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Guide to the Main Functions of the Reserve Bank

The Reserve Bank's outputs are classified according to the major functions of the Bank. Definitions of each output are provided below and where necessary further explanation is provided to enhance the reader's understanding.

Monetary Policy Formulation

Formulating and publicly presenting an ongoing monetary policy strategy to enable the Bank to maintain price stability, in the most efficient manner possible.

Market Operations

Trading, liaising with and monitoring financial markets, for effective implementation of monetary policy, and maintenance of the Bank's capacity to intervene in financial markets in support of the orderly and competitive functioning of those financial markets.

Financial System Oversight

Registering and supervising banks, promoting the efficiency and soundness of the New Zealand financial system and avoiding the significant damage to the financial system that could arise from a bank failure or other financial system distress.

Currency Operations

Maintaining the supply and integrity of legal tender currency in order to facilitate cash transactions in the community.

Registered banks pay the Reserve Bank the face value of the currency being issued to them. These funds are invested in New Zealand government securities, which are included in local currency financial assets on the Reserve Bank's balance sheet to back the liability on currency in circulation. Currency in circulation is a non-interest bearing liability. However, the New Zealand government securities investment portfolio asset is interest-bearing. The income directly associated with the issue of currency is referred to as seigniorage and provides the Bank with its main source of income.

Foreign Reserves Management

Maintaining the capability to counter circumstances of severe illiquidity in our foreign exchange market and maintaining the Bank's foreign reserves at a level and in a form suitable for foreign exchange market intervention.

The Crown has advanced foreign currency funds to the Reserve Bank. The Bank has invested these funds in foreign currency assets that are held as foreign reserves. These assets and liabilities are closely matched by currency, duration, and value. As a result the Bank limits its exposure to interest and exchange rate movements in these overseas markets.

Banking Services

Providing banking services to the government, settlement banks and appropriate overseas institutions to meet their banking needs and to facilitate effective implementation of monetary policy.

Overseas Investment Commission Secretariat

Providing the secretariat of the Overseas Investment Commission. The Commission administers New Zealand's legislative controls on major inward foreign direct investment.

Registry Services

Providing high quality depository, registry and settlement services to the securities market.

The Bank's registry services are provided through a wholly-owned subsidiary company, RBNZ Registry Limited. The function is required, under the Reserve Bank of New Zealand Act 1989, to be self-funding.

Other Outputs

Producing other outputs which cannot be classified under the Bank's main functions. These include sundry economic policy advice and overseas representation and liaison that relates to the general purposes of the Bank rather than to a particular function.

Five Year Financial Summary¹

<i>Consolidated Financial Position as at²</i>	1996 June (\$m)	1997 June (\$m)	1998 June (\$m)	1999 June (\$m)	2000 June (\$m)
Assets:					
Foreign Currency Financial	4,527	5,677	6,522	6,493	5,812
Local Currency Financial	3,915	4,029	4,413	5,321	4,092
Non-Financial Assets	66	62	61	60	51
Total Assets	8,508	9,768	10,996	11,874	9,956
Liabilities and Equity:					
Foreign Currency Financial	4,526	5,676	6,519	6,487	5,813
Local Currency Financial	1,818	1,880	2,176	2,926	1,405
Currency in Circulation	1,599	1,665	1,733	1,885	2,160
Other Liabilities	174	151	164	171	177
Equity	391	396	404	405	400
Total Liabilities and Equity	8,508	9,768	10,996	11,874	9,956

<i>Consolidated Financial Performance Financial Year Ending</i>	1996 June (\$m)	1997 June (\$m)	1998 June (\$m)	1999 June (\$m)	2000 June (\$m)	2001 June Budget (\$m)
Net Investment Income	171.7	170.4	187.4	186.1	192.4	182.1
Other Income	34.4	10.7	10.7	11.7	11.4	8.2
Total Income	206.1	181.1	198.1	197.8	203.8	190.3
Operating Expenses	38.6	37.8	37.0	44.2	44.4	40.1
Tax for Current Year	0.8	0.9	0.8	0.6	0.1	0.2
Surplus Available for Appropriation	166.8	142.5	160.3	153.0	159.3	150.0
Transfers to Equity	5.3	6.4	8.4	2.2	1.6	2.4
Payment to Government	161.4	136.0	151.9	150.8	157.7	147.6

1 Figures in this section have been rounded. Totals have not been adjusted for rounding error.

2 Where amounts have been reclassified, comparative figures have been restated.

<i>Consolidated Cost of Services³</i> <i>Financial Year Ending</i>	1996 June	1997 June	1998 June	1999 June	2000 June	2001 June Budget
	(\$m)	(\$m)	(\$m)	(\$m)	(\$m)	(\$m)
Monetary Policy Formulation	6.5	6.1	6.7	7.2	7.2	9.2
Market Operations	2.9	2.8	2.8	2.8	2.8	3.4
Financial System Oversight	3.2	2.8	2.8	2.7	3.1	3.7
Currency Operations	16.7	15.8	14.0	19.6	19.2	13.1
Foreign Reserves Management	3.5	3.7	3.7	4.0	3.7	4.0
Banking Services	0.4	0.8	0.8	1.1	1.3	1.5
Overseas Investment Commission Secretariat	0.6	0.7	0.9	0.7	0.7	0.8
Other Outputs	0.5	0.7	0.6	1.3	0.8	0.8
Total for Functions within Funding Agreement	34.3	33.4	32.3	39.4	38.8	36.5
Registry Services ⁴	4.9	5.5	5.7	5.9	6.1	4.0
Less Intercompany Transactions	(0.2)	0.2	0.2	0.4	0.4	0.3
Total Expenditure	39.4	38.7	37.8	44.9	44.5	40.2

The Statement of Cost of Services shows the total cost of providing each function, including internal transfers between functions. It includes fees charged by the Registry Services function to other functions, which are netted off against Registry income in the Consolidated Statement of Financial Performance.

3 Figures in this section have been rounded. Totals have not been adjusted for rounding error.

4 Includes taxation expense.

2000/2001 Budget Information

The Reserve Bank's budget has been prepared for a 12 month period and is consistent with the Bank's accounting policies.

The Funding Agreement commencing 1 July 2000 differs from the previous Funding Agreement (for the period ending 30 June 2000) in that it includes the Registry Operations function and allows the Bank to net certain income against expenses (see box 6 on page 29). These differences account for the different presentation between the Consolidated Budgeted Statement of Cost of Services and the Consolidated Statement of Cost of Services.

The 2000/2001 budget has been completed using prevailing interest and exchange rates at the time the budget was prepared. No allowance has been made for future changes in interest and exchange rates.

Budget Assumptions

The major assumptions underlying the preparation of the 2000/2001 budget are that:

1. The Bank performs the functions prescribed in the Reserve Bank of New Zealand Act 1989, and existing functions not directly specified in the legislation.
2. The levels of activity in the Foreign Reserves Management and Market Operations functions in 2000/2001 will be similar to the 1999/2000 levels.
3. The Auckland branch will close in December 2000, following the cessation of currency processing at the branch.
4. Currency operations in Wellington will change to a wholesale supply operation from February 2001.
5. Registry services operations will be performed by an external contractor from July 2000.
6. The operating licence for the Austraclear New Zealand System will be relinquished after December 2000.

Consolidated Budgeted Statement of Cost of Services

The Bank has budgeted to provide the following functions in 2000/2001:

	Operating Income Budget 2001 \$000	Operating Income Actual 2000 \$000	Operating Expenses Budget 2001 \$000	Operating Expenses Actual 2000 \$000	Operating Surplus (Deficit) Budget 2001 \$000	Operating Surplus (Deficit) Actual 2000 \$000
<i>For the year ended 30 June</i>						
Functions:						
Monetary Policy Formulation	12	35	9,185	7,194	(9,173)	(7,159)
Market Operations	14,619	14,646	3,382	2,795	11,237	11,851
Financial System Oversight	25	7	3,740	3,074	(3,715)	(3,067)
Currency Operations	156,130	166,498	13,101	19,198	143,029	147,300
Foreign Reserves Management	13,555	16,547	4,009	3,699	9,546	12,848
Banking Services	1,145	1,518	1,532	1,316	(387)	202
Overseas Investment Commission Secretariat	787	628	801	691	(14)	(63)
Other Outputs	1	2	845	841	(844)	(839)
Registry Services ⁵	4,343	6,317	3,998 ⁶	6,125 ⁶	345	192
Total Gross Income/Expense	190,617	206,198	40,593	44,933	150,024	161,265
Less Intercompany Transactions	348	2,446	348	446	-	2,000
Total for Bank	190,269	203,752	40,245	44,487	150,024	159,265
Income Netted Against Expenses Under Funding Agreement ⁷			8,685	11,801		
Net Funding Agreement Levels			31,560	32,686		

⁵ Registry Services function was excluded from prior Funding Agreements. The Funding Agreement commencing 1 July 2000 includes the Registry Services function.

⁶ Includes taxation expense.

⁷ The Funding Agreement commencing 1 July 2000 allows certain income items, such as property rental and registry fees, to be netted against expenses in the calculation of Funding Agreement levels.

Consolidated Budgeted Statement of Financial Performance

<i>For the year ended 30 June</i>	Budget 2001 \$000	Actual 2000 \$000
Operating Income:		
Net Investment Income	182,054	192,354
Other Income	8,215	11,398
Total Operating Income	190,269	203,752
Operating Expenses:		
Personnel	17,342	20,146
Asset Management	5,916	6,289
New Currency Issued	5,511	9,341
Administration	1,206	1,600
Other	10,101	7,012
Total Operating Expenses	40,076	44,388
Operating Surplus	150,193	159,364
Taxation	169	99
Surplus Available for Appropriation	150,024	159,265



**RESERVE
BANK**

O F N E W Z E A L A N D

17 August 2000

MANAGEMENT STATEMENT

Pursuant to section 165 of the Reserve Bank of New Zealand Act 1989, we hereby certify that:

1. We have been responsible for the preparation of the annual financial statements and for the judgements used in them.
2. We have been responsible for establishing and maintaining a system of internal controls designed to provide reasonable assurance as to the integrity and reliability of the Bank's financial reporting.
3. In our opinion, the annual financial statements for the year ended 30 June 2000 fairly reflect the financial position and operations of the Bank.

Governor

Deputy Chief Executive

Deputy Governor



Audit report

To the readers of the Financial Statements of the Reserve Bank of New Zealand

We have audited the financial statements on pages 43 to 84. The financial statements provide information about the past financial performance of the Reserve Bank of New Zealand and group and its financial position as at 30 June 2000. This information is stated in accordance with the accounting policies set out on pages 43 to 47.

Governors' responsibilities

The Governors are responsible for the preparation of financial statements which give a true and fair view of the financial position of the Reserve Bank of New Zealand and group as at 30 June 2000 and the results of its operations and cash flows for the year ended on that date.

Auditors' responsibilities

It is our responsibility to express an independent opinion on the financial statements presented by the Governors and report our opinion to you.

Basis of opinion

An audit includes examining, on a test basis, evidence relevant to the amounts and disclosures in the financial statements. It also includes assessing:

- the significant estimates and judgements made by the Governors in the preparation of the financial statements;
- whether the accounting policies are appropriate to the Reserve Bank of New Zealand and group circumstances, consistently applied and adequately disclosed.

We conducted our audit in accordance with New Zealand Auditing Standards issued by the Institute of Chartered Accountants of New Zealand. We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to obtain reasonable assurance that the financial statements are free from material misstatements, whether caused by fraud or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Our firm carries out other assignments for the Reserve Bank of New Zealand and group in the area of taxation advice and special consultancy projects. The firm has no other interest in the Reserve Bank of New Zealand and group.

Unqualified opinion

We have obtained all the information and explanations we have required.

In our opinion:

- proper accounting records have been kept by the Reserve Bank of New Zealand and group as far as appears from our examination of those records;
- the financial statements on pages 43 to 84:
 - comply with New Zealand generally accepted accounting practice;
 - give a true and fair view of the financial position of the Reserve Bank of New Zealand and group as at 30 June 2000 and the results of its operations and cash flows for the year ended on that date.

Our audit was completed on 17 August 2000 and our unqualified opinion is expressed as at that date.

Wellington



Reserve Bank of New Zealand 1999/2000 Financial Statements

Statement of Accounting Policies

These are the consolidated financial statements of the Reserve Bank of New Zealand, a body corporate under the Reserve Bank of New Zealand Act 1989. These statements apply to the financial year ended 30 June 2000. They have been prepared in accordance with part VI of the Reserve Bank of New Zealand Act 1989. Unless otherwise stated, the measurement base is historic cost.

In these financial statements, the Reserve Bank of New Zealand is also referred to as the "Reserve Bank" or the "Bank".

(a) Basis of Consolidation

The Reserve Bank accounts for its Registry Services function through a wholly-owned subsidiary company (RBNZ Registry Limited). The consolidated financial statements include this subsidiary company. The purchase method of consolidation is used. All material inter-company balances and transactions have been eliminated. (Abridged financial statements for RBNZ Registry Limited appear in note 31.) Parent financial statements are not produced because the difference between the parent and group accounts is not material.

(b) Foreign Currency Conversions

Transactions in foreign currencies have been translated to New Zealand currency using exchange rates applying on the settlement dates of transactions. Foreign currency financial assets and financial liabilities have been translated to New Zealand currency using mid-market exchange rates applying at balance date. The following New Zealand dollar closing exchange rates for major currencies were used to convert foreign currency assets and liabilities to New Zealand dollars for reporting purposes:

	2000	1999
Euro	0.4919	0.5138
Japanese yen	49.44	64.05
United States dollars	0.4685	0.5310

(c) Financial Assets and Liabilities

The Bank presents financial assets and liabilities, and the associated income and expense streams, by distinguishing between foreign currency and local currency activities. Foreign currency activities mainly arise from the Bank's foreign reserves management function. Local currency activities mainly reflect the assets and liabilities associated with monetary policy implementation, investment of the proceeds of issuing circulating currency and banking activities.

The separate reporting of these activities is considered to provide a better presentation of the Bank's financial position, financial performance and risk profile. The Bank considers that the combined reporting of foreign and local currency activities would weaken the informational value of the financial statements.

All financial assets and liabilities are recognised in the Statement of Financial Position on a trade date basis. This means that purchases and sales of financial assets are recognised from the date at which the purchase or sale is agreed.

Foreign Currency Marketable Securities

Foreign currency marketable securities are valued at quoted market mid-prices. Any premium or discount on purchase is capitalised and amortised over the term of the security on a constant yield to maturity basis. Changes in market value are recognised as an increase or decrease in the value of the Marketable Securities in the Statement of Financial Position.

Gains and losses on marketable securities are recognised immediately in the Statement of Financial Performance as Gain (Loss) from Unrealised Price Revaluation income (where the revaluation gains or losses have not been realised) and as Realised Gains (Losses) from Price Changes where the gains or losses have been realised by selling the security.

Foreign Currency Term Liabilities

Foreign currency term liabilities are reported at market or fair value. The funds from these liabilities are invested in foreign currency marketable securities. Hence, this valuation policy ensures consistency with the policy adopted for the corresponding assets. Market or fair value is imputed by deriving the fair value rate from the relevant market yield curve of similar liabilities and discounting the future cash flows of the liabilities at this rate. Changes in the value of these liabilities are recognised as an increase or decrease in the value of the Term Liabilities in the Statement of Financial Position.

Gains and losses on foreign currency term liabilities are recognised immediately in the Statement of Financial Performance as (Gain) Loss from Unrealised Price Revaluation expenses (where the revaluation gains or losses have not been realised) and as Realised (Gains) Losses from Price Changes where the gains or losses have been realised through repayment of the liability.

Repurchase and Reverse-Repurchase Transactions

Securities sold under agreements to repurchase are retained as Marketable Securities in the Statement of Financial Position. The obligation to repurchase (Securities Sold Under Agreements to Repurchase) is disclosed as a liability. The difference between the sale and repurchase price represents an expense and is amortised over the term of the contract and reported in the Statement of Financial Performance.

Securities held under reverse-repurchase agreements are recorded as an asset in the Statement of Financial Position (Securities Purchased Under Agreements to Re-sell). The difference between the purchase price and sale price represents income and is amortised over the term of the contract and reported in the Statement of Financial Performance.

Both repurchase and reverse-repurchase transactions are reported at the original transaction value.

Securities Lending Programme

Securities lent out under the securities lending programme are accounted for on the same basis as repurchase and reverse-repurchase transactions.

Derivative Instruments

The Bank's involvement in derivatives comprises forward foreign exchange swap transactions, interest rate futures and a cross currency interest rate swap.

Foreign exchange swap contracts are used as part of hedged foreign exchange transactions for both monetary policy implementation and foreign reserves management. The unrealised foreign exchange gain (loss) on unsettled swap forward transactions is offset by the foreign exchange revaluation on the associated money market instruments. Any balance date net value is reported in the category Short-Term Advances. Premiums and discounts relating to the forward contracts are amortised over the term of the contract and reported in the Statement of Financial Performance as Liquidity Management Swap Income.

Futures are used to enhance expected returns on foreign currency assets and, from time to time, to hedge interest rate and foreign exchange risk. Margin and cash accounts are recognised in the Statement of Financial Position as Other Cash Balances. The net market value of futures positions is reported as Futures within the balance of Marketable Securities. Gains and losses on futures are recognised immediately in the Statement of Financial Performance within the balance of Other Foreign Currency Income. The notional principal of futures held at balance date is disclosed in a note to the financial statements.

The cross currency interest rate swap is part of a series of hedged transactions that enhance the yield on foreign currency marketable securities. The market value of the principal components of the swap is derived by discounting the future cashflows based on the appropriate market yield curves. Changes in the market value of the principal components are recognised immediately as an increase or decrease in the value of Marketable Securities in the Statement of Financial Position. Gains and losses are recognised immediately in the Statement of Financial Performance as Unrealised Price Revaluation income (as the gains and losses are not yet realised). Net interest income on the principal amounts is reported as Interest Income from Marketable Securities. The accrued interest on the principal amounts is reported within the balance of Foreign Currency Accrued Interest.

Short Sales of Marketable Securities

A short sale is a sale of a security that we do not own. Short sales arise as part of the foreign reserves management function (see note 1) and the net returns on short sales are reported as income generated through departures from neutral risk positions (see note 24). Securities which are sold short are recorded at quoted market prices and reported as Short Sales of Marketable Securities in the Statement of Financial Position. Any gains or losses are recognised immediately in the Statement of Financial Performance on the same basis as foreign currency marketable securities.

Unsettled Transactions

Amounts due from unsettled sales of securities (transactions not yet due for settlement) are reported as assets under the title Receivable from Unsettled Sales of Securities. Amounts payable for unsettled purchases of securities are reported as liabilities under the title Payable for Unsettled Purchases of Securities.

Unsettled transactions are reported at the contract amounts.

Investment Portfolio - NZ Government Securities

The Bank's investment portfolio is accounted for on a constant yield to maturity basis. This reflects the intention to hold the portfolio until maturity as these assets represent the investment of the proceeds from issuing currency and the Bank's equity. Any premium or discount on purchase is capitalised and amortised over the term of the security on a constant yield to maturity basis.

Market Test Activities

From time to time, the Bank may hold small trading positions in local currency securities as part of market test activities. These are valued at quoted market prices. Changes in market value are recognised as an increase or decrease in the value of Other Local Currency Financial Assets. Gains or losses are recognised immediately in the Statement of Financial Performance as Gain (Loss) from Market Test Activities.

Transaction Value

The following financial assets and liabilities are valued at transaction date value:

- a) local and foreign currency cash; and
- b) deposits.

(d) Currency in Circulation

Currency issued by the Reserve Bank represents a claim on the Bank in favour of the holder. The liability for Currency in Circulation is recorded at face value in the Statement of Financial Position.

(e) Collectors' and Demonetised Currency

The Reserve Bank has a liability for the face value of collectors' currency. However, it is most unlikely that significant amounts of collectors' currency will be returned for redemption. The face value of collectors' currency is therefore recognised as a contingent liability.

The Bank has a liability for the face value of demonetised currency still in circulation. Except for a portion retained in the Statement of Financial Position to cover expected future redemption, this is also recognised as a contingent liability.

(f) Land and Buildings

Land is carried at market value. Property intended for sale is valued at the lower of book value or market value. Buildings are valued at market value except for the specialised basements and ground floors occupied by the Reserve Bank, which are valued at adjusted replacement cost when the property is intended to be held for the longer term. Surpluses of book value over historic cost for this class of asset are recorded in the Properties Revaluation Reserve. Where the book value of this class of asset falls below historic cost, previous revaluations are reversed and any remaining balance is charged as an expense in the financial year it occurs. Independent valuations of this class of asset are obtained triennially. Because of this policy of regular valuation, buildings are not depreciated.

(g) Other Fixed Assets

Other Fixed Assets are carried at cost, less depreciation. The following assets held by the Reserve Bank of New Zealand are depreciated on a straight line basis over the given terms:

Computer Hardware	4 years
Computer Software	5 years
Plant and Equipment	5 years

Motor vehicles are depreciated on a diminishing value basis at a rate of 26 percent per annum. Other assets are depreciated on a straight line basis over their expected useful lives.

(h) Operating Leases

Where the Bank is the lessee, the lease rentals payable on operating leases are recognised in the Statement of Financial Performance over the term of the lease on a basis consistent with the expected benefits derived from the leased assets.

Where the Bank is the lessor, the assets leased out are retained in the balance of Fixed Assets and depreciated on the same basis as Other Fixed Assets.

(i) Inventories

Inventories are carried at the lower of cost or realisable value. Cost is determined on a weighted average basis. Unissued currency stocks are recorded as inventory at the cost of acquisition and expensed when issued.

(j) Accounts Receivable

Accounts Receivable are carried at expected realisable value after making due allowance for doubtful debts.

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(k) Currency and Artwork Collections and Archives

Items held in the Reserve Bank's currency and artwork collections and archives that have a material commercial value are independently valued at estimated market values. Nominal values have been placed on items with no material commercial value. Collections are not depreciated. Additions are held at cost until subsequent revaluations.

(l) Provision for Restructuring

A provision for restructuring is recognised only when the Bank has a detailed restructuring plan and the plan has either started to be implemented or has been communicated to those affected by it. Only those expenses that are necessarily entailed by the restructuring and are not associated with ongoing activities are included in the provision.

(m) Personnel Expenses

Personnel expenses include the full cost of all staff benefits, including any applicable Fringe Benefit Tax. Salaries and leave accrued at year end are reported as Accrued Employee Entitlements.

(n) Taxation

Only RBNZ Registry Limited is liable for income tax.

The taxation charged against profit includes both current and deferred taxation calculated under the comprehensive method.

Deferred taxation arises from items of income and expenditure being included in taxation computations in periods different from those in which they are recorded in the Statement of Financial Performance.

(o) Income Allocated Between Functions

Each function receives income and incurs expenses relating directly to the assets and liabilities used exclusively by that function. The income and expenses for each function are presented in the Statement of Cost of Services. Notional balance sheets are calculated for each of the Bank's functions as though each function operated autonomously. Income and expense flows are also attached to the notional funding for each function. This structure enables each function to more accurately report the financial outcome of the services provided.

The income earned from the assets funded by the Bank's net equity is allocated equally to the Foreign Reserves Management and Market Operations functions.

(p) Cash Flows

Cash is defined as those items that are convertible to cash within two working days and are used in the day-to-day cash management of the Bank.

Investing activities include the cash movements, including realised gains and losses, in the Reserve Bank's financial asset portfolios. Also included are cash flows arising from movements in fixed assets, and the repayment of loans to staff.

Financing activities are those arising from the issue of circulating currency, borrowing from the Treasury, and payment of the net operating surplus to the Crown.

Operating activities include income and expenditure cash flows not included as investing or financing activities.

(q) Custodial Activities

Securities held by the Reserve Bank through a subsidiary company, New Zealand Central Securities Depository Limited, under custodial arrangements are not included in these financial statements (see note 33).

(r) Segmental Reporting

The Bank presents financial assets and financial liabilities, and the associated income and expense streams, by distinguishing between foreign currency and local currency activities. In addition, the Bank provides operating results by function. The Bank considers that these reporting approaches provide appropriate segmental reporting of the Bank's activities.

(s) Comparative Amounts

To ensure consistency with the current year, comparative figures have been restated where appropriate. The only material change is the reclassification of Short Sales of Marketable Securities as a liability balance. Previously, these were reported within the balance of Marketable Securities.

(t) Changes in Accounting Policies

There has been no change in the Reserve Bank's accounting policies for the year ended 30 June 2000 and uniform accounting policies have been applied throughout the Bank.

Consolidated Statement of Financial Position

<i>As at 30 June</i>	Note	2000 \$000	1999 \$000
Assets:			
Foreign Currency Financial Assets			
Cash Balances with Other Central Banks		105,537	381,118
Other Cash Balances		3,037	-
Marketable Securities	2	4,226,880	4,139,314
Receivable from Unsettled Sales of Securities		90,524	41,435
Securities Purchased Under Agreements to Re-sell		1,314,560	1,860,245
Accrued Interest		71,380	70,506
Total Foreign Currency Financial Assets		5,811,918	6,492,618
Local Currency Financial Assets			
Cash on Hand		58	78
Securities Purchased Under Agreements to Re-sell		1,600,265	3,063,648
Investment Portfolio - NZ Government Securities		2,445,433	2,205,712
Accrued Interest		46,584	50,579
Other Local Currency Financial Assets	3	91	1,265
Total Local Currency Financial Assets		4,092,431	5,321,282
Total Financial Assets		9,904,349	11,813,900
Non-Financial Assets			
Accounts Receivable		1,822	2,180
Inventories	4	8,151	7,122
Deferred Taxation		214	60
Currency & Artwork Collection		778	767
Fixed Assets	5	40,394	49,372
Total Non-Financial Assets		51,359	59,501
Total Assets		9,955,708	11,873,401

	Note	2000 \$000	1999 \$000
Liabilities:			
Foreign Currency Financial Liabilities			
Payable for Unsettled Purchases of Securities		123,097	283,221
Short Sales of Marketable Securities		186,536	599,588
Securities Sold Under Agreements to Repurchase		911,618	1,190,600
Term Liabilities		4,496,971	4,313,042
Accrued Interest		94,647	99,815
Total Foreign Currency Financial Liabilities		5,812,869	6,486,266
Local Currency Financial Liabilities			
Government Deposits		1,327,376	2,880,976
Other Deposits	6	77,693	45,169
Accrued Interest		245	408
Total Local Currency Financial Liabilities		1,405,314	2,926,553
Total Financial Liabilities		7,218,183	9,412,819
Other Liabilities			
Currency in Circulation		2,159,965	1,884,816
Provision for Transfer of Surplus	9	157,681	150,818
Miscellaneous Liabilities	7	19,779	20,058
Total Other Liabilities		2,337,425	2,055,692
Total Liabilities		9,555,608	11,468,511
Equity	10	400,100	404,890
Total Liabilities and Equity		9,955,708	11,873,401

The above statement is to be read in conjunction with the notes on pages 56 to 84.

Consolidated Statement of Financial Performance

<i>For the year ended 30 June</i>	Note	Actual 2000 \$000	Budget 2000 \$000	Actual 1999 \$000
Operating Income:				
Income from Foreign Currency Financial Assets				
Interest Income	17	165,555		198,083
Gain (Loss) from Unrealised Price Revaluations		(12,464)		(26,045)
Realised Gain (Loss) from Price Changes		(3,463)		34,598
Other Foreign Currency Income		(2,002)		(4,011)
Total Income from Foreign Currency Financial Assets		147,626		202,625
Expenses on Foreign Currency Financial Liabilities				
Interest Expense	18	176,230		196,009
(Gain) Loss from Unrealised Price Revaluations		(32,922)		3,238
Realised (Gain) Loss from Price Changes		485		(10,206)
Other Foreign Currency Expenses		644		375
Total Expenses on Foreign Currency Financial Liabilities		144,437		189,416
Net Foreign Exchange Revaluation Gain (Loss)	19	(439)		(901)
Foreign Currency Investment Income		2,750		12,308
Income from Local Currency Financial Assets				
Interest Income	17	248,605		252,562
Liquidity Management Swap Income		22,616		697
Gain from Market Test Activities		27		25
Total Income from Local Currency Financial Assets		271,248		253,284
Total Expenses on Local Currency Financial Liabilities	18	81,644		79,478
Local Currency Investment Income		189,604		173,806
Net Investment Income⁸		192,354	171,263	186,114
Other Income	20	11,398	12,872	11,717
Total Operating Income		203,752	184,135	197,831

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8 The Bank does not forecast the main drivers of gross investment income and expenses for budget purposes (exchange rates and interest rates). Hence, the budget for investment income is presented on a net basis.

	Note	Actual 2000 \$000	Budget 2000 \$000	Actual 1999 \$000
Operating Expenses:				
Personnel ⁹		20,146	19,624	21,391
Asset Management	21	6,289	6,379	6,041
New Currency Issued ¹⁰	23	9,341	8,159	8,323
Administration		1,600	1,789	1,602
Other	22	7,012	7,042	6,858
Total Operating Expenses		44,388	42,993	44,215
Operating Surplus		159,364	141,142	153,616
Taxation	32	99	343	645
Surplus Available for Appropriation	9	159,265	140,799	152,971

The above statement is to be read in conjunction with the notes on pages 56 to 84.

9 Personnel expenses are over budget mainly due to the restructuring of RBNZ Registry Limited (see note 8).

10 New Currency Issued expenses are over budget due to higher-than-expected demand for new currency, particularly over the Year 2000 period (see note 23).

Consolidated Statement of Cost of Services

	Note	Operating Income	Operating Expenses	Operating Surplus (Deficit)	Operating Surplus (Deficit)	Operating Surplus (Deficit)
		Actual 2000 \$000	Actual 2000 \$000	Actual 2000 \$000	Budget 2000 \$000	Actual 1999 \$000
<i>For the year ended 30 June</i>						
Functions:						
Monetary Policy Formulation		35	7,194	(7,159)	(7,325)	(7,204)
Market Operations		14,646	2,795	11,851	5,480	14,906
Financial System Oversight		7	3,074	(3,067)	(3,067)	(2,687)
Currency Operations	23	166,498	19,198	147,300	137,682	125,881
Foreign Reserves Management	24	16,547	3,699	12,848	9,899	22,997
Banking Services		1,518	1,316	202	378	751
Overseas Investment Commission Secretariat		628	691	(63)	68	41
Other Outputs		2	841	(839)	(1,011)	(1,021)
Total for Functions within Funding Agreement		199,881	38,808	161,073	142,104	153,664
Registry Services ¹¹	31	6,317	6,125 ¹²	192	695	1,307
Less Intercompany Transactions ¹³		2,446	446	2,000	2,000	2,000
Surplus Available for Appropriation		203,752	44,487	159,265	140,799	152,971

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The Consolidated Statement of Cost of Services shows the total cost of providing each function, including internal transfers between functions.

The above statement is to be read in conjunction with the notes on pages 56 to 84.

11 The 1999/2000 result for the Registry Services function includes \$746,000 provided for restructuring costs as described in note 8.

12 Includes taxation expense.

13 Intercompany transactions include \$2,000,000 dividend paid from the Registry Services function. Other intercompany transactions are mainly for the purchase of registry services by other Bank functions.

Consolidated Statement of Movements in Equity

<i>For the year ended 30 June</i>	Note	2000 \$000	1999 \$000
Equity at Start of Year		404,890	404,242
Net Surplus for the Year		159,265	152,971
Movement in Properties Revaluation Reserve	10	(6,400)	(1,505)
Movement in Currency and Artwork Collections Revaluation Reserve	10	26	-
Total Recognised Revenues and Expenses for the Year		152,891	151,466
Provision for Transfer of Surplus to Government	9	(157,681)	(150,818)
Equity at End of Year		400,100	404,890

The above statement is to be read in conjunction with the notes on pages 56 to 84.

Consolidated Statement of Cash Flows

<i>For the year ended 30 June</i>	Note	2000 \$000	1999 \$000
Cash Flows From Operating Activities:			
Source:			
Interest Received - Foreign Currency		238,674	190,016
- Local Currency - Investment Portfolio		171,861	162,646
- Other		78,385	108,843
Liquidity Management Swap Income		22,616	697
Fees, Commission and Other Income Received		8,636	6,975
Net GST Received (Paid)		103	(77)
		520,275	469,100
Disbursements:			
Interest Paid - Foreign Currency		181,397	218,577
- Local Currency		81,808	70,009
Payments to Suppliers and Employees		41,559	32,569
Income Tax Paid		390	693
		305,154	321,848
Net Cash Flow From Operating Activities	25	215,121	147,252
Cash Flows From Investing Activities:			
Source:			
Net (Increase) Decrease in Foreign Currency Securities Purchased under Agreements to Re-sell		545,686	(428,431)
Net (Increase) Decrease in Other Local Currency Financial Assets		1,173	277
Net Repayment of Advances to Government		-	1,194,982
Sale of Fixed Assets		203	77
		547,062	766,905
Disbursements:			
Net Increase (Decrease) in Foreign Currency Marketable Securities		324,318	(500,220)
Net Increase (Decrease) in Other Foreign Currency Financial Assets		49,089	(118,690)
Net (Increase) Decrease in Other Foreign Currency Financial Liabilities		889,712	(630,480)
Net Purchases of NZ Government Securities for Investment Portfolio		237,367	116,843
Purchase of Fixed Assets		1,174	1,931
		1,501,660	(1,130,616)
Net Cash Flow From Investing Activities		(954,598)	1,897,521

	Note	2000 \$000	1999 \$000
Cash Flows From Financing Activities:			
Source:			
Issue of Circulating Currency		10,264,622	11,618,884
Withdrawal of Circulating Currency		9,989,473	11,467,376
Net Issue of Circulating Currency		275,149	151,508
Disbursements:			
Transfer of SDRs to Treasury		-	367,070
Net Repayment of Reserve Bank Bills		-	1,213,000
Payment for Demonetised Currency		39	78
Net Repayment of Foreign Currency Term Liabilities		447,176	301,738
Payment of Surplus to Government		150,818	151,890
		598,033	2,033,776
Net Cash Flow From Financing Activities		(322,884)	(1,882,268)
Cash Flow from All Activities		(1,062,361)	162,505
Plus Exchange Rate Effect		592,440	23,168
Net Cash Flow from All Activities		(469,921)	185,673
Opening Cash Balance		3,734,582	3,548,909
Closing Cash Balance	26	3,264,661	3,734,582

The above statement is to be read in conjunction with the notes on pages 56 to 84.

Cash is defined in the Statement of Cash Flows as those items that could be liquidated in two working days and are used in the day-to-day cash management of the Bank. This definition includes local currency securities purchased under agreements to re-sell and a substantial portion of the Bank's foreign reserves portfolio (see note 2).

Cash movements in some portfolios have been presented net as this is considered to provide a fairer presentation of the movements in the Bank's cash profile.

For further information on the management of the Bank's liquidity, see Note 16. Liquidity Risk.

Notes to be read as part of the Consolidated Financial Statements

1. Nature and Extent of Activities

The Reserve Bank's role as a central bank determines the nature and extent of its activities with respect to financial instruments. This role is defined by the Reserve Bank of New Zealand Act 1989.

(a) Foreign Currency Activities

Foreign currency activities result mainly from the Reserve Bank's holdings of foreign currency assets under its foreign reserves management function. The foreign reserves management portfolio comprises foreign currency assets held for foreign exchange intervention purposes ("foreign reserves"), pursuant to section 24 of the Reserve Bank of New Zealand Act 1989, and other foreign currency assets held for trading purposes. The entire foreign reserves portfolio is actively managed. The foreign currency assets are held in various currencies. The majority are denominated in United States dollars, Japanese yen and euros. The overall level of intervention assets is determined by the Treasurer on advice from the Bank.

The financial instruments held within these foreign currency portfolios consist mainly of sovereign securities, securities held under reverse-repurchase transactions or balances held with other central banks, commercial banks and settlement institutions. Liquidity and credit risk are key criteria in determining the type of instruments held.

The funding for foreign reserves is provided by foreign currency loans from the Treasury. These loans incur interest at market rates. Generally these loans are held to maturity, though from time to time the opportunity to repay early may be taken at the instigation of either the Bank or the Treasury where this is expected to reduce the cost of funding.

Subject to liquidity and credit risk constraints being satisfied, the Bank defines benchmark portfolios that represent a "neutral" asset structure in terms of market risk relative to the funding structure. The neutral position is established to minimise the Bank's exposure to foreign currency risk and interest rate risk arising from changes in the yield curve. In general, liquidity and credit risk constraints dictate that the return on the neutral asset structure will be less than the cost of funding.

The Reserve Bank also holds, from time to time, foreign currency assets and liabilities that arise from the implementation of domestic monetary policy. Any foreign currency exposures related to domestic monetary policy implementation activity are fully hedged through the use of foreign currency swaps.

The Bank also participates in the foreign exchange dealing markets on its own account.

(b) Departures from Neutral Positions

Departures of the asset portfolio from the neutral asset structure are undertaken where there is an expected increase in returns, within defined risk boundaries. Exposures are also incurred by short sales of marketable securities, again for expected return enhancement within defined risk boundaries.

Decision-making for departures from neutral asset positions typically involves delegated discretion to specialist staff or trading strategies pre-agreed with the Bank's senior management.

For further information on the risk management policies relating to financial instruments, see notes 12 to 16.

(c) Events during 1999/2000

- (i) The Bank implemented systems and procedures to trade interest rate futures in the foreign currency portfolios from 1 July 1999. The first futures trade was transacted on 16 July 1999.
- (ii) The Bank adopted an externally developed Value at Risk model for measuring interest rate risk in its foreign currency portfolios on 1 July 1999. Previously an internally developed Funds at Risk model (based on duration and convexity) was used.

(d) Derivatives

The Bank's involvement in derivatives comprises forward foreign exchange swap transactions, interest rate futures and a cross currency interest rate swap.

The Bank uses forward foreign exchange swap contracts as part of hedged foreign exchange transactions for both monetary policy implementation and foreign reserves management. The Bank did not have any forward foreign exchange swap transactions outstanding at 30 June 2000 (1999 nil).

The Bank uses interest rate futures to enhance expected returns and to hedge interest rate and foreign currency risk in its foreign currency portfolios. At 30 June 2000, the Bank had 334 open contracts (1999 nil) with a total notional principal of \$711,016,000 (1999 nil).

In November 1997, the Bank entered into a cross currency interest rate swap (exchanging principal of US \$110 million) as part of a series of hedged transactions to enhance the yield on the US dollar fixed rate portfolio.

(e) Securities Lending Programme

As part of its foreign reserves operations, the Reserve Bank participates in a securities lending programme managed by Chase Manhattan Bank. Under the programme, Chase Manhattan Bank lends out securities owned by the Bank in exchange for cash or alternative securities. The range of financial assets that can be acquired under the programme is constrained by guidelines compatible with those that apply to the Bank's own foreign currency asset portfolios.

The total market value of securities which have been made available to participate in this programme is limited to US \$700 million. As at 30 June 2000, the market value of securities lent out under the programme was US \$406.1 million (1999 US \$400.8 million).

(f) Local Currency Activities

Local currency activities arise as follows:

(i) Liquidity management operations.

Liquidity management largely involves the Reserve Bank offsetting the daily net flows through Government Deposits by advancing funds to or withdrawing funds from the banking system. Most of this business is undertaken through daily open market operations. Residual liquidity is handled by the Official Cash Rate scheme (OCR) (introduced on 17 March 1999). Under the OCR scheme, the Bank advances or withdraws cash at a margin to the OCR. The financial instruments used in this process include local currency reverse repurchase transactions and forward foreign exchange swap contracts.

(ii) Holding assets representing the investment of the Reserve Bank's net equity and supporting the liability for currency in circulation.

This investment portfolio comprises holdings of New Zealand government bonds. The Bank's policy is to hold these investments until maturity.

(iii) As part of the Year 2000 contingency plan, the Bank purchased an option to enter into a repurchase transaction (lend securities and borrow foreign currency) with a counterparty that had access to the United States Federal Reserve discount window. This option was purchased in case the security repurchase market experienced difficulties and the Bank needed additional foreign currency for intervention purposes over the Year 2000 period. The option cost \$30,000 and expired on 15 January 2000.

From time to time, the Bank may also hold small trading positions in Crown or registered bank securities as part of market test activities.

(g) Restrictions on Title to Assets

As part of the active management of its foreign currency operations, the Reserve Bank enters into security repurchase transactions. The securities sold by the Bank under repurchase agreements continue to be recorded as Marketable Securities in the Bank's Statement of Financial Position. At balance date, securities with a book value of \$912 million (1999 \$1,191 million) had been sold to counterparties under repurchase agreements. These transactions are also recognised as a liability for Securities Sold under Agreements to Repurchase in the Bank's Statement of Financial Position.

The Bank also purchases securities under reverse-repurchase agreements in both its foreign currency and local currency operations. These transactions are recognised as Securities Purchased under Agreements to Re-sell in the Bank's Statement of Financial Position.

(h) Concentrations of Funding

The Bank has a concentration of funding from the New Zealand government. The funding for foreign reserves is provided by foreign currency loans from the Treasury. Funding for local currency assets is from government deposits, bank deposits and the issue of circulating currency.

Asset Notes

2. Foreign Currency Marketable Securities

	2000 \$000	1999 \$000
Marketable Securities - Liquifiable within two working days (considered cash equivalent)	2,960,834	3,215,883
- Liquifiable outside two working days (not considered cash equivalent)	1,042,601	719,793
Futures	303	-
Cross Currency Swap Position	223,142	203,638
Total Marketable Securities	4,226,880	4,139,314
Cross Currency Swap Position		
- Swap Derivative Components	(86,358)	(35,531)
- Government Securities	309,500	239,169
	223,142	203,638

The change in the value of the Cross Currency Swap position is largely offset by changes in the value of the Bank's liabilities. This is consistent with the Bank's risk management practice of matching assets and liabilities.

3. Other Local Currency Financial Assets

	2000 \$000	1999 \$000
Receivable from Unsettled Foreign Exchange Transactions	-	1,000
Advances to Staff	69	174
Term Loans	19	91
Other Financial Assets	3	-
Total Other Local Currency Financial Assets	91	1,265

4. Inventories

	2000 \$000	1999 \$000
Bank Notes for Circulation	6,487	4,087
Coin for Circulation	1,049	2,716
Collectors' Currency	615	319
Total Inventories	8,151	7,122

5. Fixed Assets

	Historic Cost 2000 \$000	Accumulated Depreciation 2000 \$000	Book Value 2000 \$000	Historic Cost 1999 \$000	Accumulated Depreciation 1999 \$000	Book Value 1999 \$000
Freehold Land			8,080			8,080
Buildings			17,835			17,835
Property Intended for Sale			6,600			13,000
Total Land and Buildings			32,515			38,915
Computer Hardware	3,030	1,918	1,112	4,538	3,116	1,422
Plant	5,503	5,202	301	5,643	5,343	300
Office Equipment	4,132	3,321	811	6,543	5,481	1,062
Software	4,521	2,809	1,712	7,747	5,266	2,481
Currency Processing Equipment	3,601	2,857	744	5,019	3,294	1,725
Motor Vehicles	74	57	17	186	116	70
Building Improvements	4,962	2,492	2,470	5,155	2,660	2,495
Tenancy Inducements	1,483	1,148	335	1,659	1,116	543
Leased Currency Equipment	1,420	1,065	355	-	-	-
Work in Progress	22	-	22	359	-	359
			7,879			10,457
Total Fixed Assets			40,394			49,372

The book values for land and buildings are market values based on existing use with the exception of the Wellington specialised basement and ground floors occupied by the Bank, which are valued at adjusted replacement cost. The market value of the Wellington Head Office to a purchaser not requiring the Bank's specialised facilities is assessed at \$22,600,000 (1999 \$22,600,000).

	Valuation Date	Registered Valuer	Last Valuation \$000
Auckland Property	June 2000	Jones Lang LaSalle Limited	6,600
Wellington Head Office	June 1998	Jones Lang Wooton Limited	24,350
Wellington Carparks	June 1999	Darroch Limited	1,565
			32,515

Liability and Equity Notes

6. Other Deposits

	2000 \$000	1999 \$000
Settlement Bank Deposits	48,503	1,141
Central Bank Deposits	2,684	2,030
Staff Deposits	-	4,818
International Monetary Fund Deposits	26,297	37,180
Other Deposits	209	-
Total Other Deposits	77,693	45,169

7. Miscellaneous Liabilities

	Note	2000 \$000	1999 \$000
Accounts Payable		15,324	14,925
Accrued Employee Entitlements		1,661	2,021
Other Current Liabilities		336	401
Provision for Restructuring	8	1,245	1,466
Demonetised Currency		1,213	1,245
Total Miscellaneous Liabilities		19,779	20,058

Demonetised currency is recognised as a contingent liability (see note 30(c)) except for \$1,213,000 (1999 \$1,245,000), which has been retained to cover future expected redemption.

Pre-decimal-currency coin was issued by the Treasury and is included in the Bank's contingent liabilities (see note 30(b)).

8. Provision for Restructuring

	2000 \$000	1999 \$000
Currency Operations	668	1,466
RBNZ Registry Limited	577	-
Total Provision for Restructuring	1,245	1,466
Currency Operations		
Balance at Start	1,466	-
Less Expenses Incurred	(894)	-
Additions to Provision	96	1,466
Balance at End	668	1,466

During 1998/1999, the Bank made a provision for the restructuring of its currency operations. This provision includes payments to currency staff who were or will be made redundant, as the volume of bank note processing diminishes. The decline in bank note processing arose in part from the introduction of the more durable polymer notes and in part from a recognition that some of the processing that had been undertaken previously was unnecessary. The Bank has publicly announced that it intends to close the Auckland branch and has already closed the Christchurch branch. The precise timing of remaining redundancy payments will depend on the pace with which the banks are able to set up alternative distribution systems but is expected to be largely complete within the 2000/2001 year.

	2000 \$000	1999 \$000
RBNZ Registry Limited		
Balance at Start	-	-
Provision Made	746	-
Less Expenses Incurred	(169)	-
Balance at End	577	-

During 1999/2000, the Bank provided for restructuring RBNZ Registry Limited. This includes the out-sourcing of processing activities associated with the registration, transfer and payment for debt securities (registry out-sourcing). The Bank also announced it would relinquish the licence for the Austraclear New Zealand System, which offers electronic clearing and settlement services for debt and equity securities. The Bank has provided for payments to staff who will be made redundant as a result of the registry out-sourcing and relinquishment of the licence for the Austraclear New Zealand System. The payments relating to registry out-sourcing are expected to be completed early in the 2000/2001 financial year. The payments relating to the relinquishment of the Austraclear New Zealand System licence are expected in mid-2000/2001, depending on the finalised relinquishment terms.

9. Transfers to Retained Earnings and Provision for Transfer of Surplus

Under section 162 of the Reserve Bank of New Zealand Act 1989, the Bank's surplus, after any transfers to or from Equity, is paid to the government.

Transfers to or from the Reserve Bank's Equity reflect the difference between actual operating expenses and the level of expenditure specified under the Bank's Funding Agreement with government, plus the RBNZ Registry net surplus. Under-spending by the Bank in relation to the Funding Agreement results in a transfer to Equity. Over-spending by the Bank results in a transfer from Equity. In the current year, under-expenditure by the Bank of \$1,392,000 (1999 \$846,000) has consequently been transferred to the Bank's Equity. In addition, the RBNZ Registry net surplus of \$192,000 (1999 \$1,307,000) is added to the Bank's consolidated equity.

The Bank's subsidiary, RBNZ Registry Limited, does not propose to pay the Bank a dividend (1999 \$2,000,000) in respect of the year ended 30 June 2000.

The Treasurer may authorise additional transfers to Equity. In the current year, no additional transfers have been made and the Bank's consolidated surplus, net of the transfers noted above, has been recorded in the Provision for Transfer of Surplus.

	2000 \$000	1999 \$000
Allowable Expenditure under Funding Agreement	40,200	40,200
Operating Expenses for Functions Covered by the Funding Agreement	38,808	39,354
Under-expenditure Transferred to Equity	1,392	846
Surplus Available for Appropriation	159,265	152,971
Less Transfers to Equity:		
Under-expenditure under Funding Agreement	1,392	846
RBNZ Registry Limited Surplus	192	1,307
Total Transfers to Equity	1,584	2,153
Provision for Transfer of Surplus	157,681	150,818

10. Equity

	2000 \$000	1999 \$000
Retained Earnings		
Opening Balance	397,663	395,510
Add Transfers to Retained Earnings:		
Reserve Bank of New Zealand	1,392	846
RBNZ Registry Limited	192	1,307
Closing Balance	399,247	397,663
Properties Revaluation Reserve		
Opening Balance	6,547	8,052
Increase (Decrease) in Value of Auckland Property	(6,400)	(1,500)
Increase (Decrease) in Value of Wellington Property	-	(5)
Closing Balance	147	6,547
Currency and Artwork Collections Revaluation Reserve		
Opening Balance	680	680
Increase (Decrease) in Value of Currency and Artwork Collections	26	-
Closing Balance	706	680
Total Equity	400,100	404,890

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The Properties Revaluation Reserve recognises the surplus of book value over cost of the Bank's properties in Auckland and Wellington.

11. Fair Value of Financial Instruments

The fair value of a financial instrument is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms-length transaction.

When a financial instrument is traded in an organised and liquid market that is able to absorb a significant transaction without moving the price against the trader, quoted market values represent fair value.

(a) Derivatives

The fair value of derivatives is calculated using discounted cash flow models based on current interest rates for the type and maturity of the underlying instrument.

As at 30 June 2000, the Bank had no forward foreign exchange swap contracts, hence there was no unrealised foreign exchange gain or loss (1999 nil).

The fair value of the futures positions held by the Bank at 30 June 2000 was \$303,000 (1999 nil).

The fair value of the derivative components of the cross currency swap at 30 June 2000 was -\$86.4 million (1999 -\$35.5 million). The swap is part of a series of hedged transactions that enhance the yield on the US dollar portfolio. The total value of the Cross Currency Swap position at 30 June 2000 was \$223,142,000 (1999 \$203,638,000) (see note 2).

(b) Financial Assets and Liabilities

All other financial assets and liabilities are valued at either quoted market prices or prices derived from market yield curves, as described in the Bank's accounting policies, except as detailed overleaf.

Repurchase and Reverse-Repurchase Agreements

The reported value of repurchase and reverse-repurchase agreements is considered to approximate their fair value due to the short term nature of the agreements.

Unsettled Transactions

The reported value of unsettled sales and purchases is considered to approximate their fair value due to the very short term until settlement occurs.

Investment Portfolio - NZ Government Securities

The Bank's holdings of NZ government securities have a fair value of \$2,508,276,000 (1999 \$2,298,421,000). This has been calculated by discounting the current holdings of NZ government securities at 30 June 2000 market rates.

Deposits

The carrying values of deposits are considered to approximate their fair value as they are payable on demand.

(c) *Currency in Circulation*

The fair value of currency in circulation is considered to be its face value as reported in the accounts.

Risk Management Notes

12. Risk Management

In its financial activities, the Bank is subject to interest rate, credit, foreign currency, liquidity and operating risk. The policies for managing interest rate, credit, foreign currency and liquidity risk are outlined in notes 13 to 16. A Risk Management Committee comprised of senior management is responsible for advising the Governor on the monitoring and management of all risks to which the Bank is exposed.

Operating risk is the risk of loss arising from the breakdown of internal controls. These risks are managed as part of the day-to-day running of all business operations.

Comprehensive guidelines control the manner in which the Reserve Bank conducts its local currency, foreign currency reserves management, and foreign exchange dealing operations. These guidelines contain specific provisions designed to minimise the risk associated with each operation.

A separate Risk Unit maintains the Bank's financial risk management framework. This is outlined in notes 13 to 16. The Risk Unit and Financial Services Group are responsible for the daily monitoring of the Bank's financial risk exposures.

The Risk Assessment and Assurance Department (which includes Audit Services) reports to the Governors and the Audit Committee of the Board of Directors. A risk-based framework which evaluates key business risks and internal controls is used to determine the extent and frequency of audits conducted. All Bank departments are subject to review and audit.

An Audit Committee, comprised of three non-executive members of the Board of Directors, monitors the accounting practices and policies and internal control systems of the Bank on behalf of the Board of Directors. The Committee also reviews the internal audit function and has direct access to the external auditor.

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13. Interest Rate Risk

Interest rate risk is the risk of loss arising from changes in interest rates.

Foreign Currency Interest Rate Risk

Because the Bank's foreign currency assets are funded by foreign currency liabilities whose interest rate characteristics cannot be exactly replicated, even "neutral" asset portfolios involve interest rate risk. The interest rate characteristics of the liabilities are similar to those of high rated bank and corporate instruments, but liquidity considerations require that most investments are in United States, Japanese and German domestic government instruments. The Bank accepts the associated spread risk as inevitable, but seeks to closely limit additional (mainly duration-related) interest rate mismatches. As at 30 June 2000, the calculated potential daily loss from interest rate movements would have been less than \$2.9 million (1999 \$3.3 million) on 99 out of 100 days.

Interest rate risk arising from departures from the neutral position is managed in three ways (and monitored daily):

- (a) Discretionary positions adopted by specialist staff are controlled by "Value at Risk" (VaR) limits. VaR measures the potential daily loss from most movements in market interest rates. The VaR limits are set so daily losses are expected to be less than \$2.5 million on 99 out of 100 days. Given the VaR positions on 30 June 2000, the likely (99 days out of 100 probability) loss from interest rate movements would have been less than \$299,000 (1999 \$485,000). During 1999/2000, actual daily losses on all our foreign currency investment portfolios were within (predicted) VaR 99% of the time. (Note that for the purposes of this "back-testing" analysis, the daily profit and loss is adjusted for losses arising from crossing bid/ask spreads, pricing errors and similar anomalies.)

VaR limits, actual VaR as at 30 June 2000, the peak and average VaR values over the period for discretionary positions by foreign currency asset portfolio were as follows.

<i>VaR</i>	\$000	\$000	\$000	\$000	United States Dollar Portfolio \$000 ¹⁴	Euro Portfolio	Japanese Yen Portfolio	Total 2000	Total 1999
Limit					n/a	n/a	n/a	2,500	n/a
As at 30 June 2000					57	28	214	299	485
Peak over period					309	319	330	560	n/a
Average over period					117	95	66	278	n/a

- (b) Interest rate risk arising from trading strategies or positions pre-agreed with the Bank's senior management is constrained by limits on position size. No trading strategies were in operation on 30 June 2000, hence there was no interest rate risk arising from these strategies as at 30 June 2000 (1999 the calculated potential daily loss from interest rate movements would have been less than \$1.1 million on 99 out of 100 days).
- (c) Stop-loss limits are set for the various departures from the neutral position. Separate stop-loss limits of \$2 million and \$3 million in any calendar month are applied to discretionary and strategic departures from the neutral position, respectively. Therefore, the maximum total loss before stop-loss limits would be triggered is \$5 million in any calendar month.

Local Currency Interest Rate Risk

Interest rate risk on the Investment Portfolio – New Zealand Government Securities is not actively managed as a matter of policy. This decision recognises:

- (a) that active risk management could require the Bank to carry out transactions that may seem in conflict with the Bank's monetary policy stance; and
- (b) that the investment portfolio held by the Bank is exactly matched by liabilities held by the Crown, so from a consolidated Crown position the interest rate risk is eliminated.

The Reserve Bank's exposure to interest rate risk that arises from liquidity management operations is minimal due to the very short-term nature of the exposures created and because the exposures are offset by other interest-bearing assets and liabilities.

Assets and liabilities will mature or re-price within the following periods:

<i>As at 30 June 2000</i>	Weighted Average Interest Rate	Total 2000 \$000	Non- Interest Sensitive \$000	6 Months or Less \$000	6 to 12 Months \$000	1 to 2 Years \$000	2 to 5 Years \$000	Over 5 Years \$000
Foreign Currency Financial Assets								
Cash Balances with Other Central Banks	6.43%	105,537	-	105,537	-	-	-	-
Other Cash Balances	2.68%	3,037	-	3,037	-	-	-	-
Marketable Securities	3.91%	4,226,880	-	1,145,894	113,558	578,451	1,225,163	1,163,814
Receivable from Unsettled Sales of Securities	0%	90,524	-	90,524	-	-	-	-
Securities Purchased Under Agreements to Re-sell	6.14%	1,314,560	-	1,314,560	-	-	-	-
Accrued Interest	0%	71,380	-	71,380	-	-	-	-
Total Foreign Currency Financial Assets	4.35%	5,811,918	-	2,730,932	113,558	578,451	1,225,163	1,163,814
Foreign Currency Financial Liabilities								
Payable for Unsettled Purchases of Securities	0%	123,097	-	123,097	-	-	-	-
Short Sales of Marketable Securities	4.62%	186,536	-	-	-	21,324	42,176	123,036
Securities Sold Under Agreements to Repurchase	6.20%	911,618	-	911,618	-	-	-	-
Term Liabilities	4.40%	4,496,971	-	1,693,213	161,288	533,941	1,058,648	1,049,881
Accrued Interest	0%	94,647	-	94,647	-	-	-	-
Total Foreign Currency Financial Liabilities	4.52%	5,812,869	-	2,822,575	161,288	555,265	1,100,824	1,172,917
Foreign Currency Interest Rate Sensitivity Gap		(951)	-	(91,643)	(47,730)	23,186	124,339	(9,103)
Local Currency Financial Assets								
Cash on Hand	0%	58	-	58	-	-	-	-
Securities Purchased Under Agreements to Re-sell	6.41%	1,600,265	-	1,600,265	-	-	-	-
Investment Portfolio - NZ Government Securities	7.49%	2,445,433	-	-	501,274	152,186	585,593	1,206,380
Accrued Interest	0%	46,584	-	46,584	-	-	-	-
Other Local Currency Financial Assets	5.73%	91	-	30	38	15	8	-
Non-Financial Assets	0%	51,359	51,359	-	-	-	-	-
Total Local Currency Assets	6.90%	4,143,790	51,359	1,646,937	501,312	152,201	585,601	1,206,380
Local Currency Financial Liabilities								
Government Deposits	6.50%	1,327,376	-	1,327,376	-	-	-	-
Other Deposits	3.90%	77,693	-	77,693	-	-	-	-
Accrued Interest	0%	245	-	245	-	-	-	-
Other Liabilities	0%	2,337,425	2,337,425	-	-	-	-	-
Equity	0%	400,100	400,100	-	-	-	-	-
Total Local Currency Liabilities and Equity	2.16%	4,142,839	2,737,525	1,405,314	-	-	-	-
Local Currency Interest Rate Sensitivity Gap		951	(2,686,166)	241,623	501,312	152,201	585,601	1,206,380
On-Balance Sheet Interest Rate Sensitivity Gap		-	(2,686,166)	149,980	453,582	175,387	709,940	1,197,277
Off-Balance Sheet Instruments		-	-	(213,211)	215,582	12,807	19,210	(34,388)
Total Interest Rate Sensitivity Gap		-	(2,686,166)	(63,231)	669,164	188,194	729,150	1,162,889
All Currencies		-	(2,686,166)	(63,231)	669,164	188,194	729,150	1,162,889
New Zealand		951	(2,686,166)	241,623	501,312	152,201	585,601	1,206,380
United States		(1,497)	-	(286,337)	215,549	24,108	282,612	(237,429)
Euro		611	-	(42,746)	(58,425)	111,496	27,111	(36,825)
Japan		(340)	-	23,954	10,728	(99,611)	(166,174)	230,763
Other		275	-	275	-	-	-	-

Comparative figures as at 30 June 1999 were:

<i>As at 30 June 1999</i>	Weighted Average Interest Rate	Total 1999 \$000	Non- Interest Sensitive \$000	6 Months or Less \$000	6 to 12 Months \$000	1 to 2 Years \$000	2 to 5 Years \$000	Over 5 Years \$000
Foreign Currency Financial Assets								
Cash Balances with Other Central Banks	4.78%	381,118	-	381,118	-	-	-	-
Other Cash Balances	-	-	-	-	-	-	-	-
Marketable Securities	3.50%	4,139,314	-	394,681	468,652	386,448	1,081,442	1,808,091
Receivable from Unsettled Sales of Securities	0%	41,435	-	41,435	-	-	-	-
Securities Purchased Under Agreements to Re-sell	1.48%	1,860,245	-	1,860,245	-	-	-	-
Accrued Interest	0%	70,506	-	70,506	-	-	-	-
Total Foreign Currency Financial Assets	2.94%	6,492,618	-	2,747,985	468,652	386,448	1,081,442	1,808,091
Foreign Currency Financial Liabilities								
Payable for Unsettled Purchases of Securities	0%	283,221	-	283,221	-	-	-	-
Short Sales of Marketable Securities	2.99%	599,588	-	-	-	-	184,890	414,698
Securities Sold Under Agreements to Repurchase	1.03%	1,190,600	-	1,190,600	-	-	-	-
Term Liabilities	3.76%	4,313,042	-	1,135,374	283,878	702,425	773,688	1,417,677
Accrued Interest	0%	99,815	-	99,815	-	-	-	-
Total Foreign Currency Financial Liabilities	2.97%	6,486,266	-	2,709,010	283,878	702,425	958,578	1,832,375
Foreign Currency Interest Rate Sensitivity Gap		6,352	-	38,975	184,774	(315,977)	122,864	(24,284)
Local Currency Financial Assets								
Cash on Hand	0.14%	78	-	78	-	-	-	-
Securities Purchased Under Agreements to Re-sell	4.49%	3,063,648	-	3,063,648	-	-	-	-
Investment Portfolio - NZ Government Securities	7.58%	2,205,712	-	-	446,758	503,304	452,163	803,487
Accrued Interest	0%	50,579	-	50,579	-	-	-	-
Other Local Currency Financial Assets	1.25%	1,265	-	1,000	86	37	142	-
Non-Financial Assets	0%	59,501	59,501	-	-	-	-	-
Total Local Currency Assets	5.66%	5,380,783	59,501	3,115,305	446,844	503,341	452,305	803,487
Local Currency Financial Liabilities								
Government Deposits	4.50%	2,880,976	-	2,880,976	-	-	-	-
Other Deposits	0.57%	45,169	-	45,169	-	-	-	-
Accrued Interest	0%	408	-	408	-	-	-	-
Other Liabilities	0%	2,055,692	2,055,692	-	-	-	-	-
Equity	0%	404,890	404,890	-	-	-	-	-
Total Local Currency Liabilities and Equity	2.41%	5,387,135	2,460,582	2,926,553	-	-	-	-
Local Currency Interest Rate Sensitivity Gap		(6,352)	(2,401,081)	188,752	446,844	503,341	452,305	803,487
On-Balance Sheet Interest Rate Sensitivity Gap		-	(2,401,081)	227,727	631,618	187,364	575,169	779,203
Off-Balance Sheet Instruments		-	-	-	-	-	-	-
Total Interest Rate Sensitivity Gap		-	(2,401,081)	227,727	631,618	187,364	575,169	779,203
All Currencies		-	(2,401,081)	227,727	631,618	187,364	575,169	779,203
New Zealand		(6,352)	(2,401,081)	188,752	446,844	503,341	452,305	803,487
United States		3,219	-	165,812	(57,626)	(189,670)	71,039	13,664
Euro		1,400	-	(215,286)	242,400	(126,307)	88,285	12,308
Japan		1,500	-	88,216	-	-	(36,460)	(50,256)
Other		233	-	233	-	-	-	-

14. Credit Risk

Credit risk is the risk of loss arising from a counterparty to a financial contract failing to discharge its obligations.

(a) Credit Risk Management

Credit risk in the foreign currency portfolios is monitored and managed daily. End-of-day exposures are controlled through comprehensive individual counterparty and issuer credit limits. Exposures against these limits are measured in credit-equivalent terms depending on the nature of the exposure. Exposures to particular classes of counterparty are constrained by aggregate credit limits. Counterparties are allocated to a particular class based mainly on their credit rating. Geographical exposures are controlled by country limits. Limits are updated as necessary when new market information emerges, with all limits formally reviewed on an annual basis.

Credit risk in the local currency portfolios is also monitored and managed daily. Intra-day and inter-day exposures are controlled through comprehensive individual counterparty and issuer limits. Exposures to the New Zealand government are not included in this credit framework. Most exposures arise under intra-day reverse-repurchase agreements entered into with settlement account holders under the real time gross settlement system. Securities that the Bank accepts under intra-day reverse-repurchase agreements include New Zealand government bonds, Treasury bills, and short term paper issued by registered banks, local authorities and highly rated corporates. The securities are held in the Bank's name for the duration of the exposure and there is no charge for this intra-day liquidity. The exposures to the counterparty from whom securities are purchased under reverse-repurchase agreements are monitored but are not subject to formal limits. The Bank usually only accepts New Zealand government paper in its inter-day liquidity management operations. However, as part of the Year 2000 contingency plan, the Bank accepted (two name) bank paper in open market operations and overnight reverse-repurchase transactions from 1 December 1999 until 7 January 2000.

The maximum loss that the Bank would suffer as a result of a security issuer defaulting is the value reported in the accounts.

(b) Concentrations of Credit Exposure

The Bank's significant end-of-year concentrations of credit exposure by industry type were as follows.

	2000 \$000	1999 \$000
New Zealand Government	4,005,923	5,286,108
Other Sovereign Issuers (excluding New Zealand Government)	4,887,780	5,844,460
Supranational Financial Institutions	112,483	182,197
Foreign Banks	898,036	436,705
Other	127	64,430
Total Financial Assets	9,904,349	11,813,900

Credit exposures arising from securities purchased under agreements to re-sell (reverse-repurchase agreements) are classified according to the issuer of the security for credit exposure concentration purposes. This is consistent with the Bank's view of the substance of the credit exposure and internal risk management purposes. An alternative approach would be to classify credit exposures arising from securities purchased under agreements to re-sell according to the counterparty to the transaction. Using this approach would result in credit exposures of \$1.35 billion (1999 \$1.86 billion) being reported against securities trading firms and \$1.6 billion (1999 \$3.06 billion) reported against New Zealand banks instead of against Other Sovereign Issuers and the New Zealand Government respectively.

The Bank's maximum credit risk exposure in relation to derivatives is the cost of re-establishing the derivative contracts in the market in the event of the failure of the counterparty to fulfil its obligations. This cost is the fair value of the derivatives as reported in Note 11. Fair Value of Financial Instruments.

The Bank's significant end-of-year concentrations of credit exposure by geographical area (based on the entity's country of ownership) were as follows.

	2000 \$000	1999 \$000
New Zealand	4,006,051	5,286,357
USA	2,039,004	2,213,410
Japan	2,062,607	2,045,851
Germany	1,092,673	1,894,100
Supranational Financial Institutions	112,483	182,197
Other	591,531	191,985
Total Financial Assets	9,904,349	11,813,900

(c) *Credit Exposure by Credit Rating*

The following table presents the Bank's financial assets based on Standard and Poor's credit rating of the issuer. AAA is the highest quality rating possible and indicates the entity has an extremely strong capacity to pay interest and principal. AA is a high grade rating indicating a very strong capacity and A is an upper medium grade indicating a strong capacity. BBB is the lowest investment grade rating indicating a medium capacity to pay interest and principal. Ratings lower than AAA can be modified by + or - signs to indicate relative standing within the major categories. N/R indicates the entity has not been rated by Standard and Poor's.

	Credit Rating	2000 \$000	% of 2000 financial assets	1999 \$000	% of 1999 financial assets
Foreign Currency Financial Assets					
Cash Balances with Other Central Banks	AAA	105,537	1.1%	380,953	3.2%
	AA+	-	-	165	0%
Other Cash Balances	AA	3,037	0.0%	-	-
Marketable Securities	AAA	3,625,820	36.6%	3,796,076	32.2%
	AA+	205,975	2.1%	63,793	0.5%
	AA	245,663	2.5%	81,820	0.7%
	AA-	149,422	1.5%	197,625	1.7%
Receivable from Unsettled Sales of Securities	AAA	90,524	0.9%	41,435	0.4%
Securities Purchased Under Agreements to Re-sell	AAA	1,314,560	13.3%	1,860,245	15.7%
Accrued Interest	Various	71,380	0.7%	70,506	0.6%
		5,811,918	58.7%	6,492,618	55.0%
Local Currency Financial Assets					
Cash on Hand	AA	-	-	78	0%
	N/A	58	0.0%	-	-
Securities Purchased Under Agreements to Re-sell	AA+	1,600,265	16.1%	3,063,648	25.9%
Investment Portfolio - NZ Government Securities	AA+	2,445,433	24.7%	2,205,712	18.7%
Accrued Interest	AA+	46,584	0.5%	50,579	0.4%
Other Local Currency Financial Assets	AA	-	-	1,000	0%
	N/R	91	0.0%	265	0%
		4,092,431	41.3%	5,321,282	45.0%
Total Financial Assets		9,904,349	100.0%	11,813,900	100.0%

	Credit Rating	2000 \$000	% of 2000 financial assets	1999 \$000	% of 1999 financial assets
Summary by Major Credit Category					
Foreign Currency Financial Assets	AAA	5,136,441	51.9%	6,078,709	51.5%
	AA+/-	604,097	6.1%	343,403	2.9%
	Various	71,380	0.7%	70,506	0.6%
Total Foreign Currency Financial Assets		5,811,918	58.7%	6,492,618	55.0%
Local Currency Financial Assets	AA+/-	4,092,282	41.3%	5,321,017	45.0%
	N/R	91	0%	265	0%
	N/A	58	0%	-	-
Total Local Currency Financial Assets		4,092,431	41.3%	5,321,282	45.0%
Total Financial Assets		9,904,349	100.0%	11,813,900	100.0%

(d) *Credit Exposure by Counterparty*

The table below shows the number of issuers where the Bank's credit exposures equalled or exceeded 10% of equity¹⁵ for:

- End-of-year actual credit exposure.
- Peak end-of-day credit exposure (on the basis of limits).
- Peak local currency intra-day credit exposures (on the basis of limits). These exposures arise through intra-day reverse-repurchase agreements entered into with settlement account holders under the real time gross settlement system.

<i>% of equity</i>	End-of-year 2000	End-of-year 1999	Peak end-of-day 2000	Peak end-of-day 1999	Peak local currency intra-day 2000	Peak local currency intra-day 1999
10% to 19.9%	6	7	29	28	19	21
20% to 29.9%	5	1	1	1	1	1
30% to 39.9%	1	-	16	16	11	1
40% to 49.9%	-	-	2	2	-	10
60% to 69.9%	-	-	20	19	-	-
70% to 79.9%	-	-	-	1	-	-
80% to 89.9%	-	-	2	-	-	-
90% to 99.9%	-	-	14	16	-	-
100% to 109.9%	-	-	3	-	-	-
110% to 119.9%	-	-	3	3	-	-
120% to 129.9%	-	-	-	3	-	-
130% to 139.9%	-	-	2	-	-	-
140% to 149.9%	-	-	-	2	-	-
150% to 159.9%	-	-	-	-	-	-
190% to 199.9%	1	-	9	9	-	-
240% to 249.9%	-	-	1	1	-	-
410% to 419.9%	-	1	-	-	-	-
430% to 439.9%	-	-	-	-	-	-
490% to 499.9%	1	-	2	2	-	-
500% to 509.9%	-	2	-	-	-	-
510% to 519.9%	-	-	-	-	-	-
520% to 529.9%	1	-	-	-	-	-
610% to 619.9%	-	-	-	1	-	-
740% to 749.9%	-	-	1	1	-	-
780% to 789.9%	-	-	1	-	-	-

Peak end-of-day exposures greater than 100% were to foreign banks, supranational financial institutions and sovereign issuers. End-of-year exposures greater than 100% were to highly-rated sovereign issuers.

15 Excludes exposures to the New Zealand government.

15. Foreign Currency Risk

Foreign currency risk is the risk of loss arising from changes in exchange rates. The Reserve Bank is not exposed to any significant foreign currency risk. The assets held in foreign currency portfolios are matched by foreign currency liabilities of approximately equal value. All foreign exchange trading exposures are constrained by low intra-day and overnight position limits and stop-loss limits (monitored on a daily basis). Foreign currency assets and liabilities arising from domestic monetary policy implementation activity are fully hedged using foreign currency swaps.

As at 30 June, the Reserve Bank's net exposure to major currencies, including forward foreign exchange swap contracts and foreign currency swaps, was as follows.

	Currency of Denomination				Total All Currencies \$000
	United States Dollar \$000	Euro \$000	Japanese Yen \$000	Other Currencies \$000	
<i>As at 30 June 2000</i>					
Foreign Currency Financial Assets					
Cash Balances with Other Central Banks	102,965	2,223	74	275	105,537
Other Cash Balances	882	810	1,345	-	3,037
Marketable Securities	1,814,744	727,600	1,684,536	-	4,226,880
Receivable from Unsettled Sales of Securities	-	49,667	40,857	-	90,524
Securities Purchased Under Agreements to Re-sell	1,118,840	154,828	40,892	-	1,314,560
Accrued Interest	28,902	29,351	13,127	-	71,380
Total Foreign Currency Financial Assets	3,066,333	964,479	1,780,831	275	5,811,918
Foreign Currency Financial Liabilities					
Payable for Unsettled Purchases of Securities	-	41,877	81,220	-	123,097
Short Sales of Marketable Securities	21,324	124,423	40,789	-	186,536
Securities Sold Under Agreements to Repurchase	866,936	-	44,682	-	911,618
Term Liabilities	2,132,318	772,063	1,592,590	-	4,496,971
Accrued Interest	47,252	25,505	21,890	-	94,647
Total Foreign Currency Financial Liabilities	3,067,830	963,868	1,781,171	-	5,812,869
Off-Balance Sheet Instruments	-	-	-	-	-
Net Currency Exposure	(1,497)	611	(340)	275	(951)

	Currency of Denomination				Total All Currencies \$000
	United States Dollar \$000	Euro \$000	Japanese Yen \$000	Other Currencies \$000	
<i>As at 30 June 1999</i>					
Foreign Currency Financial Assets					
Cash Balances with Other Central Banks	363,734	357	16,794	233	381,118
Other Cash Balances	-	-	-	-	-
Marketable Securities	1,555,182	1,117,356	1,466,776	-	4,139,314
Receivable from Unsettled Sales of Securities	-	41,435	-	-	41,435
Securities Purchased Under Agreements to Re-sell	829,965	721,385	308,895	-	1,860,245
Accrued Interest	25,421	32,752	12,333	-	70,506
Total Foreign Currency Financial Assets	2,774,302	1,913,285	1,804,798	233	6,492,618
Foreign Currency Financial Liabilities					
Payable for Unsettled Purchases of Securities	-	283,221	-	-	283,221
Short Sales of Marketable Securities	72,724	228,011	298,853	-	599,588
Securities Sold Under Agreements to Repurchase	754,830	204,127	231,643	-	1,190,600
Term Liabilities	1,903,804	1,154,599	1,254,639	-	4,313,042
Accrued Interest	39,725	41,927	18,163	-	99,815
Total Foreign Currency Financial Liabilities	2,771,083	1,911,885	1,803,298	-	6,486,266
Off-Balance Sheet Instruments	-	-	-	-	-
Net Currency Exposure	3,219	1,400	1,500	233	6,352

16. Liquidity Risk

Liquidity risk is the risk that an entity will encounter difficulty in raising funds at short notice to meet commitments associated with financial instruments. Liquidity risk is also the risk that an entity will have to sell a financial asset quickly at much less than its fair value.

Foreign Currency Activities

Liquidity is a key criterion in determining the composition of the Bank's foreign currency assets. This reflects the potential requirement to liquefy foreign reserves for intervention purposes should the need arise. Accordingly, there is an array of interacting controls aimed at ensuring quick access to funds. These controls include liquid asset ratios based on the liquidity characteristics of securities held and limits on the minimum and maximum proportion of reserves that may be held in any one currency. These limits are monitored on a daily basis.

The Bank has additional liquidity arrangements for foreign currency assets including:

- Repurchase agreements with other central banks that provide for the Bank to sell securities in exchange for foreign currency, while simultaneously agreeing to repurchase those same securities at a specified later date for an agreed amount. In essence, the arrangement allows the Bank to enhance the liquidity of its foreign reserves portfolio with minimum additional risks.
- Maintaining a standby credit facility (US \$100 million) to augment the amount of foreign currency that can be accessed.

Local Currency Activities

The Bank is responsible for managing the daily liquidity of the banking system. This includes advancing and withdrawing funds from the banking system in order to smooth out the daily peaks and troughs. The nature of these activities, which mostly involve offsetting the flow of funds from one Bank customer (the Crown) to other Bank customers (settlement banks on behalf of their clients), is such that the Bank is not subject to the liquidity constraints that impact on other organisations.

Consolidated Statement of Financial Performance Notes

17. Interest Income from Financial Assets

	2000 \$000	1999 \$000
Interest Income from Foreign Currency Financial Assets		
Cash Balances with Other Central Banks	23,060	11,811
Other Cash Balances	39	-
Marketable Securities	130,657	154,760
Short-Term Advances	-	2,130
Securities Purchased Under Agreements to Re-sell	11,215	19,862
Securities Lending	584	737
International Monetary Fund	-	8,783
Total Interest Income from Foreign Currency Financial Assets	165,555	198,083
Interest Income from Local Currency Financial Assets		
Securities Purchased Under Agreements to Re-sell	78,139	42,544
Advances to Government	-	44,837
Investment Portfolio - NZ Government Securities	170,220	164,079
Government Bank Accounts	211	1,027
Advances to Staff	19	24
Term Loans	2	5
Other Securities	14	46
Total Interest Income from Local Currency Financial Assets	248,605	252,562
Total Interest Income from Financial Assets	414,160	450,645

18. Interest Expense on Financial Liabilities

	2000 \$000	1999 \$000
Interest Expense on Foreign Currency Financial Liabilities		
Securities Sold Under Agreements to Repurchase	3,560	11,132
Term Liabilities	172,670	178,205
IMF Special Drawing Rights	-	6,672
Total Interest Expense on Foreign Currency Financial Liabilities	176,230	196,009
Interest Expense on Local Currency Financial Liabilities		
Government Deposits	76,862	33,326
Other Deposits	4,782	1,950
Reserve Bank Bills	-	44,202
Total Interest Expense on Local Currency Financial Liabilities	81,644	79,478
Total Interest Expense on Financial Liabilities	257,874	275,487

19. Net Foreign Exchange Revaluation Gain (Loss)

	2000 \$000	1999 \$000
Foreign Exchange Revaluations:		
Gain (Loss) on Financial Assets	700,656	26,746
Gain (Loss) on Financial Liabilities	(701,095)	(27,647)
Net Foreign Exchange Revaluation Gain (Loss)	(439)	(901)

20. Other Income

	Actual 2000 \$000	Budget 2000 \$000	Actual 1999 \$000
Fees for Registry Services	5,371	5,833	6,225
Sales of Collectors' Currency	2,560	3,601	1,539
Rental Income from Properties	1,571	1,492	1,731
Registered Bank Fees	3	5	5
Currency Distribution Income	396	417	499
Overseas Investment Commission Fees	627	711	763
Miscellaneous	870	813	955
Total Other Income	11,398	12,872	11,717

21. Asset Management Expenses

	Actual 2000 \$000	Budget 2000 \$000	Actual 1999 \$000
Depreciation	3,563	3,725	3,372
(Gain) Loss on Disposal of Fixed Assets	411	(8)	3
Other Asset Management Expenses	2,315	2,662	2,666
Total Asset Management Expenses	6,289	6,379	6,041

22. Other Operating Expenses

	Actual 2000 \$000	Budget 2000 \$000	Actual 1999 \$000
Other Professional Fees	2,051	1,903	1,722
Computer Expenses	1,658	1,517	1,732
Information	1,076	1,026	940
Operational Travel	708	683	667
Rental and Lease Expenses	255	398	254
Printing	239	243	306
Agency and Commissions	411	629	293
Audit Fees	232	234	235
Non-Executive Directors' Remuneration	105	105	100
Donations	4	7	1
Miscellaneous	273	297	608
Total Other Operating Expenses	7,012	7,042	6,858

Other Operating Expenses include \$44,000 (1999 \$117,000) paid to the Bank's auditors for work undertaken outside their capacity as auditors of the Bank.

Consolidated Statement of Cost of Services Notes

23. Currency Operations

The Reserve Bank owns properties in Auckland and Wellington. As these buildings are primarily designed for secure currency operations, their operating costs are reported as part of the Currency Operations function.

The buildings also provide office accommodation for other Bank functions. These functions pay market rentals via internal costing systems. Surplus office space is rented to other parties on market terms.

As part of the Currency Operations function, the Bank issues collectors' currency. The net gain for this activity in 1999/2000 was \$1,522,000 (1999 \$44,000 loss). The 1999 result included redundancy expenses of \$305,000 arising from providing for restructuring Collectors' Currency Operations during the 1999/2000 financial year. This restructuring has been delayed and is expected to occur during the 2000/2001 year.

Seigniorage is the income directly associated with the issue of currency and provides the Bank with its main source of income. Registered banks pay the Reserve Bank the face value of the currency issued to them. These funds are invested in New Zealand government securities, which are included in local currency financial assets, to back the currency in circulation liability. Currency in circulation is a non-interest bearing liability. However, the New Zealand government securities investment portfolio is interest bearing. The resulting interest income is seigniorage.

Packaging and handling fees are charged to banks for the provision of currency distribution services.

	2000 \$000	1999 \$000
Seigniorage	161,941	141,705
Sales of Collectors' Currency	2,560	1,538
Rental Income from Properties	1,571	1,731
Currency Distribution Income	396	499
Other Income	30	44
Operating Income	166,498	145,517
New Note Issue Expenses	5,727	6,180
New Coin Issue Expenses	3,079	1,410
Collectors' Currency Issue Expenses	535	733
Currency Issue Expenses	9,341	8,323
Currency Processing Expenses	9,938	11,605
Net Property Management Expenses (Income)	(81)	(292)
Operating Expenses	19,198	19,636
Currency Operations Function Operating Surplus	147,300	125,881

24. Foreign Reserves Management

The Reserve Bank holds foreign currency assets to enable intervention in the foreign exchange market, should that ever prove necessary. These foreign reserves are fully funded by foreign currency borrowings through the Treasury. New Zealand pays more to borrow overseas than it can earn investing in high quality assets able to be realised quickly. As a result, holding reserves involves a small net cost, although some reduction in that cost is possible through active management of the holdings. The Bank specifies a neutral asset portfolio designed to limit interest rate and exchange rate mismatches against the liabilities and departures from the neutral asset portfolio (active management) arise from discretionary positions taken by specialist staff, trading strategies pre-agreed with senior management and the cross-currency swap. The net income arising from departures from the neutral asset portfolio represents the active management of reserves.

	2000 \$000	1999 \$000
Departures from Neutral Positions	(4,100)	6,608
Gain (Loss) on Neutral Asset/Liability Structure	7,400	(2,744)
Net Investment Income	3,300	3,864
Other	(597)	(208)
Foreign Exchange Difference on Translation	-	(322)
Foreign Reserves Management Gain (Loss)	2,703	3,334
Income on IMF Reserve Position	-	8,900
Residual Income Allocation	13,844	14,718
Operating Income	16,547	26,952
Operating Expenses	3,699	3,955
Foreign Reserves Management Function Operating Surplus	12,848	22,997

The Foreign Reserves Management function was responsible for holding New Zealand's International Monetary Fund Special Drawing Rights, prior to the role's transfer to Treasury during 1998/1999. Hence, the income from this role was reported as part of the Foreign Reserves Management function during 1998/1999.

Residual Income Allocation represents the income earned from the assets funded by the Bank's net equity, which is allocated equally to the Foreign Reserves Management and Market Operations functions.

For further information on the Foreign Reserves Management function, see Note 1. Nature and Extent of Activities, parts (a) to (e). Further information on the risk management structure is contained in notes 12 to 16.

Other Notes

25. Reconciliation of Operating Cash Flows with Reported Operating Surplus

	2000 \$000	1999 \$000
Reported Operating Surplus	159,265	152,971
Add (Subtract) Non-Cash Items:		
Depreciation	3,563	3,372
Amortisation of Premium/Discount on Purchase of Securities	71,639	1,557
Net Unrealised Price Revaluations	(20,458)	29,283
Write-off of Demonetised Coins	7	-
Net Unrealised Foreign Exchange (Gain) Loss ¹⁶	569,348	(117,280)
	624,099	(83,068)
Add (Subtract) Movements in Other Working Capital Items:		
Decrease in Accounts Receivable	358	(228)
Decrease in Miscellaneous Liabilities	(247)	8,499
Increase in Inventories	(1,029)	(792)
Decrease in Interest Payable	(5,331)	(22,503)
Decrease in Interest Receivable	3,121	19,411
Increase in Deferred Taxation	(154)	16
	(3,282)	4,403
Add (Subtract) Investing and Financing Activities:		
Net Realised Foreign Exchange (Gain) Loss	(568,909)	118,181
Net Realised Price Revaluations	3,948	(45,235)
Net Cash Flow from Operating Activities	215,121	147,252

¹⁶ This represents the net unrealised effect of exchange rate movements on the Bank's foreign currency assets and liabilities. The net effect on the Bank's overall results, after allowing for realised exchange rate gains and losses, is a net loss of \$439,000 (1999 \$901,000 loss).

26. Consolidated Cash Balances

	2000 \$000	1999 \$000
Foreign Currency Assets:		
Cash Balances with Other Central Banks	105,536	381,118
Other Cash Balances	3,037	-
Marketable Securities - Liquifiable within two working days	2,960,834	3,215,883
Local Currency Assets:		
Cash on Hand	58	78
Securities Purchased Under Agreements to Re-sell	1,600,265	3,063,648
	4,669,730	6,660,727
Demand Liabilities:		
Government Deposits	1,327,376	2,880,976
Settlement Bank Deposits	48,503	1,141
Central Bank Deposits	2,684	2,030
Staff Deposits	-	4,818
International Monetary Fund Deposit	26,297	37,180
Other Deposits	209	-
	1,405,069	2,926,145
Closing Cash Balances	3,264,661	3,734,582

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27. Statement of Commitments

The Bank is committed to pay an annual lease for computer workstations of \$162,000 per annum until August 2002.

28. Free Services

The Reserve Bank of New Zealand Act 1989 empowers the Bank to charge directly for some of its functions.

Some services are provided free of charge. These include services such as providing information to Ministers and Parliament, contributing to policy and briefing papers, providing information to the public, storing official documents securely, and providing information and library facilities to parties such as government departments and economic research organisations.

The Reserve Bank receives some free services from other organisations. In general, these relate to the provision of information necessary to perform the Bank's functions.

The Bank liaises closely with other central banks and international agencies. Information and staff training are exchanged free of charge with these institutions.

29. Related Parties

In the normal course of its operations, the Bank enters into transactions with related parties. Related parties include the Crown, as ultimate owner of the Reserve Bank, various government departments and Crown entities.

Transactions entered into include:

- (a) banking services;
- (b) agency transactions (at no charge);
- (c) foreign exchange transactions; and
- (d) funding from the Treasury as part of the foreign reserves management operations.

The Bank does not present the values of transactions and outstanding balances with Crown-related parties due to the large volume of transactions and the large number of related parties. Unless otherwise stated, all transactions take place with reference to market rates. Therefore, disclosure of the values of transactions and outstanding balances with Crown entities would not provide useful or material additional information.

30. Contingent Liabilities

- (a) In terms of a Trust Deed dated 16 May 1980, the Reserve Bank has a contingent liability to maintain the actuarial soundness of the Reserve Bank of New Zealand Staff Superannuation and Provident Fund, following each triennial review of the Fund.

On 2 February 1995, the Bank ceased making contributions to the defined benefit division of the Fund on the advice of the Fund's Actuary that such contributions were no longer necessary. The position is re-examined as part of each triennial review (last completed for the period ended 31 March 1999).

The Actuary performed a limited scope investigation on the financial position of the Fund based on the Fund's annual accounts as at 31 March 2000. The Actuary reported on 19 July 2000 that:

- (i) the assets of the Fund would have been sufficient at 31 March 2000 to provide for the benefits payable to or in respect of all members, including existing pensioners, in the event of the Fund being wound up at that time;
 - (ii) the assets of the Fund would have been sufficient at 31 March 2000 to provide for benefits to members, including existing pensioners, that are attributable to membership prior to 1 April 2000; and
 - (iii) to his knowledge, there had been no circumstances between 31 March 2000 and 30 June 2000 that would cause him to form a different opinion as at 30 June 2000.
- (b) Coin issued by the Treasury prior to July 1989 is not recorded by the Reserve Bank within the total of currency in circulation. The Bank has accepted liability for all coin in the first instance, whether issued by the Treasury or the Bank. However, should coin returned to the Bank exceed that issued by the Reserve Bank, the liability for the excess would revert to the Treasury. The face value of coin issued by the Treasury is \$87,702,000.
 - (c) The Bank has a contingent liability for currency in circulation that has been demonetised but not returned to the Bank. The face value of demonetised currency is \$37,174,000. This includes coin issued by Treasury with a face value of \$12,950,000.

- (d) The Bank has a liability for the face value of collectors' currency. However, it is most unlikely that significant amounts of collectors' currency will be returned for redemption at face value. The face value of all collectors' currency issued by the Bank to date is \$8,418,000 (1999 \$7,399,000).

Collectors' coin was issued by the Treasury prior to July 1989. Particular specimens of series issued both before and after 1989 are not generally distinguishable. The Bank has in practice accepted a contingent liability for all collectors' coin, but part of this liability could revert to the Treasury should large quantities of coin be returned.

- (e) The Bank has indemnified the statutory managers of DFC New Zealand Limited against liability arising from the statutory management of DFC New Zealand Limited, which essentially ended on 15 October 1997. However, these indemnities continue and were given under sections 5 and 39 of the Reserve Bank of New Zealand Act 1989, on substantially the same terms as those provided by the Crown under Part V of the Reserve Bank of New Zealand Act 1989.

Previous Year's Contingent Liabilities

The above five contingent liabilities were recorded in the Reserve Bank's 1999 *Annual Report*. The only liabilities to arise during the year were:

- (i) demonetised currency with a face value of \$39,089 was returned to the Bank for redemption at face value; and
- (ii) collectors' currency with a face value of \$1,140 was returned to the Bank for redemption at face value.

RBNZ Registry Limited Notes

31. RBNZ Registry Limited

The Reserve Bank operates registry services through a wholly-owned subsidiary company, RBNZ Registry Limited. The Bank provides various support services to RBNZ Registry Limited and charges for these services at their cost to the Bank.

Abridged audited financial statements follow. The accounting policies used to prepare the statements are identical to the Reserve Bank of New Zealand accounting policies.

RBNZ Registry Limited Abridged Statement of Financial Position

<i>As at 30 June</i>	2000 \$000	1999 \$000
Assets:		
Current Assets	7,813	11,356
Non-Current Assets	459	646
Total Assets	8,272	12,002
Liabilities:		
Current Liabilities	4,906	8,828
Equity:		
Issued Capital	3,000	3,000
Retained Earnings	366	174
Total Liabilities and Equity	8,272	12,002

RBNZ Registry Limited Abridged Statement of Financial Performance

<i>For the year ended 30 June</i>	2000 \$000	1999 \$000
Operating Income	6,317	7,175
Operating Expenses	6,026 ¹⁷	5,223
Net Surplus Before Tax	291	1,952
Taxation	99	645
Net Surplus After Tax	192	1,307

RBNZ Registry Limited Abridged Statement of Movements in Equity

<i>For the year ended 30 June</i>	2000 \$000	1999 \$000
Equity at Start of Year	3,174	3,867
Net Surplus for the Year	192	1,307
Less Dividend Provided For	-	2,000
Equity at End of Year	3,366	3,174

17 Includes \$746,000 provided for restructuring costs as described in note 8.

32. Taxation

Section 180 of the Reserve Bank of New Zealand Act 1989 exempts the Reserve Bank from income tax. The Bank incurs and meets liabilities for goods and services tax and fringe benefit tax.

The Bank's subsidiary company, RBNZ Registry Limited, is liable for income tax. The table below relates only to RBNZ Registry Limited.

<i>For the year ended 30 June</i>	2000 \$000	1999 \$000
Income Tax Expense:		
Net Surplus Before Tax	291	1,952
Add Back Permanent Difference	9	3
	300	1,955
Income Tax Expense at 33%	99	645
Current Tax Charge:		
Tax Effect of Timing Differences	154	(15)
Current Tax Charge	253	630
Deferred Taxation:		
Opening Balance	(60)	(76)
Deferred Portion of Current Tax Charge	(154)	16
Deferred Taxation Liability (Asset)	(214)	(60)

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33. Custodial Activities

The Reserve Bank of New Zealand operates the Austraclear New Zealand System, which is a securities clearing and settlement system. It holds assets on behalf of the participants in the name of New Zealand Central Securities Depository Limited (NZCSD), which it has appointed as custodian trustee in terms of the Trustee Act 1956.

NZCSD is a wholly-owned subsidiary of the Reserve Bank of New Zealand, which in terms of a Deed of Appointment between the Reserve Bank of New Zealand and NZCSD dated 19 May 1995 is incorporated solely for the purpose of acting as a custodian trustee. With the exception of the local currency securities owned by the Bank and held through NZCSD, the Reserve Bank has no beneficial interest in the securities that NZCSD holds, or any management obligations apart from safe-keeping.

The total of securities held by NZCSD at 30 June 2000 was \$79.2 billion (1999 \$83.0 billion).