Tonga Development Bank

your partner in development

2009

Annual Report

serving Tonga for 32 years

Hon. Minister for Public Enterprises
Ministry of Public Enterprises
Nuku'alofa

Hon. Minister

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 2009, as required under the Tonga Development Bank Act, 1977 Section 10 (7) and the Public Enterprises Act 2002 Section 20 (1).

Respectfully

……………………...
Dr. Giulio Masasso T. Paunga
Chairman

CONTENTS

NUKU'ALOFA HEAD OFFICE

P. O. Box 126
Nuku'alofa
Kingdom of Tonga
Telephone: (676) 23-333
Facsimile: (676) 23-775
E-mail: tdevbank@tdb.to
Website : www.tdb.to

VISION

"To be recognized as Tonga's best Provider of development finance with selected commercial activities which employs prudent banking principles, meets customer needs, demonstrates integrity and operates profitably".

MISSION

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

BACKGROUND

Tonga Development Bank was established on 1st September 1977 under the Tonga Development Bank Act.

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 other selected commercial activities including 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.

BOARD OF DIRECTORS AS AT 31DECEMBER 2009

DR. GIULIO MASASSO T. PAUNGA
Dr. Paunga has been the Chairman of the Bank Board since March 2009.

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

MR. PAULA TAUMOEPEAU
(Alternate : Mr David Edwards)
Business man and has been a director of the Bank since September 2009.

MR. POUSIMA AFEAKI
(Alternate: Mr Minoru Nishi Jr)
Commercial Farmer who has been a director of the Bank since March 2009.

MR. SIMIONE SEFANAIA
Managing Director of the Bank since October 2006.

BOARD WITH SENIOR MANAGEMENT

CHAIRMAN'S REPORT 2009

I am pleased to report that the Tonga Development Bank continued to deliver positive financial results despite the worldwide and domestic declining trend in the economic conditions for the fiscal year ended 31 December 2009. A net profit after tax of T$1.56 million was recorded for the end of the year, an increase of T$0.61 million compared to T$0.95 million in 2008.

It should also be noted that in July 2009 the Bank suffered a major theft and although the reported loss was limited by insurance and stop payment of cheques it is significant and a concern that it remains unresolved.

System liquidity improved substantially in 2009 compared to 2008. The very high liquidity towards the end of the year resulted in deposit interest rates falling below 5%.

The Bank's profitability was affected by:

- Lower actual approvals as compared to budget. This was due to the prevailing economic conditions resulting in the lack of viable and sustainable projects presented for funding. Also, we had, in planning, anticipated increased opportunities for loans to support the agriculture sector. This was expected to come from the establishment of a blast freezer, fumigation chamber and renovation of the High Temperature Forced Air Treatment Plant at the airport to become operational in 2009. However these developments were delayed and the lending demand did not eventuate. There were also many inquiries for loans to be refinanced from the commercial banks but most were outside policy and/or not viable therefore not taken up.
- The level of provisioning for 2009 was lower than 2008. This was due mainly to the change in provisioning policy endorsed by the National Reserve Bank of Tonga (NRBT) whereby all Credit Risk Rate D accounts were provisioned at least 50% of total debt and all Credit Risk Rate E accounts were provisioned at 100% of total debt regardless of availability of possibly realizable security assets. Also all C3 accounts with provisions were removed.
- More efficient control of costs, on the positive side.

Throughout the period Management continued to maintain a strong and open relationship with the Reserve Bank of Tonga and Government. As a Bank we recognized the challenges facing lenders locally and we therefore restricted our lending to good viable projects within the bank's policy guidelines.

The Board acknowledges and commends the NRBT on its effective management of the liquidity situation in consultation and working together with the Association of the Banks in Tonga (ABT). This resulted in the liquidity shortage experienced in 2008 being effectively addressed in 2009. At the end of 2009 there was surplus liquidity in the banking system. This resulted in the substantial reduction in deposit interest rates with some of the resulting benefits transferred to customers through reduction in lending interest rates.

The robbery case which occurred in July 2009 was an unfortunate event and the first of its kind to happen to the Bank. It is still under investigation by the Police Department. The total amount of cheques and cash stolen was about $500K. The estimated net loss to the Bank is about T$130k, while the rest of about T$370K was recovered from both insurance and replacement cheques. The Bank has tightened security measures including installation of high-tech security cameras at Head Office and the Hahake District Office in Tongatapu. Similar installations are scheduled for Vava'u, Ha'apai and 'Eua Branch in 2010.

An ADB consultant completed a study on the potential for the Bank to increase its micro finance activities. The Bank has since reviewed the various recommendations and has started to implement some options, but with some modifications.

In our drive to extend lending to disadvantaged groups in the society the Bank has created a micro product that allows lending to customers in the agricultural sector that do not have the usual security collateral to satisfy existing lending policy requirements. At present this product is still under trial.

We are committed to ensure continuance of good governance and compliance practices so as to meet the requirements of the National Reserve Bank of Tonga (NRBT) as well as the International Financial Reporting Standards (IFRS) and Basel Banking accord initiatives. These commitments are also supported by our own policy and operational manuals that are regularly reviewed to ensure that they remain relevant to local market conditions.

We continue to support our people's involvement in a diverse range of activities within the community and sponsorship of many organization's events that promote health, education, sports and community development.

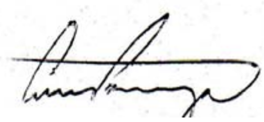
Economic and market conditions for 2009 were expected to improve as a result of the proposed establishment of a blast freezer, fumigation chamber and renovation of the High Temperature Force Air Treatment Plant (HTFATP) at the airport and to become operational during the year. It was anticipated that these facilities would have created export opportunities to result in increased lending income earning opportunities, as well as improved distribution of income in rural areas. However these developments did not eventuate and are now anticipated during 2010.

There is still a need to increase lending to the agricultural sector as a basis for improving economic development. However this very much depends on construction of appropriate infrastructure, overcoming of certain regulatory requirements, and further development of existing export industries such as kava, vanilla, vegetables, root crops and squash. Late in 2009 the Board approved for the Managing Director to join a Private sector initiative to visit Japan and Korea with the intend of re-establishing the fortunes of the squash industry here in Tonga. The benefits of this visit are expected to show positive results from the 2010 season.

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 Customer Service and efficiency of our operations.

I acknowledge the effort and commitment of the TDB Management team in achieving the result for 2009. I would also like to thank the Board of Directors for their valuable contribution in the provision of strategic direction towards achieving the Bank's goals and objectives for the year.

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.



………………………………..
Dr. Giulio Masasso T. Paunga
Chairman

MANAGING DIRECTOR'S REVIEW

Tonga Development Bank has again delivered another positive result for its shareholder during 2009 despite the very difficult economic conditions experienced during the year.

Our continued focus on strategic areas of activity and improving efficiency during 2009 has resulted in a most pleasing result with after tax profits of T$1.56 million.

The declining trend in economic conditions experienced in 2009 affected the Bank's rate of growth and performance and resulted in the performance in some areas being below expectations.

The overall financial results for 2009 were satisfactory as reported below:

	IFRS Adoption			
Key performance Indicators	**2009**	**2008**	**2007**	**2006**
	%	%	%	%
Net Interest Income to average total assets	5.4	5.6	6.2	6.9
Non Interest income to average total assets	6.3	4.5	4.1	4.9
Operating Costs to income	70.9	64.7	74.3	68.4
Return on equity	9.4	3.8	5.0	7.1
Return on Average Earning Assets	3.2	1.7	2.3	3.0

Overview of Financial Performance
(All figures are in Tongan Pa'anga)

The after tax profit was $1,569,885 for the twelve months ending 31 December 2009 compared to $951,093 for the year to 31 December 2008. The Major contributing factors to this result were:

- Net operating income increased by 3.1% from $6,360,141 in 2008 to $6,557,366 at year end 2009.
- Interest Income decreased by 11.2% from $6,081,794 in 2008 to $5,398,992 at year end 2009.
- Non interest income increased by 20.3% from $2,802,716 in 2008 to $3,372,711 at year end 2009. The increase was largely due to deferring Establishment Fees from 2007 and 2008 due to adoption of IFRS.
- Reduction in the Interest and other borrowing expenses by 12.3%. The reduction was largely due to reduction in the interest on saving deposits by 43.7%, cost of borrowings by 40.0% and cost of promissory notes by 4.6%.
- Operating expenses (excluding bad debts) reduced by 2.5% percent from $4,109,658 in 2008 to $4,007,166 in 2009. This was mainly due to reduced utility and administration costs during the year.
- Reduction in provisioning for impaired loan.

Loan Portfolio

The total loan portfolio recorded decline of 24.0% from $48 million in 2008 to $36.0 million at year-end 2009. The reduction was largely due to a repayment of one major agricultural loan of $9.2 million in 2009 and lower approval than budgeted.

Approval

The level of approvals dropped by 11.0% from 15.9 million in 2008 to $14.2 million in 2009. This was largely due to the prevailing economic conditions resulting in the lack of viable projects to be funded. There were many enquiries for loans to be refinanced from commercial banks but those outside policy and already struggling were not considered.

Approval Position by Sector	2009	2008
Housing and Personal Loan	48%	41%
Industries and Business	23%	32%
Agriculture and Fisheries	24%	22%
Staff Loan	5%	4%
Squash Loan	-	1%
Total	100%	100%

The Housing and Personal Loans remained the dominant sector of the Bank's portfolio.

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, vanilla, vegetables, root crops and squash.

Root crops has continued to be the major contributor to total agricultural lending during the year. This continued to reflect lack of alternative crops.

The Bank continued to assist the development of the squash industry because of its positive potential for the economy but general reluctance to borrow in 2009 reflects the challenges faced by the Industry.

Micro Lending Product

The Bank introduced a special Micro Lending Product in March 2009. The procedure involves meetings and training of borrowers on project proposals before they receive funding assistance. Key players for technical aspects involve the Ministry of Agriculture, Fisheries, Forestry and Food extension officers and for verification involve the Town Officers. Thus, potential borrowers are properly educated and provided with financial skills before they draw down on the loan. Criteria of this product allows clients with lower security coverage to participate and lower interest rates and fees are charged. A special component requiring savings was also built into the product.

Outer Island Development

Lending at Outer Islands amounted to $3.7 million contributing 26 percent in amount and 40 percent of accounts to the total loan approvals for the year. This is the same level as of year end 2008.

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 2009, 566 loans were approved totaling $1,278K. 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. Note that there is increased lending to this sector as compared to 2008 (303 accounts with $784K).

Arrears

The arrears ratio was recorded at 3.92% at year end 2009 as compared to a target of 5.0%. This is a big improvement from an arrears ratio of $7.04% in 2008.

In terms of Good vs Bad Bank we achieved a ratio of 92.8% to 7.2% in 2009. The target for 2009 was 90% : 10%.

Provision

There has been a remarkable decline in Provisions for loan losses and was due largely to the removal of the C3 accounts with provisions and introduction of group provisioning during the year.

We were conscious of the IFRS requirements for provisioning and we have continued to focus our strategy on making sure that quality of loans and security assets are maintained.

General loan recoveries and some write back from provisions also contributed to the level of profitability for 2009.

	2009 $	IFRS Adoption 2008 $
Specific Provision	2,505,107	2,605,913
Productive Provision	-	2,807,864
Collective Provision	526,711	-
Total Provision	**$3,031,818**	**$5,413,759**

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 continued in 2009. This contributed significantly to maintaining quality and consistency in our loan portfolio.

Information Systems

The overall technology delivery and services in 2009 were satisfactory. The performances were focused on maximizing benefits in terms of productivity gains and process improvements for the bank's operation. This includes:

- the installation of the Bank's security and alarm system;
- replacing of the UPS machine to provide continuity power for around 36 PCs when there is a sudden shut down;
- upgrading of the Bank's payroll system from Micropay Payroll Manager system to Micropay Meridian;
- revising of the Bank's Disaster Recovery Plan and Business Continuity Plan to include preparations and action plans for a Tsunami Disaster.

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 2009, 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.

Funding

Loan repayments has continued to be the Bank's main funding source. Promissory Note issues have also supported funding at competitive interest rates.

Savings Bank has continued to provide a source of funding in 2009.

The deadline for drawdown from the EIB loan was August 2009. There were no drawdown in 2009.

MANAGING DIRECTOR'S REVIEW (continued)

Funding Sources:

	2009 ($000)	2009 %	2008 ($000)	2008 %
Loan Repayment	11,968	71.3	15,357	93.4
Promissory Notes	861	5.1	403	2.4
Saving Deposit net increase	337	2.0	(354)	(2.2)
Net increase from operation	3,164	18.8	1,805	10.9
Net increase from investments	468	2.8	(744)	(4.5)
Total	**$16,799**	**100%**	**$16,467**	**100%**

Staff

The number of our full time staff was reduced during the year by 2 to 118. Staff who resigned or retired were not automatically replaced. Four staff retired at end of 2009.

Staff Training

Most of the training conducted were on the job training. Three staff were attending overseas training / workshops.

Staff Retirement Fund

The Bank continued to maintain its Retirement Fund Scheme which has operated since 1st January 1990.

The Fund's total assets as at 31st December 2009 was recorded at $4.1 million.

Customer Service

The Bank continued to implement its customer surveys to identify shortfalls in this area. We also continued to enhance our good relationship and seeking to maintain and improve our customer service level and add value to the business and personal aspirations of our valued customers.

Staff Quarterly Awards continued in 2009 aiming to improve staff morale and their effectiveness in performance of Customer Service.

Customer complaints process continued in 2009. It provided customer feedback on specific matters which required immediate attention.

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

We will be looking at completing a feasibility study into the future direction of the Bank.

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 2009.

I acknowledge the ongoing support received by the Bank from the Ministry of Finance and National Planning, Ministry of Public Enterprises and other related Government Ministries during the year 2009. The Government, as shareholder, has given invaluable support to the Bank in fulfilling its objectives in 2009.

The level of profitability for 2009 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 2009 are 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.

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

Malo 'aupito

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

FIVE YEARS SUMMARY

Profit & Loss TOP $'000s	2005	2006	2007 Restated	2008 IFRS Adoption	2009	Movement 2008/2009
Interest Income	5,516	5,991	6,282	6,082	5,399	-11.2%
Interest Expense	2,119	2,045	2,409	2,524	2,214	-12.3%
Net Interest Income	3,397	3,946	3,873	3,557	3,185	-10.5%
Fees & commission income	2,377	2,175	2,265	2,604	3,013	+15.7%
Other Operating Income	190	192	164	199	360	+80.9%
Losses on loans & advances	(31)	901	816	1,009	576	-42.9%
Bad Debts	22	30	52	45	49	+8.9%
Income Tax Expense	642	304	406	333	437	+31.2%
Operating Profit after tax	2,105	1,690	1,216	951	1,570	+65.1%
Earnings per share	2.00	1.61	1.15	0.90	1.49	+65.5%

Balance Sheet TOP $'000s	2005	2006	2007 Restated	2008 IFRS	2009	Movement 2008/09
Average assets	56,826	57,492	62,481	63,987	58,632	-8.4%
Total Assets	54,963	60,022	64,933	63,037	54,227	-14.0%
Gross Loans	41,252	43,472	48,633	47,984	36,011	-24.9%
Saving Deposits	3,251	4,647	4,757	4,403	4,740	+7.6%
Shareholder's equity	19,989	23,978	24,587	25,063	16,670	-33.5%

Performance Ratios	2005	2006	2007 Restated	2008 IFRS Adoption	2009	Movement 2008/ 09
Return on Assets	3.7%	2.9%	1.9%	1.5%	3.6%	+2.1%
Return on Equity	10.5%	7.1%	5.0%	3.8%	9.4%	+5.6%
Operating Costs to Total Income	69.2%	70.4%	73.0%	74.7%	70.9%	-3.8%
Operating Income to Average Portfolio	20.2%	19.7%	19.9%	18.4%	23.2%	+4.8%

TONGA DEVELOPMENT BANK LIMITED
DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2009

In accordance with a resolution of the Board of Directors, the directors herewith submit the Balance Sheet as at 31 December 2009, Statement of Comprehensive Income, Statement of Changes in Equity and Statement of Cash Flows 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 period and up to the date of this report:

- Dr. Masasso T. Paunga (Chairman – appointed 20 March 2009)
- Lennie Niit
- Pousima Afeaki (appointed 20 March 2009)
- Paula Taumoepeau (appointed 1 September 2009)
- Simione Sefanaia (Managing Director)
- Minoru Nishi JR (Alternate - appointed 1 September 2009)
- David Edwards (Alternate - appointed 1 September 2009)
- 'Aisake Valu Eke (Chairman – resigned 1 January 2009)
- Hon. Paul Karalus (Deputy Chairman – resigned 15 March 2009)
- Sepa Mafi (resigned 31 October 2009)
- Paulo Kautoke (Alternate - resigned 20 May 2009)
- Mana Latu (Alternate - resigned 31 August 2009)

2. PRINCIPAL ACTIVITY

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

During the year ended 31 December 2009 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 2009 was $ 1,569,885 (2008: $951,093).

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 approved 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 which was paid on 26 June 2009.

A bonus dividend of $9,177,840 was recommended by the Board and approved by the Shareholder at an Extra-ordinary General Meeting on the 16 October 2009. This bonus dividend was applied to repay the Squash Exporters Council Incorporated Limited loan at the Bank.

The directors also recommended that dividend based on 50% of net profit after tax be declared for the year ended 31 December 2009. This amounted to $784,943 or $0.75 per issued share.

6. RESERVES

The directors recommend that no amounts be transferred to reserves in respect of the year ended 31 December 2009.

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, directors are not aware of any other matters 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 2009 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 this 5th day of March, 2010.

……………………..	……………………………
Simione Sefanaia	**Dr. Masasso T. Paunga**
Managing Director	**Chairman of the Board**

TONGA DEVELOPMENT BANK LIMITED

DIRECTORS' STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2009

In the opinion of the Directors:

(a) the accompanying statement of comprehensive income is drawn up so as to give a true and fair view of the results of the Bank for the year ended 31 December 2009;

(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 2009;

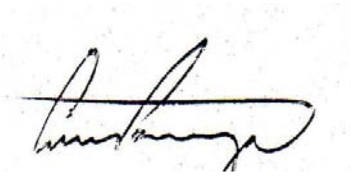
(c) the accompanying statement of changes in equity is drawn up so as to give a true and fair view of the movement in shareholder's funds for the year ended 31 December 2009; and

(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 2009.

Signed in accordance with a resolution of the directors this 5th of March , 2010.

……………………………

Simione Sefanaia
Managing Director



…………..………………

Dr. Masasso T. Paunga
Chairman of the Board

INDEPENDENT AUDIT REPORT TO THE MEMBERS OF TONGA DEVELOPMENT BANK LIMITED

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers
52 Narara Parade
P O Box 54
Lautoka, Fiji Islands
Telephone +679 666 0400
+679 666 1055
Facsimile +679 666 1798
+679 666 4671

Scope

We have audited the accompanying financial statements of the Tonga Development Bank Limited which comprise the balance sheet as of December 2009 and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes as set out on pages 15 to 48.

Directors' and Management's Responsibility for the Financial Statements

Directors and management are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and with the requirements of the Tonga Companies Act, 1995 and Tonga Development Bank Act, 1977. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

This report is made solely to the Bank's shareholders, as a body, in accordance with Section 214(1) of the Tonga Companies Act 1995. Our audit work has been undertaken so that we might state to the Bank's shareholders those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank and the Bank's shareholders as a body, for our audit work, for this report, or for the opinions we have formed. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

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

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

PRICEWATERHOUSECOOPERS

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 2009 and of its financial performance, changes in equity, and its cash flows of the Bank for the year ended on that date;

      (b) give the information required by the Tonga Development Bank Act 1977 and Tonga Companies Act 1995 in the manner so required.

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

……………………………...

8 March 2010
Lautoka, Fiji

PricewaterhouseCoopers
Chartered Accountants

Tonga Development Bank Limited

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2009

	Notes	2009 $	2008 $
Continuing operations			
Interest income	6	5,398,992	6,081,794
Interest and other borrowing expenses	6	(2,214,337)	(2,524,369)
Net interest income		3,184,655	3,557,425
Fees and commission income	7	3,013,125	2,603,693
Other operating income	8	359,586	199,023
Net operating income		6,557,366	6,360,141
Losses on loans and advances	14	(575,943)	(1,008,722)
Non-lending loss	9	(130,000)	-
Bad debts written off		(49,040)	(44,923)
Bad debts recovered/reversed		211,332	87,234
Other operating expenses	10	(4,007,166)	(4,109,658)
Profit before income tax		2,006,549	1,284,072
Income tax expense	20	(436,664)	(332,979)
Profit for the year from continuing operations		**$1,569,885**	**$951,093**
Other comprehensive income		-	-
Total comprehensive income for the year		**$1,569,885**	**$951,093**
Earnings per share	29	$1.49	$0.90

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

TONGA DEVELOPMENT BANK LIMITED

BALANCE SHEET AS AT 31 DECEMBER 2009

	Notes	2009 $	2008 $
ASSETS			
Cash on hand and at Bank	11	2,816,802	931,130
Investment securities – held to maturity	13	7,984,942	7,500,000
Loans and advances	14	32,979,051	42,570,390
Other assets	15	565,161	421,022
Amounts receivable from shareholder	16	9,270	64,061
Amounts receivable from NRBT	17	39,000	-
Statutory reserve deposit	17	981,000	1,826,000
Property, plant and equipment	18	6,824,566	7,115,614
Investment property	19	1,010,097	1,069,282
Deferred tax asset	20	1,017,206	1,539,540
Total Assets		$54,227,095	$63,037,039
LIABILITIES			
Savings deposits		4,739,703	4,402,564
Other liabilities	21	874,910	1,129,962
Amount payable to NRBT	17	-	66,000
Borrowings	22	29,994,546	29,810,160
Current tax liability	20	-	532,059
Managed funds	23	130	309,372
Deferred tax liability	20	1,163,181	1,248,795
Provision for dividend	28	784,943	475,547
Total Liabilities		37,557,413	37,974,459
SHAREHOLDERS' EQUITY			
Share capital	24	10,530,190	10,530,190
Retained earnings		6,139,492	14,532,390
Total Shareholders' Equity		16,669,682	25,062,580
Total Equity and Liabilities		$54,227,095	$63,037,039

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

Signed in accordance with a resolution of the directors this 5th day of March, 2010.

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

……………………………..
Dr. Masasso T. Paunga
Chairman of the Board

TONGA DEVELOPMENT BANK LIMITED

STATEMENT OF CHANGES IN EQUITY - YEAR ENDED 31 DECEMBER 2009

	Notes	Share Capital	Retained Earnings	Total
		$	$	$
Balance 31 December 2007		10,530,190	14,056,844	24,587,034
Comprehensive income for the year		-	951,093	951,093
Transactions with owners - Dividends	28	-	(475,547)	(475,547)
Balance 31 December 2008	30	$10,530,190	$14,532,390	$25,062,580
Comprehensive income for the year		-	1,569,885	1,569,885
Transactions with owners – dividends	28	-	(9,962,783)	(9,962,783)
Balance 31 December 2009	30	$10,530,190	$6,139,492	$16,669,682

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

TONGA DEVELOPMENT BANK LIMITED

CASH FLOW STATEMENT - YEAR ENDED 31 DECEMBER 2009

	Note	2009 $	2008 $
Cash flows from operating activities			
Interest received		5,699,260	5,976,948
Interest payment		(2,307,793)	(2,564,579)
Fees and commission received		2,934,577	2,632,436
Other income		232,691	160,920
Income tax paid		(532,059)	(714,794)
Payment to employees and suppliers		(3,119,716)	(3,685,597)
Cash flows from operating activities before changes in operating assets and liabilities		2,906,960	1,805,334
Changes in operating assets and liabilities:			
Disbursements of Loans		(13,186,501)	(14,657,995)
Repayments of loans		11,968,466	15,357,461
Increase in other debtors and prepayments		(144,139)	(25,624)
Decrease in amounts receivable from shareholder		54,791	(64,061)
Increase/(decrease) in other liabilities		202,702	(146,921)
Net cash from operating activities		1,802,279	2,268,194
Cash flows from investing activities			
Purchase of property, plant and equipment		(335,863)	(287,330)
Proceeds from sale of plant and equipment		10,218	6,503
Net decrease/(increase) in statutory deposits		740,000	(443,000)
Net decrease in Government bonds		54,000	(20,000)
Net cash from / (used in) investing activities		468,355	(743,827)
Cash flows from financing activities			
Net increase in TDB promissory notes		861,090	402,750
Net increase /(decrease) in savings deposits - Balance Sheet		337,139	(354,319)
Dividend paid		(475,547)	(606,990)
Net payments in TDB bonds		-	(931,069)
Repayment of borrowings		(676,702)	(495,603)
Net cash from /(used in) financing activities		45,980	(1,985,231)
Net increase (decrease) in cash and cash equivalents		2,316,614	(460,864)
Cash and cash equivalents at beginning of year		5,031,130	5,491,994
Cash and cash equivalents at year end	12	$7,347,744	$5,031,130

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.

Note 2. **Summary of Significant Accounting Policies**

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

(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 Bank 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) Standards, amendments and interpretations effective on or after 1 January 2009

The following standards, amendments and interpretations, which became effective in 2009 are relevant to the Bank:

IFRS 7 "Financial instruments - Disclosures' (amendment) - effective 1 January 2009. the amendment requires enhanced disclosures about fair value measurement and liquidity risk. In particular, the amendment requires disclosure of fair value measurements by level of a fair value measurement hierarchy. As the change in accounting policy only results in additional disclosure, there is no impact on earnings per share.

IAS 1 (revised). 'Presentation of financial statements' - effective 1 January 2009. The revised standard prohibits 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 in a statement of comprehensive income.

IAS 32 and IAS 1, 'Puttable financial instruments are obligations arising on liquidiation' The IASB amended IAS 32 in February 2008. It now requires some financial instruments that meet the definition of a financial liability to be classified as equity. Puttable financial instruments that represent a residual interest in the net assets of the entity are now classified as equity provided that specified conditions are met. Similar to those requirements is the exception to the definition of a financial liability for instruments that entitle the holder to a pro rata share of the net assets of an entity only on liquidation. The adoption of the IAS 32 amendment does not have any material effects for the Bank.

The following interpretation became effective in 2009, but was not relevant for the Bank's operations:

- IFRS 2, 'Share-based payment' - Vesting conditions and cancellations
- IFRIC 16, 'Hedges of a net investment in a foreign operation'
- IFRIC 13, 'Customer loyalty programmes'

(ii) Standards and amendments early adopted by the Bank

The Bank has not early adopted any standards and amendments.

Note 2. Summary of Significant Accounting Policies (continued)

(a) **Basis of preparation (**continued)

(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 2010 or later periods, but the bank has not early adopted them:

IFRIC 17, 'Distribution of non-cash assets to owners' (effective on or after 1 July 2009). The interpretation is part of the IASB's annual improvements projects published in April 2009.This interpretation provides guidance on accounting for arrangements whereby an entity distributes non-cash assets to shareholders either as a distribution of reserves or as dividends. IFRS 5 has also been amended to require that assets are classified as held for distribution only when they are available for distribution in their present condition and the distribution is highly probable. The bank will apply IFRIC 17 from 1 January 2010. It is not expected to have a material impact on the bank's financial statements

IFRIC 18, 'Transfers of assets from customers'. IFRIC 18 was issued in January 2009. It clarifies how to account for transfers of items of property, plant and equipment by entities that receive such transfers from their customers. The interpretation also applies to agreements in which an entity receives cash from a customer when that amount of cash must be used only to construct or acquire an item of property, plant and equipment, and the entity must then use that item to provide the customer with ongoing access to supply of goods and/or services. The bank is not materially impacted by applying IFRIC 18.

IFRS 9, 'Financial instruments part 1: Classification and measurement' IFRS 9 was issued in November 2009 and replaces those parts of IAS 39 relating to the classification and measurement of financial assets

(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 who makes strategic decisions.

(c) Foreign currency translation

(i) Functional and presentation currency

Items included in the financial statements of the Bank 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 fro m the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement

Note 2. Summary of Significant Accounting Policies (continued)

(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 no 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.

(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 response 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.

Note 2. Summary of Significant Accounting Policies (continued)

(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 Bank 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.

(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 o f, 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 Bank of financial assets is impaired. A financial asset or a Bank 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 Bank 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 b y 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.

Note 2. Summary of Significant Accounting Policies (continued)

(h) Impairment of financial assets (continued)

Assets carried at amortised cost (continued)

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.

(i) Property, plant and equipment

Land and buildings comprise mainly Bank offices located in the island o f Kingdom o f 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	8
Library	8
Machines	8
Computers	4
Vehicles	4 - 5

The useful lives for furniture and equipment, library and machines have been revised from 5 years to 8 years and computers from 5 years to 4 years by management and accordingly the effect on the financial statements is a reduction in depreciation charge by approximately $2,981.

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.

Note 2. Summary of Significant Accounting Policies (continued)

(j) **Investment Property** (continued)

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, 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 u se are:

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

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 amortisatio n 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 exceed s 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 Banked at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered 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.

Note 2. Summary of Significant Accounting Policies (continued)

(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.

(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
Dividend s 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 before the balance sheet date are dealt with in the statement of changes in equity.

(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.

Note 2. Summary of Significant Accounting Policies (continued)

(t) Comparatives

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

Note 3. 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.

3.1 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 3. Financial Risk Management (continued)

3.1 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. These were transferred to C1 and C2 in September 2009.
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 o f 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.

3.2 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 Banks, and to industries.

The Bank structures the levels of credit risk it undertakes b y placing limits on the amount of risk accepted in relation to one borrower, or Banks 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 shareholders/directors; 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 3. Financial Risk Management (continued)

3.3 Impairment and provisioning policies

The internal rating systems described in Note 3.1 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:

Bank's rating

	2009		2008	
	Loans and Advances (%)	**Impairment Provision (%)**	**Loans and Advances (%)**	**Impairment Provision (%)**
A	2.55	-	1.37	-
B	19.21	-	11.01	-
C1	59.23	-	41.89	6.8
S	1.35	-	24.41	5.2
C3	-	-	11.16	39.7
C2	11.92	52.5	0.79	0.2
D	4.37	31.4	7.38	39.1
E	1.37	16.1	1.99	9.0
	100	100	100	100

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 it's enforceability) and the anticipated receipts for that individual account.

C3 loans were transferred to C1 and C2 in September 2009 following a review by the Asian Development Bank.

Note 3. Financial Risk Management (continued)

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

	2009		2008	
	$	%	$	%
Industry sector:				
Agriculture	7,034,530	19.3	18,891,300	39.4
Industry and Business	8,704,640	23.9	9,340,249	19.4
Housing and Personal	17,876,790	49.0	17,124,279	35.7
Staff	2,852,611	7.8	2,628,321	5.5
	$ 36,468,571	100.0	$ 47,984,149	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 Bank in the portfolio, are backed by collateral;
- Risk assessment review by Risk Management Manager; and
- The bank has introduced a stringent selection process upon granting loans and advances.

3.5 Loans and advances

(i) Loans and advances are summarised as follows:

As at 31 December 2009	Agriculture	Industry & business	Housing & personal	Staff	Total
	$	$	$	$	$
Neither past due nor impaired	3,857,378	4,979,856	14,685,619	2,782,495	26,305,348
Past due but not impaired	880,137	768,027	1,567,562	46,177	3,261,903
Individually impaired	2,168,794	2,904,623	1,370,200	-	6,443,617
Gross	6,906,309	8,652,506	17,623,381	2,828,672	36,010,868
Less: allowance for impairment	(1,332,031)	(553,960)	(1,145,826)	-	(3,031,817)
Net	$5,574,278	$8,098,546	$16,477,555	$2,828,672	$32,979,051

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

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 3. Financial Risk Management (continued)

3.5 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 2009	Agriculture	Industry & Business	Housing & Personal	Staff	Total
	$	$	$	$	$
Grades					
A	19,338	552,141	325,099	32,380	928,958
B	159,465	1,419,972	4,739,217	686,746	7,005,400
C1	3,315,557	3,059,877	9,874,711	2,087,309	18,337,454
C2	491,239	-	-	-	491,239
	$3,985,599	$5,031,990	$14,939,027	$2,806,435	$26,763,051

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

(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 2009	Agriculture	Industry & Business	Housing & Personal	Staff	Total
	$	$	$	$	$
Past due up to 30 days	647,031	514,393	1,115,103	46,177	2,322,704
Past due 30 – 60 days	164,009	153,952	404,929	-	722,890
Past due 60 – 90 days	69,097	99,682	47,530	-	216,309
	$880,137	$768,027	$1,567,562	$46,177	$3,261,903
Fair value of collateral	$4,684,604	$464,421	$3,128,331	$3,800	$8,281,156

Note 3. Financial Risk Management (continued)

3.5 Loans and advances

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

(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 2009					
Term loans	227,796	162,237	296,523	4,909	691,465
As at 31 December 2008 Term loans	361,560	228,752	348,356	-	938,668

(v) Repossessed collateral

During year, the Bank obtained assets by taking possession of collateral held as security, as follows:

Nature of assets	Carrying amount	
	2009	**2008**
	$	$
Land - Tax allotment	60,000	10,000
Town allotment	15,000	7,000
Motor Vehicle	32,000	-

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

(vi) Loans and advance exposure by categories:

	2009	2008
	$	$
Large corporate entities	4,624,429	1,584,476
SMEs	28,025,765	43,752,707
Other	3,818,377	2,646,966
	$36,468,571	$47,984,149

Note 3. Financial Risk Management (continued)

3.6 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.

3.6.1 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:

	2009	2008
	$	$
Liabilities		
Borrowings – foreign	$ 248,239	$ 455,608

3.6.2 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.

3.7 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 Bankings based on the remaining period at balance sheet date to the contractual maturity date.

Note 3. Financial Risk Management (continued)

3.7 Liquidity risk

Maturities of assets and liabilities

As at 31 December 2009	**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	2,816,802	-	-	-	-	-	2,816,802
Investment securities – held to maturity	200,000	2,230,942	3,100,000	2,454,000	-	-	7,984,942
Loans and services	2,075,286	2,976,514	8,482,907	12,739,509	6,247,133	457,702	32,979,051
Statutory reserve deposit	-	-	-	-	-	981,000	981,000
Property, plant and equipment	-	-	-	-	-	6,824,566	6,824,566
Investment Property	-	-	-	-	-	1,010,097	1,010,097
Other assets	39,000	353,672	220,759	1,017,206	-	-	1,630,637
Total Assets	$5,131,088	$5,561,128	$11,803,666	$16,210,715	$6,247,133	$9,273,365	$54,227,095
Liabilities							
Saving deposits	4,739,703	-	-	-	-	-	4,739,703
Borrowings	50,078	65,900	276,856	2,124,065	2,132,063	-	4,648,961
Promissory Notes	1,388,498	2,840,086	10,659,795	10,457,206	-	-	25,345,585
Other liabilities	-	1,659,852	130	1,163,181	-	-	2,823,163
Total Liabilities	6,178,279	4,565,838	10,936,781	13,744,452	2,132,063	-	37,557,413
Net Liquidity Gap	$(1,047,191)	$995,290	$866,885	$2,466,263	$4,115,070	$9,273,365	$16,669,682
As at 31 December 2008							
Total Assets	5,356,739	6,470,205	16,745,871	17,371,403	6,593,467	10,499,354	63,037,039
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

Note 3 Financial Risk Management (continued)

3.8 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 2009	**No later than 1 year**	**1 – 5 years**	**Over 5 years**	**Total**
	$	$	$	$
Loan commitments	3,531,206	-	-	3,531,206
Operating lease commitments	8,620	34,480	212,740	255,840
Capital commitments	-	-	-	-
Total	$3,539,826	$34,480	$212,740	$3,787,046
At 31 December 2008				
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

3.9 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 $3,454,000 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 3. Financial Risk Management (continued)

3.9 Fair value of financial assets and liabilities (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.

3.10 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.

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 2009 and year ended 31 December 2008. During those two years, the Bank complied with all of the externally imposed capital requirements to which they are subject.

Tier 1 Capital	**2009**	**2008**
	$	$
Share capital	10,530,190	10,530,190
Retained earnings	6,139,492	14,532,390
Total	$16,669,682	$25,062,580
Risk weighted assets	$32,979,051	$42,570,390
Ratio	50.55%	58.87%

Note 4. 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 5. 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 6. Net Interest Income

	2009	2008
	$	$
Interest income		
Loans and advances	4,829,790	5,407,486
Term deposits and securities	569,202	674,308
	$5,398,992	$6,081,794
Interest and other borrowing expenses		
Borrowings	160,594	267,631
TDB promissory notes	1,973,429	2,069,396
TDB bonds	-	49,071
Savings deposits	76,238	135,466
Bank overdraft	4,076	2,805
	$2,214,337	$2,524,369

Borrowings cost comprises foreign exchange loss/ (gain) of ($22,561) (2008: exchange loss of $62,641)

Interest income accrued on impaired financial assets is $16,448 (2008: $67,164)

Note 7. Fees and Commission Income

	2009 $	2008 $
Service fees	2,660,098	2,116,278
Commissions	353,028	487,415
	$3,013,125	$2,603,693

Note 8. Other Operating Income

	2009 $	2008 $
Rent	103,380	87,037
Other	256,206	111,986
	$359,586	$199,023

Note 9. Non lending loss

The Bank has recorded a non lending loss of $130,000 (2008: $Nil) in respect of the Bank robbery during the year.

Note 10. Other Operating Expenses

	2009 $	2008 $
Staff costs (refer below)	2,044,911	2,090,565
Administrative expenses	547,897	593,949
Auditor's remuneration - audit	51,928	48,378
Depreciation - Property, plant and equipment	497,709	575,925
- Investment property	59,185	58,953
Gain/(loss) on sale/disposal of plant and equipment	118,988	(6,503)
Premises	241,514	367,529
Travel	203,937	225,970
Insurance loss	1,933	16,321
Others	239,168	138,571
	$4,007,166	$4,109,658

Staff costs comprise:

Wages and salaries and other staff costs	1,938,215	1,925,616
Retirement fund	106,696	164,743
	$2,044,911	$2,090,359

Note 10. Other Operating Expenses (continued)

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

	2009 $	2008 $
Cash on hand	121,599	272,999
Cash at Bank	2,695,203	658,131
	$2,816,802	$931,130

Note 12. Cash and Cash Equivalents

	2009 $	2008 $
For the purposes of the cash flow statement, cash and cash equivalents comprise the following:		
Cash on hand and at Bank	2,816,802	931,130
Investment securities – Westpac Bank of Tonga	4,530,942	4,100,000
	$7,347,744	$5,031,130

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

	2009 $	2008 $
Westpac Bank of Tonga	4,530,942	4,100,000
Government of Tonga Local Development Bond	3,454,000	3,400,000
	$7,984,942	$7,500,000

The year end interest rate receivable on term deposits range from 4.3% to 7.0% (2008: 9.25% to 9.75%) per annum and the interest rate for the Government of Tonga Local Development Bond range from 6.0% to 10% (2008: 6.75% to 10.00%) 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

	2009	2008
	$	$
Gross loans and advances	36,010,869	47,984,149
Less : Impairment losses on loans and advances	(3,031,818)	(5,413,759)
Net loans	$32,979,051	$42,570,390
Loans and advances approved but not yet disbursed amounted to:	$3,531,206	$2,762,530

Allowance for losses on loans and advances

	2009	2008
	$	$
Movements in allowance for losses on loans and advances are as follows:		
Balance at beginning of the year	5,413,759	4,811,290
Provision for loan impairment	2,973,160	1,904,250
Provisions written back	(2,397,217)	(895,528)
Loans written off during the year	(2,957,884)	(406,253)
Balance at end of year	$3,031,818	$5,413,759
Composition of allowance for losses on loans and advances:		
Specific provision	2,505,107	2,605,913
Productive provisions	-	2,807,846
Collective provisions	526,711	-
	$3,031,818	$5,413,759
The losses on loans and advances as shown in the income Statement is arrived as follows:		
Provision for loan impairment	2,973,160	1,904,250
Provisions written back	(2,397,217)	(895,528)
	$575,943	$1,008,722

Non accrual loans and advances

	2009	2008
Non accrual loans and advances	2,761,715	3,391,851
Less: specific provision for impairment	(1,211,544)	(1,801,864)
	$1,550,171	$1,589,987

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

In August 2009 the directors approved the adoption of a collective provisioning policy based on the existing internal credit risk rating system. The following percentages are assigned to each loan grade for the purposes of assessing collective provisions for those assets that a similar credit risk characteristics, and for which no specific provisions are made:

Grade	% for collective provisions
C1	2%
S	5%
C2	5%
D	50%
E	100%

Note 15. Other Assets

	2009	2008
	$	$
Prepayment	264,262	31,349
Accrued interest	220,759	310,668
Other assets	80,140	79,005
	$565,161	$421,022

Note 16. Amounts Receivable from Shareholder

	2009	2008
	$	$
Comprises the following:		
Claims for EEC	9,270	9,195
Claims for Subsidy	-	54,866
	$9,270	$64,061

Note 17. Statutory Reserve Deposit

	2009	2008
	$	$
National Reserve Bank of Tonga (NRBT)	$981,000	$1,826,000

The Statutory Reserve Deposit with National Reserve Bank of Tonga (NRBT) is not available for use in the Bank's day to day operations. The Statutory Reserve Deposit rate at year end was 5% (2008: 10%)

	2009	2008
	$	$
Amounts receivable from/(payable) to NRBT	$39,000	$66,000

Amounts receivable from/(payable) to NRBT represent surplus/(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
	$	$	$	$	$
For the ended 31 December 2008					
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 (net amount)	-	-	-	-	-
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 31December 2008					
Cost	6,947,830	922,873	516,084	1,787,038	10,173,825
Accumulated depreciation	(421,606)	(755,655)	(446,149)	(1,434,800)	(3,058,210)
Net book amount	$6,526,224	$167,218	$69,934	$352,238	$7,115,614
For the year ended 31 December 2009					
Opening net book amount	6,526,224	167,218	69,934	352,238	7,115,614
Additions	67,703	13,952	34,571	219,637	335,863
Disposals	(115,196)	(10,270)	(3,738)	-	(129,202)
Depreciation charge	(185,459)	(55,221)	(35,750)	(221,279)	(497,709)
Net book amount	$6,293,272	$155,680	$65,018	$350,596	$6,824,566

Note 18. Property, Plant and Equipment (continued)

At **31 December 2009**					
Cost	6,876,217	892,138	536,855	2,004,980	10,310,189
Accumulated depreciation	(582,944)	(776,458)	(471,837)	(1,654,384)	(3,485,623)
Net book amount	$6,293,272	$115,680	$65,018	$350,596	$6,824,566

The depreciation policy adopted in respect of the above is set out in Note 2 (i)

Note 19. Investment Property

	Land & Building $	Total $
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	(58,954)	(58,954)
Closing net book amount	$1,069,282	$1,069,282
At 31 December 2008		
Cost	1,187,221	1,187,221
Accumulated depreciation	(117,939)	(117,939)
Net book amount	$1,069,282	$1,069,282
For the year ended 31 December 2009		
Opening net book amount	1,069,282	1,069,282
Additions	-	-
Disposals	-	-
Depreciation charge	(59,184)	(59,184)
Closing net book amount	$1,010,097	$1,010,097
At 31 December 2009		
Cost	1,187,221	1,187,221
Accumulated depreciation	(117,124)	(117,124)
Net book amount	$1,010,097	$1,010,097

(a) The depreciation policy adopted in respect of the above is set out in Note 2 (j).

(b) The following amounts have been recognised in the Statement of Comprehensive Income:

	2009 $	**2008** $
Rental income	17,560	33,117
Direct operating expenses arising from investment properties	21,641	71,773

Note 20. Taxation

	2009 $	2008 $
Income tax is brought to account using the liability method of tax effect accounting.		
(a) Operating profit before income tax	$2,006,549	$1,284,072
Prima facie income tax charge on the operating profit at 25% (2008: at graduated rates to 30%)	501,638	370,222
Tax effect of non deductible expenditure:		
Grants and exempt income	(64,918)	(113,726)
Tax effect of prior year adjustment	-	18,334
Tax effect of over provision - prior year	(56)	-
Tax effect of change in tax rate - net	-	58,149
Income tax expense	$436,664	$332,979
(b) Income tax expense comprises:		
Current tax expense	-	532,059
Over provision – prior year	(56)	-
Deferred tax expense - net	436,720	(257,229)
Tax effect of change in tax rate - net	-	58,149
Income tax expense	$436,664	$332,979

(c) **Deferred tax asset**

	2009 $	2008 $
(i) Deferred tax asset comprises the net effect of the following (amounts recognized in profit or loss):		
Allowance for loan losses	757,955	1,353,440
Other provisions	19,669	20,159
Unrealised exchange loss	42,062	43,790
Unearned revenue	114,424	122,151
Tax loss for the year	83,096	-
	$1,017,206	$1,539,540
(ii) The movement in deferred tax asset is as follows:		
Balance at 1 January	1,539,540	1,613,430
Income statement (charge)/credit	(522,334)	219,017
Tax effect of change in tax rate	-	(292,907)
	$1,017,206	$1,539,540

Note 20. **Taxation** (continued)

	2009 $	2008 $
(e) **Deferred tax liability**		
(i) The balance comprises temporary differences attributable to:		
Depreciation	$1,163,181	$1,248,795
(ii) The movement in deferred tax liability is as follows:		
Opening balance	1,248,795	1,521,764
Tax effect of change in tax rate	-	(234,758)
Credit to income statement	(85,614)	(38,211)
	$1,163,181	$1,248,795

Note 21. **Other Liabilities**

	2009 $	2008 $
Accrued interest	531,291	634,928
Provisions for annual leave and staff bonus	78,677	80,637
Other creditors and accruals	264,942	414,397
	$874,910	$1,129,962

Other creditors and accruals include the following:

	2009	2008
Accruals and creditors	263,671	209,128
Withholding tax payable	-	6,663
Credit holding accounts	1,268	198,606
	$264,939	$414,397

Note 22. **Borrowings**

	Notes	2009 $	2008 $
Comprises:			
Borrowings	(a)	4,648,961	5,325,665
Tonga Development Bank promissory notes	(b)	25,345,585	24,484,495
		$29,994,546	$29,810,160

Note 22. Borrowings (continued)

(a) Borrowings comprise the following:	Principal repayment term	Interest rate	2009 $	2008 $
Government of the Kingdom of Tonga				
Asian Development Bank	1993 – 2023	3.00%	629,923	676,584
International Fund for Agriculture Development 2	1993 – 2013	3.00%	461,431	593,229
International Fund for Agriculture Development 3	1999 – 2020	3.00%	1,907,182	2,097,900
International Development Association	1998 – 2023	3.00%	1,402,188	1,502,344
			4,400,724	4,870,057
Other borrowings				
European Investment Bank VI	2009 - 2026	5.5%	207,571	240,103
European Union	1988 – 2019	1.50%	40,666	45,316
Agence Francaise Development	2000 – 2009	5.00%	-	170,189
			$248,237	455,608
			$4,648,961	$5,325,665

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.

	2009 $	2008 $
(b) Tonga Development Bank promissory notes	$25,345,585	$24,484,495

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.

	2009 $	2008 $
(c) Tonga Development Bank bonds	-	-

Tonga Development Bank Bonds were rolled over to Tonga Development Bank Notes on maturity on 31 August 2008.

Note 23. Managed Funds

The Bank manages these funds on behalf of the Government agencies and at year end the balances for respective funds were as follows:

	Total Funds $	Advance to Projects $	2009 $	2008 $
UNCDF Fisheries Development Fund	-	-	-	126,996
New Zealand Borrower Diversification Fund	315,241	315,111	130	182,376
	$315,241	$315,111	$130	$309,372

There was a payment of $126,996 to Ministry of Fisheries in 2009 for research facilities.

Note 24. Capital

	2009 $	2008 $
(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:

- Dr. Masasso T. Paunga (Chairman – appointed 20 March 2009)
- Lennie Niit
- Pousima Afeaki (appointed 20 March 2009)
- Paula Taumoepeau (appointed 1 September 2009)
- Simione Sefanaia (Managing Director)
- Minoru Nishi JR (Alternate - appointed 1 September 2009)
- David Edwards (Alternate - appointed 1 September 2009)
- Aisake Valu Eke (Chairman – resigned 1 January 2009)
- Hon. Paul Karalus (Deputy Chairman—resigned 15 March 2009)
- Sepa Mafi (resigned 31 October 2009)
- Paulo Kautoke (Alternate - resigned 20 May 2009)
- Mana Latu (Alternate - resigned 31 August 2009))

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

	2009 $	2008 $
Directors' fees and retirement benefit	117,522	76,996
Management's salaries & allowances	184,182	177,370
Total	$301,704	$254,366

Note 25. Related Party Transactions (continued)

(iii) Transactions with related parties comprise of:

	2009 $	2008 $
Loans and advances to directors or director-related entities		
Balance at beginning of the year	2,476,111	2,240,002
Reclassification of loan to retired director	(2,131,109)	-
Loans advanced during the year	25,500	724,247
Loan and interest repayments during year	(139,609)	(807,551)
Interest and costs	35,646	319,413
Balance at end of the year	$266,539	$2,476,111

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

	2009 $	2008 $
Interest paid/payable on borrowings	151,581	173,475
Repayments of borrowings during the year	625,575	625,521
Borrowings from the Government of the Kingdom of Tonga are disclosed in note 22 (a)	4,400,724	4,870,057
The Government purchased TDB bonds and promissory notes during the year and the balances at year end are as follows:		
TDB promissory notes	4,233,144	5,169,335
Interest paid/payable on TDB bonds and promissory notes	237,922	233,574

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

(ii) Term deposits

	2009 $	2008 $
Interest received/receivable on Government of Tonga Local Development Bonds	292,153	463,960
Government of Tonga Local Development Bonds at year end - refer note 13.	3,454,000	3,400,000

(iii) Loans and advances

	2009 $	2008 $
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

Note 26. Commitments and Contingent Liability

		2009 $	2008 $
(a)	Capital commitment	-	-
(b)	Contingent liability	-	-
(c)	Operating lease commitments	255,840	264,460

(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:

	2009 $	2008 $
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	212,740	221,360
	255,840	$264,460

(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:

	2009 $	2008 $
Not later than one year	88,309	88,309
Later than one year but not later than five years	32,082	120,391
	$120,391	208,700

Note 27. Financing Arrangements

	2009 $	2008 $
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 was in August 2009.

Note 28. Dividends

	2009 $	2008 $
(a) The directors have declared a dividend of 50% of net profit after tax in respect of the year ended 31 December 2008. This amounted to $475,547 $0.45 per issued share.	-	475,547
(b) The directors have declared a dividend of 50% of net profit after tax in respect of the year ended 31 December 2009. This amounted to $784,943 or $0.75 per issued share.	784,943	-
(c) Bonus dividend for 2009	9,177,840	-

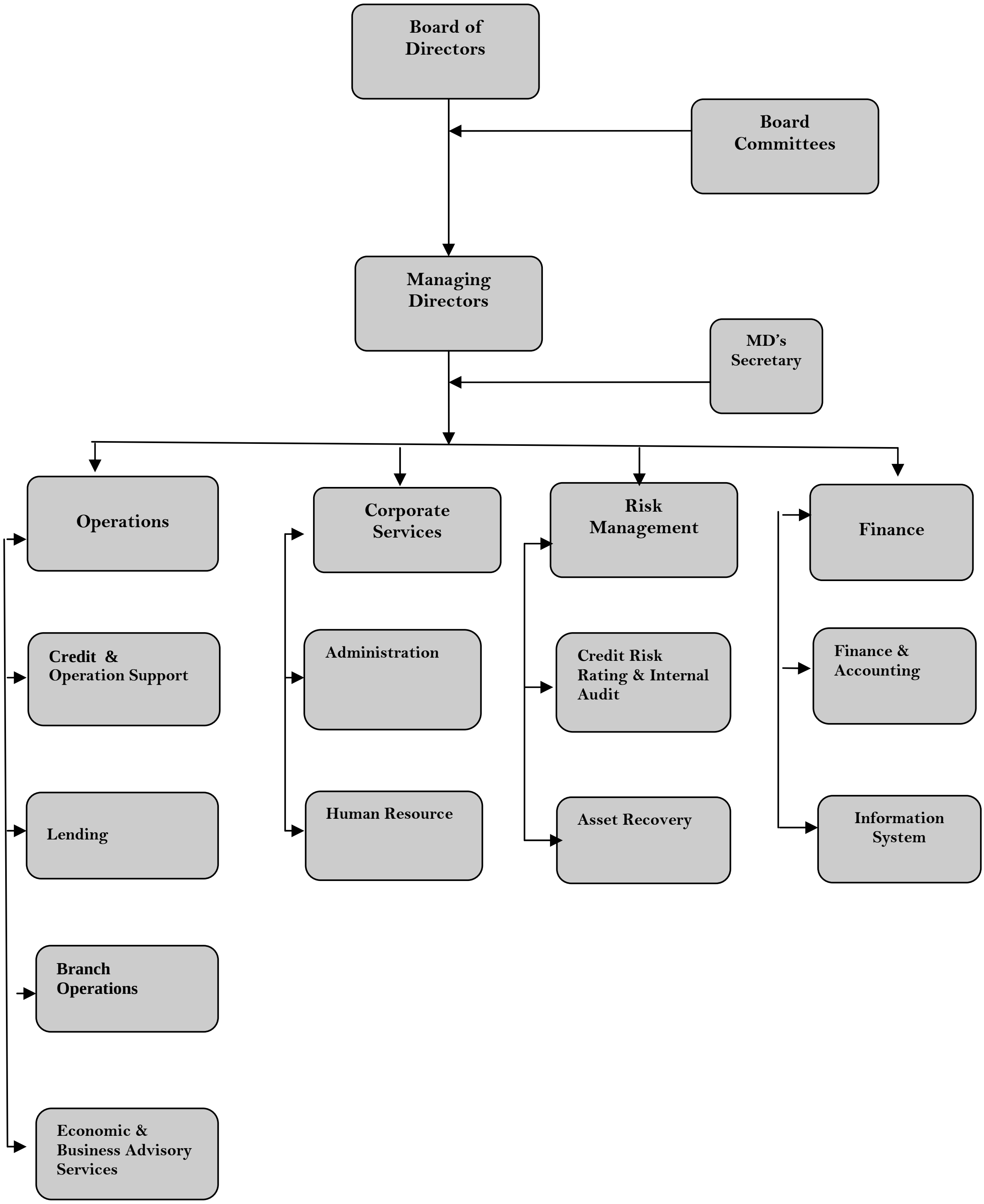
Note 29. Earnings per Share

	2009 $	2008 $
Net profit after tax	1,569,885	951,093
Number of issued shares	1,053,019	1,053,019
Earnings per share	$ 1.49	$ 0.90

Note 30. Return on Equity

	2009 $	2008 $
Net profit after tax	1,569,885	951,093
Shareholder's Equity	16,669,682	25,062,580
Return on Equity	9.42%	3.79%

CORPORATE STRUCTURE AS AT 31 DECEMBER 20009



SENIOR MANAGEMENT TEAM AS AT 31 DECEMBER 2009

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
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

Managers

Vava'u Branch	Mr Fuka'eiki Kupu
Ha'apai Branch	Mr 'Eliki 'Ofa
'Eua Branch	Mr. Kolokesa Paunga
Niuatoputapu Branch	Mrs Mafi Hoa
Niuafo'ou Branch	Mr Laulotu Finau
Hahake District Office	Mr Tokotaha Fonua