National Reserve Bank of Tonga

Annual Report 2009-10

Pangike Pule Fakafonua ‘o Tonga

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National Reserve Bank of Tonga

Annual Report for the Year Ended 30 June 2010

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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.

Governor's Forward

The 2009/10 financial year has been a difficult and challenging year for Tonga's economy. The impact of the global crisis continued to suppress domestic economic activity through the fall in remittances, decline in tourist receipts, credit contraction and stagnant exports. The impact of the global crisis also affected government revenue due to lower imports, which placed considerable strains on the government's fiscal balance. Tonga was hard hit by the tsunami in September 2009 and cyclone Rene in February 2010 causing loss of life and severe damages. Moreover, the tragic disaster of the sinking of the MV Princess Ashika led to a major reallocation of government priorities and resources. The Ministry of Finance estimated economic growth to have contracted by 1.2 percent in 2009/10, the second consecutive year of negative growth experienced by the Tongan economy.

The weak economic conditions and lower imports supported the official foreign reserves over the year. The external balance of the country continued to improve, stability and confidence in the financial sector was maintained and inflation remained low. The level of official foreign exchange reserves continued to rise reaching 7.2 months of imports at the end of the financial year. The receipts of the IMF SDR allocations, official foreign aid, capital injections by banks and deferred import payments also propped up foreign reserves. Inflation has been generally moderated at 2.7 percent at the end of 2009/10 compared with 1.2 percent at the end of June 2009, and the average inflation fell to 1.7 percent from 5.6 percent in the previous year. Going forward, import payments is expected to pick up reducing the level of foreign reserves but will remain at adequate levels. Inflation is projected to rise, in line with the rebound in oil prices and the movement in the exchange rate.

Monetary policy continued to focus on achieving its twin objectives of maintaining an adequate level of foreign reserves and promoting low and stable inflation. Despite accomplishing the monetary policy objectives, the economy remained weak and private sector credit continued to fall. In 2009/10, the monetary policy remained accommodative, following the decision by the Reserve Bank in June 2009 to ease the monetary policy stance by ceasing the issue of the NRBT notes. In August 2009, the Statutory Required Reserves (SRD) was reduced from 10 percent to 5 percent and in January 2010, the Reserve Bank commenced paying 1 percent interest on banks' exchange settlement account (ESA) balances over T$1 million. These measures were adopted to enable further reduction on domestic banks' interest rates in order to support credit growth, stimulate economic activity and to assist borrowers who are facing financial difficulties. The Reserve Bank also reduced the interest rate on the repurchase facility for domestic banks from 4.5 percent to 1.9 percent in March 2010 in line with the decline in the inter-bank lending interest rate. These monetary policy measures assisted to bring about reductions in lending rates but credit growth continued to fall thus the anticipated impact of these monetary policy measures was not fully achieved. The basis of the policy decisions of the Reserve Bank are published on its six monthly Monetary Policy Statements.

However, in terms of its role as the bank regulator, progress was made in enhancing accountability and transparency within the financial system. The Reserve Bank revised its Prudential Statements No.1 and No.2 on Asset Quality and Credit Risk Grading to effectively implement the requirements of the International Financial Reporting Standards. Furthermore, the Prudential Statement No.4 on Disclosure was revised during the year to require banks to disclose the effective interest rate to their customers. The Reserve Bank's supervision continued to focus on interest rates and credit risk management. The latter was largely atttributed to the continued high level of non-performing loans, reflecting the impact of the slow down in economic activity and fall in remittances, which adversely affected the profitability and capital positions of the banks. This led to banks injecting additional capital to meet the Reserve Bank's minimum capital requirements.

During the year, the Transaction Reporting Authority (TRA) in coordination with the Crown Law Department focused on the preparation for Tonga's mutual evaluation by the Asia Pacific Group on Money Laundering (APG) which took place in November 2009. Following the mutual evaluation, the TRA worked together with the National Committee on Money Laundering and Terrorist Financing in preparing the response to the Mutual Evaluation report which was discussed and adopted at the APG Annual Meeting in July 2010.

The Reserve Bank continued working towards improving the quality of notes in circulation and acquired a new note processing machine to assist with the authentication and the fitness sorting of currency notes for circulation. The demand for currency notes by the public continued to increase during the year.

The Reserve Bank's review of its internal control system during the year focused on its Information Technology (IT) system and engaged Pricewaterhouse Coopers to carry out a thorough IT General Control Audit review to ensure that the Bank's IT system is secure and complies with international standards.

The Reserve Bank continued its effort to strengthen its capacity through supporting staff training on the job, in-house, locally and abroad. Staff participated in courses across a range of central banking functions, including bank supervision and capital adequacy, monetary policy formulation and forecasting, settlement and currency, human resource management and information technology.

The annual accounts of the National Reserve Bank of Tonga continued to 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 expanded to T$200 million, an increase of 19.8 percent from the previous year mainly due to the increase in the level of official foreign reserves over the year. The Reserve Bank's net operating profit fell by 47.3 percent from the previous year to T$1.3 million attributed to the decline in global interest rates to record low levels throughout the year, reflecting the prolonged impact of the global economic and financial crisis.

I would like to thank the staff of the Reserve Bank for their hard work, commitment and cooperation during 2009/10. I would also like to extend my appreciation to the Board of Directors for their continued support and guidance during the year. I wish to acknowledge the support from the Government of Tonga and the financial sector to ensure that stability in the financial system was maintained. I am grateful to the International Monetary Fund, World Bank, Asian Development Bank, Pacific Technical Assistance Centre (PFTAC), the Reserve Banks of Australia, New Zealand and Fiji, other regional central banks, the Bank of England Centre for Central Banking Studies, AusAID, NZAid and APG for the technical assistance provided to the National Reserve Bank of Tonga in 2009/10.

Siosi C. Mafi
Governor

Board of Directors of the National Reserve Bank of Tonga during the year ended 30 June 2010

Mrs. Siosi Cocker Mafi

Chairperson & Governor

HRH Princess Salote Pilolevu Tuita

Director

Mr. Richard Prema

Director

Mr. ‘Aisake Eke

Director

Principal objectives and functions of the National Reserve Bank of Tonga

i) Principal objectives of the Bank

(1) 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.

(2) Subject to subsection (1), the Bank shall conduct its activities in a manner that supports macroeconomic stability and economic growth.

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;

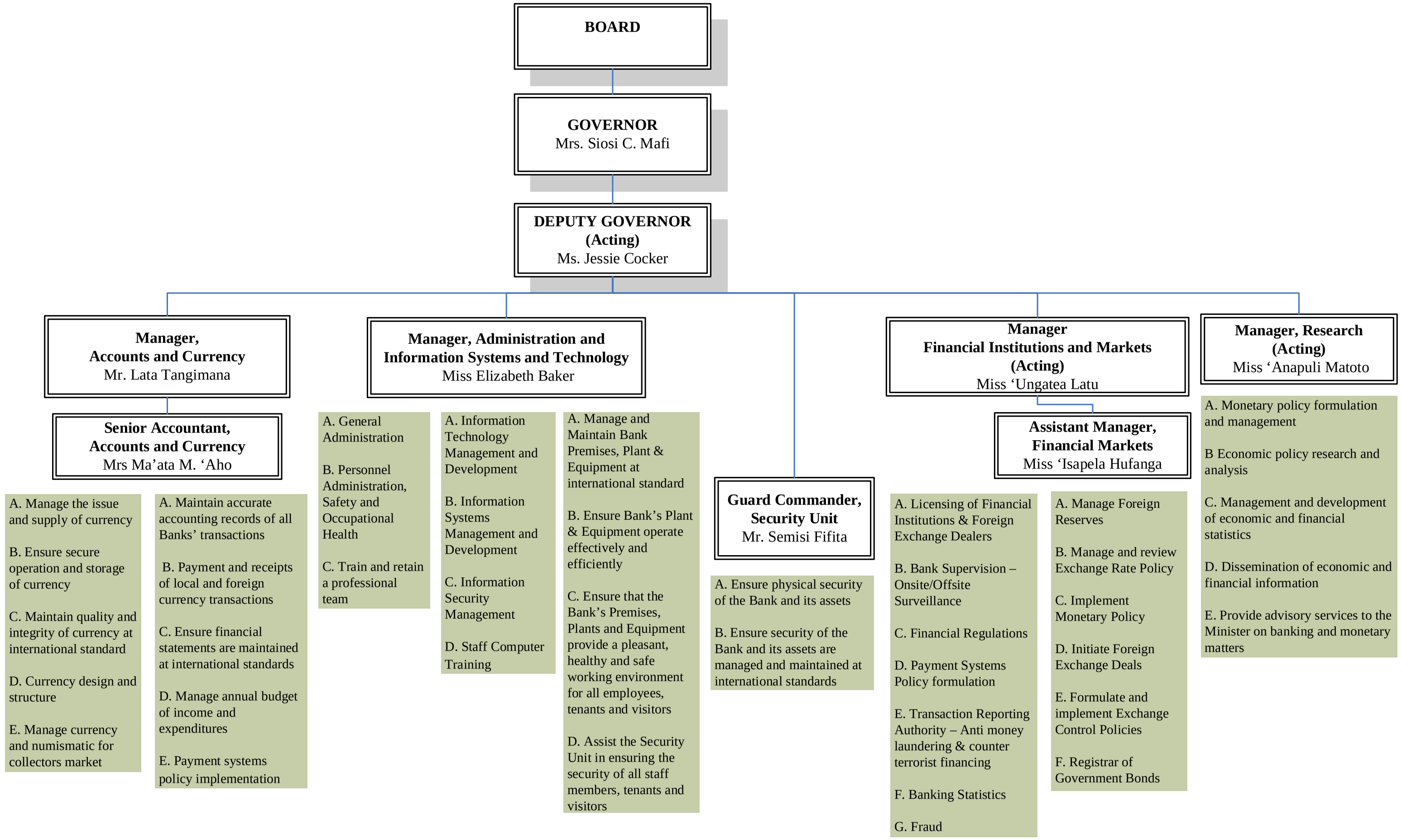
(g) undertake banking business, in Tonga or elsewhere, subject to the provisions of this Act;

(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 (Ammendment) Act, 2007

NATIONAL RESERVE BANK OF TONGA
JUNE 2010



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Economic Overview

Overseas Economic Developments

The world economy continued to recover during the year mainly due to robust growth in Asia and encouraging signs of growth in private demand. According to the IMF World Economic Outlook Update July 2010, the global economy grew by over 5 percent during the year to March 2010 and projected to grow by around 4.5 percent in the year to December 2010, a much better outcome than expected a year ago. The recovery in the advanced economies has been modest but steady, given high unemployment, rising public debt, and weak household balance sheets. At the same time, economic growth in many emerging and developing countries have been strong backed by continuing expansion in demand underpinned by rising income, stronger banking systems and lower level of public debt. However following the financial turbulence in the euro area, uncertainties about sovereign risks, fiscal sustainability and policy responses pose downside risks to the outlook on the recovery in the world economy. Given the difference in the pace of economic growth in the emerging and developing economies and the advanced economies and the downside risks to the outlook for economic recovery, the IMF has called for combinations of complimentary fiscal, monetary, financial sector reform and structural reform policies to promote strong, sustainable and balanced global growth in the medium term.

The United States economy is recovering after the global economic crisis, but consumers and financial institutions remain cautious as weak housing markets, high unemployment, and risks in Europe remain a concern. GDP growth increased at an annual rate of 1.6 percent in the second quarter of 2010, from 3.7 percent in the first quarter primarily reflected by positive contributions from nonresidential fixed investment, personal consumption expenditures, exports, federal government spending, and private inventory investment. US federal funds rate remained at 0.25 percent in view of the economic conditions, including subdued inflationary trends. In the United States, a stronger growth of 3.3 percent and 2.9 percent are projected for 2010 and 2011 due to the pick up in private demand.

Table 1. INTERNATIONAL ECONOMIC INDICATORS

Country	Real GDP Annual percent change			Consumer Prices Annual percent change			Current Account Balances Percent of GDP		
	2009	2010	2011	2009	2010	2011	2009	2010	2011
United States	-2.4	3.3	2.9	2.0	1.7	1.9	-2.9	-3.2	-3.4
Japan	-5.2	2.4	1.8	-1.7	-1.1	-0.2	2.8	2.8	2.4
Euro area	-4.1	1.0	1.3	0.4	1.2	1.4	-2.0	-1.4	-1.3
China	9.1	10.5	9.6	0.7	3.1	2.4	5.8	6.2	6.5
Australia	1.3	3.0	3.5	2.1	2.3	2.3	-4.1	-3.5	-3.7
New Zealand	-1.6	3.0	3.2	2.0	2.3	0.5	-3.0	-4.6	-5.7

IMF World Economic Outlook Update, July 2010

The Australian economy expanded at its fastest pace in three years by 1.2 percent in the second quarter of 2010, compared with 0.7 percent in the first quarter. The growth was fuelled by an improvement in household consumption expenditure and net exports mainly on demand for the country's iron ore and other commodities from China. The Reserve Bank of Australia hiked interest rates by 25 basis points in October, November and December 2009, and April, May and June 2010 to 4.50 percent at the end of June 2010 from 3.00 percent in July 2009. Inflationary pressures have moderated reflecting a number of factors such as easing in demand, slowing in wage growth and movement in the exchange rate. Growth is expected to be about 3.0 percent in 2010, before accelerating to 3.5 percent in 2011, with still-robust commodity prices boosting private domestic demand.

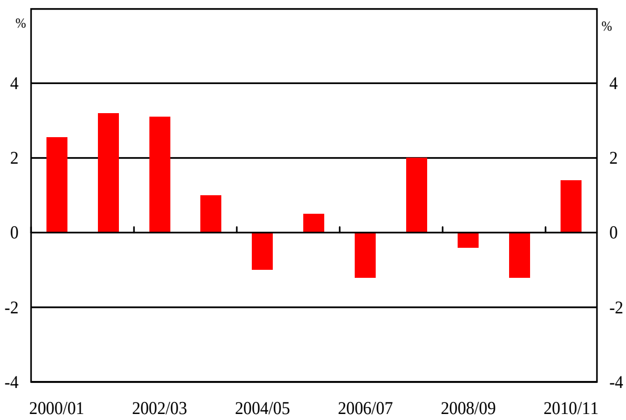
The New Zealand economy has continued its recovery since exiting recession in the June quarter of 2009. GDP expanded by 0.6 percent in the first quarter of 2010 due to strong exports and rise in manufacturing. The Reserve Bank of New Zealand has kept rates at 2.50 percent since July 2009 until June 2010 when it raised the interest rates by 25 basis points to 2.75 percent. Monetary tightening has been required to contain inflation risks, fuelled by an upturn in the domestic outlook and government related price changes due in October 2010. Inflation increased by 1.8 percent over the year to June 2010 mainly due to higher tobacco, transport and housing prices. Despite the potential for inflation expectations to rise, officials signaled that further monetary tightening is likely to be more moderate than projected given softer domestic activity and uncertainty over the global outlook. Growth is projected to be around 3.0 percent in 2010, before accelerating to 3.2 percent in 2011.

Asia has become a bigger player on the economic world stage. The strength of Asia's economies has helped them weather the global financial crisis, and today the region is leading the world into economic recovery. Asia has performed considerably better than other regions of the world underpinned by strong fundamentals and quick and forceful policy responses to the crisis. In China, GDP expanded by 10.3 percent in the June quarter. Given the strong rebound in exports and resilient domestic demand so far this year, the economy is now forecast to grow by 10.5 percent in 2010, before slowing to about 9.5 percent in 2011, when further measures are taken to slow credit growth and maintain financial stability. Similarly, other Asian countries such as India, Singapore, Taiwan, Korea, Malaysia and Thailand have all seen strong growth from significant increase in production and trade.

Central and Eastern Europe were hard hit by the global financial crisis because of the region's close trade links and reliance on capital flows. Just as the world economy is emerging from crisis, the European Union is faced with a host of new challenges, including how to address the serious fiscal problems in some euro countries, most notably Greece. Today, the region is in recovery, but even though most countries in central and Eastern Europe will see positive GDP growth this year, a return to the high growth rates that preceded the crisis is unlikely. Exports are now recovering, but domestic demand is projected to stay weak. Growth is now expected to be about 1.0 percent in 2010 then rise to 1.3 percent in 2011.

In the Pacific region, most economies have shown signs of moderate recovery following the weak performances in 2008/09 due to the spillover effects of the global financial crisis. The tourism sector has improved and played a crucial support for economic growth in Fiji and Vanuatu. Activities in the resource rich mining sector in Papua New Guinea increased and the growth in Solomon's log exports contributed to the improvement in their merchandise trade balances. Remittances are slowly increasing and inflation pressures had been moderate throughout 2009/10. However, the rebound in world oil prices will exert pressure on the level of foreign reserves and will provide upside risk to inflation mainly transportation and oil-related sectors for many Pacific Island countries.

Figure 1: Gross Domestic Product
Annual percent change



Source: Statictics Department and Ministry of Finance

Domestic Economic Conditions

Economic growth is estimated by the Ministry of Finance to have fallen further from a contraction of 0.4 percent in 2008/09 to a contraction of 1.2 percent in 2009/10. This is the second consecutive year of negative growth experienced by the Tongan economy, reflecting the impact of the global financial crisis through the fall in remittances, decline in tourist receipts, stagnant exports, the banks' tight lending conditions and the effects of the Ashika tragedy, the tsunami and the tropical cyclone which hit Tonga in September 2009 and February 2010, causing loss of life and severe damages. The combination of these developments and the inability of the government to provide fiscal stimulus together with monetary policy easing being muted by the tight credit conditions and the high level of non performing loans contributed to suppressing demand and the weak economic activity in Tonga.

Sea Cucumber

Agricultural output continued to remain subdued in 2009/10 particularly with the decline in the exports of squash. The drought and cyclone Rene contributed to the decline in agricultural production in 2009/10. Fish exports fell in 2009/10 which was offset by the exports of the sea cucumber mainly to China and Hong Kong. The decline in fish exports during the year reflected high fuel costs, high operation cost, depletion in fish stock and fishermen turning their focus to harvesting sea cucumber. The entrance of sea cucumbers into the export market is a positive sign for the development of the export sector, however, there are serious challenges regarding the future development and sustainability of this industry.

Taumoepeau Building

The reconstruction of Nuku'alofa was ongoing with many projects nearing completion such as the Taumoepeau Building, Sanft, Narottam, Lalita Store and Royco. However, the delays in the commencement of some of the planned construction projects, such as the urban infrastructure project, the reconstruction of the residential dwellings in Niuatoputapu that were affected by the tsunami and the reconstruction of other business buildings in the central business district slowed down construction activity expected for 2009/10. The fall in remittances and banks' tightening lending conditions also contributed to the slowdown in the construction activity.

Narottam Store

The commerce, restaurants and hotels sector contracted in 2009/10, reflecting the spillover effects of the global crisis. Total arrivals into the Kingdom which includes air and cruise ship arrivals, and returning nationals declined by 11.7 percent in the year ended June 2010 compared to 6.8 percent increase in the previous year. The decline in the total number of arrivals is mainly due to the fall in the number of cruise ships entering the Kingdom from 24 cruise ships in 2008/09 to 17 in 2009/10. Tourism earnings reported by the commercial banks' overseas exchange transactions (OET) fell by 13.3 percent in the year ended June 2010 compared to 39.2 percent increase in the same period last year.

Table 2. TONGA MAIN ECONOMIC INDICATORS [1/]

		2006/07	2007/08	2008/09	2009/10
Economic Activity					
Real GDP	% change	-1.2	2.0	-0.4	-1.2
Tourist Arrivals (air & sea)	Thousands	52.8	67.1	71.7	63.3
Money, Prices & Interest Rates					
CPI (average)	% change	5.1	9.6	5.6	1.7
CPI (year-end)	% change	5.7	12.2	1.2	2.7
Money Supply (M3 - year end)	$m pa'anga	286.9	306.0	302.6	320.2
Domestic Credit (year end)	$m pa'anga	295.2	332.9	318.7	282.0
Weighted term deposit interest rate (year end)	% per annum	6.6	6.4	5.8	4.0
Weighted lending rate (year end)	% per annum	12.4	12.7	12.5	11.6
External Sector					
Merchandise exports fob (OET basis)	$m pa'anga	26.7	23.5	11.5	11.4
Merchandise imports fob (OET basis)	$m pa'anga	217.5	262.4	271.4	208.0
Official foreign reserves (year end)	$m pa'anga	91.6	89.1	136.3	170.5
Import coverage (year end)	Months	4.4	3.5	5.3	7.2
Exchange rate (period end)	US$/T$	0.5131	0.5407	0.4967	0.5123

1/ Sources: Ministry of Finance, Tonga Visitors Bureau, Department of Statistics and National Reserve Bank of Tonga

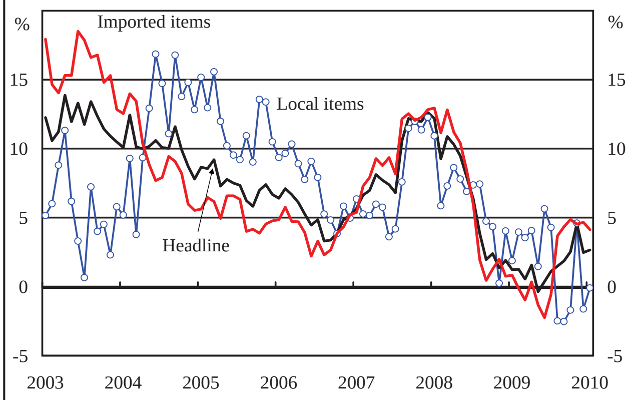
Prices

Headline inflation as measured by the Consumer Price Inflation (CPI) remained moderate in 2009/10. The CPI rose by 2.7 percent in the year ended June 2010, an increase from 1.2 percent in the year ended June 2009. The rise in the headline inflation was mainly due to the increase in the prices of imported transportation and imported food. The average annual inflation rate in 2009/10 was 1.7 percent, down from 5.6 percent recorded in the same period a year earlier.

Imported inflation increased by 4.1 percent in the year ended June 2010, from the 0.8 percent increase recorded in the previous year. The major contributions to the rise in imported inflation were from transportation and food. The increase in imported transportation reflected the rebound in world oil prices from an average of around US$69 per barrel in June 2009 to US$74 per barrel in June 2010. The strengthening of the New Zealand dollar against the Tongan pa'anga contributed to the rise in imported food prices from New Zealand, the main source of imported food for Tonga.

Figure 2: Consumer Prices

Year-ended percentage change



Source: Statistics Department

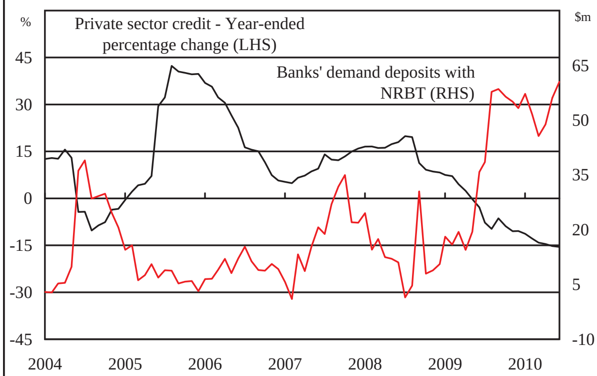
Domestic prices fell by 0.1 percent in the year ended June 2010, compared to the 1.8 percent rise in the year ended June 2009. The major contributions to the fall in domestic inflation were the decline in domestic food prices mainly meat, fish and poultry, and the fall in miscellaneous prices mostly education fees, which more than offset the increases in the electricity price in October 2009, March and June 2010.

Financial Intermediation

Total broad money (M3), a broad measure of money supply, rose by 5.8 percent in the year ended June 2010, compared to 1.1 percent decline in the previous year. The increase in broad money was mainly due to increases in demand deposits and currency in circulation, reflecting the increase in foreign reserve and liquidity in the banking system.

Despite the availability of excess liquidity in the system, demand for credit fell during the financial year 2009/10 in line with the slow down in economic activity. Total private sector credit contracted further by 15.5 percent, year on year to June 2010 compared to the 2.9 percent decline in the year ended June 2009. The further contraction in banks' lending was attributed to a combination of increased bad debts provisions and write offs caused by the rapid increase in non-performing loans, the settlement of the long outstanding squash council loans, banks tightening credit standards together with very low demand for new credits reflecting the impact of the decline in remittances, tourist receipts and stagnant exports. Business credit fell significantly by 24.8 percent and household credit fell by 4.1 percent in the year to June 2010. Nevertheless, 50.6 percent of total credit to the private sector was lent to the business sector and 49.0 percent was lent to the household sector.

Figure 3: Banking Sector Liquidity and Private Sector Credit



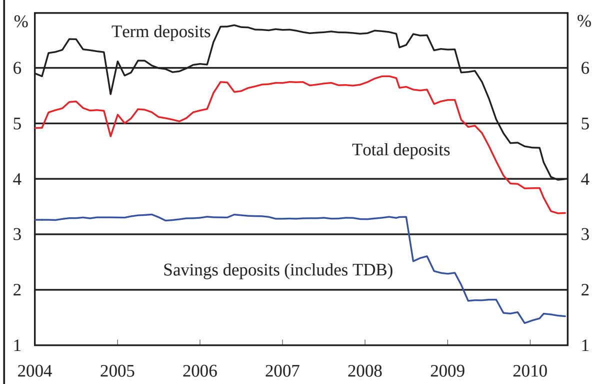
Source: Licensed Financial Institutions and National Reserve Bank of Tonga

The net credit position of government with the banking system fell in 2009/10 to $28.1 million from $34.7 million in 2008/09, reflecting the fall in government's revenue collection during the year due to the marked decrease in imports.

Interest Rates

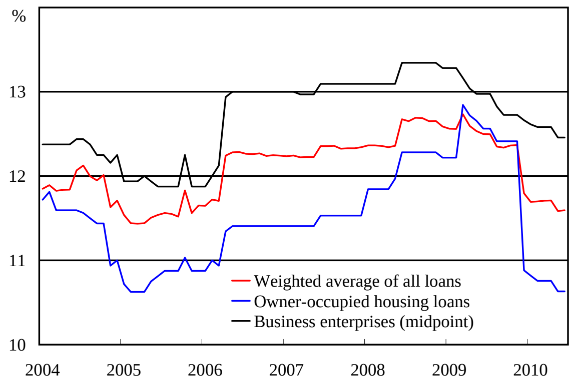
Interest rates have been generally declining in 2009/10 as a consequence of the financial difficulties facing the economy and the financial sector. During the financial year 2009/10, the Reserve Bank eased monetary policy stance further by reducing the SRD from 10 percent to 5 percent in August 2009. This was to encourage the domestic banks to reduce their lending rates to ease the financial difficulties of borrowers and to encourage lending to support economic activity. In January 2010, the Reserve Bank paid 1 percent interest on the banks' exchange settlement account balances over T$1 million to help further reduce interest rates. At the end of June 2010, the weighted average of interest rates paid by

Figure 4: Weighted Deposit Interest Rates



Source: Licensed Financial Institutions

Figure 5: Weighted Lending Rate



Source: Licensed Financial Institutions

commercial banks for deposits less than $50,000 on 3 to 48 months fell to 4.0 percent from 5.8 percent a year earlier.

The lending indicator rate, a weighted average of interest rates across household and business lending, fell to 11.6 percent from 12.5 percent a year earlier partly reflecting measures implemented by the Reserve Bank.

External Developments

According to the Overseas Exchange Transactions (OET) data collected from the commercial banks, the current account deficit was more than offset by the capital account surplus and the net unrecorded inflows, resulting in a rise in the level of official foreign exchange reserves (Table 3). The reduction in the trade deficit in 2009/10 was mainly due to the substantial fall in imports, reflecting weak domestic demand. The combination of the 10 percent ($17.8 million) fall in remittances and the domestic credit contraction of 15 percent ($54.1 million) continued to depress domestic demand during the year. Consequently, the value of imports fell by 23.3 percent ($63.4 million) to $208 million at the end of June 2010. Exports remained stagnant during 2009/10 with the receipt from the exports of sea cucumber making up for the fall in receipts from fish and agricultural exports.

Net transfers rose by $8.9 million to $166.8 million in 2009/10 largely reflecting the receipts of SDR allocations from the IMF. However, private remittances, Tonga's main source of foreign exchange earnings, fell by 10 percent year on year to June 2010, reflecting the impact of the global financial crisis as unemployment rates remained high in the main remittance source countries. The deficit on the services account widened to $7.9 million in 2009/10 from $5.4 million in 2008/09, reflecting the fall in tourist receipts. With the absence of the large one-off private receipts last year, the surplus in the net investment income fell to $5.3 million. These movements resulted in the improvement in the current account deficit by $17.3 million to $32.5 million deficit in 2009/10.

The capital account surplus fell by $31.7 million to $37.9 million in 2009/10, reflecting lower private capital inflows. The capital account surplus together with the net unrecorded inflows more than offset the current account deficit which resulted in an overall balance of payments surplus of $34.2 million and a higher level of official foreign reserves. Gross official foreign reserves rose to a record high of $170.5 million at the end of June 2010, an amount equivalent to 7.2 months of imports (Table 2).

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

	2006/07	2007/08	2008/09	2009/10
A. Merchandise trade balance	-186.6	-238.9	-259.9	-196.6
Exports, f.o.b.	26.3	23.5	11.5	11.4
Imports, f.o.b.	212.9	262.4	271.4	208.0
B. Services balance	-35.8	-6.2	-5.4	-7.9
Receipts	38.8	70.1	83.7	71.8
Payments	74.7	76.3	89.1	79.8
C. Investment income balance	7.1	6.4	57.5	5.3
Receipts	12.9	13.0	61.0	14.7
Payments	5.8	6.6	3.4	9.4
D. Transfers balance	168.6	180.2	157.9	166.8
Receipts	187.3	203.6	177.7	183.3
Private	186.8	202.8	175.2	157.4
Official	0.5	0.8	2.5	25.9
Payments	18.7	23.4	19.9	16.5
Private	18.1	23.1	18.5	12.7
Official	0.6	0.3	1.3	3.8
E. Current account balance (A+B+C+D)	-46.7	-58.6	-49.8	-32.5
F. Capital account balance	53.8	69.0	69.6	37.9
Official capital	19.7	22.7	-11.0	8.4
Inflows	24.7	26.5	18.4	22.8
Outflows	5.0	3.7	29.4	14.4
Private capital	34.2	46.2	80.6	29.4
Inflows	39.9	50.5	88.9	38.0
Outflows	5.7	4.3	8.3	8.6
G. Other items, net	1.3	-12.9	27.4	28.8
H. Overall balance (E+F+G) 1/	8.4	-2.5	47.1	34.2

1/ Corresponds to changes in gross official foreign reserves.

Source: National Reserve Bank of Tonga

Economic Outlook

Economic activity is expected to rebound slowly in the next financial year 2010/11, unless further major economic shocks occur. Agricultural export is expected to be supported by the establishment of the fumigation facilities in Tongatapu and Vava'u which will assist exports from Tonga to meet the import standards of overseas markets. Construction will continue to drive economic activity in Tonga with the ongoing reconstruction of the Nuku'alofa central business district, the rebuilding of residential dwellings in Niuatoputapu that were destroyed by the tsunami in September 2009, building of infrastructure, churches, schools and the construction of the final phase of the Vaiola hospital.

The projected recovery in the economy brings with it risks of lower official foreign reserves and higher inflation. The level of foreign reserves is expected to fall but will remain at adequate level, above 4 months of import cover. Imports are projected to rise given the planned construction projects and the continuing increase in oil prices. Nevertheless, the expected receipts of foreign aid funds will help to ease the downward pressure on foreign reserves. The Reserve Bank will continue to closely monitor Tonga's economic and financial conditions to maintain an adequate level of foreign reserves.

Inflation is expected to remain under pressure from the rising world oil prices and the movement in the exchange rates particularly with the appreciation of the New Zealand dollar which will put upward pressure on imported inflation. The increase in world oil prices will exert upward pressure on the price of fuel and oil-related services such as electricity, transportation and others. Nevertheless, headline inflation is expected to remain in single digit in 2010/11 and the Reserve Bank will continue to promote low inflation and price stability.

Financial Markets

External Reserves

Despite the 10 percent decline in remittances over the year, the gross official foreign reserves was maintained above the required level of 3 to 4 months of imports and this has contributed to maintaining confidence in the financial system during the global economic and financial crisis. The gross official external reserves ranged between 5.6 months and 7.2 months of import cover. The level of gross external reserves increased from a low of $139.4 million to peak at $170.5 million and 7.2 months of import coverage as at the 30th June 2010. This compares with $136.3 million and 5.3[1] months of import at 30th June 2009. The significant increase in the level of foreign reserves was attributed mainly to receipts from the IMF of the Special Drawing Rights allocation to Tonga, receipts of large aid inflows for the government, as well as the capital injection by the commercial banks. At the same time, the months of import coverage rose during the year reflecting the fall in imports. The decline in imports was the result of the slowdown in economic activity as demand continued to be depressed by the decline in remittances and contraction of credit growth. Deferred oil and other import payments also contributed to the decline in imports.

The Bank's investment policy continued to focus on obtaining maximum income commensurate with safety, liquidity and the maintenance of overall value which continued to be a challenge, given the uncertainty and volatility in the global financial markets. The European debt crisis and continued aftermath of the global economic and financial crisis resulted in the relatively low international interest rates and the decline in foreign exchange investment income. At the same time, the foreign reserves remained at high levels therefore excess funds were invested to maximize income. Against this background, the management of the foreign reserves was enhanced to ensure safety as well as income subject to the maintenance of sufficient liquidity to meet the outflows. The Reserve Bank increased its correspondent banks for its investments by one bank and continued to closely monitor the international banks' credit ratings to ensure that the Reserve Bank's investments were held with banks that were rated above the Board approved minimum "A" rating by international credit rating agencies. Investments were also held in deposits with central banks. The Reserve Bank holds the external reserves mainly in Australian dollars, New Zealand dollars, and the US dollars.

External Value of the Pa'anga

The Tongan pa'anga is calculated daily by reference to a weighted basket of currencies of Tonga's major trading partners.

The Reserve Bank monitors the movement of the rate of exchange of the pa'anga against other currencies with a view to ensuring that the country's balance of payments position and price stability are maintained at levels that are consistent with the achievement of macroeconomic stability. The Reserve Bank may also make adjustments to the Tongan pa'anga exchange rate to enable the Reserve Bank to react in a flexible manner to external and internal shocks. These adjustments continued during 2009/10. In 2009/10, the external value of the pa'anga ranged between US$0.50 and US$0.53, compared with the range of US$0.45 to US$0.54 in 2008/09. The pa'anga fluctuated between AUD0.55 to AUD0.61 and NZD0.71 to NZD0.76 in 2009/10, reflecting reduced volatility during the year, compared with a range of AUD0.56 to AUD0.70 and NZD0.71 to NZD0.86 respectively in 2008/09.

Based on the 2008/09 review of the banks' exchange rate spread, the Reserve Bank and the commercial banks agreed to limit the exchange rate spreads of banks and foreign exchange dealers which became effective in August 2009. These limits were placed on the exchange rate spreads for telegraphic transfers (TTs) as follows: USD/TOP up to a maximum of 220 basis points, AUD/TOP up to a maximum of 300 basis points, and NZD/TOP up to a maximum of 350 basis points. This measure has contributed

[1] Revised from 5.1

to the reduction of the commercial banks' and authorized foreign exchange dealers' exchange rate spread and the promotion of competitive exchange rates offered to the public. The Reserve Bank continued to respond to requests for exchange rates and continued to publish the exchange rates weekly on the Reserve Bank's website, to improve public access to exchange rate information.

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 purchaser in the spot foreign exchange markets during the year. Foreign exchange purchases of T$165.3 million exceeded sales of T$131.1 million giving a total foreign exchange turnover for the year of T$296.4 million.

Exchange Control Operations

During 2009/10, the Reserve Bank processed 860 exchange control applications for payments of amounts above the delegated limits and all capital payments as stipulated in the Exchange Control guidelines. The approved exchange control applications amounted to T$194.2 million in 2009/10 (of which 13 percent were classified as capital transactions) compared to the 878 exchange control applications processed in 2008/09 amounting to T$212.4[2] million. The decrease in exchange control applications is in line with the decline in demand for imports and deferred oil import payments. The increase in the proportion of capital payments over the year largely reflects the increase in loan repayments due mainly to the commencement of the China loan repayment and the bringing onshore of a major utility loan. The exchange control data on foreign currency payments by large importers are key inputs to the Reserve Bank's foreign reserves management and monetary policy decisions. The Reserve Bank also received 19 applications for the removal of foreign currency cash over T$10,000 across the border, of which all applications were approved totaling T$6.8 million.

The Exchange Control Policy Guideline was revised in January 2010 to reflect current practice and again in April 2010 to comply with the IMF Article VIII. The IMF Article VIII requires that the tax clearance is for taxes related to the particular payment application only. The Reserve Bank conducted training for the banks and foreign exchange dealers to improve their understanding of its exchange control requirements.

Spot checks were undertaken during the year to ensure banks were compliant with the exchange control guidelines. This resulted in the reduction in the delegation limit to $20,000 for all import payments and the temporary suspension of the delegation limit for advanced import payments for one non-compliant bank.

Domestic Market Operations

During the year 2009/10, the Reserve Bank continued to cease the issue of Reserve Bank notes. The Reserve Bank's decision to cease the issue of Reserve Bank notes was part of its decision to start easing its monetary policy stance and leaving excess liquidity in the system to encourage banks to lend and assist with economic recovery. Therefore, at the end of June 2010, there were no outstanding Reserve Bank Notes.

[2] Revised from T$211.5 million

Registrar of Government Bonds

The Reserve Bank acts as the registrar for all of the Government of Tonga's bond issues. Over the course of the year, the Reserve Bank issued 5 new Government of Tonga Bonds. At the end of June 2010, the total value of Government of Tonga Bonds outstanding was $29.45 million, an increase from $21.45 million in the previous year.

Financial Sector

The Reserve Bank is responsible for the promotion of a sound and efficient financial system. These objectives are pursued through the licensing, regulating and supervising of financial institutions (banks).

There are 4 banks licensed to operate in Tonga.

	Branches (including Head Office at Nuku'alofa, Tongatapu)	ATMs	Internet Banking	Other services
Australia and New Zealand Banking Group Limited (ANZ)	3	11	Yes	Internet Banking Platform
Westpac Bank of Tonga (WBOT)	5	8	Yes	Financial Education Program – Financial First Steps Program & Women in Business Program
MBf Bank Limited	2	-	No	-
Tonga Development Bank (TDB)	6	-	No	Microfinance

Due to the economic slow down and general reduction in business volume in 2009/10, the banks continued with its current banking services and did not introduce any new services during the year. In addition, ANZ bank indicated that effective in July 2010, it will cease its rural banking services in Tongatapu given the small number of customers utilizing this facility as well as their concerns for the safety of their staff transporting cash in rural areas.

The Westpac Bank of Tonga and the Tonga Development Bank maintained their head office and branches on Tongatapu as well as branches on the islands of Vava'u, Ha'apai, and 'Eua. The MBf Bank Limited maintained their head office on Tongatapu and a branch on the island of Vava'u. The ANZ Bank also maintained their head office on Tongatapu, a branch at Ma'ufanga, and a sub-branch on Vava'u.

Tonga Development Bank continued to be the only bank serving the outermost islands of Niuatoputapu and Niuafo'ou and also the only bank offering microfinance services to the rural areas in Tongatapu and the outer islands.

Westpac Bank of Tonga continued to provide the "Financial First Steps Program", and provided a new "Women in Business" program, which are financial education programs on how to manage money to many of its customers in Tongatapu. These programs are co-funded by the Australian Aid and were open to customers of the other banks as well as the outer islands. Meanwhile, the Tonga Development Bank continued to provide its Business Advisory training program for many of its small business customers.

Supervision and Regulation of Licensed Financial Institutions

The Reserve Bank continued to meet with the Association of Banks in Tonga (ABT) to discuss issues which would support the soundness and stability of the financial system. These issues included head office oversight, capital adequacy, asset quality, interest rates and liquidity in the banking system.

During 2009/10, the Reserve Bank focused its supervisory activities on interest rates given the public concerns over interest rates where the decrease in lending rates have been much slower than the decline in deposit interest rates. In addition, the Reserve Bank's supervision continued to focus on the bank's credit risk management due to the continued high level of non-performing loans, although the level of non-performing loans has improved compared to the previous year. The continued slow down in the economy and the fall in remittances continued to contribute to the level of high non-performing loans in the banking system, which adversely affected the profitability and capital position of the banks. This led to more stringent supervisory actions on some of the banks particularly on improving their capital position and credit risk management system. The Reserve Bank continued to hold regular meetings with banks in order to discuss the quality of reporting in terms of accuracy and timeliness which continued to be major issues with licensed financial institutions. Various actions and administrative penalties were being levied on banks as a result. Furthermore, the Reserve Bank participated in the IMF PFTAC's project to standardize the prudential returns in the Pacific region to improve accuracy, especially with Australian banks, where the preparations of the reports are being centralized.

In addition, the Reserve Bank continued to implement the requirements of the Financial Institutions Act 2004, by revising Prudential Statements No.1 and No.2 on Asset Quality and Credit Risk Grading in April 2010. These revisions were to effectively implement the requirements of the International Financial Reporting Standards. The Prudential Statement No.4 on Disclosure was also revised during the year to reflect the requirement for banks to disclose the Effective Interest Rate (EIR) to customers and to incorporate the EIR calculator.

Technical assistances were funded by the IMF/PFTAC and the Bank during the year to strengthen the Reserve Bank's supervisory framework by designing new prudential returns and the review of existing Prudential Statements, enhancing the offsite monitoring tools, and to assist with the onsite visit to one licensed financial institution. The Bank also enhanced its supervisory capacity by recruiting another Bank Examiner. During the year, all the Bank Examiners benefited from these technical assistances and the training that they provided.

The Reserve Bank continued to be the custodian for the business recovery and private sector reconstruction facilities funded by the Australian and New Zealand Governments. As at the end of June 2010, the balance of the private sector reconstruction facility was at T$9.1 million compared to T$9.6 million in the previous year. The due date for new loan applications under this facility had expired in December 2009.

Financial Performance

The total assets of the financial system declined by $25.9 million to $431.8 million in 2009/10, a decrease of 5.7 percent over the year. The contraction in banks' assets was mainly due to significant loan write offs during the year. Total net loans (total gross loans net off total provisions) by the banks to the non-financial sector fell by $42.4 million (13.8 percent) compared with a decrease of $40.1 million (11.6 percent) recorded in 2008/09. The significant decline in net loans reflected banks continuing to consolidate and clean up their balance sheet. At the end of 2009/10, the banks' outstanding loans portfolio comprised of loans to industries and businesses including agriculture (46.5 percent) and private individuals (46.5 percent of which 34.1 percent was for housing). Furthermore, the Statutory Required Deposits (SRD) balance declined by $14.7 million reflecting the reduction in SRD requirement that was effective in August 2009. At the same time, the Exchange Settlement Account increased by $26.9 million.

Table 4. Financial Sector Deposit Accounts					
	2005/06	**2006/07**	**2007/08**	**2008/9**	**2009/10**
Demand Deposits					
Number of Accounts	2,878	2,657	2,687	2,650	2,469
Value of Deposits ($m)	56.1	66.7	66.4	70.0	80.0
Saving Deposits					
Number of Accounts	39,361	45,816	44,486	43,547	36,004
Value of Deposits ($m)	62.4	54.1	53.7	48.8	51.9
Time Deposits					
Number of Accounts	2,318	1,710	1,747	1,489	1,489
Value of Deposits ($m)	113.0	130.5	165.8	161.6	157.5
Total Number of Accounts	**44,557**	**50,183**	**48,920**	**47,686**	**39,962**
Total Value of Deposits ($m)	**231.4**	**251.2**	**286.0**	**280.3**	**289.4**

Source: National Reserve Bank of Tonga

Total liabilities decreased by $13.5 million (3.6 percent) due mainly to a decrease in total borrowing by the banks from other financial institutions of $13.4 million (28.0 percent). This was mainly attributed to a decrease in borrowings from foreign banks following the conversion of a major utility foreign currency loan to local currency. Total deposits by non-financial sector, on the other hand, rose by $9.0 million (3.2 percent) to $289.4 million in 2009/10 and the total number of accounts reported decreased by 16.2 percent to 39,962 (Table 4). The increase in deposits and the slow down in lending to the private sector have contributed to the high level of liquidity in the banking system.

Profitability

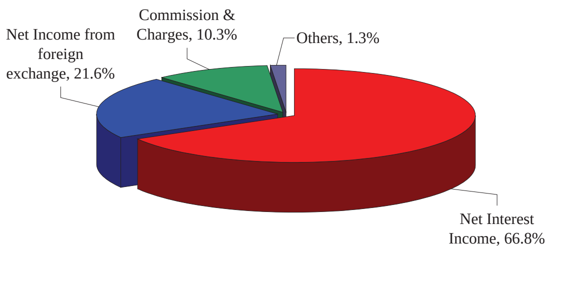
The total financial sector as a group showed a pre-tax loss of 1.6 percent in 2009/10, compared with a pre-tax loss of 6.1 percent in 2008/09 (Table 5). The notable improvement in the recorded loss indicates that the bulk of the loan loss provisions were raised in the previous year. Loan loss provision expenses decreased significantly to 5.2 percent of average assets in 2009/10 compared to 10.6 percent in 2008/09.

Table 5. FINANCIAL PERFORMANCE					
	2005/06	**2006/07**	**2007/08**	**2008/09**	**2009/10**
Pre-tax Net Profit (% average total assets)	6.4	2.9	4.9	(6.1)	(1.6)
Total Operating Income (% average total assets)	11.5	11.2	11.9	11.1	9.8
Net Interest Income (% average total assets)	6.9	6.6	6.3	6.3	6.6
Non-interest Income (% average total assets)	4.7	4.6	5.6	4.9	3.3
Average Net Interest Margin (%)	8.3	7.9	7.6	7.2	7.9
Total Operating Expenses (% average total assets)	4.9	5.5	5.5	6.6	6.3
Consolidated Risk-weighted Capital Ratio (%)	21.2	20.7	22.4	26.5	22.2

Source: Licensed Financial Institutions

Total operating income further decreased to 9.8 percent of average assets from 11.1 percent in 2008/09. The decline in operating income was attributed mainly to the decline in non-interest income to 3.3 percent of average assets from 4.9 percent in the previous year. This was mainly due to the decrease in foreign exchange income to 2.1 percent from 3.1 percent of average assets in the previous year reflecting the fall in foreign exchange transaction volume and the limit imposed by the Reserve Bank on exchange spreads for TTs. Foreign exchange business made up 21.6 percent of banks' total operating income, a decrease from 27.9 percent in the previous year and 11.6 percent came from commission and charges plus other income sources. Net interest income was 6.6 percent of average assets, slightly increasing from 6.3 percent in 2008/09. Accordingly, the average net interest margin (net interest income as a percentage of average earning assets) for the banks slightly increased to 7.9 percent in 2009/10 compared with 7.2 percent in 2008/09. The bulk of banks' operating income was derived from the extension of loans, the composition of net interest income increased to 66.8 percent of total operating income in 2009/10 compared with 56.4 percent in 2008/09.

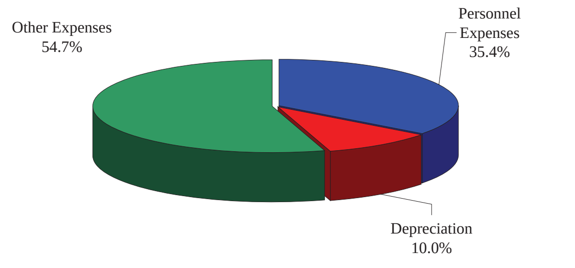
Figure 6: Financial Sector - Components of Total Operating Income



Source: Licensed Financial Institutions

The operating expenses of the banks slightly decreased to 6.3 percent of average assets in 2009/10 compared to 6.6 percent in 2008/09. This was mainly due to a decrease in the banks' other operational expenses over the year. About 35 percent of administrative expenses of the banks were taken up by employees' remuneration, a slight increase from 34 percent in the previous year. Depreciation and amortisation accounted for 10 percent of total administrative expenses and the balance of 54.7 percent was made up of the purchase of various goods and services necessary for the operations of the banks.

Figure 7 : Financial Sector - Components of Total Operating Expenses



Source: Licensed Financial Institutions

Liquidity

Liquidity in the banking system continued to remain at high levels in 2009/10 underpinned by the contraction in credit growth, increase in deposits and the capital injection by one of the major banks. Net loans as a proportion of deposits decreased to 75.8 percent from 86.7 percent in 2008/09. Furthermore, the Liquid Asset Ratio increased to 27.3 percent from 17.5 percent in 2008/09, which was well above the minimum Reserve Bank requirement of 5 percent.

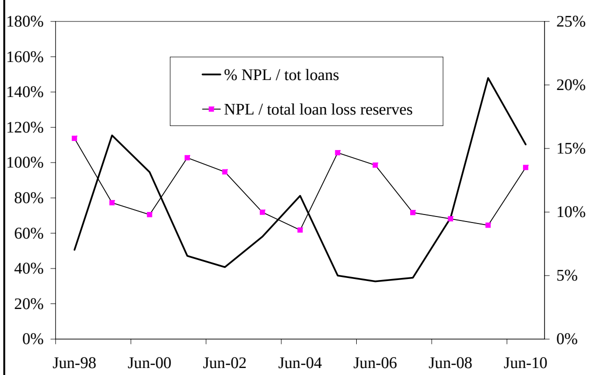
Capital

The capital position of the banking industry remained strong and above the minimum ratio required by the Reserve Bank following the injection of additional capital during the year. The consolidated risk weighted capital ratio for all the banks decreased to 22.2 percent at the end of June 2010 compared with 26.1 percent at the end of June 2009. The decrease in the capital adequacy ratio over the year was attributed mainly to the raising of additional loan loss provisions and the special large dividend payment made by one of the banks during the year. The continued minimal growth in loans is also supporting the maintenance of a relatively high risk weighted capital adequacy ratio.

Asset Quality

The overall quality of the banks' assets slightly improved over the year as a sizeable proportion of the banks' loans with non-accrual status were either written off or fully settled. Total non-performing loans decreased to 15.3 percent of total loans compared with 20.5 percent at the end of June 2009. The total non-performing loans comprised of loans to businesses (52.1 percent) mainly the tourism and retail and wholesale sector as well as the private individuals mostly for housing (26.1 percent). The improvement in banks' asset quality reflected improvements in risk management and oversight, better adherence to lending procedures, amid the slowdown in economic activity and remittances. Provisions against loans slightly decreased by $0.9 million (1.8 percent) due to further new provisions raised being partially offset by write off of provisioned loans over the year. Furthermore, the total provisions against the non-performing loans improved as the coverage ratio of non-performing loans to total loan loss reserves improved to 97 percent from 64.5 percent at the end of June 2009.

Figure 8: Financial Sector - Non Performing Loans - Coverage Ratio



Source: Licensed Financial Institutions

Transaction Reporting Authority

The Reserve Bank is the Transaction Reporting Authority (TRA) under the Money Laundering and Proceeds of Crime Act and performs functions similar to the functions of the Financial Intelligence Units (FIU) in other countries. These functions include combating money laundering and terrorist financing in Tonga by enhancing awareness and ensuring risk management systems are in place.

During the year, the TRA focused on the preparation for the Mutual Evaluation by the Asia Pacific Group on Money Laundering (APG) which took place in November 2009. The TRA shared the Mutual Evaluation coordinator role with the Crown Law Department. Following the November visit, the TRA worked together with the members of the National Committee and the Sub-Committee on Money Laundering and Terrorist Financing in preparing the response to the Mutual Evaluation report. The Mutual Evaluation report of Tonga was discussed and adopted at the APG Annual Meeting in July 2010. This was the first time Tonga has been evaluated against the international requirement for combating money laundering and terrorist financing. The TRA will continue to work closely with members of the National Committee and the APG in working towards making Tonga more compliant with the international requirements.

The commercial banks and authorized restricted foreign exchange dealers reported a total of 14 suspicious transactions (STR) to the TRA during the year, similar to that in the previous year. Eleven of the 14 STRs were related to significant cash or telegraphic transfer transactions that were not in line with the customers' normal course of business or the source of funds were not determined. Two of the 14 STRs were related to scams, a decline from six in the previous year, which reflects improved awareness of the identification of such activity by the banks and licensed foreign exchange dealers. Eight of the 14 STRs were reported to the Transaction Crime Unit (TCU) of the Police for further investigations. The TRA also continued to disseminate the terrorist list from the United States Department of The Treasury Office of Foreign Assets Control's (OFAC) list of Specifically Designated Nationals (SDN). Additions to the dissemination list were the Non-Cooperative Countries and Territories and countries that are subject to the Financial Action Task Force's public statements.

The TRA conducted two training sessions for banks and authorized restricted foreign exchange dealers to improve their understanding of the anti-money laundering requirements. Quarterly meetings with the banks and authorized restricted foreign exchange dealers were also conducted to enhance compliance with AML requirements.

The enactment of the amendments to the Money Laundering and Proceeds of Crime Act 2000 has been deferred to ensure the recommendations from the Mutual Evaluation report were incorporated. The approval of the Money Laundering and Proceeds of Crime Regulations 2008 by the Privy Council has also been deferred awaiting the approval of the amendments to the Money Laundering and Proceeds of Crime Act 2000. These processes are expected to be completed soon.

Operations of the Reserve Bank

Currency Operations

Notes in Circulation

During the year, the Reserve Bank continued to inspect, analyse and sort currency notes to ensure that the quality of notes and coins on issue to the public are maintained at a high standard. At the end of June 2010, the face value of currency notes on issue, both new and reissuable, totaled $31.2 million. This was an increase of $4.8 million (18 percent) over the year, a similar increase as the previous year. Currency notes issued during the year totaled $59 million and currency deposited totaled $54 million of which $11.4 million were classified by the Reserve Bank as unfit for reissue and were destroyed. The currency notes of the Kingdom are printed by De La Rue Currency in the United Kingdom.

In March 2010, the Reserve Bank acquired a new Cobra 4004 note processing machine to assist with the authentication and the fitness sorting of currency notes for circulation. This Cobra note processing machine has improved the quality of notes reissued by the Bank to the public. The machine also has an online destruction feature which assists the security and speed of the notes destruction process.

Coins in Circulation

At the end of June 2010, the face value of coins on issue totaled $1.76 million, compared to $1.75 million of the previous year. During the year, coins to a face value of $0.05 million were issued for circulation. The total face value of coins redeemed during the period was $0.002 million. During the year, the Bank ordered new 50 seniti coins from Royal Mint, United Kingdom to cater for public demand.

Note Trust Depots

The Reserve Bank has Note Trust Depot (NTD) agreements with all the commercial banks. During 2009/10, there was a decrease in commercial banks usage of NTDs as banks became more risk averse and limited the amount of cash that they maintained in the premises. The commercial banks lodged a total of $17.6 million ($21.4 million in 2008/09) and withdrew $18.1 million ($21.2 million in 2008/09) from the NTDs. Compared to the previous year, lodgements and withdrawals to NTDs decreased by 18 percent and 15 percent, respectively. At the same time deposits to the Reserve Bank vault increased by 33 percent. The Bank conducted surprise checks of these NTDs during the year and all were in order.

Counterfeit Notes

During the year, 3 counterfeit notes were reported to the Reserve Bank compared to the 53 cases in the previous year. These were all $50 pa'anga notes. These counterfeit notes were reported by the public and the banks, and were part of the counterfeit notes created by the two foreigners who were apprehended by the police in May 2008. The Reserve Bank sent these counterfeit notes to De La Rue Currency for testing and verification. The examination of these notes by De La Rue Currency confirmed that they were indeed counterfeit. The Reserve Bank has continued issuing public brochures on identifying counterfeit notes both in the English and Tongan language.

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. There were no new agreements signed during the year.

The total revenue collected from numismatic coins and notes was $0.06 million, a decrease of 116 percent from 2008/2009. The decrease in revenue was attributed mainly to lower demand for the new design notes and the implications of the global financial crisis.

Financial Performance

Gross income from operations for the year ended 30 June 2010 amounted to $5.269 million (2009, $6.832 million). The fall in the Reserve Bank's gross income in 2009/10 was mainly due to the decline in global interest rates to record low levels caused by the global economic crisis. Income on sales and purchases of foreign currencies also fell due to the lower value and volume of foreign exchange transactions. However, this was partially offset by the higher than budgeted level of foreign reserves throughout the year. Interest expense, currency, administration and other costs totaled $3.970 million (2009, $4.365 million), a decrease of 9 percent from the previous year. This was mainly due to lower operational costs for short-term technical assistance and maintenance costs. The savings from these votes were made possible by the Reserve Bank receiving external funding for short term expertise and technical assistance from the ADB and AusAid. Interest expense also fell due to lower interest paid on the bank's exchange settlement accounts in the first half of the year. The cost of issuing currency also fell as the issuing of the new design notes became more consistent throughout the financial year. The net operating profit for the year decreased by 47 percent to $1.299 million (2009: $2.467 million).

In accordance with section 8(1)(c) of the NRBT (Amendment) Act 2007, 25 percent ($324,787) of the Net Profit is to be transferred to the Bank's General Reserves, and the remainder ($974,359) is payable to Government.

The Board of Trustees of the National Reserve Bank of Tonga Staff Provident Fund continued to manage the staffs' provident fund scheme and their accounts.

Information Systems and Technology

The major achievements of the Information Systems and Technology (IST) Department during the year included the completion of a thorough IT General Control Audit Review which was conducted by PricewaterhouseCoopers (PWC) from Suva, Fiji in November, 2009. The result of this review prompted a work plan for the IT Team to commence implementing the IT audit recommendations during the year. In December 2009, the IT security policies of the Bank was formalized and approved by the Board. In June 2010, the Bank engaged PWC to provide the technical assistance required to formulate IT Policies such as IT Risk Framework, IT Strategic Plan and the configuration and training of the Central Domain Setup.

The Reserve Bank continued to improve its business continuity operations by establishing a verification and restoration test for all backup tapes at the offsite storage facility, the Tonga Defense Services office. The IT team continued its regular monthly testing of uninterrupted power supplies (UPS) connected to computer machines and random checking of antivirus updates. During the year, the Reserve Bank experienced difficulties with its internet connection which at times hindered its international communication by swift. The Reserve Bank subscribed to TCC Broadband as the backup ISP provider to the current Digicel Broadband Setup to ensure that the international connections were operational at all times.

In October 2009, the Intranet Website was launched online. This website was developed as a platform to improve communication and enhance staff awareness of official and social matters in the Bank. In addition, the IT procedures were revised and two new forms were designed to enhance the implementation of procedures and tighten internal controls. The IT Team also designed the Bank's 2009 Christmas card featuring the HM King George Tupou V Coin.

The IS Team continued with the design and documentation of the Financial Institutions and Markets Dtrans data management system and the Government Bond Data Management System. In addition, the IS Team continued to provide support to the information systems in the Bank such as Attache Payroll, Swift, Prophet Accounting System, the Security Door Access System, Dibos Recording

System and other departmental in house Database Management systems running on MS Access and MS Excel. The IT Team assisted with the installation and training on the Cobra note processing machine, and the installation and training on the Electronic Filing Server. The IT Team assisted the Reserve Bank's emergency team in ensuring the Bank was secure and prepared for shutdown during the tsunami and cyclone warnings, during the year.

General Administration

In recognition of the importance of its human resource base, the Reserve Bank implemented the separation of its human resource team from the Administration Department at the beginning of the year. The training function remained temporarily with the Administration Department. The Administration Department's major achievements during the year included the revision of the administration operation procedures to improve the accuracy and timeliness of the i) reconciliation process of monthly commitment data and fixed asset data against accounts records, ii) monthly, quarterly and end of year inventory stock take process, and iii) electronic filing and scanning processes.

The evacuation process during a natural disaster was coordinated and implemented by the Reserve Bank's Emergency Team to ensure smooth business continuity of the Bank's operations following the tsunami and cyclone warnings during the year.

Human Resources

The Human Resource (HR) Team continued to recruit staff to fill vacancies and at the end of the year, the Reserve Bank staff increased by 2 to 70 staff compared to 68 staff, in the previous year. The Bank recruited 11 staff during the year and processed 9 staff resignations. The staff resignations were mainly for personal reasons, migration and to pursue further studies overseas.

In December 2009, the Board approved the revised NRBT Staff Terms and Condition of Service, Rules and Orders, Personal Loan Scheme, Travel Policies and Study Leave Policies. The Board also approved the NRBT Disciplinary Policy which outlines activities that warrant disciplinary actions such as sexual and other harassment and excessive absenteeism including tardiness. This policy would assist management and staff to solve performance problems and help staff meet the high standards of personal and professional conduct which is expected of Reserve Bank Staff. Following the Board approval of the new policies, an awareness program to all staff of the Bank was conducted to ensure that all staff understood the changes reflected on the approved policies. The Human Resource procedures, master staff files and job descriptions were also revised according to the approved policies.

The HR Team continued to emphasize the importance of staff health by providing services to monitor staff weight and blood pressure on a monthly basis.

Training & Development

Throughout the year, the Reserve Bank continued to invest in the training of its Human Resource, through overseas training, local training and in-house training programs. One of the Bank Examiners attended the Bank of Papua New Guinea onsite visit to Westpac PNG in August, 2009, the Acting Manager Financial Institutions and Markets and another Bank Examiner attended the Association of Financial Supervisors of Pacific Countries (AFSPC) workshop held at Nadi, Fiji in October, 2009, and another Bank Examiner attended the AFSPC workshop for the Standardization of Prudential Returns held at Honiara, Solomon Islands in June, 2010. A Research Statistical Assistant attended the Remittances Statistics Seminar held at Singapore in October, 2009, the Senior Building Officer attended the Cobra 4004 Engineering Training held at Melbourne, Australia in February 2010 and the Acting Deputy Governor attended the IMF Central Bank Financial Safeguards Workshop held in Singapore in December, 2009.

One of the senior staff successfully completed her post graduate degree under the AusAID Funded Scholarship Program and resumed duties in August 2009. Local training for staff at the Reserve Bank included two Customer Service Training and Time Management Training by the S&K Performance Solutions (Tonga) and the Financial First Steps (FFS) training conducted by Westpac Bank of Tonga.

The Reserve Bank provided inter-departmental trainings on Swift Processor Errors for swift creators, awareness training with the Note Destructors to enhance understanding on destruction procedures, and the Security Guards sat a security written test on the Guard Standing Orders and Terms and Conditions. A fitness test for Security Guards was also conducted to monitor Security Guards' fitness status. 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 included Distance Flexible Learning courses to Pennfoster, USA in the areas of Electricity for 1 Building Staff as well as Economic, Accounting and Management courses with the University of the South Pacific (USP) for 3 Research Staff, 1 Financial Markets Staff, and 2 Currency Staff. The Bank also supported CISCO courses on CISCO Certified Network Associate (CCNA) for 3 IT Staff with Tupou Tertiary Institute, 1 Human Resource staff to undertake a course with the National Centre for Vocational Studies (NCVS). The Bank supported 2 Senior Staff to undertake AusAID funded Postgraduate courses online to Australia.

NRBT Staff in-house training

During the year, the Reserve Bank continued to receive advisory and technical services provided by the International Monetary Fund (IMF), World Bank, Asian Development Bank - Pacific Economic Management Assistance (ADB/PEM), AusAID, the Pacific Financial Technical Assistance Centre (PFTAC), Asia Pacific Group on Money Laundering (APG), Neurogen (NZ), PowerGen (NZ), Otis Ltd (NZ), Reserve Bank of Fiji, Reserve Bank of Australia and Reserve Bank of New Zealand and other Central Banks. These advisory and technical services were mainly in the areas of economic forecasting, monetary policy, exchange rate, bank supervision and capital adequacy. A local Consultant also provided technical assistance to study the requirements for the return of export proceeds to Tonga.

Attendance at Meetings

In July 2009, the Governor joined a study tour funded by the ADB to observe how microfinance works in Vanuatu. The Acting Deputy Governor and the Acting Manager Financial Institutions and Markets attended the APG annual meeting held in Brisbane, Australia. In September 2009, the Governor attended the Coombs Declaration Working Party meeting held in Wellington, NZ, and the Pacific responses to the Economic Crisis held at Honolulu, Hawaii. In October, 2009, the Governor and the Acting Manager of Research attended the World Bank/IMF Annual meeting held in Istanbul, Turkey. In November 2009, the Acting Manager Financial Institutions and Markets and a Bank Examiner attended the AFSPC annual meeting in Nadi, Fiji. In December 2009, the Governor and Manager Accounts & Currency attended the South Pacific Central Bank Governors' Annual Meeting held at Honiara, Solomon Islands. In February 2010, the Governor attended the Reserve Bank of Australia 50th Anniversary held in Sydney, Australia. In April 2010, the Governor and the Acting Manager Financial Institutions and Markets attended the South Pacific Governors special meeting in Auckland, New Zealand.

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. Major achievements during the year included the review of the Guards Standing Orders, the strengthening of the physical perimeters of the Bank premises by increasing the height of the fence in the front corners, the installation of PTZ cameras at the front and back areas for more image coverage of the building and enhanced checking of identity cards of visitors and vehicles entering the Bank premises. In addition, the security unit played a vital part in assisting the NRBT Evacuation Team to conduct the evacuation processes during the tsunami and cyclone warnings during the year.

Building, Plants and Equipment

The Building Team continued to ensure that appropriate and timely maintenance services were conducted to the Bank's property plant and equipment during the year. The major achievements were the preparation for two major projects, the Lift upgrade project and the Cardax Door Access project. In addition, the Building Team contributed to the renovation of the note counting room and the operation and maintenance of the note processing machine. The Building Team also supervised contracted maintenance works such as Chubb NZ, Otis NZ, Kiwi Tonga, ITL (Tonga), and assisted the NRBT Evacuation Team to conduct the evacuation processes during the tsunami and cyclone warnings during the year. Other major works included quarterly tenants meeting and fire drills, managing the cleaning services, and improving the building maintenance registers.

External Relations

During the year, the Reserve Bank continued to prepare reports for the Government on the level of the foreign reserves, liquidity, exchange rates and government bonds. Related information and press releases on these subjects were also posted to the Bank's website. 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.

The Reserve Bank continued to support projects to enhance financial literacy and awareness. As a member of the Coombs Declaration Working Group (now renamed as the Money Pacific Working Group), the Reserve Bank distributed 15,000 copies of the Money Pacific 2010 Calendar to schools and church groups. This calendar project aimed at improving financial awareness by providing basic financial tips to families on the calendar. It also aimed at promoting the reduction of the costs of remittances by encouraging families to use the MoneyPacific website to compare costs of remittances from New Zealand and Australia. This calendar project was supported by NZ Aid, AusAid, Reserve Bank of New Zealand, World Bank, New Zealand Ministry of Pacific Island Affairs, National Reserve Bank of Tonga and was piloted in Tonga and Samoa. The feedbacks on this project were very positive and its success has secured sponsorship for another production of calendars for 2011.

Board of Directors

The composition of the Board remained unchanged during the year. The Board of Directors met regularly to discuss and formulate the policies of the Reserve Bank and to monitor its operations.

Senior Officers during the year ended 30 June 2010

Governor	Siosi C. Mafi
Acting Deputy Governor	Jessie Cocker
Manager, Accounts & Currency	Lata Tangimana
Manager Information System & Technology and Administration	Elizabeth Baker
Acting Manager, Financial Institutions & Markets	‘Ungatea Latu
Acting Manager, Research Department	‘Anapuli Matoto
Assistant Manager, Financial Markets	‘Isapela Hufanga
Senior Accountant, Accounts & Currency	Ma’ata Mone ‘Aho
Guard Commander	Semisi Fifita

National Reserve Bank of Tonga

Financial Statements
Year Ended 30 June 2010

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NATIONAL RESERVE BANK OF TONGA

FINANCIAL STATEMENTS
30 JUNE 2010

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 2010, and the related Statements of Comprehensive Income, Distribution, Changes in Equity and Cash Flows for the year ended on that date and report as follows:

1. DIRECTORS

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

HRH Princess Salote Pilolevu Tuita
Mr Richard Prema
Mrs Siosi C Mafi
Mr ʻAisake Eke

2. PRINCIPAL ACTIVITIES

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

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

The principal functions of the Bank shall be, to -

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

3. TRADING RESULTS

The operating profit of the Bank for the year ended 30 June 2010 was $1,299,146 (2009: $2,467,062).

4. GENERAL 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 $324,787 (2009: $616,766) 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 $974,359 (2009: $1,850,296) is payable to the Government of the Kingdom of Tonga.

DIRECTORS' REPORT - Continued

6. BAD AND DOUBTFUL DEBTS

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

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

7. PROVISIONS

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

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 20 day of September, 2010.

Mrs Siosi C Mafi
CHAIRPERSON

Mr Richard Prema
DIRECTOR

NATIONAL RESERVE BANK OF TONGA

FINANCIAL STATEMENTS
30 JUNE 2010

STATEMENT BY DIRECTORS

In the opinion of the Directors:

(a) the accompanying balance sheet is drawn up so as to give a true and fair view of the state of affairs of the Bank as at 30 June 2010,

(b) the accompanying statement of comprehensive income is drawn up so as to give a true and fair view of the results of the Bank for the year ended 30 June 2010,

(c) the accompanying statement of distribution is drawn up so as to give a true and fair view of the distribution of operating profit of the Bank for the year ended 30 June 2010,

(d) the accompanying statement of changes in equity is drawn up so as to give a true and fair view of the movement in equity for the year ended 30 June 2010, and

(e) the accompanying statement of cash flows is drawn up so as to give a true and fair view of the cash flows of the Bank for the year ended 30 June 2010.

For and on behalf of the Board of Directors by authority of a resolution of the Directors this 20 day of September, 2010.

Mrs Siosi C Mafi
CHAIRPERSON

Mr Richard Prema
DIRECTOR

INDEPENDENT AUDIT REPORT

To the Shareholder of the National Reserve Bank of Tonga

Scope

We have audited the accompanying financial statements of the National Reserve Bank of Tonga which comprise the balance sheet as at 30 June 2010 and the statement of comprehensive income, statement of distribution, statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes as set out on pages 32 to 52.

Directors' and Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

This report is made solely to the Reserve Bank's shareholder. Our audit work has been undertaken so that we might state to the Bank and its shareholder those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank and the Bank's shareholder, for our audit work, for this report, or for the opinions we have formed. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

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

INDEPENDENT AUDIT REPORT (continued)

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

Opinion

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

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

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20 September 2010
Suva, Fiji

PricewaterhouseCoopers
Charted Accountants

NATIONAL RESERVE BANK OF TONGA

BALANCE SHEET
AS AT 30 JUNE 2010

	Notes	2010 $	2009 $
ASSETS			
Foreign Currency Assets			
Short Term Investments and Current Accounts	9	145,224,089	129,396,341
Accrued Interest		1,343,408	1,415,399
International Monetary Fund	10		
- Reserve Tranche Position		4,918,486	5,335,514
- Special Drawing Rights		20,327,609	1,520,468
Local Currency Assets			
Cash on Hand	19	115,083	127,900
Accrued Interest		12,034	9,466
Other Assets	11	3,786,430	4,464,707
International Monetary Fund - Currency Subscription	10	15,239,788	16,550,132
Property, Plant and Equipment	12	8,643,788	8,171,276
Total Assets		**199,610,715**	**166,991,203**
LIABILITIES			
Foreign Currency Liabilities			
Accrued Interest		7,900	-
Demand Deposits	13(a)	10,407,305	10,345,958
IMF Special Drawing Rights Allocation	10	18,910,422	-
Local Currency Liabilities			
Demand Deposits	13(b)	86,395,678	61,285,894
Payable to Government	14	974,359	1,850,296
Accrued Interest		118,993	29,110
Currency in Circulation	15	32,924,309	28,175,399
Statutory Reserve Deposits	16	14,793,000	29,470,000
International Monetary Fund - Currency Subscription	10	15,239,788	16,550,132
Other Liabilities	17	683,067	1,027,538
Employee Provisions	18	92,535	57,990
Total Liabilities		**180,547,356**	**148,792,317**
NET ASSETS		**19,063,359**	**18,198,886**
CAPITAL AND RESERVES			
Authorised Capital		5,000,000	5,000,000
Paid up Capital		5,000,000	5,000,000
General Reserves		9,692,927	9,368,140
Revaluation Reserve Account		4,370,432	3,830,746
TOTAL CAPITAL AND RESERVES		**$19,063,359**	**$18,198,886**

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

NATIONAL RESERVE BANK OF TONGA

STATEMENT OF COMPREHENSIVE INCOME YEAR ENDED 30 JUNE 2010

Income	**Notes**	**2010**	**2009**
		$	**$**
Interest Income	5	3,526,890	4,409,499
Other Income	6	1,742,987	2,423,244
Total Operating Income		**5,269,877**	**6,832,743**
Expenses			
Interest expense	7	294,059	424,443
Administration and other expenses	8	3,676,672	3,941,238
Total Operating Expenses		**3,970,731**	**4,365,681**
Net Profit for the year		**1,299,146**	**2,467,062**
Net gains arising from the translation of foreign currency balances to local currency		539,686	1,510,409
Other comprehensive income for the period		**539,686**	**1,510,409**
Total comprehensive income		**$1,838,832**	**$3,977,471**

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

NATIONAL RESERVE BANK OF TONGA

STATEMENT OF DISTRIBUTION
YEAR ENDED 30 JUNE 2010

	Notes	2010	2009
Operating profit		**$1,299,146**	**$2,467,062**
Distribution as follows:	2(m)		
Transfer to General Reserves as required under:			
• Section 8(1)(c) of the National Reserve Bank of Tonga (Amendment) Act, 2007		324,787	616,766
Balance Payable to Government of Tonga as required under Section 8(3) of the National Reserve of Tonga (Amendment) Act, 2007	14	974,359	1,850,296
		$1,299,146	**$2,467,062**

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

NATIONAL RESERVE BANK OF TONGA

STATEMENT OF CHANGES IN EQUITY
YEAR ENDED 30 JUNE 2010

	Paid up Capital $	General Reserves $	Revaluation Reserve Account $	Total $
Balance 30 June 2008	**5,000,000**	**8,751,374**	**2,320,337**	**16,071,711**
Other comprehensive income				
Net gains arising from the translation of foreign currency balances to Tongan currency	-	-	1,510,409	1,510,409
Transfer to General Reserves (as provided for under Section 8(1)(c) of the National Reserve Bank of Tonga (Amendment) Act 2007, and approved by the Minister of Finance	-	616,766	-	616,766
Balance 30 June 2009	**$5,000,000**	**$9,368,140**	**$3,830,746**	**$18,198,886**
Other comprehensive income				
Net gains arising during the year from translation of foreign currencies to Tongan currency	-	-	539,686	539,686
Transfer to General Reserves (as provided for under Section 8(1)(c) of the National Reserve Bank of Tonga (Amendment) Act 2007, and approved by the Minister of Finance	-	324,787	-	324,787
Balance 30 June 2010	**$5,000,000**	**$9,692,927**	**$4,370,432**	**$19,063,359**

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 2010

	Note	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		$	$
Rental income		838,864	497,748
Numismatic sales		55,385	127,893
Other income		827,620	1,899,594
Interest received		3,596,313	4,525,890
Purchase of currency		(16,421)	(72,919)
Other Interest paid		(196,276)	(726,742)
Administrative expenses		(2,853,515)	(4,204,557)
Net cash inflow from operating activities		**2,251,970**	**2,046,907**
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of fixed assets		(871,568)	(1,558,481)
Net movement in IMF accounts		(18,390,113)	(336,070)
Net movement in staff loans		(18,209)	(295,099)
Net movement in Government of Tonga bonds		-	9,677,000
Net cash (outflow) / inflow from investing activities		**(19,279,890)**	**7,487,350**
CASH FLOWS FROM FINANCING ACTIVITIES			
Net movement in currency in circulation		4,748,909	4,053,824
Net movement in demand deposits		43,510,496	32,013,143
Net movement in statutory deposits		(14,677,000)	(84,000)
Net movement in Government of Tonga accounts		(1,279,240)	(182,377)
Net cash inflow from financing activities		**32,303,165**	**35,800,590**
Net effect of change in exchange rates		**539,686**	**1,510,409**
NET INCREASE IN CASH		**15,814,931**	**46,845,256**
CASH AT BEGINNING OF FINANCIAL YEAR		**129,524,241**	**82,678,985**
CASH AT END OF FINANCIAL YEAR	**19**	**$145,339,172**	**$129,524,241**

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

1. GENERAL INFORMATION

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

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

The principal functions of the Bank shall be, to -

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

These financial statements have been approved for issue by the Board of Directors on 20 September 2010.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS

a) Basis of accounting

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

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

b) Foreign currencies

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

Exchange gains and losses arising during the year from changes in the valuation of foreign currencies are taken to the revaluation reserve account in accordance with the provisions of Section 33 of the National Reserve Bank of Tonga Act, 1988 and the NRBT (Amendment)

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

Act, 2007 and are not included in the computation of annual profits and losses of the Bank as required under International Accounting Standard 21, "The effects of changes in foreign exchange rates" (IAS 21). The impact of this on the statement of comprehensive income is $539,686 (2009: $1,510,409).

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.

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.

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.

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

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 - 2%
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 and staff make contributions to a staff provident scheme based on the years of service.

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

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.

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

k) Staff Loans

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

A provision for impairment is based on an appraisal carried out at the end of the financial year. 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.

m) General Reserve and Distribution of Profits

- Section 8(1) of the National Reserve Bank of Tonga (Amendment) 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 authorised capital of the Bank, 50 percent until the General Reserve is equal to the authorised capital of the Bank; and
  c) where the General Reserve exceeds 100 percent but does not exceed 200 percent of the authorised capital of the Bank, 25 percent or such lesser sum to increase the General Reserve to twice the authorised capital of the Bank; Provided that upon agreement between the Minister and the Bank, the General Reserve may be increased.

- Section 8(2) states that subject to Section 8(1), the remainder of the net profits for the financial year shall be applied to the redemption of any securities issued under Section 6 held by the Bank.

- Section 8(3) states that the 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.

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.

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

o) Segment Reporting

The Bank presents 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.

p) Leases

Where the Bank is the lessee, the lease rentals payable on operating leases are recognised in the statement of comprehensive income over the term of the lease.

Where the 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.

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 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 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 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.

(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.

3. FINANCIAL RISK MANAGEMENT - Continued

(c) Credit Risk Management - continued

Credit risk or safety is a key criterion in the determination of the composition of the Bank's foreign currency assets.

To manage this credit risk, the Bank prescribes minimum credit ratings acceptable for investment and specifies the maximum permissible credit exposure to individual banks and countries. In addition, the number of commercial banks, with whom the Bank may deal with in foreign exchange must have minimum credit ratings of **A.**

The NRBT uses Standard and Poors credit ratings for 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.

	2010 $	2009 $
Financial Institutions – Foreign	145,224,089	129,396,341
Total financial investments	**$145,224,089**	**$129,396,341**

(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 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.

The note 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.

NATIONAL RESERVE BANK OF TONGA

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS YEAR ENDED 30 JUNE 2010

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 2010

	0-3 months	3-12 months	1- 5 years	Over 5 Years	No Specific maturity	Total
Assets						
Foreign Currency Assets						
Short Term Commercial Paper						
and C/Accounts	62,963,144	70,703,724	11,557,221	-	-	145,224,089
Accrued Interest	1,343,408	-	-	-	-	1,343,408
International Monetary Fund						
- Reserve Tranche Position	-	-	-	-	4,918,486	4,918,486
- Special Drawing Rights	-	-	-	-	20,327,609	20,327,609
Local Currency Assets						
Cash on hand	115,083	-	-	-	-	115,083
Accrued Interest	12,034		-	-	-	12,034
Domestic Securities	-	-	-	-	-	-
Other Assets	716,966	-	-	-	3,069,464	3,786,430
International Monetary Fund						
- Currency Subscription	-	-	-	-	15,239,788	15,239,788
Property, Plant and Equipment	-	-	-	-	8,643,788	8,643,788
Total Assets	**65,150,635**	**70,703,724**	**11,557,221**	**-**	**52,199,135**	**199,610,715**
Liabilities						
Foreign Currency Liabilities						
Demand Deposits	10,407,305	-	-	-	-	10,407,305
IMF SDR Allocation	-	-	-	-	18,910,422	18,910,422
Accrued Interest	7,900	-	-	-	-	7,900
Local Currency Liabilities						
Demand Deposits	86,395,678	-	-	-	-	86,395,678
Payable to Government	974,359	-	-	-	-	974,359
Accrued Interest	118,993	-	-	-	-	118,993
Currency in Circulation	-	-	-	-	32,924,309	32,924,309
Statutory Reserve Deposits	-	-	-	-	14,793,000	14,793,000
International Monetary Fund						
- Currency Subscription	-	-	-	-	15,239,788	15,239,788
Other Liabilities	266,886	-	-	-	416,181	683,067
Employee Provisions	74,973	-	17,562	-	-	92,535
Total Liabilities	**98,246,094**	**-**	**17,562**	**-**	**82,283,700**	**180,547,356**
Liquidity Gap	**(33,095,459)**	**70,703,724**	**11,539,659**	**-**	**(30,084,565)**	**19,063,359**

NATIONAL RESERVE BANK OF TONGA

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS YEAR ENDED 30 JUNE 2010

4. MATURITY ANALYSIS - Continued

MATURITY ANALYSIS- 30 June 2009

	0-3 months	3-12 months	1- 5 years	Over 5 Years	No Specific maturity	Total
Assets						
Foreign Currency Assets						
Short Term Commercial Paper and C/Accounts	19,158,519	110,237,822	-	-	-	129,396,341
Accrued Interest	1,415,399	-	-	-	-	1,415,399
International Monetary Fund						
- Reserve Tranche Position	-	-	-	-	5,335,514	5,335,514
- Special Drawing Rights	-	-	-	-	1,520,468	1,520,468
Local Currency Assets						
Cash on hand	127,900	-	-	-	-	127,900
Accrued Interest	9,466		-	-	-	9,466
Domestic Securities	-	-	-	-	-	-
Other Assets	-	96,034	-	-	4,368,673	4,464,707
International Monetary Fund						
- Currency Subscription	-	-	-	-	16,550,132	16,550,132
Property, Plant and Equipment	-	-	-	-	8,171,276	8,171,276
Total Assets	**20,711,284**	**110,333,856**	**-**	**-**	**35,946,063**	**166,991,203**
Liabilities						
Foreign Currency Liabilities						
Demand Deposits	10,345,958	-	-	-	-	10,345,958
Accrued Interest	-	-	-	-	-	-
Local Currency Liabilities						
Demand Deposits	61,285,894	-	-	-	-	61,285,894
Payable to Government	1,850,296	-	-	-	-	1,850,296
Accrued Interest	29,110	-	-	-	-	29,110
Currency in Circulation	-	-	-	-	28,175,399	28,175,399
Statutory Reserve Deposits	-	-	-	-	29,470,000	29,470,000
International Monetary Fund						
- Currency Subscription	-	-	-	-	16,550,132	16,550,132
Other Liabilities	408,595	-	-	-	618,943	1,027,538
Employee Provisions	57,990	-	-	-	-	57,990
Total Liabilities	**73,977,843**	**-**	**-**	**-**	**74,814,474**	**148,792,317**
Liquidity Gap	**(53,266,559)**	**110,333,856**	**-**	**-**	**(38,868,411)**	**18,198,886**

NATIONAL RESERVE BANK OF TONGA

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS YEAR ENDED 30 JUNE 2010

5. INTEREST INCOME

	2010 $	2009 $
Overseas investments	3,502,717	4,237,986
Domestic investments	-	159,315
Staff Loans	24,173	12,198
	$3,526,890	**$4,409,499**

6. OTHER INCOME

	2010 $	2009 $
Numismatic Coins	55,385	127,893
Rental Income	859,984	430,706
Gain on sale of Assets	12,580	3,755
Forex sales/ purchases	774,087	1,832,466
Bank user fees	26,807	16,558
Information services – publications	45	200
Miscellaneous	14,099	11,666
	$1,742,987	**$2,423,244**

7. INTEREST EXPENSE

	2010 $	2009 $
Foreign Currency Accounts	54,337	11,623
Domestic Currency Accounts	239,722	412,820
	$294,059	**$424,443**

8. ADMINISTRATION AND OTHER EXPENSES

	2010 $	2009 $
Administration	1,086,945	1,309,048
Retirement Fund	162,724	195,067
Staff Costs	1,284,487	1,096,755
Audit Fees	25,000	21,500
Currency Issue (refer note 11)	718,460	882,263
Depreciation	399,056	436,605
	$3,676,672	**$3,941,238**

NATIONAL RESERVE BANK OF TONGA

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS YEAR ENDED 30 JUNE 2010

9. SHORT TERM INVESTMENTS AND CURRENT ACCOUNTS

	2010 $	2009 $
Current Account	16,792,884	19,158,519
Short term Investments	128,431,205	110,237,822
	$145,224,089	**$129,396,341**

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 2010, Tonga's membership subscription to the International Monetary Fund was SDR 6,900,000 (2009: SDR 6,900,000). Of the total amount SDR 1,711,633 (2009: SDR 1,711,633) 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.

(iii) A general allocation of Special Drawing Rights (SDRs) became effective on August 28, 2009. The allocation is designed to provide liquidity to the global economic system by supplementing the Fund's member countries' foreign exchange reserves. The general SDR allocation was made to IMF members who are participants in the Special Drawing Rights Department in proportion to their existing quotas in the Fund, which are based broadly on their relative size in the global economy. Tonga being a member was allocated an amount of SDR 5,115,038 (TOP$14,698,385).

A Special Drawing Rights (SDRs) allocation was also made to those member countries which joined the Fund after the General Allocation in 1981. Tonga, being one of these countries was allocated an amount of SDR 1,465,789 (TOP$4,212,037) on 7 September 2009.

The total allocation of SDR 6.6 million (TOP$18.9 million) increased the Bank's assets through SDR department and also creates an increase in liability of the same.

NATIONAL RESERVE BANK OF TONGA

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS YEAR ENDED 30 JUNE 2010

11. OTHER ASSETS

	2010 $	2009 $
Staff loans and advances	469,770	451,561
Currency and numismatics	3,069,464	3,771,503
Other assets	247,196	241,643
	$3,786,430	**$4,464,707**

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

12. PROPERTY, PLANT & EQUIPMENT

(a) Property, Plant & Equipment include:

	2010 $	2009 $
Leasehold land & buildings and improvements – at cost	11,702,118	11,657,801
Less: accumulated depreciation	4,165,572	3,930,386
	7,536,546	7,727,415
Other fixed assets – at cost	2,516,056	1,881,045
Less: accumulated depreciation	1,533,268	1,437,184
	982,788	443,861
Work in progress	124,454	-
Total – at cost	14,342,628	13,538,846
Less: accumulated depreciation	5,698,840	5,367,570
	$8,643,788	**$8,171,276**

(b) Reconciliation of Property, Plant & Equipment

FIXED ASSETS	**Land, Building & Improvement $**	**Other Fixed Assets $**	**Work in Progress $**	**Total $**
At 30th June 2010				
Opening net book amount	**7,727,415**	**443,861**	**-**	**8,171,276**
Additions	44,317	702,797	124,454	871,568
Depreciation	(235,186)	(163,870)	-	(399,056)
Closing net book amount	**7,536,546**	**982,788**	**124,454**	**8,643,788**

13. (a) FOREIGN CURRENCY DEMAND DEPOSITS

	2010 $	2009 $
Government of Tonga	10,353,467	10,244,780
Other institutions	53,838	101,178
	$10,407,305	**$10,345,958**

(b) LOCAL CURRENCY DEMAND DEPOSITS

	2010 $	2009 $
International Banks	24,292	26,184
Domestic Banks	60,465,748	35,788,787
Government of Tonga	25,905,638	25,470,923
	$86,395,678	**$61,285,894**

14. PAYABLE TO GOVERNMENT

	2010 $	2009 $
Amount payable to government in accordance with Section 8(3) of the National Reserve Bank of Tonga (Amendment) Act 2007	**$974,359**	**$1,850,296**

15. CURRENCY IN CIRCULATION

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

	2010 $	2009 $
Notes	31,159,667	26,429,375
Coins	1,764,642	1,746,024
	$32,924,309	**$28,175,399**

16. STATUTORY RESERVE DEPOSITS

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

17. OTHER LIABILITIES

	2010 $	2009 $
Other creditors and accruals	491,667	609,394
Payable to the National Reserve Bank of Tonga Staff Provident Scheme - refer note below	191,400	418,144
	$683,067	**$1,027,538**

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

18. EMPLOYEE PROVISIONS

	2010 $	2009 $
Opening Balance	57,990	50,022
Entitlements during the year	101,370	54,507
Utilised/reversals	(66,825)	(46,539)
	$92,535	**$57,990**

19. CASH AND CASH EQUIVALENTS

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

	2010 $	2009 $
Cash on hand	115,083	127,900
Short term investments and current accounts	145,224,089	129,396,341
	$145,339,172	**$129,524,241**

20. 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 2010 were Siosi C Mafi (Chairperson and Governor), HRH Princess Salote Pilolevu Tuita, Richard Prema and 'Aisake Eke.

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

The Bank contributes to the National Reserve Bank of Tonga Staff Provident Fund in accordance with the Provident Scheme Rules.

Transactions with related parties

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

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

The funds of the Provident Scheme are invested within the Bank at an average rate of 4.43% per annum. The total interest paid by the Bank for the financial year amounted to $4,853. The Trustees of the Provident Scheme are indemnified by the Bank against all losses, damages or other costs which may be sustained or suffered by or made against a trustee as a result of any act or omission committed by the Trustee or Trustees which is not a breach of trust on the part of the Trustee.

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

	2010 $	2009 $
Rental and utilities income – Tonga SAT	68,733	65,757
Rent receivable from Tonga SAT	137,372	45,649
Purchase of goods	2,153	1,969

The Directors are paid fees and sitting allowances for services rendered. The Directors are also entitled to a retirement fund which at year end amounted to $170,520. The Bank also provides non-cash benefits to the Executive Directors and executive officers in addition to their salaries.

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

	2010 $	2009 $
Executive officers	349,143	381,010
Director's fees and remuneration	42,880	42,880
	$392,023	**$423,890**

21. COMMITMENTS

(a) Operating lease commitments

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

Details of the major operating leases are as follows:

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

(ii) On 6 April 1990 the bank entered into an agreement with His Majesty the King of Tonga to rent the property in Kolofo'ou for 100 years ending 5 April 2089. Under the agreement, rent is payable at $2,000 per year.

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

	2010 $	2009 $
Due not later than one year	5,000	5,000
Due later than one year but not later than five years	20,000	20,000
Due later than five years	381,000	386,000
	$406,000	$411,000

(b) Capital and other commitments

	2010 $	2009 $
Commitment for capital expenditure not provided for in the financial statements are as follows:		
Approved and contracted	$424,046	-

22. CONTINGENT LIABILITIES

Contingencies not otherwise provided for in the accounts and which existed at 30 June 2010 comprise:

(i) Contracts for foreign exchange transactions was nil (2009: $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.

23. 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:

Statutory Reserve Deposits

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

Demand Deposits

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

Currency in Circulation

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

Other Financial Assets and Liabilities

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

24. EVENTS SUBSEQUENT TO BALANCE DATE

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

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

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