Tonga Development Bank

Annual Report

2014

31st March 2015

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 2014, as required under the Tonga Development Bank Act, 2014 Section 18 (6) and the Public Enterprises Act 2002 Section 20 (1).

Respectfully

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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 Tonga Development Bank Act was reviewed and re-enacted in 2014.

The TDB Act 2014 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, savings, investments and advisory services which are provided on sound professional banking principles and ensuring such loans are repaid. The Bank is now expanding its products & services to include commercial banking activities. It is expected to complete within 3 years time.

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 2014

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

MR PAULA TAUMOEPEAU

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

MRS LEPAOLA VAEA

Deputy CEO of the Ministry of Revenue & Customs. Director of the Board in February 2014.

MR TEVITA LAVEMAAU

Appointed in January 2014 and resigned in November 2014. He is the Minister for Revenue & Customs.

MRS LETA HAVEA KAMI
She was appointed in September 2013 as Managing Director & CEO.

I am pleased to report that for the year ended 31 December 2014, the Tonga Development Bank (TDB) delivered positive results for its shareholder against very difficult economic conditions experienced during the year.

It has been a year with many rewarding moments, as well as some challenges. Although it was a year of transformation, we made solid progress on many fronts.

The TDB reported net profit after tax of $1.414 million as compared to $1.530 million of the budget 2014 and $1.637 in 2013. This is a decrease of 13.7% from the 2013 results.

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

At the beginning of the year, we were challenged after Cyclone Ian struck the Ha'apai Islands in January 2014. With the main islands being affected severely, the Bank approved three (3) months moratorium on interests, service fees and repayments for all Ha'apai customers for January to March 2014. The total interest income and fees forgone was $84,603 and the loan repayments forgone was $379,431 for 3 months. The moratorium on cash repayment loans continued for a further 3 months to July 2014 while borrowers with loan repayments from salaries started to service their loans.

In February 2014, Government made a decision to offer 40% of TDB shares for sale. Consequently, TDB fully paid up its shares from retained earnings to $14.0 million and arranged for proper valuation of its shares. The negotiation by Government with the accepted bidder and the due diligence by the National Reserve Bank of Tonga continued to the end of June 2014. The bidder withdrew, to the regret of Government, and the proposed purchase of the shares and provision of interest free funds did not eventuate.

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.

The TDB Act was reviewed and re-enacted in 2014 to allow the Bank to take on full commercial banking activities starting in 2014 and over the next 4 - 5 years. At the same time, the Bank maintains its mandate to provide development banking despite the lack of funds for such a function.

The shareholder (Government of Tonga) and the Bank's Board of Directors, in adopting the Feasibility Study into the future direction of the Bank jointly funded by International Finance Corporation (IFC) and the TDB, decided at the end of 2013 to expand the products and services of the Bank into full commercial operation starting in 2014.

In line with the Bank's Strategic Plan, banking services were expanded to include commercial products and services to match market opportunities. The Cheque and Overdrafts facilities were launched in July 2014 and the Forex Exchange and Transactional Banking to be implemented starting in 2015 onwards.

Government had outsourced its Sub-Treasury operations at 'Eua and Ha'apai through Agency arrangements with the Bank as from July 2014. The agency agreement with Westpac Bank of Tonga regarding its Ha'apai and 'Eua operations were renewed for another year in the second half of 2014.

While the Police investigation of the June 2009 robbery remains unsolved, it is an ongoing concern to the Bank that this has been going for over 5 years with no results. The Bank had offered a standing reward of $20,000 for information leading to conviction but so far without any result. The Bank is not prepared for this indefinite drift and is considering withdrawing its offer and closing this matter as far as it is concerned.

Before the beginning of its new financial year in July 2014, the Government rushed through proposals of economic stimulant funding to help private sector development through provision of directed low interest loans with Government funds managed by the TDB. Although this competes in many ways directly with the Banks activities and the management fee does not cover the costs, the Bank was cooperated fully to ensure Government's intended outcome is achieved.

The Bank continued to support a diverse range of activities within the community and provide sponsorship to organizations and events that promote health, education, sports and community development.

In 2015 the Bank will continue its expansion of products and services, primarily into foreign exchange and international business. This will continue into 2016 and 2017 when it will be fully commercialized and other services such as internet banking will be provided.

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 the Bank shall remain focused on pursuing sustainable and profitable growth. The Bank continues to aim at providing the Kingdom and the people of Tonga the best banking service at very competitive costs.

I am proud to acknowledge the effort and commitment of the Bank's Management team and staff in achieving the results for 2014. I extent gratitude and thanks to the Board of Directors for their valuable contributions and the strategic direction towards achieving the Bank's results for the year and transformation currently being understaken.

I would also like to thank the Government of Tonga and the Minister and Ministry of Public Enterprises, as shareholders, for the continuing support to the Bank.

Last but most important is the Bank's gratitude and appreciation to our customers for their ongoing confidence and support of the Bank. The Bank looks forward to continue working closely with its stakeholders and customers to provide banking services for all needs as the Bank expands the range of products and services to full modern and competitive banking facilities over the next three years and into future.

Malo 'aupito

Lord Matoto
Chairman

The Tonga Development Bank continues to fulfil its mandate to the public and shareholder by operating profitably in 2014 despite prolonged economic slowdown.

While it was a challenging year, the overall financial results for 2014 was satisfactory and this was made possible through the continued commitment and dedication of the Bank's Management and staff. The Bank remained focused on executing its core business diligently and effective service delivery throughout its branch network to provide financial solutions to its customers. This together with our conscious effort to control expenses has enabled the Bank to continue to enhance its values whilst focusing on effective customer service.

The challenges started early with Cyclone Ian (Category 5) devastating the Ha'apai Island group on Saturday, 11th January, 2014. Our main building in Ha'apai was extensively damaged but we were able to pass the test of the Bank's disaster recovery and business continuity plans successfully commencing operation by Monday, 13th January 2015. The repair work of the main office building was completed in August 2014 and reopened to the public on 1st September 2014.

1. OVERVIEW OF THE FINANCIAL PERFORMANCE

(All figures are in Tongan Pa'anga)

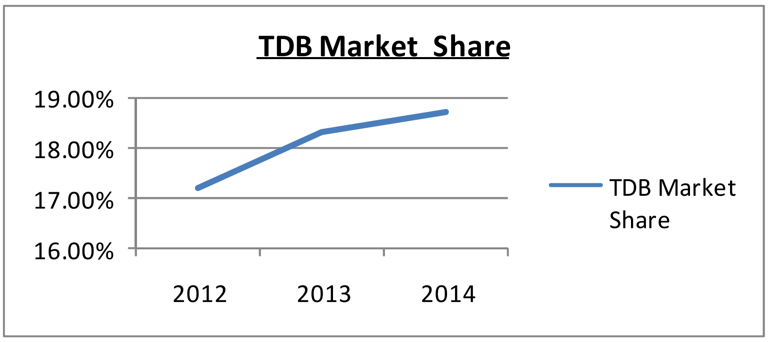
The net profit after tax was $1.414m for the twelve months ending 31 December 2014 which is below the $1.637m recorded for the year 2013. The major contributing factors to this result were:

- Higher costs of funds due to higher level of liquidity.
- Losses on loans and advances increased significantly from $0.389m in 2013 to $0.694m in 2014 which is an increase of $0.305m (78.4%).
- The Income tax expenses increased significantly from $0.269m in 2013 to $0.405m in 2014 which is an increase of $0.136m (50.6%).

2. DOMESTIC BANKING ENVIROMENT

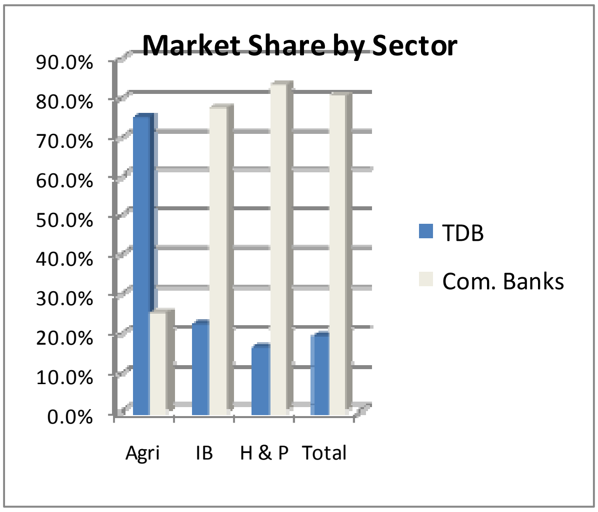
In Tonga, there are four Commercial Banks that are wholly or partially foreign owned (ie: Westpac Bank of Tonga, ANZ Bank, MBf Bank and Pacific International Commercial Bank). TDB is the only Development Bank in Tonga and is solely owned by the Government of Tonga.

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 except the Housing and Personal sector which declined in 2014. This reflects the loans refinanced by Commercial Banks in 2014. The majority was housing and personal loans.



B) Lending Sector Share

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



3. LENDING SECTORS

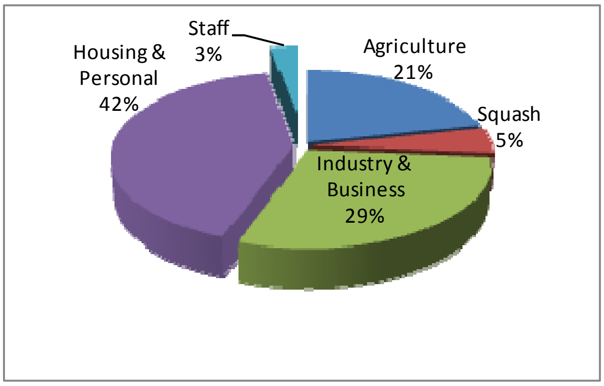
a) Loan Portfolio

With prudent lending practice, we have been able to grow our loan portfolio by $4.0m (8.45%) from $47.3m in 2013 to $51.3m at year end 2014.

The portfolio growth in 2014 was 8.5% and 11.8% in 2013.

b) Approval

The level of approval increased by $0.4m (2%) from $18.9m in 2013 to $19.3m at year end 2014. The total loan approval by major sector is as follows:



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

Government Managed Funds

TDB signed an Implementation Agreement to manage Government funds in August 2014 to be lent to key economic sectors to facilitate growth.

c) Agriculture/Fisheries Sector

Lending to agriculture and fisheries sector had increased by $0.48m (12.9%) from $3.69m in 2013 to $4.18m in 2014. This growth was 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, this $0.48m increase is less than $1.15m increase in 2013. The prolonged drought experienced in 2014 contributed to this scenario.

The total loan portfolio for Agriculture was $5.56m in 2014 represented 10.84% of the overall loan portfolio. It increased by 14.60% from $4.86m in 2013 to $5.56m in 2014.

d) Squash

The 2014 squash season recorded an increase in grower participation as well as lending from about $0.6m in 2013 to $0.9m in 2014. Despite squash projects hard hit by the prolonged drought in 2014, 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 and key line ministries (MAFFF and MCTL), overseas marketing agencies and exporters contributed to the sustainability of the industry.

e) Industry & Business

Lending to Industry and Business was $5.7m in 2014 compared to $5.8m in 2013 a slight decrease of $0.1m (1.8%). The decrease reflects the impact of Industry & Business loans of $1.5m approved under the Government Managed Funds. However, the opportunities for lending in the commercial sector have improved compared to 2013, especially to public and SME sectors. We continue to receive enquiries for refinancing debts from commercial banks. The Bank only considers proposals that are within our lending policy guidelines and are considered viable.

The total loan portfolio for Industry and Business was $21.3m in 2014 which is 41.59% of the total portfolio. The Industry and Business sector increased by $3.6m (20.3%) from $17.7m in 2013.

f) Housing & Personal

The Housing and Personal Loans remained dominant in the bank's lending and portfolio in 2014.

The total lending to Housing and Personal was $8.1m in 2014 compared to $8.6m in 2013. This is a decrease of $0.5m (6.1%).

Housing and Personal lending totalled about $21.9m (42.62%) of the portfolio in 2014. This reflects the high demand from this sector compared to productive sectors.

g) Staff Loans

Staff loans as at end of 2014 was $2.5m (4.95%) of the loans portfolio. Total approval for 2014 of $0.53m was slightly higher than the budget of $0.50m.

h) Outer Island Lending

Lending in the Outer Islands amounted to $5.3m contributing 27.6% in loans approved in 2014. This was an increase from $5.1m recorded in 2013.

4. PERFORMANCE TARGETS AND MEASURES

a) Credit Risk Management (CRM)

We continued to apply prudent credit risk management principles and it's 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.

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 2014 was 32.66%.

c) Arrears

The arrears ratio was recorded at 3.39% at year end 2014 as compared to a target of 4.5%. This is an increase from the arrears ratio result of 2.3% at year end 2013.

The 2014 target for the number of accounts in arrears was 570. However, the actual number of account in arrears was 651. The impact of the prolonged drought and Cyclone Ian in 2014 contributed to the increase in arrears.

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.

5. 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 44.4% of the funding required.

6. REVOLVING FUNDS

The Bank manages funds on behalf of the New Zealand Government, ADB, Pacific Islands Forum Secretariat (PIFS) and Government of Tonga.

7. NET INTEREST MARGIN (NIM)

The Bank's 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 2014 the net interest margin was 7.05%. This margin results in the Bank achieving a Net Profit after Tax of $1.414m and a Return on Equity of 6.97%.

8. HUMAN RESOURCE MANAGEMENT

a) Staff

Full time staff numbers were 100 in December 2014 compared to 94 in December 2013. The increase due to capacity building recruitment to support the Bank's expansion plans.

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 7.22% and male to female ratio was at 1 : 1.26.

Staff salary expense for 2014 was projected to be $2,107,000. However actual figure as at end December 2014 was $2,050,032.

This reflects the continued increase in productivity now being achieved in all areas of the Bank's operations.

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 IT 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 March, Management Training was conducted by Management Learning Associates (NZ). In May and October 2014, trainings were carried out for staff by Hay Group of New Zealand on Job Evaluation and New Performance Appraisal System.

c) Retirement Fund

The Bank continues to contribute to the National Retirement Benefit Fund scheme (NRBF) at 5% as from 1st July 2012. In 2014, the Bank approved to increase its contribution to the NRBF from 5% to 7.5% to be effective 1st January 2015.

d) Customer Service

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 2014. It provided customer feedback on specific matters which required immediate attention and improvement.

e) QUARTERLY AWARDS

Staff Quarterly Awards continued in 2014 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 award available for special recognition of exceptional performance during the year.

9. 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.

10. INFORMATION TECHNOLOGY (IT)

The IT Department continues to provide critical support to the schedule of the product and service expansion plans particularly with the two facilities (overdraft and cheque accounts) launched in July 2014.

For the first time this year, the printing of the Bank cheques for loan disbursements and bill payments are on cheque printers in all offices except the Niuas. The internet connections for the cheque printers in the Outer Islands were assisted by Digicel.

In addition to the new Business Expansion projects, the Government Managed Funds were set up into the system and started with periodic reporting.

The renewal of the Symantec antivirus was effected through the support of our software supplier Datec Australia.

The security camera server in the Vava'u branch was also replaced with a new server. This was coordinated by the Praesidia-Alliance as part of localizing the support to lower costs and ease of support.

11. 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 2014, 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.

12. PREMISES

Major renovation was carried at Head Office to extend customer area to add comfort and convenience. More customer booths and counter space open design to serve people in friendly environment.

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.

13. BUSINESS ADVISORY SERVICES (BAS)

The Bank's business advisory services offer a variety of specialized services to its clients ranging from group training to one on one consultation. The BAS also plays a vital role in providing ongoing business advisory support to the Lending Staff.

14. 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).

15. WORKING HOURS

The Bank's normal working hour is 8.30am to 4.30pm from Monday to Friday. As part of the expansion plan, the Bank will start opening on Saturdays to the public by 1st quarter of 2015. The working hours for Saturday would be from 9.00am to 1.00pm.

16. HOST REGIONAL CONFERENCE

On August 12th, 2014, the Association of Development Financing Institutions in the Pacific's (ADFIP) 2015 Annual General Meeting was hosted by the Bank. It was opened by the Deputy Prime Minister and attended by Board Chairman/Directors and CEOs from Fiji Samoa, Kiribati, Tuvalu, FSM, Palau, Tahiti and Cook Islands. The ADFIP is the umbrella organisation of development finance institutions in the Pacific.

17. FUTURE DIRECTION

As part of the expansion of the Bank's products and services, Foreign Exchange transactions are planned to be introduced by 1st half of 2015. The Bank is then working closely with NRBT on their Prudential Statement requirements to develop appropriate policies of foreign exchange and international business transactions.

17. 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 2014. It is indeed a privilege leading the Tonga Development Bank team in 2014.

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 to enable the Bank in fulfilling its objectives in 2014.

Ongoing support and loyalty of all our customers and their trust given to the Bank during 2014 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
Chief Executive Officer

FIVE YEARS SUMMARY

Profit & Loss TOP $'000s	2010	2011	2012	2013	2014	Movement 2013/2014
Interest Income	4,632	4,537	4,603	4,511	4,706	4.3%
Interest Expense	1,744	1,410	1,095	1,189	1,473	23.9%
Net Interest Income	2,888	3,127	3,509	3,322	3,233	-2.7%
Fees & commission income	2,707	2,452	2,266	2,362	2,556	8.2%
Other Operating Income	272	251	339	443	580	30.9%
Losses on loans & advances	361	133	383	389	694	78.4%
Bad Debts	16	34	73	4	31	675%
Income Tax Expense	389	439	597	270	406	50.4%
Operating Profit after tax	1,426	1,712	1,329	1,638	1,414	-13.7%
Earnings per share	1.35	1.63	1.26	1.56	1.01	-35.3%

Balance Sheet TOP $'000s	2010	2011	2012	2013	2014	Movement 2013/14
Average assets	55,520	59,422	61,589	65,472	77,273	18.0%
Total Assets	57,202	61,642	61,537	69,407	85,140	22.7%
Gross Loans	39,930	40,660	42,328	47,329	51,379	8.6%
Saving Deposits	5,495	6,315	6,885	9,246	10,888	17.8%
Shareholder's equity	17,383	18,239	18,903	19,722	20,288	2.9%

Performance Ratios	2010	2011	2012	2013	2014	Movement 2013/14
Return on Assets	2.5%	2.9%	2.2%	2.5%	1.8%	-0.7%
Return on Equity	8.2%	9.4%	7.0%	8.30%	6.97%	-1.33%
Operating Costs to Total Income	72.7%	72.2%	70.8%	71.1%	70.1%	-1.0%
Operating Income to Average Portfolio	27.4%	19.5%	15.2%	16.3%	18.8%	2.5%

Directors' Report for the year ended 31 December 2014

In accordance with a resolution of the Board of Directors, the directors herewith submit the Balance Sheet as at 31 December 2014, Statement of Profit or loss and other 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)
Paula Taumoepeau
Leta Kami
Tevita Lavemaau - appointed in January 2014 and resigned November 2014
Lepaola Vaea - appointed in February 2014

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 2014 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 2014 was $ 1,414,055 (December 2013: $1,637,768).

4. PROVISIONS

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

5. DIVIDENDS

The directors declared a dividend based on 50% of net profit after tax for the year ended 31 December 2013. This amounted to $818,884 or $0.78 per issued share which was paid on 15th May 2014.

The directors also declared a dividend based on 60% of the net profit after tax for the year ended 31 December 2014. This amounted to $848,433 or $0.61 per issued share.

6. RESERVES

The directors recommend that no amounts be transferred to reserves in respect of the year ended 31 December 2014.

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 profit or loss and other comprehensive income and balance sheet were made out to ascertain that all known bad debts were written off and adequate provision was made for doubtful debts.

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

9. EVENTS SUBSEQUENT TO BALANCE DATE

Since the end of the year, the directors are not aware of any other matters or circumstances not otherwise sealt with in the report that has significantly affected the operations of the Bank, the results of those operations or state of affairs of the Bank.

10. UNUSUAL TRANSACTIONS

The results of the Bank's operations for the year ended 31 December 2014 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 19th day of March 2015.

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

Statement by Directors for the year ended 31 December 2014

In the opinion of the Directors:

(a) the accompanying statement of profit or loss and other 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 2014;

(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 2014;

(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 2014; 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 2014.

Signed in accordance with a resolution of the directors this 19th day of March 2015.

Leta Havea Kami
Managing Director & CEO

Lord Matoto
Chairman of the Board

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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 2014 and the statements of profit or loss and other 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, 2014, 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.

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Opinion

In our opinion the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2014, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

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, 2014, 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 purpose of our audit.

Restriction on Distribution or Use

This report is made solely to the Bank's shareholder. 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.

19 March 2015
Suva, Fiji

PricewaterhouseCoopers

PricewaterhouseCoopers
Chartered Accountants

Statement of Profit or loss and other comprehensive income for the year ended 31 December 2014

	Notes	2014 $	2013 $
Continuing operations			
Interest income	6	4,705,980	4,510,477
Interest and other borrowing expenses	6	(1,473,314)	(1,188,625)
Net interest income		3,232,666	3,321,852
Fees and commission income	7	2,555,519	2,361,674
Other operating income	8	580,311	443,817
Net operating income		6,368,496	6,127,343
Losses on loans and advances	13	(694,322)	(389,100)
Bad debts written off		(30,587)	(4,174)
Bad debts recovered/reversed		196,617	184,954
Other operating expenses	9	(4,020,215)	(4,011,488)
Profit before income tax		1,819,989	1,907,535
Income tax expense	19	(405,934)	(269,767)
Profit for the year from continuing operations		**$1,414,055**	**$1,637,768**
Other profit or loss and other comprehensive income		-	-
Total profit or loss and other comprehensive income for the year		**$1,414,055**	**$1,637,768**
Earnings per share	28	$1.01	$1.56

The above statement of profit or loss and other comprehensive income should be read in conjunction with the accompanying notes.

Balance Sheet - As at 31 December 2014

	Notes	2014 $	2013 $
ASSETS			
Cash on hand and at Bank	10	20,094,545	7,547,317
Investment securities – held to maturity	12	4,864,652	6,469,091
Loans and advances	13	49,074,544	45,383,503
Other assets	14	461,220	373,833
Amounts receivable from shareholder	15	3,578	6,792
Amounts receivable from NRBT	16	-	25,000
Statutory reserve deposit	16	2,772,000	2,011,000
Property, plant and equipment	17	6,597,817	6,380,028
Investment property	18	497,217	538,583
Deferred tax asset	19	774,695	671,362
Total Assets		$85,140,268	$69,406,509
LIABILITIES			
Savings deposits		10,887,871	9,245,715
Other liabilities	20	2,076,668	1,843,329
Amount payable to NRBT	16	23,000	-
Borrowings	21	48,548,895	35,718,334
Current tax liability	19	539,165	550,250
Managed funds	22	833,554	412,937
Deferred tax liability	19	1,094,779	1,094,779
Dividends payable	27	848,433	818,884
Total Liabilities		64,852,365	49,684,228
SHAREHOLDERS' EQUITY			
Share capital	23	14,000,000	10,530,190
Retained earnings		6,287,903	9,192,091
Total Shareholders' Equity		20,287,903	19,722,281
Total Equity and Liabilities		$85,140,268	$69,406,509

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

Signed in accordance with a resolution of the directors this 19th of March 2015.

Leta Havea Kami
Managing Director & CEO

Lord Matoto
Chairman of the Board

Statement of Changes in Equity - Year ended 31 December 2014

	Notes	Share Capital	Retained Earnings	Total
		$	$	$
Balance 31 December 2012		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
Comprehensive income				
Profit for the year		-	1,414,055	1,414,055
Other comprehensive income		-	-	-
Total comprehensive income		-	1,414,055	1,414,055
Transactions with owners		3,469,810	(3,469,810)	
Dividends declared in 2014	27	-	(848,433)	(848,433)
Total transactions with owners		3,469,810	(4,318,243)	(848,433)
Balance 31 December 2014	29	$14,000,000	$6,287,903	$20,287,903

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

Statement of Cash Flows - Year ended 31 December 2014

	Notes	2014 $	2013 $
Cash flows from operating activities			
Interest received		4,767,126	4,607,107
Interest payment		(1,329,723)	(994,360)
Fees and commission received		2,555,519	2,361,674
Other income		558,549	439,173
Income tax paid		(520,352)	(440,658)
Payment to employees and suppliers		(3,348,294)	(3,118,340)
Cash flows from operating assets and liabilities		2,682,825	2,854,596
Changes in operating assets and liabilities:			
Disbursements of Loans		(25,055,460)	(22,453,566)
Repayments of loans		21,256,744	17,628,842
(Decrease)/increase in other debtors and prepayments		(148,533)	77,402
Increase in amounts receivable from shareholder		3,214	(543)
Increase/decrease in other liabilities		(6,829)	(171,628)
Net cash (used in)/from operating activities		1,268,039	(2,064,897)
Cash flows from investing activities			
Purchase of property, plant and equipment	17	(752,918)	(279,863)
Proceeds from sale of plant and equipment		22,913	4,644
Net decrease /(increase) in statutory deposits	16	(713,000)	(312,000)
Net increase in Government bonds	12	100,000	1,000,000
Net cash from/(used in) investing activities		(1,343,005)	412,781
Cash flows from financing activities			
Net increase in TDB promissory notes and bonds		13,192,705	4,518,445
Net increase in savings deposits		1,642,156	2,360,736
Dividends paid		(818,884)	(664,564)
Repayments of borrowings		(362,144)	(331,692)
Net cash generated from financing activities		13,653,833	5,882,925
Net increase in cash and cash equivalents		11,042,789	4,230,809
Cash and cash equivalents at beginning of year		10,618,408	6,387,599
Cash and cash equivalents at year end	11	$21,661,197	$10,618,408

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 which was replaced by TDB Act in August 2014 and is also incorporated under the Tonga Companies Act 1995. The address of its registered office is at Fatafehi Road, Nuku'alofa, Tonga.

The financial statements were approved for issue by the Directors on 19th March 2015.

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 which was replaced by TDB Act August 2014. 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 2014 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 2014, 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'	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 profit or loss and other comprehensive income rather than the income statement, unless this creates an accounting mismatch.	Annual periods beginning on or after 1 January 2018

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 profit or loss and other 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.

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 profit or loss and other 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 profit or loss and other comprehensive income. Dividends on available-for-sale equity instruments are recognised in the statement of profit or loss and other 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 profit or loss and other 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 profit or loss and other 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 profit or loss and other 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 profit or loss and other 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 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 profit or loss and other 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 profit or loss and other 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 profit or loss and other 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 profit or loss and other 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 profit or loss and other 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

(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.

(u) Rounding

Amounts have been rounded to the nearest dollar except where otherwise noted.

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

	2014		2013	
	Loans and Advances	Impairment Provision	Loans and Advances	Impairment Provision
	(%)	(%)	(%)	(%)
A	7.46	-	8.02	-
B	21.13	-	17.70	-
C1	56.26	28.90	56.85	30.06
S	9.30	4.38	10.83	5.27
C2	2.46	11.55	2.38	10.70
D	2.14	25.19	3.12	29.47
E	1.25	29.98	1.10	24.50
	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:

	2014		2013	
	$	%	$	%
Industry sector:				
Agriculture	5,607,433	10.92	4,855,799	10.26
Industry and Business	21,353,979	41.55	17,725,842	37.46
Housing and Personal	21,876,154	42.58	22,317,486	47.15
Staff	2,541,590	4.95	2,429,441	5.13
	$51,379,156	100.00	$47,328,568	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 2014	**Agriculture**	**Industry & business**	**Housing & personal**	**Staff**	**Total**
	$	$	$	$	$
Neither past due nor impaired	3,189,813	13,024,975	19,042,549	2,489,854	37,747,191
Past due but not impaired	1,801,656	6,841,579	1,925,795	51,736	10,620,766
Individually impaired	615,964	1,487,425	907,810	-	3,011,199
Gross	5,607,433	21,353,979	21,876,154	2,541,590	51,379,156
Less: allowance for impairment	(1,418,926)	(512,287)	(373,399)	-	(2,304,612)
Net	$4,188,507	$20,841,692	$21,502,755	$2,541,590	$49,074,544

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

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.

Notes to and Forming Part of the Financial Statement 31 December 2014 (continued)

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 2014	Agriculture	Industry & Business	Housing & Personal	Staff	Total
	$	$	$	$	$
Grades					
A	348,874	2,290,811	882,723	310,273	3,832,681
B	251,404	3,355,427	5,845,414	1,405,362	10,857,607
C1	2,589,535	2,601,553	12,314,412	774,219	18,279,719
S	-	4,777,184	-	-	4,777,184
	$3,189,813	$13,024,975	$19,042,549	$2,489,854	$37,747,191

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

(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 2014	Agriculture	Industry & Business	Housing & Personal	Staff	Total
	$	$	$	$	$
Past due up to 30 days	961,125	5,966,221	1,043,608	51,703	8,022,657
Past due 30 – 60 days	222,765	146,632	70,496	10	439,903
Past due 60 – 90 days	617,766	728,726	811,691	23	2,158,206
	$1,801,656	$6,841,579	$1,925,795	$51,736	$10,620,766
Fair value of collateral	$4,353,263	$4,903,869	$4,071,467	$74,240	$13,402,839

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 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

(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 2014	1,529,228	6,677,961	3,359,602	368,416	11,935,207
Term loans					
As at 31 December 2013	1,796,846	6,198,117	4,114,985	151,489	12,261,437
Term loans					

(v) Repossessed collateral

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

Nature of assets	**Carrying amount**	
	2014	**2013**
	$	$
Land - Tax allotment	80,000	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:

	2014 $	2013 $
Large corporate entities	17,929,529	13,173,840
SMEs	27,432,291	28,628,975
Other	6,017,336	5,525,753
	$51,379,156	$47,328,568

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:

	2014 $	2013 $
Liabilities		
Borrowings – foreign	$1,753,328	$ 1,777,937

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 2014	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	20,094,545	-	-	-	-	-	20,094,545
Investment securities – held to maturity	-	-	1,566,652	3,298,000	-	-	4,864,652
Loans and services	2,056,916	3,705,926	11,458,403	16,558,464	15,294,835	-	49,074,544
Statutory reserve deposit	-	-	-	-	-	2,772,000	2,772,000
Property, plant and equipment	-	-	-	-	-	6,597,817	6,597,817
Investment Property	-	-	-	-	-	497,217	497,217
Other assets	321,964	20,479	60,243	774,695	-	62,112	1,239,493
Total Assets	22,473,425	3,726,405	13,085,298	20,631,159	15,294,835	9,929,146	85,140,268
Liabilities							
Saving deposits	10,887,871	-	-	-	-	-	10,887,871
Borrowings	145,437	10,270	845,928	1,968,221	1,130,449	-	4,100,305
Promissory Notes	2,911,413	1,954,252	7,269,353	25,200,071	7,102,500	-	44,437,589
TDB bonds	-	-	-	11,001	-	-	11,000
Other liabilities	998,444	321,473	2,027,442	2,036,702	-	31,538	5,415,599
Total Liabilities	14,943,165	2,285,995	10,142,723	29,215,995	8,232,949	31,538	64,852,365
Net Liquidity Gap	$7,530,260	$1,440,410	$2,942,575	($8,584,835)	$7,061,886	$9,897,608	$20,287,903
As at 31 December 2013							
Total Assets	9,131,561	3,114,406	15,853,285	20,593,385	11,721,643	8,992,229	69,406,509
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

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 2014	No later than 1 year	1 – 5 years	Over 5 years	Total
	$	$	$	$
Loan commitments	2,018,153	-	-	2,018,153
Operating lease commitments	13,420	47,680	162,740	223,840
Capital commitments	-	-	-	-
Total	$2,031,573	$47,680	$162,740	$2,241,993
At 31 December 2013				
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

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 $3,298,000 (2013:$3,398,000) 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 2014 and year ended 31 December 2013. During that period, the Bank complied with all of the externally imposed capital requirements to which they are subject.

Tier 1 Capital	**2014**	**2013**
	$	$
Share capital	14,000,000	10,530,190
Retained earnings	6,287,903	9,192,091
Total	$20,287,903	$19,722,281
Risk weighted assets	$49,074,544	$45,383,503
Ratio	41.34%	43.46%

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 profit or loss and other 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

	2014 $	2013 $
Interest income		
Loans and advances	4,486,632	4,137,204
Term deposits and securities	219,348	373,273
	$4,705,980	$4,510,477
Interest and other borrowing expenses		
Borrowings	78,316	89,022
TDB promissory notes	1,267,329	985,054
TDB Bond	325	3,665
Savings deposits	123,258	106,993
Bank charges	4,086	3,891
	$1,473,314	$1,188,625

Borrowings cost comprises foreign exchange loss/(gain) of $3,578 (2013: $6,792).

Interest income accrued on impaired financial assets is $6,784 (2013:$1,268)

NOTE 7. FEES AND COMMISSION INCOME

	2014 $	2013 $
Service fees	2,405,254	2,201,913
Commissions	150,265	159,761
	$2,555,519	$2,361,674

NOTE 8.

	Note	2014 $	2013 $
Rent		169,827	196,101
Other	a/	410,484	247,716
a/ Other operating income "Other" includes the following:		$580,311	$443,817
Cost of operation and Government policy obligation obligation at the Niuas		176,750	150,000
WBOT agency agreement fee		55,000	55,000
Other income		156,972	38,072
Gain on sale		21,762	4,644
		$410,484	$247,716

NOTE 9. OTHER OPERATING EXPENSES

		2014 $	2013 $
Staff costs (refer below)		2,050,032	1,976,682
Administrative expenses		727,199	785,387
Auditor's remuneration - audit fee		27,000	22,231
Depreciation - Property, plant and equipment		533,979	530,454
- Investment property		41,366	41,366
Premises		254,178	288,047
Travel		173,686	159,971
Others	a/	212,775	207,350
		$4,020,215	$4,011,488

a/ *Include Staff training ($92,242) and Directors' fees ($76,894).*

Staff costs comprise:

	2014	2013
Wages and salaries and other staff costs	1,844,884	1,685,307
Retirement fund	205,148	291,375
	$2,050,032	$1,976,682

The Bank makes contributions to the National Retirement Benefit Fund for all permanent employees at a rate of 5%. Employers bonus contributions was introduced from January 2014 at a rate of 3% - 8% depending on staff performance rating.

NOTE 10. CASH ON HAND AND AT BANK

	2014 $	2013 $
Cash on hand	1,770,412	1,172,634
Cash at Bank	18,324,133	6,374,683
	$20,094,545	$7,547,317

NOTE 11. CASH AND CASH EQUIVALENTS

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

	2014 $	2013 $
Cash on hand and at Bank	20,094,545	7,547,317
Investment securities	1,566,652	3,071,091
	$21,661,197	$10,618,408

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

	2014 $	2013 $
Westpac Bank of Tonga	534,108	2,075,244
ANZ Bank	439,471	435,551
MBf Bank	593,073	560,296
Government of Tonga Local Development Bond	3,298,000	3,398,000
	$4,864,652	$6,469,091

The year end interest rate receivable on term deposits range from 1% to 6.50% (2013: 1.0% to 6.50%) per annum and the interest rate for the Government of Tonga Local Development Bond range from 3.00% to 6.00% (2013: 3.2% to 6.65%) per annum.
The interest is receivable on maturity for term deposits and annually after one year from the date of issue for the Government of Tonga Local Development Bonds.

NOTE 13. LOANS AND ADVANCES

	2014	2013
	$	$
Gross loans and advances	51,379,156	47,328,568
Less : Allowance losses on loans and advances	(2,304,612)	(1,945,065)
Net loans	49,074,544	45,383,503
Loans and advances approved but not yet disbursed amounted to:	$2,018,153	$2,415,494

Allowance for losses on loans and advances

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

	2014	2013
Balance at beginning of the year	1,945,065	1,695,597
Provision for loan impairment	918,135	934,151
Provisions written back	(223,813)	(545,051)
Loans written off during the year	(334,775)	(139,632)
Balance at end of year	$2,304,612	$1,945,065

Composition of allowance for losses on loans and advances:

	2014	2013
Specific provision	1,089,395	793,537
Collective provisions	1,215,217	1,151,528
	$2,304,612	$1,945,065

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

	2014	2013
Provision for loan impairment	918,135	934,151
Provisions written back	(223,813)	(545,051)
	$694,322	$389,100

Non accrual loans and advances

	2014	2013
Non accrual loans and advances	2,135,803	1,221,746
Less: specific provision for impairment	(982,266)	(805,648)
	$1,153,537	$416,098

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

	2014 $	2013 $
Prepayment	198,804	73,407
Accrued interest	104,185	165,331
Other assets	158,231	135,095
	$461,220	$373,833

Other assets including the following:

Robbery recovery	56,941	60,941
Lawyers suspense	41,583	45,176
Others	59,707	28,978
	$158,231	$135,095

NOTE 15. AMOUNTS RECEIVABLE FROM SHAREHOLDERS

Comprises the following:	2014 $	2013 $
Claims for EEC	$3,578	$6,792

NOTE 16. STATUTORY RESERVE DEPOSIT

	2014 $	2013 $
National Reserve Bank of Tonga (NRBT)	$2,772,000	$2,011,000

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% (2013: 5%)

	2014 $	2013 $
Amounts receivable from/(payable to) NRBT	(23,000)	25,000

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 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
For the year ended 31 December 2014					
Opening net book amount	5,647,761	82,250	210,109	439,908	6,380,028
Additions	371,219	92,763	63,133	225,803	752,918
Disposals	-	-	(1,150)	-	(1,150)
Depreciation charge	(193,665)	(29,567)	(109,303)	(201,444)	(533,979)
Closing net book amount	$5,825,315	$145,446	$162,789	$464,267	$6,597,817
At 31 December 2014					
Cost	7,333,485	1,005,062	661,215	2,761,143	11,760,905
Accumulated depreciation	(1,508,170)	(859,616)	(498,426)	(2,296,876)	(5,163,088)
Net book amount	$5,825,315	$145,446	$162,789	$464,267	$6,597,817

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 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
For the year ended 31 December 2014		
Opening net book amount	538,583	538,583
Additions	-	-
Disposals	-	-
Depreciation charge	(41,366)	(41,366)
Closing net book amount	$497,217	$497,217
At 31 December 2014		
Cost	829,248	829,248
Accumulated depreciation	(332,031)	(332,031)
Net book amount	$497,217	$497,217

(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 profit or loss and other comprehensive income:

	2014 $	2013 $
Rental income	37,560	38,287
Direct operating expenses arising from investment properties	5,061	8,008

NOTE 19. TAXATION

	2014 $	2013 $
Income tax is brought to account using the liability method of tax effect accounting.		
(a) **Operating profit before income tax**	1,819,989	1,907,535
Prima facie income tax charge on the operating profit at 25%	454,997	476,884
Tax effect of non deductible expenditure:		
Grants and exempt income	(49,063)	(62,044)
Tax effect of over provision - prior year	-	(145,073)
Income tax expense	405,934	269,767
Temporary Differences—deferred tax	103,333	84,658
	509,267	354,425
Add: opening current tax liability	550,250	636,484
Less: tax paid	(520,353)	(440,659)
Current tax liability	$539,165	$550,250
(b) **Income tax expense comprises:**		
Current tax expense	509,267	520,352
Under/(Over) provision – prior year	-	(145,073)
Deferred tax expense - net	(103,333)	(105,512)
Income tax expense	$405,934	$269,767

(c) **Deferred tax asset**

	2014 $	2013 $
(i) Deferred tax asset comprises the net effect of the following (amounts recognized in profit or loss):		
Allowance for loan losses	576,153	486,266
Other provisions	44,854	40,035
Unearned revenue	153,688	145,061
	$774,695	$671,362
(ii) The movement in deferred tax asset is as follows:		
Balance at 1 January	671,362	587,471
Charge to statement of profit or loss and other comprehensive income	103,333	83,891
Balance at end of six months / year	$774,695	$671,362

NOTE 19. TAXATION - CONTINUED

		2014	2013
(e)	**Deferred tax liability**		
(i)	The balance comprises temporary differences attributable to:	$	$
	Depreciation	$1,094,779	$671,362
(ii)	The movement in deferred tax liability is as follows:		
	Balance at 1 January	1,094,779	1,095,546
	Credit to statement of profit or loss and other comprehensive income	-	(767)
	Balance at end of six months / year	$1,094,779	$1,094,779

NOTE 20. OTHER LIABILITIES

	2014	2013
	$	$
Accrued interest	635,480	491,889
Provisions for annual leave and staff bonus	96,577	85,766
Deferred Income	614,751	580,246
Other creditors and accruals	729,860	685,428
	$2,076,668	$1,843,329

Other creditors and accruals include the following:

Accruals and creditors	617,556	605,721
Withholding tax payable	1,050	2,104
Credit holding accounts	111,254	77,603
	$729,860	$685,428

NOTE 21. BORROWINGS

	Notes	2014	2013
		$	$
Comprises:			
Borrowings	(a)	4,100,305	4,462,449
Tonga Development Bank promissory notes	(b)	44,437,589	31,161,699
Tonga Development Bank Bond		11,001	94,184
		$48,548,895	$35,718,334

NOTE 21. BORROWINGS - CONTINUED

(a) Borrowings comprise the following:	Principal repayment term	Interest rate	2014 $	2013 $
Government of the Kingdom of Tonga				
Asian Development Bank	1993 – 2023	3.00%	396,619	443,279
International Fund for Agriculture Development 3	1999 – 2020	3.00%	1,048,950	1,239,668
International Development Association	1998 – 2023	3.00%	901,409	1,001,565
			2,346,978	2,684,512
Other borrowings				
European Investment Bank VI	2009 - 2026	5.5%	118,899	138,619
European Union	1988 – 2019	1.50%	16,739	21,629
Private Sector Reconstruction Facility	2011 – 2025	0.00%	1,617,689	1,617,689
			1,753,327	1,777,937
			$4,100,305	$4,462,449

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.

	2014 $	2013 $
(b) Tonga Development Bank promissory notes	44,437,589	31,161,699

The interest rate at year end on promissory notes ranged from 1.0% per annum to 5.00% 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

	Total Fund $	Advance to Projects $	2014 $	2013 $
Livelihood Reactivation Project - Niuatoputapu	94,400	(52,783)	41,617	22,605
New Zealand Borrower Diversification Fund	290,535	(49,765)	240,770	181,589
ADB Microfinance	362,760	(209,937)	152,823	208,743
	$747,695	($312,485)	$435,210	$412,937
Government Managed Funds				
Agriculture Marketing Fund -1%	50,000	(82,455)	(32,455)	-
Tourism Loan Fund – 1%	-	(15,254)	(15,254)	-
Manufacturing Fund – 1%	100,000	(16,687)	83,313	-
Student Loan Scheme Fund – 1%	200,000	(292,432)	(92,432)	-
Agriculture Marketing & Production Fund – 4%	1,100,000	(1,085,439)	14,561	-
Fisheries Development & Export Fund	100,000	-	100,000	-
Tourism Loan Fund – 4%	200,000	-	200,000	-
Development of Livestock-4%	-	(6,111)	(6,111)	-
Constructions – 4%	800,000	(800,000)	-	-
Retailer & Wholesaler Fund – 4%	100,000	(53,278)	46,722	-
Other Priority Sectors Funds – 4%	100,000	-	100,000	-
Total of Government Managed Funds	2,750,000	(2,351,656)	398,344	-
Total Managed funds	$3,497,695	($2,664,141)	$833,554	$412,937

Percentages noted above represent the interest rate at which managed funds are on lent.

NOTE 23. CAPITAL

	2014 $	2013 $
(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	$14,000,000	$10,530,190

The Directors resolved to issue a further 346,981 shares at $10 each, fully paid, from the Bank's retained earnings to the Government.

NOTE 24. RELATED PARTY TRANSACTIONS

(a) Directors

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

Lord Matoto (Chairman)
Paula Taumoepeau
Leta Havea Kami
Tevita Lavemaau—appointed January 2014 and resigned November 2014
Lepaola Vaea - appointed February 2014

NOTE 24. RELATED PARTY TRANSACTIONS - CONTINUED

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

	2014	2013
	$	$
Directors' fees and retirement benefit	72,130	83,353
Management salaries and other short term employee benefits	205,127	188,904
Total	277,257	272,257

(iii) Transactions with related parties comprise of:

Loans and advances to directors or director-related entities

	2014	**2013**
	$	**$**
Balance at beginning of the year	-	45,943
Loan balance related to a retired Director	-	(26,493)
Loans advanced during the year	-	23,450
Loan and interest repayments during year	-	(47,695)
Interest and costs	-	4,795
Balance at end of the year	$-	$ -

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

	2014	**2013**
	$	$
Interest paid/payable on borrowings	78,015	99,202
Repayments of borrowings during the year	337,535	554,745
Borrowings from the Government of the Kingdom of Tonga are disclosed in note 21 (a)	2,346,978	2,684,512
The Government purchased TDB bonds and promissory notes during the year and the balances at year end are as follows:		
TDB promissory notes	10,574,746	4,238,323
Interest paid/payable on TDB bonds and promissory notes	83,440	111,507

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

(ii) Term deposits

	2014	**2013**
	$	$
Interest received/receivable on Government of Tonga Local Development Bonds	196,253	296,253
Government of Tonga Local Development Bonds at year end (Refer note 12.)	3,298,000	3,398,000

NOTE 25. COMMITMENTS AND CONTINGENT LIABILITY

		2014	2013
(a)	Capital commitment	$ -	$ -
(b)	Contingent liability	$ -	$ -
(c)	Operating lease commitments	**$223,840**	**$237,260**

(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:

	2014	2013
	$	$
Not later than one year	13,420	13,420
Later than one year but not later than five years	47,680	53,680
Later than five years	162,740	170,160
	$223,840	$237,260

(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:

	2014	2013
	$	$
Not later than one year	70,879	162,708
Later than one year but not later than five years	32,143	339,999
Later than five years	19,213	26,424
	$122,235	$529,131

NOTE 26. FINANCING ARRANGEMENTS

	2014	2013
	$	$
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

NOTE 27. DIVIDENDS

	2014 $	2013 $
(a) The directors have 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
(b) The directors also declared a dividend of 60% of net profit after tax for the year ended 31 December 2014. This amounted to $848,433 or $0.61 per issued share.	848,433	-

NOTE 28. EARNINGS PER SHARE

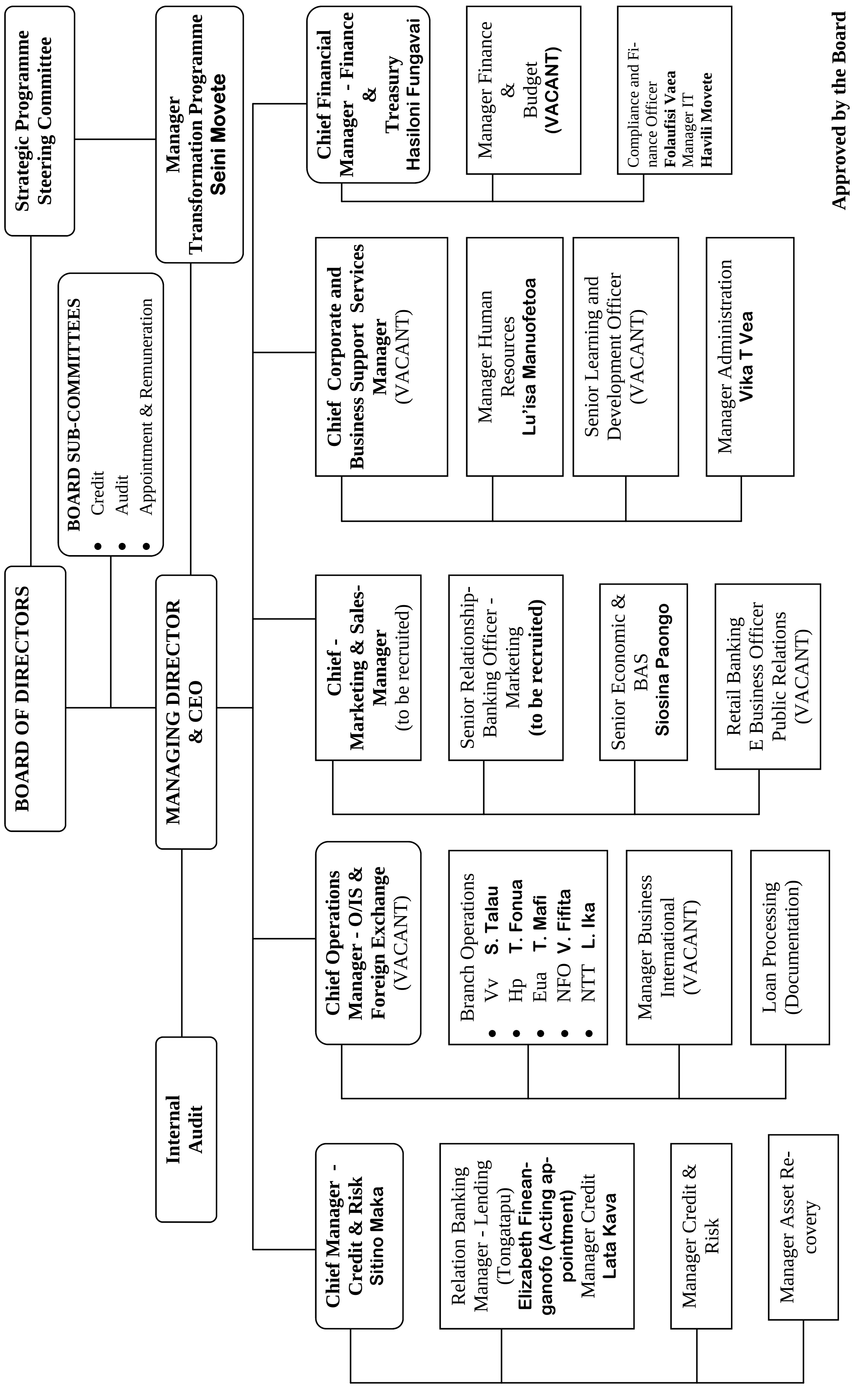
	2014 $	2013 $
Net profit after tax	1,414,055	1,637,768
Number of issued shares	1,400,000	1,053,019
Earnings per share	$1.01	$1.56

NOTE 29. RETURN ON EQUITY

	2014 $	2013 $
Net profit after tax	1,414,055	1,637,768
Shareholder’s Equity	20,287,903	19,722,281
Return on Equity	6.97%	8.30%

Corporate Structure as at 31 December 2014

ANNEX 2



Approved by the Board 3rd March 2014

Senior Management Team as at 31 December 2014

SENIOR EXECUTIVES

Managing Director & CEO	Mrs Leta Kami (appointed 02 September 2013)
Deputy Managing Directors	
• Transformation	Mrs Seini Movete
• Finance	Mr Hasiloni Fungavai
• Credit & Risk	Mr Sitino Maka

HEAD OFFICE

Managers

• Lending- Tongatapu	Mrs ‘Elisapesi Fineanganofo
• Loans District 1 & 2	Mr Saia Talau
• Asset Recovery	Mr Samisoni Masila
• Credit and Operations Support	Mrs Lata Kava
• Finance & Budgeting	Mrs Fusipeau Fifita
• Information Services	Mr Siokatame Havili Movete
• System Operations	Mrs Silia Tupou
• Human Resource	Mrs Siosina Paongo
• Administration	Mrs Vika. T. Vea
• Senior Economist	Mrs Piula Tangataevaha
• Senior Internal Auditor	Mr Samiu Fifita

BRANCH OFFICES

Managers

• Vava’u Branch	Mr ‘Eliki ‘Ofa
• 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