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30 August 2006

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 2006 fairly reflect the financial position and operations of the Bank.

Handwritten signature of Alan Bollard in black ink.

Governor

Handwritten signature of the Deputy Governor in black ink.

Deputy Governor

2 The Terrace, PO Box 2498, Wellington, New Zealand
Telephone 64 4 472 2029, Fax 64 4 473 8554



PricewaterhouseCoopers
 113-119 The Terrace
 PO Box 243
 Wellington
 New Zealand
 Telephone +64 4 462 7000
 Facsimile +64 4 462 7001

Audit Report

To the readers of the Reserve Bank of New Zealand and Group's Financial Statements for the year ended 30 June 2006

The Auditor-General is the auditor of the Reserve Bank of New Zealand and group. The Auditor-General has appointed me, John Meehan, 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 2006.

Unqualified Opinion

In our opinion the financial statements of the Reserve Bank of New Zealand and group on pages 62 to 112:

- comply with generally accepted accounting practice in New Zealand; and
- give a true and fair view of:
 - the Reserve Bank of New Zealand and group's financial position as at 30 June 2006; and
 - the results of operations and cash flows for the year ended on that date.
- based on our examination the Reserve Bank of New Zealand and group kept proper accounting records.

The audit was completed on 30 August 2006, 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

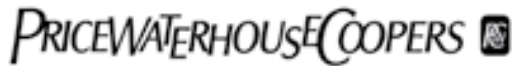
We carried out the audit in accordance with the Auditor-General's Auditing Standards, which incorporate the New Zealand Auditing Standards.

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.

Financial Statements



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.

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 give a true and fair view of the financial position of the Reserve Bank of New Zealand and group as at 30 June 2006. They must also give a true and fair view of the results of 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, process reviews, 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.



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 2006 included on the Reserve Bank of New Zealand's website. The Reserve Bank of New Zealand's Governor is responsible for the maintenance and integrity of the Reserve Bank of New Zealand's website. We have not been engaged to report on the integrity of the Reserve Bank of New Zealand's website. We accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

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 30 August 2006 to confirm the information included in the audited financial statements presented on this website.

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

A handwritten signature in black ink, appearing to read 'John Meehan'.

John Meehan
On behalf of the Auditor-General
Wellington, New Zealand

A handwritten signature in black ink, appearing to be the name of a representative from PricewaterhouseCoopers.

PricewaterhouseCoopers



Financial Statements

GUIDE TO THE MAIN FUNCTIONS OF THE RESERVE BANK

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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. The Bank ceased providing these services from 25 August 2005.

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.

RESERVE BANK OF NEW ZEALAND 2005/06 FINANCIAL STATEMENTS

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Consolidated Statement of Financial Position

As at 30 June	Note	2006 \$000	2005 \$000
Assets:			
Foreign Currency Financial Assets:			
Cash Balances with Other Central Banks		96,653	113,399
Other Cash Balances		6,586	3,147
Marketable Securities	2	3,998,036	4,093,781
Receivable from Unsettled Sales of Securities		76,398	133,099
Securities Purchased Under Agreements to Re-sell		7,408,670	3,603,388
Shareholding in the Bank for International Settlements	6	117,364	92,949
Dividend Receivable		1,878	1,478
Accrued Interest		39,080	45,239
Total Foreign Currency Financial Assets		11,744,665	8,086,480
Local Currency Financial Assets:³⁰			
Cash on Hand		2	2
Securities Purchased Under Agreements to Re-sell		122,787	265,199
Investment Portfolio – New Zealand Government Securities		4,839,781	4,518,230
Accrued Interest		72,451	82,556
Other Local Currency Financial Assets		58	32
Total Local Currency Financial Assets		5,035,079	4,866,019
Total Financial Assets		16,779,744	12,952,499
Other Assets:			
Accounts Receivable and Deferred Costs	3	15,297	2,111
Inventories	4	11,098	6,221
Fixed Assets	5	53,724	35,640
Total Other Assets		80,119	43,972
Total Assets		16,859,863	12,996,471

³⁰ Foreign currency assets and liabilities do not match primarily due to \$4,623.9 million (2005 \$739.8 million) of assets arising from forward foreign exchange swap contracts from Market Operations. The assets are fully hedged through forward transactions.

Consolidated Statement of Financial Position continued

As at 30 June	Note	2006 \$000	2005 \$000
Liabilities:			
Foreign Currency Financial Liabilities:			
Payable for Unsettled Purchases of Securities		76,417	144,535
Short Sales of Marketable Securities		342,061	1,221,190
Derivative Financial Instruments in a Loss Position	3	149,308	20,169
Securities Sold Under Agreements to Repurchase		1,211,805	1,836,731
Term Liabilities	7	5,313,886	4,031,644
Accrued Interest		36,785	54,005
Total Foreign Currency Financial Liabilities		7,130,262	7,308,274
Local Currency Financial Liabilities:			
Government Deposits		2,247,963	667,474
Other Deposits	8	2,086,883	121,971
Securities Sold Under Agreements to Repurchase		192,721	-
Accrued Interest		913	132
Total Local Currency Financial Liabilities		4,528,480	789,577
Total Financial Liabilities		11,658,742	8,097,851
Other Liabilities:			
Currency in Circulation	9	3,348,025	3,182,623
Provision for Transfer of Surplus to the New Zealand Government	12	410,000	139,284
Miscellaneous Liabilities	10	21,696	22,534
Total Other Liabilities		3,779,721	3,344,441
Total Liabilities		15,438,463	11,442,292
Equity	13	1,421,400	1,554,179
Total Liabilities and Equity		16,859,863	12,996,471

The above statement is to be read in conjunction with the notes on pages 76 to 112.

Consolidated Statement of Movements in Equity

For the year ended 30 June	Note	2006 \$000	2005 \$000
Net Surplus for the Year		253,907	272,744
Increase in Property Revaluation Reserve	13	15,290	-
Increase in Shareholding in the Bank for International Settlements	13	8,024	-
Total Recognised Revenues and Expenses for the Year		277,221	272,744
Provision for Transfer of Surplus to the New Zealand Government	12	(410,000)	(139,284)
Capital provided by the New Zealand Government	13	-	1,000,000
Movement in Equity for the Year		(132,779)	1,133,460
Equity at Start of Year		1,554,179	420,719
Equity at End of Year		1,421,400	1,554,179

The above statement is to be read in conjunction with the notes on pages 76 to 112.

Consolidated Statement of Cost of Services

For the year ended 30 June	Note	Operating	Operating	Operating	Unaudited	Operating
		Income	Expenses	Surplus	Operating	Surplus
		Actual	Actual	(Deficit)	Surplus	(Deficit)
		2006	2006	2006	2006	2005
		\$000	\$000	\$000	\$000	\$000
Functions:						
Monetary Policy Formulation		-	8,719	(8,719)	(8,330)	(7,444)
Market Operations		9,554	4,270	5,284	(3,155)	(2,026)
Financial System Surveillance		-	7,670	(7,670)	(8,271)	(6,394)
Currency Operations	24	215,913	10,686	205,227	202,318	192,957
Foreign Reserves Management ³¹	25	(50,961)	6,729	(57,690)	4,126	(2,252)
Settlement Services		4,549	1,855	2,694	(281)	918
Registry and Depository Services	26	3,860	3,188	672	845	1,143
Overseas Investment Commission Secretariat ³²		159	178	(19)	-	(150)
Other Outputs		-	720	(720)	(496)	(517)
Total for the Bank before Earnings on Investments						
Funded by Equity		183,074	44,015	139,059	186,756	176,235
Earnings on Investments Funded by Equity		114,848	-	114,848	87,800	96,509
Total for Bank		297,922	44,015	253,907	274,556	272,744
Income Retained under the Funding Agreement			8,143			
Net Expenditure as per the Funding Agreement			35,872			

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 76 to 112.

31 The updated model and assumptions used to determine the fair value of Term Liabilities (refer to note 7) resulted in a charge to operating income of \$73.4 million, the impact of which is reflected in the operating deficit for the Foreign Reserves Management function.

32 On 25 August 2005, the secretariat services and funding provided by the Bank to the Overseas Investment Commission were discontinued.

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Consolidated Statement of Financial Performance

For the year ended 30 June	Note	Actual 2006 \$000	Unaudited Budget 2006 \$000	Actual 2005 \$000
Operating Income:				
Income from Foreign Currency Financial Assets:				
Interest Income	27	365,078		166,238
Dividend Income		1,878		1,478
Gain/(Loss) from Fair Value Changes	29	(9,417)		5,369
Total Income from Foreign Currency Financial Assets		357,539		173,085
Expenses on Foreign Currency Financial Liabilities:				
Interest Expenses	28	181,981		128,567
Loss/(Gain) from Fair Value Changes	29	25,780		(23,424)
Total Expenses on Foreign Currency Financial Liabilities		207,761		105,143
Net Foreign Exchange Revaluation Gain/(Loss) on Foreign Currency Activities	30	(8,829)		(2,111)
Liquidity Management Swap Income attributable to Local Currency Activities		(183,991)		(57,970)
Foreign Currency Net Investment Income/(Expense)		(43,042)		7,861
Income from Local Currency Financial Assets:				
Interest Income	27	316,363		323,340
Liquidity Management Swap Income		183,991		57,970
Gain/(Loss) from Fair Value Changes	29	(73)		13
Total Income from Local Currency Financial Assets		500,281		381,323
Expenses on Local Currency Financial Liabilities:				
Interest Expenses	28	167,623		87,307
Loss/(Gain) from Fair Value Changes	29	(139)		-
Total Expenses on Local Currency Financial Liabilities		167,484		87,307
Local Currency Net Investment Income		332,797		294,016
Net Investment Income		289,755	312,051	301,877
Other Income	31	8,167	6,840	8,358
Total Operating Income		297,922	318,891	310,235
Operating Expenses:				
Personnel Expenses		21,613	20,041	18,313
New Currency Issued Expenses	24	6,136	6,630	5,857
Asset Management Expenses	32	5,197	5,771	3,875
Other Operating Expenses	33	11,069	11,893	9,446
Total Operating Expenses		44,015	44,335	37,491
Net Surplus for the Year		253,907	274,556	272,744

The above statement is to be read in conjunction with the notes on pages 76 to 112.

Consolidated Statement of Cash Flows

For the year ended 30 June	Note	2006 \$'000	2005 \$'000
Cash Flows from Operating Activities:			
Sources from Operating Income:			
Interest Received - Foreign Currency		293,551	86,439
- Local Currency - Investment Portfolio		311,665	256,710
- Other		17,472	41,620
Liquidity Management Swap Income		64,973	38,120
Dividend		1,478	990
Fees, Commission and Other Income Received		8,694	8,299
		697,833	432,178
Disbursements for Operating Expenses:			
Interest Paid - Foreign Currency		198,352	118,618
- Local Currency		166,842	87,390
Payments to Suppliers and Employees		46,351	33,492
		411,545	239,500
		286,288	192,678
Operating Cash Flows from Changes in Asset Balances:			
Net (Increase)/Decrease in Foreign Currency Securities Purchased Under Agreements to Re-sell		(3,805,282)	(1,316,802)
Net (Increase)/Decrease in Foreign Currency Marketable Securities		850,567	(1,103,975)
Net (Increase)/Decrease in Other Local Currency Financial Assets		142,478	1,188,790
		(2,812,237)	(1,231,987)
Operating Cash Flows from Changes in Liability Balances:			
Net (Increase)/Decrease in Other Foreign Currency Financial Liabilities		1,374,916	(1,397,466)
Net (Increase)/Decrease in Local Currency Financial Liabilities		(3,738,122)	592,661
		(2,363,206)	(804,805)
Operating Cash Flows from Changes in Asset and Liability Balances			
		(449,031)	(427,182)
Net Cash Flows from Operating Activities	35	(162,743)	(234,504)
Cash Flows from Investing Activities:			
Sources:			
Maturity of New Zealand Government Securities		689,800	714,000
Sale of Fixed Assets		667	88
Total Sources of Cash Flows from Investing Activities		690,467	714,088
Disbursements:			
Purchases of New Zealand Government Securities for Investment Portfolio		1,014,046	1,966,660
Purchase of Shares in the Bank for International Settlements		-	5,371
Purchase of Fixed Assets		6,414	7,579
Total Disbursements of Cash Flows from Investment Activities		1,020,460	1,979,610
Net Cash Flows from Investing Activities		(329,993)	(1,265,522)

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Consolidated Statement of Cash Flows continued

For the year ended 30 June	Note	2006 \$000	2005 \$000
Cash Flows from Financing Activities:			
Sources:			
Issue of Circulating Currency		1,648,549	1,653,501
Withdrawal of Circulating Currency		1,483,147	1,465,676
Net Issue of Circulating Currency		165,402	187,825
Transfer of Liability for Currency from Treasury		-	87,602
Additional Foreign Currency Term Liabilities		1,103,907	1,028,425
Capital provided by the New Zealand Government		-	1,000,000
Total Sources of Cash Flows from Financing Activities		1,269,309	2,303,852
Disbursements:			
Payment for Demonetised Currency		29	27
Repayment of Foreign Currency Term Liabilities		622,858	579,362
Payment of Surplus to the New Zealand Government		139,284	191,748
Total Disbursements of Cash Flows from Financing Activities		762,171	771,137
Net Cash Flows from Financing Activities		507,138	1,532,715
CASH FLOWS FROM ALL ACTIVITIES		14,402	(32,689)
Plus Exchange Rate Effect		(27,709)	(7,799)
NET CASH FLOWS FROM ALL ACTIVITIES		(13,307)	(24,890)
Opening Cash Balance		116,548	91,658
CLOSING CASH BALANCE	36	103,241	116,548

The above statement is to be read in conjunction with the notes on pages 76 to 112.

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.

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) and its amendments. These statements apply to the financial year ended 30 June 2006. They are prepared in accordance with part VI of the Act, and comply with Generally Accepted Accounting Practice in New Zealand, which implies compliance with New Zealand Financial Reporting Standards (NZ FRS).

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 30 August 2006.

(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 NZ FRS 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 included in the New Zealand Government reporting group, 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 FRS 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 policies between existing NZ FRS 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 FRS, 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.

At 30 June 2006, the Bank had made formal designations required under NZ IAS 39: Financial Instruments: Recognition and Measurement (NZ IAS 39) in order to apply the Fair Value Through Profit or Loss or Available for Sale classification of financial instruments. The designations resulted in one material change to existing accounting treatment. This related to the Investment Portfolio – New Zealand Government Securities, which was designated as Available for Sale. The New Zealand Government Securities in the Investment Portfolio will be reported at market value, and the unrealised gains and losses will be booked to equity. Realised gains and losses will be booked to profit or loss, together with the coupon income and amortisation of any premium or discount on acquisition.

As a result of this change in accounting policy, at 1 July 2006 the Bank will increase the carrying value of the Investment Portfolio – New Zealand Government Securities by \$53.9 million, with a corresponding increase in the Bank's equity at that date.

The Bank has designated its investment in shares issued by the Bank for International Settlements ("BIS shares") as Available for Sale. The Available for Sale designation produces the same result through equity as the existing treatment. The Bank has designated the forward foreign exchange contracts used to hedge the BIS shares as a fair value hedge. Changes in the fair value of the shares due to market value movements will be recognised in equity.

Changes in the value of the hedges, and the corresponding change in value of the shares that result from the translation of foreign currency, will offset in profit or loss. Changes due to the translation of foreign currency that have not been effectively hedged will be recognised in equity. The adoption of NZ IFRS will not impact on the carrying value of the BIS shares or the value of the hedges for the comparative period commencing 1 July 2006.

The Bank has established that, under NZ IAS 39, the hedge of old coins to be scrapped does not meet the criteria for hedge accounting. Upon initial recognition for the comparative period commencing 1 July 2006, Accounts Receivable and Deferred Costs will reduce by \$15.7 million, and equity will also reduce by that amount.

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 material.

The change from mid-market pricing to bid or offer price will decrease the financial assets by \$2.5 million and will increase the financial liabilities by \$1.5 million. The Bank's equity will reduce by \$4.0 million.

Post-Employment Benefits

NZ IAS 19: Employee 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.

As a result of the adoption of NZ IAS 19, the Bank will recognise an asset of \$1.7 million, as at 1 July 2006, with a corresponding increase in equity. This represents the present value of reductions in future contributions to the Bank's defined benefit superannuation scheme.

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 (NZ IAS 2) 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 impact of this change in accounting policy on the Bank's opening NZ IFRS Balance Sheet at 1 July 2006 is an increase in inventory of \$2.1 million, with a corresponding increase in the Bank's equity.

Demonetised Currency

The Reserve Bank Act 1989 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 FRS, when currency in circulation is demonetised 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 2005 to be reinstated. The Bank has not derecognised any currency in circulation since 1 July 2005.

Collectors' Currency

Under NZ IFRS the Reserve Bank will recognise a liability for the face value of collectors' currency sold after 1 July 2004. A charge to equity will be required on transition for the face value of coins sold since 1 July 2004. The amount to be recognised in the opening NZ IFRS Balance Sheet is \$0.4 million, which will increase the liability for currency in circulation and reduce the Bank's equity.

Impairment Losses

As per NZ IAS 36, the Bank has reviewed all assets for impairment. No impairment adjustments were made.

(c) Basis of Preparation of Financial Statements

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

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 accounts 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 43).

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.

	2006	2005
euro	0.4756	0.5752
Japanese yen	69.5986	77.2000
United States dollars	0.6083	0.6962
SDR ³³	0.4099	0.4774

Comparative Amounts

To ensure consistency with the current year, comparative figures have been restated where appropriate. Certain presentational changes have been made in the Financial Statements.

Changes in Accounting Policies

Previously, securities sold under agreements to repurchase and securities held under agreements to re-sell were measured and recorded at contract value inclusive of any accrued income or expense. The implementation of the new treasury system during 2005/06 allowed the Bank to provide a mark-to-market value on these instruments, which the Bank believes better reflects their value. As a result of this change in accounting policy, the assets relating to securities held under reverse-repurchase agreements are \$4.9 million lower than if they had been reported at amortised cost, and the liabilities relating to securities sold under agreements to repurchase are \$0.3 million lower than would otherwise have been reported. The unrealised loss from market value changes, of \$4.6 million, was reflected in a lower reported net surplus.

There have been no other material changes to the Reserve Bank's accounting policies for the year ended 30 June 2006, 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.

³³ 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.

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.

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 curves 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

The Bank enters into repurchase agreement transactions for both foreign currency and local currency activities. These repurchase agreement transactions are recorded at fair value.

Foreign currency Securities Sold Under Agreements to Repurchase are recorded in Marketable Securities in the Statement of Financial Position. The obligation to repurchase the securities is disclosed within foreign currency liabilities as Securities Sold Under Agreements to Repurchase.

Local currency repurchase agreement transactions are recorded in Investment Portfolio – New Zealand Government Securities in the Statement of Financial Position. The obligation to repurchase the securities is disclosed within local currency liabilities as Securities Sold Under Agreements to Repurchase.

The Bank enters into reverse-repurchase agreement transactions for both foreign currency and local currency activities. These reverse-repurchase agreement transactions are recorded at fair value within assets as Securities Purchased Under Agreements to Re-sell.

Market value movements for repurchase and reverse-repurchase agreement transactions are reported in the Statement of Financial Performance.

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 only 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 revaluation is imputed by deriving the fair value rate from the relevant market yield curve of similar contracts and discounting the future cash flows of the contracts at this rate.

Changes in fair value relating to market value movements are recognised in the Statement of Financial Performance as Gain/(Loss) from Fair Value Changes. 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 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 Gain/(Loss) from Fair Value Changes. 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 Gain/(Loss) from Fair Value Changes. 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 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 included in the Statement of Financial Position as Deferred Costs 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

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 Value Changes.

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 recorded at expected realisable value after making due allowance for doubtful debts.

Inventories

Inventories are recorded 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 recorded at fair value. Buildings are recorded at depreciated fair value. 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 leases and finance lease liabilities are disclosed in note 37.

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 Miscellaneous Liabilities, Accrued Employee Entitlements (see note 10).

(f) Cash Flows

Cash is defined as Cash Balances with Other Central Banks (including short-term deposits) and other amounts available at call with other institutions.

Investing activities include cash movements relating to long-term holdings of New Zealand Government Securities 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 the distribution to the Crown.

Operating activities include income and expenditure cash flows not included in investing or financing activities, and also includes cash movements relating to the Bank's financial assets and liabilities other than long-term holdings of New Zealand Government Securities and long-term debt from The Treasury.

(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.

NOTES TO BE READ AS PART OF THE CONSOLIDATED FINANCIAL STATEMENTS

1. Nature and Extent of Activities

The Reserve Bank's role as a central bank determines the nature and extent of its activities with respect to financial instruments. This role is defined by the Reserve Bank of New Zealand Act 1989 (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 and 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 its 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, credit and market 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 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 old coins, which will be replaced with new coins issued in July 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 2006, the fair value of securities lent out under the programme was \$717.0 million (2005 \$589.6 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. For the year to 30 June 2006, no losses have been incurred from section 16 activities (2005 nil).

Sections 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 2006, there have been no payments to or from the Crown under section 21 of the Act (2005 nil).

(e) 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 \$1,211.8 million (2005 \$1,836.7 million), including securities lent out under the securities lending programme (refer to c above).

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 \$192.7 million securities sold to counterparties under repurchase agreements relating to the liquidity management operations (2005 \$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. At balance date, the book value of foreign currency assets under reverse-repurchase agreements was \$7,408.7 million (2005 \$3,603.4 million). At balance date, the book value for local currency assets under reverse-repurchase agreements was \$122.8 million (2005 \$266.2 million).

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 (2005 \$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 to inject funds into the banking system 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 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 2005/06

In July 2005 the Bank commenced operating a bond lending facility in the New Zealand dollar securities market. The facility makes certain of the bonds in the Bank's investment portfolio available to the market through the use of reverse-repurchase agreements and repurchase agreements.

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).

In November 2005, the Bank decided to include Japanese yen denominated instruments in its benchmark of core foreign reserves.

The Reserve Bank increased the settlement cash level from \$20 million to \$2,000 million in February 2006. This increased the amount of cash left in the banking system each day and provided additional liquidity for banks to meet their payment and settlement obligations. Foreign exchange swaps were the predominant instrument used to inject this additional liquidity into the banking system.

On 30 June 2006 the Reserve Bank advised the financial markets of the completion of its review of the liquidity management operations regime³⁴. The public consultation phase commenced with the release of a consultation document on 17 March 2006. More information regarding the review is on page 29 of this *Annual Report*.

During 2005/06 the Bank continued its strategy of growing its foreign reserves. During the year the level of core reserves increased from 2,018.2 million SDR to 2,164.5 million SDR.

³⁴ As detailed on page 40 of the 2004/05 *Annual Report* a Bank priority for 2005/06 was a review of the provision of liquidity to the banking system

Asset Notes

2. Foreign Currency Marketable Securities

	Note	2006 \$000	2005 \$000
Marketable Securities:			
- Liquefiable within two days		2,058,121	1,983,564
- Liquefiable outside two days		1,922,329	2,099,689
Derivative Financial Instruments in a Gain Position	3	17,586	10,528
Total Marketable Securities		3,998,036	4,093,781

3. Derivative Financial Instruments

	Book Value 2006 ³⁵ \$000	Notional Principal 2006 \$000	Book Value 2005 \$000	Notional Principal 2005 \$000
Interest Rate Futures:				
Interest Rate Futures in a Gain Position	520	82,364	353	10,908
Interest Rate Futures in a Loss Position	(990)	2,002	-	-
Net Futures Position	(470)	84,366	353	10,908
At 30 June 2006, the Bank had 450 open Interest Rate Futures contracts (2005: 562).				
Interest Rate Swaps:				
Interest Rate Swaps in a Gain Position	1,520	41,098	(966)	396,724
Interest Rate Swaps in a Loss Position	(2,065)	399,130	(3,066)	211,308
Net Interest Rate Swap Position	(545)	440,228	(4,032)	608,032
Forward Foreign Exchange Contracts:				
Forward Foreign Exchange Contracts in a Gain Position	15,546	916,100	11,141	130,060
Forward Foreign Exchange Contracts in a Loss Position	(146,253)	4,207,485	(17,103)	665,652
Net Forward Foreign Exchange Contracts Position	(130,707)	5,123,585	(5,962)	795,712
Total Derivative Financial Instruments in a Gain Position ³⁶	17,586	1,039,562	10,528	537,692
Total Derivative Financial Instruments in a Loss Position	(149,308)	4,608,617	(20,169)	876,960
Net Derivative Financial Instruments Recognised on Balance Sheet	(131,722)	5,648,179	(9,641)	1,414,652

The table does not include forward foreign exchange contracts and commodity futures used to hedge the expected revenue from disposal of coins returned to the Bank and withdrawn from circulation in 2006/07. These off-balance sheet forward foreign exchange contracts have a nominal value of USD 6.3 million (2005 USD 7.5 million). The off-balance sheet commodity futures contracts have a nominal value equivalent to the disposal of 1,781 tonnes of cupro-nickel (2005 1,285 tonnes). A net cost of \$15.7 million (2005 gain of \$0.04 million) from these hedging contracts has been deferred and recognised in the Statement of Financial Position in Accounts Receivable and Deferred Costs. The deferred cost will be recognised and offset in the Statement of Financial Performance in the same period that the revenue from the scrapped metal is recognised.

35 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.

36 Derivatives Financial Instruments in a Gain Position are included in the Statement of Financial Position as Foreign Currency Marketable Securities.

Financial Statements

4. Inventories

	2006 \$000	2005 \$000
Bank Notes for Circulation	6,344	3,084
Coin for Circulation	4,751	3,137
Collectors' Currency	3	-
Total Inventories	11,098	6,221

On 31 July 2006, the Bank issued new coins to replace the current 10 cent, 20 cent, and 50 cent coins. On 1 November 2006, the 5 cent coin will be withdrawn and the old coins will be demonetised. A contract has been entered into for the sale of the old coins for their scrap metal content. Inventories of these coins held at 30 June 2006 have been written down to net realisable value. The write-down included in the Statement of Financial Performance was \$2.2 million.

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 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
Year ended 30 June 2006						
Opening Net Book Value	35,640	22,824	1,713	7,702	1,524	1,877
Additions	6,431	-	1,722	3,345	1,364	-
Revaluation	13,598	13,598	-	-	-	-
Accumulated Depreciation Written Back	4,915	2,029	-	1,963	923	-
Less Disposals	3,238	337	-	1,978	923	-
Less Depreciation	3,622	414	449	2,450	309	-
Closing Net Book Value	53,724	37,700	2,986	8,582	2,579	1,877
As at 30 June 2006						
Cost	65,299	37,700	5,573	15,126	5,023	1,877
Accumulated Depreciation	11,575	-	2,587	6,544	2,444	-
Net Book Value	53,724	37,700	2,986	8,582	2,579	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. The book value of the land and buildings would have been \$6.8 million (2005 \$6.9 million) if the Bank had recorded these using historical cost less depreciation.

	Valuation Date	Registered Valuer
Wellington Head Office	30 June 2006	Jones Lang Lasalle Advisory Limited
Wellington Carparks	30 June 2006	Jones Lang Lasalle Advisory Limited

The Computer Hardware and Software category includes computers that are leased under finance leases, with a net book value of \$413,000 (2005 \$281,000). Future liabilities relating to leases are disclosed in note 37.

Work-in-Progress at 30 June 2006 was \$3.6 million (2005 \$5.5 million), comprising:

	2006 \$000	2005 \$000
Computer Hardware	1,851	3,978
Plant and Equipment	162	870
Property Improvements	1,583	619
Total Work-in-Progress	3,596	5,467

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 shares (2005 3,211 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 2006 \$000	Unamortised Discount/ (Premium) 2006 \$000	Weighted Average Interest Rate 2006 %	Total Market Value 2005 \$000	Unamortised Discount/ (Premium) 2005 \$000	Weighted Average Interest Rate 2005 %
Unsecured Term Liabilities:						
Due to be Repaid:						
One year or less	635,939	-	6.0	620,408	351	3.0
Between one and two years	830,791	2,143	3.4	560,958	-	3.2
Between two and five years	799,488	-	3.9	1,371,454	2,782	2.5
Over five years	3,047,668	-	3.7	1,478,824	-	2.6
Total Unsecured Term Liabilities	5,313,886	2,143		4,031,644	3,133	

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.

The Bank continues to record Term Liabilities at fair value, but is using an updated model and assumptions that provide for a higher degree of precision in the determination of the fair value. As a result of these revisions Term Liabilities were \$73.4 million higher at 30 June 2006, compared to that which would have been determined using previous estimates.

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8. Other Deposits

	2006 \$000	2005 \$000
Settlement Bank Deposits	1,984,247	57,183
Central Bank Deposits	68,668	15,537
International Monetary Fund Deposits	33,968	49,251
Total Other Deposits	2,086,883	121,971

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.

As at 30 June 2006, the following bank notes and coins were in circulation:

Denomination:	Number of Note Forms/ Coins 2006 000	Face Value 2006 \$000	Number of Note Forms/ Coins 2005 000	Face Value 2005 \$000
5c	574,140	28,707	585,420	29,271
10c	237,010	23,701	238,650	23,865
20c	152,895	30,579	154,960	30,992
50c	57,394	28,697	57,692	28,846
\$1	64,025	64,025	63,346	63,346
\$2	61,210	122,420	60,886	121,771
\$5	18,256	91,282	17,964	89,818
\$10	17,651	176,507	17,270	172,704
\$20	56,329	1,126,582	54,106	1,082,114
\$50	10,425	521,248	9,924	496,222
\$100	11,343	1,134,277	10,437	1,043,674
Total Currency in Circulation		3,348,025		3,182,623

10. Miscellaneous Liabilities

	Note	2006 \$000	2005 \$000
Accounts Payable		2,295	4,427
Accrued Employee Entitlements		4,453	3,744
Provision for Restructuring	11	-	87
Demonetised Currency		13,933	13,961
Other Current Liabilities		576	1
Capitalised Lease Obligations	37	439	314
Total Miscellaneous Liabilities		21,696	22,534

Demonetised currency is recognised as a contingent liability (see note 41 (b)) except for \$13.9 million (2005 \$14.0 million), which has been retained to cover future expected redemptions. Of this total, \$12.8 million relates to demonetised coins issued by The Treasury.

11. Provision for Restructuring

	2006 \$000	2005 \$000
Opening Balance	87	294
Additions to Provision	-	29
Less Expenses Incurred	(72)	(185)
Unused Balance Written Back	(15)	(51)
Total Provision for Restructuring	-	87

Restructuring costs were incurred principally with respect to the Bank's Overseas Investment Commission Secretariat function, and Registry and Depository Services function.

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

The Notional Surplus Income calculated in accordance with the Act is \$706.9 million. As this is greater than the reported operating surplus for the year, the Governor and Board, under section 162 (4) (b) of the Act, recommended to the Minister of Finance a lesser payment of \$410.0 million. The Minister has given a direction that a dividend of \$410.0 million be paid.

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13. Equity

	Note	2006 \$000	2005 \$000
Retained Earnings:			
Net Surplus for the year		253,907	272,744
Provision for Transfer of Surplus to the New Zealand Government	12	(410,000)	(139,284)
Transfer from Reserves		-	57
Movement in Retained Earnings		(156,093)	133,517
Opening Balance		536,826	403,309
Closing Balance		380,733	536,826
Capital:			
Capital provided by the New Zealand Government		-	1,000,000
Movement in Capital		-	1,000,000
Opening Balance		1,000,000	-
Closing Balance		1,000,000	1,000,000
Properties Revaluation Reserve:			
Revaluation of Property		15,290	-
Transfer to Retained Earnings		-	(57)
Movement in Properties Revaluation Reserve		15,290	(57)
Opening Balance		15,758	15,815
Closing Balance		31,048	15,758
Bank for International Settlements Shareholding Revaluation Reserve:			
Revaluation of shareholding in the Bank for International Settlements		8,946	-
Losses recovered through profit and loss from prior years		(922)	-
Movement in Bank for International Settlements Shareholding Revaluation Reserve		8,024	-
Opening Balance		-	-
Closing Balance		8,024	-
Currency and Artwork Collections and Archives Revaluation Reserve:			
Movement in Currency and Artwork Collections and Archives Revaluation Reserve		-	-
Opening Balance		1,595	1,595
Closing Balance		1,595	1,595
Total Equity		1,421,400	1,554,179

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 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) 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.

(b) 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 \$4.895 billion, exclusive of accrued interest (2005 \$4.639 billion). This has been calculated by valuing the current holdings at market prices.

(c) Short-Term Deposits

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

(d) 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.

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

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

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15. Concentrations of Funding

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

	Total 2006 \$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	76,417	-	-	-	76,417
Short Sales of Marketable Securities	342,061	-	-	-	342,061
Derivative Financial Instruments in a Loss Position	149,308	1,257	-	-	148,051
Securities Sold Under Agreements to Repurchase	1,211,805	-	-	269,438	942,367
Term Liabilities	5,313,886	5,313,886	-	-	-
Accrued Interest	36,785	31,737	-	277	4,771
Total Foreign Currency Financial Liabilities	7,130,262	5,346,880	-	269,715	1,513,667
Local Currency Financial Liabilities:					
Government Deposits	2,247,963	2,247,963	-	-	-
Other Deposits	2,086,883	-	-	-	2,086,883
Securities Sold Under Agreements to Repurchase	192,721	-	-	98,254	94,467
Accrued Interest	913	913	-	-	-
Total Local Currency Financial Liabilities	4,528,480	2,248,876	-	98,254	2,181,350
Total Financial Liabilities	11,658,742	7,595,756	-	367,969	3,695,017
Other Liabilities:					
Currency in Circulation	3,348,025	-	3,348,025	-	-
Provision for Transfer of Surplus to the New Zealand Government	410,000	410,000	-	-	-
Miscellaneous Liabilities	21,696	-	13,933	-	7,763
Total Other Liabilities	3,779,721	410,000	3,361,958	-	7,763
Total Liabilities	15,438,463	8,005,756	3,361,958	367,969	3,702,780

Concentrations of Funding

	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 New Zealand 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

Risk Management Notes

16. Risk Management³⁷

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 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 tradeoffs 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 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.

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.

³⁷ Additional information on the Bank's risk management framework can be found on the internet website (www.rbnz.govt.nz/finmarkets/foreignreserves) but such information does not form a part of these financial statements.

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. In measuring compliance with credit limits, actual exposures are calculated on a credit-equivalent basis. In particular, where exposures to counterparties are collateralised by securities issued by sovereign states or other issuers, for the purpose of limit compliance, the measure of actual credit exposure is reduced to reflect the collateral held.

Credit risk in local currency portfolios is 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 as collateral for its inter-day and intra-day liquidity management operations. 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. On 30 June 2006 the Reserve Bank advised the financial markets of the completion of its review of the liquidity management operations regime³⁸. More information regarding the review is on page 29 of this *Annual Report*.

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 Government Securities. The collateral taken at balance date was \$nil (2005 \$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.

³⁸ As detailed on page 40 of the 2004/05 Annual Report a Bank priority for 2005/06 was a review of the provision of liquidity to the banking system

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(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:³⁹

	Classified by Industry of Issuer		Classified by Industry of Counterparty	
	2006	2005	2006	2005
	\$000	\$000	\$000	\$000
New Zealand Government	5,040,138	4,865,987	4,917,275	4,600,786
Other Sovereign Issuers	9,154,780	5,409,557	1,804,195	2,096,546
Supranational Financial Institutions	477,514	128,911	477,514	128,911
Foreign Banks	1,957,831	2,222,610	8,717,217	3,562,262
Securities Trading Firms	149,456	35,737	863,516	2,009,096
New Zealand Banks	-	-	2	265,201
Other	25	289,697	25	289,697
Total Financial Assets	16,779,744	12,952,499	16,779,744	12,952,499

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 in a gain position as reported in note 3.

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

	2006	2005
	\$000	\$000
New Zealand	5,040,162	4,877,156
United States of America	7,146,609	2,607,294
Europe	3,664,904	5,246,849
Supranational Financial Institutions	477,514	128,911
Japan	323,538	5,897
Other	127,017	86,392
Total Financial Assets	16,779,744	12,952,499

(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.

³⁹ The differences between amounts disclosed by industry and by counterparty relate to Securities Purchased Under Agreements to Re-sell.

	Credit Rating	2006 \$000	% of 2006 Financial Assets	2005 \$000	% of 2005 Financial Assets
Foreign Currency Financial Assets:					
Cash Balances with Other Central Banks	AAA	82,147	0.5	105,777	0.8
	AA+	-	-	1,380	0.0
	AA-	10,184	0.1	6,242	0.0
	N/R	4,322	0.0	-	-
Other Cash Balances	AA+	4,361	0.0	1,076	0.0
	AA-	2,225	0.0	2,071	0.0
Marketable Securities	AAA	1,957,348	11.7	2,419,496	18.7
	AA+	355,208	2.1	690,609	5.3
	AA	308,568	1.8	110,377	0.9
	AA-	1,106,048	6.6	724,014	5.6
	A+	41,902	0.2	-	-
	A-	-	-	38,320	0.3
	Various ⁴⁰	130,169	0.8	110,965	0.9
	N/R	98,793	0.6	-	-
Receivable from Unsettled Sales of Securities	AA+	-	-	96,549	0.7
	AA-	76,398	0.5	-	-
	N/R	-	-	36,550	0.3
Securities Purchased Under Agreements to Re-sell	AAA	7,408,670	44.2	3,403,705	26.3
	AA+	-	-	91,144	0.7
	AA	-	-	45,744	0.4
	AA-	-	-	62,795	0.5
Shareholding in the Bank for International Settlements	N/R ⁴¹	117,364	0.7	92,949	0.7
Dividend Receivable	N/R	1,878	0.0	1,478	0.0
Accrued Interest	Various	39,080	0.2	45,239	0.3
Total Foreign Currency Financial Assets		11,744,665	70.0	8,086,480	62.4
Local Currency Financial Assets:					
Cash on Hand	AAA	2	0.0	2	0.0
Securities Purchased Under Agreements to Re-sell	AAA	122,787	0.7	265,199	2.0
Investment Portfolio – New Zealand Government Securities	AAA	4,839,781	28.8	4,518,230	34.9
Accrued Interest	AAA	72,451	0.4	82,556	0.6
Other Local Currency Financial Assets	AA+	25	0.0	11	0.0
	AA-	33	0.0	-	-
	N/R	-	-	21	0.0
Total Local Currency Financial Assets		5,035,079	30.0	4,866,019	37.6%
Total Financial Assets		16,779,744	100.0	12,952,499	100.0%

40 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.

41 For internal management purposes, the Reserve Bank assumes a AAA rating to the Bank for International Settlements, which has not been assessed by ratings agencies.

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	Credit Rating	2005 \$000	% of 2006 Financial Assets	2005 \$000	% of 2004 Financial Assets
Summary by Major Credit Category:					
Foreign Currency Financial Assets	AAA	9,448,165	56.3	5,928,978	45.8
	AA+/-	1,904,894	11.4	1,870,321	14.4
	Various	169,249	1.0	156,204	1.2
	N/R	222,357	1.3	130,977	1.0
Total Foreign Currency Financial Assets		11,744,665	70.0	8,086,480	62.4
Local Currency Financial Assets	AAA	5,035,021	30.0	4,865,987	37.6
	AA+/-	58	0.0	11	0.0
	N/R	-	-	21	0.0
Total Local Currency Financial Assets		5,035,079	30.0	4,866,019	37.6
Total Financial Assets		16,779,744	100.0	12,952,499	100.0

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

The following table shows the number of individual counterparties, or groups of closely related counterparties, where the Bank's credit exposures equalled or exceeded 10 per cent of the Bank's equity as at the end of the year. These exposures are measured without taking into account collateral held by the Bank for credit exposures to individual counterparties. Credit exposures are measured taking into account any enforceable rights of set-off.

% of Equity	End-of-year 2006	End-of-year 2005
10% to 19.9%	7	6
20% to 29.9%	5	4
30% to 39.9%	-	2
40% to 49.9%	2	1
50% to 59.9%	-	1
70% to 79.9%	-	1
80% to 89.9%	1	-
290% to 299.9%	-	1
320% to 329.9%	1	-
340% to 349.9%	1	-

Credit risks are managed under a framework that specifies limits for exposures to counterparties. Under that framework, for the purposes of measuring compliance with credit limits, actual exposures are calculated on a credit-equivalent basis. In particular, where exposures to counterparties are collateralised by securities issued by sovereign states or other issuers, for the purpose of measuring compliance with limits, actual credit exposures are reduced to reflect the collateral held.

The Bank does not constrain credit exposure to certain sovereign issuers (eg, the US). Exposures to these sovereign issuers are managed through other limits and controls (such as currency composition limits).

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, German, and Japanese 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 (VaR) 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 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 2006 was 4.5 years (2005 4.9 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.

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

	Weighted Average Interest Rate %	Total 2006 \$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	3.0	96,653	-	96,653	-	-	-	-
Other Cash Balances	0	6,586	-	6,586	-	-	-	-
Marketable Securities	4.2	3,998,036	-	3,517,216	21,329	-	79,807	379,684
Receivable from Unsettled Sales of Securities	0	76,398	-	76,398	-	-	-	-
Securities Purchased Under Agreements to Re-sell	4.7	7,408,670	-	7,408,670	-	-	-	-
Shareholding in the Bank for International Settlements	0	117,364	117,364	-	-	-	-	-
Dividend Receivable	0	1,878	1,878	-	-	-	-	-
Accrued Interest	0	39,080	-	39,080	-	-	-	-
Total Foreign Currency Financial Assets	4.4	11,744,665	119,242	11,144,603	21,329	-	79,807	379,684
Foreign Currency Financial Liabilities:								
Payable for Unsettled Purchases of Securities	0	76,417	-	76,417	-	-	-	-
Short Sales of Marketable Securities	4.1	342,061	-	-	-	92,122	76,892	173,047
Derivative Financial Instruments in a Loss Position	1.1	149,308	-	149,308	-	-	-	-
Securities Sold Under Agreements to Repurchase	4.3	1,211,805	-	1,211,805	-	-	-	-
Term Liabilities	4.0	5,313,886	-	5,271,769	-	42,117	-	-
Accrued Interest	0	36,785	-	36,785	-	-	-	-
Total Foreign Currency Financial Liabilities	3.9	7,130,262	-	6,746,084	-	134,239	76,892	173,047
Foreign Currency Interest Rate Sensitivity Gap		4,614,403	119,242	4,398,519	21,329	(134,239)	2,915	206,637
Local Currency Financial Assets:								
Cash on Hand	0	2	-	2	-	-	-	-
Securities Purchased Under Agreements to Re-sell	7.3	122,787	-	122,787	-	-	-	-
Investment Portfolio – New Zealand Government Securities	6.4	4,839,781	-	563,923	-	-	1,318,000	2,957,858
Accrued Interest	0	72,451	-	72,451	-	-	-	-
Other Local Currency Financial Assets	0	58	-	58	-	-	-	-
Other Assets	0	80,119	80,119	-	-	-	-	-
Total Local Currency Assets	6.3	5,115,198	80,119	759,221	-	-	1,318,000	2,957,858
Local Currency Financial Liabilities:								
Government Deposits	7.2	2,247,963	-	2,247,963	-	-	-	-
Other Deposits	7.0	2,086,883	-	2,086,883	-	-	-	-
Securities Sold Under Agreements to Repurchase	5.8	192,721	-	192,721	-	-	-	-
Accrued Interest	0	913	-	913	-	-	-	-
Other Liabilities	0	3,779,721	3,779,721	-	-	-	-	-
Equity	0	1,421,400	1,421,400	-	-	-	-	-
Total Local Currency Liabilities and Equity	3.3	9,729,601	5,201,121	4,528,480	-	-	-	-
Local Currency Interest Rate Sensitivity Gap		(4,614,403)	(5,121,002)	(3,769,259)	-	-	1,318,000	2,957,858
On-Balance Sheet Interest Rate Sensitivity Gap		-	(5,001,760)	629,260	21,329	(134,239)	1,320,915	3,164,495
Off-Balance Sheet Instruments		-	-	142,936	1,644	(9,673)	(83,408)	(51,499)
Total Interest Rate Sensitivity Gap		-	(5,001,760)	772,196	22,973	(143,912)	1,237,507	3,112,997
Interest Rate Sensitivity Gap by Currency:								
New Zealand dollar		49,906	(5,174,130)	948,178	-	-	1,318,000	2,957,858
United States dollar		(95,810)	106,249	(143,485)	2,453	(42,117)	(46,249)	27,339
euro		(16,907)	40,755	(68,376)	20,520	(9,673)	(45,177)	45,044
Japanese yen		(30,498)	12,344	4,758	-	-	(37,542)	(10,058)
Other		93,309	13,022	31,121	-	(92,122)	48,475	92,813

	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	113,399	-	113,399	-	-	-	-
Other Cash Balances	0	3,147	-	3,147	-	-	-	-
Marketable Securities	2.8	4,093,781	-	2,726,011	38,396	247,340	522,382	559,652
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	45,239	-	45,239	-	-	-	-
Total Foreign Currency Financial Assets	2.4	8,086,480	94,427	6,624,283	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		778,206	94,427	987,128	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	4,518,230	-	-	692,746	482,264	1,320,878	2,022,342
Accrued Interest	0	82,556	-	82,556	-	-	-	-
Other Local Currency Financial Assets	0	32	-	32	-	-	-	-
Other Assets	0	43,972	43,972	-	-	-	-	-
Total Local Currency Assets	5.8	4,909,991	43,972	347,789	692,746	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		(778,206)	(4,854,648)	(441,788)	692,746	482,264	1,320,878	2,022,342
On-Balance Sheet Interest Rate Sensitivity Gap		-	(4,760,221)	545,340	694,173	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)	219,272	693,814	473,848	1,133,460	2,239,827
Interest Rate Sensitivity Gap by Currency:								
New Zealand dollar		(24,032)	(4,854,648)	312,386	692,746	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
Japanese yen		(28,693)	12,069	(40,762)	-	-	-	-
Other		81,765	11,239	32,281	-	(989)	(52,751)	91,985

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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 2006, 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, and from the determination of the fair value of term loans using the new model and assumptions referred to in note 7. 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 2006, the Bank's net exposure to major currencies, including forward foreign exchange contracts and foreign currency swaps, was as follows:

	Total All Currencies 2006 \$000	Currency of Denomination			
		United States dollar \$000	euro \$000	Japanese yen \$000	Other Currencies \$000
Foreign Currency Financial Assets:					
Cash Balances with Other Central Banks	96,653	37,213	33,571	10,184	15,685
Other Cash Balances	6,586	4,486	1,120	305	675
Marketable Securities	3,998,036	1,754,638	1,713,781	313,357	216,260
Receivable from Unsettled Sales of Securities	76,398	-	-	-	76,398
Securities Purchased Under Agreements to Re-sell	7,408,670	6,249,468	930,609	-	228,593
Shareholding in the Bank for International Settlements	117,364	49,977	41,471	12,717	13,199
Dividend Receivable	1,878	1,878	-	-	-
Accrued Interest	39,080	24,195	12,341	-	2,544
Total Foreign Currency Financial Assets	11,744,665	8,121,855	2,732,893	336,563	553,354
Foreign Currency Financial Liabilities:					
Payable for Unsettled Purchases of Securities	76,417	-	-	-	76,417
Short Sales of Marketable Securities	342,061	31,715	146,907	-	163,439
Derivative Financial Instruments in a Loss Position	149,308	139,728	6,663	1,081	1,844
Securities Sold Under Agreements to Repurchase	1,211,805	749,170	258,725	-	203,910
Term Liabilities	5,313,886	3,021,303	2,292,583	-	-
Accrued Interest	36,785	19,455	14,646	-	2,684
Total Foreign Currency Financial Liabilities	7,130,262	3,961,371	2,719,524	1,081	448,294
Off-Balance Sheet Instruments ⁴²	(4,664,309)	(4,256,302)	(30,276)	(365,980)	(11,751)
Net Foreign Currency Exposure	(49,906)	(95,810)	(16,907)	(30,498)	93,309

42 Forward foreign exchange contracts with a nominal value of USD 6.3 million and commodity future contracts with a nominal value equivalent to the disposal of 1,781 tonnes of cupro-nickel, relating to future expected income from the scrapping of old coins, are not included in the above risk note.

	Total All Currencies 2005 \$000	Currency of Denomination			
		United States dollar \$000	euro \$000	Japanese yen \$000	Other Currencies \$000
		Foreign Currency Financial Assets:			
Cash Balances with Other Central Banks	113,399	55,854	35,440	6,242	15,863
Other Cash Balances	3,147	1,219	1,197	153	578
Marketable Securities	4,093,781	2,071,365	1,807,971	(46,935)	261,380
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	12,071	11,237
Dividend Receivable	1,478	1,478	-	-	-
Accrued Interest	45,239	17,133	26,121	(224)	2,209
Total Foreign Currency Financial Assets	8,086,480	4,214,197	3,463,608	(28,693)	437,386
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 ⁴³	(754,174)	(667,479)	(32,719)	-	(53,976)
Net Foreign Currency Exposure	24,032	(23,445)	(5,595)	(28,693)	81,765

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

	2006 \$000	2005 \$000
Australian dollar	9,039	9,117
British pound	1,446	438
Canadian dollar	(3,282)	66
Swiss francs	44	48
Various currencies (Asian Bond Fund 2)	86,062	72,096
Total Other Currencies	93,309	81,765

⁴³ Forward foreign exchange contracts with a nominal value of USD 7.5 million and commodity future contracts with a nominal value equivalent to the disposal of 1,285 tonnes of cupro-nickel, relating to future expected income from the scrapping of old coins, 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. For the purposes of measuring Value at Risk (VaR), term liabilities have been measured using the methodology used at 30 June 2005.

(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 (2005 \$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 (2005 \$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 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.

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

VaR	Aggregate Portfolios		Risk-Neutral Portfolios		Trading Portfolios	
	2006 \$000	2005 \$000	2006 \$000	2005 \$000	2006 \$000	2005 \$000
Limit	6,000	6,000	4,000	4,000	2,000	2,000
As at 30 June	384	451	254	244	130	207
Peak over period	736	704	370	294	504	512
Low over period	280	192	119	107	48	38
Average over period	429	416	227	177	202	238

The Asian Bond Fund 1 (ABF1) investment, in the amount of USD 25 million, was entered into with other Executives' Meeting of Asian and Pacific Central Banks (EMEAP)⁴⁴ countries in 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 2006, VaR for the ABF1 investment was estimated at \$199,000 (2005 \$167,000), with a peak VaR of \$224,000 (2005 \$273,000) 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 in March 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 fund managers 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 2006, VaR for the ABF2 investment was estimated at \$770,000 (2005 \$575,000), with a peak VaR of \$932,000 (2005 \$666,000).

44 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.

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 2006 \$000	Total Market Risk On Aggregate Portfolios 2005 \$000
Limit				6,000	6,000
As at 30 June	184	323	(123)	384	451
Peak over period	358	631	(260)	736	704
Low over period	112	217	(98)	280	192
Average over period	217	365	(153)	429	416

(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 liquidate 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.

(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.

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23. Maturity Analysis

	Total 2006 \$000	No Fixed Maturity \$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	96,653	-	96,653	-	-	-	-
Other Cash Balances	6,586	-	6,586	-	-	-	-
Marketable Securities	3,998,036	130,169	3,502,240	21,329	-	90,531	253,767
Receivable from Unsettled Sales of Securities	76,398	-	76,398	-	-	-	-
Securities Purchased Under Agreements to Re-sell	7,408,670	-	7,408,670	-	-	-	-
Shareholding in the Bank for International Settlements	117,364	117,364	-	-	-	-	-
Dividend Receivable	1,878	-	1,878	-	-	-	-
Accrued Interest	39,080	-	39,080	-	-	-	-
Total Foreign Currency Financial Assets	11,744,665	247,533	11,131,505	21,329	-	90,531	253,767
Foreign Currency Financial Liabilities:							
Payable for Unsettled Purchases of Securities	76,417	-	76,417	-	-	-	-
Short Sales of Marketable Securities	342,061	-	-	-	92,122	76,892	173,047
Derivative Financial Instruments in a Loss Position	149,308	-	148,500	-	-	-	808
Securities Sold Under Agreements to Repurchase	1,211,805	-	1,211,805	-	-	-	-
Term Liabilities	5,313,886	-	635,939	-	830,791	799,488	3,047,668
Accrued Interest	36,785	-	36,785	-	-	-	-
Total Foreign Currency Financial Liabilities	7,130,262	-	2,109,446	-	922,913	876,380	3,221,523
Foreign Currency Maturity Gap	4,614,403	247,533	9,022,059	21,329	(922,913)	(785,849)	(2,967,756)
Local Currency Financial Assets:							
Cash on Hand	2	-	2	-	-	-	-
Securities Purchased Under Agreements to Re-sell	122,787	-	122,787	-	-	-	-
Investment Portfolio – New Zealand Government Securities	4,839,781	-	563,922	-	-	1,318,000	2,957,859
Accrued Interest	72,451	-	72,451	-	-	-	-
Other Local Currency Financial Assets	58	-	58	-	-	-	-
Other Assets	80,119	53,724	26,395	-	-	-	-
Total Local Currency Assets	5,115,198	53,724	785,615	-	-	1,318,000	2,957,859
Local Currency Financial Liabilities:							
Government Deposits	2,247,963	-	2,247,963	-	-	-	-
Other Deposits	2,086,883	-	2,086,883	-	-	-	-
Securities Sold Under Agreements to Repurchase	192,721	-	192,721	-	-	-	-
Accrued Interest	913	-	913	-	-	-	-
Other Liabilities	3,779,721	3,369,721	410,000	-	-	-	-
Equity	1,421,400	1,421,400	-	-	-	-	-
Total Local Currency Liabilities and Equity	9,729,601	4,791,121	4,938,480	-	-	-	-
Local Currency Maturity Gap	(4,614,403)	(4,737,397)	(4,152,856)	-	-	1,318,000	2,957,859
Net Maturity Gap	-	(4,489,864)	4,869,194	21,329	(922,913)	532,151	(9,897)

	Total 2005 \$000	No Fixed Maturity \$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	113,399	-	113,399	-	-	-	-
Other Cash Balances	3,147	-	3,147	-	-	-	-
Marketable Securities	4,093,781	111,109	2,711,650	38,396	260,780	523,302	448,544
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	92,949	92,949	-	-	-	-	-
Dividend Receivable	1,478	-	1,478	-	-	-	-
Accrued Interest	45,239	-	45,239	-	-	-	-
Total Foreign Currency Financial Assets	8,086,480	204,058	6,611,400	38,396	260,780	523,302	448,544
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	778,206	204,058	4,002,191	(104,890)	(442,830)	(1,527,875)	(1,352,448)
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	4,518,230	-	-	692,746	482,263	1,320,878	2,022,343
Accrued Interest	82,556	-	82,556	-	-	-	-
Other Local Currency Financial Assets	32	-	32	-	-	-	-
Other Assets	43,972	35,640	8,332	-	-	-	-
Total Local Currency Assets	4,909,991	35,640	356,121	692,746	482,263	1,320,878	2,022,343
Local Currency Financial Liabilities:							
Government Deposits	667,474	-	667,474	-	-	-	-
Other Deposits	121,971	-	121,971	-	-	-	-
Accrued Interest	132	-	132	-	-	-	-
Other Liabilities	3,344,441	3,197,584	146,857	-	-	-	-
Equity	1,554,179	1,554,179	-	-	-	-	-
Total Local Currency Liabilities and Equity	5,688,197	4,751,763	936,434	-	-	-	-
Local Currency Maturity Gap	(778,206)	(4,716,123)	(580,313)	692,746	482,263	1,320,878	2,022,343
Net Maturity Gap	-	(4,512,065)	3,421,878	587,856	39,433	(206,997)	669,895

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 2006 was \$189,000 (2005 \$263,000) and included a currency stock write-off of \$nil (2005 \$72,000).

Currency Operations includes income and expenses associated with property management. The net surplus for this activity in 2006 was \$300,000 (2005 \$219,000).

	2006 \$000	2005 \$000
Operating Income:		
Seigniorage Income	214,380	202,038
Other Income	1,533	446
Total Operating Income	215,913	202,484
Currency Issued Expenses:		
New Coin Issued Expenses	1,561	3,020
New Note Issued Expenses	2,413	2,759
Write-Down of Coin Inventory	2,162	78
Total Currency Issued Expenses	6,136	5,857
Other Currency Expenses	4,550	3,670
Total Operating Expenses	10,686	9,527
Currency Operations Operating Surplus	205,227	192,957

On 31 July 2006, the Bank issued new coins to replace the current 10 cent, 20 cent, and 50 cent coins. On 1 November 2006, the 5 cent coin will be withdrawn and the old coins will be demonetised. A contract has been entered into for the sale of the old coins for their scrap metal content. Inventories of these coins held at 30 June 2006 have been written down to net realisable value.

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.

	2006 \$000	2005 \$000
Gain/(Loss) on Active Management Trading	4,785	(180)
Gain/(Loss) on Risk-Neutral Asset/Liability Structure ⁴⁵	(57,593)	2,515
Net Investment Income	(52,808)	2,335
Other Income	183	19
Foreign Exchange Difference on Translation	1,664	(103)
Total Operating Income	(50,961)	2,251
Total Operating Expenses	6,729	4,503
Foreign Reserves Management Operating Deficit	(57,690)	(2,252)

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. 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 registry services to issuers of fixed interest securities. The Bank exited the retail registry business in December 2004.

	2006 \$000	2005 \$000
Operating Income:		
Registry and Depository Services Fees	3,860	4,030
Other Income	-	44
Total Operating Income	3,860	4,074
Operating Expenses:		
Personnel Expenses	727	781
Other Expenses	2,461	2,150
Total Operating Expenses	3,188	2,931
Registry and Depository Services Operating Surplus	672	1,143

⁴⁵ The updated model and assumptions used to determine the fair value of Term Liabilities (refer to note 7) resulted in a charge to operating income of \$73.4 million, the impact of which is reflected in Gain/(Loss) on Risk-Neutral Asset/Liability Structure.

Consolidated Statement of Financial Performance Notes

27. Interest Income from Financial Assets

	2006 \$000	2005 \$000
Interest Income from Foreign Currency Financial Assets:		
Cash Balances with Other Central Banks	3,476	2,607
Other Cash Balances	98	28
Marketable Securities	123,336	70,195
Securities Purchased Under Agreements to Re-sell	164,264	54,866
Securities Lending Programme	644	422
Amortised Interest on Liquidity Management Swaps	73,260	38,120
Total Interest Income from Foreign Currency Financial Assets	365,078	166,238
Interest Income from Local Currency Financial Assets:		
Securities Purchased Under Agreements to Re-sell	14,496	41,629
Investment Portfolio – New Zealand Government Securities	298,866	280,968
Government Bank Accounts	3,001	743
Total Interest Income from Local Currency Financial Assets	316,363	323,340
Total Interest Income from Financial Assets	681,441	489,578

28. Interest Expense on Financial Liabilities

	2006 \$000	2005 \$000
Interest Expense on Foreign Currency Financial Liabilities:		
Securities Sold Under Agreements to Repurchase	18,287	14,277
Term Liabilities	161,873	114,209
Other	1,821	81
Total Interest Expense on Foreign Currency Financial Liabilities	181,981	128,567
Interest Expense on Local Currency Financial Liabilities:		
Government Deposits	71,901	76,652
Other Deposits	62,055	4,343
Securities Sold Under Agreements to Repurchase	33,413	4,812
Other	254	1,500
Total Interest Expense on Local Currency Financial Liabilities	167,623	87,307
Total Interest Expense on Financial Liabilities	349,604	215,874

29. 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.

	2006 \$000	2005 \$000
Gain/(Loss) from Unrealised Fair Value Changes	(29,882)	12,943
Gain/(Loss) from Realised Fair Value Changes	20,465	(7,574)
Total Gain/(Loss) from Fair Value Changes on Foreign Currency Financial Assets	(9,417)	5,369
Loss/(Gain) from Unrealised Fair Value Changes	25,780	(23,424)
Loss/(Gain) from Realised Fair Value Changes	-	-
Total Loss/(Gain) from Fair Value Changes on Foreign Currency Financial Liabilities	25,780	(23,424)
Gain/(Loss) from Unrealised Fair Value Changes	(73)	-
Gain/(Loss) from Realised Fair Value Changes	-	13
Total Gain/(Loss) from Fair Value Changes on Foreign Currency Financial Assets	(73)	13
Loss/(Gain) from Unrealised Fair Value Changes	(139)	-
Loss/(Gain) from Realised Fair Value Changes	-	-
Total Loss/(Gain) from Fair Value Changes on Foreign Currency Financial Liabilities	(139)	-
Total Gain/(Loss) from Fair Value Changes	(35,131)	28,806

30. Net Foreign Exchange Revaluation Gain/(Loss)

	2006 \$000	2005 \$000
Unrealised Revaluation Gain/(Loss)	492,016	(89,529)
Realised Revaluation Gain/(Loss)	723,556	(319,934)
Total Foreign Exchange Revaluation Gain/(Loss) on Foreign Currency Assets	1,215,572	(409,463)
Unrealised Revaluation (Gain)/Loss	1,149,478	(182,797)
Realised Revaluation (Gain)/Loss	74,923	(224,555)
Foreign Exchange Revaluation Loss/(Gain) on Foreign Currency Liabilities	1,224,401	(407,352)
Net Foreign Exchange Revaluation Gain/(Loss)	(8,829)	(2,111)

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31. Other Income

	Actual 2006 \$000	Unaudited Budget 2006 \$000	Actual 2005 \$000
Registry and Depository Services Fees	3,861	3,607	4,030
Property Rental Income	1,599	1,603	1,600
Currency Distribution Income	1,358	209	-
Exchange Settlement Account System Income	1,093	1,309	1,440
Overseas Investment Commission Fees	159	-	825
Collectors' Currency Income	73	68	377
Miscellaneous Income	24	44	86
Total Other Income	8,167	6,840	8,358

32. Asset Management Expenses

	Note	Actual 2006 \$000	Unaudited Budget 2006 \$000	Actual 2005 \$000
Depreciation of Property, Plant and Equipment	5	3,622	4,289	2,250
Other Asset Management Expenses		1,557	1,462	1,704
Finance Charges Relating to Finance Leases		23	20	21
Gain on Disposal of Fixed Assets		(5)	-	(100)
Total Asset Management Expenses		5,197	5,771	3,875

33. Other Operating Expenses

		Actual 2006 \$000	Unaudited Budget 2006 \$000	Actual 2005 \$000
	Note			
Professional Fees		3,275	4,004	3,411
Computer Expenses		1,493	1,701	1,162
Information Expenses		1,147	1,065	1,011
Administration Expenses		1,352	1,440	1,138
Operational Travel Expenses		805	802	573
Agency and Commission Fees		818	903	1,015
Printing Expenses		576	697	267
Auditor Remuneration:				
Statutory Audit		197	178	208
Payments Systems Audits		36	34	40
Advisory Services		118	100	56
Non-Executive Directors' Remuneration Expenses	34	156	155	152
Rental and Lease Expenses		383	351	183
Bad Debt Expenses		-	-	-
Miscellaneous Expenses		713	463	230
		11,069	11,893	9,446

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 for advice with respect to the application of accounting policies to the Financial Statements and review of the Bank's Financial Services Group. 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.

34. 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.

	2006 \$000	2005 \$000
Non-Executive Directors:		
A Grimes (Chair)	36	36
A Paterson (Deputy Chair)	24	23
P Baines	20	19
H Fletcher	20	19
J Goulter	20	19
Rt. Hon E Thomas	18	18
M Waring	18	18
Total Non-Executive Directors' Remuneration Expenses	156	152

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Other Notes

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

	2006 \$000	2005 \$000
Reported Operating Surplus	253,907	272,744
Operating Cash Flow from Changes in Asset and Liability Balances	(449,031)	(427,182)
Add/(Subtract) Non-Cash Items:		
Depreciation	3,622	2,250
Amortisation of Premium/Discount on Financial Instruments	(9,170)	(13,687)
Net Unrealised Market Value Changes	55,596	(36,367)
Net Unrealised Foreign Exchange (Gain)/Loss	657,463	(93,268)
	707,511	(141,072)
Decrease/(Increase) in Current Assets:		
Movement in Accounts Receivable	(13,586)	(1,180)
Movement in Inventories	(4,877)	637
Movement in Interest Receivable	16,237	(53,002)
	(2,226)	(53,545)
Increase/(Decrease) in Current Liabilities:		
Movement in Miscellaneous Liabilities	12,639	1,845
Movement in Interest Payable	(16,439)	9,866
	(3,800)	11,711
Net Movements in Other Working Capital Items	(6,026)	(41,834)
Add/(Subtract) Investing and Financing Activities:		
Net Realised Foreign Exchange (Gain)/Loss	(648,634)	95,379
Net Realised Market Value Changes	(20,465)	7,561
Return of Demonetised Coin	-	-
Gain on Sale of Fixed Assets	(5)	(100)
	(669,104)	102,840
Net Cash Flow from Operating Activities	(162,743)	(234,504)

36. Cash Balances

	2006 \$000	2005 \$000
Foreign Currency Cash Assets:		
Cash Balances with Other Central Banks	96,653	113,399
Other Cash Balances	6,586	3,147
Total Foreign Currency Cash Assets	103,239	116,546
Local Currency Cash Assets:		
Cash on Hand	2	2
Total Local Currency Cash Assets	2	2
Closing Cash Balances	103,241	116,548

37. 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.

	2006 \$000	2005 \$000
Computer Equipment Finance Leases:		
Due within one year	256	202
Due within one to two years	133	110
Due within two to five years	50	2
Present Value of Minimum Lease Payments	439	314
Finance charge	24	14
Total Minimum Lease Payments	463	328
Comprising:		
Due within one year	273	213
Due within one to two years	140	113
Due within two to five years	50	2
Total Minimum Lease Payments	463	328

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(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.

	2006 \$000	2005 \$000
Office Equipment Operating Leases:		
Due within one year	48	68
Due within one to two years	-	48
Due within two to five years	-	-
Total Office Equipment Operating Lease Commitments	48	116

(c) Capital Expenditure and Inventory Commitments

	2006 \$000	2005 \$000
Capital Expenditure and Inventory:		
Property, Plant and Equipment - Due within one year	1,021	1,129
- Due within one to three years	-	70
Inventories - Due within one year	10,131	5,808
Total Capital Expenditure and Inventory Commitments	11,152	7,007

(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:

	2006 \$000	2005 \$000
Tenancy Lease Payments Receivable:		
Receivable within one year	1,482	1,455
Receivable within one to five years	3,507	4,801
Receivable later than five years	-	123
Total Tenancy Lease Payments Receivable	6,379	7,664

38. 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 43.

39. 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.

40. Related Parties

In the normal course of its operations, the Reserve Bank enters into transactions with related parties. Related parties include the Crown, 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.

41. 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 of the financial position of the Fund as at 31 March 2006 and reported on 18 July 2006 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 2006 to provide for benefits to members, including existing pensioners, that are attributable to membership prior to 1 April 2006. 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 Consumers 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 2006 and 30 June 2006 that would cause the Actuary to form a different opinion as at 30 June 2006.

(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 \$36.8 million (2005 \$36.9 million), including \$12.8 million (2005 \$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, \$13.9 million (2005 \$14.0 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 \$10.2 million (2005 \$10.0 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 2006, the Bank had a contingent liability of \$29.38 million (SDR 12.04 million) (2005 \$25.24 million, SDR 12.04 million) in respect of uncalled and unpaid capital attached to its shareholding in the Bank for International Settlements.

42. 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.

43. 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 safekeeping or acting as paying agent in certain circumstances.

The total value of securities held by NZCSD at 30 June 2006 was \$94.2 billion (2005 \$88.7 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.

44. Significant Post Balance Date Events

As at 30 August 2006, when the financial statements were authorised for issue, there were no significant post balance date events to report.



**Reserve Bank
of New Zealand**

2 The Terrace
Wellington 6011
New Zealand
P O Box 2498
Wellington 6140
New Zealand
Phone: +64 4 472 2029
Fax: +64 4 473 8554

**For further information
write to:**

The Librarian
Reserve Bank of New Zealand
P O Box 2498
Wellington
New Zealand

E-mail us at
rbnz-info@rbnz.govt.nz or
visit us at *www.rbnz.govt.nz*

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of New Zealand

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Cue Design
Photography:
Stephen A'Court

