TONGA DEVELOPMENT BANK

your partner in development...

ANNUAL REPORT 2008

"Serving Tonga for 31 years"








CONTENTS

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SHAREHOLDER

Government of Tonga

Background and corporate objectives

Tonga Development Bank was established on 1st September 1977 under the Tonga Development Bank Act. Once established the Bank took over the following Credit Schemes previously administered by the Government of Tonga. Agricultural Credit Scheme, Fisheries Loan Scheme and Industrial Fund following the enactment of the Tonga Development Bank Act in the same year.

The Bank was initially a joint venture between the Government of Tonga holding 95 percent of the Authorized shares and Bank of Tonga who held the balance. In 1998, the Government of Tonga acquired the full 100 percent holding.

The Bank's main function is to promote Tonga's economic and social advancement by providing financial and advisory assistance to the people and enterprises operating or about to operate in Tonga.

In addition to development loan activities, the Bank also extends its service into Investment facilities, Savings Bank and accommodating Personal and Housing Loans.

A Board of 5 Directors oversees the policy management of the Bank. This includes a Managing Director appointed by the Government who is responsible for recommending and implementing strategies and policies and overseeing day to day management of the business.

VISION STATEMENT

To be recognized as Tonga's best provider of development finance which employs prudent banking principles, meets customer needs, demonstrates integrity and operates profitably.

MISSION STATEMENT

Committed to promoting Tonga's economic and social advancement by providing high quality and responsive development banking services while operating professionally as a profitable and financially sound development financing institution.

Hon. Minister for Public Enterprises & Information
Ministry of Public Enterprises & Information
NUKU'ALOFA

Dear Sir

I have the pleasure to present, on behalf of the Board of Directors, the Annual Report and Statement of Accounts of the Tonga Development Bank for the financial year ended 31 December 2008, as required under the Tonga Development Bank Act, 1977 Section 10 (4).

Yours faithfully

……………………...
Hon. Paul Karalus
ACTING CHAIRMAN OF THE BOARD

Board of Directors as at 31 December 2008

MR. 'AISAKE VALU EKE (Alternate : Mr Paulo Kautoke)

'Aisake Eke is the Secretary for Finance. Mr Eke has been the Chairman of the Bank Board since October 2004.

MR. LENNIE NIIT (Alternate : Mr Viliami Fakava)

Retired Commercial Fisherman and now business man. Mr Niit has been a director of the Bank since September 2006.

MR. SEBASTIAN MAFI (Alternate : Mr Mana Latu)

Business man and has been a director of the Bank since December 1999.

HON. PAUL KARALUS (Alternate : Mr Minoru Nishi)

Commercial Farmer and business man who has been a director of the Bank since January 2003. Hon Karalus, Minister for Transport, was appointed as Deputy Chairman of the Bank Board of Directors in September 2006.

MR. SIMIONE SEFANAIA

Managing Director of the Bank since October 2006.

ACTING CHAIRMAN'S REPORT 2008

I am pleased to report that for the year ended 31 December, 2008 the Tonga Development Bank delivered positive results for shareholder inspite of the very difficult economic conditions experienced during the year.

The Bank reported a Net Profit after tax of T$0.95 million compared to T$1.2 million in 2007. The major causes of the decrease are low approvals, high deposit rates and significant increase in impairment provisioning and reduction in interest rate for a major loan account.

Tight system liquidity was again a feature of the Tongan economy especially during the first half of the year and remains a key area of focus for the Bank's Management.

The Bank's profitability was affected by :

- substantial increase in the deposit rates as commercial banks competed for liquidity to cover financial requirements as they become due. TDB did not compete above 11% and this resulted in the Bank losing at least T$3 million of deposits during the first half of 2008. This situation eased considerably later in 2008.

- lower actual approvals as compared to budget. This is due to the prevailing economic conditions resulting in the lack of realistic projects to be funded. There were many inquiries for loans to be refinanced from commercial banks. However loans outside policy and already struggling were resisted.

- level of provisioning for 2008 was higher than anticipated. This was due mainly to deterioration of security assets as well as financial positions regarding old squash debts and guaranteed loans without supporting assets

- decision to reduce interest rate in one major loan account which resulted in the Bank forgoing a significant amount of interest revenue in 2008.

Throughout this period Management continued to maintain a strong and open relationship with the Reserve Bank of Tonga and the Government. As a Bank we recognized the lack of bankable propositions and therefore restricted lending to potentially viable projects that met the bank's policy guidelines.

The Board acknowledges the Reserve Bank of Tonga on its management of the liquidity situation, ensuring stability in the financial system during this period and the consultative approach taken in working with the Association of the Banks in Tonga.

The introduction of the International Financial Reporting Standards (IFRS) has resulted in a restatement of the income and expenditure data. No general provision allowed, only specific provisions and establishment fees are amortized over the term of the loan.

The Bank has restructured its operation to address developmental needs in the rural areas as well as business sectors. In this regard the Bank has restructured its lending to includes a Business Development Unit as well as Micro Lending Unit.

Our commitment to good governance and compliance practices continued with investment made throughout the year to enhance our risk and compliance controls ensuring we comply with the requirements of the NRBT as well the International Financial Reporting Standard (IFRS). We have also made necessary adjustments to comply with the new Income Tax Act which became effective from 1st July 2008.

We continued to be involved in a diverse range of activities within the community and including sponsorship of many organizations' events that helps promoting health, education, sports and community development.

In the face of the World Economic situation, the economic and market conditions for us in 2009 remain challenging and are expected to improve. The Ministry of Agriculture, Fisheries and Food (MAFF) has indicated that funds will be available for the establishment of a blast freezer, fumigation chamber and renovation of the High Temperature Force Air Treatment Plant (HTFATP) at the airport. These should create export opportunities with new lending potential. These developments can increase income earning opportunities as well as distribution of income in the rural areas.

There is still a need to increase lending to the agricultural sector as a basis for improving economic development. However this will depend on construction of appropriate infrastructure, overcoming of certain regulatory requirements, and further development of existing export industries such as kava, root crops, buttercup squash as well as butternut squash.

The Board and Management are confident about the Bank's prospects for the future and are committed to the realization of our business plans and strategies. We will continue to actively manage our balance sheet and maintain a high quality asset portfolio whilst improving the service and efficiency of our operations.

I acknowledge the effort and commitment of the TDB Management team and staff in achieving the results for 2008. I would also like to thank the Board of Directors for their valuable contributions in the provision of strategic direction towards achieving the Bank's goals and objectives for the year 2008.

I thank the shareholder for the continuing interest and support. I would also like to thank our customers for their continuing support and trust in the Bank and the services it provides.

……………………...

Hon. Paul Karalus

ACTING CHAIRMAN OF THE BOARD

MANAGING DIRECTOR'S REVIEW

Against the background of the very difficult economic conditions experienced by the Tongan economy during 2008, Tonga Development Bank delivered another positive result for its shareholder.

The challenging economic developments in 2008 affected the Bank's rate of growth and performance and resulted in the performance in some areas being below expectations. There has also been some unexpected increase to operating expense that detracted from the year's underlying profitability. Impairment provisioning increased significantly due to the requirements of IFRS relative to shortfall in security assets that affected our profitability. However the overall financial result for 2008 was satisfactory and this was made possible through the continued commitment and spirit of the Bank's Management and staff who remained dedicated to our goals despite numerous challenges faced.

We have remained focused on our role and this strategy enabled the Bank to consolidate its effort towards delivering financial solutions to our customers.

	IFRS Adoption	**Restated**		
Key performance Indicators	2008	2007	2006	2005
	%	%	%	%
Net Interest Income to average total assets	5.6	6.2	6.9	6.0
Non Interest income to average total assets	4.5	4.1	4.9	5.0
Operating Costs to income	64.7	74.3	68.4	53.9
Return on equity	3.8	5.0	7.1	10.4
Return on Average Earning Assets	1.7	2.3	3.0	4.0

Overview of Financial Performance

(All figures are in Tongan Pa'anga)

The after tax profit was $951,093 for the twelve months ending 31 December 2008 compared to $1,216,157 for the year to 31 December 2007. The Major contributing factors to this result were:

- Net interest income decreased by 8.1% percent to $3,557,425. This was the result of decrease in Interest Income by 3.2% and increase in Interest expense by 4.8%. Decrease in Net Interest Income was largely due to substantial increase in the deposit rates, reduction in interest rate in one major loan account and no interest earned for some of the problem accounts.
- Non interest income increased by 15.7 percent to $2,809,219. The increase was largely due to deferring Establishment Fees from 2007 due to first time adoption of IFRS
- Operating expenses (excluding bad debts) increased by 4.1% percent to $4,116,161. This was mainly due to increased utility and operating costs during the year.
- Increase in provisioning for impaired loan.

Loan Portfolio

The total loan portfolio recorded decline of 1.3% to $48.0 million at year-end 2008. This reflects the prevailing economic conditions resulting in a lack of viable projects to be funded.

Provision

Provisions for loan losses were above expectations because of accounts with shortfall on security assets, non reliance on unsupported director guarantees as required under IFRS, poor performance of old squash loans and deterioration of some security assets.

	IFRS Adoption	Restated
	2008	2007
	$	$
Specific Provision	2,605,913	2,444 ,799
Productive Provision	2,807,846	2,366,491
Total Provision	**$5,413,759**	**$4,811,290**

There was a more stringent approach given for loan provisioning in 2008 because of IFRS disclosure requirements.

General loan recoveries and some write backs from provisions also contributed to the level of profitability for 2008.

Approvals

The level of approvals decreased by 8.6% to $15.9 million in 2008 compared to 20% increase to $17.4 million in 2007.

Approval Position by Sector	2008	2007
Housing and Personal Loan	41%	37%
Industries and Business	32%	35%
Agriculture and Fisheries	22%	23%
Staff Loan	4%	3%
Squash Loan	1%	2%
TOTAL	100%	100%

The low lending to squash in 2008 continued to reflect the challenges faced by the Industry. Two big business loans contributed well to the approval level last year.

Root crops has continued to be the major contribution to total agricultural lending during the year which continued to reflects lack of alternative crops and the continuing reliance on semi-subsistence agriculture.

Outer Island Development

Lending at Outer Islands amounted to $3.7 million contributing 22 percent in amount and 45 percent of accounts to the total loan approvals for the year. This was a 11% reduction from 2007.

Agricultural sector (e.g. cropping and agriculture processing of kava) and for Women's Development handicraft projects continued to dominate lending in the Outer Islands.

Women in Development

In 2008, 303 loans were approved totaling $784K. These included lending to women groups, individuals that have projects for producing Tongan handicrafts (final products) and cultivation of source plants such as mulberry and pandanus and community development projects such as funding kitchen and catering projects etc.

Arrears

The arrears ratio was recorded at 7.04% at year end 2008 as compared to a target of 5.0%. This was mainly due to non repayment of two major squash loan accounts.

Internal training on arrears management practices and appropriate assessment of new proposals is ongoing and continuous effort is applied to improve both arrears and enhance loan portfolio management.

At the end of the year 2008 we achieved a ratio of 91% to 9% "Good Bank/Bad Bank" as compared to a target of 90% : 10%.

Credit Risk Management

Credit Risk Management is an ongoing process aimed at maintaining and improving the quality of the Loan Portfolio.

The centralized credit approval process has continued and this contributed significantly to maintaining quality and consistency in our loan portfolio.

Insurance

Sufficient insurance coverage of all security assets with the Bank's interest is maintained. Life insurance cover is often required and assigned to the Bank for borrowers with exposures over $40,000.00.

The Loan Protection Insurance Scheme (LPCI) with the Federal Pacific Insurance Ltd in 2008, provides cover for all lending to individuals' loans up to $35,000.00 and below the age of 70. Several loans have been repaid through this source.

In the even of death of a borrower, the LPCI covers the balance of the debt.

Funding

Loan repayments has continued to be the Bank's main funding source. Promissory Note issues have also supported funding at competitive interest rates. The System liquidity was tight during the first and second quarter of 2008 and this had an adverse impact of the cost of funds. However we resisted unacceptable risk lending during this time.

Savings Bank has continued to provide a source of funding in 2008.

One project was funded from the credit line from the EIB in 2008. Disbursement of this credit line has been extended to August 2009. Disbursement is very slow due to unavailability of eligible projects.

Staff

The number of our full time staff was reduced during the year by 4 to 110. Staff who resigned or retired were not automatically replaced.

Staff Training

Staff training and development in 2008 focused on improving skills of our junior staff. Two staff attended overseas training during the year.

Staff Retirement Fund

The Bank continued to maintain its Retirement Fund Scheme which has operated since 1st January 1990. The last actuarial review was in 2008 and based on the audit accounts as at 31st December 2007. The outcome of the review was satisfactory with the Bank's contribution reducing from 11.5% to 6.5%.

The Fund's total assets as at 31st December 2008 was recorded at $4.1 million.

Customer Service

The Bank continued seeking to improve its Customer Service Standards which were introduced in 2005 and a Customer Care program was commissioned in 2006 to support our on going commitment to quality customer service.

Staff Quarterly Awards were reviewed in 2008 to improve their effectiveness and improve on performance of Customer Service.

Customer complaints process provided customer feedback on specific matters which required immediate attention. These also provided opportunities to improve our levels of customer service.

Premises

All Bank's properties have continued to be maintained and upgraded during the year with expected useful lives of 35 years for office buildings and 25 years for residential buildings.

Future Direction

The Bank will continue to build on the achievements in 2008.

We are very conscious of the IFRS requirements especially provisioning and will work towards effectively addressing this issue.

Agriculture and Business will continue to be our main focus. We will enhance further development of lending in these areas. We envisage increase lending in agriculture due to proposed infrastructure development by MAFFF.

We will continue seeking to maintain and improve our customer service level and add value to the business and personal aspirations of our valued customers.

We will continue in 2009 to focus on staff training to ensure the right skills and tools are established for our staff to deliver on our service to our customers.

Acknowledgement

The Bank's staff continues to be a highly committed team and are proud of the Bank's heritage and dedicated to it's customer needs and strategy. It is indeed a privilege leading the Tonga Development Bank team in 2008.

I acknowledge the ongoing support received by the Bank from the Ministry of Finance, Ministry of Public Enterprises & Information and other related Government Ministries during the year 2008. The Government, as shareholder, has given invaluable support to the Bank in fulfilling its objectives in 2008.

The level of profitability for 2008 has been attained through hard work and dedication of the Bank's management team and all its staff is also acknowledged.

Ongoing support and loyalty of all our customers and their trust given to the Bank during 2008 is also acknowledged. The Bank can assure you all that we do care about your business and goals. Maintaining a good repayment of loans has helped us in achieving our mission as best provider of Development Banking services in Tonga.

Our challenge now is to leverage off the current platform of strong performance, product range, position in the market and to ensure the momentum translates into superior customer service and ongoing growth.

I would also like to extend my gratitude and sincere thanks to the Acting Chairman and the members of the Board of Directors for their continued support and providing strategic direction during the year.

Finally I wish to acknowledge the significant five years contribution of "out going" Chairman of the Board, 'Aisake Eke to the Bank. His remarkable strategic guidance has helped the Bank to achieve a sound position that it now enjoys. He will be remembered as a Chairman of extraordinary accomplishments and a compassionate leader.

Malo 'aupito

…………………...
Simione Sefanaia
Managing Director

FIVE YEAR SUMMARY

Profit & Loss TOP $000'S	2004	2005	2006	2007 Restated	2008 IFRS Adoption	Movement 2007/2008
Interest Income	5,535	5,516	5,991	6,282	6,082	-3.2%
Interest Expense	2,048	2,119	2,045	2,409	2,524	+4.8%
Net Interest Income	3,487	3,397	3,946	3,873	3,557	-8.2%
Fees & commission income	2,158	2,377	2,175	2,265	2,604	+15.0%
Other Operating Income	212	190	192	164	205	+25%
Losses on loans & advances	327	(31)	901	816	1,009	+23.7%
Bad Debts	32	22	30	52	45	-13.5%
Income Tax Expense	822	642	304	406	333	-18.0%
Operating Profit after tax	2,216	2,105	1,690	1,216	951	-21.8%
Earnings per share	2.10	2.00	1.61	1.15	0.90	-21.8%

Balance Sheet TOP $000'S	2004	2005	2006	2007 Restated	2008 IFRS Adoption	Movement 2007/08 2005/ 06
Average assets	54,705	56,826	57,492	62,481	63,987	+2.4%
Total Assets	58,688	54,963	60,022	64,933	63,037	-2.9%
Gross Loans	38,646	41,252	43,472	48,633	47,984	-1.3%
Saving Deposits	2,583	3,251	4,647	4,757	4,403	-7.4%
Shareholder's equity	18,230	19,989	23,978	24,587	25,063	+1.9%

Performance Ratios	2004	2005	2006	2007 Restated	2008 IFRS Adoption	Movement 2007/ 08
Return on Assets	4.1%	3.7%	2.9%	1.9%	1.5%	-0.4%
Return on Equity	12.2%	10.5%	7.1%	5.0%	3.8%	-1.2%
Operating Costs to Total Income	48.1%	53.9%	68.4%	73.0%	74.7%	+1.7%
Operating Income to Average Portfolio	18.6%	20.2%	19.7%	25.2%	24.5%	-0.7%

In accordance with a resolution of the Board of Directors, the directors herewith submit the Balance Sheet at 31 December 2008, Income Statement, Statement of Changes in Equity and Cash Flow Statement for the year ended on that date and report as follows:

1. DIRECTORS

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

- 'Aisake Valu Eke (Chairman - resigned 1 January 2009)
- Hon. Paul Karalus (Acting Chairman)
- Lennie Niit
- Sepa Mafi
- Simione Sefanaia(Managing Director)
- Paulo Kautoke (Alternate)
- Mana Latu (Alternate)
- Minoru Nishi (Alternate, upto 15 December 2008)
- Dr. Viliami Fakava (Alternate, upto 13 February2008)

2. PRINCIPAL ACTIVITY

The principal activity of the Bank is the provision of development banking services in the Kingdom of Tonga.

During the year ended 31 December 2008 there has been no material change in the nature of the Bank's business or in the classes of business in which the Bank has an interest.

3. TRADING RESULTS

The net profit after income tax for the year ended 31 December 2008 was $951,093 (2007: $1,216,157).

4. PROVISIONS

There were no material movements in provisions, other than provisions for losses on loans and advances, depreciation and employee entitlements.

5. DIVIDENDS

The directors declared dividends based on 40% of net profit after tax for the year ended 31 December 2007. This amounted to $606,984 or $0.58 per issued share and was paid out in June 2008. The directors also recommended that dividend based on 50% of net profit after tax be declared for the year ended 31 December 2008. This amounted to $475,547 or $0.45 per issued share.

6. RESERVES

Directors have recommended to transfer asset revaluation reserve of $4,433,460 and general reserve of $9,924,686 to retained earnings in respect of the year ended 31 December 2008.

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

8. BAD AND DOUBTFUL DEBTS

The directors took reasonable steps before the Bank's income statement and balance sheet 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.

9. EVENTS SUBSEQUENT TO BALANCE DATE

Since the end of the 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.

10. UNUSUAL TRANSACTIONS

The results of the Bank's operations for the year ended 31 December 2008 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.

11. 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.

12. RELATED PARTY TRANSACTIONS

All related party transactions have been adequately recorded in the financial statements. The transactions with Related parties are on normal commercial terms and conditions.

13. DIRECTORS' BENEFITS

No director has, since the end of the year, received or become entitled to receive a benefit (other than loans and advances given in the normal course of operation or benefit included in the total amount of emoluments received or due and receivable by directors as shown in the Bank's financial statements) by reason of contract made by the Bank or related entity with the director or with a firm of which he is a member or with a company in which he has substantial financial interest.

Signed in accordance with a resolution of the directors the 11th day of March, 2009.

…………………………..
Simione Sefanaia
Managing Director

……………………………
Hon. Paul Karalus
Acting Chairman of the Board

In the opinion of the Directors:

(a) the accompanying income statement is drawn up so as to give a true and fair view of the results of the Bank for the year ended 31 December 2008;

(b) the accompanying balance sheet is drawn up so as to give a true and fair view of the state of affairs of the Bank at 31 December 2008;

© the accompanying statement of changes in equity is drawn up so as to give a true and fair view of the movement in shareholders funds for the year ended 31 December 2008; and

(d) 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 31 December 2008.

Signed in accordance with a resolution of the directors this 11th March, 2009.

....	....
Simione Sefanaia	**Hon. Paul Karalus**
Managing Director	**Acting Chairman of the Board**

Scope

We have audited the financial statements of the Tonga Development Bank Limited for the year ended 31 December 2008 as set out on pages 15 to 52. The Bank's directors and management are responsible for the preparation and presentation of the financial statements and the information they contain. We have conducted an independent audit of these financial statements in order to express an opinion on them to the members of the Bank.

Our audit has been conducted in accordance with International Standards on Auditing to provide reasonable assurance as to whether the financial statements are free of material misstatement. Our procedures included examination on a test basis, of evidence supporting the amounts and other disclosures in the financial statements and the evaluation of accounting policies and significant accounting estimates. These procedures have been undertaken to form an opinion as to whether in all material aspects, the financial statements are presented fairly in accordance with International Financial Reporting Standards and relevant statutory requirements so as to present a view that is consistent with our understanding of the Bank's financial position, the results of its operations, changes in equity and its cash flows.

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

Audit Opinion

In our opinion:

(a) proper books of account have been kept by the Bank, so far as it appears from our examination of those books, and
(b) the accompanying financial statements which have been prepared in accordance with International Financial Reporting Standards:

(i) are in agreement with the books of account;
(ii) to the best of our information and according to the explanations given to us:

(a) give a true and fair view of the state of affairs of the Bank as at 31 December 2008 and of the results, changes in equity and cash flows of the Bank for the year ended on that date;

(b) are in accordance with the provisions of the Tonga Development Bank Act 1977 and Tonga Companies Act 1995.

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

PricewaterhouseCoopers

……………………………...
PricewaterhouseCoopers
Chartered Accountants

Lautoka

16th March 2009

INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2008

	Notes	2008 $	(Restated) 2007 $
Interest income	7	6,081,794	6,281,651
Interest and other borrowing expenses	7	(2,524,369)	(2,408,863)
Net interest income		3,557,425	3,872,788
Fees and commission income	8	2,603,693	2,265,052
Other operating income	9	205,526	163,729
Net operating income		6,366,644	6,301,569
Losses on loans and advances	14	(1,008,722)	(815,948)
Bad debts written off		(44,923)	(52,343)
Bad debts recovered/reversed		87,234	141,708
Other operating expenses	10	(4,116,161)	(3,952,500)
Profit before income tax		1,284,072	1,622,486
Income tax expense	20	(332,979)	(406,329)
Net profit		$951,093	$1,216,157
Earnings per share	29	$0.90	$ 1.15

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

TONGA DEVELOPMENT BANK LIMITED
BALANCE SHEET AS AT 31 DECEMBER 2008

	Notes	2008 $	(Restated) 2007 $
ASSETS			
Cash on hand and at bank	11	931,130	963,492
Investment securities – held to maturity	13	7,500,000	7,908,502
Loans and advances	14	42,570,390	43,822,156
Other assets	15	421,022	281,191
Amounts receivable from shareholder	16	64,061	-
Statutory reserve deposit	17	1,826,000	1,817,000
Property, plant and equipment	18	7,115,614	7,413,514
Investment property	19	1,069,282	1,118,930
Deferred tax asset	20	1,539,540	1,613,430
Total Assets		$63,037,039	$64,938,215
LIABILITIES			
Savings deposits		4,402,564	4,756,883
Other liabilities	21	1,129,962	993,805
Amount payable to NRBT	17	66,000	500,000
Borrowings	22	29,810,160	30,800,658
Provision for tax		532,059	714,794
Managed funds	23	309,372	456,293
Deferred tax liability	20	1,248,795	1,521,764
Provision for dividend	28	475,547	606,984
Total Liabilities		37,974,459	40,351,181
SHAREHOLDERS' EQUITY			
Share capital	24	10,530,190	10,530,190
Retained earnings		14,532,390	14,056,844
Total Shareholders' Equity		25,062,580	24,587,034
Total Equity and Liabilities		$63,037,039	$64,938,215

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

Signed in accordance with a resolution of the directors this 11th day of March, 2009.

………………………….
Simione Sefanaia
Managing Director

…………………………..
Hon. Paul Karalus
Acting Chairman of the Board

STATEMENT OF CHANGES IN EQUITY - YEAR ENDED 31 DECEMBER 2008

	Notes	Share Capital	Asset Revaluation Reserve	Retained Earnings	General Reserve	Total
		$	$	$	$	$
Balance 31 December 2006		10,530,190	4,433,460	-	9,014,211	23,977,861
Net profit for the year		-	-	1,517,459	-	1,517,459
Dividend 2007	28	-	-	(606,984)	-	(606,984)
Transfer to General Reserve		-	-	(910,475)	910,475	-
Balance 31 December 2007		10,530,190	4,433,460	-	9,924,686	24,888,336
Adjustments on adoption of IFRS						
Transfer of Asset Revaluation Reserve	2.2 (a)	-	(4,433,460)	4,433,460	-	-
Transfer of General Reserve	2.4(b)	-	-	9,924,686	(9,924,686)	-
Establishment fee (net of tax)	2.4(a)	-	-	(301,302)	-	(301,302)
Adjusted opening balance 1 January 2008		10,530,190	-	14,056,844	-	24,587,034
Net profit for the year		-	-	951,093	-	951,093
Dividend 2008	28	-	-	(475,547)	-	(475,547)
Balance 31 December 2008		$10,530,190	$ -	$14,532,390	$ -	$25,062,580

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

CASH FLOW STATEMENT - YEAR ENDED 31 DECEMBER 2008

	Note	2008 $	2007 $
Cash flows from operating activities			
Interest received		5,976,948	6,334,655
Interest payment		(2,564,579)	(2,364,905)
Fees and commission received		2,632,436	2,672,035
Other income		160,920	187,236
Income tax paid		(714,794)	(552,201)
Payment to employees and suppliers		(3,685,597)	(3,283,852)
Cash flows from operating activities before changes in operating assets and liabilities		1,805,334	2,992,968
Changes in operating assets and liabilities:			
Disbursements of Loans		(14,657,995)	(19,242,634)
Repayments of loans		15,357,461	13,360,414
Decrease/(increase) in other debtors and prepayments		(25,624)	105,372
(Increase)/decrease in amounts receivable from shareholder		(64,061)	28,472
(Decrease) in other liabilities		(146,921)	(77,621)
Net cash (used in)/from operating activities		2,268,194	(2,833,029)
Cash flows from investing activities			
Purchase of plant and equipment		(287,330)	(140,039)
Proceeds from sale of plant and equipment		6,503	8,638
Net decrease/(increase) in statutory deposits		(443,000)	5,000
Net decrease in Government bonds		(20,000)	-
Net cash (used in)/from investing activities		(743,827)	(126,401)
Cash flows from financing activities			
Net increase in TDB promissory notes		402,750	4,559,871
Net (decrease)/increase in savings deposits		(354,319)	110,080
Dividend paid		(606,990)	(507,127)
Net payments in TDB bonds		(931,069)	(411,740)
Repayment of borrowings		(495,603)	(652,728)
Net cash (used in)/from financing activities		(1,985,231)	3,098,356
Net (decrease)/increase in cash and cash equivalents		(460,864)	138,926
Cash and cash equivalents at beginning of year		5,491,994	5,353,068
Cash and cash equivalents at year end	12	$5,031,130	$5,491,994

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

Note 1. General Information

Tonga Development Bank Limited (the "Bank") provides development banking services in the Kingdom of Tonga.

The Bank was established in the Kingdom of Tonga by the Tonga Development Bank Act 1977 and is also incorporated under the Tonga Companies Act 1995. The address of its registered office is at Fatafehi Road, Nuku'alofa, Tonga.

The bank's financial statements have been approved for issue by the Board of Directors on 11th March, 2009.

Note 2. Transition to International Financial Reporting Standards (IFRS)

2.1 Application of IFRS 1

The bank's financial statements for the year ended 31 December 2008 will be the first annual financial statements that comply with International Financial Reporting Standards (IFRS). The financial statement has been prepared as described in note 3. The bank has applied IFRS 1, First Time Adoption of International Financial Reporting Standards, in preparing these financial statements.

The bank's transition date is 1 January 2007 and has prepared its opening balance sheet at that date. The bank's IFRS adoption date is 1 January 2008.

In preparing this financial statement in accordance with IFRS 1, the bank has applied certain optional exemptions from full retrospective application of IFRS.

2.2 Exemptions from full retrospective application elected by the bank

Fair value as deemed cost exemption

(a) On adoption of IFRS, the Bank has elected to apply the exemption available under IFRS 1 and account for the fair value as deemed cost at 1 January 2008. The property was carried on the balance sheet on the basis of valuation performed in prior years. Accordingly the asset revaluation reserve relating to the previous revaluations has been transferred to retained earnings.

(b) On adoption of IFRS, the Bank's investment in residential properties has been restated from property, plant and equipment to investment property. The property was carried on the balance sheet on the basis of valuation performed in prior years. The company has elected to apply the exemption available under IFRS 1 and account for the fair value as deemed cost at 1 January 2008.

2.3 Changes to accounting policies

(a) **Revenue Recognition**

The Bank charges establishment fee to the borrowers to cover banks costs for loan appraisals, loan processing including inspection and loan documentation, etc. This fee is paid upfront by the borrower when the loan is approved and before loan is disbursed. The bank charges establishment fee on approval of the loans. Under the previous GAAP this is accounted for as revenue in the year the fee is received.

According to the recognition criteria established by IAS 18 the origination fees received by the entity relating to the creation or acquisition of a financial asset other than one that under IAS 39 is classified as a financial assets 'at fair value through profit or loss'. The IAS 18 requires interest to be recognised based on effective interest rate method.

Note 2. Transition to International Financial Reporting Standards (IFRS) (continued)

Accordingly, establishment fees received by the Bank have been deferred based on the term of the loan and adjusted against the loan accounts.

This represents a change in the accounting policy and adjustment has been made on transition to IFRS on 1 January 2007.

(b) General reserve – the general reserve amount has been transferred to retained earnings on adoption of IFRS as there was no legal requirement for maintaining this reserve.

(c) Apart from the above there are no other changes in the accounting policies. In preparing the financial statements existing accounting policies were amended or revised to comply with IFRS.

2.4 Reconciliation of Income Statement from Generally Accepted Accounting Practices to IFRS at 1 January 2008

	Notes	GAAP Income Statement $	Adjustments on Transition $	Opening IFRS Income Statement $
Interest income		6,281,651	-	6,281,651
Interest and other borrowing expenses		(2,408,863)	-	(2,408,863)
Net interest income		3,872,788	-	3,872,788
Fees and commission income	2.4.1	2,695,484	(430,432)	2,265,052
Other operating income		163,729	-	163,729
Net operating income		6,732,001	(430,432)	6,301,569
Losses on loans and advances		(815,948)	-	(815,948)
Bad debts written off		(52,343)	-	(52,343)
Bad debts recovered/reversed		141,708	-	141,708
Other operating expenses		(3,952,500)	-	(3,952,500)
Profit before income tax		2,052,918	(430,432)	1,622,486
Income tax expense	2.4.2	(535,459)	129,130	(406,329)
Net profit		$1,517,459	$(301,302)	$1,216,157

2.4.1 On adoption of IFRS the establishment fee is being recognised in accordance with IAS 18. The establishment fee is being amortised over the term of the loan. Also refer note 2.3 (a).

2.4.2 The income tax expense and deferred tax asset adjustments reflects the adjustment relating to the establishment fee.

2.5 Reconciliation of equity from Generally Accepted Accounting Practices to IFRS at 1 January 2008

	Notes	GAAP balance sheet $	Adjustments on transition $	Opening IFRS balance sheet $
ASSETS				
Cash on hand and at bank		963,492	-	963,492
Investment securities – held to maturity		7,908,502	-	7,908,502
Loans and advances	2.4.1	44,252,588	(430,432)	43,822,156
Other assets		281,191	-	281,191
Statutory reserve deposit		1,817,000	-	1,817,000
Property, plant and equipment	2.5.1	8,532,444	(1,118,930)	7,413,514
Investment property	2.5.1	-	1,118,930	1,118,930
Deferred tax asset	2.4.2	1,484,300	129,130	1,613,430
Total Assets		$65,239,517	$(301,302)	$64,938,215
LIABILITIES				
Savings deposits		4,756,883	-	4,756,883
Other liabilities		993,805	-	993,805
Amount payable to NRBT		500,000	-	500,000
Borrowings		30,800,658	-	30,800,658
Provision for tax		714,794	-	714,794
Managed funds		456,293	-	456,293
Deferred tax liability		1,521,764	-	1,521,764
Provision for dividend		606,984	-	606,984
Total Liabilities		40,351,181	-	40,351,181
SHAREHOLDERS' EQUITY				
Share capital		10,530,190	-	10,530,190
Retained earnings	2.5.2	-	14,358,146	14,056,844
	2.4.1	-	(430,432)	-
	2.4.2	-	129,130	-
Asset revaluation reserve	2.5.2	4,433,460	(4,433,460)	-
General reserve	2.5.2	9,924,686	(9,924,686)	-
Total Shareholders' Equity		24,888,336	(301,302)	24,587,034
Total Equity and Liabilities		$65,239,517	$(301,302)	$64,938,215

2.5.1 The bank's residential properties are being rented out. On transition to IFRS the rented properties is being restated as investment property in accordance with IAS 40. Corresponding adjustment has been in the property, plant and equipment.

2.5.2 On transition to IFRS the asset revaluation reserve and general reserve has been transferred to retained earnings.

Note 3. Summary of Significant Accounting Policies

The principal accounting policies adopted in the preparation of these financial statements are set out below.

(a) **Basis of preparation**

The Bank's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and requirements of the Tonga Companies Act 1995 and Tonga Development Act 1977. The financial statements have been prepared under the historical cost convention, as modified by the revaluation of available for-sale financial assets. The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the bank's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 4.

(i) Interpretations effective in 2008

IFRIC 14, 'IAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction', provides guidance on assessing the limit in IAS 19 on the amount of the surplus that can be recognised as an asset. It also explains how the pension asset or liability may be affected by a statutory or contractual minimum funding requirement. This interpretation does not have any impact on the bank's financial statements, as the superannuation scheme is managed separately by the bank.

IFRIC 11, 'IFRS 2 – Group and treasury share transactions', provides guidance on whether share-based transactions involving treasury shares or involving group entities (for example, options over a parent's shares) should be accounted for as equity-settled or cash-settled share-based payment transactions in the stand-alone accounts of the parent and group companies. This interpretation does not have an impact on the bank's financial statements.

(ii) Standards and amendments early adopted by the bank

The bank has not early adopted any standards and amendments.

(iii) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the bank.

The following standards and amendments to existing standards have been published and are mandatory for the bank's accounting periods beginning on or after 1 January 2009 or later periods, but the bank has not early adopted them:

IAS 1 (Revised), 'Presentation of financial statements' (effective from 1 January 2009). The revised standard will prohibit the presentation of items of income and expenses (that is, 'non-owner changes in equity') in the statement of changes in equity, requiring 'non-owner changes in equity' to be presented separately from owner changes in equity. All non-owner changes in equity will be required to be shown in a performance statement, but entities can choose whether to present one performance statement (the statement of comprehensive income) or two statements (the in come statement and statement of comprehensive income). Where entities restate or reclassify comparative information, they will be required to present a restated balance sheet as at the beginning comparative period in addition to the current requirement to present balance sheets at the end of the current period and comparative period. The bank will apply IAS 1 (Revised) from 1 January 2009. It is likely that both the income statement and statement of comprehensive income will be presented as performance statements.

IFRS 8 replaces IAS 14, 'Segment reporting', and aligns segment reporting with the requirements of the US standard SFAS 131, 'Disclosures about segments of an enterprise and related information'. The new standard requires a 'management approach', under which segment information is presented on the same basis as that used for internal reporting purposes.

Note 3. Summary of Significant Accounting Policies (continued)

(iii) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the bank.

IAS 40 (Amendment), 'Investment property' (and consequential amendments to IAS 16) (effective from 1 January 2009). The amendment is part of the IASB's annual improvements project published in May 2008. Property that is under construction or development for future use as investment property is within the scope of IAS 40. Where the fair value model is applied, such property is, therefore, measured at fair value. However, where fair value of investment property under construction is not reliably measurable, the property is measured at cost until the earlier of the date construction is completed and the date at which fair value becomes reliably measurable. The amendment will not have an impact on the bank's financial statements.

IAS 20 (Amendment), 'Accounting for government grants and disclosure of government assistance' (effective from 1 January 2009). The benefit of a below market rate government loan is measured as the difference between the carrying amount in accordance with IAS 39, 'Financial instruments: Recognition and measurement', and the proceeds received with the benefit accounted for in accordance with IAS 20. The amendment will not have an impact on the bank's financial statement as there are no loans received or other grants from the government.

The following standards and amendments and interpretations to existing standards have been published and are mandatory for the accounting periods beginning on or after 1 January 2009 or later periods. These have not been analysed in detail as there will be no impact on the bank's financial statements.

- IFRS 1 (Amendment) 'First time adoption of IFRS', and IAS 27 'Consolidated and separate financial statements'.
- IFRS 2 (Amendment), 'Share-based payment'
- IFRS 3 (Revised), 'Business combinations'.
- IFRS 5 (Amendment), 'Non-current assets held-for-sale and discontinued operations' (and consequential amendment to IFRS 1, 'First-time adoption').

- IAS 16 (Amendment), 'Property, plant and equipment' (and consequential amendment to IAS 7, 'Statement of cash flows').
- IAS 19 (Amendment), 'Employee benefits'.
- IAS 23 (Amendment), 'Borrowing costs'
- IAS 27 (Revised), 'Consolidated and separate financial statements'.
- IAS 28 (Amendment), 'Investments in associates' (and consequential amendments to IAS 32, 'Financial Instruments: Presentation', and IFRS 7, 'Financial instruments: Disclosures').
- IAS 29 (Amendment), 'Financial reporting in hyperinflationary economies'.
- IAS 31 (Amendment), 'Interests in joint ventures' (and consequential amendments to IAS 32 and IFRS 7).
- IAS 32 (Amendment), 'Financial instruments: Presentation', and IAS 1 (Amendment), 'Presentation of financial statements' – 'Puttable financial instruments and obligations arising on liquidation'
- IAS 36 (Amendment), 'Impairment of assets'.
- IAS 38 (Amendment), 'Intangible assets'.
- IAS 39 (Amendment), 'Financial instruments: Recognition and measurement'.
- IAS 41 (Amendment), 'Agriculture'.

- IFRIC 13, 'Customer loyalty programmes'.
- IFRIC 15, 'Agreements for construction of real estates' (effective from 1 January 2009).

Note 3. Summary of Significant Accounting Policies (continued)

(b) **Segment Reporting**

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Managing Director and Deputy Managing Directors that makes strategic decisions.

(c) **Foreign currency translation**

(i) Functional and presentation currency

Items included in the financial statements of the bank's are measured using the currency of the primary economic environment in which the entity operates ('the functional currency').

The financial statements are presented in Tongan Pa'anga, which is the bank's functional and presentation currency.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

(d) **Financial assets**

The bank classifies its financial assets in the following categories: loans and receivables; held-to-maturity investments; and available-for-sale financial assets. Management determines the classification of its investments at initial recognition.

(i) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than: (a) those that the entity intends to sell immediately or in the short term, which are classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss; (b) those that the entity upon initial recognition designates as available for sale; or (c) those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration.

(ii) Held-to-maturity financial assets

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the bank's management has the positive intention and ability to hold to maturity. If the bank were to sell other than an insignificant amount of held-to-maturity assets, the entire category would be reclassified as available for sale.

Note 3. Summary of Significant Accounting Policies (continued)

(d) Financial assets

(iii) Available-for-sale financial assets

Available-for-sale investments are those intended to be held for an indefinite period of time, which may be sold in reponse to needs for liquidity or changes in interest rates, exchange rates or equity prices. Regular-way purchases and sales of financial assets at fair value through profit or loss, held to maturity and available for sale are recognised on trade-date – the date on which the bank commits to purchase or sell the asset.

Financial assets are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit and loss are initially recognised at fair value, and transaction costs are expensed in the income statement. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the bank has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognised when they are extinguished – that is, when the obligation is discharged, cancelled or expires.

Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method.

Gains and losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are included in the income statement in the period in which they arise. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in equity, until the financial asset is derecognised or impaired. At this time, the cumulative gain or loss previously recognised in equity is recognised in profit or loss. However, interest calculated using the effective interest method and foreign currency gains and losses on monetary assets classified as available for sale are recognised in the income statement. Dividends on available-for-sale equity instruments are recognised in the income statement when the entity's right to receive payment is established.

The fair values of quoted investments in active markets are based on current bid prices. If there is no active market for a financial asset, the bank establishes fair value using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

(e) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(f) Interest income and expense

Interest income and expense for all interest-bearing financial instruments, except for those classified as held for trading or designated at fair value through profit or loss are recognised within 'interest income' and 'interest expense' in the income statement using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the bank estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Note 3. Summary of Significant Accounting Policies (continued)

(g) Fee and commission income

Fees and commissions are generally recognised on an accrual basis when the service has been provided. Service fees charged by the bank for servicing a loan are recognised as revenue as the services are provided. Loan establishment fees are recognised as income in the accounting period in which it is earned rather than received. The amount received is deferred over the term of the financial asset other than the earned amount which is recognised as income in the current accounting period.

Commission and fees arising from negotiating, or participating in the negotiation of, a transaction for a third party – such as arrangement or renewal of insurance policies – are recognised on completion of underlying transaction. Performance linked fees or fee components are recognised when the performance criteria are fulfilled.

(h) Impairment of financial assets

Assets carried at amortised cost

The bank assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The criteria that the Bank uses to determine that there is objective evidence of an impairment loss include:

- Delinquency in contractual payments of principal or interest;
- Cash flow difficulties experienced by the borrower;
- Breach of loan covenants or conditions;
- Initiation of legal proceedings;
- Deterioration in the value of collateral.

The estimated period between a loss occurring and its identification is determined by bank's management for each identified portfolio. In general, the periods used vary between three months and 12 months; in exceptional cases, longer periods are warranted.

The bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually.

The amount of the loss is measured as the difference between the asset's carrying amount and the estimated value of collateralised security discounted by the bank's security values. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement.

When a loan is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the loans credit rating), the previously recognised impairment loss is reversed by adjusting the doubtful loan account. The amount of the reversal is recognised in the income statement in impairment charge for loan losses.

Note 3. Summary of Significant Accounting Policies (continued)

(i) Property, plant and equipment

Land and buildings comprise mainly bank offices located in the island of Kingdom of Tonga. All property, plant and equipment are stated at cost less depreciation. Cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the bank and the cost of the item can be measured reliably. All other repairs and maintenance are charged to other operating expenses during the financial period in which they are incurred.

Depreciation is calculated on a straight line basis so as to write off the cost or revalued amount of each property, plant and equipment over its expected useful life. The expected useful life of each asset is as follows:

	Years
Leasehold land	Life of lease
Buildings	25 - 40
Furniture and equipment	5
Library	5
Machines	5
Computers	5
Vehicles	4 - 5

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

(j) Investment Property

Investment property, principally comprising residential leasehold land and buildings, is held for long term rental yields and is occupied by other third parties.

Investment property is shown at cost less subsequent depreciation and impairment. Cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the company and the cost of the item can be measured reliably. All other repairs and maintenance are expensed in the income statement during the financial period in which they are incurred.

Depreciation is calculated using the straight line method to allocate the cost of each asset to its residual value over its estimated useful life. The principal annual rates in use are:

		Life
Leasehold land	-	Term of lease
Buildings - residential	-	25 – 40

Note 3. Summary of Significant Accounting Policies (continued)

(j) Investment Property (continued)

Rental income from investment property is recognised in the income statement on a straight-line basis over the term of the lease.

Land held under operating lease is classified and accounted for as investment property when the rest of the definition of investment property is met. The operating lease is accounted for as if it were a finance lease.

(k) Impairment of non-financial asset

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

(l) Leases

Bank is the lessee

The leases entered into by the bank are primarily operating leases. The total payments made under operating leases are charged to other operating expenses in the income statement on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

(m) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash and non-restricted balances with central banks, and short-term government securities.

(n) 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.

(o) Employee benefits

(i) Employee leave entitlements
Employee entitlements to annual leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date. Employee entitlements to sick leave and casual leave are not recognised until the time of leave.

(ii) Pension obligations
The bank has in place retirement fund scheme which was established in 1990. The Bank's contributions to the retirement fund scheme are charged to the income statement in the period to which the contributions relate.

Note 3. Summary of Significant Accounting Policies (continued)

(p) Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

The principal temporary differences arise from depreciation of property, plant and equipment, revaluation of property, plant and equipment, provisions for loan losses, unrealised exchange gains/losses and other provisions for staff entitlements.

The rates enacted or substantively enacted at the balance sheet date are used to determine deferred income tax.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised.

The tax effects of income tax losses available for carry-forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

(q) Borrowings

Borrowings are recognised initially at fair value net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

(r) Share Capital

Ordinary shares are classified as equity and carried at the Bank's financial statements at par value.

(a) Share issue costs
Incremental costs directly attributable to the issue of new shares or options or to the acquisition of a business are shown in equity as a deduction, net of tax, from the proceeds. No additional shares were issued during the financial year.

(b) Dividends on ordinary shares
Dividends on ordinary shares are recognised in equity in the period in which they are approved by the Bank's shareholders.

Dividends for the year that are declared after the balance sheet date are dealt with in the subsequent events note.

(s) Fiduciary activities

Assets and income arising thereon together with related undertakings to return such assets to third parties or customers are excluded from these financial statements where the Bank acts in a fiduciary capacity.

(t) Comparatives

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

Note 4. Financial Risk Management

The bank's activities expose it to a variety of financial risks and those activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is core to the development banking business. The Bank's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effects on the Bank's financial performance.

The bank's risk management policies are designed to identify and analyse these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The bank regularly reviews its risk management policies and systems to reflect changes in markets, products and emerging best practice.

Risk management is carried out by a Risk Management department under policies approved by the Board of Directors and prudential guidelines issued by the National Reserve Bank of Tonga. Bank Treasury identifies and evaluates financial risks in close co-operation with the Bank's operating units. The Board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk and credit risk. In addition, internal audit is responsible for the independent review of risk management and the control environment. The most important types of risk are credit risk, liquidity risk, market risk and other operational risk. Market risk includes currency risk and interest rate risk.

4.1 Credit risk

The bank takes on exposure to credit risk, which is the risk that a counterparty will cause a financial loss for the bank by failing to discharge an obligation. Credit risk is the most important risk for the bank's business; management therefore carefully manages its exposure to credit risk. Credit exposures arise principally in lending activities that lead to loans and advances, and investment activities that bring debt securities into the bank's asset portfolio. There is also credit risk in off-balance sheet financial instruments, such as loan commitments. The credit risk management and control are centralised in credit risk management team and reported to the Board of Directors and Assets and Liabilities Committee regularly.

(a) Loans and advances

In measuring credit risk of loan and advances to customers and to banks at a counterparty level, the Bank reflects three components (i) the 'probability of default' by the client or counterparty on its contractual obligations; (ii) current exposures to the counterparty and its likely future development, from which the Bank derive the 'exposure at default'; and (iii) the likely recovery ratio on the defaulted obligations (the 'loss given default').

These credit risk measurements are embedded in the bank's daily operational management.

(i) The bank assesses the probability of default of individual counterparties using internal rating tools tailored to the various categories of counterparty. They have been developed internally and are also based on prudential guidelines issued by National Reserve Bank of Tonga. The bank clients are segmented into eight rating classes. The bank's rating scale, which is shown below, reflects the range of default probabilities defined for each rating class. The rating tools are kept under review and upgraded as necessary.

Note 4. Financial Risk Management (continued)

4.1 Credit risk

(a) Loans and advances

Bank's ratings	Description of the grade
A	Customers with well conducted loans, fully secured and operational & financial stability
B	Accounts where arrangements are generally observed but lending is not considered at risk, a minor degree of concern during general economic pressures, reasonable financial condition and adequate security
C1	Fully productive accounts but not generating sufficient income to meet repayment, repayments from other sources may be required, partial or full security and arrears may occur for up to 3 months.
S	Special mention will be a loan in excess of $250,000 and current rating will be A,B, or C1; moved into arrears of 30 to 60 days and requires special attention and monitoring, repayment difficulties and showing high degree of risk.
C3	Productive loans with shortfall between the value of security assets and the loan balances.
C2	Accounts of doubtful quality requiring active management supervision, projects have failed arrears between 3 to 6 months and no financial data.
D	Sub standard and doubtful customers whose loans have been classified non accrual and partial loss of interest and fee is expected, doubt about ability to service the debt; realisable value of security is insufficient to cover principal and interest, breach of repayment arrangements and accounts in arrears over 6 months.
E	Loss of principal and interest is expected, accounts under legal action and accounts may be written off if no improvements over 12 months.

4.2 Risk limit control and mitigation policies

The Bank manages limits and controls concentrations of credit risk wherever they are identified – in particular, to individual counterparties and groups, and to industries.

The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review, when considered necessary. Limits on the level of credit risk by product and industry sector's are approved by the Board of Directors.

Exposure to credit risk is also managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate.

Some other specific control and mitigation measures are outlined below.

(a) Collateral

The bank employs a range of policies and practices to mitigate credit risk. The most traditional of these is the taking of security for funds advances, which is common practice. The bank implements guidelines on the acceptability of specific classes of collateral or credit risk mitigation. The principal collateral types for loans and advances are:

- Mortgages over residential and commercial properties;
- Charges over business assets such as premises, inventory and accounts receivable;
- Guarantees by the borrowers; and
- Charges over financial instruments such as debt securities and equities.

In order to minimise the credit loss the Bank will seek additional collateral from the counterparty as soon as impairment indicators are noticed for the relevant individual loans and advances or will seek to increase repayments.

Note 4. Financial Risk Management (continued)

4.3 Impairment and provisioning policies

The internal rating systems described in Note 4.1 focus more on credit-quality mapping from the inception of the lending. In contrast, impairment provisions are recognised for financial reporting purposes only for losses that have been incurred at the balance sheet date based on objective evidence of impairment.

The impairment provision shown in the balance sheet at year-end is derived from each of the eight internal rating grades. The table below shows the percentage of the bank's balances relating to loans and advances and the associated impairment provision for each of the Banks' internal rating categories:

Group's rating	2008		2007	
	Loans and Advances (%)	Impairment Provision (%)	Loans and Advances (%)	Impairment Provision (%)
A	1.37	-	1.74	0.1
B	11.01	-	13.36	4.9
C1	41.89	6.8	48.65	43.5
S	24.41	5.2	22.65	-
C3	11.16	39.7	-	-
C2	0.79	0.2	3.34	32.6
D	7.38	39.1	8.48	7.2
E	1.99	9.0	1.78	11.7
	100.0	100.0	100.0	100.0

The internal rating tool assists management to determine whether objective evidence of impairment exists, based on the following criteria set out by the bank:

- Delinquency in contractual payments of principal or interest;
- Cash flow difficulties experienced by the borrower
- Breach of loan covenants or conditions;
- Initiation of legal proceedings;
- Deterioration of the borrower's competitive position;
- Deterioration in the value of collateral; and
- Downgrading below C1 grade level.

The Bank's policy requires the review of individual financial assets based on the bank's guidelines at least annually or more regularly when individual circumstances require. Impairment allowances on individually assessed accounts are determined by an evaluation of the incurred loss at balance-sheet date on a case-by-case basis, and are applied to all individually significant accounts. The assessment normally encompasses collateral held (including re-confirmation of its enforceability) and the anticipated receipts for that individual account.

Note 4. Financial Risk Management (continued)

4.4 Maximum exposure to credit risk before collateral held as categorised by the industry sectors:

	2008		2007	
	$	%	$	%
Industry sector:				
Agriculture	18,891,300	39.4	18,350,648	37.7
Industry and Business	9,340,249	19.4	10,803,972	22.2
Housing and Personal	17,124,279	35.7	16,663,897	34.3
Staff	2,628,321	5.5	2,814,929	5.8
	$ 47,984,149	100.0	$48,633,446	100.0

Management is confident in its ability to continue to control and sustain minimal exposure of credit risk to the bank resulting from its loan and advances portfolio based on the following:

- Mortgage loans, which represent the biggest group in the portfolio, are backed by collateral;
- Risk assessment review by Risk Asset Manager; and
- The bank has introduced a stringent selection process upon granting loans and advances.

4.5 Loans and advances

(i) Loans and advances are summarised as follows:

As at 31 December 2008	**Agriculture**	**Industry & business**	**Housing & personal**	**Staff**	**Total**
	$	$	$	$	$
Neither past due nor impaired	12,962,888	7,076,339	12,475,244	1,724,001	34,238,472
Past due but not impaired	1,406,678	981,943	1,055,875	13,037	3,457,533
Individually impaired	4,521,734	1,281,967	3,593,160	891,283	10,288,144
Gross	18,891,300	9,340,249	17,124,279	2,628,321	47,984,149
Less: allowance for impairment	(3,285,748)	(489,577)	(1,391,834)	(246,600)	(5,413,759)
Net	$15,605,552	$8,850,672	$15,732,445	$2,381,721	$42,570,390

As at 31 December 2007	**Agriculture**	**Industry & business**	**Housing & personal**	**Staff**	**Total**
	$	$	$	$	$
Neither past due nor impaired	12,474,772	9,003,721	13,301,598	2,133,450	36,913,541
Past due but not impaired	1,290,166	433,277	1,076,220	201,687	3,001,350
Individually impaired	4,585,710	1,366,974	2,286,079	479,792	8,718,555
Gross	18,350,648	10,803,972	16,663,897	2,814,929	48,633,446
Less: allowance for impairment	(2,526,313)	(459,561)	(1,345,624)	(479,792)	(4,811,290)
Net	$15,824,335	$10,344,411	$15,318,273	$2,335,137	$43,822,156

The total impairment provision for loans and advances is specific provision based on review of all specific individual accounts in the past due but not impaired and individually impaired categories. These accounts are subject to regular monitoring by the banks.

Note 4. Financial Risk Management (continued)

4.5 Loans and advances

(ii) Loans and advances neither past due or impaired are summarised as follows:
The credit quality of the portfolio of loans and advances that were neither past due nor impaired can be assessed by reference to the internal rating system adopted by the bank.

As at 31 December 2008	Agriculture	Industry & Business	Housing & Personal	Staff	Total
	$	$	$	$	$
Grades					
A	23,647	356,705	241,856	39,969	662,177
B	69,902	1,107,044	3,636,889	504,150	5,317,985
C1	2,844,887	3,849,672	8,596,499	1,179,882	16,470,940
C2	10,024,452	1,762,918	-	-	11,787,370
	$12,962,888	$7,076,339	$12,475,244	$1,724,001	$34,238,472

As at 31 December 2007	Agriculture	Industry & Business	Housing & Personal	Staff	Total
	$	$	$	$	$
Grades					
A	28,855	457,085	259,482	64,830	810,252
B	254,913	2,267,078	3,188,407	528,619	6,239,017
C1	3,371,779	4,521,087	9,853,709	1,540,001	19,286,576
C2	8,819,225	1,758,471	-	-	10,577,696
	$12,474,772	$9,003,721	$13,301,598	$2,133,450	$36,913,541

(iii) Loans and advances past due but not impaired are summarised as follows:

Loans and advances less than 90 days past due are not considered impaired, unless other information is available to indicate the contrary. Gross amount of loans and advances by class to customers that were past due but not impaired were as follows:

As at 31 December 2008	Agriculture	Industry & Business	Housing & Personal	Staff	Total
	$	$	$	$	$
Past due up to 30 days	1,165,204	567,921	713,493	13,037	2,459,655
Past due 30 – 60 days	129,924	352,658	196,540	-	679,122
Past due 60 – 90 days	111,550	61,363	145,842	-	318,755
	$1,406,678	$981,942	$1,055,875	$13,037	$3,457,532
Fair value of collateral	$3,729,176	$2,150,812	$2,833,074	$55,592	$8,768,654

Note 4. Financial Risk Management (continued)

4.5 Loans and advances

(iii) Loans and advances past due but not impaired are summarised as follows:

As at 31 December 2007	Agriculture	Industry & business	Housing & personal	Staff	Total
	$	$	$	$	$
Past due up to 30 days	939,246	183,656	840,020	201,687	2,164,609
Past due 30 – 60 days	133,688	234,916	211,159	-	579,763
Past due 60 – 90 days	217,233	14,705	25,042	-	256,980
	$1,290,167	$433,277	$1,076,221	$201,687	$3,001,352
Fair value of collateral	$2,879,870	$825,478	$2,495,018	$180,756	$6,381,122

(iv) Loans and advances renegotiated

Restructuring activities include extended payment arrangements, approved external management plans, modification and deferral of payments. Following restructuring, a previously overdue customer account is reset to a normal status and managed together with other similar accounts. Restructuring policies and practices are based on indicators or criteria which, in the judgment of the management, indicate that payment will most likely continue. These policies are kept under continuous review.

Renegotiated loans that would otherwise be past due or impaired are as follows:

	Agriculture	Industry & business	Housing & personal	Staff	Total
	$	$	$	$	$
As at 31 December 2008					
Term loans	361,560	228,752	348,356	-	938,668
As at 31 December 2007					
Term loans	354,468	264,049	338,761	-	957,278

(v) Repossessed collateral

During 2008, the bank obtained assets by taking possession of collateral held as security, as follows:

Nature of assets	Carrying amount
	$
Tax allotment	10,000
Town allotment	7,000

Repossessed properties are sold as soon as practicable, with the proceeds used to reduce the outstanding indebtedness.

(vi) Loans and advance exposure by categories:

	2008	2007
	$	$
Large corporate entities	1,584,476	16,987,948
SMEs	43,752,707	28,817,074
Other	2,646,966	2,828,424
	$47,984,149	$48,633,446

Note 4. Financial Risk Management (continued)

4.6 Market risk

The Bank takes on exposure to market risks, which is the risk that the fair value or future cash flows of financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate and currency, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads and foreign exchange rates.

4.6.1 Foreign exchange risk

The bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The bank's risk management policy is designed to identify situations requiring active management and also to enable the bank to develop strategies for managing foreign exchange exposure.

The Bank's assets and liabilities are mainly in local currency except to the extent shown below:

	2008	2007
	$	$
Liabilities		
Borrowings – foreign	$ 455,608	$ 353,095

4.6.2 Interest rate risk

The Bank takes on exposure due to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase or decrease as a result of such changes. The Bank monitors the level of interest rate risk on a quarterly basis. Interest rates are reviewed annually or earlier if warranted.

4.7 Liquidity risk

Liquidity risk is the risk that the Bank is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. The consequence may be the failure to meet obligations to repay depositors and fulfil commitments to lend.

The Bank is exposed to daily calls on its available cash resources from current accounts, maturing deposits and loan draw downs. The Bank does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The Bank monitors the level of liquidity on a daily basis.

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

Note 4. Financial Risk Management (continued)

4.7 Liquidity risk

Maturities of assets and liabilities

As at 31 December 2008	**Up to 1 month**	**1 - 3 months**	**3 - 12 months**	**1 - 5 years**	**Over 5 years**	**No specific maturity**	**Total**
Assets	**($)**	**($)**	**($)**	**($)**	**($)**	**($)**	**($)**
Cash on hand and at bank	931,130	-	-	-	-	-	931,130
Investment securities – held to maturity	200,000	1,900,000	4,400,000	1,000,000	-	-	7,500,000
Loans and services	4,225,609	4,361,515	12,069,478	14,831,863	6,593,467	488,458	42,570,390
Statutory reserve deposit	-	-	-	-	-	1,826,000	1,826,000
Property, plant and equipment	-	-	-	-	-	7,115,614	7,115,614
Investment Property	-	-	-	-	-	1,069,282	1,069,282
Other assets	-	208,690	276,393	1,539,540	-	-	2,024,623
Total Assets	$5,356,739	$6,470,205	$16,745,871	$17,371,403	$6,593,467	$10,499,354	$63,037,039
Liabilities							
Saving deposits	4,402,564	-	-	-	-	-	4,402,564
Borrowings	552,377	481,458	481,914	482,394	417,145	2,910,377	5,325,665
Promissory Notes	13,860,803	6,592,363	2,561,132	297,042	1,173,155	-	24,484,495
Other liabilities	66,000	1,605,509	841,431	1,248,795	-	-	3,761,735
Total Liabilities	18,881,744	8,679,330	3,884,477	2,028,231	1,590,300	2,910,377	37,974,459
Net Liquidity Gap	$(13,525,005)	$(2,209,125)	$12,861,394	$15,343,172	$5,003,167	$7,588,977	$25,062,580
As at 31 December 2007							
Total Assets	6,418,823	6,626,028	17,605,188	16,733,728	7,506,306	10,048,142	64,938,215
Total Liabilities	5,931,108	4,929,422	12,141,679	14,234,416	3,114,556	-	40,351,181
Net Liquidity Gap	$487,715	$1,696,606	$5,463,509	$2,499,312	$4,391,750	$10,048,142	$24,587,034

Note 4. Financial Risk Management (continued)

4.8 Off-balance sheet items

(a) Loan commitments

The dates of the contractual amounts of the Bank's off-balance sheet financial instruments that commit it to extend credit to customers and other facilities, are summarised in the table below.

(b) Operating lease commitments
Where the Bank is the lessee, the future minimum lease payments under non-cancellable operating leases, as disclosed in note 26, are summarised in the table below.

(c) Capital commitments
Capital commitments (note 26) are summarised in the table below.

At 31 December 2008	**No later than 1 year**	**1 – 5 years**	**Over 5 years**	**Total**
	$	$	$	$
Loan commitments	2,762,530	-	-	2,762,530
Operating lease commitments	8,620	34,480	221,360	264,460
Capital commitments	-	-	-	-
Total	$2,771,150	$34,480	$221,360	$3,026,990
At 31 December 2007				
Loan commitments	538,788	-	-	538,788
Operating lease commitments	8,620	34,480	229,980	273,080
Capital commitments	-	-	-	-
Total	$547,408	$34,480	$229,980	$811,868

4.9 Fair value of financial assets and liabilities

The fair value is the amount for which an asset could be exchanged, or a liability settled between knowledgeable, willing parties in an arm's length transaction.

The valuation of the Bank's financial assets and liabilities is discussed below:

(i) **Term deposits**

The carrying values of term deposits are considered to approximate their fair values as they are denominated in cash and these amounts are repayable on demand.

(ii) **Investment securities**

Investment securities comprise interest bearing bonds which are being held to maturity. The fair value of the investment securities of $3,400,000 is based on the indicative pricing using the prevailing interest rates.

(iii) **Loans and advances to customers**

Loans and advances are net of provisions for impairment. The carrying values of loans and advances are considered to approximate their fair values as all doubtful accounts have been provided for.

(iv) **Savings deposits**

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

Note 4. Financial Risk Management (continued)

(v) **Borrowings**

The carrying values of borrowings are considered to approximate their fair value as they are repayable on demand.

(vi) **Other Financial Assets and Liabilities**

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

4.10 Capital management

The Bank's objectives when managing capital are:

- To comply with the capital requirements set by the regulators of the banking markets where the bank operates;
- To safeguard the bank's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders; and
- To maintain a strong capital base to support the development of its business.

Capital adequacy and the use of regulatory capital are monitored daily by the Bank's management, based on the guidelines developed by the National Reserve Bank of Tonga (NRBT), for supervisory purposes. The required information is filed with the NRBT on a quarterly basis.

The NRBT requires the bank to: (a) hold the minimum level of the regulatory capital, and (b) maintain a ratio of total regulatory capital to the risk-weighted asset at or above the agreed minimum of 18%.

The bank's regulatory capital as managed by its Treasury is divided into two tiers:

- Tier 1 capital: share capital, retained earnings and reserves created by appropriations of retained earnings; and
- Tier 2 capital: qualifying subordinated loan capital.

The risk-weighted assets are measured by means of a hierarchy of five risk weights classified according to the nature of – and reflecting an estimate of credit, market and other risks associated with – each asset and counterparty, taking into account any eligible collateral or guarantees. A similar treatment is adopted for off-balance sheet exposure, with some adjustments to reflect the more contingent nature of the potential losses.

The table below summarises the composition of regulatory capital and the ratios of the bank for the years ended 31 December 2008 and 2007. During those two years, the bank complied with all of the externally imposed capital requirements to which they are subject.

Tier 1 Capital	**2008**	**2007**
	$	$
Share capital	10,530,000	10,530,000
Retained earnings	14,532,390	14,056,844
Total	$25,062,580	$24,587,034
Risk weighted assets	42,570,390	43,822,156
Ratio	59%	56%

Note 5. Critical accounting estimates and judgments

The bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Impairment losses on loans and advances

The bank reviews its loan portfolios to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the income statement, the bank makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated values of collateralised security values. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers, or local economic conditions that correlate with defaults on assets in the industry sectors. The methodology and assumptions used for reviewing impairment are reviewed regularly.

Note 6. Segment analysis

Industry segment

The Bank operates predominantly in the financial services industry.

Geographical segment

The Bank operates in Tonga and is therefore one geographical area for reporting purposes.

Note 7. Net Interest Income

	2008	2007
	$	$
Interest income		
Loans and advances	5,407,486	5,518,826
Term deposits and securities	674,308	762,825
	$6,081,794	$6,281,651
Interest and other borrowing expenses		
Borrowings	267,631	245,838
TDB promissory notes	2,069,396	1,931,837
TDB bonds	49,071	91,989
Savings deposits	135,466	135,771
Bank overdraft	2,805	3,428
	$2,524,369	$2,408,863

Borrowings cost comprises foreign exchange loss of $62,641 (2007: $18,156)

Interest income accrued on impaired financial assets is $67,164 (2007 - $20,182)

Note 8. Fees and Commission Income

	2008 $	(Restated) 2007 $
Service fees	2,116,278	1,777,872
Commissions	487,415	487,180
	$2,603,693	$2,265,052

Note 9. Other Operating Income

	2008 $	2007 $
Rent	87,037	71,203
Gain on sale of plant and equipment	6,503	6,872
Other	111,986	85,654
	$205,526	$163,729

Note 10. Other Operating Expenses

	2008 $	2007 $
Staff costs (refer below)	2,090,565	1,973,684
Administrative expenses	593,949	450,723
Auditor's remuneration - audit	48,378	25,753
Depreciation	634,878	643,874
Premises	367,529	410,584
Travel	225,970	198,550
Insurance loss	16,321	19,099
Others	141,571	230,233
	$4,116,161	$3,952,500

Staff costs comprise:

Wages and salaries and other staff costs	1,925,616	1,803,784
Retirement fund	164,743	169,900
	$2,090,359	$1,973,684

The average number of persons employed by the Bank during the year 2008 was 120 (2007: 113).

In 1990 the Bank established a retirement fund for all its permanent employees. The Bank made annual contributions to the fund equal to 12% of annual salaries until 30 September 2002 and from 1 October 2002 the contribution was reduced to 10.50% of annual salaries. There was an actuarial review of the retirement fund in 2005 and the Board approved an increase in contributions to 11% effective retrospectively as from 1 January 2005 and 11.5% from 1 January 2006. It was resolved in an actuarial review in 2008 that Bank's contribution in respect of retirement fund scheme, be reduced from 11.5% to 6.5% effective from 1 October 2008.

Note 11. Cash on hand and at Bank

	2008 $	2007 $
Cash on hand	272,999	251,127
Cash at Bank	658,131	712,365
	$931,130	$963,492

Note 12. Cash and Cash Equivalents

	2008 $	2007 $
For the purposes of the cash flow statement, cash and cash equivalents comprise the following:		
Cash on hand and at bank	931,130	963,492
Investment securities – Westpac Bank of Tonga	4,100,000	4,528,502
	$5,031,130	$5,491,994

Mandatory reserve deposits are not available for use in the Bank's day-to-day operations. Cash-in hand and balances with central banks and mandatory reserve deposits are non-interest-bearing. Other money-market placements are floating-rate assets.

Note 13. Investment Securities –Held to Maturity

	2008 $	2007 $
Westpac Bank of Tonga	4,100,000	4,528,502
Government of Tonga Local Development Bond	3,400,000	3,380,000
	$7,500,000	$7,908,502

The year end interest rate receivable on term deposits range from 7.0% to 10.0% (2007: 9.25% to 9.75%) per annum and the interest rate for the Government of Tonga Local Development Bond range from 6.75% to 10% (2007: 6.50% to 8.00%) per annum. The interest is receivable on maturity for term deposits and annually after a year from date of issue for the Government of Tonga Local Development Bond.

Note 14. Loans and Advances

	2008 $	(Restated) 2007 $
Gross loans and advances	47,984,149	48,633,446
Less : Impairment losses on loans and advances	(5,413,759)	(4,811,290)
Net loans	$42,570,390	$43,822,156
Loans and advances approved but not yet disbursed Amounted to:	$2,762,530	$538,788

Note 14. Loans and Advances (continued)

Allowance for losses on loans and advances	2008 $	(Restated) 2007 $
Movements in allowance for losses on loans and advances are as follows:		
Balance at beginning of the year	4,811,290	4,375,040
Provision for loan impairment	1,904,250	1,244,701
Provisions written back	(895,528)	(428,753)
Loans written off during the year	(406,253)	(379,698)
Balance at end of year	$5,413,759	$ 4,811,290
Composition of allowance for losses on loans and advances:		
Specific provision	2,605,913	2,444,799
Productive provisions	2,807,846	2,366,491
	$5,413,759	$ 4,811,290
The losses on loans and advances as shown in the income statement is arrived as follows:		
Provision for loan impairment	1,904,250	1,244,701
Provisions written back	(895,528)	(428,753)
	$1,008,722	$815,948

Non accrual loans and advances

Non accrual loans and advances	3,391,851	3,239,401
Less: specific provision for impairment	(1,801,864)	(1,539,495)
	$1,589,987	$1,699,906

Loans to directors and director related entities are disclosed in note 25 (a) (iii).

Note 15. Other Assets

	2008 $	2007 $
Prepayment	31,349	70,721
Accrued interest	310,668	193,630
Other assets	79,005	16,840
	$421,022	$281,191

Note 16. Amounts Receivable from Shareholder

	2008 $	2007 $
Comprises the following:		
Claims for EEC	9,195	-
Claims for Subsidy	54,866	-
	$64,061	$ -

Note 17. Statutory Reserve Deposit

	2008	2007
	$	$
National Reserve Bank of Tonga (NRBT)	$1,826,000	$1,817,000

The Statutory Reserve Deposit with National Reserve Bank of Tonga (NRBT) is not available for use in the Bank's day to day operations.

	2008	2007
	$	$
Amounts payable to NRBT	$66,000	$500,000

Amounts payable to NRBT represent shortfall in the statutory reserve deposit at year end.

Note 18. Property, Plant and Equipment

	Leasehold Land and buildings	Fixtures, fittings & equipment	Motor vehicles	Computers	Total
	$	$	$	$	$
At 31 December 2006					
Cost	6,870,789	785,088	530,444	1,841,498	10,027,819
Accumulated depreciation	(59,841)	(612,852)	(339,640)	(1,155,090)	(2,167,423)
Net book amount	$ 6,810,948	$172,236	$190,804	$686,408	$7,860,396
For the year ended 31 December 2007					
Opening net book amount	6,810,948	172,236	190,804	686,408	7,860,396
Additions	-	43,869	215	95,955	140,039
Disposals	-	-	(1,768)	-	(1,768)
Depreciation charge	(179,881)	(69,312)	(81,909)	(254,051)	(585,153)
Closing net book amount	$6,631,067	$146,793	$107,342	$528,312	$7,413,514
At **31 December 2007**					
Cost	6,870,789	828,957	505,046	1,752,090	9,956,882
Accumulated depreciation	(239,722)	(682,164)	(397,704)	(1,223,778)	(2,543,368)
Net book amount	$6,631,067	$146,793	$107,342	$528,312	$7,413,514
For the year ended **31**					
Opening net book amount	6,631,067	146,793	107,342	528,312	7,413,514
Additions	77,041	93,916	26,000	81,068	278,025
Disposals	0	0	0	0	0
Depreciation charge	(181,884)	(73,491)	(63,408)	(257,142)	(575,925)
Closing net book amount	$6,526,224	$167,218	$69,934	$352,238	$7,115,614
At **31 December 2008**					
Cost	6,947,830	922,873	531,046	1,833,158	10,234,907
Accumulated depreciation	(421,606)	(755,655)	(461,112)	(1,480,920)	(3,119,293)
Net book amount	$6,526,224	$167,218	$69,934	$352,238	$7,115,614

The depreciation policy adopted in respect of the above is set out in Note 3 (i)

Note 19. Investment Property

	Land & Building $	Total $
At 31 December 2006		
Cost	1,177,916	1,177,916
Accumulated depreciation	(265)	(265)
	$1,177,651	$1,177,651
Opening net book amount	1,177,651	1,177,651
Additions	-	-
Disposals	-	-
Depreciation charge	(58,721)	(58,721)
	$1,118,930	$1,118,930
At 31 December 2007		
Cost	1,177,916	1,177,916
Accumulated depreciation	(58,986)	(58,986)
	$1,118,930	$1,118,930
For the year ended 31 December 2008		
Opening net book amount	1,118,930	1,118,930
Additions	9,305	9,305
Disposals	-	-
Depreciation charge	(58,953)	(58,953)
	$1,069,282	$1,069,282
At 31 December 2008		
Cost	1,187,221	1,187,221
Accumulated depreciation	(117,939)	(117,939)
	$1,069,282	$1,069,282

(a) The depreciation policy adopted in respect of the above is set out in Note 3 (j).

(b) The following amounts have been recognised in the income statement:

	2008 $	2007 $
Rental income	33,117	13,671
Direct operating expenses arising from investment properties	71,773	52,664

Note 20. Taxation

	2008 $	(Restated) 2007 $
Income tax is brought to account using the liability method of tax effect accounting.		
(a) Operating profit before income tax	$1,284,072	$ 1,622,486
Prima facie income tax charge on the operating		
profit at graduated rates to 30%	370,222	471,746
Tax effect of non deductible expenditure:		
Sundry expenses	-	1,126
Grants and exempt income	(113,726)	(73,470)
Tax effect of prior year adjustment	18,334	8,203
Tax effect of over provision - prior year	-	(1,276)
Tax effect of change in tax rate - net	58,149	-
Income tax expense	$332,979	$406,329
(b) Income tax expense comprises:		
Current tax expense	532,059	714,794
Over provision – prior year	-	(1,276)
Deferred tax expense - net	(257,229)	(307,189)
Tax effect of change in tax rate - net	58,149	-
Income tax expense	$332,979	$406,329
(d) **Deferred tax asset**		
(i) Deferred tax asset comprises the net effect of the following (amounts recognised in profit or loss):		
Allowance for loan losses	1,353,440	1,428,387
Other provisions	20,159	20,793
Unrealised exchange loss	43,790	35,120
Unearned revenue	122,151	129,130
	$1,539,540	$1,613,430
(ii) The movement in deferred tax asset is as follows:		
Balance at 1 January 2007	1,613,430	1,357,504
Income statement credit	219,017	255,926
Tax effect of change in tax rate	(292,907)	-
	$1,539,540	$1,613,430

Note 20. Taxation (continued)

	2008 $	2007 $
(e) **Deferred tax liability**		
(i) The balance comprises temporary differences attributable to:		
Depreciation	$1,248,795	$1,521,764
(ii) The movement in deferred tax liability is as follows:		
Opening balance	1,521,764	1,573,027
Tax effect of change in tax rate	(234,758)	-
Credit to income statement	(38,211)	(51,263)
	$1,248,795	$1,521,764

Note 21. Other Liabilities

	2008 $	2007 $
Accrued interest	634,928	702,707
Provisions for annual leave and staff bonus	80,637	69,311
Other creditors and accruals	414,397	221,787
	$1,129,962	$ 993,805

Note 22. Borrowings

	Notes	2008 $	2007 $
Comprises:			
Borrowings	(a)	5,325,665	5,787,845
Tonga Development Bank promissory notes	(b)	24,484,495	24,081,744
Tonga Development Bank bonds	(c)	-	931,069
		$29,810,160	$30,800,658

Note 22. Borrowings (continued)

(a) Borrowings comprise the following:	Principal repayment term	Interest rate	2008 $	2007 $
Government of the Kingdom of Tonga				
Asian Development Bank	1993 – 2023	3.00%	676,584	723,245
International Fund for Agriculture Development 2	1993 – 2013	3.00%	593,229	725,028
International Fund for Agriculture Development 3	1999 – 2020	3.00%	2,097,900	2,383,977
International Development Association	1998 – 2023	3.00%	1,502,344	1,602,500
			4,870,057	5,434,750
Other borrowings				
	2009 - 2026	5.5%	240,103	-
	1988 – 2019	1.50%	45,316	49,911
Agence Francaise Development	2000 – 2009	5.00%	170,189	303,184
			455,608	353,095
			$5,325,665	$5,787,845

The Government of the Kingdom of Tonga has arranged loans and grants from the Asian Development Bank, the International Development Association and the International Fund for Agricultural Development all of which are fully drawn.

The Government of the Kingdom of Tonga has guaranteed the repayment of the fully drawn loan from the European Union. These loans together with the loans from the European Investment Bank are in various currencies.

	2008 $	2007 $
(b) Tonga Development Bank promissory notes	$24,484,495	$24,081,744

The interest rate at year end on promissory notes ranged from 5.75% per annum to 8.00% per annum. Interest is paid out on maturity and semi-annually for terms over 180 days.

	2008 $	2007 $
(c) Tonga Development Bank bonds	$ -	$931,069

The interest rate at year end on bonds ranged from 6% per annum to 7.75% per annum. Interest is payable semi-annually on 31 August and 28 February each year. There are Government Guarantees on repayment of principal and interest payable on bonds issued under this Prospectus pursuant to the Public Finance Management Act.

Note 23. Managed Funds

The Bank manages these funds on behalf of the Government agencies and at year end the balances for

	Total Funds $	Advance to Projects $	2008 $	2007 $
UNCDF Fisheries Development Fund	126,996	-	126,996	251,578
New Zealand Borrower Diversification Fund	318,283	135,907	182,376	204,715
	$445,279	$135,907	$309,372	$456,293

There was a payment of $124,582 to Ministry of Fisheries in 2007 for Waka Fishing Boat Repair.

Note 24. Capital

	2007 $	2006 $
(a) Authorised		
1,400,000 ordinary shares of $10 each	$14,000,000	$14,000,000
(b) Issued and fully paid		
1,053,019 ordinary shares of $10 each	$10,530,190	$10,530,190

Note 25. Related Party Transactions

(a) <u>Directors</u>

(i) The directors of Tonga Development Bank Limited during the year were:

- Aisake Valu Eke (Chairman – resigned 1 January 2009)
- Hon. Paul Karalus (Acting Chairman)
- Lennie Niit
- Sepa Mafi
- Simione Sefanaia (Managing Director)
- Paulo Kautoke (Alternate)
- Mana Latu (Alternate)
- Minoru Nishi (Alternate, upto 15 December 2008)
- Dr. Viliami Fakava (Alternate, upto 13 February 2008)

(ii) Directors' fees and emoluments during the year were:

	2008 $	2007 $
Directors' fees and retirement benefit	76,996	52,092
Management's salaries & allowances	73,716	61,000
Total	$150,712	$113,092

Note 25. Related Party Transactions (continued)

	2008 $	2007 $
(iii) Transactions with related parties comprise of:		
Loans and advances to directors or director-related entities		
Balance at beginning of the year	2,240,002	454,843
Loans advanced during the year	724,247	1,806,900
Loan and interest repayments during the year	(807,551)	(174,200)
Interest and costs	319,413	152,459
Balance at end of the year	$2,476,111	$2,240,002

The above transactions are on normal commercial terms and conditions.

(b) Shareholder

In the normal course of its operations, the Bank enters into transactions with the shareholder, the Government of the Kingdom of Tonga. These transactions include guarantee and financing transactions which are carried out on normal trading terms. The Government of the Kingdom of Tonga owns 100% of the shares in the Bank.

(i) Borrowings

	2008 $	2007 $
Interest paid/payable on borrowings	173,475	201,398
Repayments of borrowings during the year	625,521	639,135
Borrowings from the Government of the Kingdom of Tonga are disclosed in note 22 (a)	4,870,057	5,434,750
The Government purchased TDB bonds and promissory notes during the year and the balances at year end are as follows:		
TDB promissory notes	5,169,335	4,469,336
Interest paid/payable on TDB bonds and promissory notes	233,574	171,734

Interest payable on the bonds and promissory notes range from 6.75% to 7.75% per annum.

(ii) Term deposits

	2008 $	2007 $
Interest received/receivable on Government of Tonga Local Development Bonds	463,960	356,185
Government of Tonga Local Development Bonds at year end - refer note 13.	3,400,000	3,380,000

(iii) Loans and advances

	2008 $	2007 $
The Government has provided guarantees for the borrowings of certain borrowers to the Bank. At year end the total outstanding loans under the guarantees amount to:	9,053,458	8,662,309

Note 26. Commitments and Contingent Liability

	2008 $	2007 $
	$ -	$ -
(b) Contingent liability	$ -	$ -

(c) Operating lease commitments

(i) The Bank has leases over various leasehold properties in the Kingdom for a maximum term of 50 years. The minimum operating lease payments at balance sheet date are as follows:

	2008 $	2007 $
Not later than one year	8,620	8,620
Later than one year but not later than five years	34,480	34,480
Later than five years	221,360	229,980
	$264,460	$273,080

(ii) The Bank has entered into lease agreements to rent out its various properties for terms ranging from one to five years. The minimum lease payments receivable at balance sheet date are as follows:

	2008 $	2007 $
Not later than one year	88,309	61,552
Later than one year but not later than five years	120,391	138,018
	$208,700	$199,570

Note 27. Financing Arrangements

	2008 $	2007 $
Arrangements with Westpac Bank of Tonga are as follows:		
(i) Documentary letter of credit limit secured by letter of negative pledge	500,000	500,000
(ii) Forward exchange contract limit	100,000	100,000
	$600,000	$600,000

An EIB credit line was signed on 15 December 2005 for a financing facility of EUR 4 million. This initial available credit and a further EUR 2 million are available to the bank. The draw down of the facility commenced in 2008 and final draw down is expected in August 2009.

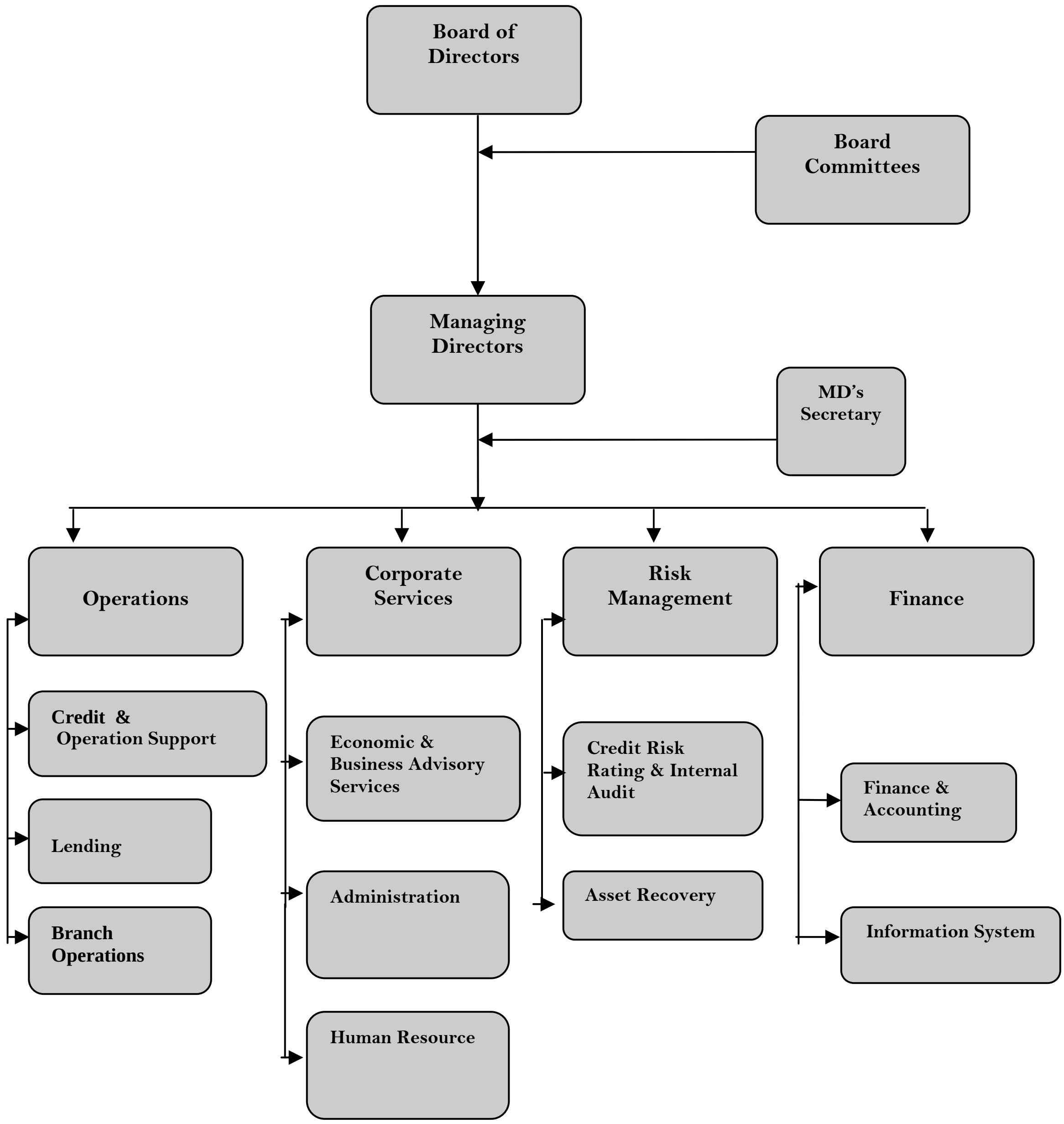
Note 28. Dividends

	2008 $	2007 $
(a) The directors have proposed a dividend of 40% of net profit after tax in respect of the year ended 31 December 2007. This amounted to $ 606,984 or $0.58 per issued share.	$ -	$ 606,984
(b) The directors have proposed a dividend of 50% of net profit after tax in respect of the year ended 31 December 2008. This amounted to $475,547 or $0.45 per issued share.	$475,547	$ -

Note 29. Earnings per Share

	2008 $	2007 $
Net profit after tax	951,093	1,216,157
Number of issued shares	1,053,019	1,053,019
Earnings per share	$ 0.90	$ 1.15

CORPORATE STRUCTURE
AS AT 31 DECEMBER 2008



SENIOR MANAGEMENT TEAM
AS AT 31 DECEMBER 2008

SENIOR EXECUTIVES

Managing Director	Mr Simione Sefanaia
Deputy Managing Directors	
Operations	Mrs Leta Havea Kami
Finance	Mr Hasiloni Fungavai
Manager Risk Management	Mr John Bath

HEAD OFFICE

Managers

Lending- Tongatapu	Mrs Seini Movete
Loans District 1 & 2	Mr Sitino Maka
Asset Recovery	Mr. Samisoni Masila
Credit and Operations Support	Mrs Lata Kava
Corporate Services	Mr ‘Etikeni Samani
Finance and Budgeting	Mr Soane Malia Kauhalaniua
Accounting Support	Mrs Pelinita Faletau
Information Services	Mr Siokatame Havili Movete
System Operations	Mrs Silia Tupou
Human Resource	Mrs Lu’isa Manuofetoa
Administration	Ms Vika. T. Taufa

BRANCH OFFICES

Manager

Vava’u Branch	Mr Fuka’eiki Kupu
Ha’apai Office	Mrs ‘Elisapesi Fineanganofo
Eua Office	Mr. Tokotaha Fonua
Niuatoputapu Office	Mrs Mafi Hoa
Niuafo’ou Office	Mr Laulotu Finau
Hahake Office	Mr Mosese Fifita