CAPITAL SECURITY BANK LIMITED

FINANCIAL REPORT

2019

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Chairman's Report

Dear Stakeholders,

I write to report on a very successful year for the Bank and one that has CSB well positioned to meet the unprecedented uncertainties presented to global business by the current pandemic.

CSB is in a strong position with Tier-1 capital ratio of 20%, strong liquidity in investment grade assets and operating in a well-regulated jurisdiction. We have a number of banking relationships and it is particularly pleasing to have recently established a relationship with China Construction Bank Limited and to significantly increase the relationship and business flows with OCBC based in Singapore.

We continue to be diligent on compliance matters. This year, CSB upgraded its daily compliance screening processes and arranged for an overseas trainer to undertake compliance courses for our staff. With respect to international commitments the Cook Islands Financial Services Development Authority has been instrumental in ensuring the necessary legislation was passed to have the European Union Code of Conduct Group place the Cook Islands on its 'White List' of compliant nations. These are significant steps for the country's reputation, correspondent banking relationships and the ability to conduct international transactions.

The Bank's Board and executive are prepared and ready for the challenges that lie ahead. It is blessed to be located in a country which has to date had no recorded cases of COVID-19, CSB's balance sheet is strong and its conservative investment strategy will help ensure it remains a stable platform in turbulent seas.

I would like to thank our executive for their leadership and staff for their tireless dedication and our clients for their trust and partnership.

Brian Mason
Chairman

CEO's Report

Kia orana Clients and Stakeholders,

It was an excellent year for CSB. In 2019, our 23rd year of operation, we generated a record profit of $3.48m and distributed $2.1m in dividends to shareholders. We continue to strengthen our capital position with over $7m of Total Capital at year end and further improved our already strong regulatory capital ratios.

In last year's report I said that we would be introducing a debit card in 2019 which would add to the bank's product range and also provide our clients with faster access to their funds via cash withdrawal and on the internet. We introduced the CSB Debit Card in October 2019 and have seen interest and adoption from clients. Having quick access to funds is something we know our clients require and we have been pleased to offer this.

We have continued enhancement on CSB's online banking platform from both client accessibility and sending instructions in the online portal to enhancing security protocols to keep client data safe. Throughout the year we continued to provide very competitive interest rates and simplified our fees, having monthly account fees reduce to zero if clients held more than $500,000 with CSB.

In the first quarter of 2020 the world altered with COVID-19 forcing changes for all of us in the way we live and work. While in the Cook Islands we have been COVID-19 free it has had major impacts globally. Through these changes and the market volatility we maintain a single focus for our clients – to provide capital security. To ensure that your funds are safe. You will see on page 4 under Financial highlights how we achieve this by investing in very high quality government bonds and bank bonds with top rated banks. The Bank has 97% of its investments in Investment Grade bonds and with financial institutions (as rated by Standard and Poor's) and the remainder largely in cash moving to and from clients' accounts. These investments ensure our clients can be sure of the safety of their deposits and we will maintain this approach to ensure capital security.

A key part of being located in the Cook Islands is continuing to support the local community. It is important to us to do so and in 2019 we sponsored a vaka (a 6 person outrigger canoe) and a young Cook Islands team training in the 4 person canoe, chasing the dream of a place in the 2024 Olympics. In addition to donations to local schools, we also bought holiday gifts for children who may not have received one otherwise.

We have had a strong start to 2020 and while it has been a very eventful year so far we all hope that it will return to a more normal state soon. CSB will continue to service our clients to the highest level for all their offshore private banking needs.

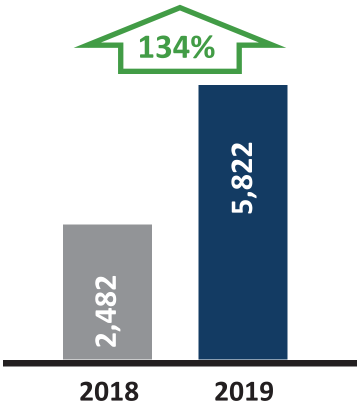
Meitaki Maata

Gerard Field
Chief Executive Officer

Financial highlights

OPERATING REVENUE

(thousand USD)

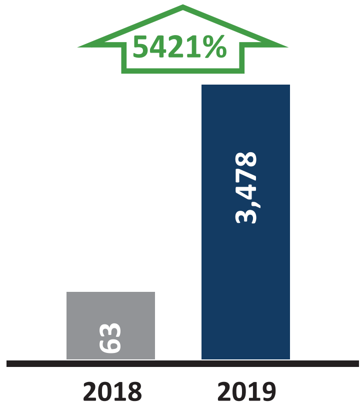


OPERATING EXPENSE

(thousand USD)

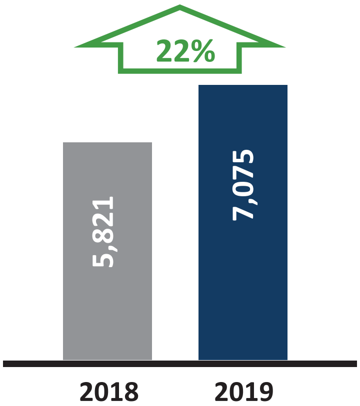
PROFIT

(thousand USD)



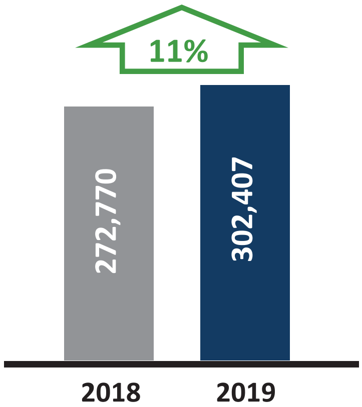
TOTAL CAPITAL

(thousand USD)

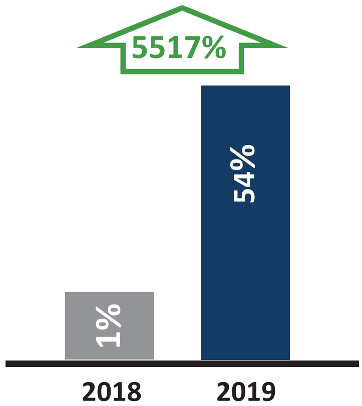


TOTAL ASSETS

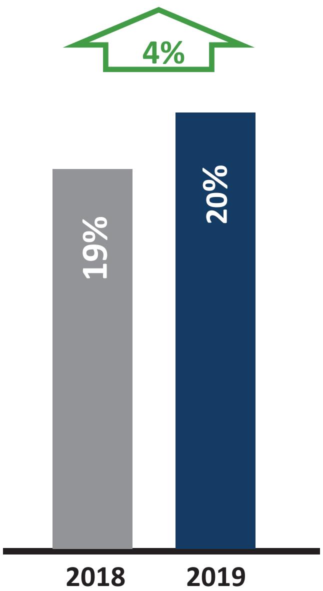
(thousand USD)



RETURN ON EQUITY

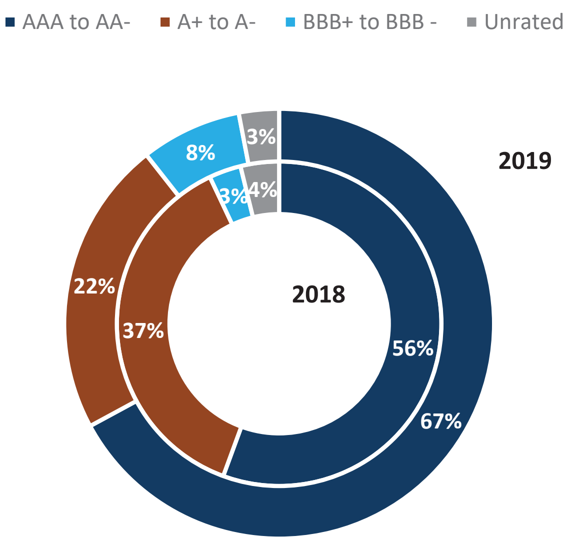


TOTAL CAPITAL RATIO



CAPITAL SECURITY

Cash Investments and Loans
S&P Rating



Report of the Directors to the Shareholder
For the year ended 31 December 2019

The Directors are pleased to present the annual report and financial statement of Capital Security Bank Limited (the Bank) and its subsidiary Capital Security Bank Cook Islands Limited (the banking group) for the year ended 31 December 2019.

Results

Consolidated results for the year were a profit after taxation of $3,478,017 (2018: $62,662).

Dividends

Dividends of $2,168,256 (2018: $Nil) have been paid during the year. The Directors declared a final dividend on 18 May 2020, for the year ended 31 December 2019 of $113,272 (2018: $37,100).

Significant Changes in the State of Affair

There have been no significant changes in the operation of the Banking Group.

Auditor

In 2019 the Directors appointed KPMG (Rarotonga) as auditors. It is proposed that KPMG continue in office.

Directors

Brian Mason, David Steens, Andrew Yiangou and Brendon Stone continue in office.

Brendon Stone
Director
20 May 2020

Andrew Yiangou
Director
20 May 2020

Independent Auditor's Report

To the shareholder of Capital Security Bank Limited

Report on the audit of the consolidated financial statements

Opinion

In our opinion, the accompanying consolidated financial statements of Capital Security Bank Limited and its subsidiaries (the 'Group') on pages 9 to 28:

i. present fairly in all material respects the Group's financial position as at 31 December 2019 and its financial performance and cash flows for the year ended on that date; and

ii. comply with International Financial Reporting Standards (IFRSs)

In accordance with the requirements of section 49 (2) of the Banking Act 2011, we report that:

- We have obtained all information and explanations that we have required; and
- In our opinion, proper accounting records have been kept by the Group as far as appears from our examination of those records.

We have audited the accompanying consolidated financial statements which comprise:

- the consolidated statement of financial position as at 31 December 2019;
- the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended; and
- notes, including a summary of significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) ('ISAs (NZ)'). We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

We are independent of the Group in accordance with Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board and the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants ('IESBA Code'), and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

Our responsibilities under ISAs (NZ) are further described in the auditor's responsibilities for the audit of the consolidated financial statements section of our report.

Our US KPMG member firm has also provided other services to the Group in relation to consultancy services. Subject to certain restrictions, partners and employees of our firm may also deal with the Group on normal terms within the ordinary course of trading activities of the business of the Group. These matters have not impaired our independence as auditor of the Group. The firm has no other relationship with, or interest in, the Group.

Emphasis of matter

We draw attention to Note 20 of the consolidated financial statements which describes the uncertainties arising from the Covid-19 outbreak, which has become a global pandemic subsequent to the 31 December 2019 reporting date. Due to the rapidly changing situation and uncertainties around the duration, scale and impact of the outbreak, the current financial impact is not significant but is continually being monitored by the Group. Our opinion is not modified in respect to this matter.

Other information

The Directors, on behalf of the Group, are responsible for the other information included in the Group's financial statements. Other information includes the Chairman's report, CEO's report, Financial highlights and the Corporate directory. Our opinion on the consolidated financial statements does not cover any other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Use of this independent auditor's report

This independent auditor's report is made solely to the shareholder as a body. Our audit work has been undertaken so that we might state to the shareholder those matters we are required to state to them in the independent 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 shareholder as a body for our audit work, this independent auditor's report, or any of the opinions we have formed.

Responsibilities of the Directors for the consolidated financial statements

The Directors, on behalf of the Group, are responsible for:

— the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards;

— implementing necessary internal control to enable the preparation of a consolidated set of financial statements that is fairly presented and free from material misstatement, whether due to fraud or error; and

— assessing the ability to continue as a going concern. This includes disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate or to cease operations or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objective is:

— to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error; and

- to issue an independent auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs NZ will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error. They are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs (NZ), the auditor exercises professional judgement and maintains professional scepticism throughout the audit.

The auditor also:

- Identifies and assesses the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, designs and performs audit procedures responsive to those risks, and obtains audit evidence that is sufficient and appropriate to provide a basis for the auditor's opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtains an understanding of internal control relevant to the audit 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 Group's internal control.
- Evaluates the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Concludes on the appropriateness of the use of the going concern basis of accounting by those charged with governance and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If the auditor concludes that a material uncertainty exists, the auditor is required to draw attention in the auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify the auditor's opinion. The auditor's conclusions are based on the audit evidence obtained up to the date of the auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluates the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtains sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. The auditor is responsible for the direction, supervision and performance of the Group audit. The auditor remains solely responsible for the audit opinion.

The auditor communicates with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that the auditor identifies during the audit.

KPMG
Rarotonga

20 May 2020

Statement of Comprehensive Income
For the year ended 31 December 2019

	Note	Banking Group 2019	2018
Interest income		**2,068,733**	1,002,559
Interest expense		**(1,572,214)**	(643,181)
Net interest income	2	**496,519**	359,378
Net income from other financial instruments at fair value through profit or loss		**3,903,628**	906,947
Other operating income	3	**1,422,306**	1,217,237
Total operating income		**5,822,453**	2,483,562
Operating expenses	4	**2,344,436**	2,420,900
Profit before income tax expense		**3,478,017**	62,662
Income tax expense	6	**-**	-
Profit for the year		**3,478,017**	62,662
Other comprehensive income			
Movement in foreign currency translation reserve, net of income tax		**805**	(7,014)
Total comprehensive income		**3,478,822**	55,648

The notes on pages 13 to 28 are an integral part of these financial statements.

Statement of Changes in Equity
For the year ended 31 December 2019

	Note	Share Capital	Retained Earnings	Foreign Currency Translation Reserve	Total
Banking Group					
Balance at 31 December 2018		**3,218,400**	**2,611,192**	**(8,508)**	**5,821,084**
Adjustment on initial application of IFRS 16	1	-	**(56,700)**	-	**(56,700)**
Restated balance at 1 January 2019		**3,218,400**	**2,554,492**	**(8,508)**	**5,764,384**
Share Capital Issued		-	-	-	**-**
Profit After Taxation		-	**3,478,017**	-	**3,478,017**
Movement in Foreign Currency Translation Reserve		-	-	**805**	**805**
Total Comprehensive Income for the Year		-	**3,478,017**	**805**	**3,478,822**
Dividends Paid		-	**(2,168,256)**	-	**(2,168,256)**
Balance at 31 December 2019		**3,218,400**	**3,864,253**	**(7,703)**	**7,074,950**
Balance at 1 January 2018		3,218,400	2,548,530	(1,494)	5,765,436
Share Capital Issued		-	-	-	-
Profit After Taxation		-	62,662	-	62,662
Movement in Foreign Currency Translation Reserve		-	-	(7,014)	(7,014)
Total Comprehensive Income for the Year		-	62,662	(7,014)	55,648
Dividends Paid		-	-	-	-
Balance at 31 December 2018		3,218,400	2,611,192	(8,508)	5,821,084

The notes on pages 13 to 28 are an integral part of these financial statements.

Balance Sheet
As at 31 December 2019

	Note	Banking Group 2019	2018
Assets			
Cash and cash equivalents	8	**26,825,520**	63,270,282
Investments	9	**182,253,201**	135,044,281
Marketable securities	10	**91,940,738**	70,338,031
Loans and advances to customers	11	**500,000**	3,487,033
Other assets	12	**492,087**	474,388
Property, plant and equipment		**93,259**	110,431
Right-of-use assets	5i	**266,651**	-
Intangibles		**36,025**	45,032
Total assets		**302,407,481**	272,769,478
Liabilities			
Other liabilities	14	**1,121,703**	1,212,972
Income in advance		**145,579**	171,054
Client Funds on Deposit at Amortised Cost		**201,782,793**	195,097,919
Client Funds on Deposit at Fair Value		**91,941,033**	70,328,224
Lease liability		**324,824**	-
Amounts due to related entities	15	**16,599**	138,225
Total liabilities		**295,332,531**	266,948,394
Equity			
Share capital	7(a)	**3,218,400**	3,218,400
Foreign currency translation reserve	7(b)	**(7,703)**	(8,508)
Retained earnings		**3,864,253**	2,611,192
Total equity		**7,074,950**	5,821,084
Total equity and liabilities		**302,407,481**	272,769,478

The notes on pages 13 to 28 are an integral part of these financial statements.

Cash Flow Statement
For the year ended 31 December 2019

	Note	Banking Group 2019	2018
Cash Flow from Operating Activities			
Cash was provided from:			
Interest received		**2,096,410**	896,606
Net income from financial instruments		**3,903,628**	906,947
Other income received		**1,362,695**	1,313,933
		7,362,733	3,117,486
Cash was applied to:			
Payments to Suppliers and Employees		**2,184,745**	2,422,650
Interest Paid		**1,598,155**	484,478
Net Tax Paid / (Refunded)	6	**-**	(2,190)
		3,782,900	2,904,938
Cash Flows from Operating Profits before Changes in Operating Assets & Liabilities		**3,579,833**	212,548
Changes in Operating Assets & Liabilities			
Net (Increase)/Decrease in Net Securities at Fair Value		**10,102**	(10,119)
Client Loan Repayments		**2,987,033**	1,263,426
Net (increase)/decrease in Investments		**(47,208,920)**	578,918
Net increase / (decrease) in Client Funds on Deposit at Amortised Cost		**6,684,874**	(2,035,170)
Net increase / (decrease) in Uncleared Source of Funds at Year End		**(156,648)**	630,670
Cash Flows from Operating Assets and Liabilities		**(37,683,559)**	427,725
Net Cash Flows from Operating Activities		**(34,103,726)**	640,273
Cash Flow from Investing Activities			
Cash was applied to:			
Purchase of Intangibles & Fixed Assets		**2,583**	57,099
Net Cash Flow from Investing Activities		**(2,583)**	(57,099)
Cash Flow from Financing Activities			
Cash was provided from:			
Net increase/(decrease) in inter-company balances		**(121,626)**	61,794
Cash was applied to:			
Lease liability	5 iii	**49,376**	-
Dividends Paid		**2,168,256**	-
		2,217,632	-
Net Cash Used in Financing Activities		**(2,339,258)**	61,794
Net increase / (decrease) in cash held		**(36,445,567)**	644,968
Opening cash and cash equivalents		**63,270,282**	62,632,328
Effect of exchange rate fluctuations on balances held		**805**	(7,014)
Closing cash and cash equivalents		**26,825,520**	63,270,282
Cash and cash equivalents at year end comprised	8	**26,825,520**	63,270,282
Operating Cash flow Reconciliation			
Net Profit After Taxation		**3,478,017**	62,662
Plus Non-cash items			
Depreciation and amortisation		**62,806**	29,467
Lease liability interest	5 ii	**16,805**	-
Plus (Less) Movements in Working Capital			
Changes in Operating Assets & Liabilities		**(37,683,559)**	427,725
(Increase) / Decrease in Other assets		**(17,699)**	(184,015)
Increase in Accruals & Provisions		**65,379**	231,722
Increase / (Decrease) in Income in Advance		**(25,475)**	72,712
Net Cash flow from Operating Activities		**(34,103,726)**	640,273

The notes on pages 13 to 28 are an integral part of these financial statements.

Note 1 Principal Accounting Policies

Reporting entity

The financial statements presented are the consolidated financial statements comprising Capital Security Bank Limited (the Bank) and its wholly owned subsidiary, Capital Security Bank Cook Islands Limited (the Banking Group). Refer to Note 13 Investment in Subsidiary for further details. The Banking Group's principal activity is the provision of financial services.

The Bank was incorporated on 22 October 1997 under the laws of the Cook Islands and the Group holds licenses as both an international and domestic bank under the Banking Act 2011.

The financial statements are prepared for the statutory purpose of filing with the Registrar under the Cook Islands Banking Act 2011. The Bank is registered under the Cook Islands International Companies Act 1981-82.

Basis of preparation

The financial statements have been prepared under the historical cost convention, modified by the application of fair value measurements required or allowed by relevant accounting standards. Accounting policies have been consistently applied to all periods presented, unless otherwise stated, throughout the Banking Group.

The financial statements also comply with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

The reporting currency of the financial statements is United States dollars which is the Bank's functional currency and the Banking Group's presentation currency. The functional currency of the subsidiary is New Zealand dollars. Unless otherwise indicated, amounts are rounded to the nearest dollar.

The financial statements have been prepared on a going concern basis after considering the Banking Group's funding and liquidity position.

Principles of consolidation

The consolidated financial statements of the Banking Group incorporate the assets, liabilities and results of all controlled entities. Controlled entities are all entities in which the Bank is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Intercompany transactions, balances and any unrealised income and expense (except for foreign currency transaction gains or losses) between controlled entities are eliminated.

The assets and liabilities of entities whose functional currency is not the United States dollar, are translated at the exchange rates ruling at balance date. Revenue and expense items are translated at the average spot rate for the period reported. Exchange differences are taken to the foreign currency translation reserve.

Assumptions and estimates

The preparation of financial statements requires the use of certain critical accounting estimates and assumptions that affect the reported amount of assets, liabilities, revenues and expenses and the disclosed amount of contingent liabilities. It also requires management to exercise judgement in the process of applying accounting policies. The notes to the financial statements include areas involving a higher degree of judgement or complexity, or areas where assumptions are significant to the Banking Group. Refer to Note 18.

Assumptions made at each reporting date are based on best estimates at that date. Although the Banking Group has internal control systems in place to ensure that estimates can be reliably measured, actual amounts may differ from those estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the reporting period in which the estimates are revised and in any future periods affected.

Changes in accounting policies and disclosures

New and amended accounting standards and interpretations

All new required standards, amendments and interpretations have been adopted in the current period.

IFRS 16 Leases has been applied by the Banking Group from 1 January 2019 using the modified retrospective approach, under which the cumulative effect of initial application is recognised in retained earnings at 1 January 2019. Accordingly, the comparative information presented for 2018 is not restated - i.e. it is presented, as previously reported, under IAS 17 and related interpretations. The details of the changes in accounting policies are disclosed below. Additionally, the disclosure requirements in IFRS 16 have not generally been applied to comparative information.

Note 1 Principal Accounting Policies *continued*

Definition of a lease

Previously, the Group determined at contract inception whether an arrangement is or contains a lease under IFRIC 4 Determining whether an Arrangement contains a Lease. The Group now assesses whether a contract is or contains a lease based on the definition of a lease, as explained in Note 5.

On transition to IFRS 16, the Group elected to apply the practical expedient to grandfather the assessment of which transactions are leases. The Group applied IFRS 16 only to contracts that were previously identified as leases. Contracts that were not identified as leases under IAS 17 and IFRIC 4 were not reassessed for whether there is a lease under IFRS 16.

As a lessee

As a lessee, the Group leases office premises. The Group previously classified these leases as operating leases under IAS 17 based on its assessment of whether the lease transferred substantially all of the risks and rewards incidental to ownership of the underlying asset to the Group. Under IFRS 16, the Group recognises right-of-use assets and lease liabilities for leases of branch and office premises – i.e. these leases are on-balance sheet.

Further, the Group has not entered into any new leases during the year ended 31 December 2019.

The Group has only a single lease of office premises, the Group has elected not to separate non-lease components and account for the lease and associated non-lease components as a single lease component.

On transition, for these leases, lease liabilities were measured at the present value of the remaining lease payments, discounted at the Group's incremental borrowing rate as at 1 January 2019.

Right-of-use assets are measured at their carrying amount as if IFRS 16 had been applied since the commencement date, discounted using the lessee's incremental borrowing rate at the date of initial application.

The Group used a number of practical expedients when applying IFRS 16 to leases previously classified as operating leases under IAS 17. In particular, the Group:

- relied on its assessment of whether leases are onerous under IAS 37 Provisions, Contingent Liabilities and Contingent Assets immediately before the date of initial application as an alternative to performing an impairment review;
- used hindsight when determining the lease term.

Impact on financial statements

Impact on transition*

On transition to IFRS 16, the Group recognised additional right-of-use assets and additional lease liabilities, recognising the difference in retained earnings. The impact on transition is summarised below.

	1 January 2019
Right-of use asset	**300,695**
Lease liability	**357,395**
Retained earnings	**(56,700)**

* For the impact of IFRS 16 on profit or loss for the period and for the details of accounting policies under IFRS 16 and IAS 17, see Note 5.

When measuring lease liabilities for leases that were classified as operating leases, the Group discounted lease payments using its assumed incremental borrowing rate at 1 January 2019. The weighted-average rate applied is 4%.

	1 January 2019
Operating lease commitments at 31 December 2018 as disclosed under IAS 17 in the Group's consolidated financial statements	**185,039**
Discounted using the incremental borrowing rate at 1 January 2019	**357,395**
Lease liabilities recognised at 1 January 2019	**357,395**

Note 1 Principal Accounting Policies *continued*

New and amended accounting standards and interpretations not yet effective

No new and amended accounting standards and interpretations relevant to the Banking Group are not yet effective and have not been applied in preparing these financial statements.

Foreign currency translation

Foreign currency transactions are recorded at the exchange rates in effect at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at balance date are translated at closing rates. Gains and losses due to currency fluctuations on these items are included in the statement of comprehensive income.

The Bank owns one subsidiary, Capital Security Bank Cook Islands Limited, which has a functional currency of New Zealand dollars. The assets and liabilities of this subsidiary are translated into United States dollars at spot exchange rates at the reporting date. The income and expenses of this subsidiary are translated into United States dollars at the average spot rate for the period reported. Foreign currency differences on the translation of this subsidiary are recognised in the foreign currency translation reserve. If this subsidiary was disposed of, in part or in full, the relevant amount in the foreign currency translation reserve would be transferred to the statement of comprehensive income.

Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When available the Banking Group measures the fair value of an instrument using the quoted price in an active market for that instrument. If there is no quoted price in an active market, then the Banking Group uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price.

The Banking Group measures fair value using the following hierarchy:
Level 1 : inputs that are quoted market prices (unadjusted) in active markets for identical instruments
Level 2: inputs other than quoted prices included in Level 1 that are observable directly or indirectly
Level 3: inputs that are unobservable

Due to the nature of financial instruments that the Banking Group holds, the fair value and carrying value of financial instruments are not materially different. The only financial instruments measured at fair value are Marketable Securities, Treasury Assets and a portion of Client Funds on Deposit. These are categorised into Level 2 in the fair value hierarchy. Refer fair value disclosures in note 18. Marketable securities and treasury assets consist of portfolios and assets managed by an external investment manager. These portfolios include cash, interest bearing deposits, bonds and shares. The fair value is determined based on the value obtained from the investment manager. The investment manager values the portfolio using standard market techniques such as cash valued at face value, interest bearing deposits based on discounted cash flows, shares based on listed prices. Assumptions and inputs used include benchmark interest rates, bond and equity prices, foreign currency exchange rates.

Financial assets

Financial assets comprise items such as Cash and cash equivalents, Investments, Marketable securities, Loans and advances to customers and Other assets.

Financial assets are classified into the following measurement categories:

- those to be measured at fair value through profit or loss
- those to be measured at amortised cost.

The classification depends on the Banking Group's business model for managing financial assets and the contractual terms of the financial assets' cash flows.

Note 1 Principal Accounting Policies *continued*

i) Financial assets measured at fair value through profit or loss

Items at fair value through profit or loss include items held for trading, items specifically designated as fair value through profit or loss on initial recognition and debt instruments with contractual terms that do not represent solely payments of principal and interest.

Financial assets held at fair value through profit or loss are initially recognised at fair value, with transaction costs being recognised in the income statement as incurred. Subsequently, they are measured at fair value with gains and losses recognised in the income statement as they arise.

Where a financial asset is held at fair value, the movement in fair value attributable to interest rate market movements is either an observable market value or calculated based on changes in observable market interest rates for swaps.

Financial assets designated at fair value through profit or loss

Upon initial recognition, financial assets may be designated at fair value through profit or loss. For a financial asset, the fair value option is only applied if it eliminates an accounting mismatch that would otherwise arise from measuring items on a different basis.

ii) Financial assets measured at amortised cost

A financial asset is measured at amortised cost only if:

- it is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and
- the contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest.

These assets are initially recognised at fair value plus direct attributable transaction costs and subsequently measured at amortised cost.

Financial liabilities

Financial liabilities comprise items such as Client funds on deposit and Amounts due to related entities.

Financial liabilities may be held at fair value through profit or loss or at amortised cost.

i) Financial liabilities held at fair value through profit or loss

Items held at fair value through profit or loss comprise both items held for trading and items specifically designated at fair value through profit or loss on initial recognition. A financial liability is classified as held for trading if it is incurred principally for the purpose of selling in the near term, it forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short term profit taking, or it is a derivative (not in a qualifying hedge relationship).

Financial liabilities held at fair value through profit or loss are initially recognised at fair value with transaction costs being recognised immediately in the income statement. Subsequently, they are measured at fair value and any gains and losses are recognised in the income statement as they arise.

Liabilities may be designated at fair value through profit or loss if they meet the following criteria:

- where designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets and liabilities (not only financial assets and liabilities) or recognising the gains and losses on them on different bases; or
- those that are part of a group of financial assets, financial liabilities or both, that are managed and their performance is evaluated by management on fair value basis in accordance with the documented risk management or investment strategy

Once a financial instrument has been designated at fair value through profit or loss upon initial recognition, the Banking Group cannot subsequently change the designation.

The carrying amount disclosed is considered to approximate the contractual amount due on maturity on the financial liabilities designated at fair value through profit or loss on initial recognition.

ii) Financial liabilities held at amortised cost

All other financial liabilities, Amounts due to related entities and certain amounts within Client funds on deposit are measured at amortised cost using the effective interest method.

Note 1 Principal Accounting Policies *continued*

Derecognition of financial instruments

The Banking Group derecognises a financial asset when the contractual cash flows from the asset expire or it transfers its rights to receive contractual cash flows on the financial asset in a transaction in which substantially all risks and rewards of ownership are transferred. Any interest in transferred financial assets that is created or retained by the Banking Group is recognised as a separate asset or liability.

A financial liability is derecognised from the balance sheet when the Banking Group has discharged its obligation or the contract is cancelled or expired.

Offsetting

The Banking Group offsets financial assets and financial liabilities and reports the net balance in the balance sheet when, and only when, there is currently a legally enforceable right to set off and there is an intention to settle on a net basis or to realise the asset and settle the liability simultaneously. Refer to Note 15.

Cash Flow Statement

The Cash Flow Statement has been prepared using the direct approach. Financing activities are those activities which result in changes to the size and composition of the capital structure of the Banking Group. This includes both equity and debt not falling within the definition of cash. Dividends paid in relation to the capital structure are included in financing activities. Operating activities include all transactions and other events that are not investing or financing activities.

The composition of "Cash and cash equivalents" is described in Note 8.

Note 2 Net interest income

Accounting policy

Interest income and expense is recognised in profit or loss using the effective interest method. The effective interest rate is established on initial recognition of the financial assets and liabilities and is not revised subsequently. The calculation of the effective interest rate includes all yield related fees and commissions paid or received that are an integral part of the effective interest rate.

Note 3 Other operating income

Accounting policy

Fees and commissions

Unless included in the effective interest calculation, fees and commissions are recognised on an accrual basis as the service is provided. Fees and commissions not integral to the effective interest rate arising from negotiating, or participating in the negotiation of a transaction with a third party are recognised on completion of the underlying transaction.

Funds management and other fiduciary activities

Fees and commissions earned through the marketing of funds management products and other fiduciary activities are included in the income statement as they are earned.

Note 4 Operating expenses

Accounting policy

Operating expenses are recognised as the underlying service is rendered or over the period in which an asset is consumed or once a liability is incurred.

Employee entitlements

Wages and salaries, annual leave and other employee entitlements expected to be paid or settled within 12 months of providing the service are measured at their nominal amounts using remuneration rates that the Banking Group expects to pay when the liabilities are settled.

Note 4 Operating expenses *continued*

	Banking Group	
	2019	2018
Amortisation and depreciation		
Amortisation of intangible assets	**9,006**	5,160
Depreciation on property, plant and equipment	**19,756**	24,307
Depreciation on right-of-use assets	**34,044**	-
Total amortisation and depreciation	**62,806**	29,467
Personnel expenses		
Salaries and other staff expenses	**810,274**	868,791
Total personnel expenses	**810,274**	868,791
Fees paid to auditors		
Audit and review of financial statements	**42,587**	38,863
Other assurance and risk related services	**-**	18,777
Total fees paid to auditors	**42,587**	57,640
Other		
Operating lease rental expense	**-**	48,827
Lease liability expense	**16,805**	-
Other expenses	**1,411,964**	1,416,175
Total other operating expenses	**1,428,769**	1,465,002
Total operating expenses	**2,344,436**	2,420,900

Included in Other expenses are consulting fees of USD25,000 paid to KPMG-USA.

Note 5 Leases

Accounting policy

The Group has applied IFRS 16 using the modified retrospective approach and therefore the comparative information has not been restated and continues to be reported under IAS 17 and IFRIC 4. The details of accounting policies under IAS 17 and IFRIC 4 are disclosed separately.

Policy applicable from 1 January 2019

At inception of a contract, the Group assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset, the Group uses the definition of a lease in IFRS 16.

This policy is applied to contracts entered into (or changed) on or after 1 January 2019.

Group acting as a lessee

At commencement or on modification of a contract that contains a lease component, the Group allocates consideration in the contract to each lease component on the basis of its relative stand-alone price. However, for leases of office premises the Group has elected not to separate non-lease components and accounts for the lease and non-lease components as a single lease component.

Refer to transition to IFRS 16 in Note 1 for initial application.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the end of the lease term. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the Group's incremental borrowing rate.

The Group determines its incremental borrowing rate by analysing various external sources and makes certain adjustments to reflect the terms of the lease and type of asset leased.

Note 5 Leases *continued*

Lease payments included in the measurement of the lease liability comprise the following:

- fixed payments, including in-substance fixed payments;
- variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;
- amounts expected to be payable under a residual value guarantee; and
- the exercise price under a purchase option that the Group is reasonably certain to exercise, lease payments in an optional renewal period if the Group is reasonably certain to exercise an extension option, and penalties for early termination of a lease unless the Group is reasonably certain not to terminate early.

The lease liability is measured at amortised cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in the Group's estimate of the amount expected to be payable under a residual value guarantee, if the Group changes its assessment of whether it will exercise a purchase, extension or termination option or if there is a revised in-substance fixed lease payment.

When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use asset, or is recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero.

The Group presents right-of-use assets and lease liability, individually in the statement of financial position.

Policy applicable before 1 January 2019

For contracts entered into before 1 January 2019, the Group determined whether the arrangement was or contained a lease based on the assessment of whether:

- fulfilment of the arrangement was dependent on the use of a specific asset or assets; and
- the arrangement had conveyed a right to use the asset.

The Group did not have any finance leases under IAS 17.

Assets held under other leases were classified as operating leases and were not recognised in the Group's statement of financial position. Payments made under operating leases were recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received were recognised as an integral part of the total lease expense, over the term of the lease.

Leases as lessee

The Group leases an office premises. The lease runs for a period of 5 years, with two options to renew the lease after that date.

Previously, these leases were classified as operating leases under IAS 17.

Information about leases for which the Group is a lessee is presented below.

i. Right-of use assets

Right-of-use assets relate to leased office premises.

Previously, these leases were classified as operating leases under IAS 17.

Information about leases for which the Group is a lessee is presented below.

	2019
Balance at 1 January	**300,695**
Less depreciation charge for the year	**34,044**
Balance at 31 December	**266,651**

See Note 16 for maturity analysis of lease liabilities as at 31 December 2018.

ii. Amounts recognised in profit or loss

	2019
2019 - Leases under IFRS 16	
Interest on lease liabilities	**13,437**
Foreign exchange adjustment at 31 December 2019	**3,368**
	16,805

Note 5 Leases *continued*

	2018
2018 - Operating leases under IAS 17	
Lease expense	**48,827**

iii. Amounts recognised in statement of cash flows

	2019
Total cash outflow for leases	**49,376**

iv. Extension options

The lease of office premises contains extension options exercisable by the Group up to 120 days before the end of the non-cancellable contract period. The Group has already exercised the renewal option for a further 5 years in 2017. The extension options held are exercisable only by the Group and not by the lessors. The Group assesses at lease commencement date whether it is reasonably certain to exercise the extension options. The Group reassesses whether it is reasonably certain to exercise the options if there is a significant event or significant changes in circumstances within its control.

The Group has already included the potential future lease payments as it is likely to utilise the next and final extension options. Therefore there would be no resultant increase in lease liability.

Note 6 Income tax

Accounting policy

Under the terms of section 249(2) of the Cook Islands International Companies Act 1981-82, the Bank is not subject to taxation in the Cook Islands. Capital Security Bank Cook Islands Limited is subject to income tax under the Income Tax Act 1997. Income tax on the profit for the year comprises current and deferred tax. Income tax is recognised in profit or loss except to the extent that it relates to items recognised directly in other comprehensive income, in which case it is recognised in equity or other comprehensive income. Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years. Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that the related tax benefit will be realised.

	2019	2018
Income tax on operating profit charged to the income statement		
Profit for the year before tax	**3,478,017**	62,662
less profit for tax-exempt entity	**3,454,830**	84,629
Taxable income/(loss)	**23,187**	(21,967)
Tax charge/(credit) at domestic company rate of 20%	**4,637**	(4,393)
Accumulated domestic tax loss offset	**(4,637)**	-
Future income tax benefit not recognised	**-**	4,393
Income tax expense/(benefit)	**-**	-
Opening income tax receivable	**-**	2,190
Refund received	**-**	(2,190)
Closing income tax receivable	**-**	-

Note 7 Capital and Reserves

(a) Share Capital

Balance 1 January	**3,218,400**	3,218,400
Movement during the year	**-**	-
Balance 31 December	**3,218,400**	3,218,400

The authorised and paid up capital of the Company is 2,000,000 (2018: 2,000,000) Class A ordinary shares with a par value of NZ$1.00 each, and 2,000,000 (2018: 2,000,000) Class B ordinary shares with a par value of USD$1.00 each. All shares rank equally with respect to dividends and the Company's residual assets.

(b) Reserves

Foreign Currency Translation Reserve

This contains all foreign currency differences arising from the translation of the financial statements of subsidiaries where the operating currency is NZD.

Note 8 Cash and cash equivalents

Accounting policy

Cash and cash equivalents consists of cash, transaction balances with other institutions and deposits with an original term of 3 months or less to maturity.

Note 9 Investments

Accounting policy

The Banking Group holds investments in bank deposits, bank bonds, floating rate notes, public securities, financial institution notes and multilateral development bank notes.

Note 10 Marketable securities

The Banking Group maintain investments on behalf of clients with third party institutions in segregated accounts. The Banking Group bear no financial risk in relation to these accounts under the terms and conditions agreed with the clients. As any movement in Marketable securities is directly attributable to Clients there is no affect to Profit or Loss.

	2019	2018
Marketable Securities at Fair Value	**91,940,738**	70,338,031

All marketable securities at fair value have no defined maturity date, and no interest is receivable on these.

Included within marketable securities are portfolios made up of cash, interest bearing deposits, bonds and shares.

Included within liabilities is client funds on deposit at fair value being the amount owed to clients for marketable securities held on their behalf.

Note 11 Loans and advances to customers

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Banking Group provides money or services directly to a customer and has no intention of trading the loan.

Loans and advances are measured at amortised cost using the effective interest method, net of any provision for credit impairment. Under the effective interest method, fee income and costs directly related to the origination of the loan are deferred over the expected life of the assets or, where appropriate, a shorter period. When calculating the effective interest rate, the Banking Group estimates cash flows considering all contractual terms of the financial instrument and excluding future credit losses.

All loans and advances to customers require collateral in the form of cash, interest bearing deposits and marketable securities. There are no arrears (2018: nil) and nil credit impairment (2018: nil). The percentage of exposure that is subject to collateral requirements at year end was 100% (2018: 100%)

Note 12 Other assets

	2019	2018
Accrued interest receivable	**260,495**	288,172
Sundry debtors	**34,657**	521
Prepayments	**134,617**	104,600
Prepaid commission	**62,318**	81,095
Total other assets	**492,087**	474,388

Note 13 Investment in subsidiary

The Capital Security Bank Limited Group consists of the Bank and its following subsidiary:

	Holding	**Balance Date**	**Country of Incorporation**	**Principal Activities**
Capital Security Bank Cook Islands Limited	100%	31 December	Cook Islands	Financial Services

Note 14 Other liabilities

Accounting policy

An accrual is recognised if, as a result of a past event, the Banking Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

	Banking Group	
	2019	2018
Employee entitlements	**14,686**	35,897
Uncleared deposits	**590,699**	747,347
Accrued interest payable	**209,095**	235,036
Other accruals	**307,223**	194,692
	1,121,703	1,212,972

Note 15 Related entity transactions

The ultimate parent company of Capital Security Bank Limited is CSB Holdings Limited. During the period ended 31 December 2019, there were dealings between the Bank and its related entities as well as other related parties (including key management personnel). Details of these transactions are outlined below.

Related entities

Amounts due to ultimate parent	**(16,599)**	(138,225)
Total amounts due to related entities	**(16,599)**	(138,225)

No provisions have been recognised in respect of loans provided to related entities (2018: nil). There were no debts with any of the above parties written off or forgiven during the period ended 31 December 2019 (2018: nil).

Transactions with related entities

The Banking Group provides banking and other administrative services to related entities on normal terms and conditions.

During the financial year, there have been dealings between the Bank and its controlled entities, and the Banking Group and its related entities. The Bank provides a range of services to related entities including the provision of banking facilities. These transactions are subject to commercial terms and conditions. The Bank provides some accounting administration and banking services to controlled and related entities for which fees may not be charged.

Dividends paid to shareholders are disclosed in the Statement of changes in equity.

In addition to the balances with related entities above, the following associated companies have deposit accounts with the Group:

CSB Investment Advisors, LLC	**1,091**	1,053
	1,091	1,053
Loans have also been made to the following related companies by the Banking Group:		
Caribbean Capital Lenders, LLC	**760,000**	760,000
Bridging Management, LLC	**7,111,985**	7,111,985
East Coast Residential, LLC	**-**	2,090,000
Pacific North Residential, LLC	**2,090,000**	2,090,000
Southwest Housing Management, LLC	**3,092,250**	7,337,721
Northern Facilities, LLC	**3,616,935**	3,685,050
Royal Blue House, LLC	**631,750**	631,750
Northport Management House, LLC	**1,934,675**	2,164,575
	19,237,595	25,871,081

The Bank and Group have a right of set off in respect to client funds on deposit and loans made to clients of $19,237,595 (2018: $25,871,081). These balances are not recorded in the Balance Sheet.

The terms of these loans require that security is held over a deposit with the Bank for the same amount of the loan and the Bank has the right and ability to settle both simultaneously and therefore loss given default is nil.

Note 15 Related entity transactions *continued*

Key management personnel

Key management personnel are defined as being Directors and the executive team of the Bank. The information relating to key management personnel disclosed below includes transactions with those individuals, their close family members and their controlled entities.

Deposits with both non-executive and executive key management personnel of the Bank are made in the ordinary course of business on commercial terms and conditions.

	Banking Group	
	2019	2018
Payments to key management personnel	**603,969**	655,219
Deposits due to key management personnel	**237,736**	134,475

Note 16 Contingent liabilities and other commitments

Accounting policy

Contingent liabilities are possible obligations whose existence will only be confirmed by uncertain events or present obligations where the transfer of economic benefits is not probable or cannot be reliably measured. Where some loss is probable, provisions have been made. Contingent liabilities are not recognised in the balance sheet, but are disclosed unless the likelihood of payment is remote.

There are no contingent liabilities for the Banking Group as at balance date (2018: nil).

Credit related commitments

For commitments to extend credit, the maximum credit exposure to the banking Group is the full amount of the commitment. Irrevocable commitments to extend credit are agreements to lend to a customer which can be drawn down at any time before the commitments expire as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiry dates or other termination clauses and may require payment of a fee by the customer.

Irrevocable commitments to extend credit	**-**	312,967

Other commitments

With the transition to IFRS 16 the Group no longer has operating lease commitments as previously disclosed under IAS 17. For further details refer to Changes in accounting policies and disclosures.

Land and buildings operating lease commitments

Non-cancellable future minimum lease payments:

Due within one year	**-**	48,271
Due between one and five years	**-**	136,768
Due after five years	**-**	-
Total land and buildings lease commitments	**-**	185,039

Note 17 Capital adequacy

The Banking Group's capital includes Share Capital, Reserves, and Retained earnings. The Banking Group's policy is to exceed regulatory requirements for capital so as to maintain investor, creditor, and market confidence and to sustain the future development of the business.

The Banking Group is subject to the following prudential capital requirements by the regulator, Financial Supervisory Commission:

- Tier-One Capital must be at least 10% of Risk-Weighted Assets
- Total Capital and Reserves must be at least 15% of Risk-Weighted Assets

At balance date the Banking Group's Tier-One Capital represented 19.77% (2018: 19.06%) of Risk-Weighted Assets.
The Banking Group's Total Capital and Reserves represented 19.77% (2018: 19.06%) of Risk-Weighted Assets.

The Group's policies in respect of the capital management are regularly reviewed by the Directors.

Note 18 Classification of financial instruments and fair value measurement

Categories of financial assets and financial liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date under current market conditions. For the purposes of this note, carrying amount refers to amounts reflected in the balance sheet. The methodologies and assumptions used in the fair value estimates are described in the Fair value measurement part of this note.

	2019 Carrying Amount	2018 Carrying Amount
	(USD 000's)	
Financial Assets		
At amortised cost		
Cash and cash equivalents	**26,826**	63,270
Investments	**70,135**	30,925
Loans and advances to customers	**500**	3,487
Other assets	**260**	288
Fair Value through profit or loss		
Marketable securities	**91,941**	70,338
Investments	**112,118**	104,119
	301,780	272,427
Financial Liabilities		
Fair Value through profit or loss		
Client Funds on Deposit	**91,941**	70,328
At amortised Cost		
Client Funds on Deposit	**201,783**	195,098
Amounts due to related entities	**17**	138
Other financial liabilities	**1,122**	1,213
	294,863	266,777

The fair value estimates are based on the following methodologies and assumptions:

Cash and cash equivalents

These are liquid in nature and therefore equate to fair value.

Investments

These assets are primarily short term in nature or are receivable on demand. In such cases the carrying amounts approximate their fair value.

Loans and advances to customers

These are measured at amortised cost using the effective interest method, less any impairment. This is materially the same as fair value as the interest rate of these loans are not materially different to the current market rates.

Other financial assets/liabilities

These include accrued interest which is approximately equal to the carrying amounts on the balance sheet due to their short term nature.

Note 18 Classification of financial instruments and fair value measurement *continued*

Investments, Marketable securities and Client funds on deposit at fair value

These are valued at fair value based on the valuation performed by the investment manager.

Amounts due to/from related entities

These are short-term liabilities/assets and therefore equate to fair value.

Client funds on deposit at amortised cost

The fair value of client funds on deposit at amortised cost is calculated using the effective interest method, and is materially the same as the carrying amount as these all mature within 12 months and there is no material difference between the interest rate of these liabilities and current market rates.

Note 19 Risk management

The Group's activities expose it to a variety of financial risks, including the effects of changes in foreign currency exchange rates and interest rates. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance. Risk management is carried out by the Directors, which involves the identification and evaluation of financial risks.

Exposure to credit, liquidity, currency, price risk and interest rate risk arises in the normal course of the Group's business.

Credit Risk

The Group applies ECL model separately for each financial asset category measured at amortised cost.

At year end there are no past due or impaired assets and no impairment provision has been recognised due to the following:

Credit risk is the possibility that a loss may occur from the failure of a counterparty to perform according to the terms of contract. The Group deals with reputable financial institutions for investing and cash handling purposes and the probability of default is considered very low.

The terms of Loans to clients require that security is held over balances invested with the Bank that cover the full amount of the loan facility made by the Bank and therefore loss given default is always nil (refer Note 11).

It has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis.

The maximum exposure to credit risk approximates to the carrying amount of each financial asset in the balance sheet. Loans and deposits that have the right of set off (Note 11 and Note 15) and marketable securities (Note 10) do not carry risk.

The Directors consider that none of the Bank's or Banking Group's financial assets are impaired or past due.

	Standard & Poor's	Banking Group	
	Credit rating	**2019**	**2018**
Concentrations of credit risk:			
Cash and cash equivalents - rated	AA-	**5,816,634**	7,433,439
	A+	**15,144,847**	51,984,097
	A-	**34,043**	-
		20,995,524	59,417,536
Cash and cash equivalents - unrated		**5,829,996**	3,852,746
		26,825,520	63,270,282
Investments due from other institutions - rated	AA-	**45,523,200**	15,000,000
	A+	**24,612,483**	15,531,167
		70,135,683	30,531,167
Investments due from other institutions - unrated		**-**	394,548
		70,135,683	30,925,715

Note 19 Risk management *continued*

The following table shows the credit quality of treasury assets included in Investments.

Standard & Poor's Credit rating	2019	2018
AAA	**12,932,934**	2,470,875
AA+	**57,026,315**	73,158,230
AA-	**19,333,783**	14,137,890
A+	**2,524,653**	1,665,489
A	**1,086,583**	1,475,209
A-	**3,316,591**	4,776,796
BBB+	**9,362,637**	4,854,752
BBB	**4,900,578**	1,579,325
BBB-	**1,633,444**	-
	112,117,518	104,118,566

Liquidity Risk

Prudent liquidity risk management implies maintaining sufficient cash at bank and marketable securities and the ability to close out market positions. The Directors ensure that sufficient cash reserves are maintained at all times to meet any liquidity requirements deemed likely to arise, giving due consideration to historical experience as well as the prevailing market conditions. Where cash reserves are nevertheless found to be inadequate to meet client requirements the Banking Group has the right to close out interest-bearing deposits held at other financial institutions within 48 hours. The Bank's documented investment strategy and practical management of treasury asset investments is based on the view and practical testing that the Bank has the ability to readily sell its treasury assets when required.

Liquidity Maturity Analysis

The following tables present the Banking Group's financial assets and liabilities by relevant maturity groupings based upon contractual maturity date. The amounts disclosed in the tables represent undiscounted principal only. As a result, the amounts in the tables below align with the amounts reported on the Balance Sheet.

The cash flows presented below may differ significantly from actual cash flows. This occurs as a result of future actions by the Banking Group and its counterparties, such as early repayment or refinancing of term loans and borrowings. Deposits include customer savings deposits and transactional accounts, which are at call. History demonstrates that such accounts provide a stable source of long term funding for the Banking Group.

31 December 2019 (USD 000's)	0 to 1 Month	2 to 12 Months	1 to 3 years	3+ years	Total	Carrying Amount
Financial Assets						
Cash and cash equivalents	**26,826**	-	-	-	**26,826**	**26,826**
Investments	**33,987**	**98,847**	**44,448**	**4,971**	**182,253**	**182,253**
Marketable securities at fair value	**91,941**	-	-	-	**91,941**	**91,941**
Loans and advances to customers	-	-	-	**500**	**500**	**500**
Other assets excluding prepayments	**111**	**183**	-	-	**294**	**294**
	152,865	**99,030**	**44,448**	**5,471**	**301,814**	**301,814**
Financial Liabilities						
Client Funds on Deposit at amortised cost	**149,347**	**52,436**	-	-	**201,783**	**201,783**
Client Funds on Deposit at fair value	**91,941**	-	-	-	**91,941**	**91,941**
Amounts due to related entities	**17**	-	-	-	**17**	**17**
Other liabilities	**971**	**151**	-	-	**1,122**	**1,122**
Total	**242,276**	**52,587**	-	-	**294,863**	**294,863**
Gap	**(89,411)**	**46,443**	**44,448**	**5,471**	**6,951**	**6,951**

Note 19 Risk management *continued*

31 December 2018 (USD 000's)	0 to 1 Month	2 to 12 Months	1 to 3 years	3+ years	Total	Carrying Amount
Financial Assets						
Cash and cash equivalents	26,592	36,678	-	-	63,270	63,270
Investments	15,928	42,477	60,845	15,794	135,044	135,044
Marketable securities at fair value	70,338	-	-	-	70,338	70,338
Loans and advances to customers	1,300	1,987	-	200	3,487	3,487
Other assets excluding prepayments	110	179	-	-	289	289
	114,268	81,321	60,845	15,994	272,428	272,428
Financial Liabilities						
Client Funds on Deposit at amortised cost	165,335	29,763	-	-	195,098	195,098
Client Funds on Deposit at fair value	70,328	-	-	-	70,328	70,328
Amounts due to related entities	138	-	-	-	138	138
Other liabilities	1,050	163	-	-	1,213	1,213
Total	236,851	29,926	-	-	266,777	266,777
Gap	(122,583)	51,395	60,845	15,994	5,651	5,651

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Banking Group's income and operating cash flows are substantially dependent on changes in market interest rates. All deposits received from customers are invested on comparable terms to minimise the impact on the Group's financial performance of adverse movements in market interest rates and exposures are monitored by the Directors on an ongoing basis. The Group therefore has a limited exposure to market interest rate movements since client interest-bearing deposits are re-negotiated at the first opportunity consistent with the interest rates being received by the Group. Any sensitivity on the net interest-bearing balances is therefore immaterial.

Foreign Currency Risk

Foreign currency risk is the risk that the value of a financial instrument will fluctuate due to movements in exchange rates. The Banking Group incurs foreign currency risk on purchases and expenses that are denominated in a currency other than the United States dollar. The currency giving rise to this risk is primarily the New Zealand dollar. The Banking Group ensures that the net exposure is kept to an acceptable level, by buying or selling foreign currencies at spot where necessary to address short term imbalances. At balance date there were no significant foreign currency exposures.

Price Risk

Price risk is the risk that changes in market prices will adversely affect the value of the Banking Group's treasury assets. The objective of the Banking Group's price risk management is to manage and control price risk by engaging multiple investment managers and specifying the range of investment grades in which they can invest.

As detailed in note 10, the Banking Group bear no financial risk in relation to marketable securities held at fair value. Any changes in value of these marketable securities (asset) is reflected in the client deposits held at fair value (liability).

Notes to the Financial Statements
For the year ended 31 December 2019

Note 19 Risk management *continued*

Interest Rate Repricing Analysis

The following is a summary of the Banking Group's interest rate gap position:

	Less than 3 months (USD 000)	3 to 6 months (USD 000)	7 months to 1 year (USD 000)	1 to 3 years (USD 000)	Over 3 years (USD 000)	Not bearing interest (USD 000)	Total (USD 000)
At 31 December 2019							
Assets							
Cash and cash equivalents	**26,826**	**-**	**-**	**-**	**-**	**-**	**26,826**
Investments	**112,007**	**6,531**	**24,318**	**34,426**	**4,971**	**-**	**182,253**
Marketable securities	**-**	**-**	**-**	**-**	**-**	**91,941**	**91,941**
Loans and advances to customers	**-**	**-**	**-**	**-**	**500**	**-**	**500**
Other assets	**-**	**-**	**-**	**-**	**-**	**294**	**294**
Total assets	**138,833**	**6,531**	**24,318**	**34,426**	**5,471**	**92,235**	**301,814**
Liabilities							
Client Funds on Deposit at Amortised Cost	**173,322**	**17,627**	**10,834**	**-**	**-**	**-**	**201,783**
Client Funds on Deposit at Fair Value	**-**	**-**	**-**	**-**	**-**	**91,941**	**91,941**
Other Liabilities	**-**	**-**	**-**	**-**	**-**	**1,122**	**1,122**
Total Liabilities	**173,322**	**17,627**	**10,834**	**-**	**-**	**93,063**	**294,846**
Interest Sensitivity Gap	**(34,489)**	**(11,096)**	**13,484**	**34,426**	**5,471**	**(828)**	**6,968**
At 31 December 2018							
Assets							
Cash and cash equivalents	63,270	-	-	-	-	-	63,270
Investments	35,712	28,982	7,037	49,005	14,123	185	135,044
Marketable securities	-	-	-	-	-	70,338	70,338
Loans and advances to customers	1,600	-	1,887	-	-	-	3,487
Other Assets	-	-	-	-	-	289	289
Total Assets	100,582	28,982	8,924	49,005	14,123	70,812	272,428
Liabilities							
Client Funds on Deposit at Amortised Cost	176,547	5,186	13,365	-	-	-	195,098
Client Funds on Deposit at Fair Value	-	-	-	-	-	70,328	70,328
Other Liabilities	-	-	-	-	-	1,213	1,213
Total Liabilities	176,547	5,186	13,365	-	-	71,541	266,639
Interest Sensitivity Gap	(75,965)	23,796	(4,441)	49,005	14,123	(729)	5,789

Marketable securities are held for clients for trading and are not managed based on the individual maturities or interest rates. The corresponding client deposit at fair value liability is accounted for the in the same manner.

Note 20 Subsequent events

On 11 March 2020 the World Health Organization declared the COVID-19 coronavirus outbreak to be a pandemic. COVID-19 is having major impacts on people, societies and the global market with increased volatility and quarantining of people in a number of countries. The Cook Islands government declared a Code Yellow on 25 March and introduced a number of measures to ensure the virus didn't reach the country and implemented social distancing. On 18 April the government announced the Cook Islands was COVID-19 free. The Group activated its Business Continuity Plan during this period and had staff working remotely and maintained operations with no issues. We have seen through this time that while markets were volatile we had the ability to meet all our operational requirements and have all instructions completed in a timely manner. To date the outbreak has had no material impact. We will continue to monitor the virus and how it affects countries and markets and any impact on the Group.

The Directors declared an interim dividend for 2020, distributed on 25 March 2020 of $363,662 and the Directors declared a final dividend on 18 May 2020, for the year ended 31 December 2019 of $113,272 (2018: $37,100).

Corporate directory

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Chair and Independent Non-Executive Director
David Steens
Non-Executive Director
Brendon Stone
Independent Non-Executive Director
Andrew Yiangou
Independent Non-Executive Director

Audit and risk committee
Brendon Stone
Chair
Andrew Yiangou
Member

Senior management
Gerard Field
Chief Executive Officer
Ian Haddow
Chief Financial Officer
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