31st March 2014

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 2013, as required under the Tonga Development Bank Act, 1977 Section 10 (7) and the Public Enterprises Act 2002 Section 20 (1).

Respectfully

....

Lord Matoto
Chairman

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BACKGROUND

Tonga Development Bank was established on 1st September 1977 under the Tonga Development Bank Act 1977 and incorporated under the Companies Act, 1995 and registered again in 2001.

The TDB Act stipulates the mandate for TDB which may be summed up as promoting the social and economic development of the people and enterprises in Tonga through loans and advisory services which are provided on sound professional banking principles and ensuring such loans are repaid.

The Tonga Government is the sole shareholder of TDB since 1998. A Board of five Directors appointed by the Government oversees the policy management of the Bank. The Board includes a Managing Director and CEO to oversee the day to day management of the business.

VISION

"To be recognized as Tonga's outstanding provider of development and commercial finance which employs prudent banking principles to meet customer needs, demonstrates integrity and operates profitably"

MISSION

"To be committed to promoting Tonga's economic and social advancement by providing high quality development and commercial banking products and responsive professional services, while operating profitably as a financially sound banking institution"

BOARD OF DIRECTORS AS AT DECEMBER 2013

LORD MATOTO
Former Managing Director of the Bank and former Minister for Finance & National Planning. Chairman of the Board since February 2013.

MR POUSIMA AFEAKI
Commercial farmer and has been a Director of the Bank since March 2009. Chairman of the Board since November 2010 and resigned in January 2013.

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

MR PENISIMANI VEA
Former Managing Director of the Bank. Mr Vea has been a Director of the Bank since February 2012 and resigned in October 2013..

REV. DR. TEVITA KOLOA'IA HAVEA
Secretary General for the Free Wesleyan Church of Tonga. Mr Havea has been a Director of the Bank since September 2012 and resigned in August 2013.

MRS LETA HAVEA KAMI
Acting Managing Director of the Bank since February 2013 and appointed in September 2013 as Managing Director & CEO.

CHAIRMAN'S REPORT 2013

I am pleased to report the results of the Tonga Development Bank (TDB) for its 36th year of operation in Tonga.

Despite Tonga's sluggish economy the Tonga Development Bank continues to deliver positive financial results for 2013. A net profit after tax of $1.637 million was recorded for the year end December 2013 compared to $1.329 million in 2012.

The Bank increased its lending portfolio by 11.8% from $42.327 million in 2012 to $47.328 million in 2013. This included lending to private and public sectors which helps to positively stimulate the economy of Tonga.

The statutory objective for Public Enterprises is 10% in terms of Return on Equity (ROE). The Bank's ROE for 2013 was 8.30%, an increase over the 2012 ROE of 7.03%.

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 to be in surplus in 2013. This resulted in very low rates offered for depositors. Against this background, the Bank continued to focus on operational efficiency, staff development and providing superior service and assistance to customers.

The quality of the Bank's assets was well maintained. There has been a significant reduction in our bad debts charged for 2013 and was due largely to the effective arrears management undertaken in proactive attention to potential problem accounts in a timely manner.

The Bank continues to maintain a strong and open relationship with the National Reserve Bank of Tonga (NRBT) and also with the Bank's shareholder, the Government of Tonga.

In line with the Bank's Strategic Plan, Vinstar Limited conducted a TDB Feasibility Study and Business Plan for expansion of banking products and services. It was jointly funded by TDB and International Finance Corporation (IFC). The Final Report was approved by the Board of Directors and presented to the Cabinet in November 2013.

The outcome of the Feasibility Study confirmed that it is financially viable for the Bank to expand its services by increasing its commercial products and services to match market opportunities while maintaining its development banking mandate.

- Expansion of TDB Products and Services to include:-

  i) Cheque Account
  ii) Foreign Exchange
  iii) Bank Overdrafts
  iv) Transactional Banking for PSEs and Government

While the Police investigation of the June 2009 robbery remains unsolved. The Bank has offered a standing reward of $20,000 for information leading to conviction, so far without success.

Our commitment to extending our lending to disadvantaged groups and to effectively address developmental needs in the rural areas through the Bank's network continued in the year 2013.

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

The Board of Directors and Management are confident that the Bank will realize its business plans and strategies. The Shareholder will continue to obtain a sound return on investment and we shall remain focused on pursuing sustainable and quality earning growth.

I am proud to acknowledge the effort and commitment by the Bank Management team and staff in achieving the results for 2013. My gratitude and 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 look forward to working closely with customers in meeting their banking needs as we expand the range of products provided by the Bank to improve our service to customers.

Malo

Lord Matoto
CHAIRMAN OF THE BOARD

MANAGING DIRECTOR & CEO'S REVIEW

Tonga Development Bank has again delivered a positive result for its shareholder during 2013, despite the Kingdom's continued depressed economy.

This positive outcome had been achieved through the continued commitment of the Bank's Management and staff who remained dedicated and focused on our developmental role as well as other key sectors in order to improve our profitability.

This together with our conscious effort to control expenses has enabled the Bank to continue to enhance its values whilst focussing on effective customer service.

The Bank entered into Agency Agreement at 'Eua and Ha'apai with Westpac Bank of Tonga (WBOT) following closure of WBOT physical Branches in 'Eua and Ha'apai in August 2013.

A new District Office was opened in the Western District of Tongatapu in October 2013. This new office is based at the Tu'ivakano Polutele Hall in Nukunuku. TDB is committed to continue reaching out and making banking services conveniently accessible to all its valued customers throughout Tonga.

Towards the end of the year, the feasibility study which confirmed the expansion of the Bank's services and products were approved by the Board and endorsed by Government.

1. KEY HIGHLIGHTS OF THE YEAR:

A) Gross Lending	**2013**	**2012**	**2011**
Net Interest Income to average Total Assets	5.1%	5.7%	5.3%
Non Interest Income to average Total Assets	4.6%	4.7%	4.9%
Operating Cost to Income	71.18%	70.8%	72.2%
Return on Equity	8.30%	7.03%	9.39%
Return on Average earning Assets	3.16%	2.60%	3.47%

2. OVERVIEW OF THE FINANCIAL PERFORMANCE

(All figures are in Tongan Pa'anga)

The after tax profit was $1.6m for the twelve months ending 31 December 2013 which is above the $1.3m recorded for the year to 2012. The major contributing factors to this result were:

- Non interest income increased by 7.7% from $2.6m in 2012 to $2.8 in 2013. This is an increase of $0.20m.
- The net operating income increased from $6.11m in 2012 to $6.12m in 2013. This is an increase of $12K (0.21%).
- In 2013, other operating expenses slightly increased by $898 (0.02%) from 2012.
- General loan recoveries and some write backs from provisions also contributed to the level of profitability for 2013. Bad and Doubtful Debt expense was recorded with a net debit balance of $208K which is an increase from $178K in 2012. This is an increase of $30K (17.05%).
- The cost/income ratio projected for 2013 was 66.9% as compared to actual figure of 71.1%.
- The Income tax expenses decreased significantly from $596K in 2012 to $269K in 2013.

3. DOMESTIC BANKING ENVIROMENT

In Tonga, there are three Commercial Banks that are wholly or partially foreign owned (ie: Westpac Bank of Tonga, ANZ Bank and MBf Bank). TDB is the only Development Bank in Tonga and is solely owned by the Government of Tonga.

A summary of the TDB share in the domestic banking industry with regards to gross lending and lending by sector is presented in the following table. Note the TDB improvement over the past 3 years.

A) Gross Lending	**2013**	**2012**	**2011**
Gross Lending (T$'million)			
Commercial Banks	209.8	203.2	227.2
TDB	47.0	42.1	40.6
TOTAL	256.8	245.3	267.8
TDB Market Share	18.3%	17.2%	15.2%

B) Lending Sector Share

The Bank's percentage share in the lending sectors show increasing trend as follows:

Agriculture			
Commercial Banks	34.5%	40.0%	56.4%
TDB	65.5%	60.0%	43.6%
Industry and Business			
Commercial Banks	84.3%	87.9%	94.6%
TDB	15.7%	12.1%	5.4%
Housing and Personal			
Commercial Banks	81.9%	82.5%	84.6%
TDB	18.1%	17.5%	15.4%

4. LENDING SECTORS

a) Loan Portfolio

Through selective lending and presentation of several opportunities during the year, we have been able to grow our loan portfolio by 11.8% from $42.3m in 2012 to $47.3m at year end 2013. The special package offer of 50% reductions in the loan repayments offered by the Bank twice in 2013 contributed to this result.

The portfolio growth in 2012 was only 4.1% compare to 11.8% in 2013.

b) Approval

The level of approval increased significantly by $4.0m (26.8%) from $14.9m in 2012 to $18.9m at year end 2013. The total loan approval by major sector is as follows:

	Amount (millions $)	%
Agriculture	$3.7	19.6
Squash	$0.6	3.2
Industry and Business	$5.8	30.7
Housing and Personal	$8.2	43.4
Staff	$0.6	3.1
TOTAL	$18.9	100.0

The Bank continues to work closely with key players in the productive sectors to improve lending as a basis for contributing to economic development.

C) Agriculture/Fisheries Sector

Lending to agriculture and fisheries sector had increased significantly by $1.2m (48%) from $2.5m in 2012 to $3.70m in 2013. This was the growth we expected after the completion of the fumigation chamber, effective operation of the High Temperature Forced Air Treatment Plant (HTFA) and the completion of the processing facility. However, appropriate marketing infrastructure and regulatory requirements are still required.

The total loan portfolio for Agriculture was $4.8m in 2013 represented 10.26% of the overall loan portfolio. However, it declined by 6.1% from $5.2m in 2012 to $4.9m in 2013.

a) Squash

The 2013 squash season recorded a reduction in grower participation as well as lending from about $1.3m in 2012 to $0.6m in 2013. Despite fewer participants, the Bank will continue to assist the development of the squash industry because of its positive contribution to the economy. Close working relationship between the Bank, MAFFF and MCTL are still required for ongoing sustainability of the industry.

b) Industry & Business

Lending to Industry and Business was $5.80m in 2013 compared to $3.2m in 2012 which is an increase of $2.6m (81%). The opportunities for lending in the commercial sector have improved compared to 2012 especially on public and SMEs sectors and the Bank will continue to monitor them closely. We also continue to receive enquiries for taking over of business customers' debts from commercial banks but most of these businesses are over committed. The Bank only considers proposals that are within our lending policy guidelines and are considered to be viable.

The total loan portfolio for Industry and Business was $17.7m in 2013 which is 37.4% of the total portfolio. The Industry and Business sector was increased by $2.6m (27.3%) from $13.9m in 2012.

c) Housing & Personal

The Housing and Personal Loans remained the dominant of the Bank's lending and portfolio in 2013.

The total lending to Housing and Personal was $8.2m in 2013 compared to $7.3m in 2012. This is an increase of $0.9m (12%).

Also, the Housing and Personal lending covers about $22.3m (47.15%) of the total portfolio in 2013. We are lending to this sector due to lack of demand from the productive sectors as well as the desire to be profitable and improve return on the shareholder's equity.

d) Staff Loans

Total Staff loans as at end of 2013 was $2.4m (5.13%) of the total portfolio. Total approval for 2013 of $0.62m was higher than the budget of $500K.

e) Outer Island Lending

Lending in the Outer Islands amounted to $5.1m contributing 26.7% in loans approved for 2013. This was an increase from $4.3m recorded in 2012.

5. PERFORMANCE TARGETS AND MEASURES

A) Credit Risk Management (CRM)

We continued to apply prudent credit risk management principles 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 continued to be a significant factor in ensuring maintenance of the high standard of the loan portfolio in 2013. 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.

B) Liquid Asset Ratio

The Reserve Bank continues to impose a Liquid Asset Ratio (LAR) of 5% to ensure that sufficient liquidity is available in the system. The Bank's LAR as at end December 2013 was 15.81%.

C) Return on Equity

The Bank achieved a Return on Equity (ROE) of 8.30% compared to a target of 8.0% for 2013. The ROE for 2012 was 7.03% and the target set by the Ministry for Public Enterprises is at least 10%.

D) Arrears

The arrears ratio was recorded at 2.15% at year end 2013 as compared to a target of 4.5%. This is a slight decrease from an arrears ratio of 2.3% at year end 2012.

The 2013 target for the number of accounts in arrears was 570. However, the actual number of account in arrears was 519.

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

E) Good Bank: Bad Bank

The Bank achieved Good vs Bad Bank ratio of 95.86% to 4.14% in 2013. The target for 2013 was 90%: 10%. In 2012, the Good Bank vs Bad Bank ratio was 94.6% to 5.4%.

F) Provisions

Management actively sought to maintain adequate provisioning levels to cover existing and future losses. All problem accounts, which showed the signs of being high risk exposures, were specifically provisioned. The level of specific provisions raised in 2013 was $0.79m which is lower than $1.02m in 2012.

There was a more stringent approach given for loan provisioning in 2013 because of IFRS disclosure requirements.

6) FUNDING

The main source of funding for the Bank's lending continued to be generated internally from loan repayments and other internal sources. This provided about 60.9% of the funding required.

Term deposit through Promissory Notes is another source of funding. Savings accounts provide an increasing source of funding. In 2013, the total available fund from savings was $9.25m.

	Budget 2013	Actual 2013
	millions $	million $
Loan repayment	18.1	17.6
Net Cashflow from Operating Activities	0.4	2.1
Net TDB Promissory Notes	2.2	4.5
Net Savings Deposits	0.1	2.4
Cash at beginning of the year	5.9	6.4
Total	**26.7**	**33.0**

7) REVOLVING FUNDS

About T$290.5K in managed funds is held on behalf of the New Zealand Government. The NZ fund is available for lending for Women's development and also development in the rural areas. This fund operates on a revolving basis. The total loan portfolio at the end of 2013 was $108K.

Another revolving fund managed by the Bank is the Livelihood Reactivation Project in Niuatoputapu (LRP-NTT) $94.4K which is available for lending to the people of Niuatoputapu to help with their recovery from the tsunami disaster in 2009. Lending interest rate is 4.5% p.a. The total loan portfolio at the end of December 2013 was $72K.

Finally, a revolving fund of $208K managed by the Bank is ADB Microfinance Project was introduced in 2013. The fund is available for lending for Women's development in Outer Islands and in the rural areas. The interested borrowers are required to attend on training before filling loan applications.

8) NET INTEREST MARGIN

The Bank's Net Interest Margin (NIM) is reviewed on a quarterly basis. This includes matching of the average lending interest rates with average interest cost of funds. As at end December 2013 the net interest margin was 6.55%. This margin results in the Bank achieving a Net Profit after Tax of $1.64m and a Return on Equity of 8.30%. There was an interest rate reduction in 2013 with 0.5% effective 1st August 2013.

9) HUMAN RESOURCE MANAGEMENT

A) Staff

Full time staff numbers were maintained at 94 in December 2013 and at the end of 2012. In 1998, the number of staff was at 175 and continued to be reduced to 94 staff in 2013. This reflects the continued increase in productivity now being achieved in all areas of the Bank's operations.

Staff members 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 turnover was at the rate of 6.4% and male to female ratio was at 1 : 1.24.

Staff salary expenses for 2013 was projected to be T$2,283,000. However actual figure as at end December 2013 was T$1,976,682.

B) Staff Training

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

We continued to encourage staff to pursue formal training leading to higher qualification. On the job training and coaching continue to be an important part of staff development.

In May 2013, training was carried out on Leadership Qualities by Management Learning Associates Ltd of New Zealand. Two senior accounting staff attended IFRS training with Pricewaterhouse-Coopers in Suva, Fiji in 2013.

C) Staff Retirement Fund

The Bank is continuing to contribute to the National Retirement Benefit Fund scheme (NRBF) at 5% as from 1st July 2012.

D) 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.

Customer complaints process continued in 2013. It provided customer feedback on specific matters which required immediate attention.

E) QUARTERLY AWARDS

Staff Quarterly Awards continued in 2013 aiming to reward as well as improve staff morale and their effectiveness in performance of Customer Service. There is an Employee of the Quarter and Customer Service award which is awarded quarterly. In addition there is a MD's awards available for special tasks performed during the year.

10) MONEY TRANSFER

Despite tough competition on local money transfer, the Bank continued to operate its local money transfer. In addition we also continued to operate the Digicel Mobile Money (DMM) transfer using the mobile phone. We will continue to work together with overseas companies (Xpress Money and Friendly Island Transfer (FIT)) to facilitate remittances from overseas countries. We are waiting for them to install software and provide training for the staff before implementation.

11) INFORMATION SYSTEMS

We managed to convert our retired Ultracs sever to a Ultracs standby server. This is to be a standby server in the event the live machine fails.

We automated the process of splitting and paying of the Establishment Fees according to the term of the loans. This is our response to the External Auditor's findings to reduce human errors and to take advantage of the technology capability.

We also strengthened the security mechanisms of the Bank's Head Office and also extended to other Branch Offices. In addition to the Alarm systems, hold up buttons and alarms were also installed.

The Bank commenced exploring technical features and capabilities of the Ultracs Computer System to cater for the expanded new services and products to be utilized. These were overlapped to 2014 with continuation of testing and implementations.

12) 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 2013, provides cover for all lending to individuals' loans up to $35,000.00 (excluding arrears), and below the age of 70. This LPCI covers the balance of the debt in the event the borrower passes away.

Several loans have been repaid through this source.

13) PREMISES

All Bank's properties have continued to be maintained and upgraded during the year with expected useful life of 35 years for office buildings and 25 years for residential buildings. Appropriate insurance covers were also in place.

14) BUSINESS ADVISORY SERVICES (BAS)

The BAS unit carries out an important supportive role to the Lending structure. It provides training and one to one assistance for all clients requiring assistance and is not restricted to TDB clients. Also work in close collaboration with Tonga Business Enterprise Centre (TBEC).

The BAS continued to support borrower education and serve to raise the Bank's profile, especially in the rural areas.

15) DIVIDEND

The Bank paid on 26 June 2013 a dividend to Government of $664,564. This is 50% of the Bank's Net Profit After Tax (NPAT) for 2012. The Bank also proposes to pay 50% of the Bank NPAT for 2013 equivalent of $818,884 Dividend.

16) GOVERNMENT POLICY OBLIGATIONS (GPO)

The Government is currently subsidizing the branch operations in the two Niuas (ie: T$75K for Niuafo'ou and T$75K for Niuatoputapu).

17) FUTURE DIRECTION

Over the last 5 years, the Bank identified that it's future strategic direction needed to be determined and assessed carefully with a proper feasibility study. Thus, with the assistance of IFC and joint funding with TDB, a term of reference was drawn up in July 2013 commencing with a market feasibility and diagnostic report (Oct 2013) which confirmed that the Bank's existing corporate governance is strong and the structures in place are adequate for expansion of its services and products.

The Feasibility Study and Business Plan (Nov 2013) verified the financial viability of expanding to offer new commercial products and services to cater to the existing gaps in our services required by our customers for Cheque Accounts, Bank Overdrafts, Foreign Exchange and Transactional Banking for PSEs and Government.

In order to successfully implement and manage the Feasibility Study, a Manager Transformation Programme will be recruited in 2014 to coordinate and manage the Business Implementation Plan to ensure objectives, milestones and deliverables are achieved. This position will be a fixed period contract position (2 years) reporting to a Strategic Programme Steering Committee of the Board.

18) ACKNOWLEDGEMENT

I would like to acknowledge the continued high level of commitment and dedication given by the management team and the rest of the staff resulting in the achievement of the level of profitability in 2013. It is indeed a privilege leading the Tonga Development Bank team in 2013.

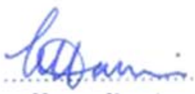
I acknowledge the ongoing support received by the Bank from the Ministry of Public Enterprises, Ministry of Finance and National Planning and other related Government Ministries during the year 2013. The Government, as shareholder, has given invaluable support to the Bank in fulfilling its objectives in 2013.

Ongoing support and loyalty of all our customers and their trust given to the Bank during 2013 are also acknowledged. The Bank can assure you all that we do care about your business and goals. We will continue to provide the relevant services required by our customers as we continue to achieve our mission as a financially sound banking institution.

Our challenge is to continue to build upon the current platform of strong performance to ensure that the Bank provides superior customer service and ongoing growth resulting in higher profitability and positive impact on developmental activities.

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



Leta Havea Kami
Managing Director & CEO

FIVE YEARS SUMMARY

Profit & Loss TOP $'000s	2009	2010	2011	2012	2013	Movement 2012/2013
Interest Income	5,399	4,632	4,537	4,603	4,511	-2.0%
Interest Expense	2,214	1,744	1,410	1,095	1,189	8.6%
Net Interest Income	3,185	2,888	3,127	3,509	3,322	-5.3%
Fees & commission income	3,013	2,707	2,452	2,266	2,362	4.2%
Other Operating Income	360	272	251	339	443	30.7%
Losses on loans & advances	576	361	133	383	389	1.6%
Bad Debts	49	16	34	73	4	-94.5%
Income Tax Expense	437	389	439	597	270	-54.8%
Operating Profit after tax	1,570	1,426	1,712	1,329	1,638	23.3%
Earnings per share	1.49	1.35	1.63	1.26	1.56	23.8%

Balance Sheet TOP $'000s	2009	2010	2011	2012	2013	Movement 2012/13
Average assets	58,632	55,520	59,422	61,589	65,472	6.3%
Total Assets	54,227	57,202	61,642	61,537	69,407	12.8%
Gross Loans	36,011	39,930	40,660	42,328	47,329	11.8%
Saving Deposits	4,740	5,495	6,315	6,885	9,246	34.3%
Shareholder's equity	16,670	17,383	18,239	18,903	19,722	4.3%

Performance Ratios	2009	2010	2011	2012	2013	Movement 2012/13
Return on Assets	2.9%	2.5%	2.9%	2.2%	2.5%	0.3%
Return on Equity	9.4%	8.2%	9.4%	7.0%	8.3%	1.3%
Operating Costs to Total Income	70.9%	72.7%	72.2%	70.8%	71.1%	0.3%
Operating Income to Average Portfolio	20.9%	27.4%	19.5%	15.2%	16.3%	1.1%

Directors' Report for the year ended 31 December 2013

In accordance with a resolution of the Board of Directors, the directors herewith submit the Balance Sheet as at 31 December 2013, 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:

Lord Matoto (Chairman) - appointed 25 February 2013
Pousima Afeaki - resigned 16 January 2013
Paula Taumoepeau
Penisimani Vea - resigned 14 October 2013
Rev. Dr. Tevita Kolo'ia Havea - resigned 27 August 2013
Leta Havea Kami (Managing Director & CEO) - appointed 02 September 2013

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 2013 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 2013 was $ 1,637,768 (December 2012: $1,329,129).

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 declared a dividend based on 50% of net profit after tax for the year ended 31 December 2012. This amounted to $664,564 or $0.63 per issued share which was paid on 26 June 2013.

The directors also declared a dividend based on 50% of the net profit after tax for the year ended 31 December 2013. This amounted to $818,884 or $0.78 per issued share.

6. RESERVES

The directors recommend that no amounts be transferred to reserves in respect of the year ended 31 December 2013.

7. BASIS OF ACCOUNTING

The directors believe the basis of 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

The directors are aware of the extent of the damages caused by Cyclone Ian to the Ha'apai Group on 11 January 2014. The Board approved a moratorium package for all Ha'apai loan customers at a cost of foregoing 3 months loan repayments, interest and fees. Damage to the Bank's office building is covered under insurance.

10. UNUSUAL TRANSACTIONS

The results of the Bank's operations for the year ended 31 December 2013 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 previous financial 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 4th day of March 2014.

Leta Havea Kami	**Lord Matoto**
Managing Director & CEO	**Chairman of the Board**

Statement by Directors for the year ended 31 December 2013

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 2013;

(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 2013;

(c) the accompanying statement of changes in equity is drawn up so as to give a true and fair view of the movement in shareholder's funds for the year ended 31 December 2013; 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 2013.

Signed in accordance with a resolution of the directors this 4th day of March 2014.

Leta Havea Kami
Managing Director & CEO

Lord Matoto
Chairman of the Board

pwc

Independent Auditor's Report

To the Shareholder of Tonga Development Bank Limited

Report on the Financial Statements

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 2013 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.

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, the Financial Institutions Act, 2004, and the Tonga Development Bank Act, 1977, and for such internal control as the directors and management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 about 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 of financial statements that give a true and fair view 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.

Opinion

In our opinion the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2013, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers, Level 8 Civic Tower, 272 Victoria Parade, Suva, Fiji.
GPO Box 200, Suva, Fiji.
T: (679)3313955 / 3315199, F: (679) 3300981 / 3300947

pwc

Report on Other Legal and Regulatory Requirements

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 are in agreement with the books of account and to the best of our information and according to the explanations given to us give the information required by the Tonga Companies Act, 1995, the Financial Institutions Act, 2004, and the Tonga Development Bank Act, 1977, 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.

Restriction on Distribution or Use

This report is made solely to the Bank's shareholder, as a body. Our audit work has been undertaken so that we might state to the Bank's shareholder those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank and the Bank's shareholder as a body, for our audit work, for this report, or for the opinions we have formed.

PricewaterhouseCoopers

4 March 2014
Suva, Fiji

PricewaterhouseCoopers
Chartered Accountants

Statement of Comprehensive Income for the year ended 31 December 2013

	Notes	2013 $	2012 $
Continuing operations			
Interest income	6	4,510,477	4,603,992
Interest and other borrowing expenses	6	(1,188,625)	(1,094,944)
Net interest income		3,321,852	3,509,048
Fees and commission income	7	2,361,674	2,266,351
Other operating income	8	443,817	339,058
Net operating income		6,127,343	6,114,457
Losses on loans and advances	13	(389,100)	(382,770)
Bad debts written off		(4,174)	(72,590)
Bad debts recovered/reversed		184,954	277,378
Other operating expenses	9	(4,011,488)	(4,010,590)
Profit before income tax		1,907,535	1,925,885
Income tax expense	19	(269,767)	(596,756)
Profit for the year from continuing operations		$1,637,768	$1,329,129
Other comprehensive income		-	-
Total comprehensive income for the year		$1,637,768	$1,329,129
Earnings per share	28	$1.56	$1.26

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

Balance Sheet - As at 31 December 2013

	Notes	2013 $	2012 $
ASSETS			
Cash on hand and at Bank	10	7,547,317	2,057,108
Investment securities – held to maturity	12	6,469,091	8,728,491
Loans and advances	13	45,383,503	40,631,992
Other assets	14	373,833	547,866
Amounts receivable from shareholder	15	6,792	6,249
Amounts receivable from NRBT	16	25,000	-
Statutory reserve deposit	16	2,011,000	1,767,000
Property, plant and equipment	17	6,380,028	6,630,619
Investment property	18	538,583	579,948
Deferred tax asset	19	671,362	587,471
Total Assets		$69,406,509	$61,536,744
LIABILITIES			
Savings deposits		9,245,715	6,884,979
Other liabilities	20	1,843,329	1,499,364
Amount payable to NRBT	16	-	43,000
Borrowings	21	35,718,334	31,531,581
Current tax liability	19	550,250	636,484
Managed funds	22	412,937	277,829
Deferred tax liability	19	1,094,779	1,095,546
Dividends payable	27	818,884	664,564
Total Liabilities		49,684,228	42,633,347
SHAREHOLDERS' EQUITY			
Share capital	23	10,530,190	10,530,190
Retained earnings		9,192,091	8,373,207
Total Shareholders' Equity		19,722,281	18,903,397
Total Equity and Liabilities		$69,406,509	$61,536,744

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

Signed in accordance with a resolution of the directors this 4th ay of March 2014.

Leta Havea Kami
Managing Director & CEO

Lord Matoto
Chairman of the Board

Statement of Changes in Equity - Year ended 31 December 2013

	Notes	Share Capital	Retained Earnings	Total
		$	$	$
Balance 31 December 2011		10,530,190	7,708,642	18,238,832
Comprehensive income Profit for the year		-	1,329,129	1,329,129
Other comprehensive income		-	-	-
Total comprehensive income		-	1,329,129	1,329,129
Transactions with owners – Dividends declared in 2012	27	-	(664,564)	(664,564)
Total transactions with owners		-	(664,564)	(664,564)
Balance 31 December 2012	29	$10,530,190	$8,373,207	$18,903,397
Comprehensive income				
Profit for the year		-	1,637,768	1,637,768
Other comprehensive income		-	-	-
Total comprehensive income			1,637,768	1,637,768
Transactions with owners				
Dividends declared in 2013	27	-	(818,884)	(818,884)
Total transactions with owners		-	(818,884)	(818,884)
Balance 31 December 2013	29	$10,530,190	$9,192,091	$19,722,281

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

Statement of Cash Flows - Year ended 31 December 2013

	Notes	2013 $	2012 $
Cash flows from operating activities			
Interest received		4,607,107	4,594,359
Interest payment		(994,360)	(1,221,578)
Fees and commission received		2,361,674	2,266,351
Other income		439,173	322,662
Income tax paid		(440,658)	(60,559)
Payment to employees and suppliers		(3,118,340)	(3,272,698)
Cash flows from operating assets and liabilities		2,854,596	2,628,537
Changes in operating assets and liabilities:			
Disbursements of Loans		(22,453,566)	(20,172,278)
Repayments of loans		17,628,842	18,468,517
(Decrease)/increase in other debtors and prepayments		77,402	(9,523)
Increase in amounts receivable from shareholder		(543)	(6,249)
(Decrease/increase in other liabilities		(171,628)	91,854
Net cash (used in)/from operating activities		(2,064,897)	1,000,858
Cash flows from investing activities			
Purchase of property, plant and equipment	17&18	(279,863)	(418,819)
Proceeds from sale of plant and equipment		4,644	16,396
Net decrease /(increase) in statutory deposits	16	(312,000)	100,000
Net increase in Government bonds	12	1,000,000	(505,000)
Net cash from/(used in) investing activities		412,781	(807,423)
Cash flows from financing activities			
Net increase/(decrease) in TDB promissory notes and bonds		4,518,445	(1,866,100)
Net increase in savings deposits		2,360,736	570,016
Dividends paid		(664,564)	(856,175)
Repayments of borrowings		(331,692)	(260,299)
Net cash generated from/ (used in) financing activities		5,882,925	(2,412,558)
Net increase/(decrease) in cash and cash equivalents		4,230,809	(2,219,123)
Cash and cash equivalents at beginning of year		6,387,599	8,606,722
Cash and cash equivalents at year end	11	$10,618,408	$6,387,599

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) New and amended standards adopted by the Bank

There are no IFRSs or IFRIC interpretations that are effective for the first time for the financial year beginning on or after 1 January 2013 that would be expected to have a material impact on the Bank.

ii) New standards and interpretations not yet adopted

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2013, and have not been applied in preparing these financial statements. None of these is expected to have a significant effect on the financial statements of the Bank, except the following set out below:

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

(a) Basis of preparation - continued

Standard/interpretation	Key requirements	Effective Date
IFRS 9, 'Financial instruments' - classification and measurement	This standard on classification and measurement of financial assets and financial liabilities will replace IAS 39, 'Financial instruments: Recognition and measurement'. IFRS 9 has two measurement categories: amortised cost and fair value. All equity instruments are measured at fair value. A debt instrument is measured at amortised cost only if the entity is holding it to collect contractual cash flows and the cash flows represent principal and interest. For liabilities, the standard retains most of the IAS 39 requirements. These include amortised - cost accounting for most financial liabilities, with bifurcation of embedded derivatives. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch.	Annual periods beginning on or after 1 January 2015
Amendment to IAS 32, 'Financial instruments: Presentation	This amendment updates the application guidance in IAS 32 'Financial instruments: Presentation', to clarify some of the requirements for offsetting financial assets and financial liabilities on the balance sheet and disclosure requirements as well. The amended disclosures will require more extensive disclosures than are currently required under IFRS. The disclosures focus on quantitative information about recognised financial instruments that are subject to master netting or similar arrangements irresoective of whether they are offset.	Annual periods beginning on or after 1 January 2014
IAS 36 'Impairment of assets	These amendments address the disclosure of information about the recoverable amount of impaired assets if that amount is based on fair value less costs of disposal. This amendment introduces additional disclosures about fair value measurements when there has been impairment or a reversal of impairment.	Annual periods beginning on or after 1 January 2014

The Bank is yet to assess the impact of the above standards and intends to adopt the standards and intends to adopt the standards no later than the accounting period in which it becomes effective.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

(b) Segment Reporting

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

(c) Foreign currency translation

(i) Functional and presentation currency

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

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

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and 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 - continued

Assets carried at amortised cost - continued

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 3 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 or collectively for financial assets that are not individually significant. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment. The assessment normally encompasses collateral held and the anticipated receipts for that individual account.

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 make contributions to the National Retirement Benefit Fund for all permanent employees ata a rate 5%. These contributions are charged to the statement of comprehensive income in the periods 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 deter mined 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

3.1 Credit risk - 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 - continued

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

	2013		**2012**	
	Loans and Advances	Impairment Provision	Loans and Advances	Impairment Provision
	(%)	(%)	(%)	(%)
A	8.02	-	8.71	-
B	17.70	-	22.25	-
C1	56.85	30.06	56.07	28.00
S	10.83	5.27	7.40	3.70
C2	2.38	10.70	2.53	25.56
D	3.12	29.47	2.19	29.61
E	1.10	24.50	0.85	13.13
	100.00	100.00	100.00	100.00

Note 3. FINANCIAL RISK MANAGEMENT - CONTINUED

3.3 Impairment and provisioning policies - continued

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.

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

	2013		2012	
	$	%	$	%
Industry sector:				
Agriculture	4,855,799	10.26	5,173,551	12.22
Industry and Business	17,725,842	37.46	13,900,820	32.84
Housing and Personal	22,317,486	47.15	20,985,064	49.58
Staff	2,429,441	5.13	2,268,154	5.36
	$47,328,568	100.00	$42,327,589	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 part 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 2013	Agriculture	Industry & business	Housing & personal	Staff	Total
	$	$	$	$	$
Neither past due nor impaired	3,461,848	14,217,704	20,508,605	2,429,441	40,617,598
Past due but not impaired	890,771	2,043,718	1,237,127	-	4,171,616
Individually impaired	503,179	1,464,420	571,755	-	2,539,354
Gross	4,855,798	17,725,842	22,317,487	2,429,441	47,328,568
Less: allowance for impairment	(1,007,070)	(522,372)	(415,623)	-	(1,945,065)
Net	$3,848,729	$17,203,470	$21,901,864	$2,429,441	$45,383,503

As at 31 December 2012	Agriculture	Industry & business	Housing & personal	Staff	Total
	$	$	$	$	$
Neither past due nor impaired	3,692,752	7,076,572	18,325,225	2,268,154	31,362,703
Past due but not impaired	1,117,936	6,187,656	1,962,294	-	9,267,886
Individually impaired	362,863	636,592	697,545	-	1,697,000
Gross	5,173,551	13,900,820	20,985,064	2,268,154	42,327,589
Less: allowance for impairment	(713,315)	(399,448)	(582,834)	-	(1,695,597)
Net	$4,460,236	$13,501,372	$20,402,230	$2,268,154	$40,631,992)

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 nor impaired are summarised as follows:

The credit quality of the portfolio of the 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 2013	Agriculture	Industry & Business	Housing & Personal	Staff	Total
	$	$	$	$	$
Grades					
A	41,819	2,513,732	908,982	329,187	3,793,720
B	158,538	1,519,181	5,406,245	1,294,504	8,378,468
C1	3,261,491	5,058,823	13,610,992	805,750	22,737,056
S		5,125,968	582,386	-	5,708,354
	$3,461,848	$14,217,704	$20,508,605	$2,429,441	$40,617,598

As at 31 December 2012	Agriculture	Industry & Business	Housing & Personal	Staff	Total
	$	$	$	$	$
Grades					
A	485,244	472,311	802,588	246,808	2,006,951
B	254,716	1,626,203	5,883,680	1,274,824	9,039,423
C1	2,952,792	4,978,058	11,638,957	746,523	20,316,329
S	-	-	-	-	-
	$3,692,752	$7,076,572	$18,325,225	$2,268,155	$31,362,703

(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 2013	Agriculture	Industry & Business	Housing & Personal	Staff	Total
	$	$	$	$	$
Past due up to 30 days	652,359	1,565,275	1,009,151	-	3,226,785
Past due 30 – 60 days	188,897	369,674	172,652	-	731,223
Past due 60 – 90 days	49,515	108,769	55,324	-	213,608
	890,771	2,043,718	1,237,127	-	4,171,616
Fair value of collateral	$2,514,212	$5,627,831	$3,255,470	-	$11,397,513

Note 3. FINANCIAL RISK MANAGEMENT - CONTINUED

3.5 Loans and advances - continued

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

As at 31 December 2012	Agriculture	Industry & business	Housing & personal	Staff	Total
	$	$	$	$	$
Past due up to 30 days	837,754	5,941,925	1,556,021	-	8,335,700
Past due 30 – 60 days	225,869	211,185	256,660	-	693,714
Past due 60 – 90 days	54,313	34,546	149,613	-	238,472
	$1,117,936	$6,187,656	$1,962,294	-	$9,267,887
Fair Value of collateral	$3,262,364	$6,792,787	$4,375,733	-	$14,430,884

(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 2013 Term loans	1,796,846	6,198,117	4,114,985	151,489	12,261,437
As at 31 December 2012 Term loans	680,895	4,074,842	1,901,166	59,166	6,716,069

(v) Repossessed collateral

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

Nature of assets	Carrying amount	
	2013	**2012**
	$	$
Land - Tax allotment	30,000	-

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:

	2013	2012
	$	$
Large corporate entities	13,173,840	9,917,614
SMEs	28,628,975	28,480,107
Other	5,525,753	3,929,868
	$47,328,568	$42,327,589

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:

	2013	2012
	$	$
Liabilities		
Borrowings – foreign	$ 1,777,937	$ 1,801,420

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

As at 31 December 2013	Up to 1 month	2 - 3 months	4 - 12 months	2 - 5 years	Over 5 years	No specific maturity	Total
Assets	($)	($)	($)	($)	($)	($)	($)
Cash on hand and at Bank	7,547,317	-	-	-	-	-	7,547,317
Investment securities – held to maturity	-	-	5,075,983	1,393,108	-	-	6,469,091
Loans and services	1,549,572	2,972,106	10,611,267	18,528,915	11,721,643	-	45,383,503
Statutory reserve deposit	-	-	-	-	-	2,011,000	2,011,000
Property, plant and equipment	-	-	-	-	-	6,380,028	6,380,028
Investment Property	-	-	-	-	-	538,583	538,583
Other assets	34,672	142,300	166,035	671,362	-	62,618	1,076,987
Total Assets	9,131,561	3,114,406	15,853,285	20,593,385	11,721,643	8,992,229	69,406,509
Liabilities							
Saving deposits	9,245,715	-	-	-	-	-	9,245,715
Borrowings	145,437	41,642	302,731	2,459,189	1,513,450	-	4,462,449
Promissory Notes	290,609	2,260,161	6,325,134	22,285,795	-	-	31,161,699
TDB bonds	-	-	-	94,186	-	-	94,186
Other liabilities	1,073,207	349,431	458,939	1,330,886	1,507,716	-	4,720,179
Total Liabilities	10,754,968	2,651,234	7,086,804	26,170,056	3,021,166	-	49,684,228
Net Liquidity Gap	($1,623,407)	$463,172	$8,766,481	($5,576,671)	$8,700,477	$8,992,229	$19,722,281
As at 31 December 2012							
Total Assets	4,122,532	3,023,559	14,611,487	20,630,682	10,170,917	8,977,567	61,536,744
Total Liabilities	8,354,223	5,608,452	19,227,805	5,173,870	4,268,997	-	42,633,347
Net Liquidity Gap	($4,231,691)	($2,584,893)	($4,616,318)	$15,456,812	$5,901,920	$8,977,567	$18,903,397

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 25, are summarised in the table below.

(c) Capital commitments

Capital commitments (note 25) are summarised in the table below.

At 31 December 2013	No later than 1 year	1 – 5 years	Over 5 years	Total
	$	$	$	$
Loan commitments	2,415,494	-	-	2,415,494
Operating lease commitments	13,420	53,680	170,160	237,260
Capital commitments	-	-	-	
Total	$2,428,914	$53,680	$170,160	$2,652,754
At 31 December 2012				
Loan commitments	1,751,534	-	-	1,751,534
Operating lease commitments	7,720	30,880	165,880	204,480
Capital commitments	-	-	-	-
Total	$1,759,254	$30,880	$165,880	$1,956,014

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 $3,398,000 (2012:$4,398,000) 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 2013 and year ended 31 December 2012. During that period, the Bank complied with all of the externally imposed capital requirements to which they are subject.

	2013	2012
Tier 1 Capital	$	$
Share capital	10,530,190	10,530,190
Retained earnings	9,192,091	8,373,207
Total	$19,722,281	$18,903,397
Risk weighted assets	$45,383,503	$40,631,992
Ratio	43.46%	46.52%

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

	2013 $	2012 $
Interest income		
Loans and advances	4,137,204	4,189,610
Term deposits and securities	373,273	414,382
	$4,510,477	$4,603,992
Interest and other borrowing expenses		
Borrowings	89,022	102,868
TDB promissory notes	985,054	885,966
TDB Bond	3,665	5,924
Savings deposits	106,993	95,649
Bank charges	3,891	4,537
	$1,188,625	$1,094,944

Borrowings cost comprises foreign exchange loss/(gain) of $6,792 (2012: $6,249).

Interest income accrued on impaired financial assets is $1,268 (2012:$9,730)

NOTE 7. FEES AND COMMISSION INCOME

	2013	2012
	$	$
Service fees	2,201,913	1,938,025
Commissions	159,761	328,326
	$2,361,674	$2,266,351

NOTE 8.

	Note	2013	2012
		$	$
Rent		196,101	141,924
Other	a/	247,716	197,134
a/ Other operating income "Other" includes the following:		$443,817	$339,058
Cost of operation and Government policy obligation obligation at the Niuas		150,000	150,000
WBOT agency agreement fee		55,000	-
Administration Fees		38,072	47,134
Gain on sale		4,644	-
		$247,716	$197,134

NOTE 9. OTHER OPERATING EXPENSES

		2013	2012
		$	$
Staff costs (refer below)		1,976,682	2,202,110
Administrative expenses		785,387	637,659
Auditor's remuneration - audit fee		22,231	21,415
Depreciation - Property, plant and equipment		530,454	474,008
- Investment property		41,366	41,863
Premises		288,047	309,262
Travel		159,971	179,639
Insurance loss		-	372
Others	a/	207,350	144,262
		$4,011,488	$4,010,590

a/ *Include Staff training $30,128 and Directors' fees $83,353 and legal fees of ($17,170).*

Staff costs comprise:

	2013	2012
Wages and salaries and other staff costs	1,685,307	1,643,229
Retirement fund	291,375	558,975
	$1,976,682	$2,202,110

NOTE 10. CASH ON HAND AND AT BANK

	2013 $	2012 $
Cash on hand	1,172,634	191,904
Cash at Bank	6,374,683	1,865,204
	$7,547,317	$2,057,108

NOTE 11. CASH AND CASH EQUIVALENTS

For the purposes of the statement of cash flows, cash and cash equivalents comprise the following:

	2013 $	2012 $
Cash on hand and at Bank	7,547,317	2,057,108
Investment securities	3,071,091	4,330,491
	$10,618,408	$6,387,599

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

NOTE 12. INVESTMENT SECURITIES – HELD TO MATURITY

	2013 $	2012 $
Westpac Bank of Tonga	2,075,244	3,024,013
ANZ Bank	435,551	777,148
MBf Bank	560,296	529,330
Government of Tonga Local Development Bond	3,398,000	4,398,000
	$6,469,091	$8,728,491

The year end interest rate receivable on term deposits range from 1% to 6.50% (2012: 2.1% to 17.15%) per annum and the interest rate for the Government of Tonga Local Development Bond range from 3.2% to 6.95% (2012: 3.2% 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 13. LOANS AND ADVANCES

	2013	2012
	$	$
Gross loans and advances	47,328,568	42,327,589
Less : Allowance losses on loans and advances	(1,945,065)	(1,695,597)
Net loans	45,383,503	40,631,992
Loans and advances approved but not yet disbursed amounted to:	$2,415,494	$1,751,534

Allowance for losses on loans and advances

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

Balance at beginning of the year	1,695,597	1,662,288
Provision for loan impairment	934,151	759,184
Provisions written back	(545,051)	(376,414)
Loans written off during the year	(139,632)	(349,461)
Balance at end of year	$1,945,065	$1,695,597

Composition of allowance for losses on loans and advances:

Specific provision	793,537	1,018,322
Collective provisions	1,151,528	677,275
	$1,945,065	$1,695,597

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

Provision for loan impairment	934,151	759,184
Provisions written back	(545,051)	(376,414)
	$389,100	$382,770

Non accrual loans and advances

Non accrual loans and advances	1,221,746	1,549,889
Less: specific provision for impairment	(805,648)	(688,050)
	$416,098	$861,839

Loans to directors and director related entities are disclosed in note 24 (a) (iii).

NOTE 13. 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%
S	2%
C2	20%
D	50%
E	100%

NOTE 14. OTHER ASSETS

		2013 $	2012 $
Prepayment		73,407	67,321
Accrued interest		165,331	261,961
Other assets	**a/**	135,095	218,584
		$373,833	$547,866

a/ *Major items include Robbery recovery ($60,941); WBOT agency claim ($7,013); Digicel Mobile Money ($1,689); Lawyers Suspense account $45,176; Fraudulent Actions Suspense accounts $1,500; Western Union transit account ($14,076) and others $4,700.*

NOTE 15. AMOUNTS RECEIVABLE FROM SHAREHOLDERS

	2013 $	2012 $
Comprises the following:		
Claims for EEC	$6,792	$6,249

NOTE 16. STATUTORY RESERVE DEPOSIT

	2013 $	2012 $
National Reserve Bank of Tonga (NRBT)	$2,011,000	$1,767,000

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 six month / year end was 5% (2012: 5%)

	2013 $	2012 $
Amounts receivable from/(payable to) NRBT	25,000	(43,000)

Amounts receivable from/(payable to) NRBT represent (shortfall)/surplus in the statutory reserve deposit at year end.

NOTE 17. PROPERTY, PLANT AND EQUIPMENT

	Leasehold Land and buildings	Fixtures, fittings & equipment	Motor vehicles	Computers	Total
At 31 December 2011					
Cost	6,922,394	887,251	509,112	2,028,975	10,347,732
Accumulated depreciation	(946,420)	(769,031)	(337,137)	(1,692,946)	(3,745,534)
Net book amount	$5,975,974	$118,220	$171,975	$336,029	$6,602,198
For the year ended 31 December 2012	**$**	**$**	**$**	**$**	**$**
Opening net book amount	5,975,974	118,220	171,975	336,029	6,602,198
Additions	3,632	7,511	127,233	364,053	502,429
Disposals	-	-	-	-	-
Depreciation charge	(183,568)	(32,094)	(80,302)	(178,044)	(474,008)
Closing Net book amount	$5,796,038	$93,637	$218,906	$522,038	$6,630,619
At 31 December 2012					
Cost	6,926,026	894,762	566,468	2,393,028	10,780,284
Accumulated depreciation	(1,129,988)	(801,125)	(347,562)	(1,870,990)	(4,149,665)
Net book amount	$5,796,038	$93,637	$218,906	$522,038	$6,630,619
For the year ended 31 December 2013					
Opening net book amount	5,796,038	93,637	218,906	522,038	6,630,619
Additions	36,241	17,537	83,774	142,311	279,863
Disposals	-	-	-	-	-
Depreciation charge	(184,518)	(28,924)	(92,571)	(224,441)	(530,454)
Closing net book amount	$5,647,761	$82,250	$210,109	$439,908	$6,380,028
At 31 December 2013					
Cost	6,962,266	912,299	599,123	2,535,340	11,009,137
Accumulated depreciation	1,314,505	(830,049)	(389,123)	(2,095,432)	(4,629,109)
Net book amount	$5,647,761	$82,250	$210,109	$439,908	$6,380,028

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

NOTE 18. INVESTMENT PROPERTY

	Land & Building $	Total $
At 31 December 2011		
Cost	829,248	829,248
Accumulated depreciation	(207,437)	(207,437)
Net book amount	$621,811)	$621,811
For the year ended 31 December 2012		
Opening net book amount	621,811	621,811
Additions	-	-
Disposals	-	-
Depreciation charge	(41,863)	(41,863)
Closing net book amount	$579,948	$579,948
At 31 December 2012		
Cost	829,248	829,248
Accumulated depreciation	(249,300)	(249,300)
Net book amount	$579,948	$579,948
For the year ended 31 December 2013		
Opening net book amount	579,948	579,948
Additions	-	-
Disposals	-	-
Depreciation charge	(41,365)	(41,365)
Closing net book amount	$538,583	$538,583
At 31 December 2013		
Cost	829,248	829,248
Accumulated depreciation	(290,665)	(290,665)
Net book amount	$538,583	$538,583

(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:

	2013 $	2012 $
Rental income	38,287	24,107
Direct operating expenses arising from investment properties	8,008	65,615

NOTE 19. TAXATION

	2013 $	2012 $
Income tax is brought to account using the liability method of tax effect accounting.		
(a) The major components of the income tax expense are:		
Current tax:		
Current tax on profits for the year	520,352	440,659
Adjustment in respect of prior year	(165,927)	195,825
Total current tax	354,425	636,484
Deferred tax:		
Origination and reversal of temporary difference	(84,658)	(39,728)
Impact of change in tax rate	-	-
Total deferred tax	(84,658)	(39,728)
Income tax expense	$269,767	$596,756
(b) **Operating profit before income tax**	$1,907,535	$1,925,885
Prima facie income tax charge on the operating profit at 25%	476,884	481,471
Tax effect of non deductible expenditure:		
Grants and exempt income	(62,044)	(74,063)
Tax effect of over provision - prior year	(145,073)	189,348
Income tax expense	$269,767	$596,756
(c) **Income tax expense comprises:**		
Current tax expense	520,352	440,659
Under/(Over) provision – prior year	(145,073)	189,348
Deferred tax expense - net	(105,512)	33,251
Income tax expense	$269,767	$596,756

(d) **Deferred tax asset**

	2013 $	2012 $
(i) Deferred tax asset comprises the net effect of the following (amounts recognized in profit or loss):		
Allowance for loan losses	486,266	423,899
Other provisions	40,035	42,160
Unearned revenue	145,061	121,412
	$671,362	$587,471
(ii) The movement in deferred tax asset is as follows:		
Balance at 1 January	587,471	568,271
Charge to statement of comprehensive income	83,891	19,200
Balance at end of six months / year	$671,362	$587,471

NOTE 19. TAXATION - CONTINUED

		2013	2012
(e)	**Deferred tax liability**		
(i)	The balance comprises temporary differences attributable to:	$	$
	Depreciation	$1,094,779	$1,095,546
(ii)	The movement in deferred tax liability is as follows:		
	Balance at 1 January	1,095,546	1,116,075
	Credit to statement of comprehensive income	(767)	(20,529)
	Balance at end of six months / year	$1,094,779	$1,095,546

NOTE 20. OTHER LIABILITIES

	2013	2012
	$	$
Accrued interest	491,889	297,624
Provisions for annual leave and staff bonus	85,766	62,398
Deferred Income	580,246	485,648
Other creditors and accruals	685,428	653,694
	$1,843,329	$1,499,364

Other creditors and accruals include the following:

	2013	2012
Accruals and creditors	605,721	630,834
Withholding tax payable	2,104	20,286
Credit holding accounts	77,603	2,574
	$685,428	$653,694

NOTE 21. BORROWINGS

	Notes	2013	2012
		$	$
Comprises:			
Borrowings	(a)	4,462,449	4,794,141
Tonga Development Bank promissory notes	(b)	31,161,699	26,636,204
Tonga Development Bank Bond		94,184	101,236
		$35,718,334	$31,531,581

NOTE 21. BORROWINGS - CONTINUED

(a) Borrowings comprise the following:	Principal repayment term	Interest rate	2013 $	2012 $
Government of the Kingdom of Tonga				
Asian Development Bank	1993 – 2023	3.00%	443,279	489,940
International Fund for Agriculture Development 2	1993 – 2013	3.00%	-	66,034
International Fund for Agriculture Development 3	1999 – 2020	3.00%	1,239,668	1,335,027
International Development Association	1998 – 2023	3.00%	1,001,565	1,101,720
			2,684,512	2,992,721
Other borrowings				
European Investment Bank VI	2009 - 2026	5.5%	138,619	157,292
European Union	1988 – 2019	1.50%	21,629	26,439
Private Sector Reconstruction Facility	2011 – 2025	0.00%	1,617,689	1,617,689
			1,777,937	1,801,420
			$4,462,449	$4,794,141

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.

	2013 $	2012 $
(b) Tonga Development Bank promissory notes	31,161,699	$26,636,204

The interest rate at year end on promissory notes ranged from 1.0% per annum to 6.65% per annum. Interest is paid out on maturity and semi-annually for terms over 180 days.

NOTE 22. 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 Fund $	Advance to Projects $	2013 $	2012 $
Livelihood Reactivation Project - Niuatoputapu	94,400	(71,795)	22,605	72,084
New Zealand Borrower Diversification Fund	290,535	(108,946)	181,589	205,745
ADB Microfinance	208,743	-	208,743	-
	$593,678	($180,741)	$412,937	$277,829

NOTE 23. CAPITAL

	2013 $	2012 $
(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 24. RELATED PARTY TRANSACTIONS

(a) Directors

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

Lord Matoto (Chairman) - appointed 25 February 2013
Pousima Afeaki - resigned 16 January 2013
Paula Taumoepeau
Penisimani Vea - resigned 14 October 2013
Rev. Dr. Tevita Kolo'ia Havea - resigned 27 August 2013
Leta Havea Kami (Managing Director & CEO) - appointed 02 September 2013

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

	2013 $	2012 $
Directors' fees and retirement benefit	83,353	90,213
Management salaries & other short term employee benefits	188,904	249,058
Total	$272,257	$339,271

NOTE 24. RELATED PARTY TRANSACTIONS - CONTINUED

(iii) Transactions with related parties comprise of:

Loans and advances to directors or director-related entities

	2013	2012
	$	$
Balance at beginning of the year	45,943	838,033
Loan balance related to a retired Director	(26,493)	(589,255)
Loans advanced during the year	23,450	207,374
Loan and interest repayments during year	(47,695)	(441,206)
Interest and costs	4,795	30,997
Balance at end of the year	$ -	$45,943

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

	2013	2012
	$	$
Interest paid/payable on borrowings	99,202	114,449
Repayments of borrowings during the year	554,745	619,465
Borrowings from the Government of the Kingdom of Tonga are disclosed in note 21 (a)	2,684,512	2,992,721
The Government purchased TDB bonds and promissory notes during the year and the balances at year end are as follows:		
TDB promissory notes	4,238,323	3,072,053
Interest paid/payable on TDB bonds and promissory notes	111,507	67,769

Interest payable on the bonds and promissory notes range from 2% to 3% per annum.

(ii) Term deposits

	2013	2012
	$	$
Interest received/receivable on Government of Tonga Local Development Bonds	296,253	296,253
Government of Tonga Local Development Bonds at year end (Refer note 12.)	3,398,000	4,398,000

NOTE 25. COMMITMENTS AND CONTINGENT LIABILITY

		2013	2012
(a)	Capital commitment	$ -	$ -
(b)	Contingent liability	$ -	$ -
(c)	Operating lease commitments	$237,260	$204,480

(i) The Bank has leases over various leasehold properties in the Kingdom for a maximum term of 56 years. The minimum operating lease payments at balance sheet date are as follows:

	2013	2012
	$	$
Not later than one year	13,420	7,720
Later than one year but not later than five years	53,680	30,880
Later than five years	170,160	165,880
	$237,260	$204,480

(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:

	2013	2012
	$	$
Not later than one year	162,708	172,056
Later than one year but not later than five years	339,999	433,287
Later than five years	26,424	33,624
	$529,131	$638,967

NOTE 26. FINANCING ARRANGEMENTS

	2013	2012
	$	$
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	1,000,000
	$1,500,000	$1,500,000

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 27. DIVIDENDS

	2013 $	2012 $
(a) The directors have declared a dividend of 50% of net profit after tax for the year ended 31 December 2012. This amounted to $664,564 or $0.63 per issued share.	-	664,564
(b) The directors also declared a dividend of 50% of net profit after tax for the year ended 31 December 2013. This amounted to $818,884 or $0.78 per issued share.	818,884	-

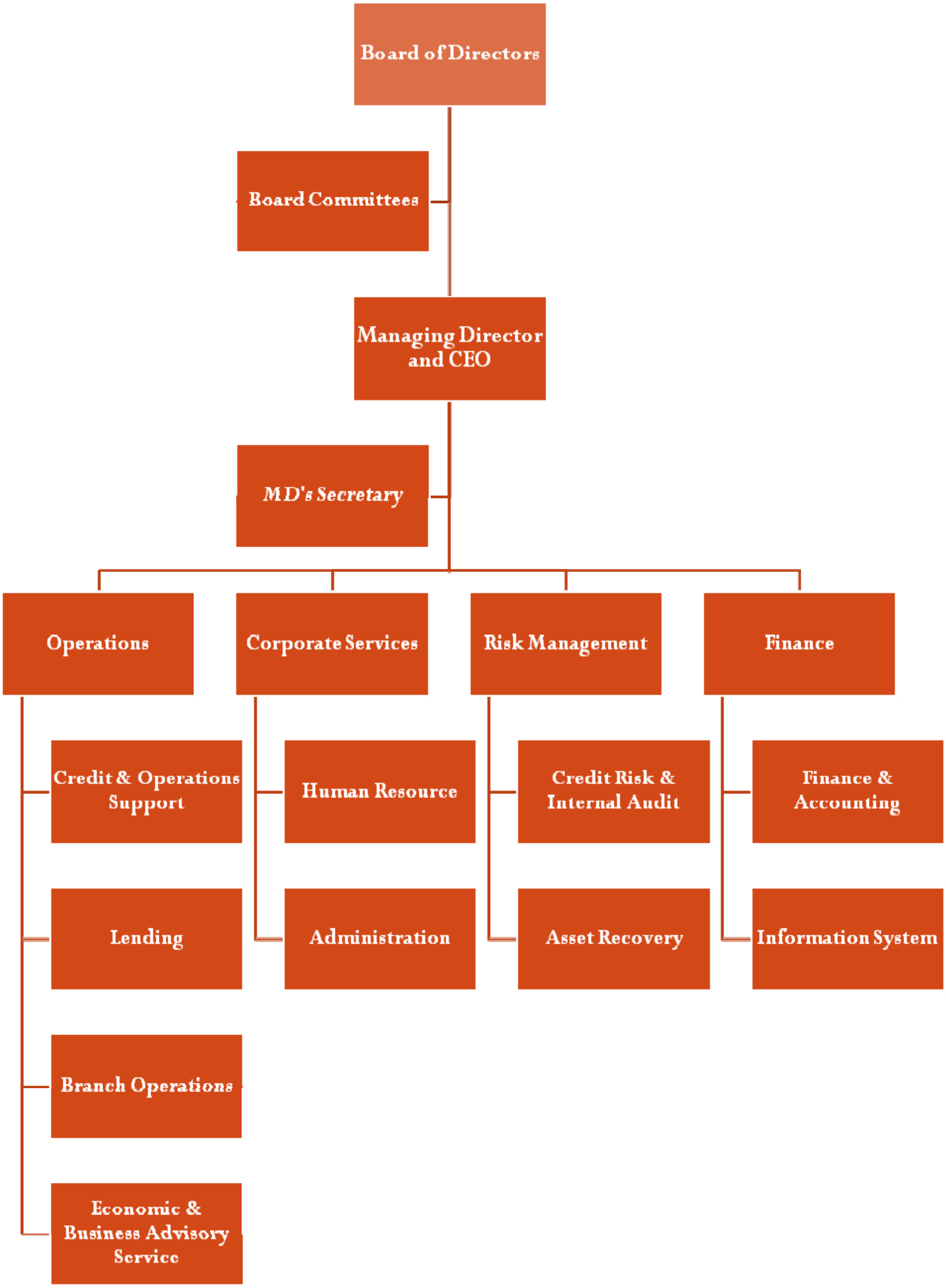
NOTE 28. EARNINGS PER SHARE

	2013 $	2012 $
Net profit after tax	1,637,768	1,329,129
Number of issued shares	1,053,019	1,053,019
Earnings per share	$1.56	$1.26

NOTE 29. RETURN ON EQUITY

	2013 $	2012 $
Net profit after tax	1,637,768	1,329,129
Shareholder's Equity	19,722,281	18,903,397
Return on Equity	8.30%	7.03%

Corporate Structure as at 31 December 2013



Senior Management Team as at 31 December 2013

SENIOR EXECUTIVES

Managing Director & CEO	Mrs Leta Kami (appointed 02 September 2013)
Deputy Managing Directors	
• Operations	Mrs Seini Movete
• Finance	Mr Hasiloni Fungavai
• Risk Management	Mrs Leta Kami

HEAD OFFICE

Managers

• Lending- Tongatapu	Mr Sitino Maka
• Loans District 1 & 2	Mrs ‘Elisapesi Fineanganofo
• 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	Mrs Vika. T. Vea
• Senior Economist	Mrs Siosina Paongo

BRANCH OFFICES

Managers

• Vava’u Branch	Mr. Sosaia Talau
• Ha’apai Branch	Mr Tokotaha Fonua
• ‘Eua Branch	Mr Tau’atevalu Mafi
• Niuatoputapu Branch	Mrs Lavinia Ika
• Niuafo’ou Branch	Mr Viliami Fifita
• Hahake District Office	Mrs ‘Atelaite Moala Fifita
• Hihifo District Office	Mr Mosese Fifita