CONTENTS OF THE FINANCIAL STATEMENTS

RESERVE BANK
OF NEW ZEALAND

23 August 2005

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 2005 fairly reflect the financial position and operations of the Bank.

Alan Bollard

Governor

Deputy Governor

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Audit Report

To the readers of the
RESERVE BANK OF NEW ZEALAND AND GROUP'S FINANCIAL STATEMENTS
For the year ended 30 June 2005

The Auditor-General is the auditor of the Reserve Bank of New Zealand and group. The Auditor-General has appointed me, Jim Chin, using the staff and resources of PricewaterhouseCoopers, to carry out the audit of the financial statements of the Reserve Bank of New Zealand and group, on his behalf, for the year ended 30 June 2005.

Unqualified Opinion

In our opinion the financial statements of the Reserve Bank of New Zealand and group on pages 54 to 102:

- comply with generally accepted accounting practice in New Zealand; and
- fairly reflect:
  - the Reserve Bank of New Zealand and group's financial position as at 30 June 2005; and
  - the results of their operations and cash flows for the year ended on that date.

The audit was completed on 23 August 2005, and is the date at which our opinion is expressed.

The basis of our opinion is explained below. In addition, we outline the responsibilities of the Governor and the Auditor, and explain our independence.

Basis of Opinion

We carried out the audit in accordance with the Auditor-General's Auditing Standards, which incorporate the New Zealand Auditing Standards.

We planned and performed the audit to obtain all the information and explanations we considered necessary in order to obtain reasonable assurance that the financial statements did not have material misstatements, whether caused by fraud or error.

Material misstatements are differences or omissions of amounts and disclosures that would affect a reader's overall understanding of the financial statements. If we had found material misstatements that were not corrected, we would have referred to them in our opinion.

The audit involved performing procedures to test the information presented in the financial statements. We assessed the results of those procedures in forming our opinion.

Audit procedures generally include:
- determining whether significant financial and management controls are working and can be relied on to produce complete and accurate data;
- verifying samples of transactions and account balances;
- performing analyses to identify anomalies in the reported data;
- reviewing significant estimates and judgements made by the Governor;
- confirming year-end balances;
- determining whether accounting policies are appropriate and consistently applied; and
- determining whether all financial statement disclosures are adequate.

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We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements.

We evaluated the overall adequacy of the presentation of information in the financial statements. We obtained all the information and explanations we required to support our opinion above.

Responsibilities of the Governor and the Auditor

The Governor is responsible for preparing financial statements in accordance with generally accepted accounting practice in New Zealand. Those financial statements must fairly reflect the financial position of the Reserve Bank of New Zealand and group as at 30 June 2005. They must also fairly reflect the results of the Reserve Bank of New Zealand and group's operations and cash flows for the year ended on that date. The Governor's responsibilities arise from the Reserve Bank of New Zealand Act 1989.

We are responsible for expressing an independent opinion on the financial statements and reporting that opinion to you. This responsibility arises from section 15 of the Public Audit Act 2001.

Independence

When carrying out the audit we followed the independence requirements of the Auditor-General, which incorporate the independence requirements of the Institute of Chartered Accountants of New Zealand.

In addition to the audit we have carried out assignments in the areas of systems audits, actuarial advice and accounting advice which are compatible with those independence requirements. Other than the audit and these assignments, we have no relationship with or interests in the Reserve Bank of New Zealand and group.

Jim Chin
On behalf of the Auditor-General
Wellington, New Zealand

PricewaterhouseCoopers

__Matters Relating to the Electronic Presentation of the Audited Financial Statements__

This audit report relates to the financial statements of the Reserve Bank of New Zealand and group for the year ended 30 June 2005 included on the Reserve Bank of New Zealand's web-site. The Reserve Bank of New Zealand's Governor is responsible for the maintenance and integrity of the Reserve Bank of New Zealand's web site. We have not been engaged to report on the integrity of the Reserve Bank of New Zealand's web site. We accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

The audit report refers only to the financial statements named above. It does not provide an opinion on any other information which may have been hyperlinked to/from these financial statements. If readers of this report are concerned with the inherent risks arising from electronic data communication they should refer to the published hard copy of the audited financial statements and related audit report dated 23 August 2005 to confirm the information included in the audited financial statements presented on this web site.

Legislation in New Zealand governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

MAIN FUNCTIONS OF THE RESERVE BANK

For the purpose of the *Annual Report* and for the Reserve Bank's planning and budgeting process, the Bank classifies its outputs according to its main functions in the ways described below.

Monetary Policy Formulation:

Developing monetary policy to achieve and maintain price stability in line with the Policy Targets Agreement.

Market Operations:

Trading, liaising with, and monitoring financial markets to effectively implement monetary policy and maintain the Bank's capacity to intervene in financial markets.

Financial System Surveillance:

Registering and supervising banks, promoting the efficiency and soundness of the New Zealand financial system, and limiting 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 to facilitate cash transactions in the community.

Foreign Reserves Management:

Managing the Bank's foreign reserves held to support the functions of the Bank, including monetary policy objectives and the maintenance of orderly markets.

Settlement Services:

Providing settlement services to the New Zealand Government, financial institutions, and appropriate overseas institutions to meet their banking needs and to facilitate effective implementation of monetary policy.

Registry and Depository Services:

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

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.

Other Outputs:

Producing other outputs that cannot be classified under the Bank's main functions. These include sundry economic policy advice and overseas representation and liaison.

Statement of Accounting Policies

(a) Reporting Entity and Statutory Base

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 (the Act). These statements apply to the financial year ended 30 June 2005. They are prepared in accordance with part VI of the Act, and comply with generally accepted accounting practice in New Zealand.

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

The Governor and Deputy Governor of the Reserve Bank authorised these financial statements for issue on 23 August 2005.

(b) Transition to New Zealand Equivalents to International Financial Reporting Standards

In December 2002, the Accounting Standards Review Board (ASRB) announced that entities required to comply with New Zealand Generally Accepted Accounting Practice (NZ GAAP) would be required to apply International Financial Reporting Standards (IFRS). The ASRB has approved a number of accounting standards (New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS)) that are based on IFRS. The new standards replace the current set of New Zealand developed Financial Reporting Standards and Statements of Standard Accounting Practice. Application of the new standards is mandatory for financial reports that cover an annual reporting period beginning on or after 1 January 2007.

The Bank, in line with most entities owned by the New Zealand Government, will adopt NZ IFRS for the year commencing 1 July 2007. The Bank's Financial Services Group has established a work programme to assess the impact of changes in financial reporting requirements on the Bank's financial statements and to implement any changes to processes required in order to deliver financial reporting on an NZ IFRS-compliant basis. The Financial Services Group provides progress reports to the Bank's Audit Committee.

Transition from existing NZ GAAP to NZ IFRS will be made in accordance with NZ IFRS 1 *First-Time Adoption of New Zealand Equivalents to International Financial Reporting Standards*. Upon adoption of NZ IFRS, comparative information will be restated to conform with the requirements of NZ IFRS.

The key areas of difference in accounting polices between existing NZ GAAP and NZ IFRS, that have been identified as relevant to the Bank to date, are set out below. The differences identified are based on work-in-progress as at the reporting date. The information provided in this note addresses significant items but does not represent a complete list of expected adjustments. The actual impact of adopting NZ IFRS may vary from the information presented and that variation may be material.

Classification of Financial Instruments

Under existing NZ GAAP, the Bank accounts for its holdings of New Zealand Government Securities on a yield-to-maturity basis, which reflects the Bank's intention to hold those securities to maturity. The Bank does not recognise unrealised gains and losses due to changes in the market value of those securities.

Under NZ IFRS, the Bank will be required to classify its holdings of New Zealand Government Securities into one of three categories:

- Held to Maturity
- Available for Sale
- Fair Value through Profit or Loss.

Because important changes to IAS 39 have been made by the International Accounting Standards Board and those changes are expected to be made to the New Zealand Equivalent standard NZ IAS 39, the Bank has not yet decided which classification to adopt in respect of its holdings of New Zealand Government Securities.

Valuation of Financial Instruments

NZ IAS 39 requires that in valuing financial instruments at fair value, the appropriate quoted market price to be used is usually the bid or offer price in respect of assets and liabilities, respectively. Currently all foreign currency assets and liabilities of the Bank which are measured at fair value and transacted in an active market are valued at a mid-price. It is acceptable to continue to use mid-price when there is an offsetting market risk position. Consequently, when there is no offsetting market risk position an adjustment is required to re-measure those assets and liabilities at either a bid or offer price, instead of mid-price. The impact of this change on the Statement of Financial Performance is not expected to be significant.

NZ IAS 39 includes prescriptive requirements for determining the fair value of financial instruments that are not traded in an active market. This is expected to result in changes to the methodology used by the Bank to measure the fair value of the foreign currency loans from the New Zealand

Debt Management Office. The Bank has not yet finalised the model to be used for determining the fair value of those loans and has not determined the extent of any adjustment required upon conversion to IFRS.

Post-Employment Benefits

NZ IAS 19 requires defined benefit pension and superannuation plan surpluses and deficits to be recognised in the Statement of Financial Position, with a corresponding entry made to retained earnings on initial transition to NZ IFRS. The size of the defined benefit superannuation scheme, the size of the scheme's current actuarial surplus, and its investment strategy, together with the actuarial work undertaken to date, indicates that the adjustment to retained earnings will not be material.

Public Benefit Entity

The Bank has received advice and concluded that, based on existing guidance, the Bank is a Public Benefit Entity (PBE). A PBE is a reporting entity whose primary objective is to provide goods and services for the community or social benefits and where any equity provided has been provided with a view to supporting that primary objective rather than for a financial return to equity holders.

PBEs are required to comply with a number of requirements under NZ IFRS that are not included in the equivalent IFRSs. For instance, the Bank will be required to comply with the PBE requirements under NZ IAS 2 *Inventories* in respect of its inventories of notes and coins. NZ IAS 2 requires inventories of PBEs to be valued at the lower of cost or current replacement cost, whereas IAS 2 requires inventories to be valued at the lower of cost or net realisable value. The difference is not expected to be material.

Demonetised Currency

The Reserve Bank Act states that the Bank has a liability for all currency in circulation, including notes and coins that are no longer legal tender and that are presented to the Bank for payment. Under NZ GAAP, when currency in circulation is demonetised, after allowing time for the currency to be presented, the Bank derecognises the liability for the face value of the demonetised currency that has not been presented and recognises a provision for the amount of that currency that it expects will be presented in future years. Under NZ IFRS, the Bank will no longer be permitted to derecognise the liability for demonetised currency which has not been presented. NZ IFRS does not permit liabilities derecognised before 1 July 2004 to be reinstated. The Bank has not derecognised any currency in circulation since 1 July 2004.

(c) Basis of Preparation of Financial Statements

The Bank's Financial Statements are prepared in accordance with New Zealand Generally Accepted Accounting Practice (NZ GAAP).

Measurement Base

The financial statements are prepared on the historical cost basis, modified by the revaluation of certain assets and liabilities as identified in specific accounting policies below.

Basis of Consolidation

The consolidated financial statements are prepared using the purchase method. All material inter-company balances and transactions are eliminated. Parent financial statements are not produced because the difference between the parent and group financial statements is not material.

Segmental Reporting

The Reserve Bank presents financial assets and financial liabilities, and their 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.

Custodial Activities

Securities held by the Reserve Bank under custodial arrangements are not included in these financial statements (see note 44).

Currency of Presentation

All amounts are expressed in New Zealand dollars unless otherwise stated.

Foreign Currency Conversions

Transactions in foreign currencies are translated to New Zealand dollars using exchange rates applying on the trade date of transactions. Foreign currency assets and liabilities are translated to New Zealand dollars using mid-market exchange rates applying at balance date. The following New Zealand dollar exchange rates for major currencies are used to convert foreign currency assets and liabilities to New Zealand dollars for reporting purposes.

	2005	2004
euro	**0.5752**	0.5214
United States dollars	**0.6962**	0.6360
SDR[35]	**0.4774**	0.4330

35 SDR (Special Drawing Right) is the unit of account of the International Monetary Fund (IMF). The SDR's value is based on a basket of currencies (currently the United States dollar, euro, Japanese yen and pound sterling). The basket is reviewed by the IMF every five years to ensure the currencies included are representative of those used in international transactions and the weightings assigned to each currency reflect its relative importance in the world's trading and financial system.

Comparative Amounts

To ensure consistency with the current year, comparative figures have been restated where appropriate.

Changes in Accounting Policies

There have been no material changes to the Reserve Bank's accounting policies for the year ended 30 June 2005, and uniform accounting policies have been applied throughout the Bank.

(d) 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 and from dealings in foreign currency for monetary policy implementation purposes. Local currency activities mainly reflect the assets and liabilities associated with the Market Operations function and investment of the proceeds from issuing circulating currency.

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 information value of the financial statements. Also refer to note 1 for an explanation of the nature and extent of the Bank's activities relating to financial assets and liabilities.

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 instruments are recognised from the date at which the purchase or sale is agreed.

Foreign Currency Marketable Securities

Foreign currency Marketable Securities are reported at fair value at quoted mid-market 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 fair value are recognised as an increase or decrease in the value of Marketable Securities in the Statement of Financial Position.

Gains and losses arising from changes in the fair value of foreign currency Marketable Securities are recognised in the Statement of Financial Performance as Gain/(Loss) from Fair Value Changes.

Foreign Currency Term Liabilities

Foreign currency Term Liabilities are reported at fair value. The funds from these liabilities are invested in foreign currency Marketable Securities. This valuation policy ensures consistency with the policy adopted for the corresponding assets. 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 arising from changes in fair value of foreign currency term liabilities are recognised in the Statement of Financial Performance as Loss/(Gain) from Fair Value Changes.

Repurchase and Reverse-Repurchase Transactions

Securities sold under agreements to repurchase are recorded as Marketable Securities in the Statement of Financial Position. The obligation to repurchase the securities is disclosed within liabilities as Securities Sold Under Agreements to Repurchase. 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 within assets as 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 transaction value inclusive of any accrued income or expense.

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 Financial Instruments

The Bank's involvement in derivative financial instruments comprises forward foreign exchange contracts, interest rate and commodities futures, and interest rate swaps.

All derivative financial instruments in a gain position are reported in the Statement of Financial Position as Foreign Currency Marketable Securities. Derivative financial instruments in a loss position are reported in the Statement of Financial Position as Derivative Financial Instruments in a Loss Position. Derivative financial instruments in a loss position are offset against derivative financial instruments in a gain position where a legal right of set-off exists.

Forward Foreign Exchange Contracts
Forward foreign exchange contracts are revalued for changes in exchange rates and are reported at fair value in the Statement of Financial Position. This fair value revaluation is calculated using forward foreign exchange points quoted in the market and interpolated to the settlement date of each contract. Apart from contracts relating to Liquidity Management operations (refer below), changes in fair value relating to market value movements are recognised in the Statement of Financial Performance as Other Foreign Currency Income/(Expense). Changes in fair value relating to foreign currency movements are recognised in the Statement of Financial Performance as Net Foreign Exchange Revaluation Gain/(Loss).

The Bank's Liquidity Management operations use forward foreign exchange contracts to effectively swap New Zealand dollars for foreign currency for a defined period of time. Interest receivable or payable and changes in fair value, relating to Liquidity Management forward foreign exchange contracts, are recognised in the Statement of Financial Performance as Liquidity Management Swap Income.

Refer to Off-Balance Sheet Derivative Financial Instruments below for the Bank's accounting policy on forward foreign exchange contracts used to hedge selected expenditure commitments and expected revenue receipts.

Interest Rate Futures
Interest rate futures are reported in the Statement of Financial Position at quoted mid-market prices. Changes in fair value relating to market value movements are recognised in the Statement of Financial Performance as Other Foreign Currency Income/(Expense). Changes in fair value relating to foreign currency movements are recognised in the Statement of Financial Performance as Net Foreign Exchange Revaluation Gain/(Loss). Margin and cash accounts arising from interest rate futures are recognised in the Statement of Financial Position as Other Cash Balances.

Interest Rate Swaps
Interest rate swaps are reported at fair value in the Statement of Financial Position. The fair value is derived by discounting the future cash flows based on the relevant market yield curves. Interest receivable or payable and changes in fair value relating to market value movements are recognised in the Statement of Financial Performance as Other Foreign Currency Income/(Expense). Changes in fair value relating to foreign currency movements are recognised in the Statement of Financial Performance as Net Foreign Exchange Revaluation Gain/(Loss). Collateral taken under an interest rate swap arrangement is not recognised by the Bank in the Statement of Financial Position. Collateral delivered under an interest rate swap arrangement remains in the Statement of Financial Position.

Off-Balance Sheet Derivative Financial Instruments
The Bank occasionally enters into derivative financial instruments, such as forward foreign exchange contracts and commodity futures to hedge anticipated transactions. These derivative financial instruments are recognised on the same basis as the underlying hedged items and are not recognised in the Statement of Financial Position but are disclosed as off-balance sheet items. The foreign exchange and price differences, and any costs associated with the hedging, up until the date that the purchase or sale transaction occurs, are deferred and included in the measurement of the purchase or sale transaction.

Where a derivative financial instrument, which is a hedge of an anticipated transaction, is terminated early but the anticipated transaction is still expected to occur, the deferred gain or loss that arises prior to termination continues to be deferred and is recognised as part of the purchase or sale transaction when it occurs. If the transaction is no longer expected to occur, the deferred gain or loss is recognised in the Statement of Financial Performance immediately.

Short Sales of Marketable Securities
A short sale is a sale of a security that the Bank does not own. Short sales arise as part of the Foreign Reserves Management function and the net returns on short sales are reported as Gain/(Loss) on Active Management Trading (see note 25). Securities that 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 in the Statement of Financial Performance on the same basis as foreign currency Marketable Securities.

Unsettled Transactions
Unsettled transactions are security purchases or sales that have been agreed, but are yet to be settled. Amounts payable for unsettled purchases of securities are reported as liabilities under the title Payable for Unsettled Purchases of Securities. Amounts due from unsettled sales of securities are reported as assets under the title Receivable from Unsettled Sales of Securities. Unsettled transactions are reported at the contract value.

Shareholding in the Bank for International Settlements

The Bank's investment in shares issued by the Bank for International Settlements (BIS) is valued at fair value, which is determined as being 70 per cent of the Bank's interest in the BIS's net asset value.

Dividends receivable are recognised in the Statement of Financial Performance under Income from Foreign Currency Financial Assets. Gains from changes in fair value are recognised in the Statement of Movements in Equity. Where a write-down otherwise results in a deficit in the Shareholding Revaluation Reserve, the amount of the deficit is recognised in the Statement of Financial Performance as Gain/(Loss) from Fair Value Changes under Income from Foreign Currency Financial Assets. Any subsequent revaluations are also recognised in the Statement of Financial Performance to the extent that the revaluation represents a recovery of deficits previously recognised in the Statement of Financial Performance. Gains or losses due to changes in foreign exchange rates and related foreign currency hedging are recognised in the Statement of Financial Performance as Net Foreign Exchange Revaluation Gain/(Loss).

Investment Portfolio - New Zealand 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. The portfolio is recorded in the Statement of Financial Position at historical cost adjusted for amortisation of any premium or discount on purchase. Interest is accrued in the Statement of Financial Performance as local currency Interest Income.

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 securities are valued at quoted market prices. Changes in fair value are recognised as an increase or decrease in the value of Other Local Currency Financial Assets. Gains or losses are recognised in the Statement of Financial Performance as Gain/(Loss) from Market Test Activities.

Other Financial Assets and Liabilities

Local and foreign currency cash, deposits and Short-Term Advances are valued at transaction date value, inclusive of any accrued interest.

(e) Other Assets and Liabilities

Accounts Receivable

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

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.

Land and Buildings

Land is carried at fair value. Buildings are carried at depreciated fair value. In respect of the specialised basement and ground floor occupied by the Reserve Bank, fair value is determined based on depreciated replacement cost. Surpluses of book value over historical cost for this class of asset are recorded in the Properties Revaluation Reserve. Where the book value of this class of asset falls below historical 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 every five years. Buildings are depreciated on a straight-line basis over 40 years.

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 fair values. Revaluations are performed every five years. Surpluses of book value over historical cost for this class of asset are recorded in the Currency and Artwork Collections and Archives Revaluation Reserve. Nominal values have been placed on items with no material commercial value. Collections are not depreciated. Additions are held at cost until subsequent revaluations.

Other Fixed Assets

Other fixed assets are carried at cost less depreciation. The following assets held by the Reserve Bank are depreciated on a straight-line basis over the following terms:

Computer Hardware and Software	3–5 years
Plant and Equipment	5 years
Property Improvements	8 years
Miscellaneous	expected useful life

Operating Leases

Where the Reserve 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.

Finance Leases

Assets under finance leases are recognised as Fixed Assets in the Statement of Financial Position. Leased assets are recognised initially at the lower of the present value of the minimum lease payments or their fair value. A corresponding liability is established and each lease payment is allocated between the liability and interest expense. Leased assets are depreciated on the same basis as equivalent property, plant and equipment.

Future commitments relating to the operating and finance leases are disclosed in note 38.

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.

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. Therefore, the face value of collectors' currency is recognised as a contingent liability.

The Bank has a liability for the face value of demonetised currency still in circulation. This is recognised as a contingent liability except for a portion retained in the Statement of Financial Position to cover expected future redemptions. This portion is reported in Miscellaneous Liabilities.

Provision for Restructuring

A provision for restructuring is recognised only when the Reserve Bank has a detailed restructuring plan and the plan has either started to be implemented or has been communicated to those affected by it. The provision includes only those expenses that are necessary for the restructuring. Any expenses that are associated with ongoing activities are excluded.

Retirement Gratuity

Retirement gratuity liabilities are recorded at actuarial value. This is calculated annually by an independent actuary using a discounted cash flow model based on the relevant market yield curves. Changes in value are recognised in the Statement of Financial Performance as Personnel Expenses. Retirement gratuity liabilities are reported in the Statement of Financial Position as Accrued Employee Entitlements.

(f) 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 Reserve 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).

Investing activities include cash movements, including realised gains and losses, in the Bank's financial asset portfolios, and cash flows arising from movements in fixed assets.

Financing activities include cash flows arising from the issue of circulating currency, borrowing from The Treasury, and payment of Notional Surplus Income to the Crown.

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

(g) Income and Expenses

Income and Expenses Allocated Amongst Functions

The Reserve Bank of New Zealand Act 1989 requires the Reserve Bank to account for revenue and expenses by reference to the functions the Bank performs. Each function receives income and incurs expenses relating directly to the assets and liabilities used exclusively by that function. These income and expenses are presented in the Statement of Cost of Services.

Income and expense flows are attached to the notional funding for each function. The Bank operates notional balance sheets to calculate the notional income and expenditure for each of the Reserve Bank's functions as though each function operates autonomously. The Bank also has systems in place to allocate operating costs to functions. Operating costs are allocated as closely as possible to reflect their consumption. Direct operating costs are assigned directly to functions. Indirect operating costs are allocated to functions based on predetermined cost drivers and related activity or usage information. These structures enable each function to more accurately report the financial outcome of the services provided.

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 in the Statement of Financial Position as Miscellaneous Liabilities, Accrued Employee Entitlements (see note 10).

Income Tax

Section CB3 of the Income Tax Act 1994 exempts the Reserve Bank from income tax.

Consolidated Statement of Financial Position

As at 30 June	Note	2005 $000	2004 $000
Assets:			
Foreign Currency Financial Assets:			
Cash Balances with Other Central Banks		**80,385**	89,204
Other Cash Balances		**3,147**	2,446
Marketable Securities	2	**4,104,946**	3,159,447
Short-Term Advances		**33,014**	-
Receivable from Unsettled Sales of Securities		**133,099**	28,303
Securities Purchased Under Agreements to Re-sell		**3,603,388**	2,286,586
Shareholding in the Bank for International Settlements	6	**92,949**	95,660
Dividend Receivable		**1,478**	990
Accrued Interest		**34,057**	18,574
Total Foreign Currency Financial Assets[36]		**8,086,463**	5,681,210
Local Currency Financial Assets:			
Cash on Hand		**2**	8
Securities Purchased Under Agreements to Re-sell		**265,199**	1,453,976
Investment Portfolio - New Zealand Government Securities		**4,518,229**	3,266,896
Accrued Interest		**82,556**	56,228
Other Local Currency Financial Assets		**50**	24
Total Local Currency Financial Assets		**4,866,036**	4,777,132
Total Financial Assets		**12,952,499**	10,458,342
Other Assets:			
Accounts Receivable		**2,111**	1,419
Inventories	4	**6,221**	6,858
Fixed Assets	5	**35,640**	30,961
Total Other Assets		**43,972**	39,238
Total Assets		**12,996,471**	10,497,580

36 Foreign currency assets and liabilities do not match primarily due to $739.8 million (2004 $97.1 million) of assets arising from forward foreign exchange swap contracts from Market Operations. The assets are fully hedged through forward transactions.

As at 30 June	Note	2005 $000	2004 $000
Liabilities:			
Foreign Currency Financial Liabilities:			
Short-Term Deposits		-	2,597
Payable for Unsettled Purchases of Securities		**144,535**	30,135
Short Sales of Marketable Securities		**1,221,190**	418,263
Derivative Financial Instruments in a Loss Position	3	**20,169**	174
Securities Sold Under Agreements to Repurchase		**1,836,731**	1,262,187
Term Liabilities	7	**4,031,644**	3,819,403
Accrued Interest		**54,005**	41,459
Total Foreign Currency Financial Liabilities		**7,308,274**	5,574,218
Local Currency Financial Liabilities:			
Government Deposits		**667,474**	1,242,466
Other Deposits	8	**121,971**	139,640
Accrued Interest		**132**	215
Total Local Currency Financial Liabilities		**789,577**	1,382,321
Total Financial Liabilities		**8,097,851**	6,956,539
Other Liabilities:			
Currency in Circulation	9	**3,182,623**	2,920,045
Provision for Transfer of Surplus to Government	12	**139,284**	191,748
Miscellaneous Liabilities	10	**22,534**	8,529
Total Other Liabilities		**3,344,441**	3,120,322
Total Liabilities		**11,442,292**	10,076,861
Equity	13	**1,554,179**	420,719
Total Liabilities and Equity		**12,996,471**	10,497,580

The above statement is to be read in conjunction with the notes on pages 67 to 102.

Consolidated Statement of Movements in Equity

For the year ended 30 June	Note	2005 $000	2004 $000
Net Surplus for the Year		**272,744**	195,137
Increase in Property Revaluation Reserve	13	-	144
Increase in Currency and Artwork Collections and Archives Revaluation Reserve	13	-	1,033
Total Recognised Revenues and Expenses for the Year		**272,744**	196,314
Provision for Transfer of Surplus to the New Zealand Government	12	**(139,284)**	(191,748)
Capital provided by the New Zealand Government	13	**1,000,000**	-
Movement in Equity for the Year		**1,133,460**	4,566
Equity at Start of Year		**420,719**	416,153
Equity at End of Year		**1,554,179**	420,719

The above statement is to be read in conjunction with the notes on pages 67 to 102.

Consolidated Statement of Cost of Services

For the year ended 30 June	Note	Operating Income Actual 2005 $000	Operating Expenses Actual 2005 $000	Operating Surplus (Deficit) Actual 2005 $000	Operating Surplus (Deficit) Budget 2005 $000	Operating Surplus (Deficit) Actual 2004 $000
Functions:						
Monetary Policy Formulation		-	7,444	(7,444)	(7,632)	(7,326)
Market Operations		1,508	3,534	(2,026)	(3,169)	(4,346)
Financial System Surveillance		15	6,409	(6,394)	(6,366)	(5,765)
Currency Operations	24	202,484	9,527	192,957	189,455	187,113
Foreign Reserves Management[37]	25	2,251	4,503	(2,252)	(1,822)	(5,420)
Settlement Services		2,547	1,629	918	(84)	(70)
Registry and Depository Services	27	4,074	2,931	1,143	816	949
Overseas Investment Commission Secretariat[38]	26	847	997	(150)	(3)	(35)
Other Outputs		-	517	(517)	(503)	(488)
Total for Bank before Earnings on Investments Funded by Equity		213,726	37,491	176,235	170,692	164,612
Earnings on Investments Funded by Equity		96,509	-	96,509	79,960	30,525
Total for Bank		310,235	37,491	272,744	250,652	195,137
Income Retained under the Funding Agreement			8,316			
Net Expenditure as per the Funding Agreement	12		29,175			

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 67 to 102.

37 Earnings relating to the Asian Bond Fund Investments have been reclassified as Operating Income for the Foreign Reserves Management function. Previously, these earnings were classified as Earnings on Investments Funded by Equity. Comparative figures have been restated to reflect this change ($316,000).

38 On 25 August 2005, the secretariat services and funding provided by the Bank to the Overseas Investment Commission were discontinued. Refer to note 45: *Significant Post-Balance Date Events*.

Consolidated Statement of Financial Performance

For the year ended 30 June	Note	Actual 2005 $000	Budget 2005 $000	Actual 2004 $000
Operating Income:				
Income from Foreign Currency Financial Assets:				
Interest Income	28	91,173		64,584
Dividend Income		1,478		990
Gain/(Loss) from Fair Value Changes	30	7,779		(10,383)
Other Foreign Currency Income/(Expense)		3,911		(4,979)
Total Income from Foreign Currency Financial Assets		104,341		50,212
Expenses on Foreign Currency Financial Liabilities:				
Interest Expenses[39]	29	77,416		139,171
Loss/(Gain) from Fair Value Changes	30	16,937		(90,409)
Other Foreign Currency Expenses/(Income)		16		(23)
Total Expenses on Foreign Currency Financial Liabilities		94,369		48,739
Net Foreign Exchange Revaluation Gain/(Loss)	31	(2,111)		72
Foreign Currency Net Investment Income/(Expense)		7,861		1,545
Income from Local Currency Financial Assets:				
Interest Income	28	323,340		338,678
Liquidity Management Swap Income		57,970		65,828
Gain from Market Test Activities		13		22
Total Income from Local Currency Financial Assets		381,323		404,528
Total Interest Expenses on Local Currency Financial Liabilities	29	87,307		183,262
Local Currency Net Investment Income		294,016		221,266
Net Investment Income		301,877	280,688	222,811
Other Income	32	8,358	8,385	9,360
Total Operating Income		310,235	289,073	232,171
Operating Expenses:				
Personnel Expenses		18,313	18,258	17,732
New Currency Issued Expenses	24	5,857	5,998	5,424
Asset Management Expenses	33	3,875	3,797	3,547
Other Operating Expenses	34	9,446	10,368	10,331
Total Operating Expenses		37,491	38,421	37,034
Net Surplus for the Year	12	272,744	250,652	195,137

The above statement is to be read in conjunction with the notes on pages 67 to 102.

The Reserve Bank's operating expenditure was $37.5 million, which was $0.9 million (2.4 per cent) below budget. The under-expenditure was a result of lower-than-budgeted Other Operating Expenses (see note 34).

39 Gains and losses relating to the revaluation of the loan associated with the Asian Bond Fund Investment have been reclassified from Interest Expenses to Loss/(Gain) from Fair Value Changes. Comparative figures have been restated to reflect this change ($1.1 million).

Consolidated Statement of Cash Flows

For the year ended 30 June	Note	2005 $000	2004 $000
Cash Flows from Operating Activities:			
Sources:			
Interest Received - Foreign Currency		60,676	93,921
- Local Currency - Investment Portfolio		256,710	220,298
- Other		45,514	117,280
Liquidity Management Swap Income		57,970	82,516
Dividend		990	-
Fees, Commission and Other Income Received		8,283	9,928
Total Sources of Cash Flows from Operating Activities		430,143	523,943
Disbursements:			
Interest Paid - Foreign Currency		67,467	124,246
- Local Currency		87,390	183,514
Payments to Suppliers and Employees		33,586	36,885
Net GST Paid/(Received)		(94)	(58)
Total Disbursements of Cash Flows from Operating Activities		188,349	344,587
Net Cash Flow from Operating Activities	36	241,794	179,356
Cash Flows from Investing Activities:			
Sources:			
Net Decrease in Other Local Currency Financial Assets		13	9,850
Maturity of New Zealand Government Securities		714,000	150,000
Sale of Fixed Assets		88	-
Total Sources of Cash Flows from Investing Activities		714,101	159,850
Disbursements:			
Net Increase/(Decrease) in Foreign Currency Securities Purchased under Agreements to Re-sell		1,316,802	(472,425)
Net Increase in Foreign Currency Marketable Securities		619,412	53,536
Net Increase/(Decrease) in Other Foreign Currency Financial Assets		33,014	(54,412)
Net Increase in Other Foreign Currency Financial Liabilities		(1,397,466)	(739,138)
Purchases of New Zealand Government Securities		1,966,660	172,152
Purchase of Shares in the Bank for International Settlements		5,371	99,945
Purchase of Fixed Assets		7,579	3,224
Total Disbursements of Cash Flows from Investing Activities		2,551,372	(937,118)
Net Cash Flow from Investing Activities		(1,837,271)	1,096,968

Consolidated Statement of Cash Flows continued

For the year ended 30 June	Note	2005 $000	2004 $000
Cash Flows from Financing Activities:			
Sources:			
Issue of Circulating Currency		1,653,501	1,601,985
Withdrawal of Circulating Currency		1,465,676	1,487,875
Net Issue of Circulating Currency		187,825	114,110
Transfer of Liability for Currency from Treasury		87,602	-
Additional Foreign Currency Term Liabilities		1,028,425	630,819
Capital Provided by the New Zealand Government		1,000,000	-
Total Sources of Cash Flows from Financing Activities		2,303,852	744,929
Disbursements:			
Payment for Demonetised Currency		27	34
Repayment of Foreign Currency Term Liabilities		579,362	601,776
Payment of Surplus to the New Zealand Government		191,748	184,419
Total Disbursements of Cash Flows from Financing Activities		771,137	786,229
Net Cash Flow from Financing Activities		1,532,715	(41,300)
CASH FLOWS FROM ALL ACTIVITIES		(62,762)	1,235,024
Plus Exchange Rate Effect		(144,115)	(152,982)
NET CASH FLOW FROM ALL ACTIVITIES		(206,877)	1,082,042
Opening Cash Balance		1,749,729	667,687
CLOSING CASH BALANCE	37	1,542,852	1,749,729

The above statement is to be read in conjunction with the notes on pages 67 to 102.

Cash is defined in the Statement of Cash Flows as those items that are convertible to cash within two working days and are used in the day-to-day cash management of the Reserve 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 movements in the Bank's cash profile.

For further information on the management of the Bank's liquidity, see note 22.

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 (the Act).

(a) Foreign Currency Activities

Foreign currency activities result mainly from the 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 Act, and other foreign currency assets held for trading purposes. The level of foreign reserve intervention assets is determined by the Minister of Finance on advice from the Bank. The funding for foreign reserves is provided mainly 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. Funding for other foreign currency assets held for trading purposes usually arises through repurchase transactions with foreign securities trading firms. Where policy considerations lead the Bank to intervene in the foreign exchange market, it may maintain an unhedged foreign currency position, with foreign currency amounts not being matched by funding in the same currencies. However, over time the Bank will manage its foreign exchange exposures such that the Bank's exposure to exchange rate movements will be close to neutral.

Foreign currency assets are held in various currencies. The majority are denominated in United States dollars and euros. 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, highly rated corporates, and settlement institutions. Liquidity and credit risk are key criteria in determining the type of instruments held.

The Bank's foreign reserves portfolio can be actively managed. Subject to liquidity and credit risk constraints, the Bank defines benchmark portfolios that represent a risk-neutral asset and liability structure. The risk-neutral position is established to minimise the Bank's exposure to interest rate risk and foreign currency risk, subject to meeting monetary policy foreign exchange intervention objectives. The Bank's active management activities seek to minimise the overall costs of holding reserves.

Departures of the actual asset and liability portfolio from the risk-neutral asset and liability structure are undertaken within defined risk boundaries, where there is an expected increase in returns. Departures from the risk-neutral structure also arise when the Bank trades in the foreign exchange markets on its own account and when marketable securities are short sold, again for expected return enhancement, within defined risk boundaries. Departures from the risk-neutral structure involve discretionary trading and portfolio management decisions undertaken by specialist staff with delegated authority from the Governor.

The Bank also holds, from time to time, foreign currency assets and liabilities that arise from domestic market operations. Any foreign currency exposures relating to market operations are fully hedged through the use of forward foreign exchange contracts.

For further information on the risk management policies relating to financial instruments, see notes 16 to 23.

(b) Derivative Financial Instruments

The Bank's involvement in derivative financial instruments includes primarily interest rate futures, interest rate swaps and forward foreign exchange contracts.

Interest rate futures and interest rate swaps are used to enhance expected returns on foreign currency assets and, from time to time, to hedge interest rate and foreign exchange risks.

Forward foreign exchange contracts are used to hedge foreign exchange transactions for both Market Operations and Foreign Reserves Management. Any unrealised foreign exchange gain or loss on unsettled forward foreign exchange contracts is offset by the foreign exchange revaluation on the associated money market instruments.

The Bank has entered into forward foreign exchange contracts in order to hedge the foreign currency exposure of its shareholding in the Bank for International Settlements and occasionally to hedge capital expenditure commitments denominated in foreign currency.

The proceeds that the Bank expects to receive from the sale of silver coins, which will be replaced with new coins to be issued in 2006, have been hedged. Metal commodities futures contracts have been used to hedge the associated price risk and forward foreign exchange contracts have been used to hedge the foreign currency exchange risk.

(c) Securities Lending Programme

As part of its foreign reserves operations, the Bank participates in a securities lending programme managed by JPMorgan Chase Bank. Under the programme, JPMorgan Chase 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.

As at 30 June 2005, the fair value of securities lent out under the programme was $589.6 million (2004 $763.1 million).

(d) Foreign Exchange Gains and Losses

Section 16 of the Act provides the Bank with the power to deal in foreign currency for the purpose of carrying out its functions and powers. At balance date, no losses had been incurred from section 16 activities.

Section 17 and 18 of the Act provide for the Minister of Finance to direct the Bank to deal in foreign exchange, or for the Minister of Finance to fix the foreign exchange rates for foreign exchange dealing by the Bank. Section 21 of the Act requires the Bank to either pay any foreign currency exchange gains to the Crown, or to be reimbursed for any foreign exchange losses, as a result of dealing in foreign exchange under sections 17 or 18 of the Act. For the year to 30 June 2005, there have been no payments to or from the Crown under section 21 of the Act (2004 nil).

(e) Restrictions on Title to Assets

As part of the active management of its foreign currency operations, the Bank enters into security repurchase transactions. These foreign currency securities sold by the Bank under repurchase agreements are recorded as an asset within Marketable Securities in the Bank's Statement of Financial Position. These foreign currency transactions are also recognised as a liability within Securities Sold Under Agreements to Repurchase in the Bank's Statement of Financial Position. At balance date, the book value of liabilities under repurchase agreements was $1,836.7 million (2004 $1,262.2 million). The fair value of these liabilities was $1,815.5 million (2004 $1,203.0 million).

The Bank enters into security repurchase transactions as part of its liquidity management operations and market testing activities. These local currency securities sold by the Bank under repurchase agreements are recorded as an asset for Investment Portfolio - New Zealand Government Securities in the Bank's Statement of Financial Position. These transactions are also recognised as a liability for Securities Sold Under Agreements to Repurchase in the Bank's Statement of Financial Position. At balance date, there were no securities sold to counterparties under repurchase agreements relating to the liquidity management operations (2004 $nil).

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.

The Bank can be required to deliver collateral under interest rate swap arrangements. Any collateral delivered by the Bank remains in the Statement of Financial Position. At balance date, collateral delivered by the Bank was $nil (2004 $nil).

(f) Local Currency Activities

The Bank's liquidity management largely involves offsetting the daily net flows to or from the Government by advancing funds to, or withdrawing funds from, the banking system. This is done mostly through daily open market operations. Any residual banking system liquidity is advanced or withdrawn using the Official Cash Rate (OCR) scheme. Under the OCR scheme, the Bank advances or withdraws cash at a margin to the OCR. The financial instruments used in these operations include local currency reverse-repurchase transactions and forward foreign exchange contracts. The Bank uses securities from its Investment Portfolio – New Zealand Government Securities in repurchase transactions to withdraw funds from the banking system for liquidity management purposes.

The Bank's Investment Portfolio – New Zealand Government Securities supports its liability for Currency in Circulation and the Bank's net Equity. The Bank holds these investments until maturity. The Bank purchases securities for the Investment Portfolio if the amount of Currency in Circulation increases or if one of the Bank's current holdings matures. The Bank manages this process by maintaining a portfolio of securities with relatively even maturities, where possible.

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

(g) Events during 2004/05

On 1 July 2004, the Bank received a capital injection of $1 billion from the New Zealand Government. The additional capital was provided in order to enhance the Bank's capacity to finance intervention in foreign currency markets under section 16 of the Act. The funds were invested in New Zealand Government Securities, with a face value of $974.8 million, a weighted average yield of 6.14%, and an average duration of 4.8 years.

In May 2005, the Bank accepted an invitation to purchase additional shares in the Bank for International Settlements. The 211 shares purchased, costing $5.7 million, ensured that the Bank maintained approximately 1 per cent of all shares on issue. As at 30 June 2005, the Bank held 3,211 shares in the Bank for International Settlements.

The Bank is one of a number of banks of the Executives' Meeting of Asian and Pacific Central Banks (EMEAP)[40] that invested in the Asian Bond Fund 2 (ABF2) to further promote investment in the local bond markets in the East Asian region. During March and April of 2005, the Bank invested a total of USD 50 million in the ABF2.

In December 2004, the Bank completed the process of exiting the retail registry business. The retail registry business was provided by the Registry and Depository Services function.

During 2004/05, the Bank initiated a review of the silver coins in circulation to determine whether to change the size and metal composition of coins. As a result of this review, in March 2005, the Bank announced its decision to replace all silver coins and to take the 5 cent coin out of circulation. The transition is scheduled to take place in the latter half of 2006. During 2004/05, the Bank entered into various hedging contracts to reduce foreign currency and commodity price risks relating to the project.

During 2004/05, the Bank and The Treasury reached an agreement that the liability relating to coins issued by The Treasury prior to July 1989 should be transferred to, and held solely by, the Bank. The agreement effectively extinguished any claims the Bank may make on The Treasury in relation to these coins. At year end, the Bank recognised an additional $74.7 million in its Currency in Circulation for coins issued by The Treasury prior to 1989. This was recognised previously as a contingent liability. The coins issued by The Treasury that have been demonetised but not returned to the Bank, with a value of $12.9 million, are disclosed by the Bank within Miscellaneous Liabilities. This was disclosed previously as a contingent liability. On 31 May 2005, the Bank received $87.6 million from The Treasury to settle all currency liabilities. These funds received from The Treasury were invested in New Zealand Government Securities, with a face value of $84.0 million, a weighted average yield of 5.75 per cent and an average duration of 12.5 years.

40 EMEAP is a cooperative organisation of central banks and monetary authorities in the East Asia Pacific region. Its primary objective is to strengthen the cooperative relationship among its members.

Asset Notes

2. Foreign Currency Marketable Securities

	Note	2005 $000	2004 $000
Marketable Securities:			
- Liquefiable within two days (considered cash equivalent)	37	**1,983,564**	1,586,201
- Liquefiable outside two days (not considered cash equivalent)		**2,099,689**	1,538,161
Derivative Financial Instruments in a Gain Position	3	**21,693**	35,085
Total Marketable Securities		**4,104,946**	3,159,447

3. Derivative Financial Instruments[41]

	Book Value 2005[42] $000	Notional Principal 2005 $000	Book Value 2004 $000	Notional Principal 2004 $000
Interest Rate Futures:				
Interest Rate Futures in a Gain Position	**353**	**10,908**	744	4,990
Net Futures Position	**353**	**10,908**	744	4,990
At 30 June 2005, the Bank had 562 open Interest Rate Futures contracts (2004: 882).				
Interest Rate Swaps:				
Interest Rate Swaps in a Gain Position	**10,100**	**396,724**	28,382	607,201
Interest Rate Swaps in a Loss Position	**(3,066)**	**211,308**	(174)	115,079
Net Interest Rate Swap Position	**7,034**	**608,032**	28,208	722,280
Forward Foreign Exchange Contracts:				
Forward Foreign Exchange Contracts in a Gain Position	**11,240**	**130,060**	5,959	97,122
Forward Foreign Exchange Contracts in a Loss Position	**(17,103)**	**665,652**	-	-
Net Forward Foreign Exchange Contracts Position	**(5,863)**	**795,712**	5,959	97,122
Total Derivative Financial Instruments in a Gain Position	**21,693**	**537,692**	35,085	709,313
Total Derivative Financial Instruments in a Loss Position	**(20,169)**	**876,960**	(174)	115,079
Net Derivative Financial Instruments Recognised on Balance Sheet	**1,524**	**1,414,652**	34,911	824,392

4. Inventories

	2005 $000	2004 $000
Bank Notes for Circulation	**3,084**	4,058
Coin for Circulation	**3,137**	2,730
Collectors' Currency	**-**	70
Total Inventories	**6,221**	6,858

41 The above derivative financial instruments note does not include forward foreign exchange contracts and commodity futures used to hedge the expected revenue receipts associated with the future disposal of silver coins. The off-balance sheet forward foreign exchange contracts have a nominal value of USD 7.5 million (fair value loss of $0.3 million) and the commodity futures contracts have a nominal value of USD 10 million (fair value gain of $0.4 million). The net gain has been deferred until the underlying sale transaction occurs.

42 The book value of Derivative Financial Instruments is the fair value of those instruments. Refer to the Statement of Accounting Policies, (d) Financial Assets and Liabilities, Derivative Financial Instruments for further information.

5. Fixed Assets

	Total $000	Land and Buildings $000	Property Improvements $000	Computer Hardware and Software $000	Plant and Equipment $000	Currency and Artworks Collections and Archives $000
As at 30 June 2004						
Cost	**43,320**	25,100	3,192	9,765	3,634	1,629
Accumulated Depreciation	**12,359**	1,200	1,859	6,363	2,937	-
Net Book Value	**30,961**	23,900	1,333	3,402	697	1,629
Year ended 30 June 2005						
Opening Net Book Value	**30,961**	23,900	1,333	3,402	697	1,629
Additions	**7,581**	-	767	5,479	1,087	248
Less Disposals (net of accumulated depreciation)	**652**	652	-	-	-	-
Less Depreciation	**2,250**	424	387	1,179	260	-
Closing Net Book Value	**35,640**	22,824	1,713	7,702	1,524	1,877
As at 30 June 2005						
Cost	**48,508**	24,439	3,851	13,758	4,583	1,877
Accumulated Depreciation	**12,868**	1,615	2,138	6,056	3,059	-
Net Book Value	**35,640**	22,824	1,713	7,702	1,524	1,877

The Bank owns its head office in Wellington and leases seven of the fourteen floors to tenants under operating leases.

The book values for land and buildings are depreciated fair values based on existing use with the exception of the specialised basement and ground floor occupied by the Reserve Bank, which are valued at depreciated replacement cost. The fair value of the Bank's land and buildings to a purchaser not requiring the Bank's specialised facilities was assessed at $23.6 million at the last valuation date. The book value of the land and buildings would have been $6.9 million (2004 $7.0 million) if the Bank had recorded these using historical cost less depreciation.

	Valuation Date	Registered Valuer
Wellington Head Office	June 2001	Jones Lang Lasalle Advisory Limited
Wellington Carparks	June 2004	DTZ New Zealand International Property Advisers

The Computer Hardware and Software category includes computers that are leased under finance leases, with a net book value of $281,000 (2004 $464,000). Future commitments relating to leases are disclosed in note 38.

Work-in-Progress at 30 June 2005 was $5.5 million (2004 $1.2 million), comprising:

	2005 $000	2004 $000
Computer Hardware and Software	**3,978**	1,198
Plant and Equipment	**870**	-
Property Improvements	**619**	-
Total Work-in-Progress	**5,467**	1,198

These amounts have been included as additions in the appropriate asset categories.

6. Shareholding in the Bank for International Settlements

The Bank owns 3,211 (2004 3,000 shares) shares issued by the Bank for International Settlements. This represents a shareholding of approximately 1 per cent of all shares on issue. The shares have a par value of SDR 5,000 each and are paid up to SDR 1,250 each.

The Bank has taken out forward foreign currency contracts to hedge the foreign currency value of the shareholding.

Liability and Equity Notes

7. Term Liabilities

	Total Market Value 2005 $000	Unamortised Discount/ (Premium) 2005 $000	Weighted Average Interest Rate 2005 %	Total Market Value 2004 $000	Unamortised Discount/ (Premium) 2004 $000	Weighted Average Interest Rate 2004 %
Unsecured Term Liabilities:						
Due to be Repaid:						
One year or less	**620,408**	**351**	**3.0%**	602,115	-	1.6%
Between one and two years	**560,958**	**-**	**3.2%**	704,380	1,118	2.2%
Between two and five years	**1,371,454**	**2,782**	**2.5%**	1,970,536	4,010	2.1%
Over five years	**1,478,824**	**-**	**2.6%**	542,372	-	1.3%
Total Unsecured Term Liabilities	**4,031,644**	**3,133**		3,819,403	5,128	

The funding for foreign reserves is provided by loans from The Treasury. These loans are unsecured and incur interest at market rates. The weighted average interest rates do not include the impact of the Bank's interest rate swaps.

8. Other Deposits

	2005 $000	2004 $000
Settlement Bank Deposits	**57,183**	71,051
Central Bank Deposits	**15,537**	11,144
International Monetary Fund Deposits	**49,251**	57,221
Other Deposits	**-**	224
Total Other Deposits	**121,971**	139,640

9. Currency in Circulation

The exclusive rights of national currency issue are vested with the Reserve Bank. Currency in Circulation comprises bank notes and coins issued by the Reserve Bank and, with effect from 31 May 2005, coins issued by The Treasury prior to July 1989[43].

As at 30 June 2005, the following bank notes and coins were in circulation:

Denomination:	Number of Note Forms/ Coins 2005 000	Face Value 2005 $000	Number of Note Forms/ Coins 2004 000	Face Value 2004 $000
5c	**585,420**	**29,271**	277,500	13,875
10c	**238,650**	**23,865**	92,330	9,233
20c	**154,960**	**30,992**	30,730	6,146
50c	**57,692**	**28,846**	11,516	5,758
$1	**63,346**	**63,346**	60,437	60,437
$2	**60,886**	**121,771**	58,622	117,244
$5	**17,964**	**89,818**	17,156	85,780
$10	**17,270**	**172,704**	16,048	160,476
$20	**54,106**	**1,082,114**	50,773	1,015,457
$50	**9,924**	**496,222**	9,171	458,526
$100	**10,437**	**1,043,674**	9,871	987,113
Total Currency in Circulation		**3,182,623**		2,920,045

The significant increase in the number and value of coins in circulation is due to the recognition on the Bank's balance sheet of the liability for the coins issued by The Treasury prior to 1989. Refer to footnote 43 below.

43 During 2004/05, the Bank and The Treasury reached an agreement that the liability relating to coins issued by The Treasury prior to July 1989 would be transferred to, and held solely by, the Bank. Coins in circulation and demonetised currency issued by The Treasury prior to July 1989 were disclosed previously as contingent liabilities but are now recognised in Currency in Circulation ($74.7 million) and Miscellaneous Liabilities ($12.9 million).

10. Miscellaneous Liabilities

	Note	2005 $000	2004 $000
Accounts Payable		**4,427**	2,646
Accrued Employee Entitlements		**3,744**	3,437
Provision for Restructuring	11	**87**	294
Demonetised Currency		**13,961**	1,140
Other Current Liabilities		**1**	519
Capitalised Lease Obligations	38	**314**	493
Total Miscellaneous Liabilities		**22,534**	8,529

Demonetised currency is recognised as a contingent liability (see note 42 (b)) except for $14.0 million (2004 $1.1 million), which has been retained to cover future expected redemptions. Of this total, $12.9 million relates to demonetised coins issued by The Treasury, for which payment was received by the Bank on 31 May 2005.

11. Provision for Restructuring

	2005 $000	2004 $000
Opening Balance	**294**	-
Additions to Provision	**29**	575
Less Expenses Incurred	**(185)**	(281)
Unused Balance Written Back	**(51)**	-
Total Provision for Restructuring	**87**	294

Restructuring costs were incurred principally with respect to the Bank's Settlement Services function and Registry and Depository Services function.

12. Transfers to Retained Earnings and Provision for Transfer of Surplus to the New Zealand Government

Under section 162 of the Reserve Bank of New Zealand Act 1989, the Minister of Finance determines the extent to which the Bank's Notional Surplus Income calculated under section 158 is to be distributed to the New Zealand Government or retained by the Bank as equity. In determining the distribution amount the Minister must have regard for the capital requirements of the Bank, the views of the Bank's Board, and any other relevant matters. A provision for transfer of the surplus to the New Zealand Government is recognised based on the Bank's best estimate of that amount.

The statutory formula for the calculation contained in section 158 of the Reserve Bank Act 1989 changed, with effect from 1 July 2004. The primary driver for calculation of Notional Surplus Income is now realised net income rather than reported net income.

For the year ended 30 June 2005, the Bank has recommended that the full amount of Notional Surplus Income of $139.3 million be transferred to the New Zealand Government.

Notional Surplus Income has been calculated as follows:

	2005 $000	2004 $000
Surplus Available for Appropriation	**272,744**	195,137
Less Net Unrealised Gains included in Surplus Available for Appropriation	**129,635**	
Realised Net Income for the Year	**143,109**	
Funding Level specified in the Funding Agreement	**33,000**	31,000
Net Expenditure as per the Funding Agreement	**29,175**	27,611
Funding Agreement Under-Expenditure Retained by the Bank	**3,825**	3,389
Provision of Notional Surplus Income for Transfer to the New Zealand Government	**139,284**	191,748

13. Equity

	2005 $000	2004 $000
Retained Earnings:		
Net Unrealised Gains for the year	129,635	-
Funding Agreement Under-Expenditure	3,825	3,389
Transfer from Reserves	57	134
Movement in Retained Earnings	133,517	3,523
Opening Balance	403,309	399,786
Closing Balance	536,826	403,309
Capital:		
Capital provided by the New Zealand Government	1,000,000	-
Movement in Capital	1,000,000	-
Opening Balance	-	-
Closing Balance	1,000,000	-
Properties Revaluation Reserve:		
Revaluation of Carparks	-	35
Accumulated Depreciation Transferred to Reserve	-	109
Transfer to Retained Earnings	(57)	-
Movement in Properties Revaluation Reserve	(57)	144
Opening Balance	15,815	15,671
Closing Balance	15,758	15,815
Currency and Artwork Collections and Archives Revaluation Reserve:		
Revaluation of Currency Collection	-	1,033
Transfer to Retained Earnings	-	(134)
Movement in Currency and Artwork Collections and Archives Revaluation Reserve	-	899
Opening Balance	1,595	696
Closing Balance	1,595	1,595
Total Equity	1,554,179	420,719

14. 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 arm's length transaction.

The quoted market value represents fair value 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.

Financial Assets and Liabilities

All financial assets and liabilities are recorded at their fair value based on either quoted market prices or prices derived from market yield curves, as described in the Reserve Bank's accounting policies, except as detailed below.

(a) 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.

(b) Unsettled Transactions

The reported value of unsettled sales and purchases is considered to approximate their fair value due to the very short period between balance date and settlement date.

(c) Short-Term Advances

The reported value of Short-Term Advances is considered to approximate their fair value due to the short term until maturity.

(d) Investment Portfolio - New Zealand Government Securities

The investment portfolio is recorded at historical cost adjusted for amortisation of any premium or discount on purchase. The fair value of the Bank's Investment Portfolio - New Zealand Government Securities is $4.639 billion (2004 $3.325 billion). This has been calculated by valuing the current holdings at market prices.

(e) Short-Term Deposits

The carrying value of Short-Term Deposits is considered to approximate their fair value as they are payable on demand.

(f) Currency in Circulation

The fair value of Currency in Circulation is considered to be its face value, as reported in the Statement of Financial Position.

(g) Provision for Transfer of Surplus to the New Zealand Government

The carrying value of the Provision for Transfer of Surplus to Government is considered to approximate its fair value due to the short period between balance date and expected payment date.

15. Concentrations of Funding

The Reserve Bank's significant end-of-year concentrations of funding were as follows:

	Total 2005 $000	New Zealand Government $000	New Zealand Public $000	Overseas Securities Trading Firms $000	Other $000
Foreign Currency Financial Liabilities:					
Payable for Unsettled Purchases of Securities	**144,535**	-	-	-	144,535
Short Sales of Marketable Securities	**1,221,190**	-	-	-	1,221,190
Derivative Financial Instruments in a Loss Position	**20,169**	-	-	-	20,169
Securities Sold Under Agreements to Repurchase	**1,836,731**	-	-	771,150	1,065,581
Term Liabilities	**4,031,644**	4,031,644	-	-	-
Accrued Interest	**54,005**	36,635	-	-	17,370
Total Foreign Currency Financial Liabilities	**7,308,274**	4,068,279	-	771,150	2,468,845
Local Currency Financial Liabilities:					
Government Deposits	**667,474**	667,474	-	-	-
Other Deposits	**121,971**	-	-	-	121,971
Accrued Interest	**132**	132	-	-	-
Total Local Currency Financial Liabilities	**789,577**	667,606	-	-	121,971
Total Financial Liabilities	**8,097,851**	4,735,885	-	771,150	2,590,816
Other Liabilities:					
Currency in Circulation	**3,182,623**	-	3,182,623	-	-
Provision for Transfer of Surplus to the Government	**139,284**	139,284	-	-	-
Miscellaneous Liabilities	**22,534**	-	13,962	-	8,572
Total Other Liabilities	**3,344,441**	139,284	3,196,585	-	8,572
Total Liabilities	**11,442,292**	4,875,169	3,196,585	771,150	2,599,388

Concentrations of Funding

	Total 2004 $000	New Zealand Government $000	New Zealand Public $000	Overseas Securities Trading Firms $000	Other $000
Foreign Currency Financial Liabilities:					
Short-Term Deposits	**2,597**	-	-	2,060	537
Payable for Unsettled Purchases of Securities	**30,135**	-	-	30,135	-
Short Sales of Marketable Securities	**418,263**	-	-	-	418,263
Derivative Financial Instruments in a Loss Position	**174**	-	-	174	
Securities Sold Under Agreements to Repurchase	**1,262,187**	-	-	1,262,187	-
Term Liabilities	**3,819,403**	3,819,403	-	-	-
Accrued Interest	**41,459**	34,457	-	-	7,002
Total Foreign Currency Financial Liabilities	**5,574,218**	3,853,860	-	1,294,556	425,802
Local Currency Financial Liabilities:					
Government Deposits	**1,242,466**	1,242,466	-	-	-
Other Deposits	**139,640**	-	-	-	139,640
Accrued Interest	**215**	192	-	-	23
Total Local Currency Financial Liabilities	**1,382,321**	1,242,658	-	-	139,663
Total Financial Liabilities	**6,956,539**	5,096,518	-	1,294,556	565,465
Other Liabilities:					
Currency in Circulation	**2,920,045**	-	2,920,045	-	-
Provision for Transfer of Surplus to the Government	**191,748**	191,748	-	-	-
Miscellaneous Liabilities	**8,529**	-	1,140	-	7,389
Total Other Liabilities	**3,120,322**	191,748	2,921,185	-	7,389
Total Liabilities	**10,076,861**	5,288,266	2,921,185	1,294,556	572,854

Risk Management Notes

16. Risk Management

The Reserve Bank is involved in policy-orientated activities. Therefore, the Bank's risk management framework differs from the risk management frameworks for most other financial institutions. The main financial risks to which the Bank is exposed include credit risk on foreign currency assets, and interest rate risk on both foreign and local currency assets and liabilities. In the management of foreign reserves, minimising liquidity risk is the prime consideration in order to maintain an effective foreign exchange intervention capability. Policies for managing interest rate, credit, foreign currency and liquidity risks are outlined in notes 18 to 22. Like most other central banks, the nature of the Bank's operations creates exposure to a range of operational risks and reputational risks.

Bank management seeks to ensure that strong and effective risk analysis and management and control systems are in place for assessing, monitoring and managing risk exposure. An Asset and Liability Committee (ALCO), comprising the Governors and senior management, is responsible for advising on the monitoring and management of the business strategy, risks, and performance of all balance sheet related activities. This review includes the appropriateness of risk-return trade-offs underlying the business strategy and portfolio structure. Specialist staff conduct the Bank's local currency, foreign currency reserves management, and foreign exchange dealing operations in accordance with a clearly defined risk management framework, including limits and delegated authorities set by the Governor. The risk management framework is subject to regular review by ALCO.

The majority of the Bank's financial risks arise from the foreign reserves management and financial market operations of the Bank's Financial Stability Department. Within this department, a Risk Unit is responsible for maintaining the Bank's financial risk management framework. A separate department of the Bank (Financial Services Group) operates independent risk reporting systems that monitor and report compliance with various risk limits and policies.

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

The Bank self-insures all property, plant and equipment including the Bank's Wellington building.

The Bank is subject to an annual external audit by the Office of the Controller and Auditor-General under the Public Audit Act 2001. Auditing arrangements are overseen by an Audit Committee comprising four of the Bank's non-executive directors, which meets regularly to monitor the financial reporting and audit functions within the Bank. The Committee also reviews the internal audit function and has direct access to the external auditor. The Committee reports to the Board of Directors on its activities.

The overall risk management framework is designed to strongly encourage the sound and prudent management of the Bank's risks. The Bank seeks to ensure the risk management framework is consistent with financial market best practice, and it periodically engages external experts to assist in reviewing and modifying risk management practices and processes.

17. Operational Risk

Operational risk is the risk of loss in both financial and non-financial terms resulting from human error and the failure of internal processes and systems.

Managing operational risk in the Bank is seen as an integral part of day-to-day operations and management, which includes explicit consideration of both the opportunities and the risks of all business activities. Operational risk management includes Bank-wide corporate policies that describe the standard of conduct required of staff, a number of mandated generic requirements (eg, a project management template), and specific internal control systems designed around the particular characteristics of various Bank activities.

Compliance with corporate policies, generic requirements, and departmental internal control systems are managed by:

- an induction programme for new employees, that makes them aware of the requirements;
- a quarterly management affirmation by each Head of Department that corporate policies and departmental internal control systems have been complied with; and
- an active internal audit function.

In addition, Heads of Departments are required to report to Governors any significant incidents that could adversely impact on the Bank. This is known as the Proactive Problem Management process. Its purpose is to notify senior management promptly of important unexpected issues and to provide them with an opportunity to give immediate advice.

The above policies and procedures for managing operational risk are reinforced by the requirements of section 165 of the Reserve Bank of New Zealand Act 1989. The Act requires that the financial statements of the Bank include a statement signed by the Governor and Deputy Chief Executive accepting responsibility for, among other things, the establishment and maintenance of a system of effective internal control within the Bank.

18. 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. Exposure concentrations to geographical location are controlled by aggregate credit limits. Exposures against these limits are measured in credit-equivalent terms depending on the nature of the exposure. Individual credit limits are set on the basis of the rating of the counterparty or issuers. Aggregate credit limits are set on the basis of country ratings and views on the likelihood of a default of one entity affecting the credit worthiness of other entities. Limits are updated as necessary when new market information emerges, with all limits formally reviewed on an annual basis. The Governor's tolerance for foreign reserve credit risk is a maximum possible loss, in the event of default of an AAA/AA+ rated non-sovereign counterparty/issuer, of no more than $350 million.

Credit risk in 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 as part of the Real-Time Gross Settlement system. Securities that the Reserve Bank accepts under intra-day reverse-repurchase agreements include New Zealand Government Securities, 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 daily, and in certain cases are subject to formal limits. The Bank accepts New Zealand Government paper in its inter-day liquidity management operations and when intra-day lending is rolled overnight through the Exchange Settlement Account System. 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.

As part of the arrangements for using financial derivatives, the Bank manages credit risk by providing or receiving collateral as financial derivatives are revalued over time. This collateral is likely to take the form of cash or New Zealand Government Securities. The collateral taken at balance date was $nil (2004 $nil).

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

(b) Concentrations of Credit Exposure

The Bank's significant end-of-year concentrations of credit exposure, classified by industry of the issuer and industry of the counterparty, were as follows[44]:

	Classified by Industry of Issuer		Classified by Industry of Counterparty	
	2005 $000	2004 $000	**2005 $000**	2004 $000
New Zealand Government	**4,865,987**	4,617,717	**4,600,786**	3,344,733
Other Sovereign Issuers	**5,409,557**	3,382,989	**2,096,546**	1,478,504
Supranational Financial Institutions	**128,911**	342,062	**128,911**	342,062
Foreign Banks	**2,222,610**	1,814,402	**3,562,262**	4,260,439
Securities Trading Firms	**35,737**	-	**2,009,096**	-
New Zealand Banks	-	175,740	**265,201**	946,513
Other	**289,697**	125,432	**289,697**	86,091
Total Financial Assets	**12,952,499**	10,458,342	**12,952,499**	10,458,342

The Bank's maximum credit risk exposure in relation to financial 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 financial derivatives as reported in note 3.

The Bank's significant end-of-year concentrations of credit exposure, based on the country in which the issuer's parent is located, were as follows:

	2005 $000	2004 $000
New Zealand	**4,877,156**	4,801,299
United States of America	**2,607,294**	1,794,767
Europe	**5,246,849**	3,468,498
Supranational Financial Institutions	**128,911**	342,062
Other	**92,289**	51,716
Total Financial Assets	**12,952,499**	10,458,342

(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 to pay interest and principal. 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.

44 The differences between amounts disclosed by industry and by counterparty relate to Securities Purchased Under Agreements to Re-sell.

	Credit Rating	2005 $000	% of 2005 Financial Assets	2004 $000	% of 2004 Financial Assets
Foreign Currency Financial Assets:					
Cash Balances with Other Central Banks	AAA	72,763	0.6%	84,760	0.8%
	AA+	1,380	0.0%	-	0.0%
	AA-	6,242	0.0%	4,444	0.0%
Other Cash Balances	AAA	-	-	796	0.0%
	AA+	1,076	0.0%	752	0.0%
	AA-	2,071	0.0%	677	0.0%
	N/R	-	-	221	0.0%
Marketable Securities	AAA	2,430,661	18.8%	1,906,910	18.2%
	AA+	690,609	5.3%	260,978	2.5%
	AA	110,377	0.9%	195,325	1.9%
	AA-	724,014	5.6%	756,092	7.2%
	A-	38,320	0.3%	-	0.0%
	Various[45]	110,965	0.9%	39,318	0.4%
	N/R	-	-	824	0.0%
Short-Term Advances	AAA	33,014	0.3%	-	-
Receivable from Unsettled Sales of Securities	AA+	96,549	0.7%	-	-
	BBB+	-	-	28,303	0.3%
	N/R	36,550	0.3%	-	-
Securities Purchased Under Agreements to Re-sell	AAA	3,403,705	26.3%	1,846,133	17.7%
	AA+	91,144	0.7%	82,891	0.8%
	AA	45,744	0.4%	-	0.0%
	AA-	62,795	0.5%	-	0.0%
	A+	-	-	357,562	3.4%
Shareholding in the Bank for International Settlements	N/R[46]	92,949	0.7%	95,660	0.9%
Dividend Receivable	AAA	1,478	0.0%	990	0.0%
Accrued Interest	Various	34,057	0.3%	18,574	0.2%
Total Foreign Currency Financial Assets		8,086,463	62.4%	5,681,210	54.3%
Local Currency Financial Assets:					
Cash on Hand	AAA	2	0.0%	8	0.0%
Securities Purchased Under Agreements to Re-sell	AAA	265,199	2.0%	1,270,723	12.2%
	AA	-	-	107,317	1.0%
	A+	-	-	56,726	0.5%
	AA-	-	-	19,210	0.2%
Investment Portfolio - New Zealand Government Securities	AAA	4,518,229	34.9%	3,266,896	31.2%
Accrued Interest	AAA	82,556	0.6%	56,228	0.5%
Other Local Currency Financial Assets	AA+	29	0.0%	20	0.0%
	N/R	21	0.0%	4	0.0%
Total Local Currency Financial Assets		4,866,036	37.6%	4,777,132	45.7%
Total Financial Assets		12,952,499	100.0%	10,458,342	100.0%

45 This includes the Bank's investments in the Asian Bond Fund 1 and Asian Bond Fund 2 (the Funds). While the Funds themselves are not rated, the underlying instruments owned by the Funds have various credit ratings.

46 For internal management purposes, the Reserve Bank applies an AAA rating to the Bank for International Settlements.

	Credit Rating	2005 $000	% of 2005 Financial Assets	2004 $000	% of 2004 Financial Assets
Summary by Major Credit Category:					
Foreign Currency Financial Assets	AAA	**5,941,621**	**45.9%**	3,878,907	37.1%
	AA+/-	**1,870,321**	**14.4%**	1,658,721	15.9%
	BBB+	**-**	**0.0%**	28,303	0.3%
	Various	**145,022**	**1.1%**	18,574	0.2%
	N/R	**129,499**	**1.0%**	96,705	0.9%
Total Foreign Currency Financial Assets		**8,086,463**	**62.4%**	5,681,210	54.3%
Local Currency Financial Assets					
	AAA	**4,865,986**	**37.6%**	4,701,172	45.0%
	AA+/-	**29**	**0.0%**	75,956	0.7%
	N/R	**21**	**0.0%**	4	0.0%
Total Local Currency Financial Assets		**4,866,036**	**37.6%**	4,777,132	45.7%
Total Financial Assets		**12,952,499**	**100.0%**	10,458,342	100.0%

(d) Credit Exposure by Counterparty as a Percentage of Bank Equity

The table on the following page shows the number of individual counterparties or groups of closely related counterparties where the Bank's credit exposures[47] equalled or exceeded 10 per cent of the Bank's equity as at the end of the year for:

- End-of-year actual credit exposure.
- Potential peak end-of-day credit exposure (on the basis of limits).
- Potential 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 as part of the Real-Time Gross Settlement system.

On 1 July 2004, the Bank received a capital injection from the New Zealand Government of $1 billion. As a result of this increase in equity, the Bank has fewer counterparties with credit equal to or exceeding 10 per cent of the Bank's equity.

47 Exposures to the New Zealand Government are excluded.

% of Equity	**End-of-year 2005**	End-of-year 2004	**Potential peak end-of-day 2005**	Potential peak end-of-day 2004	**Potential peak local currency intra-day 2005**	Potential peak local currency intra-day 2004
10% to 19.9%	**6**	13	**47**	20	-	-
20% to 29.9%	**4**	3	**30**	1	-	8
30% to 39.9%	**2**	3	**1**	-	-	10
40% to 49.9%	**1**	3	-	45	-	-
50% to 59.9%	**1**	4	**10**	-	-	-
60% to 69.9%	-	3	-	1	-	-
70% to 79.9%	**1**	2	-	-	-	-
80% to 89.9%	-	-	-	23	-	-
90% to 99.9%	-	1	-	-	-	-
120% to 129.9%	-	1	-	-	-	-
130% to 139.9%	-	2	-	2	-	-
190% to 199.9%	-	-	-	7	-	-

Potential peak end-of-day exposures greater than 100 per cent of the Bank's equity were to sovereign issuers and supranational financial institutions. The Bank does not constrain credit exposure to certain sovereign issuers (eg, the United States of America). Exposures to these sovereign issuers are managed through other limits and controls (such as currency composition limits). End-of-year exposures greater than 100 per cent were to highly rated sovereign issuers. Potential peak end-of-day exposures for these sovereign issuers are based on end-of-year exposures.

19. Interest Rate Risk

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

(a) Foreign Currency Interest Rate Risk

The Reserve Bank's risk-neutral asset portfolios are exposed to some interest rate risk because the Bank's foreign currency assets are funded by foreign currency liabilities whose interest rate characteristics cannot be exactly replicated. The interest rate characteristics of the liabilities are similar to those of highly rated bank and corporate instruments, but liquidity considerations require that a significant proportion of investments are in United States, French, and German domestic government instruments, which have different interest rate characteristics from the liabilities. The Bank accepts the associated interest rate risk as inevitable, but seeks to closely limit additional, mainly duration-related, interest rate mismatches. The Bank is continually reviewing investment opportunities for ways to reduce the costs and risks associated with holding reserves, while maintaining the liquidity of its intervention assets.

Interest rate risk arising from departures from the risk-neutral position is managed by way of Value at Risk limits and stop-loss limits for the Bank's combined market risk, as described in note 21.

(b) Local Currency Interest Rate Risk

As a matter of policy, interest rate risk on the Investment Portfolio - New Zealand Government Securities is not actively managed. This recognises that:

- active risk management could require the Bank to carry out transactions that conflict with its monetary policy stance; and
- 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 duration of the investment portfolio at 30 June 2005 was 4.9 years (2004 5.2 years).

The 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:

	Weighted Average Interest Rate	**Total 2005 $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	2.0%	**80,385**	-	80,385	-	-	-	-
Other Cash Balances	0%	**3,147**	-	3,147	-	-	-	-
Marketable Securities	2.8%	**4,104,946**	-	2,737,176	38,396	247,340	522,382	559,652
Short-Term Advances	2.0%	**33,014**	-	33,014	-	-	-	-
Receivable from Unsettled Sales of Securities	0%	**133,099**	-	133,099	-	-	-	-
Securities Purchased Under Agreements to Re-sell	2.1%	**3,603,388**	-	3,603,388	-	-	-	-
Shareholding in the Bank for International Settlements	0%	**92,949**	92,949	-	-	-	-	-
Dividend Receivable	0%	**1,478**	1,478	-	-	-	-	-
Accrued Interest	0%	**34,057**	-	34,057	-	-	-	-
Total Foreign Currency Financial Assets	2.4%	**8,086,463**	94,427	6,624,266	38,396	247,340	522,382	559,652
Foreign Currency Financial Liabilities:								
Payable for Unsettled Purchases of Securities	0%	**144,535**	-	144,535	-	-	-	-
Short Sales of Marketable Securities	2.9%	**1,221,190**	-	42,744	36,969	142,652	679,723	319,102
Derivative Financial Instruments in a Loss Position	1.7%	**20,169**	-	20,169	-	-	-	-
Securities Sold Under Agreements to Repurchase	1.7%	**1,836,731**	-	1,836,731	-	-	-	-
Term Liabilities	2.7%	**4,031,644**	-	3,538,971	-	456,706	35,967	-
Accrued Interest	0%	**54,005**	-	54,005	-	-	-	-
Total Foreign Currency Financial Liabilities	2.4%	**7,308,274**	-	5,637,155	36,969	599,358	715,690	319,102
Foreign Currency Interest Rate Sensitivity Gap		**778,189**	94,427	987,111	1,427	(352,018)	(193,308)	240,550
Local Currency Financial Assets:								
Cash on Hand	0%	**2**	-	2	-	-	-	-
Securities Purchased Under Agreements to Re-sell	6.6%	**265,199**	-	265,199	-	-	-	-
Investment Portfolio - New Zealand Government Securities	5.9%	**4,518,229**	-	-	692,745	482,264	1,320,878	2,022,342
Accrued Interest	0%	**82,556**	-	82,556	-	-	-	-
Other Local Currency Financial Assets	0%	**50**	-	50	-	-	-	-
Other Assets	0%	**43,972**	43,972	-	-	-	-	-
Total Local Currency Assets	5.8%	**4,910,008**	43,972	347,807	692,745	482,264	1,320,878	2,022,342
Local Currency Financial Liabilities:								
Government Deposits	6.5%	**667,474**	-	667,474	-	-	-	-
Other Deposits	3.0%	**121,971**	-	121,971	-	-	-	-
Accrued Interest	0%	**132**	-	132	-	-	-	-
Other Liabilities	0%	**3,344,441**	3,344,441	-	-	-	-	-
Equity	0%	**1,554,179**	1,554,179	-	-	-	-	-
Total Local Currency Liabilities and Equity	0.8%	**5,688,197**	4,898,620	789,577	-	-	-	-
Local Currency Interest Rate Sensitivity Gap		**(778,189)**	(4,854,648)	(441,770)	692,745	482,264	1,320,878	2,022,342
On-Balance Sheet Interest Rate Sensitivity Gap		-	(4,760,221)	545,341	694,172	130,246	1,127,570	2,262,892
Off-Balance Sheet Instruments		-	-	(326,068)	(359)	343,602	5,890	(23,065)
Total Interest Rate Sensitivity Gap		-	(4,760,221)	219,273	693,813	473,848	1,133,460	2,239,827
Interest Rate Sensitivity Gap by Currency:								
New Zealand dollar		**(24,032)**	(4,854,648)	312,387	692,745	482,264	1,320,878	2,022,342
United States dollar		**(23,445)**	38,257	(56,916)	1,068	(8,409)	(37,701)	40,256
euro		**(5,595)**	32,862	(27,717)	-	982	(96,966)	85,244
Other		**53,072**	23,308	(8,481)	-	(989)	(52,751)	91,985

	Weighted Average Interest Rate	Total 2004 $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	1.6%	**89,204**	-	89,204	-	-	-	-
Other Cash Balances	1.5%	**2,446**	-	2,446	-	-	-	-
Marketable Securities	1.6%	**3,159,447**	-	1,731,619	118,448	384,379	739,797	185,204
Receivable from Unsettled Sales of Securities	0%	**28,303**	-	28,303	-	-	-	-
Securities Purchased Under Agreements to Re-sell	1.5%	**2,286,586**	-	2,286,586	-	-	-	-
Shareholding in the Bank for International Settlements	0%	**95,660**	95,660	-	-	-	-	-
Dividend Receivable	0%	**990**	990	-	-	-	-	-
Accrued Interest	0%	**18,574**	-	18,574	-	-	-	-
Total Foreign Currency Financial Assets	1.5%	**5,681,210**	96,650	4,156,732	118,448	384,379	739,797	185,204
Foreign Currency Financial Liabilities:								
Short-Term Deposits	2.6%	**2,597**	-	2,597	-	-	-	-
Payable for Unsettled Purchases of Securities	0%	**30,135**	-	30,135	-	-	-	-
Short Sales of Marketable Securities	3.1%	**418,263**	-	-	-	119,380	236,629	62,254
Derivative Financial Instruments in a Loss Position	2.4%	**174**	-	(19,135)	-	-	-	19,309
Securities Sold Under Agreements to Repurchase	1.5%	**1,262,187**	-	1,262,187	-	-	-	-
Term Liabilities	1.9%	**3,819,403**	-	2,868,886	-	393,402	557,115	-
Accrued Interest	0%	**41,459**	-	41,459	-	-	-	-
Total Foreign Currency Financial Liabilities	1.9%	**5,574,218**	-	4,186,129	-	512,782	793,744	81,563
Foreign Currency Interest Rate Sensitivity Gap		**106,992**	96,650	(29,397)	118,448	(128,403)	(53,947)	103,641
Local Currency Financial Assets:								
Cash on Hand	0%	**8**	-	8	-	-	-	-
Securities Purchased Under Agreements to Re-sell	5.8%	**1,453,976**	-	1,453,976	-	-	-	-
Investment Portfolio - New Zealand Government Securities	6.6%	**3,266,896**	-	-	576,992	430,712	447,653	1,811,539
Accrued Interest	0%	**56,228**	-	56,228	-	-	-	-
Other Local Currency Financial Assets	4.8%	**24**	-	24	-	-	-	-
Other Assets	0%	**39,238**	39,238	-	-	-	-	-
Total Local Currency Assets	6.2%	**4,816,370**	39,238	1,510,236	576,992	430,712	447,653	1,811,539
Local Currency Financial Liabilities:								
Government Deposits	5.8%	**1,242,466**	-	1,242,466	-	-	-	-
Other Deposits	5.5%	**139,640**	-	139,640	-	-	-	-
Accrued Interest	0%	**215**	-	215	-	-	-	-
Other Liabilities	0%	**3,120,322**	3,120,322	-	-	-	-	-
Equity	0%	**420,719**	420,719	-	-	-	-	-
Total Local Currency Liabilities and Equity	1.6%	**4,923,362**	3,541,041	1,382,321	-	-	-	-
Local Currency Interest Rate Sensitivity Gap		**(106,992)**	(3,501,803)	127,915	576,992	430,712	447,653	1,811,539
On-Balance Sheet Interest Rate Sensitivity Gap		**-**	(3,405,153)	98,518	695,440	302,309	393,706	1,915,180
Off-Balance Sheet Instruments		**-**	-	(638,343)	(1,179)	291,473	379,638	(31,589)
Total Interest Rate Sensitivity Gap		**-**	(3,405,153)	(539,825)	694,261	593,782	773,344	1,883,591
Interest Rate Sensitivity Gap by Currency:								
New Zealand dollar		**(9,870)**	(3,501,803)	225,036	576,993	430,712	447,653	1,811,539
United States dollar		**4,254**	38,568	(652,731)	(1,053)	236,503	375,507	7,460
euro		**(3,536)**	33,844	(99,333)	118,321	(73,433)	(49,816)	66,881
Other		**9,152**	24,238	(12,797)	-	-	-	(2,289)

20. Foreign Currency Risk

Foreign currency risk is the risk of loss arising from changes in exchange rates. The assets held in foreign currency portfolios are largely matched by foreign currency liabilities of approximately equal value, subject to monetary policy foreign exchange intervention objectives. The Bank may maintain an unhedged foreign currency position consistent with its monetary policy foreign exchange objectives. During the financial year ended 30 June 2005, the Bank did not undertake any monetary policy foreign exchange intervention activities.

The Bank's exposure to foreign currency risk also arises from trading positions undertaken by specialist staff. Foreign currency risk is managed by way of Value at Risk (VaR) limits and stop-loss limits for the Bank's combined market risk, as described in note 21.

Foreign currency assets and liabilities arising from domestic Market Operations are fully hedged using forward foreign currency contracts.

The Bank has hedged foreign exchange risk on the investment in shares issued by the Bank for International Settlements using foreign currency forward contracts.

As at 30 June 2005, the Bank's net exposure to major currencies, including forward foreign exchange contracts and foreign currency swaps, was as follows:

		Currency of Denomination		
	Total All Currencies 2005 $000	United States dollar $000	euro $000	Other Currencies $000
Foreign Currency Financial Assets:				
Cash Balances with Other Central Banks	**80,385**	55,854	2,426	22,105
Other Cash Balances	**3,147**	1,219	1,197	731
Marketable Securities	**4,104,946**	2,082,530	1,807,971	214,445
Short-Term Advances	**33,014**	-	33,014	-
Receivable from Unsettled Sales of Securities	**133,099**	-	133,099	-
Securities Purchased Under Agreements to Re-sell	**3,603,388**	2,030,369	1,426,918	146,101
Shareholding in the Bank for International Settlements	**92,949**	36,779	32,862	23,308
Dividend Receivable	**1,478**	1,478	-	-
Accrued Interest	**34,057**	5,951	26,121	1,985
Total Foreign Currency Financial Assets	**8,086,463**	4,214,180	3,463,608	408,675
Foreign Currency Financial Liabilities:				
Payable for Unsettled Purchases of Securities	**144,535**	10,056	134,479	-
Short Sales of Marketable Securities	**1,221,190**	167,128	905,752	148,310
Derivative Financial Instruments in a Loss Position	**20,169**	-	3,067	17,102
Securities Sold Under Agreements to Repurchase	**1,836,731**	752,701	949,109	134,921
Term Liabilities	**4,031,644**	2,615,856	1,415,788	-
Accrued Interest	**54,005**	24,422	28,289	1,294
Total Foreign Currency Financial Liabilities	**7,308,274**	3,570,163	3,436,484	301,627
Off-Balance Sheet Instruments[48]	**(754,157)**	(667,462)	(32,719)	(53,976)
Net Foreign Currency Exposure	**24,032**	(23,445)	(5,595)	53,072

48 Forward foreign exchange contracts with a nominal value of USD 7.5 million (fair value loss of $0.3 million) and commodity futures contracts with a nominal value of USD 10 million (fair value gain of $0.4 million), relating to future expected income from the scrapping of old coins, are not included in the above risk note.

	Total All Currencies 2004 $000	Currency of Denomination United States dollar $000	euro $000	Other Currencies $000
Foreign Currency Financial Assets:				
Cash Balances with Other Central Banks	**89,204**	43,661	34,834	10,709
Other Cash Balances	**2,446**	796	880	770
Marketable Securities	**3,159,447**	1,780,375	1,378,965	107
Receivable from Unsettled Sales of Securities	**28,303**	-	28,303	-
Securities Purchased Under Agreements to Re-sell	**2,286,586**	1,356,319	930,267	-
Shareholding in the Bank for International Settlements	**95,660**	37,578	33,844	24,238
Dividend Receivable	**990**	990	-	-
Accrued Interest	**18,574**	2,155	16,419	-
Total Foreign Currency Financial Assets	5,681,210	3,221,874	2,423,512	35,824
Foreign Currency Financial Liabilities:				
Short-Term Deposits	**2,597**	537	-	2,060
Payable for Unsettled Purchases of Securities	**30,135**	-	30,135	-
Short Sales of Marketable Securities	**418,263**	134,843	283,420	-
Derivative Financial Instruments in a Loss Position	**174**	-	174	-
Securities Sold Under Agreements to Repurchase	**1,262,187**	762,941	499,244	2
Term Liabilities	**3,819,403**	2,259,908	1,559,495	-
Accrued Interest	**41,459**	21,240	20,219	-
Total Foreign Currency Financial Liabilities	5,574,218	3,179,469	2,392,687	2,062
Off-Balance Sheet Instruments[49]	**(97,122)**	(38,151)	(34,361)	(24,610)
Net Foreign Currency Exposure	9,870	4,254	(3,536)	9,152

The Reserve Bank's net foreign currency exposure, classified in the above tables as Other Currencies, comprises:

	2005 $000	2004 $000
Australian dollar	**9,117**	1,648
British pound	**438**	(535)
Canadian dollar	**66**	4,182
Japanese yen	**(28,693)**	4,654
Swiss francs	**48**	(797)
Various currencies (Asian Bond Fund 2)	**72,096**	-
Total Other Currencies	53,072	9,152

49 Forward foreign currency contracts with a nominal value of USD 1.6 million (fair value loss of $0.1 million), relating to future capital expenditure commitments, are not included in the above risk note.

21. Market Risk

The Reserve Bank manages interest rate risk and foreign currency risk (excluding foreign currency risk arising from monetary policy objectives) under the following market risk management arrangements. Policy-related positions, both existing Asian Bond Fund Investments and any foreign exchange exposure that may arise from policy driven interventions, are excluded from the scope of the limits below.

(a) Tolerance for Extreme Market Risk Losses

The Governor's tolerance for loss from interest rate risk and foreign currency risk is no more than $75 million (2004 $75 million) in aggregate in any financial year. Within this aggregate outer tolerance for market risk losses, the Governor's tolerance for market risk losses from actively managed positions is $25 million (2004 $25 million) in any financial year. Stress testing (outlined below) is used to verify the robustness of the loss tolerances in times of extreme global financial market crises.

(b) VaR Limits and Stress Testing

Interest rate and foreign exchange risks are controlled on a day-to-day basis by way of Value at Risk (VaR) limits. VaR estimates the potential daily loss from movements in market variables (interest rate changes and foreign currencies movements) in normal market conditions. The Bank uses a parametric VaR model based on equally weighted data for the previous year (250 trading days), a one-day time horizon, and a 99 per cent confidence interval. This means the Bank would expect to incur losses greater than predicted by VaR estimates only once every 100 trading days, or about 2.5 times a year. VaR does not capture market risk losses arising from the extreme price volatility associated with financial market crises. Accordingly, VaR limits are set well inside the limits of tolerance for extreme market risk. The Bank calibrates the allowance for extreme market risk losses by modelling the impact of earlier global financial crises on a representative diversified portfolio that fully utilises VaR limits.

VaR limits are set for the aggregate portfolios (total foreign reserves assets and liabilities), risk-neutral portfolios, and trading portfolios (actively managed). The VaR for the trading portfolios is calculated as the difference between the aggregate portfolios and risk-neutral portfolios.

	Aggregate Portfolios		Risk-Neutral Portfolios		Trading Portfolios	
VaR	**2005 $000**	2004 $000	**2005 $000**	2004 $000	**2005 $000**	2004 $000
Limit	**6,000**	6,000	**4,000**	4,000	**2,000**	2,000
As at 30 June	**451**	248	**244**	186	**207**	62
Peak over period	**704**	591	**294**	289	**512**	365
Low over period	**192**	247	**107**	156	**38**	24
Average over period	**416**	367	**177**	230	**238**	137

The Asian Bond Fund 1 (ABF1) investment, in the amount of USD 25 million, was entered into with other EMEAP countries on 3 July 2003. The fund is managed by the Bank for International Settlements (BIS). Positions and associated VaR are excluded from the table above. As at 30 June 2005, VaR for the ABF1 investment was estimated at $167,000 (2004 $270,000), with a peak VaR of $273,000 (2004 $290,000) during the year.

The Reserve Bank also has an investment of USD 50 million in the Asian Bond Fund 2 (ABF2), which was established by EMEAP countries to promote the local bond markets. The investment was made in two instalments, the first on 8 March 2005 and the second on 21 April 2005. ABF2 is a local currency bond fund and consists of the Pan-Asian Index Fund (PAIF) and eight individual countries sub-funds. ABF2 is managed by custodians nominated by the BIS, and the Reserve Bank's investment is by way of ownership participation in a BIS Investment Pool. ABF2 positions and VaR are excluded from the table above. As at 30 June 2005, VaR for the ABF2 investment was estimated at $575,000, with a peak VaR of $666,000.

In the year to 30 June 2005, actual daily losses on the trading portfolios were within (predicted) VaR 99.6 per cent (2004 98.8 per cent) of the time. Losses that exceed VaR more frequently than expected are analysed to verify the integrity of the VaR model, and the results of analysis are reported to senior management at the Asset and Liability Committee.

The composition of market risk for the aggregate portfolios is as follows:

VaR	Foreign Currency Risk $000	Interest Rate Risk $000	Correlation $000	Total Market Risk On Aggregate Portfolios 2005 $000	Total Market Risk On Aggregate Portfolios 2004 $000
Limit				6,000	6,000
As at 30 June	258	473	(280)	451	248
Peak over period	500	772	(209)	704	591
Low over period	83	379	(620)	192	247
Average over period	244	551	(379)	416	367

(c) Stop-Loss Limits

Stop-loss limits are set to control losses that may arise from departures from the risk-neutral position. A stop-loss limit of $6 million in any rolling 20-day trading period and $9 million in any rolling 250-day trading period is applied to the aggregate interest rate and foreign currency losses from trading positions. When aggregate market risk losses exceed the stop-loss limit, positions are closed down. The Governor must approve the re-establishment of positions.

22. 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.

(a) Foreign Currency Activities

Liquidity is a key criterion in determining the composition of the Reserve 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 daily.

The Bank has additional liquidity arrangements for foreign currency assets including repurchase agreements with other central banks enabling 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 minimal additional risks. In the prior year, the Bank had a committed credit line (USD 100 million) that would be accessed quickly to augment the foreign currency. This facility was terminated on 30 June 2005.

(b) Local Currency Activities

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

23. Maturity Analysis

	Total 2005 $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	**80,385**	80,385	-	-	-	-
Other Cash Balances	**3,147**	3,147	-	-	-	-
Marketable Securities[50]	**4,104,946**	2,722,815	38,396	260,780	523,302	559,653
Short-Term Advances	**33,014**	33,014	-	-	-	-
Receivable from Unsettled Sales of Securities	**133,099**	133,099	-	-	-	-
Securities Purchased Under Agreements to Re-sell	**3,603,388**	3,603,388	-	-	-	-
Shareholding in the Bank for International Settlements[51]	**92,949**	-	-	-	-	92,949
Dividend Receivable	**1,478**	1,478	-	-	-	-
Accrued Interest	**34,057**	34,057	-	-	-	-
Total Foreign Currency Financial Assets	**8,086,463**	6,611,383	38,396	260,780	523,302	652,602
Foreign Currency Financial Liabilities:						
Payable for Unsettled Purchases of Securities	**144,535**	144,535	-	-	-	-
Short Sales of Marketable Securities	**1,221,190**	42,744	36,969	142,652	679,723	319,102
Derivative Financial Instruments in a Loss Position	**20,169**	17,103	-	-	-	3,066
Securities Sold Under Agreements to Repurchase	**1,836,731**	1,836,731	-	-	-	-
Term Liabilities	**4,031,644**	514,091	106,317	560,958	1,371,454	1,478,824
Accrued Interest	**54,005**	54,005	-	-	-	-
Total Foreign Currency Financial Liabilities	**7,308,274**	2,609,209	143,286	703,610	2,051,177	1,800,992
Foreign Currency Maturity Gap	**778,189**	4,002,174	(104,890)	(442,830)	(1,527,875)	(1,148,390)
Local Currency Financial Assets:						
Cash on Hand	**2**	2	-	-	-	-
Securities Purchased Under Agreements to Re-sell	**265,199**	265,199	-	-	-	-
Investment Portfolio - New Zealand Government Securities	**4,518,229**	-	692,745	482,263	1,320,878	2,022,343
Accrued Interest	**82,556**	82,556	-	-	-	-
Other Local Currency Financial Assets	**50**	50	-	-	-	-
Other Assets	**43,972**	8,332	-	-	-	35,640
Total Local Currency Assets	**4,910,008**	356,139	692,745	482,263	1,320,878	2,057,983
Local Currency Financial Liabilities:						
Government Deposits	**667,474**	667,474	-	-	-	-
Other Deposits	**121,971**	121,971	-	-	-	-
Accrued Interest	**132**	132	-	-	-	-
Other Liabilities[52]	**3,344,441**	146,857	-	-	-	3,197,584
Equity	**1,554,179**	-	-	-	-	1,554,179
Total Local Currency Liabilities and Equity	**5,688,197**	936,434	-	-	-	4,751,763
Local Currency Maturity Gap	**(778,189)**	(580,295)	692,745	482,263	1,320,878	(2,693,780)
Net Maturity Gap	**-**	3,421,879	587,855	39,433	(206,997)	(3,842,170)

50 The Asian Bond Fund Investment has no fixed maturity and is presented as maturing over five years.

51 The Shareholding in the Bank for International Settlements has no fixed maturity and is presented as maturing over five years.

52 Other Liabilities includes Currency in Circulation, which has no fixed maturity and is presented as maturing over five years.

	Total 2004 $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	**89,204**	89,204	-	-	-	-
Other Cash Balances	**2,446**	2,446	-	-	-	-
Marketable Securities[53]	**3,159,447**	2,346,007	118,448	131,593	378,195	185,204
Receivable from Unsettled Sales of Securities	**28,303**	28,303	-	-	-	-
Securities Purchased Under Agreements to Re-sell	**2,286,586**	2,286,586	-	-	-	-
Shareholding in the Bank for International Settlements[54]	**95,660**	-	-	-	-	95,660
Dividend Receivable	**990**	990	-	-	-	-
Accrued Interest	**18,574**	18,574	-	-	-	-
Total Foreign Currency Financial Assets	**5,681,210**	4,772,110	118,448	131,593	378,195	280,864
Foreign Currency Financial Liabilities:						
Short-Term Deposits	**2,597**	2,597	-	-	-	-
Payable for Unsettled Purchases of Securities	**30,135**	30,135	-	-	-	-
Short Sales of Marketable Securities	**418,263**	-	-	119,380	236,629	62,254
Derivative Financial Instruments in a Loss Position	**174**	95	-	-	-	79
Securities Sold Under Agreements to Repurchase	**1,262,187**	1,262,187	-	-	-	-
Term Liabilities	**3,819,403**	602,114	-	704,380	1,970,537	542,372
Accrued Interest	**41,459**	41,459	-	-	-	-
Total Foreign Currency Financial Liabilities	**5,574,218**	1,938,587	-	823,760	2,207,166	604,705
Foreign Currency Maturity Gap	**106,992**	2,833,523	118,448	(692,167)	(1,828,971)	(323,841)
Local Currency Financial Assets:						
Cash on Hand	**8**	8	-	-	-	-
Securities Purchased Under Agreements to Re-sell	**1,453,976**	1,453,976	-	-	-	-
Investment Portfolio - New Zealand Government Securities	**3,266,896**	-	576,992	430,712	447,653	1,811,539
Accrued Interest	**56,228**	56,228	-	-	-	-
Other Local Currency Financial Assets	**24**	24	-	-	-	-
Other Assets	**39,238**	8,278	-	-	-	30,960
Total Local Currency Assets	**4,816,370**	1,518,514	576,992	430,712	447,653	1,842,499
Local Currency Financial Liabilities:						
Government Deposits	**1,242,466**	1,242,466	-	-	-	-
Other Deposits	**139,640**	139,640	-	-	-	-
Accrued Interest	**215**	215	-	-	-	-
Other Liabilities[55]	**3,120,322**	197,215	-	-	-	2,923,107
Equity	**420,719**	-	-	-	-	420,719
Total Local Currency Liabilities and Equity	**4,923,362**	1,579,536	-	-	-	3,343,826
Local Currency Maturity Gap	**(106,992)**	(61,022)	576,992	430,712	447,653	(1,501,327)
Net Maturity Gap	**-**	2,772,501	695,440	(261,455)	(1,381,318)	(1,825,168)

53 The Asian Bond Fund Investment has no fixed maturity and is presented as maturing over five years.

54 The Shareholding in the Bank for International Settlements has no fixed maturity and is presented as maturing over five years.

55 Other Liabilities includes Currency in Circulation, which has no fixed maturity and is presented as maturing over five years.

Consolidated Statement of Cost of Services Notes

24. Currency Operations

Seigniorage is the income directly associated with the issue of currency and provides the Reserve Bank with its main source of income. Registered banks pay the Bank the face value of the currency issued to them. These funds are invested in the Investment Portfolio - New Zealand Government Securities, which is included in Local Currency Financial Assets, to back the Currency in Circulation liability. Currency in Circulation is a non-interest bearing liability. However, the Investment Portfolio - New Zealand Government Securities is interest-bearing. The resulting interest income is seigniorage.

As part of the Currency Operations function, the Bank issues collectors' currency. The net profit for this activity in 2005 was $263,000 (2004 $632,000) and included a currency stock write-off of $72,000 (2004 $2,000).

Currency Operations includes income and expenses associated with property management. The net surplus for this activity in 2005 was $219,000 (2004 $133,000).

	2005 $000	2004 $000
Operating Income:		
Seigniorage Income	202,038	195,235
Other Income	446	645
Total Operating Income	202,484	195,880
Currency Issued Expenses:		
New Coin Issued Expenses	3,020	4,110
New Note Issued Expenses	2,759	1,305
Collectors' Currency Issue Expenses	78	9
Total Currency Issued Expenses	5,857	5,424
Other Currency Expenses	3,670	3,343
Total Operating Expenses	9,527	8,767
Currency Operations Operating Surplus	192,957	187,113

In March 2005, the Bank announced its decision to replace all silver coins and to take the 5 cent coin out of circulation, with the transition scheduled to take place in the latter half of 2006. The Bank has entered into various hedging contracts to reduce foreign currency and commodity price risks relating to the project.

25. Foreign Reserves Management

The Reserve Bank holds foreign currency assets to support the functions of the Bank, including monetary policy objectives and maintenance of orderly markets. These foreign reserves are fully funded by borrowing through The Treasury.

Subject to liquidity and credit risk constraints being satisfied, the Bank defines benchmark portfolios that represent a risk-neutral asset and liability structure in terms of market risk. The risk-neutral position is established to minimise the Bank's exposure to foreign currency risk and interest rate risk, subject to monetary policy foreign exchange intervention objectives. Departures from the risk-neutral position involve discretionary trading and portfolio management decisions and quantitative trading strategies, undertaken by specialist staff with delegated authority from the Governor. The net gain or loss arising from departures from the risk-neutral portfolio represents the active management of reserves.

	2005 $000	2004 $000
Gain/(Loss) on Active Management Trading	(180)	681
Gain/(Loss) on Risk-Neutral Asset/Liability Structure[56]	2,515	(1,703)
Net Investment Income	2,335	(1,022)
Other Income	19	8
Foreign Exchange Difference on Translation	(103)	(123)
Total Operating Income	2,251	(1,137)
Total Operating Expenses	4,503	4,283
Foreign Reserves Management Operating Deficit	(2,252)	(5,420)

For further information on the Foreign Reserves Management function, see note 1, parts (a) to (e). Further information on risk management is contained in notes 16 to 23.

26. Overseas Investment Commission Secretariat

The Overseas Investment Commission (OIC) administers New Zealand's legislative controls on major inward foreign direct investment. The Reserve Bank provides the secretariat of the OIC and funds its activities to the extent these are not covered by application fees.

The income and expenditure of the OIC for the year ended 30 June 2005 was:

	2005 $000	2004 $000
Operating Income:		
Application Fees	823	827
Other Income	24	2
Total Operating Income	847	829
Operating Expenses:		
Personnel Expenses	678	542
Professional Service Fees	111	117
Computing Expenses	80	81
Asset Management Expenses	55	54
Legal Fees	33	34
Other Expenses	40	36
Total Operating Expenses	997	864
Overseas Investment Commission Secretariat Operating Surplus/(Deficit)	(150)	(35)

56 Income and expenses relating to the Asian Bond Fund Investments were previously classified as Earnings on Investments Funded by Equity and were not included in Foreign Reserves Management. The comparative figures have been restated to reflect the change in classification (decreasing the Loss on Risk-Neutral Asset/Liability Structure in 2004 by $322,000 and increasing Operating Expenses by $6,000).

Fees for the OIC were introduced on 15 January 1996. Under the Funding Agreement from 1 July 2000, the OIC operating surplus/ (deficit) is retained by the Bank. The annual operating income and operating surplus/(deficit) since 15 January 1996 have been as follows:

Financial Year Ended 30 June:	Operating Income $000	Operating Surplus (Deficit) $000
1996 (six months)	373	46
1997	589	(116)
1998	583	(279)
1999	764	41
2000	628	(63)
2001	581	(94)
2002	855	(83)
2003	821	153
2004	829	(35)
2005	**847**	**(150)**
	6,870	**(580)**

On 25 August 2005, the services and funding provided by the Bank to the OIC were discontinued. Refer to note 45: *Significant Post-Balance Date Events*.

27. Registry and Depository Services

The Bank operates the Austraclear New Zealand System, which provides the financial markets with depository, clearing, settlement services and limited registry services for debt securities and equities. The Reserve Bank also provides registrar and paying agency services to issuers of fixed interest securities. The Bank exited the retail registry business in December 2004.

	2005 $000	2004 $000
Operating Income:		
Registry and Depository Services Fees	4,030	4,605
Other Income	44	186
Total Operating Income	4,074	4,791
Operating Expenses:		
Personnel Expenses	781	1,008
Other Expenses	2,150	2,834
Total Operating Expenses	2,931	3,842
Registry and Depository Services Operating Surplus	1,143	949

Consolidated Statement of Financial Performance Notes

28. Interest Income from Financial Assets

	2005 $000	2004 $000
Interest Income from Foreign Currency Financial Assets:		
Cash Balances with Other Central Banks	2,607	1,451
Other Cash Balances	28	3
Marketable Securities	53,100	33,907
Securities Purchased Under Agreements to Re-sell	35,016	28,814
Securities Lending Programme	422	409
Total Interest Income from Foreign Currency Financial Assets	91,173	64,584
Interest Income from Local Currency Financial Assets:		
Securities Purchased Under Agreements to Re-sell	41,629	121,389
Investment Portfolio - New Zealand Government Securities	280,968	217,175
Government Bank Accounts	743	114
Total Interest Income from Local Currency Financial Assets	323,340	338,678
Total Interest Income from Financial Assets	414,513	403,262

29. Interest Expense on Financial Liabilities

	2005 $000	2004 $000
Interest Expense on Foreign Currency Financial Liabilities:		
Securities Sold Under Agreements to Repurchase[57]	14,277	3,246
Term Liabilities	63,074	135,912
Other	65	13
Total Interest Expense on Foreign Currency Financial Liabilities	77,416	139,171
Interest Expense on Local Currency Financial Liabilities:		
Government Deposits	76,652	178,846
Other Deposits	10,655	4,416
Total Interest Expense on Local Currency Financial Liabilities	87,307	183,262
Total Interest Expense on Financial Liabilities	164,723	322,433

57 The gain/loss relating to the revaluation of the loan associated with the Asian Bond Fund Investment has been reclassified from note 29: *Interest Expenses on Financial Liabilities* to note 30: *Gain/(Loss) from Fair Value Changes*. Comparative figures have been restated to reflect this change ($1.1 million).

30. Gain/(Loss) from Fair Value Changes

Market value changes arise when financial instruments that are measured at fair value are revalued for changes in the market interest rates.

	2005 $000	2004 $000
Fair Value Changes on Financial Assets:		
Gain/(Loss) from Unrealised Fair Value Changes	7,452	(26,311)
Gain from Realised Fair Value Changes	327	15,928
Total Gain/(Loss) from Fair Value Changes on Financial Assets	7,779	(10,383)
Fair Value Changes on Financial Liabilities:		
Gain from Unrealised Fair Value Changes[58]	(28,915)	(94,907)
Loss from Realised Fair Value Changes	45,852	4,498
Total Loss/(Gain) from Fair Value Changes on Financial Liabilities	16,937	(90,409)
Total Gain/(Loss) from Fair Value Changes	(9,158)	80,026

31. Net Foreign Exchange Revaluation Gain/(Loss)

	2005 $000	2004 $000
Foreign Exchange Revaluations:		
Loss on Financial Assets	(409,463)	(217,230)
Gain on Financial Liabilities	407,352	217,302
Net Foreign Exchange Revaluation Gain/(Loss)	(2,111)	72

32. Other Income

	Actual 2005 $000	Budget 2005 $000	Actual 2004 $000
Registry and Depository Services Fees	4,030	3,819	4,605
Property Rental Income	1,600	1,488	1,528
Exchange Settlement Account System Income[59]	1,440	1,416	1,536
Overseas Investment Commission Fees	825	1,081	829
Collectors' Currency Income	377	532	739
Registered Bank Fees	15	36	3
Miscellaneous Income	71	13	120
Total Other Income	8,358	8,385	9,360

58 The gain/loss relating to the revaluation of the loan associated with the Asian Bond Fund Investment has been reclassified from note 29: *Interest Expense on Financial Liabilities* to note 30: *Gain/(Loss) from Fair Value Changes*. Comparative figures have been restated to reflect this change ($1.1 million).

59 Exchange Settlement Account System Income was previously included in Miscellaneous Income. Comparative figures have been restated to reflect this change in classification ($1.5 million).

33. Asset Management Expenses

	Note	Actual 2005 $000	Budget 2005 $000	Actual 2004 $000
Depreciation of Property, Plant and Equipment	5	2,250	2,192	2,132
Other Asset Management Expenses		1,704	1,605	1,410
Finance Charges Relating to Finance Leases		21	-	10
Gain on Disposal of Fixed Assets		(100)	-	(5)
Total Asset Management Expenses		3,875	3,797	3,547

34. Other Operating Expenses

	Note	Actual 2005 $000	Budget 2005 $000	Actual 2004 $000
Professional Fees		3,411	3,575	3,286
Agency and Commission Fees		1,026	1,016	1,788
Computer Expenses		1,151	1,254	1,267
Information Expenses		1,011	1,072	1,007
Administration Expenses		1,135	1,186	1,146
Operational Travel Expenses		573	713	732
Printing Expenses		267	300	179
Auditor Remuneration:				
Statutory Audit		208	156	149
Payments Systems Audits		40	31	31
Advisory Services		56	37	103
Rental and Lease Expenses		183	515	220
Non-Executive Directors' Remuneration Expenses	35	152	147	139
Bad Debt Expenses		-	-	-
Miscellaneous Expenses		233	366	284
Total Other Operating Expenses		9,446	10,368	10,331

The Statutory Audit expense comprises the fee for the audit of the annual Financial Statements of the Reserve Bank.

The Payments Systems Audits expense comprises fees paid for the contractual audits of the Austraclear depository system and the Exchange Settlement Account System.

The Advisory Services expense comprises fees relating to accounting advice with respect to the Bank's Funding Agreement, the Investment Portfolio and shares in the Bank for International Settlements, the provision of actuarial advice to the Superannuation Fund, and advice with respect to the application of accounting policies to the Financial Statements. These advisory services were approved in accordance with the Bank's External Auditor Independence Policy, which requires that prior to engaging the external auditor for any of these services, the advice of the Chair of the Audit Committee must be sought and approval must be given by the Governor.

35. Non-Executive Directors' Remuneration

Non-Executive Directors' Remuneration consists of directors' fees. Directors' fees represent consideration for services provided to the Bank for acting as directors of the Bank. Certain non-executive directors receive additional remuneration due to their involvement in Board committees. There are no fees paid to the executive directors of the Bank.

	2005 $000	2004 $000
Non-Executive Directors:		
A Grimes (Chair)	36	32
A Paterson (Deputy Chair)	23	22
P Baines	19	17
H Fletcher	19	17
J Goulter	19	17
R Richardson	-	10
Rt. Hon E Thomas	18	17
M Waring	18	7
Total Non-Executive Directors' Remuneration Expenses	152	139

Other Notes

36. Reconciliation of Net Cash Flows from Operating Activities with Reported Operating Surplus

	2005 $000	2004 $000
Reported Operating Surplus	272,744	195,137
Add/(Subtract) Non-Cash Items:		
Depreciation	2,250	2,132
Amortisation of Premium/Discount on Financial Instruments	(13,687)	23,945
Net Unrealised Market Value Changes	(36,367)	(19,761)
Net Unrealised Foreign Exchange Gain	(93,268)	(212,578)
	(141,072)	(206,262)
Decrease/(Increase) in Current Assets:		
Movement in Accounts Receivable	(1,180)	643
Movement in Inventories	637	713
Movement in Interest Receivable	(41,837)	97
	(42,380)	1,453
Increase/(Decrease) in Current Liabilities:		
Movement in Miscellaneous Liabilities	1,845	(1,803)
Movement in Interest Payable	9,866	(10,247)
	11,711	(12,050)
Net Movements in Other Working Capital Items	(30,669)	(10,597)
Add/(Subtract) Investing and Financing Activities:		
Net Realised Foreign Exchange Loss	95,379	212,506
Net Realised Market Value Changes	45,512	(11,430)
Return of Demonetised Coin	-	2
Gain on Sale of Fixed Assets	(100)	-
	140,791	201,078
Net Cash Flow from Operating Activities	241,794	179,356

37. Cash Balances

	2005 $000	2004 $000
Foreign Currency Cash Assets:		
Cash Balances with Other Central Banks	80,385	89,204
Other Cash Balances	3,147	2,446
Marketable Securities - Liquefiable Within Two Working Days	1,983,564	1,586,201
Total Foreign Currency Cash Assets	2,067,096	1,677,851
Local Currency Cash Assets:		
Cash on Hand	2	8
Securities Purchased Under Agreements to Re-sell	265,199	1,453,976
Total Local Currency Cash Assets	265,201	1,453,984
Total Cash Assets	2,332,297	3,131,835
Demand Liabilities:		
Government Deposits	667,474	1,242,466
Settlement Bank Deposits	57,183	71,051
Central Bank Deposits	15,537	11,144
International Monetary Fund Deposit	49,251	57,221
Other Deposits	-	224
Total Demand Liabilities	789,445	1,382,106
Closing Cash Balances	1,542,852	1,749,729

38. Statement of Commitments

(a) Capitalised Finance Lease Commitments

The Bank leases computer equipment under non-cancellable finance leases. The payments are determined at the beginning of the lease agreements and remain constant during the term of the lease. There are no terms of renewal or purchase options attached to the lease agreements. There are no further restrictions imposed by the agreements such as dividends, additional debt and further leasing.

	2005 $000	2004 $000
Computer Equipment Finance Leases:		
Due within one year	202	307
Due within one to two years	110	174
Due within two to five years	2	12
Present Value of Minimum Lease Payments	314	493
Finance charge	14	26
Total Minimum Lease Payments	328	519
Comprising:		
Due within one year	213	326
Due within one to two years	113	193
Due within two to five years	2	-
Total Minimum Lease Payments	328	519

(b) Operating Lease Commitments

The Bank leases office equipment under operating leases. The payments are determined at the beginning of the lease agreements and remain constant during the term of the lease.

	2005 $000	2004 $000
Office Equipment Operating Leases:		
Due within one year	68	69
Due within one to two years	48	65
Due within two to five years	-	43
Total Office Equipment Operating Lease Commitments	116	177

(c) Capital Expenditure and Inventory Commitments

	2005 $000	2004 $000
Capital Expenditure and Inventory:		
Property, Plant and Equipment - Due within one year	1,129	3,915
- Due within one to three years	70	-
Inventories - Due within one year	5,808	5,894
Total Capital Expenditure and Inventory Commitments	7,007	9,809

(d) Lease Payments Receivable

The Bank owns its head office in Wellington and leases seven of the fourteen floors to tenants under operating leases. Under the current non-cancellable lease agreements, the total minimum lease payments receivable are as follows:

	2005 $000	2004 $000
Tenancy Lease Payments Receivable:		
Receivable within one year	1,455	1,406
Receivable within one to five years	4,801	4,973
Receivable later than five years	123	1,285
Total Tenancy Lease Payments Receivable	6,379	7,664

39. Subsidiary Companies

The Reserve Bank has a wholly-owned New Zealand incorporated subsidiary, New Zealand Central Securities Depository Limited (NZCSD).

NZCSD is a non-trading company, incorporated solely for the purpose of acting as a custodian trustee. It holds assets on behalf of the participants in the Austraclear New Zealand System, as described in note 44.

40. 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 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 Bank receives some free services from other organisations, generally involving the provision of information.

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

41. Related Parties

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

Transactions entered into include:

- banking services;
- agency transactions (at no charge);
- foreign exchange transactions;
- funding from The Treasury as part of the Foreign Reserves Management operations; and
- purchases of New Zealand Government Securities.

The Bank does not disclose 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.

42. 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 (the Fund), following each triennial review of the Fund.

On 2 February 1995, the Bank suspended 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.

The Actuary carried out the triennial review for the financial position of the Fund as at 31 March 2005 and reported on 27 July 2005 that, based on the Fund's annual accounts:

- Assuming the Fund is not wound up, the assets of the Fund were sufficient at 31 March 2005 to provide for benefits to members, including existing pensioners, that are attributable to membership prior to 1 April 2005. In assessing the expected cost of those benefits, the Actuary allowed for appropriate provisions for future salary growth in respect of active members, and increases in the Consumer Price Index for pensioner members.
- It is appropriate for the Bank to continue its contribution holiday.

The Fund's Trust Deed provides for the Defined Benefit division of the Fund to be wound up in the event that the Bank is wound up or by resolution of the Bank's directors. In the event that the Fund is wound up, the Fund is required to purchase annuities having values equal to the actuarial value of benefits payable by the Fund. The Actuary reported that, based on current estimates of the cost of annuities, in the event the Defined Benefit division of the Fund is wound up, the purchase cost of annuities would exceed the value of Defined Benefit assets of the Fund. On winding up, the Bank is required by the Trust Deed to make good any shortfall. The Bank considers that the likelihood of the Fund being wound up is remote.

The Actuary reported that to his knowledge, there had been no circumstances between 31 March 2005 and 30 June 2005 that would cause the Actuary to form a different opinion as at 30 June 2005.

(b) The Bank has a contingent liability for currency in circulation that has been demonetised but not returned to the Bank. The total face value of demonetised currency is $36.9 million (2004 $36.9 million), including $12.9 million (2004 $12.9 million) of demonetised coins issued by The Treasury, for which payment was received by the Bank on 31 May 2005. Of the total face value of demonetised currency, $14.0 million (2004 $1.1 million) is recognised in the Consolidated Statement of Financial Position.

(c) 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 for all collectors' currency issued by the Bank to date is $10.0 million (2004 $9.8 million).

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. During 2004/05, the Bank agreed to accept the liability for all currency issued by The Treasury.

(d) At 30 June 2005, the Bank had a contingent liability of $25.24 million (SDR 12.04 million) (2004 $26.37 million, SDR 11.25 million) in respect of uncalled and unpaid capital attached to its shareholding in the Bank for International Settlements.

43. Income Tax

Section CB3 of the Income Tax Act 1994 exempts the Reserve Bank from income tax. The Bank incurs and meets liabilities for goods and services tax, fringe benefit tax and other withholding tax.

44. Custodial Activities

The Reserve Bank 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 Bank, which, in terms of a Deed of Appointment between the Bank and NZCSD, is incorporated solely for the purpose of acting as a custodian trustee. NZCSD is a non-trading company but has legal ownership of securities beneficially owned by members of the Austraclear New Zealand System. With the exception of the local currency securities owned by the Bank and held through NZCSD, the Bank has no beneficial interest in the securities that NZCSD holds, or any management obligations apart from safe keeping or acting as paying agent in certain circumstances.

The total value of securities held by NZCSD at 30 June 2005 was $88.7 billion (2004 $76.1 billion).

The Bank undertakes to accept liability for all costs and debts of NZCSD and all liabilities of NZCSD in the event of a claim by a third party.

45. Significant Post-Balance Date Events

Regulations effective from 25 August 2005 disestablished the Overseas Investment Commission (OIC) and established the Overseas Investment Office as a division of Land Information New Zealand (LINZ). The Bank previously funded the activities of the OIC to the extent these were not covered by application fees. The Overseas Investment Act 2005 provides that the assets and liabilities of the OIC as at the effective date of transfer will vest in the Crown. The Bank will be reimbursed for accumulated costs not covered by application fees. The impact of this reimbursement is not material.