	0	0

Subsequent to the analysis of these STRs, two of the reports were disseminated to the Police for further investigations of possible money laundering and other serious offences. Thirteen STRs were reported to the Ministry of Revenue and Customs for possible tax evasion and other tax related offences.

Years	Mar13/Jun13	2013 /14	2014/15	2015/16
Total CTRs received	1,004	3,986	4,138	7,087
Inwards	879 (TOP 20M)	2,785 (TOP 119M)	2,981 (TOP 109M)	4,680 (TOP 119M)
Outwards	125 (TOP 22M)	1,201 (TOP 119M)	1,157 (TOP 109M)	2,407 (TOP 59M)

The FIU received over seven thousand Currency Transaction reports (CTRs) during the year. Majority of the transactions reported were for inward transactions which are classified into cash, cheque and other deposits and also including inward telegraphic transfers. Both inward and outward transactions recorded over fifty percentages increase in number compared to the previous year. Majority of the transactions reported for the year were in cash and were for personal purposes. Transactions for business purposes were mostly done in cheque and telegraphic transfers.

Years	Mar13/Jun13	2013 /14	2014/15	2015/16
Total BCRs received	15	20	36	52
Inwards	1	1	7	10
Outwards	14	19	29	42

The FIU received just over fifty Border Currency reports (BCRs) from the Ministry of Revenue & Customs during the year. Majority of the reports were for outward movement of funds across the border. These outward moving currencies were mostly for shipments of currencies for currency conversion companies and banks, and also for hand-carry by travelers overseas. Inward movements reported were mostly for travelers returning or visiting Tonga that have hand-carried currencies above the reporting threshold.

During the year, the FIU also conducted analysis of the notes conversion report from banks and authorized restricted foreign exchange dealers and making comparison with information reported from Customs on the BCRs. The analysis was done on individuals converting notes/ buying Tongan Pa'anga with amounts exceeding the BCR declaration threshold of TOP\$10,000 but were not reported from Customs as they were not declared at the border. This analysis was passed on to Customs to assist with the profiling of travelers. With the Inter-agency MOU in place, the FIU was able to share eight monthly reports in 2015/16.

During the year, the FIU recruited a statistical assistant to be responsible for the data management of the unit. This recruitment brought the numbers of the FIU staff up to three.

The FIU 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.



Minister of Finance, Governor and the IMF Article IV staff

Financial Markets Operation

Monetary Policy Formulation

The Reserve Bank's monetary policy target is to maintain adequate level of foreign reserves above 3-4 months of import cover and to promote low and stable inflation below 6% annually. Throughout the 2015/16 financial year, the level of foreign reserves remained above eight months of import cover and headline inflation remained low. The Reserve Bank's monetary policy therefore remained accommodative throughout the year.

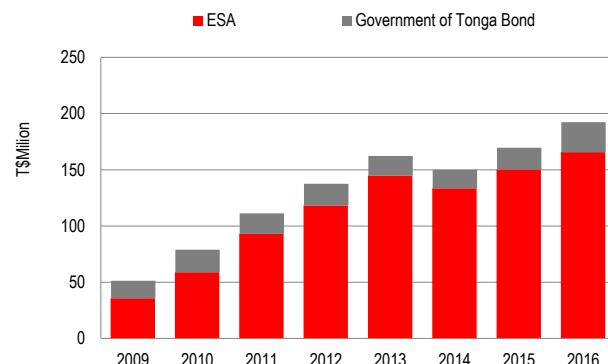
Domestic Market Operations

Given the Reserve Bank's accommodative monetary policy stance remained unchanged during the financial year 2015/16, the Reserve Bank did not issue any Reserve Bank notes. This was to continue leaving excess liquidity in the system to encourage banks to lend and support economic growth.

As of the 30 June 2016, the banking system liquidity stood at \$192.3 million, an increase from \$169.1 million at the end of June 2015. The banking system liquidity comprised mainly of \$165.7 million in the banks' Exchange Settlement Accounts (ESA) held with the Reserve Bank and \$26.6 million of Government of Tonga's Bonds held by the banks. The higher liquidity was in line with the higher foreign reserves and government bonds held by the banks.

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.

Banking System Liquidity



The Reserve Bank continued to publish financial information, such as weekly exchange rate comparisons across financial institutions, in its efforts to improve the public's understanding of financial indicators in order to make better financial decisions.

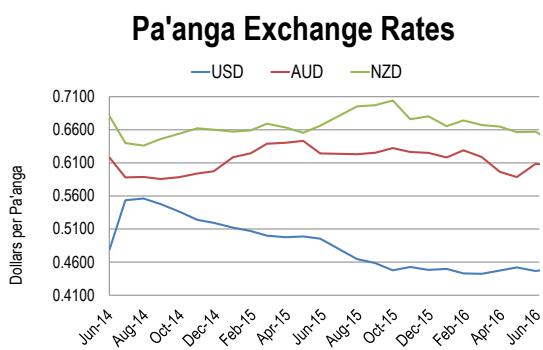
The Reserve Bank is also exploring other avenues and mechanisms in order to develop the domestic market operations in the near future to be more market oriented.

Foreign Exchange Operations

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

The Reserve Bank monitored the movement of the rate of exchange of the pa'anga against other currencies with a view to ensure that the country's balance of payments position and price stability are maintained at levels that are consistent with the achievement of macroeconomic stability.

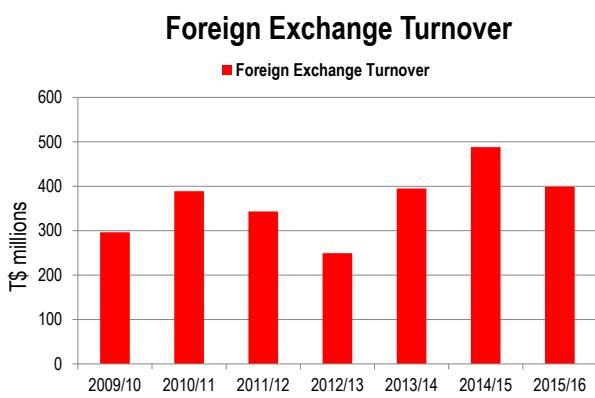
The Tongan pa'anga fluctuated against the US dollar (USD) and the Australian dollar (AUD) in wider bands in 2015/16, compared to last year. This reflected the increased volatility in the USD and AUD during the year. Meanwhile, the volatility of the New Zealand dollar (NZD) was lower in 2015/16 compared to the previous year. This largely reflects the strengthening of the USD against all major currencies during the year and the AUD weakening at a relatively larger magnitude compared to the NZD due to relatively stronger economic prospects in New Zealand.



Foreign Reserves Management

The Reserve Bank Portfolio

The gross official foreign reserves was maintained well above the benchmark of 3 to 4 months of imports. As at the end of June 2016 the level of foreign reserves peaked at a record high of T\$354.9 million, equivalent to 10.1 months of import cover compared to T\$289.7 million and 8.1 months of import as at 30 June 2015. The significant increase in the level of foreign reserves was attributed mainly to receipts of budget support for the Government. The foreign reserves ranged between 8.5 months and 10.1 months of import cover during the year.



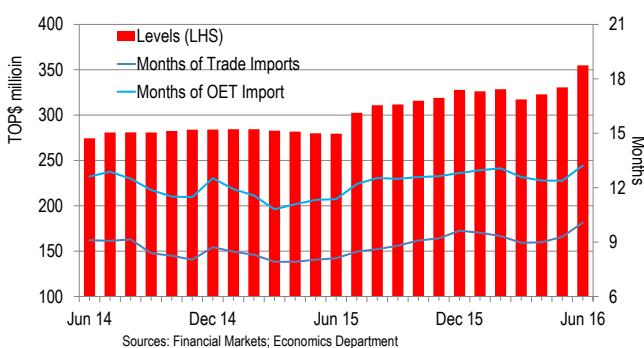
During the year, the Reserve Bank was a net purchaser in the spot foreign exchange markets. Foreign exchange purchases of T\$231.3 million exceeded sales of T\$167.7 million giving a total foreign exchange turnover for the year of T\$399 million. This is a decrease from T\$488.1 million last year. The Reserve Bank conducted foreign exchange operations for its customers, but especially the Government, and for its own account in a range of currencies.

The management of the foreign reserves met the objectives of safety, liquidity and profitability. The currency composition of the foreign reserves was mainly in US dollars, Australian and the New Zealand dollars.

The Reserve Bank's investment policy is to obtain the maximum income commensurate with safety, liquidity and the maintenance of overall value which continued to be a challenge, given the uncertainty and volatility in the global financial markets and continued low interest rates in the trading partner countries. The currency composition therefore deviated from the benchmark portfolio but remained within the Board approved limit, in order to maximize income and maintain the value of the foreign reserves. The currency composition exposes the Bank to exchange rate risk. However, the Reserve Bank continued to closely monitor the implications of the movements of the exchange rates on the value of the foreign reserves. Despite lower interest rates in the global markets and the general weakening of the NZD and AUD, the income on the investment of the foreign reserves increased by \$2.8 million compared with the previous year, which is in line with the significant increase in the level of foreign reserves of \$65.2 million.

Gross Official Foreign Reserves

Monthly



The Reserve Bank complied with all the Board approved risk parameters for the management of the 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.

Exchange Control Operations

During 2015/16, the Reserve Bank processed 824 exchange control applications for current payments of amounts above the delegated limit of \$100,000 and all capital payments as stipulated in the Exchange Control policy guidelines. The approved exchange control applications amounted to T\$198.3 million in 2015/16 (of which 12% were classified as capital transactions) compared to the 722 exchange control applications (11% capital transactions) processed in 2014/15 amounting to T\$212.3 million. The increase in the number of exchange control applications while the total amount of the applications decreased reflects the rising number of lower valued applications processed during the year. The exchange control unit achieved its target for a half day turnaround time for processing and approval of applications, provided that all the submitted documents do meet the requirements. 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 72 applications for the removal of cash, both Tongan pa'anga and foreign currency notes, totaling T\$10,000 and above across the border, of which all applications were approved and amounted to a total of T\$50.7 million. This is an increase from 47 applications totaling T\$35.6 million last year. This

increase is attributed to more applications for exports of cash by banks and foreign exchange dealers due to the more favorable exchange rates offered overseas. The exchange control unit also notified the Ministry of Revenues and Customs of all approved applications for exports of cash, two (2) days before the date of travel, with some exceptions due to late submission from banks and authorized restricted foreign exchange dealers.

Quarterly spot checks were conducted during the year to ensure banks and authorized restricted foreign exchange dealers were compliant with the exchange control guidelines. Meanwhile, internal monitoring of compliance is also carried out through other reports such as the Overseas exchange transactions, Foreign exchange transactions with value that is equivalent to T\$50,000 and above, Forward exchange contracts and the Foreign currency accounts. The annual review of the Exchange Control Policy Guidelines was completed during the year and came into effect on 1st July 2016. Press releases were posted on the website, and trainings with the banks and authorized restricted foreign exchange dealers were conducted to keep them informed of the any revisions to the exchange control guidelines and to also raise issues identified from the spot checks. The Reserve Bank still continued to issue the Gift list for those who have reached their annual delegated limit.

The review of the Foreign Exchange Control Act is in progress to be finalized in 2016/17. One of the main objectives of this review is to ensure that all foreign exchange due to Tonga such as exports proceeds are better captured. This would support the Reserve Bank's role of protecting the foreign reserves. In addition, the Reserve Bank's enforcement powers will be strengthened.

Currency Management

The National Reserve Bank of Tonga is responsible for regulating the issue of currency in Tonga. With the introduction of the new coronation currency into the banking system, the Reserve Bank is working closely with commercial banks to maintain high quality banknotes and coins in circulation. This is to ensure the general public has confidence in using Tonga's currency and has access to good quality, clean and authentic banknotes and coins at all times.

The Kingdom of Tonga's new \$50 (King Tupou VI series) was nominated for the International Bank Note Society (IBNS) Banknote of the Year Award 2015. The King Tupou VI \$50 pa'anga note was nominated for the IBNS award for the exceptional banknote issued and the note must have artistic merit and/or innovative security features and be in general circulation.

During the financial year 2015/16, the total amount of new banknotes issued by the Reserve Bank was valued at T\$85.3 million, an increase of T\$47 million from the previous year (T\$38.3 million). Of the total banknotes issued, T\$53.9 million were of the old design banknote series and T\$31.4 million new design banknotes. To maintain the quality of banknotes in circulation, a total of 2.2 million notes, with a face value of T\$35.3 million were deemed unsuitable for further circulation and subsequently destroyed. At the end of June 2016, the total value of banknotes on issue in Tonga increased by 19.4% to T\$64.2 million.

The Reserve Bank distributes almost all of its banknotes via the commercial banks, either by adding to their on-site stocks of banknotes or to their Note Trust Depots. The Reserve Bank has 8 note trust depots which are operated by commercial banks to facilitate contingent cash requirements. During the year, T\$11.5 million was deposited to the note trust depots while T\$10.5 million were withdrawn from the note trust depots. At the end of the financial year, the note trust depot balance was at T\$2.4 million, an increase of 1.1% (T\$1.1 million) from the previous year.

During the year, two (2) counterfeit notes were detected – 1 note from the King Taufa'ahau Tupou IV series and 1 note from the King Tupou VI series. The counterfeit notes were confirmed to be photocopied banknotes on an ink-jet printer. With the assistance of the Reserve Bank, the police arrested the counterfeiters, and confiscated the ink jet photocopier machine. Following these counterfeit reports, the Reserve Bank continued to raise the public awareness on these counterfeit notes and issued public notices and brochures on how to identify genuine banknotes both in the English and Tongan language.

Recall Coins and Banknotes from Circulation

To ensure efficient transition from the old to new series of banknotes and coins, the Reserve Bank recalled the following banknotes and coins from circulation which will also cease to be legal tender after the 30th September 2015:

1. All the \$50 banknotes depicting the portrait of His Majesty King Taufa'ahau Tupou IV.
2. All the \$1 banknotes



Exchange of recalled currency

3. All the existing coins issued prior to the year 2015. The above mentioned currency may be exchanged at any time from the National Reserve Bank of Tonga.

At the end of June 2016, the face value of new design coins issued to the commercial banks and the public accounted for T\$1.1 million. A total of T\$1.7 million in old design coins remain unaccounted for after the recall period.

Numismatics

During the year, an agreement was signed with the World Coin Association (WCA), Germany, for the minting and marketing of a new silver coin. The coins bear the theme, Olympic Games 2016 – Boxing.

Numismatic income increased by 24.7% to \$325,785.26 over the 2015/16 financial year, mainly due to local and international sales of the new coronation currency.



His Majesty King Tupou VI viewing the Reserve Bank Currency Awareness display during Agriculture Show 2016



New currency awareness display during His Majesty King Tupou VI coronation



New currency display during Agriculture Show in Niuafou'ou



New currency awareness programme reach out to Government Primary School in the outer islands

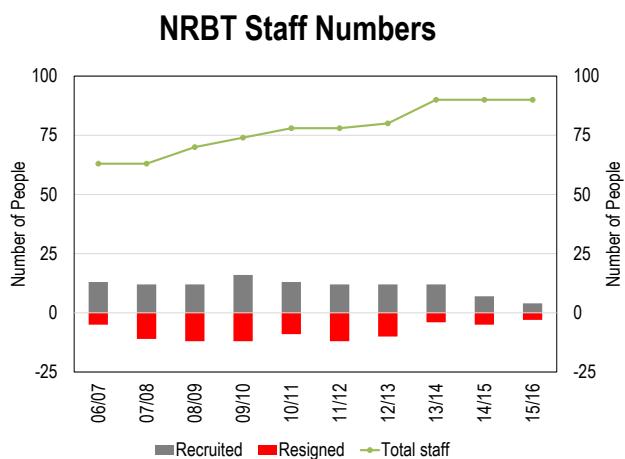
Corporate Services

Staffing

The Reserve Bank continued to focus on promoting its strategic priority to position the Reserve Bank as the employer of choice. This is through implementing competitive attraction and retention strategies in a culture of high performance. The Reserve Bank's human resource policies, staff benefits including staff loan and provident fund, training and development, transparent career path for staff and the organizational structure were reviewed.

Investing on building the Reserve Bank's capacity, 4 professional staffs were recruited mainly to the Financial Intelligence, Finance and the Economics Departments. As part of the retention strategies and promoting a culture of high performance, the Bank implemented the Monthly awards for Employee of the Month, Health awards and Best Uniform awards to encourage improvements on staff performance and conduct. The Corporate uniforms were reviewed and a new set of uniforms were issued to Staff during the year.

Following the completion of the 1 year of implementing the Reserve Bank's Corporate Plan targets and strategies, the Management team reviewed the Bank's performance against the targets and re-submitted a revised Corporate Plan 2016 – 2018 to the Board for endorsement. The Staff Job Description were also reviewed and improvements to the Human Resource Information Management System databases was implemented to improve the accuracy in Human Resources information and records.



Through the commitment and support facilitated by 90 staff and 3 daily note counters, the Reserve Bank was able to deliver on its core responsibilities effectively during the year. In 2015/16, the staff turnover was 2.7%, well below the 5% Corporate Plan annual target. This indicates that there is an improvement on how the Bank has retained its staff by managing its employees and enhancing staff job satisfaction.

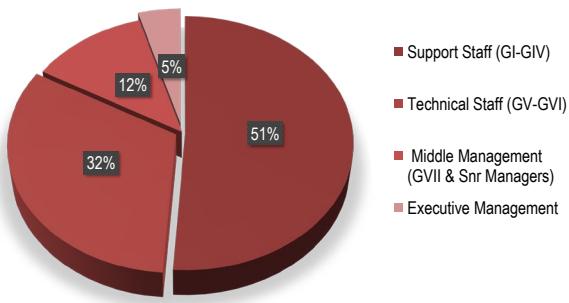
The Reserve Bank continued to engage staff through training programs offered in-house, locally and internationally to strengthen the core competencies needed to deliver the Reserve Bank's functions. During the year, the Bank completed 92% of the training programs scheduled and had emerged during the year, an increase of 12% above the Corporate Plan target of 80%. This increase reflected the Bank's commitment towards upskilling and staff development.

Instance of Training by Financial Year

	Number of training events					Number of participants				
	2011/12	2012/13	2013/14	2014/15	2015/16	2011/12	2012/13	2013/14	2014/15	2015/16
In-house	6	3	2	5	3	98	37	15	23	90
Online	-	-	3	3	2	-	-	5	7	10
Local	6	1	11	5	7	17	2	23	14	29
Overseas	4	16	28	14	28	6	17	20	11	38

Staff members were encouraged to participate in the Bank's financial for further studies program not only to further strengthen the competencies required for their job but also to build their career path at the Bank. One staff member completed a postgraduate study program in Risk Management in Australia, under the AusAID scholarship program.

Total Employees by Category 2016



The Reserve Bank acknowledges the technical support and advisory services provided through the IMF, Pacific Financial Technical Assistance Centre (PFTAC) and Australia Volunteer for International Development (AVID)



Employee of the Month Awardees for January 2016

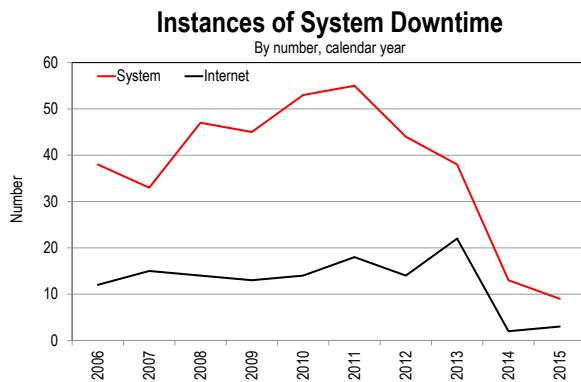
Information Technology

The main focus for the Information Technology Department was to continue to provide services that are highly accessible, uninterrupted and secured, and this financial year was no different. The instances of system downtime has continued to improve from previous years. Further-

more, continuous updating of the IT Network infrastructure and ensuring they are secured and intact with available security patches. The Email System was further developed by implementing a Secondary Client Access Server to ensure that the client's connectivity and accessibility to the email servers is highly accessible and un-interrupted. Backup Storage was further expanded with high capacity storage tapes to cater for the increase of the bank's data and information.

The desktop computer was replaced with new laptops to encourage staff to be mobile and work from anywhere in the bank. The Bank also enforced auditing of systems and technology by implementing the bi-annual internal Audit of the Access control, access rights and matrix. This check was on the server access rights against the approved access rights on the forms.

In light of recent cyber-attacks to various financial institutions and central banks overseas, the IT Department was vigilant in implementing various tasks and security checks to ensure that the NRBT corporate network and SWIFT systems is not vulnerable and secured from possible cyber-crime or from being hacked.



Property, Security and General Administration

The Property Division continued to work closely with the Security and General Administration Division towards achieving their corporate plan target for the year 2015/16 by maintaining the safety and security of the Bank's property, staff and tenants. The Property team proactively managed the Bank's Fixed Asset management processes and conducted a regular service and

maintenance of the Bank's critical plants and equipment while carrying out refurbishment projects to uphold the standard of the Bank's building. To maintain and secure the premises, the Bank's Electronic Security system was upgraded. This also provided a conducive and safe working environment to staff and tenants. The General Administration continues to strengthen internal control in the management of Central filing system, Electronic filing system and Corporate Communication systems. The corporate services projects completed during the year include:

1. Construction of a new Staff room at Level 2 to accommodate the Bank's trainings, staff function and meetings.
2. Refurbishment of the split air condition system at the Embassy of Japan's office, Level 5.
3. Promoting power saving campaign by introducing LED energy saving lights for Level 2 floor to further reduce the electricity consumption.
4. Upgrading of the Electronic Security System with a new Network Video Recorder System. The new system enabled the Bank to add Internet Protocol Cameras to the network.
5. Review of the Tenants' rental rate and Tenancy agreements.
6. Selling of the car park leasehold land to the Bank of the South Pacific.
7. Refurbishment and re-painting of the Vault and Destruction Room.



Staff enjoy outdoor activities



Construction of the new Staff Room



New Uniform for Reserve Bank staff



Opening of the new Staff Room

Financial Performance

The gross income from operations for the year ended 30 June 2016 amounted to \$12.144 million, compared to \$7.375 million of the previous year. The 65% increase in gross income in 2015/16 was mainly due to the income on the sales of numismatic currency, the sale of the Reserve Bank's rental property to BSP, as well as the interest income from the investment of the higher than expected level of foreign reserves. Furthermore, the strengthening of the New Zealand and the Australian dollar against the Tongan pa'anga also amplified the increase in foreign investment income.

Interest expense, currency, administration and other costs totaled \$8.009 million compared to \$6.114 million in the previous year. The 31% increase in total expenditure was mainly due to the higher cost of currency issued during the year. This is a result of the recall of all the old coins from circulation and the issue of the new designed

notes to replace the old designed notes. Administration cost also increased due to the purchase of goods and services for operations of the bank including maintenance and staff cost.

The net profit for the year ending 30 June 2016 was \$4.135 million, compared to \$1.260 million of the previous year. The financial result for 2015/2016 surpassed the corporate plan's annual target of \$1 million net profit per year, reflecting the effective strategies implemented during the year which have improved the bank's investment income as well as boost the marketing and sales of numismatic currency. In accordance with section 8(1) of the NRBT (Amendment) Act 2014, 30 percent of the profit shall be transferred to the Bank's General Reserves and 70 percent of the profit for the year is payable to the Government. In this regard, T\$2.894 million will be transferred to the Ministry of Finance account.

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National Reserve Bank of Tonga

Financial Statements

YEAR ENDED 30 JUNE 2016

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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 2016, 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 (up to 1 February 2016)

Mr Richard Prema

Mrs Sinaitakala Tu'itahi

Dr Sione Ngongo Kioa - Governor

Mr Tatafu Moeaki

Mr 'Uhila Liava'a (appointed on 5 February 2016)

2. PRINCIPAL ACTIVITIES

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

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

The principal functions of the Bank shall be, to:

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

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

3. TRADING RESULTS

The net profit of the Bank for the year ended 30 June 2016 was \$4,135,199 (2015: \$1,260,729).

4. GENERAL RESERVES

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

5. PAYABLE TO GOVERNMENT

In accordance with Section 8(1) of the National Reserve Bank of Tonga (Amendment) Act, 2014, the amount of \$2,894,639 (2015: \$882,510) is payable to the Government of the Kingdom of Tonga.

6. BAD AND DOUBTFUL DEBTS

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

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

7. PROVISIONS

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

8. ASSETS

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

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

9. 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 26 July 2016 the NRBT revoked the licence of the Pacific International Commercial Bank (PICB) to conduct banking business in Tonga. The PICB challenged the NRBT's decision to revoke their licence and filed a court injunction with the Supreme Court.

At the injunction hearing on 5 August 2016, PICB withdrew its submission for an injunction and has requested a trial by jury claiming damages against the NRBT in the sum of TOP10 million for general damages and TOP5 million for punitive and aggravated damages.

The Supreme Court has in the interim ordered PICB to cover the legal costs incurred by NRBT in its preparation for the injunction hearing. The NRBT has also filed an Application to Strike Out the PICB's claim with the Supreme Court on 30 August 2016 and a date for hearing of the application is yet to be set.

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 28th day September , 2016 .



Mr. Steve Edwards
Chairperson



Sione Ngongo Kioa
Governor

STATEMENT BY DIRECTORS

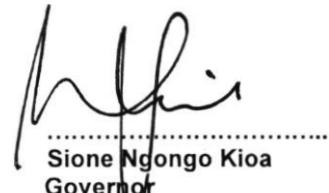
In the opinion of the Directors:

- (a) the accompanying balance sheet is drawn up so as to give a true and fair view of the state of affairs of the Bank as at 30 June 2016;
- (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 2016;
- (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 2016;
- (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 2016; 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 2016.

For and on behalf of the Board of Directors by authority of a resolution of the Directors this 28th day of September, 2016.



Mr Steve Edwards
Chairperson



Sione Ngongo Kioa
Governor



Independent Auditor's Report

To the Board of Directors of National Reserve Bank of Tonga

Report on the Financial Statements

We have audited the accompanying financial statements of the National Reserve Bank of Tonga (the 'Bank'). The financial statements comprise the statement of financial position of the Bank as at 30 June 2016 and the statements of comprehensive income, 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 International Financial Reporting Standards and with the requirements of the National Reserve Bank of Tonga Act, 1988, National Reserve Bank of Tonga (Amendment) Act, 2007 and the National Reserve Bank of Tonga (Amendment) Act, 2014 and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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.

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Opinion

In our opinion the accompanying financial statements of the National Reserve Bank of Tonga 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, National Reserve Bank of Tonga (Amendment) Act 2007 and the National Reserve Bank of Tonga (Amendment) Act 2014.

Emphasis of Matter

We draw attention to Note 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 and its variance with IAS 21 "Effect of changes in Foreign Exchange Rates". Our opinion is not qualified in respect of this matter.

Restriction on Distribution or Use

This report is made solely to the Board of Directors of the Bank. Our audit work has been undertaken so that we might state to the Board of Directors those matters we are required to state 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.

28 September 2016
Suva, Fiji

PricewaterhouseCoopers
PricewaterhouseCoopers
Chartered Accountants

BALANCE SHEET AS AT 30 JUNE 2016

	Notes	2016	2015
ASSETS		\$	\$
Foreign Currency Assets			
Short Term Investments and Current Accounts	8	327,817,394	263,691,758
Accrued Interest		11,338,185	8,803,874
International Monetary Fund (IMF)	9		
- Reserve Tranche Position		10,558,012	5,050,555
- Special Drawing Rights		16,487,060	20,923,187
Local Currency Assets			
Cash on Hand	18	55,924	418,132
Accrued Interest		39,917	23,078
Other Assets	10	12,472,735	10,714,682
International Monetary Fund - Currency Subscription	9	32,447,402	14,467,901
Property, Plant and Equipment	11	9,267,684	9,388,370
Total Assets		420,484,313	333,481,537
LIABILITIES			
Foreign Currency Liabilities			
Accrued Interest		364	349
Demand Deposits	12(a)	33,927,546	10,921,827
IMF Special Drawing Rights Allocation	9	20,217,499	19,418,101
Local Currency Liabilities			
Payable to Government	13	2,894,639	882,510
Demand Deposits	12(b)	197,641,101	185,789,222
Accrued Interest		19,867	8,490
Other Liabilities	16	1,037,121	1,187,133
Currency in Circulation	14	67,344,536	55,961,459
Statutory Reserve Deposits	15	21,526,000	18,112,000
International Monetary Fund - Currency Subscription	9	32,447,402	14,467,901
Employee Provisions	17	101,147	80,853
Total Liabilities		377,157,222	306,829,845
NET ASSETS		43,327,091	26,651,692
CAPITAL AND RESERVES			
Authorised Capital		5,000,000	5,000,000
Paid up Capital		5,000,000	5,000,000
General Reserves	2(n)	11,618,779	10,378,219
Revaluation Reserve Account		26,708,312	11,273,473
TOTAL CAPITAL AND RESERVES		43,327,091	\$26,651,692

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

STATEMENT OF COMPREHENSIVE INCOME YEAR ENDED 30 JUNE 2016

	Notes	2016	2015
Income		\$	\$
Interest Income	4	7,872,406	4,993,252
Other Income	5	4,271,844	2,381,397
Total Operating Income		12,144,250	7,374,649
Expenses			
Interest expense	6	49,024	89,886
Administration and other expenses	7	7,960,027	6,024,034
Total Operating Expenses		8,009,051	6,113,920
Net profit for the period		4,135,199	1,260,729
Other comprehensive income			
Net gains/(losses) arising from the translation of foreign currency balances to local currency	2(b)	15,434,839	3,300,010
Total other comprehensive income for the period		15,434,839	3,300,010
Total comprehensive income for the period		19,570,038	\$4,560,739

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

STATEMENT OF DISTRIBUTION YEAR ENDED 30 JUNE 2016

	Notes	2016	2015
		\$	\$
Net profit available for distribution		\$ 4,135,199	\$ 1,260,729
Distribution as follows:			
Transfer to General Reserves as required under Section 8(1)(b) of the National Reserve Bank of Tonga (Amendment) Act, 2014	2(n)	1,240,560	375,219
Balance Payable to Government of Tonga as required under Section 8(1) of the National Reserve Bank of Tonga (Amendment) Act, 2014	13	2,894,639	882,510
		\$ 4,135,199	\$ 1,260,729

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

STATEMENT OF CHANGES IN EQUITY YEAR ENDED 30 JUNE 2016

	Paid up Capital	General Reserves	Revaluation Reserve Account	Total
	\$	\$	\$	\$
Balance 30 June 2014	5,000,000	10,000,000	\$7,973,463	\$22,973,463
<i>Other comprehensive income</i>				
Net gains arising from the translation of foreign currency balances to Tongan currency	-	-	3,300,010	3,300,010
Transfer to General Reserves (as provided for under Section 8(1)(b) of the National Reserve Bank of Tonga (Amendment) Act 2014, and approved by the Minister of Finance	-	378,219	-	378,219
Balance 30 June 2015	\$5,000,000	\$10,378,219	\$11,273,473	\$26,651,692
<i>Net gains arising from the translation of foreign currency balances to Tongan currency</i>				
Net gains arising from the translation of foreign currency balances to Tongan currency	-	-	15,434,839	15,434,839
Transfer to General Reserves (as provided for under Section 8(1)(b) of the National Reserve Bank of Tonga (Amendment) Act 2014, and approved by the Minister of Finance	-	1,240,560	-	1,240,560
Balance 30 June 2016	\$5,000,000	\$11,618,779	\$26,708,312	\$43,327,091

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

STATEMENT OF CASH FLOWS YEAR ENDED 30 JUNE 2016

	Notes	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		\$	\$
Interest received		5,321,256	5,659,592
Rental income		784,068	778,981
Numismatic sales		352,180	261,053
Other income		3,135,595	1,341,363
Purchase of currency		(3,178,087)	(7,315,020)
Interest paid		(37,632)	(103,719)
Payments to suppliers and employees		(5,396,305)	(4,386,538)
Net cash (outflow)/ inflow from operating activities		981,075	(3,764,288)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of fixed assets		(498,935)	(316,894)
Net movement in IMF accounts		(1,071,330)	(1,653,599)
Net movement in staff loans		(393,111)	(899,748)
Net cash used in investing activities		(1,963,376)	(2,870,241)
CASH FLOWS FROM FINANCING ACTIVITIES			
Increase in currency in circulation		11,383,077	7,029,654
Increase in demand deposits		34,857,598	10,584,903
Increase in statutory deposits		3,414,000	1,311,000
Net movement in Government of Tonga account		(882,511)	(3,552,247)
Net movement in funds held for clearance		(260,672)	(496,819)
Net movement in IMF SDR Allocation		799,398	1,234,093
Net cash inflow from financing activities		49,310,890	16,110,584
Net increase in cash and cash equivalents		48,328,589	9,476,055
Cash and cash equivalents at the beginning of the financial year		\$ 264,109,890	\$ 251,333,825
Net effect of change in exchange rates	2 (b)	15,434,839	3,300,010
Cash and cash equivalents at the end of the financial year	18	\$ 327,873,318	\$ 264,109,890

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

1. GENERAL INFORMATION

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

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

The principal functions of the Bank shall be, to:

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

These financial statements have been approved for issue by the Board of Directors on 28 September 2016.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS

a) Basis of accounting

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

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

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

A number of new standards and amendments to standards and interpretations are effective for accounting periods beginning on or after 1 July 2016. 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'	<p>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.</p>	Annual periods beginning on or after 1 January 2018
IFRS 16: Leases	<p>IFRS 16, 'Leases', replaces the current guidance in IAS 17. Under IFRS 16, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Under IAS 17, a lessee was required to make a distinction between a finance lease (on balance sheet) and an operating lease (off balance sheet). IFRS 16 now requires a lessee to recognise a lease liability reflecting future lease payments and a 'right-of-use asset' for virtually all lease contracts. Included is an optional exemption for certain short-term leases and leases of low-value assets; however, this exemption can only be applied by lessees.</p> <p>The standard is effective for accounting periods beginning on or after 1 January 2019. Early adoption is permitted but only in conjunction with IFRS 15, 'Revenue from Contracts with Customers. The Bank is in the process of evaluating the potential effect of this standard</p>	Effective date: periods beginning on or after 1 January 2019
IFRS 15: Revenue from contracts with customers	<p>IFRS 15, 'Revenue from contracts with customers' deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognised when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18 'Revenue' and IAS 11 'Construction contracts' and related interpretations. The standard is effective for annual periods beginning on or after 1 January 2018 and earlier application is permitted. The Bank is in the process of evaluating the potential effect of this standard.</p>	Effective date: periods beginning on or after 1 January 2018

b) Foreign currencies

Foreign currencies have been translated to Tonga currency at rates of exchange ruling at year end.

Exchange gains and losses arising during the year from changes in the valuation of foreign currencies are taken to the Revaluation Reserve Account in accordance with the provisions of Section 33 of the National Reserve Bank of Tonga Act, 1988, the NRBT (Amendment) Act, 2007, the Miscellaneous Amendments (Privy Council) Act 2010 and NRBT (Amendment) Act 2014, and are not included in the computation of annual profits and losses of the Bank as required under International Accounting Standard 21, "The effects of changes in foreign exchange rates" (IAS 21). The impact of this in the statement of comprehensive income would be an increase in net profit by \$15,434,839 (2015: \$3,300,010).

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

Any credit balance in the Revaluation Reserve Account at the end of each year is applied first, on behalf of the Government, to the redemption of any non-negotiable market interest bearing notes previously transferred to the Bank by the Government to cover losses. According to the National Reserve Bank of Tonga (Amendment) Act 2014, any balance remaining in the Revaluation Reserves Account shall be carried forward to the next financial year.

c) Critical accounting estimates and judgements

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

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

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

- Note 2 (d) – Provisions for impairment of financial assets
- Note 2 (i) – Depreciation
- Note 2 (j) – Provisions for employee entitlements

d) Financial Assets and Liabilities

i. Financial Assets

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

- **Held to Maturity Investments**

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

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

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

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

Are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

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

Impairment of Financial Assets

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

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

ii. Financial Liabilities

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

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

- **Demand Deposits**

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

e) Currency and Numismatics Inventory

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

f) Currency in Circulation

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

g) Coins sold as numismatic items

The Bank sells, or receives royalties on, coins which are specially minted or packaged as numismatic items. These coins have not been accounted for as currency issued for circulation as they are not issued for monetary purposes. In terms of Section 53(2) of the National Reserve Bank of Tonga Act, 1988 and the Miscellaneous Amendments (Privy Council) Act 2010, Cabinet has specified by notice in the Gazette that the Bank shall not be required to include in its financial statements the face value of these coins in circulation.

h) Income tax

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

i) Depreciation

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

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

j) Employee Entitlements

The Bank has its own Staff Provident Fund and only certain staff contribute to this scheme. The bank and staff contributions are based on the years of service. Other staffs contribute to the National Provident Fund Scheme.

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

k) Cash and cash equivalents

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

l) Revenue Recognition

Interest income is brought to account on an accrual basis.

m) Provisions

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

n) General Reserve and Distribution of Profits

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

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

- a) where the General Reserve does not exceed 50% of the authorised capital of the Bank, 100% of the net profit be transferred to the General Reserve;
- b) where the General Reserve exceeds 50% of the authorised capital of the Bank, 30% to be transferred to the General Reserve and the authorised capital of the Bank equal 10% of the total monetary liabilities of the Bank.

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

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

o) Revaluation Reserve

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

p) Segment Reporting

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

q) Leases

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

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

r) Functional and Presentation Currency

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

3. FINANCIAL RISK MANAGEMENT

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

(a) Credit Risk

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

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

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

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

	2016	2015
	\$	\$
Foreign currency assets		
Short Term Commercial Paper and current accounts	327,817,394	263,691,758
Total financial investments	\$ 327,817,394	\$ 263,691,758

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

	2016	2015
	\$	\$
Australia	223,221,822	163,736,255
New Zealand	91,804,222	86,879,388
United States of America	12,077,700	12,190,307
Switzerland	570,776	538,127
United Kingdom	120,139	297,052
Fiji	22,735	50,629
Total financial investments	\$327,817,394	\$263,691,758

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 Supernational.

	2016	2015
	\$	\$
AAA	591,267	836,837
AA+	12,176,286	12,215,013
AA	120,139	122,007
AA-	222,996,195	193,331,011
A+	-	56,598,134
A	91,339,996	-
B+	22,735	50,629
N/R	570,776	538,127
Total financial investments	\$ 327,817,394	\$ 263,691,758

(b) Liquidity Risk

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

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

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

Maturity Analysis as at 30 June 2016

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

Maturity Analysis as at 30 June 2015

	0-3 Months	3-12 months	1-5 years	Over 5 Years	No Specific maturity	Total
Liabilities						
Foreign Currency Liabilities						
Accrued Interest	349	-	-	-	-	349
Demand Deposits	10,921,827	-	-	-	-	10,921,827
IMF Special Drawing Rights Allocation	-	-	-	-	19,418,101	19,418,101
Local Currency Liabilities						
Payable to Government	882,510	-	-	-	-	882,510-
Demand Deposits	185,789,222	-	-	-	-	185,789,222
Accrued Interest	8,490	-	-	-	-	8,490
Other Liabilities	-	-	-	-	1,187,133	1,187,133
Currency in Circulation	-	-	-	-	55,961,459	55,961,459
Statutory Reserve Deposits	-	-	-	-	18,112,000	18,112,000
International Monetary Fund						
- Currency Subscription	-	-	-	-	14,467,901	14,467,901
Employee Provisions	59,508	4,198		17,147	-	80,853
Total Liabilities (contractual maturity dates)	197,661,906	4,198		17,147	109,146,594	306,829,845

(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 2016 and 2015 in Tonga Pa'anga equivalents.

At 30 June 2016	USD	AUD	GBP	NZD	Other	Total
ASSETS						
Short Term Investments and Current Accounts	148,584,667	52,205,581	125,008	126,879,403	22,735	327,817,394
Accrued Interest International Monetary Fund	1,201,295	849,402	-	9,286,547	-	11,337,244
- Reserve Tranche Position	-	-	-	-	10,558,012	10,588,012
- Special Drawing Rights	-	-	-	-	16,487,060	16,487,060
Total Assets	149,785,962	53,054,983	125,008	136,165,950	27,067,807	366,199,710
LIABILITIES						
Demand Deposits	33,109,757	296,961	-	359,732	161,097	33,927,547
Accrued Interest	-	-	-	-	24,918	24,918
IMF Special Drawing Rights Allocation	-	-	-	-	20,217,499	20,217,499
Total Liabilities	33,109,757	296,961	-	359,732	20,403,514	54,169,964
NET POSITION	116,676,205	52,758,022	125,008	135,806,218	6,694,293	312,029,746

At 30 June 2015	USD	AUD	GBP	NZD	Other	Total
ASSETS						
Short Term Investments and Current Accounts	107,702,565	40,038,736	302,478	115,597,349	50,630	263,691,758
Accrued Interest International Monetary Fund	533,091	3,134,665	-	5,136,118	-	8,803,874
- Reserve Tranche Position	-	-	-	-	5,050,555	5,050,555
- Special Drawing Rights	-	-	-	-	20,923,187	20,923,187
Total Assets	108,235,656	43,173,401	302,478	120,733,467	26,024,372	298,469,374
LIABILITIES						
Demand Deposits	10,239,973	293,357	-	260,190	128,307	10,921,827
Accrued Interest	-	-	-	-	349	349
IMF Special Drawing Rights Allocation	-	-	-	-	19,418,101	19,418,101
Total Liabilities	10,239,973	293,357	-	260,190	19,546,757	30,340,277
NET POSITION	97,995,683	42,880,044	302,478	120,473,277	6,477,615	268,129,097

iii. Sensitivity to Foreign Currency Risk and Interest Rate Risk

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

Impact of:	2016	2015
Change in equity due to a +/-5% appreciation / depreciation of the Tonga Pa'anga	15,601,487	13,405,561
Change in profit/loss due to a rise/drop of +/-1 percentage point in interest rate	3,120,297	2,681,112

	2016	2015
	\$	\$
4. INTEREST INCOME		
Overseas investments	7,794,343	4,960,018
Staff loans	78,063	33,234
,	7,872,406	4,993,252
5. OTHER INCOME		
Numismatic coins	351,610	259,849
Rental income	784,068	778,980
Gain on sale of assets	1,836,520	-
Forex sales/ purchases	1,221,645	1,180,006
Bank user fees	77,430	161,357
Information services – publications	35	10
Miscellaneous	536	1,195
	4,271,844	2,381,397
6. INTEREST EXPENSE		
Foreign currency accounts	15,881	32,174
Domestic currency accounts	33,143	57,712
	49,024	89,886
7. ADMINISTRATION AND OTHER EXPENSES		
Administration	1,753,381	1,594,699
Retirement fund	336,714	265,001
Staff costs	2,914,331	2,312,115
Audit fees	26,133	26,288
Currency issue (refer note 10)	2,347,379	1,256,072
Depreciation	582,089	569,859
	7,960,027	\$ 6,024,034
8. SHORT TERM INVESTMENTS AND CURRENT ACCOUNTS		
Current accounts	13,481,203	13,762,613
Short term investments	314,336,191	249,929,145
	\$ 327,817,394	\$ 263,691,758

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 2016, Tonga's membership subscription to the International Monetary Fund was SDR13,800,000 (2015: SDR6,900,000). Of this total amount, SDR3,436,633 (2015: 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 2016, the Special Drawing Rights holdings had a balance of SDR5,366,538 (2015: SDR7,090,868).

10. OTHER ASSETS

	2016	2015
	\$	\$
Staff loans and advances	1,572,205	1,179,094
Currency and numismatics	4,950,267	4,119,559
Other assets	5,950,263	5,416,029
	12,472,735	10,714,682

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	Office Equipment	Furniture and Fittings	Motor Vehicles	WIP	TOTAL
At 30 June 2014						
Cost	12,944,054	3,079,656	320,168	450,232	11,342	16,805,452
Accumulated Depreciation	(4,835,827)	(1,909,602)	(195,886)	(222,802)	-	(7,164,117)
Net Book Amount	8,108,227	1,170,054	124,282	227,430	11,342	9,641,335
Year Ended 30 June 2015						
Opening net book value	8,108,227	1,170,054	124,282	227,430	11,342	9,641,335
Additions	202,588	41,980	20,326	52,000	-	316,894
Transfers in/(out)	11,342	-	-	-	(11,342)	-
Depreciation	(272,909)	(218,015)	(7,287)	(71,648)	-	(569,859)
Closing net book value	8,049,248	994,019	137,321	207,782	-	9,388,370
At 30 June 2015						
Cost	13,157,984	3,121,636	340,494	502,232	-	17,122,346
Accumulated Depreciation	(5,108,736)	(2,127,617)	(203,173)	(294,450)	-	(7,733,976)
Net Book Amount	8,049,248	994,019	137,321	207,782	-	9,388,370
Year Ended 30 June 2016						
Opening net book value	8,049,248	994,019	137,321	207,782	-	9,388,370
Additions	366,561	132,374	-	-	-	498,935
Depreciation	(439,973)	(89,745)	(8,504)	(81,399)	-	(619,621)
Closing net book value	7,975,836	1,036,648	128,817	126,383	-	9,267,684
At 30 June 2016						
Cost	13,524,545	3,254,010	340,494	502,232	-	17,621,281
Accumulated Depreciation	(5,548,709)	(2,217,362)	(211,677)	(375,849)	-	(8,353,597)
Net Book Amount	7,975,836	1,036,648	128,817	126,383	-	9,267,684

	2016	2015
	\$	\$
12. (a) FOREIGN CURRENCY DEMAND DEPOSITS		
Government of Tonga	33,874,493	10,869,418
Other institutions	53,053	52,409
	\$ 33,927,546	\$ 10,921,827
 (b) LOCAL CURRENCY DEMAND DEPOSITS		
International banks	131,374	27,083
Domestic banks	167,716,282	151,819,096
Government of Tonga	29,793,445	33,943,043
	\$ 197,641,101	\$ 185,789,222
 13. PAYABLE TO GOVERNMENT		
Amount payable to government in accordance with Section 8(1) of the National Reserve Bank of Tonga (Amendment) Act 2014	\$ 2,894,639	\$ 882,510
 14. CURRENCY IN CIRCULATION		
Notes	64,344,416	53,822,891
Coins	3,000,120	2,138,568
	\$ 67,344,536	\$ 55,961,459

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

	2016	2015
	\$	\$
Other creditors and accruals	882,848	1,102,604
Payable to the National Reserve Bank of Tonga Staff Provident Scheme – refer note below	154,273	84,529
	\$ 1,037,121	\$ 1,187,133

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

	2016	2015
	\$	\$
Opening balance	80,853	125,069
Entitlements during the year	195,270	163,931
Utilised/reversals	(174,976)	(208,147)
	101,147	80,853

18. CASH AND CASH EQUIVALENTS

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

	2016	2015
	\$	\$
Cash on hand	55,924	418,132
Short term investments and current accounts	327,817,394	263,691,758
	327,873,318	264,109,890

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 2016 were Steve Edwards (Chairperson), HRH Princess Salote Pilolevu Tuita, Richard Prema, Sinaitakala Tu'itahi, Sione Ngongo Kioa (Governor), Tatafu Moeaki and 'Uhila Liava'a.

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

Transactions with related parties

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

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

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

	2016	2015
	\$	\$
Provident Fund payments made by the Bank	342,336	265,001
	342,336	265,001

The funds of the National Reserve bank of Tonga Staff Provident Fund are invested within the Bank at an average rate of 3.96% (2015: 3.89%) per annum. The total interest paid by the Bank for the financial year amounted to \$4,294 (2015: \$7,163). The Trustees of the Staff Provident Fund are indemnified by the Bank against all losses, damages or other costs which may be sustained or suffered by or made against a trustee as a result of any act or omission committed by the Trustee or Trustees which is not a breach of trust on the part of the Trustee.

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

	2016	2015
	\$	\$
Rent received in advance from Tonga SAT	16,801	131,469
Purchase of goods	1,020	143

The Directors are paid fees and sitting allowances for services rendered. The Directors entitlements to the retirement fund at year end amounted to \$183,653 (2015:\$234,089). The Bank also provides non-cash benefits to the Executive officers in addition to their salaries.

Total remuneration below is included in 'administrative costs'.

	2016	2015
	\$	\$
Executive officers	311,633	338,303
Director's fees and allowances	114,213	127,999
	425,846	466,302

20. COMMITMENTS

(a) Operating lease commitments

Lessee Disclosure

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

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

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

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

	2016	2015
	\$	\$
Due not later than one year	3,000	5,000
Due later than one year but not later than five years	12,000	20,000
Due later than five years	213,370	356,000
	228,370	381,000

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:

	2016	2015
	\$	\$
Due not later than one year	613,232	637,172
Due later than one year but not later than five years	369,263	793,059
	\$ 982,495	\$ 1,430,231

(b) Capital and other commitments

	2016	2015
	\$	\$
Commitment not provided for in the financial statements are as follows:		
Capital commitment: approved and contracted	NIL	\$ 2,791,450

21. CONTINGENT LIABILITIES

Contingencies not otherwise provided for in the accounts and which existed at 30 June 2016 comprise:

- (i) Contracts for foreign exchange transactions was nil (2015: \$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 26 July 2016 the NRBT revoked the licence of the Pacific International Commercial Bank (PICB) to conduct banking business in Tonga. The PICB challenged the NRBT's decision to revoke their licence and filed a court injunction with the Supreme Court.

At the injunction hearing on 5 August 2016, PICB withdrew its submission for an injunction and has requested a trial by jury claiming damages against the NRBT in the sum of TOP10 million for general damages and TOP5 million for punitive and aggravated damages.

The Supreme Court has in the interim ordered PICB to cover the legal costs incurred by NRBT in its preparation for the injunction hearing. The NRBT has also filed an Application to Strike Out the PICB's claim with the Supreme Court on 30 August 2016 and a date for hearing of the application is yet to be set.