

*National Reserve Bank of Tonga*

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*Annual Report 2007-08*

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*Pangike Pule Fakafonua 'o Tonga*

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**National Reserve Bank of Tonga**

**Annual Report for the Year Ended 30 June 2008**

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Discrepancies between the sum of the constituent items and the total, as shown in some tables, are due to rounding.  
Revisions to previously published statistics are included as they occur.

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## Governor's Forward

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The Tongan economy during 2007/08 is estimated to have returned to modest growth, following several large shocks to the economy in previous years. A return to economic stability so shortly following the civil unrest in November 2006, a poor agricultural season and large scale redundancies in the civil service reflects in part decisions of policy makers.

The National Reserve Bank of Tonga played its part, ensuring that businesses affected by the civil disturbance were able to access funds, while maintaining adequate foreign reserves. At times these goals were in conflict with each other but I believe we managed to address both issues with minimal disturbance to the stability of the financial system. I am pleased to report that despite many challenges, the external balance of the country was maintained. The level of official foreign exchange reserves remained above 3 months of import cover throughout 2007/08 though was declining at the end of the financial year. The outlook is for improving foreign reserve levels on the back of anticipated increase in capital receipts in the next financial year.

This financial year has been characterized by high inflation as the rising cost of fuel and food had a significant impact on the local economy. The Reserve Bank's monetary policy measures played its part, containing inflation to 12 percent despite international commodity prices more than doubling, and by the end of the financial year signs of inflation slowing were evident. As oil and food prices drop on international markets we expect that inflation will be well under control in the next financial year.

Overall, the stability of the Tongan economy and financial system was sound throughout the financial year despite some pockets of illiquidity. To address the perceived lack of liquidity and strengthen the banks' liquidity management policies, the Reserve Bank encouraged the banks to purchase Government of Tonga bonds, against which they can enter into repurchase agreements with the Reserve Bank. The terms and conditions of the Reserve Bank's repurchase agreement facility were revised and the repurchase agreement rate was reduced to 10 percent in August to reflect lower interbank rates. Further, large import and capital payments were staggered to ensure adequate liquidity in the system. As capital payments enter the banking system, and large outflows are cleared we expect liquidity to stabilize.

In an important milestone in the development of Tonga's financial system, the National Reserve Bank (Amendment) Act 2007 was gazetted and came into effect in February 2008. This Act strengthens the institutional capacity of the Reserve Bank and ensures greater autonomy in the conduct of monetary policy. The Act also strengthens the accountability and transparency of the Reserve Bank in exercising its powers. The Reserve Bank is required to publish every six months a Monetary Policy Statement; the first of which was published in September 2007. The release of regular Statements on Monetary Policy will provide greater clarity on the policy decisions of the Reserve Bank, and greater understanding of the state of the Tongan economy and financial system.

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The Reserve Bank in its capacity as bank supervisor, issued two important prudential standards on liquidity management and the disclosure of interest rates and fees and charges by banks to ensure that liquidity risk management practices were in line with international best practice and to foster market discipline.

To combat money laundering and terrorist financing, the Reserve Bank continued to work with the Crown Law Department on the amendments to the Anti-Money Laundering and Combating of Terrorist Financing (AMLCFT) related Acts in preparation for Tonga's mutual evaluation by the Asia Pacific Group on Money Laundering (APG) in 2009.

The Reserve Bank successfully completed its administrative targets for the year, including the successful hosting of the South Pacific Central Bank Governors' Annual Meeting in December 2007 – the first time this has been held in Tonga. The Reserve Bank also, successfully completed its work on the new design of currency notes and its preparation for the first issue of the one hundred pa'anga note with the portrait of King George Tupou V on it. The new one hundred pa'anga note was issued to mark the coronation of His Majesty. The Reserve Bank continued to carry out its regular functions that contribute to monetary and financial sector stability. These functions include the supply of Tongan currency, provision of daily settlement for inter-bank transactions, foreign exchange operations with the government and the banks, foreign exchange control administration and registrar of government bonds. In order to strengthen the security and efficiency of its international payment system, the Reserve Bank upgraded its swift system during the year.

The Reserve Bank places considerable emphasis on developing the existing high skills base of its staff, through external and in-house training. Staff participated in courses across the range of central banking functions, including bank supervision, reserves management, remittances, anti-money laundering, balance of payments reporting, human resource management and information technology.

The annual accounts of the National Reserve Bank of Tonga comply with the requirements of the International Financial Reporting Standards, with the exception of the treatment of foreign currency gains and losses, which meets the provisions of the National Reserve Bank of Tonga Act, 1988. The Reserve Bank's balance sheet contracted to T\$127.2 million, a 4.5 percent decrease from the previous year attributed mainly to the decrease in the level of holding of Government of Tonga bonds. The Reserve Bank's operating profit, reached T\$3.8 million, an increase of 4.8 percent over the previous year.

I thank the staff of the Reserve Bank for their efforts during a very challenging period for the Reserve Bank and the Tongan economy. I also thank the government and members of the financial sector for their part in ensuring that confidence and stability in the system was maintained. Appreciation is also extended to the members of the Bank's Board for their continued support during the year. The assistance from the International Monetary Fund, Pacific Financial Technical Assistance Centre, the Reserve Banks of Australia, New Zealand and Fiji, other regional central banks, the Bank of England

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Centre for Central Banking Studies, AusAID, NZAid, AUSTRAC, AMLAT and the Pacific Anti-Money Laundering Project is also gratefully acknowledged.

A handwritten signature in black ink, appearing to read 'Mafi'.

Siosi C. Mafi  
Governor

**Board of Directors of the National Reserve Bank of Tonga**  
**year ended 30 June 2008**



HRH Princess Salote Pilolevu Tuita  
*Acting Chairperson*



Hon. Siosiu T. T. 'Utoikamanu  
*Minister of Finance*



Mr. Richard Prema  
*Director*



Mrs. Siosi Cocker Mafi  
*Governor*



Mr. Henry Cocker



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## **Principal objectives and functions of the National Reserve Bank of Tonga**

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i) The principal objectives of the National Reserve Bank of Tonga shall be, to:

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

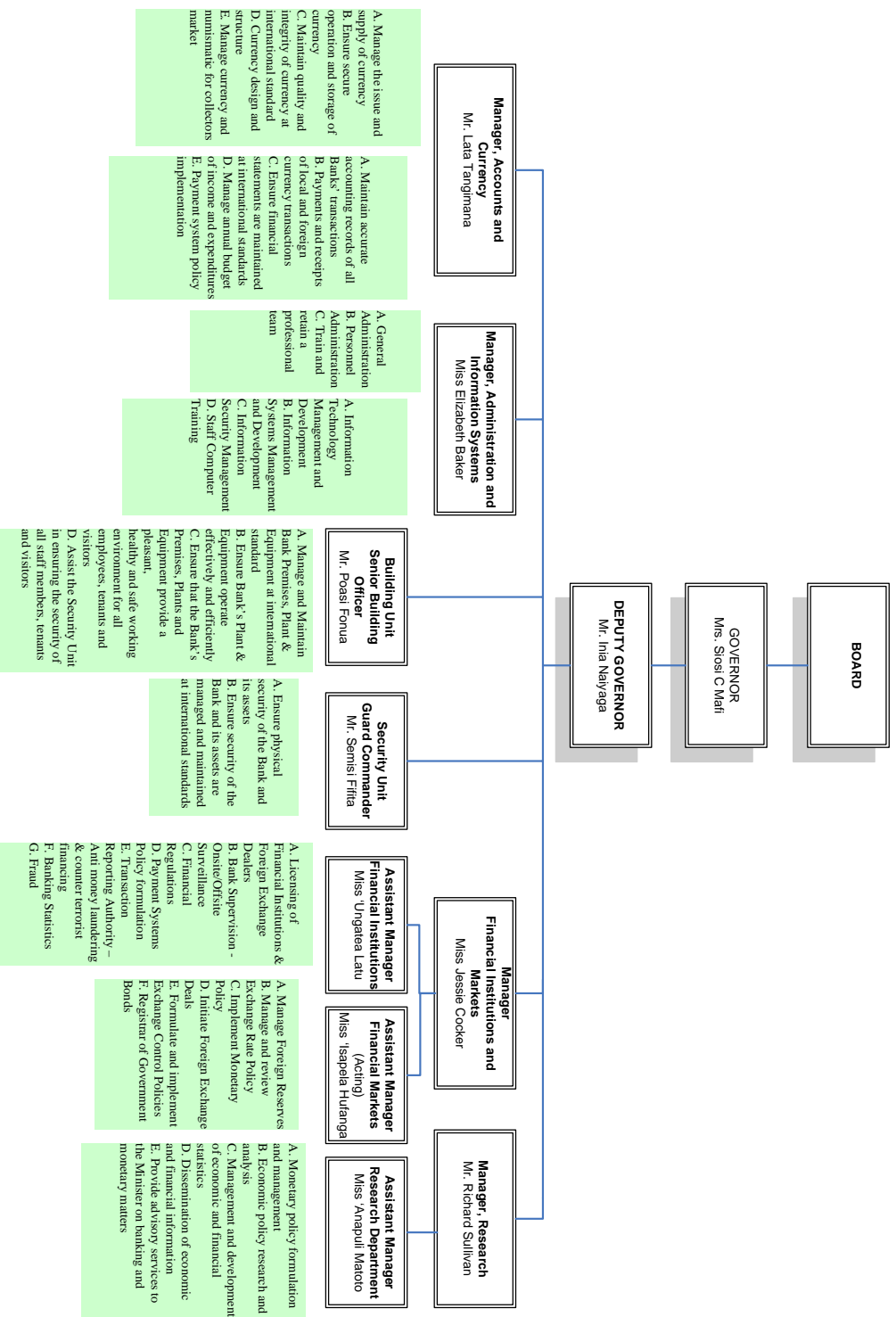
ii) The principal functions of the National Reserve Bank of Tonga shall be, to:

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

Section 4 and Section 4A

National Reserve Bank of Tonga Act ( As amended in 2007)

# NATIONAL RESERVE BANK OF TONGA JUNE 2008



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## Economic Overview

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### Overseas Economic Developments

The global economy reeled from the credit crises that slowed economic activity throughout 2007/08 and high commodity prices, especially fuel and food, that pushed inflation higher across the world. GDP growth slowed in all of Tonga's major trading partners, while central banks grappled with rising inflation in times of slowing activity.

The United States ended 2007 in poor shape following the credit crunch brought on by large loan defaults there. However, recent economic activity has been better than expected. Real GDP grew in both the March and June quarters following a contraction in December. Contributing to this renewed growth have been tax rebates this year, supporting consumer spending, a weak US dollar helping to boost the export sector. Still, the US economy remains soft as the US housing market remains weak and both business and consumer confidence are low.

	Real GDP			Consumer Prices			Current Account Balances		
	Annual percent			Annual percent change			Percent of GDP		
	2006	2007	2008	2006	2007	2008	2006	2007	2008
United States	2.9	1.9	1.9	3.2	2.7	2.3	-6.2	-5.7	-5.5
Japan	2.2	2.0	1.7	0.3	0.3	0.5	3.9	4.5	4.3
Euro area	2.8	2.5	2.1	2.2	2.0	2.0	-0.3	-0.2	-0.4
China	11.1	11.5	10.0	1.5	4.5	3.9	9.4	11.7	12.2
Australia	2.7	4.4	3.8	3.5	2.3	2.8	-5.5	-5.7	-5.6
New Zealand	1.6	2.8	2.3	3.4	2.4	2.7	-8.7	-8.5	-8.6

Source : IMF World Economic Outlook, October 2007

Annual GDP growth in Australia has slowed, falling to 2.7 percent in the year to June. There has also been some easing in business conditions, and consumer confidence remains at low levels. Despite this, inflation pressures remain strong. New Zealand, likewise has seen GDP slow considerably, with annual growth slowing to around 2 percent and confirmation of a technical recession with consecutive negative quarterly growth in the March and June quarters. Inflation is still rising with imported fuel costs the main culprit.

Many Asian economies have also experienced softening activity. GDP has contracted in Japan, Singapore and Hong Kong in the June quarter, while growth slowed in China, India, South Korea and Taiwan. There are signs that slowing global growth is now contributing to softening export activity in the region. At the same time, high prices for food and fuel are dampening households' real incomes with high inflation being reported across the region, especially in India and China, while Japan's inflation is indisputably positive for the first time in more than a decade.

Economic activity in the United Kingdom stalled in the June quarter, and contracted within the eurozone. Both economies suffered from weakness in domestic demand. The UK economy was dampened by an ongoing housing slump while the high euro stifled export growth in the eurozone. Inflation in both economies continued to cause concern.

In the Pacific region the high cost of imported fuel and food is causing inflation rates around 10 percent in many countries. While most economies are managing to contain domestic inflation, the imported component is pushing headline inflation uncomfortably high. Also, most economies are experiencing slower economic growth than in previous years. While Papua New Guinea and Samoa are seeing their expansions slow down, Fiji and the Solomon Islands are seeing contractions in activity.

## Domestic Economic Conditions

Economic growth was estimated by the Ministry of Finance to have increased by 1.2 percent in 2007/08 compared to a contraction of 3.2 percent in 2006/07. The recovery in economic activity largely reflected positive growth in most sectors except agriculture. The contraction in the agriculture sector, which accounts for around a quarter of GDP was mainly due to a decline in the production of squash and vanilla as indicated in the Statistics trade report. However, root crops like taro and yam contributed positively to total exports. Total fish exports were also subdued for the year ending 2007/08.

Construction activity is estimated to have risen as more rebuilding and tourism projects are to be completed, some of which were in preparation for the coronation of King George V. This increase is consistent with credit growth during the year.

According to surveys by the Reserve Bank, sales of household goods increased from the previous financial year, whereas sales of vehicles dropped.

The tourism sector improved due to a substantial increase in tourist receipts by 75 percent for the year ending June 2008 after a decline in the previous year. Total visitor arrivals into the Kingdom including returning nationals rose by 27 percent compared to the previous year as both air and cruise ship arrivals increased.

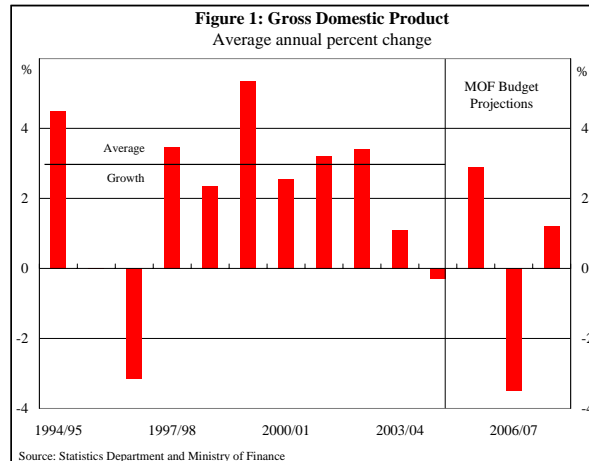


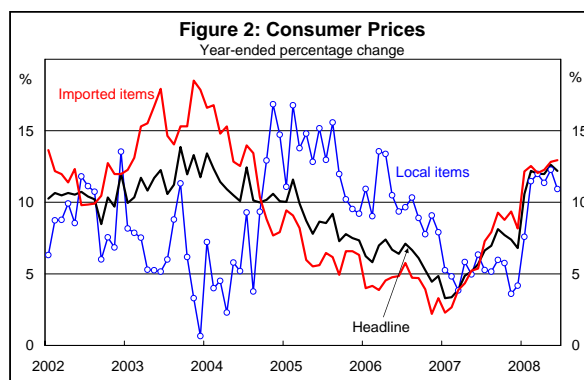
Table 2. TONGA MAIN ECONOMIC INDICATORS <sup>1/</sup>					
		2004/05	2005/06	2006/07	2007/08
<b>Economic Activity (1995/96 base)</b>					
Real GDP	% change	-0.3	2.9	-3.2	1.2
Tourist Arrivals	Thousands	51.9	53.3	52.8	67.1
<b>Money, Prices &amp; Interest Rates</b>					
CPI (average)	% change	9.9	7.2	5.1	9.3
CPI (year-end)	% change	8.7	6.4	5.7	9.6
Money Supply (M2 - year end)	\$m pa'anga	203.5	237.3	265.5	287.2
Domestic Credit (year end)	\$m pa'anga	210.3	264.5	295.2	332.9
Weighted term deposit interest rate (year end)	% per annum	6.0	6.8	6.6	6.4
Weighted lending rate (year end)	% per annum	11.5	12.3	12.3	12.7
<b>External Sector</b>					
Merchandise exports fob (OET basis)	\$m pa'anga	31.1	31.0	26.7	23.5
Merchandise imports fob (OET basis)	\$m pa'anga	204.2	245.4	217.5	262.4
Official foreign reserves (year end)	\$m pa'anga	82.1	83.2	91.6	89.1
Import coverage (year end)	Months	4.4	4.3	4.5	3.6
Exchange rate (period end)	US\$/T\$	0.5204	0.4848	0.5131	0.5407

<sup>1/</sup> Sources: Ministry of Finance Budget 2008/09, Tonga Visitors Bureau, Department of Statistics and National Reserve Bank of Tonga

## Prices

The Consumer Price Index measured headline inflation to be 12.2 percent in the year ending June 2008, the highest since 2002/03 and up from 5.7 percent in the year ended June 2007. The average annual inflation rate was 9.6 percent compared to 5.1 percent recorded in the same period a year earlier. The rise in the rate of inflation was mainly due to higher prices of imported goods especially fuel and food prices.

Imported inflation increased at a rate of 12.9 percent, up from the 5.4 percent recorded in the year ended June 2007. Price pressures were from food and transportation. The weakening of the Tongan pa'anga against NZD and AUD contributed to the increase in food prices as a large proportion of imported food products are from these two countries. The continued rise of world oil prices, which reached more than USD\$140 per barrel contributed nearly half of the imported inflation.

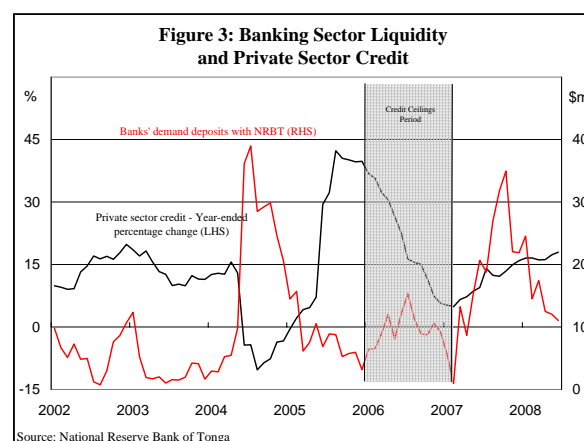


Domestic prices rose 10.9 percent in the year ended June 2008, compared to 6.3 percent rise in the year ended June 2007. The rise in domestic inflation largely reflected the hike in transportation prices where petrol and diesel prices rose to 308.74 and 340.58 seniti per liter respectively. Food prices also recorded an increase of 9.4 percent. Most categories made positive contributions to higher inflation rate in June 2008.

## Financial Intermediation

Total broad money (M3), a broad measure of money supply, increased by 6.7 percent in the year-ended June 2008, slower than in the previous two years. Demand for credit has been very strong in line with reconstruction efforts. However, banks have been constrained through large import payments, reducing their ability to lend as much as is being demanded. Nevertheless private sector credit rose 18.0 percent during the year.

Throughout the financial year 2007/08, lending by the banking system was mostly towards the business sector which saw business credit rise by 36.0 percent. On the other hand household credit rose by a significantly more moderate 1.8 percent in the year to June 2008.

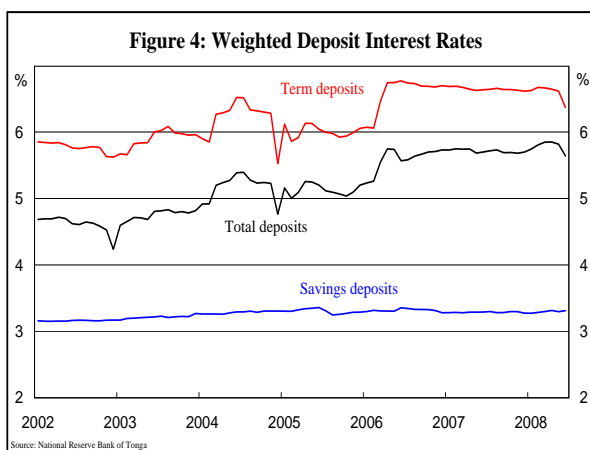


The increase in lending in 2007/08 was funded by a large rise in term deposits, increasing by 20.0 percent in the year ended June 2008. Saving and demand deposits fell slightly in the year.

The government continued to be a net lender to the banking system in the financial year 2007/08 accommodating the growth in credit to the private sector.

## Interest Rates

Deposit interest rates were relatively stable in 2007/08, though term deposit rates for retail investors fell in June 2008. By the end of June 2008, the Reserve Bank's term deposit indicator rate, a weighted average of interest rates paid by commercial banks for deposits less than \$50,000, fell to 6.4 percent



from 6.6 percent a year earlier (Figure 4). The banks do however pay significantly higher wholesale interest rates, though at present this information is not available.

The lending indicator rate, a weighted average of interest rates across household and business lending, rose to 12.7 percent from 12.3 percent a year earlier as banks passed on their higher wholesale funding costs.

The increase in nominal interest rates and the rise in inflation resulted in real deposit interest rates moving to negative territory, dropping as low as negative 5.8 percent in June 2008.

## External Developments

According to the Overseas Exchange Transactions reported by the banking system for the year 2007/08, the widening in the current account deficit together with the net unrecorded outflow were larger than the improvement in the capital account surplus resulting in a decline in the level of official foreign exchange reserve to \$89.1 million, an equivalent of 3.6 months of imports. (Table 3)

The deterioration in the trade deficit by \$48.2 million to \$238.9 million in the year ending June 2008 was largely due to the increase in imports payments, especially fuel. Exports receipts fell to \$23.5 million compared to \$26.7 million a year earlier due to lower export earnings from agriculture especially squash.

The reduction in the services deficit to \$6.2 million from \$35.8 million in 2006/07 reflected higher receipts from tourism followed by receipts from other private services. Net investment income recorded a \$6.4 million surplus, down from \$7.1 million during the the previous year. Inward private remittances underpinned the improvement in the net transfers to \$180.2 million. The total surplus of the net transfers and the net investment income were insufficient to finance the total deficit in the trade balance and services balances resulting in the current account deficit of \$58.6 million in the year 2007/08.

The capital account balance rose by \$15.2 million to \$69.0 million, reflecting higher private capital inflows. The net unrecorded outflow plus the widening current account deficit more than offset the capital account surplus which resulted in an overall balance of payments deficit of \$2.5 million compared with a surplus of \$8.4 million recorded for the year 2006/07.



	2004/05 <sup>2/</sup>	2005/06 <sup>2/</sup>	2006/07	2007/08
<b>A. Merchandise trade balance</b>	-173.1	-214.4	-190.8	-238.9
Exports, f.o.b.	31.1	31.0	26.7	23.5
Imports, f.o.b.	204.2	245.4	217.5	262.4
<b>B. Services balance</b>	-19.3	-15.7	-35.8	-6.2
Receipts	45.9	50.9	38.8	70.1
Payments	65.2	66.6	74.7	76.3
<b>C. Investment income balance</b>	3.1	5.7	7.1	6.4
Receipts	6.6	9.9	12.9	13.0
Payments	3.5	4.2	5.8	6.6
<b>D. Transfers balance</b>	178.1	178.4	168.6	180.2
Receipts	208.7	205.5	187.3	203.6
<i>Private</i>	208.1	205.0	186.8	202.8
<i>Official</i>	0.6	0.5	0.5	0.8
Payments	30.6	27.1	18.7	23.4
<i>Private</i>	30.0	26.5	18.1	23.1
<i>Official</i>	0.6	0.5	0.6	0.3
<b>E. Current account balance (A+B+C+D)</b>	-11.1	-46.1	-50.9	-58.6
<b>F. Capital account balance</b>	24.2	45.2	53.8	69.0
Official capital	9.4	16.8	19.7	22.7
<i>Inflows</i>	16.2	22.8	24.7	26.5
<i>Outflows</i>	6.9	6.0	5.0	3.7
Private capital	14.9	28.4	34.2	46.2
<i>Inflows</i>	34.2	37.5	39.9	50.5
<i>Outflows</i>	19.3	9.1	5.7	4.3
<b>G. Other items, net</b>	-20.7	2.0	5.5	-12.9
<b>H. Overall balance (E+F+G) <sup>1/</sup></b>	-7.6	1.1	8.4	-2.5

1/ Corresponds to changes in gross official foreign reserves.  
2/ Revised  
Totals may not add up due to rounding.  
Source: National Reserve Bank of Tonga

## Economic outlook

The outlook for the Tongan economy is considerably brighter than this time last year. After coping with significant economic shocks in the past two years, major investment is taking place and activity is on the upswing led by increased tourist number. However, this renewed growth is funded by lending and brings with it higher inflation and the risk of lower foreign reserves. Inflation is already high and although imported food inflation is slowing, high oil prices will mean the Reserve Bank will have to remain vigilant.

Foreign Reserves have come under pressure from the increased lending and the high import component of new investment. Substantial grants and debt repayment will ease that concern in the second half of 2008, but the prospect of large import bills are a concern.

Given the above and despite the uncertainty of the future foreign receipts for the Tongan economy, the Reserve Bank projects that the level of official foreign reserves will remain above 3 months of import cover throughout the next year.

# Financial Markets

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## External Reserves

The Reserve Bank is required to maintain, within the limit of its powers, external reserves at a level of at least 3 to 4 months of imports. During the year, the gross official external reserves ranged between 3.6 months and 5.9 months of import cover. The level of gross external reserves ranged from \$88.1 million to a peak of \$114.6 million during the year. At 30th June 2008, the total official external reserves were at \$88.1 million, equivalent to 3.6 months of imports. This compares with the level of \$91.6 million at 30 June 2007, equivalent to 4.4 months of imports. The fall in the months of import coverage reflected the increase in the volume as well as the price of imports following the global rise in oil and food prices. The maintenance of the level of official foreign reserves between 3 to 4 months of imports continued to contribute to maintaining confidence in the financial system of the country after the events of November 2006.

The Reserve Bank holds the external reserves mainly in Australian dollars, New Zealand dollars, US dollars, pounds sterling, euro and special drawing rights. In managing the external reserves, the Reserve Bank's policy is to obtain the maximum income commensurate with safety, liquidity and the maintenance of overall value. Accordingly, the external reserves are invested in deposits with international banks that have a minimum "A" rating by international credit rating agencies, government securities and deposits with central banks. During the year, the Rabo Australia Bank and the Deutsche Bank AG were included in the current list of approved counter parties with which the Reserve Bank could place investments or transact in the foreign exchange markets.

## Foreign Exchange Operations

The Reserve Bank conducts foreign exchange operations with the domestic commercial banks in the intervention currency only, the US dollar. The Reserve Bank quotes daily buying and selling rates for the US dollar against the pa'anga. These rates generally form the basis of the commercial banks' publicly quoted foreign exchange dealing rates. The Reserve Bank also conducts foreign exchange operations for its other customers, and for its own account, in a range of currencies. The Reserve Bank was a net seller in the spot foreign exchange markets during the year. Foreign exchange sales of T\$127.7 million exceeded purchases of T\$125.3 million giving a total foreign exchange turnover for the year of T\$253 million.

## Exchange Control Operations

The Foreign Exchange Control (Amendment) Regulations 2000 assigns the authority over sending money and securities out of the Kingdom to the Reserve Bank. This authority includes licensing of foreign exchange dealers. During the year, the Reserve Bank received 3 applications for restricted foreign exchange dealer licences and approved 2 authorized restricted foreign exchange dealers. The Reserve Bank has licensed four authorized restricted foreign exchange dealers under the Foreign Exchange Control (Amendment) Act 2000. The commercial banks are licensed as authorized foreign exchange dealers under their banking licence. These licensed authorized restricted foreign exchange dealers are the:

1. Fund Management Limited which operates Western Union
2. Rowena Financial Services Limited.
3. Melie-mei-langi Money Transfer
4. Mana Money Transfers

According to the terms and conditions of their licences, these authorized restricted foreign exchange dealers are restricted to the business of accepting foreign exchange and making foreign exchange payments only. These licensed authorized restricted foreign exchange dealers and the commercial banks are required to comply with the Reserve Bank's Exchange Control and the Anti-Money

Laundering and Counter terrorist Financing requirements. The commercial banks or authorized foreign exchange dealers are licensed to undertake foreign exchange business such as the purchase and sales of foreign exchange, writing forward exchange rate contracts, as well as providing foreign currency loans and deposits.

The Reserve Bank continued to liaise with the Ministry of Labour Commerce and Industries to ensure all companies and businesses that are currently accepting foreign exchange and making foreign exchange payments and transfers are licensed. Any entity that is engaged in buying and selling foreign exchange must be licensed by the Reserve Bank under the Foreign Exchange Control Act. The Foreign Exchange Control (Amendment) Regulations 2000 gives the Reserve Bank the administrative powers of the Foreign Exchange Control Regulations. The Reserve Bank's prior approval is required for all outward current transfers of T\$50,000 and above and all capital transfers irrespective of the amount. All outward current transfers of less than T\$50,000 have been delegated to the commercial banks and licensed restricted foreign exchange dealers. These requirements were introduced in 2000 to assist the Reserve Bank with the management of the official foreign reserves, when it fell below the adequate level. During the year, the Reserve Bank held meetings with the banks and some large customers, mainly importers to clarify and improve the understanding of its exchange control policies and requirements.

The Reserve Bank also conducted quarterly technical meetings with the Revenue Services Department and Customs to coordinate efforts in ensuring the objectives of the exchange control policies and requirements are being achieved. The Reserve Bank had issued four exchange control directives and exchange control documentary requirement guidelines to the commercial banks and authorized foreign exchange dealers to require them to sight supporting documents prior to sending foreign exchange outward payments. The Reserve Bank processed 895 exchange control applications totalling T\$194.6 million in 2007/08 (of which 5 percent were classified as capital transactions) compared to the 872 exchange control applications processed in 2006/07 amounting to T\$156.5 million. The increase in exchange control applications may be attributed to the increase in imports as well as the increase in awareness by the commercial banks and the authorized foreign exchange dealers on the exchange control requirement in Tonga.

### **Domestic Market Operations**

At the end of June 2008, there were no outstanding Reserve Bank Notes. Since March 2007, the Reserve Bank has not issued any Reserve Bank notes following its decision to ease its monetary policy stance and allow banks to consider lending for the recovery of those who were affected by the event of November 2006.

The National Reserve Bank of Tonga Act prohibits the Reserve Bank from making unsecured loans to any of its customers. Any borrowing from the Reserve Bank has to be secured by government bonds, NRBT notes or any other security specified by the Board. In 2007/08, the Reserve Bank received one application and entered into a repurchase agreement transaction with one of the licensed financial institutions. As at the end of June 2008, the repurchase agreement rate remained unchanged at 12 per cent per annum.

The activities in the domestic inter-bank market moderated during the 2007/08 financial year. Total loans of \$8.68 million were made during the year for maturities ranging from overnight to one week compared to total loans of \$17.07 million in the previous year. The fall in total loans and the shorter term maturities in the inter-bank market largely reflected the improvement in the total liquidity in the financial system. The interest rate charged by the banks for overnight loans remained unchanged at 10 per cent per annum during 2007/08.

**Registrar of Government Bonds**

The Reserve Bank acts as registrar for all of the Government of Tonga's bond issues. The Reserve Bank issued 2 new Government of Tonga bonds during the financial year. The total value of Government of Tonga bonds outstanding was at \$21.45 million at 30 June 2008 compared to \$24.7 million in the previous year. The total value of government bonds outstanding declined towards the end of the year due to the government bonds that matured in June 2008. The Reserve Bank continued to provide a secondary market for government bonds until February 2008. The National Reserve Bank of Tonga (Amendment) Act 2007, which came into effect in February 2008, prohibits the Reserve Bank from underwriting or holding Government of Tonga bonds. For this reason, the Reserve Bank continued to market its holdings of government bonds on its website in its effort to divest its current holdings of Government of Tonga bonds and to create a secondary market for government bonds.

## Financial Institutions

The National Reserve Bank of Tonga (Amendment) Act, 2007 and the Financial Institutions Act, 2004 authorise the Reserve Bank to undertake the prudential supervision of licensed financial institutions. The primary objectives of the Reserve Bank in this area are the stability of the financial system and the security of depositors' funds with licensed financial institutions.

During the year, there was no change to the composition of the financial system in Tonga which is three commercial banks, a development bank and the central bank.

### Financial Sector: Facilities and Operations

#### *Licensed Financial Institutions in Tonga*

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

The Westpac Bank of Tonga maintained its head office and two branches on Tongatapu as well as branches on the islands of Vava'u, Ha'apai, and 'Eua. The MBf Bank Limited maintained its head office on Tongatapu and a branch on the island of Vava'u. Following the destruction of its head office in 2006, the ANZ Bank continues to operate from its main branch at Mailetaha with additional two sub-branches in Nuku'alofa, Tongatapu. The ANZ also maintained its sub-branch on Vava'u. The TDB maintained its head office on Tongatapu, as well as branches on the islands of Vava'u, Ha'apai, Eua, Niuaotuputu and Niuafo'ou.

The total assets of the financial sector (licensed financial institutions) reached \$443.7 million in 2007/08, an increase of \$47.1 million (11.9 percent) over the year. Total net loans by the banks to the non-financial sector grew by \$55.7 million (19.2 percent) compared with a \$16.5 million (6.0 percent) growth recorded in 2006/07. At the end of the 2007/08, the banks' outstanding loans portfolio comprised: 52.5 percent for industries and businesses including agriculture; 45.8 percent for private individuals

**Table 4. FINANCIAL SECTOR ACCOUNTS**

	2003/04	2004/05	2005/06	2006/07	2007/08
<b>Demand Deposits</b>					
Number of Accounts	14,487	22,077	2,878	2,657	2,687
Value of Deposits (\$m)	69.7	68.3	56.1	67	66
<b>Saving Deposits</b>					
Number of Accounts	29,693	66,885	39,361	45,816	44,486
Value of Deposits (\$m)	37.1	41.9	62.4	54	54
<b>Time Deposits</b>					
Number of Accounts	2,002	2,428	2,318	1,710	1,747
Value of Deposits (\$m)	67.2	88.4	113.0	131	166
<b>Total Number of Accounts</b>	<b>46,182</b>	<b>91,390</b>	<b>44,557</b>	<b>50,183</b>	<b>48,920</b>
<b>Total Value of Deposits (\$m)</b>	<b>174.0</b>	<b>198.6</b>	<b>231.5</b>	<b>251.2</b>	<b>286.0</b>
Source: National Reserve Bank of Tonga					

(of which 33.2 percent was for housing); and the remaining 1.7 percent was for other types of loans. The marked increase in the growth in credit extended by banks to the private sector resulted in the weakening of the liquidity position in the banking industry. This increase in lending reflects improving confidence in the economy after the civil unrest in November 2006. Since banks increased lending to private sector, their holdings with other financial institutions fell by \$5.9 million (23.4 percent) and their holdings of notes and coins fell by \$5.7 million (10.8 percent).

On the liabilities side, total deposits by non-financial sector grew by \$34.7 million (13.8 percent) to \$286.0 million in 2007/08 and the total number of accounts reported to have decreased by 2.5 percent to 48,920 (Table 4). Total notes and bonds issued by the banks decreased by \$2.1 million (7.9 percent) over the year. The increase in deposits and the fall in investment in notes issued by the domestic banks was outweighed by the increase in loans and resulted in the weakening of the liquidity position of the banking industry during the year. Total borrowing by the banks from other financial institutions decreased by \$0.8 million (2.2 percent) mainly due to the decline in deposits by foreign banks.

### Financial Performance

The total financial sector as a group showed a pre-tax profit of 4.1 percent in 2007/08, compared with 4.6 percent in 2006/07 (Table 5). This was attributed to the increase in provisioning for non performing loans.

Total operating income increased to 14.3 percent of average assets from 11.2 percent in 2006/07. Net interest income was 7.6 percent of average assets, a slight increase from 6.6 percent in 2006/07. Even though the bulk of banks' operating income was derived from the extension of loans, the composition of net interest income fell to 52.9 percent of total operating income in 2007/08 compared with 59.3 percent in 2006/07. Foreign exchange business made up 25.3 percent of total operating income, an increase from 24.4 percent in the previous year and the balance of 21.9 percent came from commission and charges plus other income sources. Total non-interest income, as a percentage of average assets increased to 6.7 percent from 4.6 percent in the previous year. The average net interest margin (net interest income as a percentage of average earning assets) for the banks fell slightly to 7.6 percent in 2007/08 compared with 7.9 percent in 2006/07 which was due mainly to the increase in interest expense driven by banks competing for deposits and continuing to pay high interest rates to fund the increase in credit.

**Table 5. FINANCIAL SECTOR - FINANCIAL PERFORMANCE**

	2003/04	2004/05	2005/06	2006/07	2007/08
Pre-tax Net Profit (% average total assets)	5.2	6.5	6.4	4.6	4.1
Total Operating Income (% average total assets)	12.0	12.6	11.5	11.2	14.3
Net Interest Income (% average total assets)	7.4	7.7	6.9	6.6	7.6
Non-interest Income (% average total assets)	4.6	4.9	4.7	4.6	6.7
Average Net Interest Margin (%)	8.9	9.8	8.3	7.9	7.6
Total Operating Expenses (% average total assets)	5.6	5.7	4.9	5.5	6.6
Consolidated Risk-weighted Capital Ratio (%)	27.6	22.4	21.2	20.7	20.4

Source: Licensed Financial Institutions

The operating expenses of the banks increased to 6.6 percent of average assets in 2007/08 compared to 5.5 percent in 2006/07. This was mainly due to an increase in the banks' administrative expenses over the year. About 36.3 percent of administrative expenses of the banks were taken up by employees' remuneration, an increase from 33.9 percent in the previous year. Depreciation and amortisation accounted for 7.4 percent of total administrative expenses and the balance of 56.3 percent was made up of the purchase of various goods and services necessary for the operations of the banks.

**Liquidity**

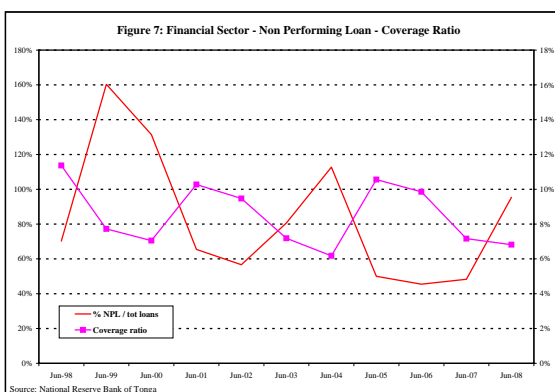
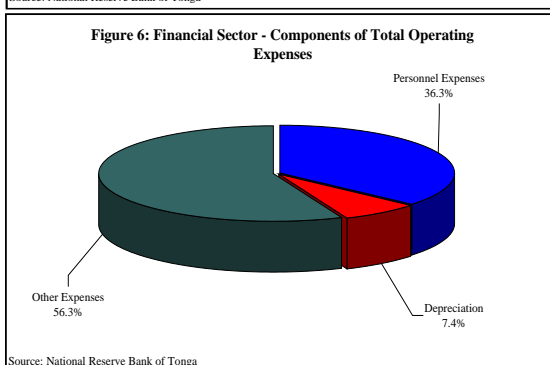
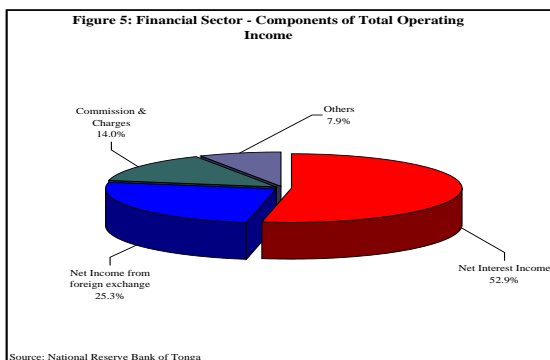
Liquidity in the banking system had weakened towards the latter part of 2007/08 underpinned by the growth in credit. Net loans as a proportion of deposits increased to 100 percent from 93.6 percent in 2006/07. Furthermore, the Liquid Asset Ratio fell to 6.3 percent compared with 10.6 percent in 2006/07.

**Capital**

The capital position of the banking industry remains strong and above the minimum ratio required by the Reserve Bank. The consolidation risk weighted capital ration for all the banks decreased slightly to 20.4 percent at the end of June 2008 compared with 20.7 percent at the end of June 2007. The decrease in the capital adequacy ratio over the year was attributed mainly to the fall in profits and increase in risk weighted assets.

**Asset Quality**

The overall quality of the banks' assets weakened over the year as more of the banks' loans were downgraded to non-accrual status. Total non-performing loans rose to 9.5 percent of total loans compared with 4.8 percent at the end of June 2007. The large increase in total non-performing loans outweighed the increase in provisions and resulted in the weakening of the coverage ratio of the non-performing loans by total loan loss reserves to 68.2 percent from 71.6 percent at the end of June 2007 (Figure 7)



## **Supervision of Licensed Financial Institutions**

During the year, the Financial Institutions Department, which is responsible for administering the supervisory functions of the Reserve Bank, continued its supervisory activities. The Reserve Bank continued to monitor and evaluate the overall strategies, policies and performance of licenced financial institutions - where appropriate with reference to specific legal and/or prudential criteria - and formed a view as to the soundness of the institution and the competence of those managing them. The Reserve Bank continued its supervisory activities through the system of regular reports received from the licenced financial institutions and onsite examinations throughout the year. The reports were analysed for any significant changes in their financial conditions and to ensure that the activities of the licenced financial institutions complied with the terms and conditions of their licences and other specified regulatory and prudential standards such as capital adequacy, limits on credit exposures, asset quality, credit risk grading and provisioning.

During the 2007/08 year, although liquidity in the banking system had improved, the Reserve Bank focussed on liquidity risk management by licenced financial institutions based on information from its onsite and offsite examinations, and against the background of increasing import payments, large transfers in the inter-bank settlement systems as well as the pace of growth in credit. The Reserve Bank saw the need to strengthen the process of forecasting, monitoring and managing liquidity by the licensed financial institutions. Against this background, the Reserve Bank issued the following two important prudential standards:

1. Prudential Statement 4: Disclosures of interest rates and fees and charges by Licenced Financial Institutions;
2. Prudential Statement 5: Liquidity

These statements would ensure that the liquidity risk management practices by licenced financial institutions are in line with international best practice and would foster market discipline in the charging of interest rates as well as other fees and charges. This will enable the general public to compare interest rates and fees and charges between various services and products provided by banks.

The Reserve Bank conducted an on-site examination of one licensed financial institution to review its risk management systems and their applications. The main focus of the risk management review was on credit, operational, liquidity, and interest rate risk management systems as well as compliance with anti-money laundering and combating the financing of terrorism laws. The Reserve Bank continued to hold regular meetings with licensed financial institutions in order to discuss their operations and compliance with the financial institutions regulations. In addition, the Reserve Bank continued to conduct quarterly technical meetings with each bank to clarify the Reserve Bank's reporting requirements, improve the accuracy of reporting to the Reserve Bank and to discuss issues of mutual interest to both parties. The Reserve Bank also held technical meetings with the Ministry of Labour, Commerce, and Industries to coordinate efforts and to facilitate the procedures for licensing of banks and foreign exchange dealers.

To assist businesses that were affected by the civil riots of November 2006, and in addition to the business recovery facility, the private sector reconstruction facility was established during the year and funded by the Australian and New Zealand Governments. The Reserve Bank is the custodian for these facilities. As at the end of June 2008, T\$11 million of the private sector reconstruction facility remains to be lent out.

The Reserve Bank continued to meet with the Association of Banks in Tonga to discuss issues which would support the soundness and stability of the financial system. These issues included liquidity in the banking system, credit growth and interest rates.



**Transaction Reporting Authority**

The Financial Institutions department is also responsible for carrying out the functions of the Transaction Reporting Authority (TRA) as stipulated under section 11(2) of the Money Laundering and Proceeds of Crime Act 2000. The functions of the TRA are similar to the functions of Financial Intelligence Units (FIU) in other countries.

During the year, the Reserve Bank continued with its effort to develop its suspicious transaction reporting framework in cooperation with licensed financial institutions. The commercial banks and authorized restricted foreign exchange dealers reported a total of 6 suspicious transactions to the TRA during the year, a marked decrease compared with 19 reports in the previous year. Two of the 6 suspicious transactions received by the TRA were reported to the Police for further investigations.

The Pacific Anti-Money Laundering Program (PALP) Legal Mentor, based in Tonga at the Crown Law Office, conducted a preliminary review of Tonga's AML/CFT legal framework. Following this review the Reserve Bank and the Crown Law Department continued to work together to implement recommendations from this review especially in preparation for Tonga's mutual evaluation by the Asia Pacific Group on Money Laundering (APG) in 2009. In March 2008, the Commonwealth Secretariat provided Technical Assistance to the Reserve Bank to assist with the preparation of the proposed amendments to the AMLCFT related Acts. This was completed in June 2008 and was anticipated to be discussed by the Legislative Assembly during the 2008 Parliament session.

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# Operations of the Reserve Bank

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## Currency Operation

### Circulation Notes

At the end of June 2008, the face value of currency notes on issue, both new and reissuable, totalled \$22.4 million. This was an increase of 9 percent from \$20.6 million in the previous year. Currency notes issued during the year totalled \$42 million and currency deposited totalled \$39 million of which \$11.1 million were classified by the Reserve Bank as unfit for reissue and were destroyed; the balance was retained for reissue. The currency notes of the Kingdom are printed by De La Rue in the United Kingdom.

### New Design Currency Notes

The work on the new design for currency notes re-commenced in March 2007 with a public survey throughout Tonga to obtain public opinion and views on the proposed changes. The work involved the introduction of a new \$100 note and redesigning of all the existing denominations with improved security features to combat counterfeiting. De La Rue our existing Note Printer was again successful with its bid to produce the new design currency notes which will now have the portrait of His Majesty King George Tupou V.

At the end of June 2008, the work on the new currency notes was progressing well and nearing completion. The production of the 100 pa'anga note was to be completed and shipped from De La Rue in July 2008. The new \$100 note was launched by His Majesty King George Tupou V on 25th July 2008 and issued to the public on 30 July 2008 to mark His Majesty's coronation. The other denominations (\$50, \$20, \$10, \$5, \$2, and \$1) of the new design family of notes is expected to be issued to the general public early next year, 2009.

### Circulation Coins

At the end of June 2008, the face value of coins on issue totalled \$1.7 million, and this is similar to \$1.7 million of the previous year. During the year, coins to a face value of \$66,625 were issued, \$51,425 of which were new coins. During the year, the Reserve Bank did not order new coins.

### Note Trust Depots

The Reserve Bank has Note Trust Depot (NTD) agreements with all commercial banks. The record shows that commercial banks increased their utilization of NTDs this year. During 2007/08 the commercial banks lodged a total of \$14.4 million (\$11.5 million in 2006/07) and withdrew \$14.3 million (\$12 million in 2006/07). Lodgements to and withdrawals from NTDs increased by 25 percent and 19 percent respectively over the previous year while deposits to the NRBT vault decreased by 18 percent. The Reserve Bank conducted surprise checks of these NTDs during the year and all were in order.

### Counterfeits

During the year, 39 counterfeit notes were reported to the Reserve Bank compared to 3 cases in the previous year. These included two \$10 notes, six \$20 notes and thirty-one \$50 notes. These counterfeit notes were reported by a member of the public, Westpac Bank of Tonga, ANZ Bank, MBf Bank and Tonga Development Bank during November 2007 to June 2008. On 21 May, 2008 the Transnational Crime Unit of Tonga Police Force reported some \$50 counterfeit notes were seized from two foreigners' home. The foreign nationals have been charged and awaiting court hearing. The Reserve Bank sent these counterfeit notes to De La Rue for testing and verification. Examination of these notes by De La Rue confirmed that they were indeed counterfeits. The Reserve Bank continues to produce and issue

to the public brochures on identifying counterfeit notes both in English and Tongan. The public has also been advised to report to both the Reserve Bank and the Police if they receive any suspicious looking currency notes.

### **Numismatic Coins and Notes**

During the year, numismatic coins were issued to collectors throughout the world under agreements between the Reserve Bank and various producers for the production and marketing of coins of various denominations. Total revenue collected from numismatic coins program during the year was \$53,506 and this amount has been included with other income of the Reserve Bank in its Income Statement.

### **Financial Performance**

Gross income from operations for the year ended 30 June 2008 amounted to \$8.027 million (2007, \$7.434 million). The improvement in the Reserve Bank's gross income in 2007/08 was mainly due to the higher than expected level of investible foreign reserves and higher than budgeted yields throughout the year. Interest expense, currency, administration and other costs totalled \$4.238 million (2007, \$3.820 million). The net operating profit for the year increased by 4.8 percent to \$3.789 million (2007, \$3.614 million).

In accordance with section 8(1)(c) of the NRBT (Amendment) Act 2007, 25 percent (\$947,251) of the Net Profit is to be transferred to the General Reserves, and the remainder (\$2,841,754) is payable to Government. The Minister of Finance has approved the transfer of \$3,000,000 from the General Reserves to increase the Paid Up Capital to \$5,000,000 to be in line with the Paid Up Capital stipulated in the NRBT (Amendment) Act 2007.

### **Information Systems and Technology**

In conjunction with Swift and Decillion Solutions of Australia, the 2nd Phase Migration was completed and confirmed in April 2008 that the NRBT upgraded swift system is ready to go live in September 2008. The major upgrade was the replacement of the Bilateral Exchange Keys (BKE) with a new system known as the Relational Management Application (RMA). This was a mandatory process to complete in order to enhance security measures of the external pipeline of the international financial transactions.

The Reserve Bank continued to improve its network security management systems by upgrading the capacity and volume of the servers, strengthening computer auditing policies, establishing a routine for daily checking of critical areas of operations to ensure business operations are ready and running smoothly before 9:00am. In addition, procedures to improving testing and verification of offsite backup tapes were closely monitored. The Information Systems and Technology Department played a vital role on two major projects during 2008: the preparation for the South Pacific Central Bank Governors' Annual Meeting and the Currency Notes New Design Project.

### **General Administration**

In addition to the normal services of administration of the Reserve Bank, one of the major achievements during the year was the successful implementation of the upgrade of the conference and board rooms in Level 5 and the opening in November, 2007 followed by the Annual Meeting of the Central Bank Governors of the South Pacific that was hosted by NRBT in December, 2007. Other major achievements conducted were the updating of the master operations procedures and staff job descriptions, and conducting staff backup inter-departmental training for multi-skilling of staff, improvement of the checking and verification process for all areas of administration.

## **Staff**

Staff numbers had decreased by 1 from 65 to 64 at the end of June 2008 after the movements of recruitments, resignations and terminations during the year. Mrs Siosi Cocker Mafi, was reappointed by the Privy Council as Governor of the National Reserve Bank of Tonga for another five year term for the period 2nd May, 2008 to 1 May 2013. Mr. Inia Naiyaga's contract as Deputy Governor was extended for another year until 30th June, 2009 with the approval of the NRBT Board. Miss 'Anapuli Matoto, Assistant Manager of Research Department was nominated to take up Tonga's turn to provide an Advisor in the Office of the Executive Director of the South East Asia Group, International Monetary Fund, Washington D.C., United States of America for one year after the return of Miss Jessie Cocker, Manager of Financial Institutions and Markets in May 2008 after serving as Advisor for one year.

During the year, the Reserve Bank continued to receive advisory and technical services provided by the International Monetary Fund (IMF), AusAID, NZAid, the Pacific Financial Technical Assistance Centre (PFTAC) based in Suva, Reserve Bank of Fiji, Reserve Bank of New Zealand and Reserve Bank of Australia. These advisory and technical services were mainly in the areas of human resource management, reviewing of the Financial Institutions and Markets database system, end of year procedures for payroll, banking supervision and onsite visit to banks. anti-money laundering. Other assistance was received from private service providers in the areas of information systems and technology, accounts and building management.

## **Training**

Staff training needs analysis (TNA) was conducted for each member of the staff during the year. The TNA was then used as the guide by the Reserve Bank to provide local and overseas training opportunities for its staff and legal advisor to facilitate capacity building. The overseas training courses attended by staff included the IMF/STI courses in Singapore on Financial Programming and Policies, Strengthening Central Bank Independence through Transparency and Efficiency, Balance of Payments and International Investment Position Manual (BPM6). Other trainings included PFTAC courses on Framework for Strategic Asset Allocation, Revised Core Principles for Effective Banking Supervision and Problem Bank situations, Central Bank Operations, Settlement & Monetary Policy Issues for Pacific Islands, and AMLAT workshop on Pacific Regional Financial Intelligent Unit. In addition, staff attended courses on Maintaining and Managing Microsoft Exchange Server 2003 and Windows Server 2003 provided by Datec Limited, Suva Fiji.

The Reserve Bank arranged for 3 senior staff to attend short training attachments at the Reserve Bank of Fiji with the Administration Department, Currency Department, and Financial Markets Department and at the Reserve Bank of New Zealand with the Building, Plant and Equipment Department. The Reserve Bank supported one senior staff who was awarded with an AusAID scholarship to do postgraduate studies in Australia for 1.5 years.

Local training for staff arranged by the Reserve Bank during the year included the Customer Service Training by S&K Performance Solution, First Aid Training by the Red Cross Centre conducted at the Reserve Bank and the Income Tax Act 2007 Awareness by the Inland Revenue Department. The Reserve Bank provided in-house training to the staff on Microsoft applications and departmental on the job training. The Reserve Bank continued to support staff development through financial assistance to those undertaking approved part time and correspondence courses aligned to the Training Policy of the Bank. This includes Distance Education courses to Pennfoster, United States of America in the areas of Electricity, Plumbing and Electronics for Building Staff, an attachment to the Power Generator Company in Auckland, New Zealand, courses with the University of the South Pacific and Open Polytechnic of New Zealand.

### **Attendance at Meetings**

In September 2007, the Governor attended the PFTAC Tripartite Review Committee Meeting held in Nadi, Fiji. In October 2007, the Governor and the Senior Research Officer were part of the Government's delegation to the Annual Meeting of the World Bank/IMF held in Washington D.C, USA. Also in October, 2007, the Acting Manager Financial Institutions and Markets and Bank Examiner Trainee attended the AFSPC Workshop and Annual Meeting at the Central Bank of Samoa. In December 2007, the Governor hosted the South Pacific Central Bank Governors' Annual Meeting at the National Reserve Bank of Tonga. In January, 2008, the Deputy Governor and Assistant Manager Research Department attended the Central Bank Operations workshop held in Vanuatu. In March 2008, the Governor and the Manager of Accounts and Currency attended the Currency Conference in Kuala Lumpur, Malaysia. In April, 2008, the Governor attended the SEACEN Governor's Meeting held in Indonesia. In May 2008, the Governor attended the Asian Development Bank (ADB) annual meeting held in Madrid, Spain as part of the Government's delegation.

### **Security**

The Reserve Bank's security unit continued to carry out its responsibilities of ensuring that the security and safety of the Bank's staff and premises were maintained at all times.

### **Building, Plants and Equipment**

The Reserve Bank's building, plants and equipment unit continued to maintain the Bank's building, plant and equipment at a high standard.

### **External Relations**

During the year the Reserve Bank continued to prepare reports for the government on the level of the foreign reserves, interest rates and exchange rates. The Reserve Bank conducted regular meetings with the domestic banks in order to review activities in the banking sector as well as to discuss policy issues. The Reserve Bank also met with representatives of international aid agencies and bilateral aid donors to discuss matters of mutual interest. In April 2008, the Reserve Bank again hosted the IMF Article IV annual consultation.

### **Board of Directors**

During the year the Board of Directors met regularly to formulate the policies of the Reserve Bank and to monitor its operations. There were changes to the members of the Board during the year with the former Minister of Finance Siosiua 'Utoikamanu retiring and the appointment of Mr Henry Cocker as the representative of the Ministry of Finance on 13 February 2008.



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## **Senior Officers**

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### **Senior Officers as at 30 June 2008**

<b>Governor</b>	Siosi C. Mafi
<b>Deputy Governor</b>	Inia R. Naiyaga
<b>Manager, Financial Institutions &amp; Markets</b>	Jessie Cocker
<b>Manager, Research Department</b>	Richard Sullivan
<b>Manager, Accounts &amp; Currency</b>	Lata Tangimana
<b>Manager Information System &amp; Technology and Administration</b>	Elizabeth Baker
<b>Assistant Manager, Research Department</b> ( Under Secondment to IMF)	‘Anapuli Matoto
<b>Assitant Manager, Finacial Institutions</b> ( Postgraduate Studies)	‘Ungatea Latu
<b>Acting Assistant Manager, Financial Markets</b>	‘Isapela Hufanga
<b>Guard Commander</b>	Semisi Fifita
<b>Senior Building Officer</b>	Poasi Fonua





# **National Reserve Bank of Tonga**

## **Financial Statements Year Ended 30 June 2008**

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**NATIONAL RESERVE BANK OF TONGA****FINANCIAL STATEMENTS**  
**30 JUNE 2008****DIRECTORS' REPORT**

In accordance with a resolution of the Board of Directors, the directors herewith submit the Balance Sheet of the Bank as at 30 June 2008, and the related Income Statement, Statement of Changes in Equity, and Cash Flow Statement 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:

HRH Princess Salote Pilolevu Tuita  
Mr Siosiuu.T.T.'Utoikamanu (up to 13<sup>th</sup> February 2008)  
Mr Richard Prema  
Mrs Siosi C Mafi  
Mr Henry Cocker (appointed 13<sup>th</sup> February 2008)

**2. PRINCIPAL ACTIVITIES**

The National Reserve Bank of Tonga's principal objectives as a central bank, as defined in Section 4 of the National Reserve Bank of Tonga (NRBT) (Amendment) Act 2007, shall be, to:

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

The principal functions of the bank shall be, to;

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

**3. TRADING RESULTS**

The operating income of the Bank for the year ended 30 June 2008 was \$3,789,005 (2007: \$3,613,967).

**NATIONAL RESERVE BANK OF TONGA****FINANCIAL STATEMENTS**  
**30 JUNE 2008****4. RESERVES**

In accordance with Section 8(1)(c) of the National Reserve Bank of Tonga (Amendment) Act, 2007, the Minister and the Board of Directors have agreed to transfer \$947,251 (2007: \$3,613,967) to the General Reserve at year end.

**5. PAYABLE TO GOVERNMENT**

In accordance with Section 8(3) of the National Reserve Bank of Tonga (Amendment) Act, 2007, subject to Section 8(1) and Section 8(2), the amount of \$2,841,754 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 doubtful debts, depreciation and 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.

**NATIONAL RESERVE BANK OF TONGA****FINANCIAL STATEMENTS**  
**30 JUNE 2008****10. EVENTS SUBSEQUENT TO BALANCE DATE**

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

**11. BASIS OF ACCOUNTING**

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

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

**12. OTHER CIRCUMSTANCES**

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

**13. UNUSUAL TRANSACTIONS**

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

For and on behalf of the Board of Directors in accordance with a resolution of the Directors this 30<sup>th</sup> day of September, 2008.



**Mrs Siosi C Mafi**  
**CHAIRPERSON**



**Mr Richard Prema**  
**DIRECTOR**

**NATIONAL RESERVE BANK OF TONGA**

**FINANCIAL STATEMENTS**  
**30 JUNE 2008**

**STATEMENT BY DIRECTORS**

In the opinion of the Directors:

- (a) the accompanying income statement is drawn up so as to give a true and fair view of the results of the Bank for the year ended 30 June 2008,
- (b) 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 2008,
- (c) 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 2008, and
- (d) the accompanying cash flow statement 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 2008.

For and on behalf of the Board of Directors by authority of a resolution of the Directors this 30<sup>th</sup> day of September, 2008.



**Mrs Siosi C Mafi**  
**CHAIRPERSON**



**Mr Richard Prema**  
**DIRECTOR**

**NATIONAL RESERVE BANK OF TONGA****FINANCIAL STATEMENTS**  
**30 JUNE 2008****INDEPENDENT AUDIT REPORT**

To the Board of Directors of the National Reserve Bank of Tonga

**Scope**

We have audited the financial statements of the National Reserve Bank of Tonga for the financial year ended 30 June 2008 as set out on pages 5 to 21. The Bank's directors are responsible for the preparation and presentation of the financial statements and the information they contain. We have conducted an independent audit of these financial statements in order to express an opinion on them to the Board of Directors of the Bank.

Our audit has been conducted, in accordance with International Standards of Auditing to provide reasonable assurance as to whether the accounts are free of material misstatement. Our procedures included examination on a test basis, of evidence supporting the amounts and other disclosures in the financial statements. An audit also includes assessing, within the context of applicable laws, accounting policies used and significant accounting estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

**Audit Opinion**

The accompanying financial statements 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 accounting policies described in note 2 of the financial statements.

In our opinion, the accompanying financial statements have been prepared, in all material respects, in accordance with the basis of preparation and the accounting policies described in note 2 of the financial statements.

Without qualifying our opinion, we emphasise that the accounting policies used and disclosures made are not intended to, and do not, comply with all the requirements of International Financial Reporting Standards.

**30 September 2008**  
**Suva, Fiji**

  
**PricewaterhouseCoopers**  
**Chartered Accountants**

**NATIONAL RESERVE BANK OF TONGA****INCOME STATEMENT  
YEAR ENDED 30 JUNE 2008**

<b>Income</b>	<b>Notes</b>	<b><u>2008</u></b>	<b><u>2007</u></b>
		<b>\$</b>	<b>\$</b>
Interest Income	5	6,952,962	6,346,102
Other Income	6	1,073,655	1,087,773
<b>Total Operating Income</b>		<b>8,026,617</b>	<b>7,433,875</b>
<b>Expenses</b>			
Interest expense	7	918,312	998,766
Administration and other expenses	8	3,319,300	2,821,142
<b>Total Operating Expenses</b>		<b>4,237,612</b>	<b>3,819,908</b>
<b>Operating Profit</b>		<b>\$3,789,005</b>	<b>\$3,613,967</b>
<b>Distribution as follows:</b>			
Transfer to Reserves as required under:			
- Section 8(1)(a) of the National Reserve Bank of Tonga Act, 1988		-	3,613,967
-Section 8(1)(c) of the National Reserve Bank of Tonga (Amendment) Act, 2007		947,251	-
Balance Payable to Government of Tonga as required under Section 8(3) of the National Reserve of Tonga (Amendment) Act, 2007		2,841,754	Nil
		<b>\$3,789,005</b>	<b>\$3,613,967</b>

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

**NATIONAL RESERVE BANK OF TONGA****BALANCE SHEET**  
**AS AT 30 JUNE 2008**

	Notes	<u>2008</u> \$	<u>2007</u> \$
<b>ASSETS</b>			
<b>Foreign Currency Assets</b>			
Short Term Investments and Current Accounts	9	82,614,896	85,463,858
Accrued Interest		1,314,405	894,348
International Monetary Fund	10		
- Reserve Tranche Position		5,152,417	5,043,114
- Special Drawing Rights		1,367,495	1,108,574
- Currency Subscription		15,588,292	15,620,686
<b>Local Currency Assets</b>			
Cash on Hand		64,089	20,341
Accrued Interest		239,050	341,663
Domestic Securities	11	9,677,000	16,008,832
Other Assets	12	4,113,120	2,038,103
Property, Plant and Equipment	13	7,049,400	6,877,571
<b>Total Assets</b>		<b>127,180,164</b>	<b>133,417,090</b>
<b>LIABILITIES</b>			
<b>Foreign Currency Liabilities</b>			
Demand Deposits	14(a)	3,104,425	4,746,572
Accrued Interest		3,959	31,217
<b>Local Currency Liabilities</b>			
Demand Deposits	14(b)	34,846,364	45,170,176
Accrued Interest		327,449	417,498
Currency in Circulation	15	24,121,575	22,222,498
Statutory Reserve Deposits	16	29,554,000	25,544,000
International Monetary Fund - Currency Subscription	10	15,588,292	15,602,024
Other Liabilities	17	3,562,389	1,954,665
<b>Total Liabilities</b>		<b>111,108,453</b>	<b>115,688,650</b>
<b>NET ASSETS</b>		<b>16,071,711</b>	<b>17,728,440</b>
<b>CAPITAL AND RESERVES</b>			
Authorised Capital		5,000,000	2,000,000
Paid up Capital		5,000,000	2,000,000
General Reserves		8,751,374	10,804,123
Revaluation Reserve Account		2,320,337	4,924,317
<b>TOTAL CAPITAL AND RESERVES</b>		<b>\$16,071,711</b>	<b>\$17,728,440</b>

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



**NATIONAL RESERVE BANK OF TONGA****STATEMENT OF CHANGES IN EQUITY  
YEAR ENDED 30 JUNE 2008**

	<b>Paid up Capital</b>	<b>General Reserves</b>	<b>Revaluation Reserve Account</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>Balance - 30 June 2006</b>	2,000,000	7,190,156	1,347,673	10,537,829
Net gain arising during the year from translation of foreign currencies to Tongan currency	-	-	4,807,722	4,807,722
One fifth of remaining credit balance payable to the Government of Tonga in accordance with Section 33 (3) of NRBT Act, 1988	-	-	(1,231,078)	(1,231,078)
Transfer from Income Statement (as provided for under Section 8(1) (a) of the NRBT Act, 1988, and approved by the Minister of Finance	-	3,613,967	-	3,613,967
<b>Balance 30 June 2007</b>	<b>2,000,000</b>	<b>10,804,123</b>	<b>4,924,317</b>	<b>17,728,440</b>
Transfer out of General Reserves (as provided for under Section 6(2) of the National Reserve Bank of Tonga (Amendment) Act, 2007 and approved by the Minister of Finance	-	(3,000,000)	-	(3,000,000)
Net losses arising during the year from translation of foreign currencies to Tongan currency	-	-	(2,603,980)	(2,603,980)
Transfer from Income Statement (as provided for under Section 8(1)(c) of the National Reserve Bank of Tonga (Amendment) Act, 2007, and approved by the Minister of Finance	-	947,251	-	947,251
Increase in Paid up Capital as provided for under Section 6(1) of the National Reserve Bank of Tonga (Amendment) Act, 2007 and approved by the Minister of Finance	3,000,000	-	-	3,000,000
<b>Balance 30 June 2008</b>	<b>\$ 5,000,000</b>	<b>\$ 8,751,374</b>	<b>\$ 2,320,337</b>	<b>\$ 16,071,711</b>

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

**NATIONAL RESERVE BANK OF TONGA****STATEMENTS OF CASH FLOWS**  
**YEAR ENDED 30 JUNE 2008**

	<u>Note</u>	<u>2008</u>	<u>2007</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		\$	\$
Rental income		199,812	254,769
Numismatic sales		53,506	81,804
Other income		681,657	711,430
Interest received		6,635,518	7,011,593
Purchase of currency		(2,541,508)	(423,105)
Interest paid		(1,035,619)	(1,302,132)
Administration and other expenses		(962,529)	(2,086,357)
<b>Net cash inflow from operating activities</b>		<b>3,030,837</b>	<b>4,248,002</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchase of fixed assets		(591,192)	(582,216)
Net movement in IMF accounts		(349,562)	(41,989)
Net movement in staff loans		275,486	(52,181)
Net movement in Government of Tonga bonds		6,331,832	233,000
<b>Net cash (outflow)/inflow from investing activities</b>		<b>5,666,564</b>	<b>(443,386)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Net movement in currency in circulation		1,899,077	1,074,941
Net movement in demand deposits		(11,257,512)	6,151,533
Net movement in statutory deposits		4,010,000	(2,641,000)
Net movement in NRBT notes		-	(1,494,668)
Net movement in Government of Tonga accounts		(3,550,200)	(3,409,540)
<b>Net cash inflow/(outflow) from financing activities</b>		<b>(8,898,635)</b>	<b>(318,734)</b>
<b>NET EFFECT OF CHANGE IN EXCHANGE RATE</b>		<b>(2,603,980)</b>	<b>4,807,722</b>
<b>NET INCREASE/(DECREASE) IN CASH</b>		<b>(2,805,214)</b>	<b>8,293,604</b>
<b>CASH AT BEGINNING OF FINANCIAL YEAR</b>		<b>85,484,199</b>	<b>77,190,595</b>
<b>CASH AT END OF FINANCIAL YEAR</b>	<b>18</b>	<b>\$82,678,985</b>	<b>\$85,484,199</b>

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

**NATIONAL RESERVE BANK OF TONGA****NOTES TO AND FORMING PART OF  
THE FINANCIAL STATEMENTS  
YEAR ENDED 30 JUNE 2008****1. GENERAL INFORMATION**

The National Reserve Bank of Tonga's principal objectives as a central bank, as defined in Section 4 of the NRBT (Amendment) Act 2007, shall be, to -

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

The principal functions of the bank shall be, to;

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

These financial statements have been approved for issue by the Board of Directors on 30<sup>th</sup> September 2008.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS****a) Basis of accounting**

The financial statements of the Bank have been prepared in accordance with the National Reserve Bank of Tonga Act, 1988 and the National Reserve Bank of Tonga (Amendment) Act, 2007. The Bank's accounting policies are based on International Financial Reporting Standards ("IFRS"), effective 1 July 2006, except where the Act requires a different treatment, as noted in Note 2 (b), in which the Act takes precedence. No amendments have been made on transition to IFRS as the Bank previously applied accounting policies which are generally aligned with IFRS. However, additional disclosures have been made in the financial statements as required by IFRS.

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.

**NATIONAL RESERVE BANK OF TONGA****NOTES TO AND FORMING PART OF  
THE FINANCIAL STATEMENTS  
YEAR ENDED 30 JUNE 2008****2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS – continued****b) Foreign currencies**

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

Realised and unrealised gains and losses arising during the year from changes in the valuation of foreign currencies are taken to the revaluation reserve account in accordance with the provisions of Section 33 of the National Reserve Bank of Tonga Act, 1988 and are not included in the computation of annual profits and losses of the Bank.

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, His Majesty in Council shall cause to be transferred to the ownership of the Bank non-negotiable non-interest bearing securities issued by the Government to the extent of the deficiency.

Any credit balance in the revaluation reserve account at the end of each year is applied first, on behalf of the Government, to the redemption of any non-negotiable non-interest bearing notes previously transferred to the Bank by the Government to cover losses. According to the National Reserve Bank of Tonga (Amendment) Act 2007, any balance remaining in the revaluation reserves account shall be carried forward to the next financial year. The requirement to transfer one-fifth of the remaining balance to the Government was repealed in the National Reserve Bank of Tonga (Amendment) Act 2007.

**c) Financial Assets and Liabilities***Investment Securities*

The Reserve Bank only invests in securities with the intention to hold to maturity. The Reserve Bank does not invest in securities for trading purposes.

Held-to-maturity investments are carried at amortised cost. Any premium or discount on purchase is capitalised and amortised over the term of the maturity 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 Reserve Bank.

*Other Financial Assets and Liabilities*

Local and foreign cash, deposits and short-term advances are valued at transaction date value.

**NATIONAL RESERVE BANK OF TONGA****NOTES TO AND FORMING PART OF  
THE FINANCIAL STATEMENTS  
YEAR ENDED 30 JUNE 2008****2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS – continued****d) 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.

**e) Coins sold as numismatic items**

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

**f) Income tax**

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

**g) Depreciation**

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

Leasehold buildings	1.01%
Plant and equipment	10.0%
Carpets, drapes and security system	10.0%
Furniture, fittings, computer equipment and motor vehicles	25.0%

**h) Employee Entitlements**

The Bank administers a staff superannuation scheme to which both the Bank and staff make contributions based on the years of service. The liability recognised in the balance sheet in respect of the staff retirement fund is on an accrual basis. Other employee related liabilities are recognised and measured as the amount unpaid at year end, at the current pay rate in respect of employee services up to date.

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**NATIONAL RESERVE BANK OF TONGA**

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**NOTES TO AND FORMING PART OF  
THE FINANCIAL STATEMENTS  
YEAR ENDED 30 JUNE 2008**

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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS - Continued****i) Cash and cash equivalents**

For the purposes of the cash flow statement, cash and cash equivalents includes notes and coins held by National Reserve Bank of Tonga tellers cash, short term bills and current accounts.

**j) Revenue Recognition**

Interest income is brought to account on an accrual basis.

**k) Staff Loans**

Loans are carried in the balance sheet at historical cost net of specific provisions for bad and doubtful loans.

Provisions for bad and doubtful debts are made based on appraisal carried out at the end of the financial year and the amount has been reliably estimated. The amounts of potential losses that have been identified are either written off against provisions in the year in which they are recognized or recognized as an expense in the income statement.

**l) 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.

**NATIONAL RESERVE BANK OF TONGA****NOTES TO AND FORMING PART OF  
THE FINANCIAL STATEMENTS  
YEAR ENDED 30 JUNE 2008****2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS - Continued****m) General Reserve and Distribution of Profits**

- Section 8(1) of the National Reserve Bank of Tonga (Amendment) Act 2007 states that:
  - a) where the General Reserve does not exceed 50% of the authorised capital of the Bank, 100% of the net profit be transferred to the General Reserve;
  - b) where the General Reserve exceeds 50 percent of the authorized capital of the Bank, 50 percent until the General Reserve is equal to the authorized capital of the Bank; and
  - c) where the General Reserve exceeds 100 percent but does not exceed 200 percent of the authorized capital of the Bank, 25 percent or such lesser sum to increase the General Reserve to twice the authorized capital of the Bank; Provided that upon agreement between the Minister and the Bank, the General Reserve may be increased.
- Section 8(2) states that subject to Section(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 balance of the net profit for the financial year remaining after all deductions as above be paid to the Government of the Kingdom of Tonga.

Previously the NRBT Act 1988 did not specify the amounts to be transferred to the General Reserve and any transfer to the General Reserve was subject to the approval by the Minister of Finance. The relevant section was repealed in the NRBT (Amendment) Act 2007.

**n) 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.

**o) Segment Reporting**

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

**NATIONAL RESERVE BANK OF TONGA****NOTES TO AND FORMING PART OF  
THE FINANCIAL STATEMENTS  
YEAR ENDED 30 JUNE 2008****2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS - Continued****p) Leases**

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

**q) Currency of Presentation**

All amounts are expressed in Tongan Pa'anga.

**r) Comparatives**

Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year.

**3. FINANCIAL RISK MANAGEMENT**

The Bank identifies risks and implements controls in its operation and management of foreign reserves holdings. The main financial risks that the Bank faces are exchange rate risk, interest rate risk, credit risk, operational risk and liquidity risk.

**(a) Exchange Rate Risk Management**

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

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

**(b) Interest Rate Risk Management**

Interest rate risk refers to the risk of loss arising from changes in interest rates. The Bank limits interest rate risk by investing in short term investments of up to 12 months.



NATIONAL RESERVE BANK OF TONGANOTES TO AND FORMING PART OF  
THE FINANCIAL STATEMENTS  
YEAR ENDED 30 JUNE 2008**3. FINANCIAL RISK MANAGEMENT - Continued****(c) Credit Risk Management**

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 Reserve 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 Reserve Bank may deal with in foreign exchange must have minimum credit ratings of **A**.

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

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

	<u>2008</u>	<u>2007</u>
	\$	\$
Public Sector Securities – Local	9,677,000	16,008,832
Financial Institutions – Foreign	82,614,896	85,463,858
<b>Total financial investments</b>	<b><u>\$92,291,896</u></b>	<b><u>\$101,472,090</u></b>

**3. FINANCIAL RISK MANAGEMENT - Continued****(d) Liquidity Risk Management**

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 Reserve Bank's foreign currency assets.

To minimize the 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.

Note 4 analyses the Bank's assets and liabilities into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date.

**NATIONAL RESERVE BANK OF TONGA****NOTES TO AND FORMING PART OF  
THE FINANCIAL STATEMENTS  
YEAR ENDED 30 JUNE 2008****4. MATURITY ANALYSIS**

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

**MATURITY ANALYSIS- 30 June 2008**

<b>Maturity Analysis</b>	0-3 months \$	3-12 months \$	1- 5 years \$	Over 5 Years \$	No Specific maturity \$	Total \$
<b>Assets</b>						
<b>Foreign Currency Assets</b>						
Short Term Commercial						
Paper and C/Accounts	21,036,493	61,578,403	-	-	-	82,614,896
Accrued Interest	1,314,405	-	-	-	-	1,314,405
International Monetary Fund						
- Reserve Tranche Position	5,152,417	-	-	-	-	5,152,417
- Special Drawing Rights	1,367,495	-	-	-	-	1,367,495
- Currency Subscription	15,588,292	-	-	-	-	15,588,292
<b>Local Currency Assets</b>						
Cash on hand	64,089	-	-	-	-	64,089
Accrued Interest	239,050	-	-	-	-	239,050
Domestic Securities	-	4,188,000	5,489,000	-	-	9,677,000
Other Assets	-	43,449	-	-	4,069,671	4,113,120
Property, Plant and Equipme	-	-	-	-	7,049,400	7,049,400
<b>Total Assets</b>	<b>44,762,241</b>	<b>65,809,852</b>	<b>5,489,000</b>	<b>-</b>	<b>11,119,071</b>	<b>127,180,164</b>
<b>Liabilities</b>						
<b>Foreign Currency Liabilities</b>						
Demand Deposits	3,104,425	-	-	-	-	3,104,425
Accrued Interest	3,959	-	-	-	-	3,959
<b>Local Currency Liabilities</b>						
Demand Deposits	34,846,364	-	-	-	-	34,846,364
Accrued Interest	327,449	-	-	-	-	327,449
Currency in Circulation	-	-	-	-	24,121,575	24,121,575
Statutory Reserve Deposits	-	-	-	-	29,554,000	29,554,000
IMF - Notes Currency Subscription	-	-	-	-	15,588,292	15,588,292
Other Liabilities	2,841,755	-	-	-	720,634	3,562,389
<b>Total Liabilities</b>	<b>41,123,952</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>69,984,501</b>	<b>111,108,453</b>
<b>Liquidity Gap</b>	<b>3,638,289</b>	<b>65,809,852</b>	<b>5,489,000</b>	<b>-</b>	<b>(58,865,430)</b>	<b>16,071,711</b>

**NATIONAL RESERVE BANK OF TONGA****NOTES TO AND FORMING PART OF  
THE FINANCIAL STATEMENTS  
YEAR ENDED 30 JUNE 2008****4. MATURITY ANALYSIS - Continued****MATURITY ANALYSIS- 30 June 2007**

<b>Maturity Analysis</b>	0-3 months	3-12 months	1- 5 years	Over Years	No Specific maturity	Total
	\$	\$	\$	\$	\$	\$
<b>Assets</b>						
<b>Foreign Currency Assets</b>						
Short Term Commercial						
Paper and C/Accounts	40,016,740	43,521,275	1,925,843	-	-	85,463,858
Accrued Interest	894,348	-	-	-	-	894,348
International Monetary Fund						
- Reserve Tranche Position	5,043,114	-	-	-	-	5,043,114
- Special Drawing Rights	1,108,574	-	-	-	-	1,108,574
- Currency Subscription	15,620,686	-	-	-	-	15,620,686
<b>Local Currency Assets</b>						
Cash on hand	20,341	-	-	-	-	20,341
Accrued Interest	341,663	-	-	-	-	341,663
Domestic Securities	-	-	16,008,832	-	-	16,008,832
Other Assets	76,329	-	-	-	1,961,774	2,038,103
Property, Plant and Equipme	-	-	-	-	6,877,571	6,877,571
<b>Total Assets</b>	<b>63,121,795</b>	<b>43,521,275</b>	<b>17,934,675</b>	<b>-</b>	<b>8,839,345</b>	<b>133,417,090</b>
<b>Liabilities</b>						
<b>Foreign Currency Liabilities</b>						
Demand Deposits	4,746,572	-	-	-	-	4,746,572
Accrued Interest	31,217	-	-	-	-	31,217
<b>Local Currency Liabilities</b>						
Demand Deposits	45,170,176	-	-	-	-	45,170,176
Accrued Interest	417,498	-	-	-	-	417,498
Currency in Circulation	-	-	-	-	22,222,498	22,222,498
Statutory Reserve Deposits	-	-	-	-	25,544,000	25,544,000
IMF - Notes Currency Subscription	-	-	-	-	15,602,024	15,602,024
Other Liabilities	1,655,448	-	-	-	299,217	1,954,666
<b>Total Liabilities</b>	<b>52,020,911</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>63,667,739</b>	<b>115,688,650</b>
<b>Liquidity Gap</b>	<b>11,100,884</b>	<b>43,521,275</b>	<b>17,934,675</b>	<b>-</b>	<b>(54,828,394)</b>	<b>17,728,440</b>

NATIONAL RESERVE BANK OF TONGANOTES TO AND FORMING PART OF  
THE FINANCIAL STATEMENTS  
YEAR ENDED 30 JUNE 2008**5. INTEREST INCOME**

	<u>2008</u> \$	<u>2007</u> \$
Interest on Overseas investments	5,853,379	5,235,098
Interest on Domestic investments	1,072,415	1,089,095
Interest on Staff Loans	27,168	21,909
	<u><u>\$6,952,962</u></u>	<u><u>\$6,346,102</u></u>

**6. OTHER INCOME**

	<u>2008</u> \$	<u>2007</u> \$
Numismatic Coins	53,506	81,804
Rental Income	338,492	331,237
Gain on sale of Assets	677	7,894
Forex sales/ purchases	656,251	642,737
Bank user fees	23,960	23,591
Information services - publications	769	510
	<u><u>\$1,073,655</u></u>	<u><u>\$1,087,773</u></u>

**7. INTEREST EXPENSE**

	<u>2008</u> \$	<u>2007</u> \$
Interest on Foreign Currency Accounts	40,840	72,954
Interest on Domestic Currency Accounts	877,472	925,812
	<u><u>\$918,312</u></u>	<u><u>\$998,766</u></u>

**8. ADMINISTRATION AND OTHER EXPENSES**

	<u>2008</u> \$	<u>2007</u> \$
Administration	1,410,171	954,857
Staff Costs	1,114,122	1,026,178
Audit Fees	20,100	18,550
Currency Issue (refer note 10)	355,544	418,743
Depreciation	419,363	402,814
	<u><u>\$3,319,300</u></u>	<u><u>\$2,821,142</u></u>

NATIONAL RESERVE BANK OF TONGANOTES TO AND FORMING PART OF  
THE FINANCIAL STATEMENTS  
YEAR ENDED 30 JUNE 2008**9. SHORT TERM INVESTMENTS AND CURRENT ACCOUNTS**

	<u>2008</u> \$	<u>2007</u> \$
Current Account	12,702,168	14,722,511
Short term Investments	69,912,728	70,741,347
	<u><b>\$82,614,896</b></u>	<u><b>\$85,463,858</b></u>

**10. 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 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 2008, Tonga's membership subscription to the International Monetary Fund was SDR6,900,000 (2007: SDR6,900,000). Of the total amount SDR 1,711,633 (2007: SDR1,711,633) had been paid in foreign currencies, shown in the Balance Sheet as Reserve Tranche, 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.

**11. DOMESTIC SECURITIES**

	<u>2008</u> \$	<u>2007</u> \$
Government of Tonga Bonds	<u>\$9,677,000</u>	<u>\$16,008,832</u>

These securities which are valued in accordance with note 2(b) of the financial statements have varying maturity dates up to 31 October 2011. It is the Bank's intention to hold these investments to maturity.

**12. OTHER ASSETS**

	<u>2008</u> \$	<u>2007</u> \$
Staff loans and advances	156,462	464,886
Currency and numismatics	3,698,585	1,512,621
Other assets	258,073	93,534
	<u>4,113,120</u>	<u>2,071,041</u>
Less: Provision for doubtful debts on staff loans and advance	-	(32,938)
	<u><b>\$4,113,120</b></u>	<u><b>\$2,038,103</b></u>

The amount charged to the income statement is now based on the cost of notes and coins issued for circulation.

**NATIONAL RESERVE BANK OF TONGA****NOTES TO AND FORMING PART OF  
THE FINANCIAL STATEMENTS  
YEAR ENDED 30 JUNE 2008****13. PROPERTY, PLANT & EQUIPMENT**

(a) Property, Plant &amp; Equipment include:

	<b>2008</b>	<b>2007</b>
	<b>\$</b>	<b>\$</b>
Leasehold land & buildings – at cost	10,384,475	9,602,892
Less: accumulated depreciation	3,638,209	3,340,586
	<b>6,746,266</b>	<b>6,262,306</b>
Other fixed assets – at cost	1,729,241	1,626,033
Less: accumulated depreciation	1,426,107	1,304,367
	<b>303,134</b>	<b>321,666</b>
Work in Progress	-	293,599
Total – at cost	12,113,716	11,522,524
Less: accumulated depreciation	5,064,316	4,644,953
(b) Reconciliation of Property, Plant & Equipment	<b>\$7,049,400</b>	<b>\$6,877,571</b>

<b>FIXED ASSETS</b>	<b>Land, Bldg &amp; Improvement</b>	<b>Other Fixed Assets</b>	<b>Work in Progress</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>At 30th June 2008</b>				
Opening net book amount	6,262,306	321,666	293,599	6,877,571
Additions	487,763	103,429	-	591,192
Transfers from WIP	293,599	-	(293,599)	-
Disposal	-	-	-	-
Depreciations	(297,624)	(121,739)	-	(419,363)
<b>Closing net book amount</b>	<b>6,746,044</b>	<b>303,356</b>	<b>-</b>	<b>7,049,400</b>

**14. (a) FOREIGN CURRENCY DEMAND DEPOSITS**

	<b>2008</b>	<b>2007</b>
	<b>\$</b>	<b>\$</b>
Accounts of International Organisations	627,346	1,493,460
Accounts of Domestic Organisations	2,477,079	3,253,112
	<b>\$3,104,425</b>	<b>\$4,746,572</b>

**NATIONAL RESERVE BANK OF TONGA****NOTES TO AND FORMING PART OF  
THE FINANCIAL STATEMENTS  
YEAR ENDED 30 JUNE 2008****14. (b) LOCAL CURRENCY DEMAND DEPOSITS**

	<b><u>2008</u></b>	<b><u>2007</u></b>
	\$	\$
Banks	11,043,360	20,658,726
Government of Tonga	23,803,004	24,511,450
	<b><u>\$34,846,364</u></b>	<b><u>\$45,170,176</u></b>

**15. CURRENCY IN CIRCULATION**

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

	<b><u>2008</u></b>	<b><u>2007</u></b>
	\$	\$
Notes	22,436,666	20,564,759
Coins	1,684,909	1,657,739
	<b><u>\$24,121,575</u></b>	<b><u>\$22,222,498</u></b>

**16. STATUTORY RESERVE DEPOSITS**

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

**17. OTHER LIABILITIES**

	<b><u>2008</u></b>	<b><u>2007</u></b>
	\$	\$
Other creditors and accruals	3,477,246	1,729,489
Provision for annual leave	50,022	48,360
Superannuation scheme	35,121	176,816
	<b><u>\$3,562,389</u></b>	<b><u>\$1,954,665</u></b>

The Bank administers the employees' superannuation scheme and these funds are invested mainly in domestic securities. The fund is reconciled as follows:

Total of superannuation fund	739,121	839,816
Less: investment in domestic securities	(704,000)	(663,000)
	<b><u>\$35,121</u></b>	<b><u>\$176,816</u></b>



**NATIONAL RESERVE BANK OF TONGA****NOTES TO AND FORMING PART OF  
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YEAR ENDED 30 JUNE 2008****18. CASH AND CASH EQUIVALENTS**

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

	<u>2008</u>	<u>2007</u>
	\$	\$
Cash on hand	64,089	20,341
Short term investments and current accounts	82,614,896	85,463,858
	<u><u>\$82,678,985</u></u>	<u><u>\$85,484,199</u></u>

**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 2008 were Siosi Mafi (Chairperson and Governor), HRH Princess Salote Pilolevu Tuita, Siosia.T.T.'Utoikamanu, Richard Prema and Henry Cocker.

During the year, the following executives were identified as key management personnel of the Bank: Siosi C Mafi (Governor), Inia Naiyaga (Deputy Governor), Lata Tangimana (Manager Accounts and Currency), Elizabeth Baker (Manager Administration and Information Systems), Jessie Cocker (Manager Financial Institutions and Markets) and Richard Sullivan (Manager Research).

**Transactions with related parties**

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

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

Transactions with a director related entity includes purchases of goods and services as follow:

	<u>2008</u>	<u>2007</u>
	\$	\$
Purchase of goods	<u><u>2,249</u></u>	<u><u>16,862</u></u>

The Directors are paid sitting allowances for services rendered. The Bank also provides non-cash benefits to the Executive Directors and executive officers in addition to their salaries.

**NATIONAL RESERVE BANK OF TONGA****NOTES TO AND FORMING PART OF  
THE FINANCIAL STATEMENTS  
YEAR ENDED 30 JUNE 2008****19. RELATED PARTIES - Continued**

Total remuneration is included in 'staff costs' as follows:

	<b><u>2008</u></b>	<b><u>2007</u></b>
	\$	\$
Executive officers	191,672	221,274
Director's fees and remuneration	33,450	32,466
	<b><u>\$225,122</u></b>	<b><u>\$253,740</u></b>

**20. COMMITMENTS AND CONTINGENCIES**

Commitments and contingencies not otherwise provided for in the accounts and which existed at 30 June 2008 comprise:

- (i) Contracts for foreign exchange transactions was nil (2007: \$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 encashed for their face value. The Bank is of the opinion that in the unlikely event of encashment as legal tender, no significant loss is expected to arise.

**21. 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 arms 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:

***Domestic Securities***

The fair value of the Bank's domestic securities is TOP\$16.0m, based on quoted market prices.

***Statutory Reserve Deposits***

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

**21. FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES - Continued**

*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.

