TONGA DEVELOPMENT BANK LIMITED

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 2010, as required under the Tonga Development Bank Act, 1977 Section 10 (7) and the Public Enterprises Act 2002 Section 20 (1).

Respectfully

…………………………….
Pousima Afeaki
Chairman

CONTENTS

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BACKGROUND

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

The Bank is fully owned by the Government of Tonga.

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, Domestic Money Transfer, Business Advisory Services 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.

VISION

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

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"

BOARD OF DIRECTORS AS AT DECEMBER 2010

MR POUSIMA AFEAKI
Commercial farmer and has been a Director of the Bank since March 2009 and appointed Chairman of the Board since November 2010.

MR PAULA TAUMOEPEAU
Business man and has been a Director of the Bank since September 2009.

MR LENNIE NIIT
Retired commercial fisherman and now business man. Mr Niit has been a Director of the Bank since September 2006.

MR MINORU NISHI JR
Commercial farmer and has been a Director of the Bank since November 2010.

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

CHAIRMAN'S REPORT 2010

I am pleased to report on Tonga Development Bank's results for its 33rd year of operation in Tonga.

Against a background of banking recovery in 2009 and challenging political change in 2010, Tonga Development Bank has yet again delivered positive financial results. A net profit after tax of T$1.426 million was recorded for the end of the year 2010, slightly below the $1.570 million net profit in the previous year.

This is a pleasing outcome that was achieved by rigorous risk management standards and debt recovery activities that enabled the Bank to meet its objectives and deliver this positive result.

Banking system liquidity continued improving in 2010 and intensified the pressure on our deposit interest rates. Against this background, we continued to focus on operational efficiency, staff development and maintaining superior customer service. We will continue to work hard to ensure customer satisfaction and future growth.

The quality of the Bank's assets was well maintained. There has been a significant reduction in our bad debts charged for 2010 and was due largely to the good work undertaken in managing potential problem accounts in a timely manner.

The bank's profitability was affected by:

- The surplus liquidity in the banking system. This resulted in the substantial reduction in cost of funds. Benefits were transferred to our customers through reductions in lending interest rates. During the year 2010, our lending interest rates were reduced by 0.5% in May 2010 and by 0.5% again in September 2010, a total reduction of 1%.
- The level of provisioning was slightly higher in 2010 due mainly to changes in provisioning policy endorsed by the National Reserve Bank of Tonga.
- The Bank also recorded a non-lending loss of $60,000 due to the bank robbery in June 2009, being the excess not covered by insurance.
- The impact of changes on Loan Protection Cover Insurance fee structures and the establishment fees charged on Micro Lending.
- Vigorous control of costs and expenses.

It has always been a focus of the Bank to continue to maintain a strong and open relationship with the regulator –National Reserve Bank of Tonga (NRBT) and the Government. In November 2010 the NRBT conducted a triennial high level review of risk management systems and processes at the Bank. A satisfactory result has been indicated.

The Board acknowledges and commends the NRBT on the ongoing and effective management of the liquidity situation, ensuring stability in the financial system during this period and the consultative approach taken in working together with the Association of the Banks in Tonga (ABT) in managing system liquidity.

The Bank is happy with the direction of Government and its reform policies and commitment to improve transparency, accountability and good governance. This will create an environment in which businesses, in particular, small and medium businesses can develop, invest and grow.

The establishment of the new processing centre for agricultural products, fumigation chamber facilities and renovation of the High Temperature Force Air Treatment Plant (HTFA) at the airport will provide opportunities for growth in processing and exports of agricultural products.

To help assure the supply of agricultural products, the Bank has set up a 'book' of $500,000 for irrigation loans, beginning in 2011. The 8-week drought in 2010 with its adverse effects on squash and melon exports, highlighted the need for farmers to irrigate and for the Bank to assist.

The Police investigation of the robbery which occurred in June 2009 remains unresolved which is an ongoing concern. However, the Bank has tightened security measures including the installation of high-tech security cameras at its branches.

Our commitment to extending our lending to disadvantaged groups in the society and to effectively address developmental needs in the rural areas continued in the year 2010. Tonga Development Bank received a special award from the Association of Development Banks in Asia and the Pacific in 2010 in recognition of its efforts in successfully advancing economic and social development through innovative financing schemes that benefit the poor and disadvantaged groups in the country.

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.

The Board of Directors and Management are confident that the Bank will realize its business plan and strategies. The Shareholder will continue to obtain a sound return on its investment. The Bank will continue to effectively manage its balance sheet, maintain high quality loan asset portfolio and implement appropriate risk management techniques whilst improving customer service and efficiency of our operations. We shall remain focussed on pursuing sustainable and quality earnings growth.

I am proud to acknowledge the effort and commitment by the Bank Management team and staff in achieving the results for 2010. My grateful thanks to the Board of Directors for their valuable contributions in the provision of strategic direction towards achieving the Bank's Goals and Objectives for the year.

I would also like to thank the Government as representative of the people of Tonga who own the Bank, for its continuing interest and support to the Bank.

Last but foremost, my thanks to our Customers for their ongoing support to the Bank. We will expand the range of products provided by the Bank to improve our service to customers.

Malo fau, faka'apa'apa atu

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Pousima Afeaki
CHAIRMAN OF THE BOARD

MANAGING DIRECTOR'S REVIEW

Tonga Development Bank has again delivered a positive result for its shareholder during 2010, despite the less than perfect economic environment and the political changes experienced during the year.

This positive outcome had been achieved through the continued commitment and spirit of the Bank's Management and staff who remained dedicated to our goals and objectives through out the year. We have remained focused on key target markets and this focused strategy together with good control of expenses has enabled the Bank to continue to enhance its value while focussing on effective customer service. At the same time the Bank is always alert to potential opportunities for development during the year.

Key highlights of the year:

- In 2010, Tonga Development Bank won a special award from the Association of Development Finance in Asia and the Pacific (ADFIAP) for recognition its effort in successfully advancing economic and social development through innovative financing schemes that benefit poor and disadvantaged groups in the country.
- The Bank increased focus and programs to advance the Training, Learning and Development of our staff.
- Continued strong recovery process enabled bad debt expenses to be maintained at low levels.
- Continued loyalty to our Customer base through difficult and challenging times. During the reporting period, we offered 50% reduction in loan repayments for 3 months in May 2010 and again in December 2010. Also our lending interest rates were reduced by 0.5% in May 2010 and again in September 2010.
- Hahake District Office Strong Room has been upgraded and used as the Bank's offsite storage location due to its inland location and relatively away from shore if a tsunami strikes.
- Our Information System Unit has managed to build our old Ultracs server machine as standby server at the Bank's offsite storage. The Ultracs database in the standby server is then updated daily and it is only one day behind the live server in Head Office.

  For an overnight or next day disaster that may damaged the live server in Head Office, we can continue business the next day from the standby server.
- For improving efficiency of our communication channel with our Outer Island Offices and overseas business partners, the Bank in 2010, established Skype Communication channel.
- The Bank managed to upgrade its MS Office Products to the 2007 version to keep abreast trend in technology and being compatible with everyone else using the same products for ease of exchanging information.
- The robbery case which occurred in June 2009 remains unresolved. This is an ongoing concern. We have tightened security measures by installation of high-tech security cameras at our Head Office and our Vava'u Branch Office.

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

The after tax profit was $1,425,949 for the twelve months ending 31 December 2010 which is marginally below the $1,569,885 recorded for the year to 31 December 2009. The major contribution factors to this result were:

- Net Interest income reduced by 9.3%. Interest income decreased by 14.2% from $5,398,992 in 2009 to $4,632,005 at year end 2010. The surplus liquidity in the banking system resulted in the substantial reduction in deposit interest rates.
- Non interest income reduced by 11.7% from $3,372,711 in 2009 to $2,978,397 at year end 2010. The reduction was due largely to changes on Loan Protection Cover Insurance Commissions and a reduction in the establishment fees charged on Micro Lending.
- Net operating income decreased by 10.5% from $6,557,366 in 2009 to $5,866,057 at year end 2010.
- Reduction in the Interest and other borrowing expenses by 21.2%. The reduction was largely due to reduction in cost of promissory notes by 22.0%, cost of borrowings by 15.5%, interest on saving deposits by 12.9% and bank charges by 10.3%.
- Operating expenses (excluding bad debts) reduced by 5.5% from $4,007,166 in 2009 to $3,784,677 in 2010. This was mainly due to reduced utility and administration costs during the year.
- Provisioning for impaired loans was slightly higher in 2010.
- Reduction in the Bad and Doubtful debt. This was largely due to the good work in maintaining the quality of the loan portfolios.

Key Performance Indicators

	2010 %	2009 %	2008 %
Net Interest Income to average Total Assets	5.2	5.4	5.6
Non Interest Income to average Total Assets	5.4	6.3	4.5
Operating Cost to Income	72.7	70.9	64.7
Return on Equity	8.2	9.4	3.8
Return on Average earning Assets	3.1	3.2	1.7

Loan Portfolio

Through selective lending and presentation of several new opportunities during the year, we have been able to selectively grow our loan portfolio by 8.4% from $36.5 million in 2009 to $39.5 million at year end 2010 as compared to 24% reduction in 2009. The 50% reductions in the loan repayments offered by the Bank in May 2010 and again in December 2010 contributed to this result.

Approval

The level of approval increased by 19.0% from $14.2 million in 2009 to $16.9 million at year end 2010 as compared to 11.0% reduction in 2009. Housing and Personal Loans and few business loans contributed to the overall increase in the approval for 2010.

Approval Position by Sector	2010 %	2009 %
Housing and Personal Loans	47.5	49.0
Industry and Business Loans	32.9	23.9
Agriculture and Fisheries	17.3	19.3
Staff Loans	2.3	7.8

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 the Government commitment for 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. However lack of alternative crop and continuing reliance on semi-.subsistence agriculture is still a challenge in Agricultural developments.

The 2010 squash season saw fewer participants following the Industry shakeout in recent years. However we continued to assist the development of the industry because of it's positive potential for the economy.

Micro Lending Product

In 2010 we continued with our special Micro Lending Product introduced in 2009. 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. Thus, potential borrowers are properly educated and provided with financial skills before they draw down on the loan.

Outer Island Development

Lending at Outer Islands amounted to $4.1 million contributing 24 percent in amount and 45 percent of accounts to the total loan approvals for the year. This was a significant increase as compared to $3.7 million approved in 2009.

Women in Development

In 2010, the Bank's total lending to women's development projects recorded decline of 52.8% in numbers from 566 accounts in 2009 to 267 accounts and 50% in amount from $1.2 million in 2009 to $0.6 million.

Lending in this area included 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. Part of the Bank's lending for Women's development has been taken over by the new lending financing agency, The South Pacific Business and Development Limited. The Tonga Development Bank lend money to this Company to on lend to women's group.

Arrears

The arrears ratio was recorded at 4.4% at year end 2010 as compared to a target of 5.0%. This is an increase from an arrears ratio of $3.9% at year end 2009.

In terms of Good vs Bad Bank we achieved a ratio of 92.8% to 7.2% in 2010. The target for 2010 was 90% : 10%.

Provision

Management actively sought to maintain adequate provisioning levels to cover existing and future losses. All problem accounts, which show the signs of being high risk exposures, have been specifically provisioned. The level of specific provisions raised during the reporting period was low as compared to 2009 and this reflects the good work undertaken in managing potential problem accounts and in a timely manner.

The total provisioning was slightly higher in 2010 due mainly to changes in provisioning policy endorsed by the National Reserve Bank of Tonga.

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 2010.

	2010	2009
	$	$
Specific Provision	2,631,372	2,505,107
Group Provision	586,239	526,711
Total Provision	**$3,217,611**	**$3,031,818**

Credit Risk Management

We continued to apply prudent credit risk management principle and its an ongoing process aimed at maintaining and improving the quality of the Loan Portfolio.

The loan grading system continued to be a valuable tool in assessing the overall health of the loan portfolio during the year.

Centralized credit approval process continue to be a significant factor in ensuring maintenance of the high standard of the loan portfolio in 2010. The system of limiting credit approval authority to a selected number of officers has seen ongoing uniformity in underwriting standards/credit decisions, and close compliance with credit policy.

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

Information Systems

The overall technology delivery and services in 2010 were satisfactory. The performances were focused on maximizing benefits in terms of productivity gains and process improvements for the bank's operation.

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 Cover Insurance scheme (LPCI) with the Federal Pacific Insurance Ltd in 2010, provides cover for all lending to individuals' loans up to $35,000.00 (excluding arrears), and below the age of 70.

Several loans have been repaid through this source.

Funding

Internally generated funds from loan repayments has continued to be the Bank's main funding source. We also continue to raise funds locally through Promissory Note at competitive interest rates. At year end 2010, Cost of funds recorded with a substantially reduction as compared to year end 2009. This is a direct result from surplus liquidity in the banking system.

Savings Bank has continued to provide a source of funding in 2010.

	2010		2009	
Funding Sources:	($000)	%	($000)	%
Loan Repayment	13,689	77.8	11,968	71.3
Promissory Notes net increase	661	3.8	861	5.1
Saving Deposit net increase	756	4.3	337	2.0
Net increase from operation	2,480	14.1	3,164	18.8
Net increase from investments	-	-	468	2.8
Total	**$17,586**	100	**$16,798**	100

Staff

Full time staff number had reduced to 102 at end of December 2010 compared to 112 in December 2009. During the past years staff numbers had been continually reduced and this reflects the continued efficiencies now being achieved in all areas of the Bank's operation.

Staff who resign or retire are not automatically replaced but the relative job role is reviewed or possibly restructured. Any need for replacement is justified before any external recruitment.

Staff Training

The Bank's commitment to the development of our staff and provision of appropriate tools continued to be a high priority. During the year, numerous in-house training on lending, customer service and computer applications were provided internally by Managers and our Information System's staff.

Additionally, we strive to ensure staff compliance with regulatory requirements is applauded in the Tonga Development Bank.

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 2010 was recorded at $4.0 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 2010 aiming to reward as well as improve staff morale and their effectiveness in performance of Customer Service.

Customer complaints process continued in 2010. 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

2010 was another good year for Tonga Development Bank and we remain well positioned to continue our success and resultant strong contribution to our customers through credit provision and provision of investment opportunity for the people of Tonga.

The out look for Tonga Development Bank will continue to focus on our vision - To be recognized as Tonga's best provider of:

- Development finance with selected commercial activities
- Meets customer needs
- Demonstrates integrity and
- Operates profitability

For our customers, our focus will be to improve our customer service so as to foster our good relationship and ensure we are adding value to their business and personal aspirations of our customers.

We will be focusing on the capability of our staff to deliver quality performance will continue to be effectively addressed.

We will also be looking to continue to assess and adopt suitable products and services that enhance our new income stream and meet customer needs.

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 2010.

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 2010. The Government, as shareholder, has given invaluable support to the Bank in fulfilling its objectives in 2010.

The level of profitability for 2010 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 2010 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 build upon the current platform of strong performance, 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

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Simione Sefanaia
Managing Director

FIVE YEARS SUMMARY

Profit & Loss TOP $'000s	2006	2007 Restated	2008 IFRS Adoption	2009	2010	Movement 2009/2010
Interest Income	5,991	6,282	6,082	5,399	4,632	-14.2%
Interest Expense	2,045	2,409	2,524	2,214	1,744	-21.2%
Net Interest Income	3,946	3,873	3,557	3,185	2,888	-9.3%
Fees & commission income	2,175	2,265	2,604	3,013	2,707	-10.2%
Other Operating Income	192	164	199	360	272	-24.4%
Losses on loans & advances	901	816	1,009	576	361	-37.3%
Bad Debts	30	52	45	49	16	-67.3%
Income Tax Expense	304	406	333	437	389	-11.0%
Operating Profit after tax	1,690	1,216	951	1,570	1,426	-9.2%
Earnings per share	1.61	1.15	0.90	1.49	1.35	-9.4%

Balance Sheet TOP $'000s	2006	2007 Restated	2008 IFRS Adoption	2009 Adoption	2010	Movement 2009/10
Average assets	57,492	62,481	63,987	58,632	55,520	-5.3%
Total Assets	60,022	64,933	63,037	54,227	56,814	+4.8%
Gross Loans	43,472	48,633	47,984	36,011	39,542	+9.8%
Saving Deposits	4,647	4,757	4,403	4,740	5,495	+15.9%
Shareholder's equity	23,978	24,587	25,063	16,670	17,383	+4.3%

Performance Ratios	2006	2007 Restated	2008 IFRS Adoption	2009	2010	Movement 2009/ 10
Return on Assets	2.9%	1.9%	1.5%	2.9%	2.5%	-0.4%
Return on Equity	7.1%	5.0%	3.8%	9.4%	8.2%	-1.2%
Operating Costs to Total Income	70.4%	73.0%	74.7%	70.9%	72.7%	+1.8%
Operating Income to Average Portfolio	19.7%	19.9%	18.4%	20.9%	27.4%	+6.5%

In accordance with a resolution of the Board of Directors, the directors herewith submit the Balance Sheet as at 31 December 2010, 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:

Pousima Afeaki (Chairman - appointed 1 November 2010)
Lennie Niit
Paula Taumoepeau
Simione Sefanaia (Managing Director)
Minoru Nishi JR (from 1 November 2010)
Dr. Masasso T. Paunga (Chairman – resigned 1 November 2010)
David Edwards (Alternate - resigned 1 November 2010)

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 2010 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 2010 was $ 1,425,949 (2009: $1,569,885).

4. PROVISIONS

There were no material movements in provisions, other than provisions for losses on loans and advances, depreciation, 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 2009. This amounted to $784,943 or $0.75 per issued share which was paid on 26 June 2010.

The directors also declared an interim dividend based on 50% of net profit after tax for the year ended 31 December 2010. This is to $712,974 or $0.68 per issued share.

6. RESERVES

The directors recommend that no amounts be transferred to reserves in respect of the year ended 31 December 2010.

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 statement of comprehensive income 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 2010 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 15th day of March 2011.

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Simione Sefanaia	**Pousima Afeaki**
Managing Director	**Chairman of the Board**

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 2010;

(b) the accompanying balance sheet is drawn up so as to give a true and fair view of the state of affairs of the Bank as at 31 December 2010;

(c) the accompanying statement of changes in equity is drawn up so as to give a true and fair view of the movement in shareholders' funds for the year ended 31 December 2010; 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 2010.

Signed in accordance with a resolution of the directors this 15th day of March 2011.

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Simione Sefanaia
Managing Director

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Pousima Afeaki
Chairman of the Board

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Scope

We have audited the accompanying financial statements of Tonga Development Bank Limited (the 'Bank'). The financial statements comprise the balance sheet of the Bank as at 31 December 2010 and the statements of comprehensive income, changes in equity and cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes as set out on pages 19 to 52.

Directors' and Management's Responsibility for the Financial Statements

Directors and Management are responsible for the preparation and fair presentation of these financial statements in accordance with 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 shareholder, as a body, in accordance with the requirements 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 judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by directors and management, as well as evaluating the overall presentation of the financial statements.

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

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T: (679)3313955 / 3315199, F: (679) 3300981 / 3300947

Audit Opinion

pwc

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 2010 and of its financial performance, changes in equity, and its cash flows 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

17 March 2011
Lautoka Fiji

PricewaterhouseCoopers
Chartered Accountants

Statement of Comprehensive Income for the years ended 31 December 2010

	Notes	2010 $	2009 $
Continuing operations			
Interest income	6	4,632,005	5,398,992
Interest and other borrowing expenses	6	(1,744,345)	(2,214,337)
Net interest income		2,887,660	3,184,655
Fees and commission income	7	2,706,612	3,013,125
Other operating income	8	271,785	359,586
Net operating income		5,866,057	6,557,366
Losses on loans and advances	14	(360,672)	(575,943)
Non-lending loss	9	(60,000)	(130,000)
Bad debts written off		(15,908)	(49,040)
Bad debts recovered/reversed		169,785	211,332
Other operating expenses	10	(3,784,677)	(4,007,166)
Profit before income tax		1,814,585	2,006,549
Income tax expense	20	(388,636)	(436,664)
Profit for the year from continuing operations		**$1,425,949**	**$1,569,885**
Other comprehensive income		-	-
Total comprehensive income for the year		**$1,425,949**	**$1,569,885**
Earnings per share	29	$1.35	$1.49

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

Balance Sheet - As at 31 December 2010

	Notes	2010 $	2009 $
ASSETS			
Cash on hand and at Bank	11	1,217,542	2,816,802
Investment securities – held to maturity	13	8,854,000	7,984,942
Loans and advances	14	36,324,012	32,979,051
Other assets	15	593,410	565,161
Amounts receivable from shareholder	16	7,689	9,270
Amounts receivable from NRBT	17	-	39,000
Statutory reserve deposit	17	1,082,000	981,000
Property, plant and equipment	18	6,830,317	6,824,566
Investment property	19	950,912	1,010,097
Deferred tax asset	20	953,920	1,017,206
Total Assets		$56,813,802	$54,227,095
LIABILITIES			
Savings deposits		5,495,398	4,739,703
Other liabilities	21	1,032,256	874,910
Amount payable to NRBT	17	31,000	-
Borrowings	22	30,797,062	29,994,546
Current tax liability	20	365,656	-
Managed funds	23	49,158	130
Deferred tax liability	20	1,122,875	1,163,181
Dividends payable	28	537,740	784,943
Total Liabilities		39,431,145	37,557,413
SHAREHOLDERS' EQUITY			
Share capital	24	10,530,190	10,530,190
Retained earnings		6,852,467	6,139,492
Total Shareholders' Equity		17,382,657	16,669,682
Total Equity and Liabilities		$56,813,802	$54,227,095

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

Signed in accordance with a resolution of the directors this 15th day of March 2011.

…………………………… ……………………………

Simione Sefanaia
Managing Director

Pousima Afeaki
Chairman of the Board

Statement of Changes in Equity - Year ended 31 December 2010

	Notes	Share Capital	Retained Earnings	Total
		$	$	$
Balance 31 December 2008		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
Comprehensive income for the year		-	1,425,949	1,425,949
Transactions with owners – dividends	28	-	(712,974)	(712,974)
Balance 31 December 2010	30	$10,530,190	$6,852,467	$17,382,657

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

Statement of Cash Flows - Year ended 31 December 2010

	Note	2010 $	2009 $
Cash flows from operating activities			
Interest received		5,153,701	5,699,260
Interest payment		(2,305,921)	(2,307,793)
Fees and commission received		2,576,723	2,934,577
Other income		330,688	232,691
Income tax paid		-	(532,059)
Payment to employees and suppliers		(3,433,849)	(3,119,716)
Cash flows from operating activities before changes in operating assets and liabilities		2,321,342	2,906,960
Changes in operating assets and liabilities:			
Disbursements of Loans		(16,677,084)	(13,186,501)
Repayments of loans		13,689,276	11,968,466
Increase in other debtors and prepayments		(28,249)	(144,139)
Decrease in amounts receivable from shareholder		1,581	54,791
Increase / (decrease) in other liabilities		157,346	202,702
Net cash from operating activities		(535,788)	1,802,279
Cash flows from investing activities			
Purchase of property, plant and equipment		(423,321)	(335,863)
Proceeds from sale of plant and equipment		20,699	10,218
Net decrease /(increase) in statutory deposits		(31,000)	740,000
Net decrease in Government bonds		(400,000)	54,000
Net cash from / (used in) investing activities		(833,622)	468,355
Cash flows from financing activities			
Net increase in TDB promissory notes		661,288	861,090
Net increase / (decrease) in savings deposits		755,696	337,139
Dividends paid		(784,943)	(475,547)
Repayment of borrowings		(392,833)	(676,702)
Net cash from /(used in) financing activities		239,208	45,980
Net increase /(decrease) in cash and cash equivalents		(1,130,202)	2,316,614
Cash and cash equivalents at beginning of year		7,347,744	5,031,130
Cash and cash equivalents at year end	12	$6,217,542	$7,347,744

The above statement of cash flows 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 2010.

The following standards, amendments and interpretations, which became effective in 2010 are relevant to the Bank:

IAS 36 (amendment), ‘Impairment of assets’, effective 1 January 2010. The amendment clarifies that the largest cash-generating unit (or group of units) to which goodwill should be allocated for the purposes of impairment testing is an operating segment, as defined by paragraph 5 of IFRS 8, ’Operating segments’ (that is, before the aggregation of segments with similar economic characteristics).

(ii) Standards, amendments and interpretations effective on or after 1 January 2010 but not currently relevant to the Bank

IFRS 3 (revised), ‘Business combinations’ and consequential amendments to IAS 27,’Consolidated and separate financial statements’, IAS 28, ’Investments in associate’, and IAS 31,’Interests in joint ventures’.

IFRIC 17, ‘Distribution of non-cash assets to owners’ (effective on or after 1July 2009).

IFRIC 18,’Transfers of assets from customers’, effective for transfer of assets received on or after 1 July 2009.

IFRIC 9, ‘Reassessment of embedded derivatives and IAS 39, Financial instruments: Recognition and measurement’, effective 1 July 2009.

IFRIC 16, ‘Hedges of a net investment in a foreign operation’ effective 1 July 2009.

IFRS 2 (amendments), ‘Group cash-settled share-based payment transactions’ effective from 1 January 2010.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

(a) Basis of preparation

(ii) Standards and amendments early adopted by the Bank

The Bank has not early adopted any standards and amendments.

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

The following standards and amendments to existing standards have been published and are mandatory for the bank's accounting periods beginning on or after 1 January 2011 or later periods, but the bank has not early adopted them:

IFRS 9 'Financial instruments', issued in November 2009. This standard is the first step in the process to replace IAS 39, 'Financial instruments: recognition and measurement', IFRS 9 introduces new requirements for classifying and measuring financial assets and is likely to affect the bank's accounting for its financial assets. The standard is not applicable until 1 January 2013 but is available for early adoption.

Revised IAS 24 (revised), 'Related party disclosures', issued in November 2009. It supersedes IAS 24, 'Related party disclosures', issued in 2003. IAS 24 (revised) is mandatory for periods beginning on or after 1 January 2011. Earlier application, in whole or in part is permitted. The revised standard clarifies and simplifies the definition of related party and removes the requirement for government –related entities to disclose details of all transactions with the government and other government-related entities. The Bank will apply the revised standard from 1 January 2011.

IFRIC 19, 'Extinguishing financial liabilities with equity instruments', effective 1 July 2010.The interpretation clarifies the accounting by an entity when the terms of financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish all or part of the financial liability (debt for equity swap). It requires a gain or loss to be recognised in profit or loss, which is measured as the different between the carrying amount of the financial liability and the fair value of the equity instruments issued. If the fair value of the equity instruments issued cannot be reliably measured, the equity instruments should be measured to reflect the fair value of the financial liability extinguished.

(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.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

(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 from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of comprehensive income.

(d) Financial assets

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

(i) Loans and receivables

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

(ii) Held-to-maturity financial assets

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

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

(d) Financial assets – continued

(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 statement of comprehensive income. 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 statement of comprehensive income 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 statement of comprehensive income. Dividends on available-for-sale equity instruments are recognised in the statement of comprehensive income 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 statement of comprehensive income 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 of, a transaction for a third party, such as arrangement or renewal of insurance policies, are recognised on completion of underlying transaction. Performance linked fees or fee components are recognised when the performance criteria are fulfilled.

(h) Impairment of financial assets

Assets carried at amortised cost

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or 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.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

(h) Impairment of financial assets

Assets carried at amortised cost

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

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

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

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

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

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 statement of comprehensive income in impairment charge for loan losses.

(i) Property, plant and equipment

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

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

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

(i) Property, plant and equipment– continued

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 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 statement of comprehensive income.

(j) Investment Property

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

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

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

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

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

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

(j) Investment Property (continued)

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

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

(k) Impairment of non-financial asset

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are 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 statement of comprehensive income on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

(m) Cash and cash equivalents

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

(n) Provisions

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

(o) Employee benefits

(i) Employee leave entitlements

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

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

(o) Employee benefits - continued

(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 statement of comprehensive income 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 statement of comprehensive income over the period of the borrowings using the effective interest method.

(r) Share Capital

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

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

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

Dividends for the year that are declared before the balance sheet date are dealt with in the statement of changes in equity.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

(s) Fiduciary activities

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

(t) Comparatives

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

Note 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.

Note 3. FINANCIAL RISK MANAGEMENT - CONTINUED

(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 seven 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.

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.
C2	Accounts of doubtful quality requiring active management supervision, projects have failed arrears between 3 to 6 months and no financial data.
D	Sub standard and doubtful customers whose loans have been classified non accrual and partial loss of interest and fee is expected, doubt about ability to service the debt; realisable value of security is insufficient to cover principal and interest, breach of repayment arrangements and accounts in arrears over 6 months.
E	Loss of principal and interest is expected, accounts under legal action and accounts may be written off if no improvements over 12 months.

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 by 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.

Note 3. FINANCIAL RISK MANAGEMENT - CONTINUED

3.2 Risk limit control and mitigation policies

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.

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 seven 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

	2010		**2009**	
	Loans and Advances	Impairment Provision	Loans and Advances	Impairment Provision
	(%)	(%)	(%)	(%)
A	4.51	-	2.55	-
B	23.18	-	19.21	-
C1	56.54	15.64	59.23	-
S	-	-	1.35	-
C2	10.70	40.01	11.92	52.5
D	3.57	25.65	4.37	31.4
E	1.50	18.70	1.37	16.1
	100.00	100.00	100.00	100.00

Note 3. FINANCIAL RISK MANAGEMENT - CONTINUED

3.3 Impairment and provisioning policies

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

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

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

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

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

	2010		2009	
	$	%	$	%
Industry sector:				
Agriculture	6,090,873	15.40	7,034,530	19.29
Industry and Business	10,856,683	27.46	8,704,640	23.87
Housing and Personal	19,936,644	50.42	17,876,790	49.02
Staff	2,657,423	6.72	2,852,611	7.82
	$39,541,623	100.00	$36,468,571	100.00

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.

Note 3. FINANCIAL RISK MANAGEMENT - CONTINUED

3.5 Loans and advances

(i) Loans and advances are summarised as follows:

As at 31 December 2010	**Agriculture**	**Industry & business**	**Housing & personal**	**Staff**	**Total**
	$	$	$	$	$
Neither past due nor impaired	3,188,310	7,311,678	17,853,171	2,526,729	30,879,888
Past due but not impaired	885,969	593,461	945,734	7	2,425,171
Individually impaired	2,013,901	2,949,971	1,140,796	131,896	6,236,564
Gross	6,088,180	10,855,110	19,939,701	2,658,632	39,541,623
Less: allowance for impairment	(1,853,321)	(831,714)	(512,576)	(20,000)	(3,217,611)
Net	$4,234,859	$10,023,396	$19,427,125	$2,638,632	$36,324,012

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

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 bank.

Note 3. FINANCIAL RISK MANAGEMENT - CONTINUED

3.5 Loans and advances - continued

(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 2010	Agriculture	Industry & Business	Housing & Personal	Staff	Total
	$	$	$	$	$
Grades					
A	5,486	480,417	803,149	181,447	1,470,499
B	256,375	3,044,390	5,068,757	877,398	9,246,920
C1	2,926,449	3,786,871	11,981,265	1,467,884	20,162,469
S	-	-	-	-	-
	$3,188,310	$7,311,678	$17,853,171	$2,526,729	$30,879,888

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	3,187,336	3,007,743	9,621,303	2,063,370	17,879,752
S	491,239	-	-	-	491,239
	$3,857,378	$4,979,856	$14,685,619	$2,782,496	$26,305,349

(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 2010	Agriculture	Industry & Business	Housing & Personal	Staff	Total
	$	$	$	$	$
Past due up to 30 days	683,008	77,896	559,621	7	1,320,532
Past due 30 – 60 days	109,433	211,901	268,236	-	589,570
Past due 60 – 90 days	93,528	303,664	117,877	-	515,069
	$885,969	$593,461	$945,734	$7	$2,425,171
Fair value of collateral	$3,306,024	$966,541	$2,853,594	$17,512	$7,143,671

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 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

(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 2010					
Term loans	1,083,518	1,930,049	1,988,937	117,371	5,119,875
As at 31 December 2009 Term loans	227,796	162,237	296,523	4,909	691,465

(v) Repossessed collateral

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

Nature of assets	Carrying amount 2010	2009
	$	$
Land - Tax allotment	7,000	60,000
Town allotment	28,000	15,000
Motor Vehicle	77,000	32,000
Residential houses	223,000	-

Note 3. FINANCIAL RISK MANAGEMENT - CONTINUED

3.5 Loans and advances - continued

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

(vi) Loans and advance exposure by categories:

	2010 $	2009 $
Large corporate entities	6,727,767	4,624,429
SMEs	28,275,866	28,025,765
Other	4,537,990	3,818,377
	$39,541,623	$36,468,571

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:

	2010 $	2009 $
Liabilities		
Borrowings – foreign	$ 858,799	$ 248,239

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 on next page analyses assets and liabilities into relevant maturity Banking 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 2010	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	1,217,542	-	-	-	-	-	1,217,542
Investment securities – held to maturity	1,400,000	2,210,000	1,600,000	3,644,000	-	-	8,854,000
Loans and services	2,135,187	3,027,221	8,691,156	15,454,596	7,015,852	-	36,324,012
Statutory reserve deposit	-	-	-	-	-	1,082,000	1,082,000
Property, plant and equipment	-	-	-	-	-	6,830,317	6,830,317
Investment Property	-	-	-	-	-	950,912	950,912
Other assets	91,980	7,689	230,028	1,225,322	-	-	1,555,019
Total Assets	$4,844,709	$5,244,910	$10,521,184	$20,323,918	$7,015,852	$8,863,229	$56,813,802
Liabilities							
Saving deposits	5,495,398	-	-	-	-	-	5,495,398
Borrowings	97,757	65,899	231,805	2,150,989	2,243,739	-	4,790,189
Promissory Notes	2,984,934	3,206,294	9,956,937	9,858,708	-	-	26,006,873
Other liabilities	944,334	365,656	597,687	1,122,875	108,133	-	3,138,685
Total Liabilities	9,522,423	3,637,849	10,786,429	13,132,572	2,351,872	-	39,431,145
Net Liquidity Gap	($4,677,714)	$1,607,061	($265,245)	$7,191,346	$4,663,980	$8,863,229	$17,382,657
As at 31 December 2009							
Total Assets	5,131,088	5,561,128	11,803,666	16,210,715	6,247,133	9,273,365	54,227,095
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

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 2010	No later than 1 year	1 – 5 years	Over 5 years	Total
	$	$	$	$
Loan commitments	2,102,776	-	-	2,102,776
Operating lease commitments	8,320	33,280	187,920	229,520
Capital commitments	-	-	-	-
Total	$2,111,096	$33,280	$187,920	$2,332,296
At 31 December 2009				
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

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 $3,854,000 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 comprises of:

- 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 year ended 31 December 2010 and year ended 31 December 2009. During that period, the Bank complied with all of the externally imposed capital requirements to which they are subject.

Tier 1 Capital	**2010**	**2009**
	$	$
Share capital	10,530,190	10,530,190
Retained earnings	6,852,467	6,139,492
Total	$17,382,657	$16,669,682
Risk weighted assets	$36,324,012	$32,979,051
Ratio	47.85%	50.55%

NOTE 4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

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 statement of comprehensive income, 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

	2010	2009
	$	$
Interest income		
Loans and advances	4,141,623	4,829,790
Term deposits and securities	490,382	569,202
	$4,632,005	$5,398,992
Interest and other borrowing expenses		
Borrowings	135,669	160,594
TDB promissory notes	1,538,651	1,973,429
Savings deposits	66,370	76,238
Bank charges	3,655	4,076
	$1,744,345	$2,214,337

Borrowings cost comprises foreign exchange loss of $7,689. (2009: $22,561)

Interest income accrued on impaired financial assets is $73,344 (2009:$16,448)

NOTE 7. FEES AND COMMISSION INCOME

	2010	2009
	$	$
Service fees	2,240,975	2,660,098
Commissions	465,637	353,027
	$2,706,612	$3,013,125

NOTE 8. OTHER OPERATING INCOME

	2010	2009
	$	$
Rent	81,558	103,380
Other	190,227	256,206
	$271,785	$359,586

NOTE 9.NON LENDING LOSS

The Bank has recorded a non lending loss of $60,000 (2009: $130,000) in respect of the bank robbery in 2009.

NOTE 10. OTHER OPERATING EXPENSES

	2010	2009
	$	$
Staff costs (refer below)	2,029,560	2,044,911
Administrative expenses	583,635	547,897
Auditor's remuneration - audit	65,422	51,928
Depreciation - Property, plant and equipment	415,007	497,709
- Investment property	59,185	59,185
(Gain)/loss on disposal of plant and equipment	(18,136)	118,984
Premises	245,187	241,514
Travel	215,937	203,937
Insurance loss	8,960	1,933
Others	179,920	239,168
	$3,784,677	$4,007,166

Staff costs comprise:

Wages and salaries and other staff costs	1,931,363	1,938,215
Retirement fund	98,197	106,696
	$2,029,560	$2,044,911

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

	2010 $	2009 $
Cash on hand	126,647	121,599
Cash at Bank	1,090,895	2,695,203
	$1,217,542	$2,816,802

NOTE 12. CASH AND CASH EQUIVALENTS

	2010 $	2009 $
For the purposes of the statement of cash flow, cash and cash equivalents comprise the following:		
Cash on hand and at Bank	1,217,542	2,816,802
Investment securities	5,000,000	4,530,942
	$6,217,542	$7,347,744

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

NOTE 13. INVESTMENT SECURITIES – HELD TO MATURITY

	2010 $	2009 $
Westpac Bank of Tonga	5,000,000	4,530,942
Government of Tonga Local Development Bond	3,854,000	3,454,000
	$8,854,000	$7,984,942

The year end interest rate receivable on term deposits range from 2.9% to 4.55% (2009: 4.3% to 7.0%) per annum and the interest rate for the Government of Tonga Local Development Bond range from 3.0% to 10.0% (2009: 6.0% 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

	2010	2009
	$	$
Gross loans and advances	39,541,623	36,010,869
Less : Impairment losses on loans and advances	(3,217,611)	(3,031,818)
Net loans	$36,324,012	$32,979,051
Loans and advances approved but not yet disbursed amounted to:	$2,102,776	$3,531,206

Allowance for losses on loans and advances

Movements in allowance for losses on loans and advances are as follows:

	2010	2009
Balance at beginning of the year	3,031,818	5,413,759
Provision for loan impairment	1,201,598	2,973,160
Provisions written back	(174,880)	(2,397,217)
Loans written off during the year	(840,925)	(2,957,884)
Balance at end of year	$3,217,611	$3,031,818

Composition of allowance for losses on loans and advances:

	2010	2009
Specific provision	2,631,372	2,505,107
Collective provisions	586,239	526,711
	$3,217,611	$3,031,818

The losses on loans and advances as shown in the statement of comprehensive income is arrived as follows:

	2010	2009
Provision for loan impairment	1,201,597	2,973,160
Provisions written back	(840,925)	(2,397,217)
	$360,672	$575,943

Non accrual loans and advances

	2010	2009
Non accrual loans and advances	1,891,962	2,761,715
Less: specific provision for impairment	(1,271,948)	(1,211,544)
	$620,014	$1,550,171

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

NOTE 14. LOANS AND ADVANCES - CONTINUED

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 share similar credit risk characteristics, and for which no specific provisions are made.

Grade	% for collective provisions
C1	2%
C2	20%
D	50%
E	100%

NOTE 15. OTHER ASSETS

	2010 $	2009 $
Prepayment	91,980	264,262
Accrued interest	230,028	220,759
Other assets	271,402	80,140
	$593,410	$565,161

NOTE 16. AMOUNTS RECEIVABLE FROM SHAREHOLDER

Comprises the following:

Claims for EEC	$7,689	$9,270

NOTE 17. STATUTORY RESERVE DEPOSIT

	2010 $	2009 $
National Reserve Bank of Tonga (NRBT)	$1,082,000	$981,000

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% (2009: 5%)

	2010 $	2009 $
Amounts (payable to)/receivable from NRBT	($31,000)	$39,000

Amounts (payable to) receivable from NRBT represent (shortfall) / surplus 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 year ended 31 December 2010					
Opening net book amount	6,293,273	115,680	65,017	350,596	6,824,566
Additions	6,708	39,089	119,644	257,880	423,321
Disposals	-	(52)	-	(2,511)	(2,563)
Depreciation charge	(181,676)	(40,531)	(30,168)	(162,632)	(415,007)
Closing Net book amount	$6,118,305	$114,186	$154,493	$443,333	$6,830,317
At **31 December 2010**					
Cost	6,880,191	930,124	597,957	1,963,663	10,371,935
Accumulated depreciation	(761,886)	(815,938)	(443,464)	(1,520,330)	(3,541,618)
Net book amount	$6,118,305	$114,186	$154,493	$443,333	$6,830,317
For the year ended 31 December 2009					
Opening net book amount	6,526,224	167,218	69,934	352,238	7,115,614
Additions	67,704	13,953	34,571	219,637	335,865
Disposals	(115,196)	(10,270)	(3,738)	-	(129,204)
Depreciation charge	(185,459)	(55,221)	(35,750)	(221,279)	(479,709)
Closing net book amount	$6,293,273	$115,680	$65,017	$350,596	$6,824,566
At 31December 2009					
Cost	6,876,217	892,138	536,854	2,004,980	10,310,189
Accumulated depreciation	(582,944)	(776,458)	(471,837)	(1,654,384)	(3,485,623)
Net book amount	$6,293,273	$115,680	$65,017	$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 2010		
Opening net book amount	1,010,097	1,010,097
Additions	-	-
Disposals	-	-
Depreciation charge	(59,185)	(59,185)
Closing net book amount	$950,912	$950,912
At 31 December 2010		
Cost	1,187,221	1,187,221
Accumulated depreciation	(236,309)	(236,309)
Net book amount	$950,912	$950,912
For the year ended 31 December 2009		
Opening net book amount	1,069,282	1,069,282
Additions	-	-
Disposals	-	-
Depreciation charge	(59,185)	(59,185)
Closing net book amount	$1,010,097	$1,010,097
At 31 December 2009		
Cost	1,187,221	1,187,221
Accumulated depreciation	(177,124)	(177,124)
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:

	2010 $	2009 $
Rental income	33,655	17,560
Direct operating expenses arising from investment properties	9,139	21,641

NOTE 20. TAXATION

	2010	2009
	$	$
Income tax is brought to account using the liability method of tax effect accounting.		
(a) **Operating profit before income tax**	$1,814,585	$2,006,549
Prima facie income tax charge on the operating profit at 25%	453,646	501,638
Tax effect of non deductible expenditure:		
Grants and exempt income	(65,010)	(64,918)
Tax effect of over provision - prior year	-	(56)
Income tax expense	$388,636	$436,664
(b) **Income tax expense comprises:**		
Current tax expense	365,656	-
Over provision – prior year	-	(56)
Deferred tax expense - net	22,980	436,720
Income tax expense	$388,636	$436,664

(c) **Deferred tax asset**

	2010	2009
(i) Deferred tax asset comprises the net effect of the following (amounts recognized in profit or loss):	**$**	**$**
Allowance for loan losses	771,816	757,955
Other provisions	44,849	19,669
Unrealised exchange loss	40,140	42,062
Unearned revenue	97,115	114,424
Tax loss for the year	-	83,096
	$953,920	$1,017,206
(ii) The movement in deferred tax asset is as follows:		
Balance at 1 January	1,017,206	1,539,540
Charge to statement of comprehensive income	(63,286)	(522,334)
Balance at 31 December	$953,920	$1,017,206

NOTE 20. TAXATION - CONTINUED

(d) **Deferred tax liability**

(i) The balance comprises temporary differences attributable to:		
Depreciation	$1,122,875	$1,163,181
(ii) The movement in deferred tax liability is as follows:		
Balance at 1 January	1,163,181	1,248,795
Credit to statement of comprehensive income	(40,306)	(85,614)
Balance at 31 December	$1,122,875	$1,163,181

NOTE 21. OTHER LIABILITIES

	2010 $	2009 $
Accrued interest	477,267	531,291
Provisions for annual leave and staff bonus	71,262	78,677
Other creditors and accruals	483,727	264,942
	$1,032,256	$874,910

Other creditors and accruals include the following:

Accruals and creditors	469,288	263,674
Withholding tax payable	4,263	-
Credit holding accounts	10,176	1,268
	$483,727	$264,942

NOTE 22. BORROWINGS

	Notes	2010 $	2009 $
Comprises:			
Borrowings	(a)	4,790,189	4,648,961
Tonga Development Bank promissory notes	(b)	26,006,873	25,345,585
		$30,797,062	$29,994,546

NOTE 22. BORROWINGS - CONTINUED

(a) Borrowings comprise the following:	Principal repayment term	Interest rate	2010 $	2009 $
Government of the Kingdom of Tonga				
Asian Development Bank	1993 – 2023	3.00%	583,262	629,923
International Fund for Agriculture Development 2	1993 – 2013	3.00%	329,632	461,431
International Fund for Agriculture Development 3	1999 – 2020	3.00%	1,716,464	1,907,182
International Development Association	1998 – 2023	3.00%	1,302,032	1,402,188
			3,931,390	4,400,724
Other borrowings				
European Investment Bank VI	2009 - 2026	5.5%	191,718	207,571
European Union	1988 – 2019	1.50%	35,963	40,666
Private Sector Reconstruction Facility	2011 – 2025	0.00%	631,118	-
			858,799	248,237
			$4,790,189	$4,648,961

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

	2010 $	2009 $
(b) Tonga Development Bank promissory notes	$26,006,873	$25,345,585

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.

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	Advance to	2010	2009
	$	$	$	$
Livelihood Reactivation Project - Niuatoputapu	94,401	(83,668)	10,733	-
New Zealand Borrower Diversification Fund	310,549	(272,124)	38,425	130
	$404,950	($355,792)	$49,158	$130

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

NOTE 24. CAPITAL

	2010	2009
	$	$
(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:

- Pousima Afeaki (appointed Chairman 1 November 2010)
- Lennie Niit
- Paula Taumoepeau
- Simione Sefanaia (Managing Director)
- Minoru Nishi JR (appointed 1 November 2010)
- Dr. Masasso T. Paunga (Chairman – resigned 1 November 2010)
- David Edwards (Alternate - resigned 1 November 2010)

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

	2010	2009
	$	$
Directors' fees and retirement benefit	113,041	117,522
Management salaries & other short term employee benefits	211,394	184,182
Total	$324,435	$301,704

NOTE 25. RELATED PARTY TRANSACTIONS - CONTINUED

(iii) Transactions with related parties comprise of:

Loans and advances to directors or director-related entities

	2010	2009
	$	$
Balance at beginning of the year	266,539	2,476,111
Reclassification of loan to retired director	-	(2,131,109)
Loans advanced during the year	611,056	25,500
Loan and interest repayments during year	(116,723)	(139,609)
Interest and costs	30,456	35,646
Balance at end of the year	$791,328	$266,539

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

	2010	2009
	$	$
Interest paid/payable on borrowings	144,405	151,581
Repayments of borrowings during the year	489,890	625,575
Borrowings from the Government of the Kingdom of Tonga are disclosed in note 22 (a)	3,931,390	4,400,724
The Government purchased TDB bonds and promissory notes during the year and the balances at year end are as follows:		
TDB promissory notes	2,608,100	4,233,144
Interest paid/payable on TDB bonds and promissory notes	154,347	237,922

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

(ii) Term deposits

	2010	2009
	$	$
Interest received/receivable on Government of Tonga Local Development Bonds	253,903	292,153
Government of Tonga Local Development Bonds at year end - refer note 13.	3,854,000	3,454,000

NOTE 26. COMMITMENTS AND CONTINGENT LIABILITY

		2010	2009
(a)	Capital commitment	$ -	$ -
(b)	Contingent liability	$ -	$ -
(c)	Operating lease commitments	$229,520	$255,840

(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:

	2010	2009
	$	$
Not later than one year	8,320	8,620
Later than one year but not later than five years	33,280	34,480
Later than five years	187,920	212,740
	$229,520	$255,840

(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:

	2010	2009
	$	$
Not later than one year	84,627	88,309
Later than one year but not later than five years	42,097	32,082
	$126,724	$120,391

NOTE 27. FINANCING ARRANGEMENTS

	2010	2009
	$	$
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	1,000,000	100,000
	$1,500,000	$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 is available to the bank. The draw down of the facility commenced in 2008 and final draw down was in August 2009.

NOTE 28. DIVIDENDS

	2010 $	2009 $
(a) 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
(b) Bonus dividend for 2009	-	9,177,840
(c) The directors have declared a dividend of 50% of net profit after tax in respect of the year ended 31 December 2010. This amounted to $712,974 or $0.68 per issued share.	712,974	-

During the year the shareholder provided assistance to a number of squash farmers by approving an offset of their outstanding loan balances against the 2010 interim dividends. The assistance amounted to $175,234 (2009:Nil). The balance of dividends payable at year end was $537,740.

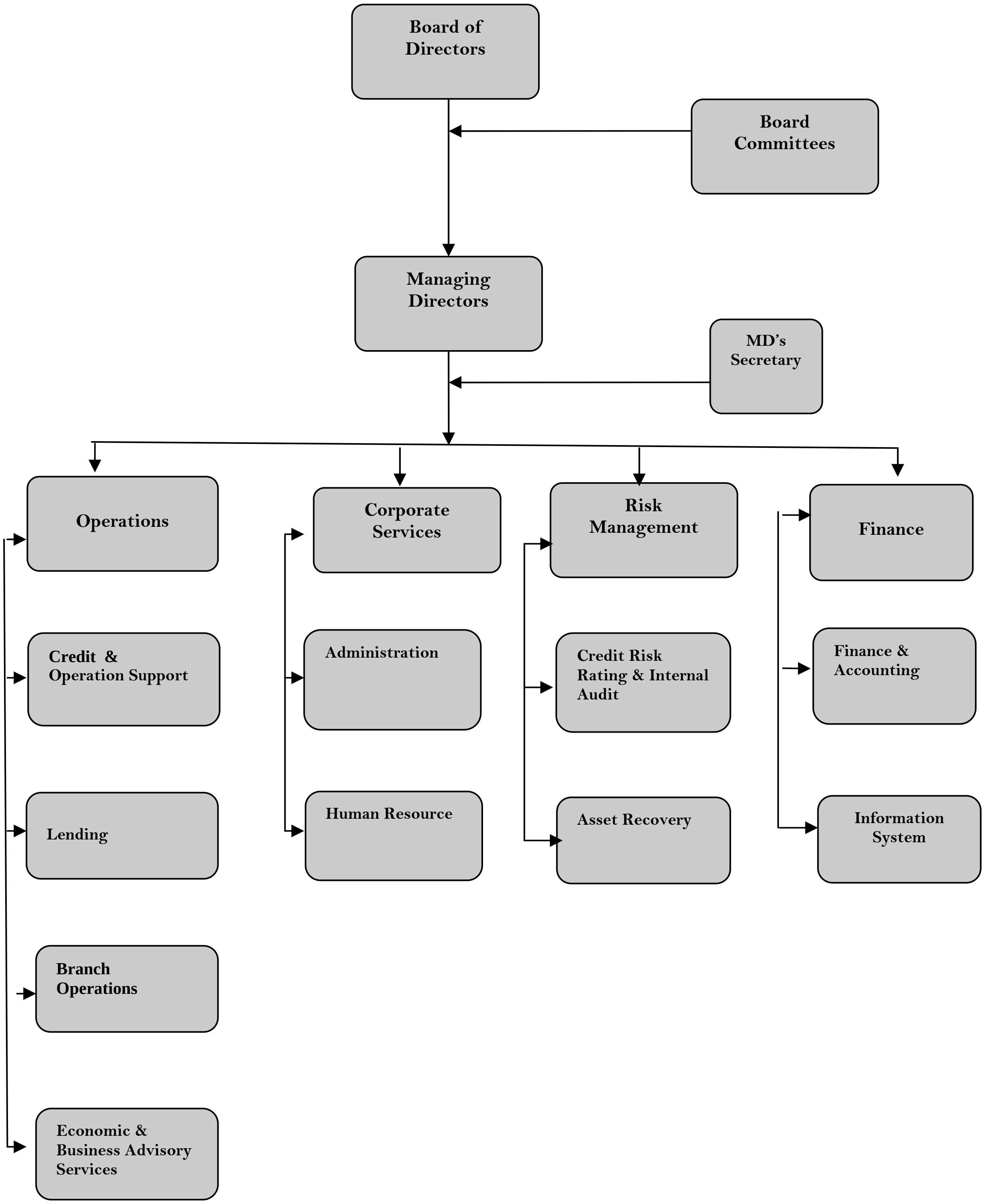
NOTE 29. EARNINGS PER SHARE

	2010 $	2009 $
Net profit after tax	1,425,949	1,569,885
Number of issued shares	1,053,019	1,053,019
Earnings per share	$1.35	$ 1.49

NOTE 30. RETURN ON EQUITY

	2010 $	2009 $
Net profit after tax	1,425,949	1,569,885
Shareholder’s Equity	17,382,657	16,669,682
Return on Equity	8.20%	9.42%

Corporate Structure as at 31 December 2010



Senior Management Team as at 31 December 2010

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
• 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	Mrs. 'Elisapesi Fineanganofo
• Ha'apai Branch	Mr 'Eliki 'Ofa
• 'Eua Branch	Mr Kolokesa Paunga
• Niuatoputapu Branch	Mrs Mafi Hoa
• Niuafo'ou Branch	Mr Tokotaha Fonua
• Hahake District Office	Mr Tau'atevalu Mafi