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27 August 2007

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 2007 fairly reflect the financial position and operations of the Bank.

A handwritten signature in blue ink, appearing to read "Alan Bollard".

Governor

A handwritten signature in blue ink, appearing to be a stylized signature.

Deputy Governor

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Auditors' report

To the readers of the Reserve Bank of New Zealand and group's Financial Statements for the year ended 30 June 2007

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 company and group, on his behalf, for the year ended 30 June 2007.

Unqualified Opinion

In our opinion:

- the financial statements of the Reserve Bank of New Zealand and group on pages 56 to 103:
 - 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 2007; 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 27 August 2007, and is the date at which our opinion is expressed.

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

Basis of Opinion

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

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

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

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

Audit procedures generally include:

- determining whether significant financial and management controls are working and can be relied on to produce complete and accurate data;
- verifying samples of transactions and account balances;
- performing analyses to identify anomalies in the reported data;



Auditors' report
Reserve Bank of New Zealand

- 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 company and group as at 30 June 2007. 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 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 company or any of its subsidiaries.

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

PricewaterhouseCoopers

Matters Relating to the Electronic Presentation of the Audited Financial Statements

This audit report relates to the financial statements of the Reserve Bank of New Zealand and group for the year ended 30 June 2007 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 27 August 2007 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.

GUIDE TO THE MAIN FUNCTIONS OF THE RESERVE BANK

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

Monetary Policy Formulation:

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

Domestic Market Operations:

Transacting with, monitoring and liaising with financial markets to manage aggregate liquidity in the New Zealand banking system. These actions are for the purpose of implementing monetary policy and monitoring financial stability.

Financial System Surveillance and Policy:

Registering and supervising banks and overseeing payment systems to promote a sound and efficient New Zealand financial system. Analysis and surveillance of financial institutions, markets and other sectors of the economy relevant to financial stability. These actions are for the purpose of limiting 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 monetary policy objectives and the maintenance of orderly markets. This includes investment of the proceeds of foreign currency swap transactions and execution of foreign currency intervention activities.

Settlement Services:

Providing settlement accounts and related payment 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 securities registry and depository services, mainly to financial institutions.

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 2006/07 FINANCIAL STATEMENTS

Consolidated Statement of Financial Position

As at 30 June	Note	2007 \$000	2006 \$000
Assets:			
Foreign Currency Financial Assets:			
Cash Balances with Other Central Banks		670,315	96,653
Other Cash Balances		2,155	6,586
Marketable Securities	2	12,517,417	3,998,036
Receivable from Unsettled Sales of Securities		-	76,398
Securities Purchased Under Agreements to Resell		3,333,036	7,408,670
Shareholding in the Bank for International Settlements	6	97,035	117,364
Dividend Receivable		1,603	1,878
Accrued Interest		31,202	39,080
Total Foreign Currency Financial Assets²⁷		16,652,763	11,744,665
Local Currency Financial Assets:			
Cash on Hand		3	2
Securities Purchased Under Agreements to Resell		15,820	122,787
Investment Portfolio - New Zealand Government Securities		4,275,819	4,839,781
Accrued Interest		66,626	72,451
Other Local Currency Financial Assets		57	58
Total Local Currency Financial Assets		4,358,325	5,035,079
Total Financial Assets		21,011,088	16,779,744
Other Assets:			
Accounts Receivable and Deferred Costs	3	1,003	15,297
Inventories	4	17,992	11,098
Fixed Assets	5	70,216	53,724
Total Other Assets		89,211	80,119
Total Assets		21,100,299	16,859,863

27 Derivative instruments are used to manage the Bank's exposure to foreign currency risk. The effective foreign currency exposure at balance date is recorded in note 19: Foreign Currency Risk.

Consolidated Statement of Financial Position *continued*

As at 30 June	Note	2007 \$000	2006 \$000
Liabilities:			
Foreign Currency Financial Liabilities:			
Short-Term Deposits		333,108	-
Payable for Unsettled Purchases of Securities		-	76,417
Short Sales of Marketable Securities		-	342,061
Derivative Financial Instruments in a Loss Position	3	91	149,308
Securities Sold Under Agreements to Repurchase		567,868	1,211,805
Term Liabilities	7	3,945,913	5,313,886
Accrued Interest		21,585	36,785
Total Foreign Currency Financial Liabilities		4,868,565	7,130,262
Local Currency Financial Liabilities:			
Government Deposits		3,150,309	2,247,963
Other Deposits	8	7,801,860	2,086,883
Securities Sold Under Agreements to Repurchase		52,324	192,721
Accrued Interest		4,810	913
Total Local Currency Financial Liabilities		11,009,303	4,528,480
Total Financial Liabilities		15,877,868	11,658,742
Other Liabilities:			
Currency in Circulation	9	3,360,153	3,348,025
Provision for Transfer of Surplus to the New Zealand Government	11	193,000	410,000
Miscellaneous Liabilities	10	90,539	21,696
Total Other Liabilities		3,643,692	3,779,721
Total Liabilities		19,521,560	15,438,463
Equity	12	1,578,739	1,421,400
Total Liabilities and Equity		21,100,299	16,859,863

The above statement is to be read in conjunction with the notes on pages 68 to 103.

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Consolidated Statement of Movements in Equity

For the year ended 30 June	Note	2007 \$000	2006 \$000
Net Surplus for the Year		332,941	253,907
Increase in Properties Revaluation Reserve	12	13,159	15,290
Increase in Bank for International Settlements Shareholding Revaluation Reserve	12	2,619	8,024
Increase in Currency and Artwork Collections and Archives Revaluation Reserve	12	1,620	-
Total Recognised Revenues and Expenses for the Year		350,339	277,221
Provision for Transfer of Surplus to the New Zealand Government	11	(193,000)	(410,000)
Movement in Equity for the Year		157,339	(132,779)
Equity at Start of Year		1,421,400	1,554,179
Equity at End of Year		1,578,739	1,421,400

The above statement is to be read in conjunction with the notes on pages 68 to 103.

Consolidated Statement of Cost of Services

For the year ended 30 June	Note	Operating Income Actual 2007 \$000	Operating Expenses Actual 2007 \$000	Operating Surplus (Deficit) Actual 2007 \$000	Unaudited Operating Surplus (Deficit) Budget 2007 \$000	Operating Surplus (Deficit) Actual 2006 \$000
Functions:						
Monetary Policy Formulation		-	8,865	(8,865)	(9,267)	(8,719)
Domestic Market Operations		12,419	4,227	8,192	(2,019)	5,284
Financial System Surveillance and Policy		37	8,312	(8,275)	(8,915)	(7,670)
Currency Operations	23	242,157	17,854	224,303	214,886	205,227
Foreign Reserves Management ²⁸	24	24,525	7,645	16,880	13,525	(57,690)
Settlement Services		8,645	1,992	6,653	2,274	2,694
Registry and Depository Services	25	3,572	2,738	834	636	672
Overseas Investment Commission Secretariat ²⁹		-	-	-	-	(19)
Other Outputs		-	763	(763)	(731)	(720)
Total for Bank before Earnings on Investments Funded by Equity		291,355	52,396	238,959	210,389	139,059
Earnings not allocated to functions:						
Earnings on Investments Funded by Equity		93,982	-	93,982	102,791	114,848
Total for Bank		385,337	52,396	332,941	313,180	253,907
Income Retained under the Funding Agreement			23,267			
Net Operating Expenses			29,129			

Operating income for each function includes allocations of notional interest income and expenditure on New Zealand dollar funding provided by (or provided to) the function through internal lending and borrowing. Notional interest rates take into account the estimated term of the funding and the associated external interest earned or incurred. Earnings on equity are not allocated to individual functions.

The total operating expenses for each function include internal transfers between functions.

The above statement is to be read in conjunction with the notes on pages 68 to 103.

28 In 2006, the Bank revised the model and assumptions used to determine the fair value of Foreign Currency Term Liabilities. This revision resulted in a charge to operating income in 2006 of \$73.4 million, the impact of which was reflected in the operating deficit for the Foreign Reserves Management function.

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

Consolidated Statement of Financial Performance

For the year ended 30 June	Note	Actual 2007 \$000	Unaudited Budget 2007 \$000	Actual 2006 \$000
Operating Income:				
Income from Foreign Currency Financial Assets:				
Interest Income	26	874,931		365,078
Dividend Income		1,611		1,878
Gain/(Loss) from Fair Value Changes	28	3,755		(9,417)
Total Income from Foreign Currency Financial Assets		880,297		357,539
Expenses on Foreign Currency Financial Liabilities:				
Interest Expense	27	206,811		181,981
Loss/(Gain) from Fair Value Changes	28	(10,320)		25,780
Total Expenses on Foreign Currency Financial Liabilities		196,491		207,761
Net Foreign Exchange Revaluation Gain/(Loss) on Foreign Currency Activities	29	5,636		(8,829)
Foreign Currency Net Investment Income		689,442		140,949
Income from Local Currency Financial Assets:				
Interest Income	26	297,300		316,363
Gain/(Loss) from Fair Value Changes	28	86		(73)
Total Income from Local Currency Financial Assets		297,386		316,290
Expenses on Local Currency Financial Liabilities:				
Interest Expense	27	624,706		167,623
Loss/(Gain) from Fair Value Changes	28	103		(139)
Total Expenses on Local Currency Financial Liabilities		624,809		167,484
Local Currency Net Investment Income/(Expense)		(327,423)		148,806
Net Investment Income		362,019	346,441	289,755
Other Income	30	23,318	19,953	8,167
Total Operating Income		385,337	366,394	297,922
Operating Expenses:				
Personnel Expenses		21,831	22,003	21,613
New Currency Issued Expenses	23	11,112	10,112	6,136
Asset Management Expenses	31	6,659	6,482	5,197
Other Operating Expenses	32	12,794	14,617	11,069
Total Operating Expenses		52,396	53,214	44,015
Net Surplus for the Year	12	332,941	313,180	253,907

The above statement is to be read in conjunction with the notes on pages 68 to 103.

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Consolidated Statement of Cash Flows

For the year ended 30 June	Note	2007 \$000	2006 \$000
Cash Flows from Operating Activities:			
Sources from Income:			
Interest Received - Foreign Currency		605,064	293,551
- Local Currency - Investment Portfolio		289,695	311,665
- Other		26,910	17,472
Foreign Currency Swap Income		190,482	64,973
Dividend		1,886	1,478
Fees, Commission and Other Income Received		37,235	8,694
Total Sources of Cash Flows from Income		1,151,272	697,833
Disbursements for Operating Expenses:			
Interest Paid - Foreign Currency		221,901	198,352
- Local Currency		620,809	166,842
Payments to Suppliers and Employees		54,702	46,351
Total Disbursements of Cash Flows from Operating Expenses		897,412	411,545
Operating Cash Flows from Income and Operating Expenses		253,860	286,288
Operating Cash Flows from Changes in Asset Balances:			
Net (Increase)/Decrease in Foreign Currency Securities Purchased under Agreements to Resell		4,075,634	(3,805,282)
Net (Increase)/Decrease in Foreign Currency Marketable Securities		(9,354,091)	850,567
Net (Increase)/Decrease in Other Local Currency Financial Assets		107,053	142,478
Total Operating Cash Flows from Changes in Asset Balances		(5,171,404)	(2,812,237)
Operating Cash Flows from Changes in Liability Balances:			
Net (Increase)/Decrease in Other Foreign Currency Financial Liabilities		803,022	1,374,916
Net (Increase)/Decrease in Local Currency Financial Liabilities		(6,476,822)	(3,738,122)
Total Operating Cash Flows from Changes in Liability Balances		(5,673,800)	(2,363,206)
Operating Cash Flows from Changes in Asset and Liability Balances		502,396	(449,031)
Net Cash Flows from Operating Activities	34	756,256	(162,743)
Cash Flows from Investing Activities:			
Sources:			
Maturity of New Zealand Government Securities		564,000	689,800
Sale of Fixed Assets		-	667
Total Sources of Cash Flows from Investing Activities		564,000	690,467
Disbursements:			
Purchases of New Zealand Government Securities for Investment Portfolio		-	1,014,046
Purchase of Fixed Assets		6,090	6,414
Total Disbursements of Cash Flows from Investment Activities		6,090	1,020,460
Net Cash Flows from Investing Activities		557,910	(329,993)

Consolidated Statement of Cash Flows *continued*

For the year ended 30 June	Note	2007 \$000	2006 \$000
Cash Flows from Financing Activities:			
Sources:			
Net Issue of Circulating Currency		87,662	165,402
Additional Foreign Currency Term Liabilities		199,698	1,103,907
Total Sources of Cash Flows from Financing Activities		287,360	1,269,309
Disbursements:			
Payment for Demonetised Currency		6,619	29
Repayment of Foreign Currency Term Liabilities		569,972	622,858
Payment of Surplus to the New Zealand Government		410,000	139,284
Total Disbursements of Cash Flows from Financing Activities		986,591	762,171
Net Cash Flows from Financing Activities		(699,231)	507,138
CASH FLOWS FROM ALL ACTIVITIES		614,935	14,402
Plus Exchange Rate Effect		(45,703)	(27,709)
NET CASH FLOWS FROM ALL ACTIVITIES		569,232	(13,307)
Opening Cash Balance		103,241	116,548
CLOSING CASH BALANCE	35	672,473	103,241

The above statement is to be read in conjunction with the notes on pages 68 to 103.

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 21: Liquidity Risk.

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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 2007. They are prepared in accordance with part VI of the Act, and comply with Generally Accepted Accounting Practice in New Zealand (NZ GAAP), 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 27 August 2007.

(b) Basis of Preparation of Financial Statements

The Bank's Financial Statements are prepared in accordance with NZ GAAP.

Measurement Base

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

Basis of Consolidation

The consolidated financial statements are prepared using the purchase method. All material inter-company balances and transactions are eliminated. Parent financial statements are not produced because the difference between the parent and group 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 42: Custodial Activities).

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.

	2007	2006
euro	0.5711	0.4756
Japanese yen	95.1924	69.5986
United States dollar	0.7735	0.6083
SDR ³⁰	0.5095	0.4099

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

The Bank has changed its accounting policy with regard to the frequency of revaluations of land and buildings. These assets are now revalued annually, rather than every five years. This change was made in preparation for the adoption of New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) from 1 July 2007. The effect of the revaluation is shown in note 5: Fixed Assets.

There have been no other material changes to the Reserve Bank's accounting policies for the year ended 30 June 2007, and uniform accounting policies have been applied throughout the Bank.

³⁰ 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 weighting assigned to each currency reflects its relative importance in the world's trading and financial system.

(c) Financial Assets and Liabilities

The Bank presents financial assets and liabilities, and the associated income and expense streams, by distinguishing between foreign currency and local currency activities. Foreign currency activities arise mainly from the Bank's Foreign Reserves Management function, dealings in foreign currency for monetary policy implementation purposes and management of domestic banking system liquidity. Local currency activities mainly reflect the assets and liabilities associated with the Domestic Market Operations function and investment of the proceeds from issuing circulating currency.

The separate reporting of these activities is considered to provide a better presentation of the Bank's financial position, financial performance and risk profile. The Bank considers that the combined reporting of foreign and local currency activities would weaken the information value of the financial statements. Also refer to note 1: Nature and Extent of Activities 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 Resell.

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 foreign currency swaps, 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.

Foreign Currency Swaps and Forward Foreign Exchange Contracts

Foreign currency swaps and forward foreign exchange contracts are revalued for changes in exchange rates and interest 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) on Foreign Currency Activities.

The Bank uses foreign currency swap 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 foreign currency swap contracts are recognised in the Statement of Financial Performance.

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) on Foreign Currency Activities. 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) on Foreign Currency Activities. Cash collateral taken under an interest rate swap arrangement is recognised by the Bank in the Statement of Financial Position.

Off-Balance-Sheet Derivative Financial Instruments

The Bank enters into derivative financial instruments, such as forward foreign currency 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 24: Foreign Reserves Management). 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 (BIS)

The Bank's investment in shares issued by the BIS is valued at fair value, which is determined as being 70 percent 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) on Foreign Currency Activities.

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. 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 Fair 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.

(d) 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 annually. 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 36: Statement of Commitments.

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' 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.

Demonetised Currency

The Bank has a liability for the face value of demonetised currency still in circulation. For currency that is demonetised before 1 July 2004, this is recognised as a contingent liability except for a portion retained in the Statement of Financial Position to cover expected future redemptions. The Bank recognises a liability for the face value of currency that was demonetised on or after 1 July 2004 and that has not been presented to the Bank for redemption. The liability for demonetised currency calculated under this policy 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 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: Miscellaneous Liabilities).

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(e) 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 include cash movements relating to the Bank's financial assets and liabilities other than long-term holdings of New Zealand government securities, long-term debt from the Treasury, and currency in circulation.

(f) Income and Expenses**Income and Expenses Allocated amongst Functions**

The Act 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 Consolidated 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: Miscellaneous Liabilities).

Income Tax

Section CW 31 of the Income Tax Act 2004 exempts the Reserve Bank from income tax.

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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 Act.

(a) Foreign Currency Activities

The Bank's foreign currency activities arise mainly from:

- holding foreign currency assets for crisis management purposes;
- the investment of proceeds of foreign currency swaps entered into for managing the aggregate level of liquidity of the New Zealand banking system; and
- the purchase or sale of foreign currency in order to meet monetary policy objectives.

Under section 24 of the Act, the Minister, in consultation with the Bank, determines the level or range of foreign reserve assets that must be maintained by the Bank.

Foreign reserve assets held for crisis management purposes are mainly funded by foreign currency loans from the Treasury which are made on arm's length terms. From late 2006, foreign reserve assets held for crisis management purposes are also partially funded by the Bank's equity and New Zealand dollar-denominated liabilities including currency in circulation and deposits placed with the Bank by financial institutions. Foreign currency swaps are used to convert New Zealand dollar funding into foreign currency and to hedge foreign currency risk.

The Bank routinely injects New Zealand dollars into the New Zealand banking system as part of its liquidity management operations. The injection of New Zealand dollars entails the Bank entering into foreign currency swap transactions for a finite term. The foreign currency received from a swap is invested in foreign currency-denominated securities for a term coinciding with the term of the swap. Proceeds received on maturity of the foreign currency investment are used by the Bank to repay the foreign currency at the end of the term of the foreign currency swap transaction.

Foreign currency purchased or sold when the Bank intervenes in the foreign exchange market to meet monetary policy objectives usually entails the Bank borrowing or lending New Zealand currency to finance the foreign currency transaction.

Part of the Bank's foreign reserves assets are held in trading portfolios, which are funded by repurchase transactions with foreign securities trading firms.

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.

For further information on the risk management policies relating to financial instruments, see notes 15 to 22.

(b) Derivative Financial Instruments

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

Foreign currency swaps are used to hedge foreign exchange transactions for both Domestic Market Operations and Foreign Reserves Management.

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.

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

The Bank hedged the proceeds that it expected to receive from the sale of cupro-nickel coins, which were replaced with new coins in July 2006. Metal commodities futures contracts were used to hedge the associated price risk, and forward foreign exchange contracts were 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 2007, the fair value of securities lent out under the programme was \$551.0 million (2006 \$717.0 million).

(d) Foreign Exchange Gains and Losses

Section 16 of the Act gives the Bank the power to deal in foreign currency for the purpose of carrying out its functions and powers. All dealings in foreign currency assets and liabilities occur under that section, except for transactions that occur at the direction of the Minister of Finance.

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 2007, there have been no payments to or from the Crown under section 21 of the Act (2006 \$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 \$567.9 million (2006 \$1,211.8 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 \$52.3 million securities sold to counterparties under repurchase agreements relating to the liquidity management operations (2006 \$192.7 million).

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 Resell in the Bank's Statement of Financial Position. At balance date, the book value of foreign currency assets under reverse-repurchase agreements was \$3,333.0 million (2006 \$7,408.7 million). At balance date, the book value for local currency assets under reverse-repurchase agreements was \$15.8 million (2006 122.8 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 (2006 \$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. Banking system liquidity is increased or decreased by advancing or withdrawing funds at a margin to the Official Cash Rate (OCR). The financial instruments used to inject funds into the banking system in these operations include foreign currency swaps and local currency reverse-repurchase transactions. 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.

Securities in the Bank's Investment Portfolio – New Zealand Government Securities are intended to be held until maturity. The Bank maintains 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 Since 30 June 2006

On 30 June 2006, following a period of market consultation, the Bank announced that it would implement reforms for the management of banking system liquidity. Implementation commenced with a transitional period from July 2006 and the new regime was fully implemented in October 2006. In broad terms, the new liquidity management regime increased the level of financial institutions' deposits placed with the Bank from around \$2,000 million to around \$8,000 million. There was a corresponding increase in the value of foreign currency swaps entered into by the Bank and the value of foreign currency assets held by the Bank. This change to the management of New Zealand dollar liquidity had no impact on the Bank's ability to implement monetary policy.

In November 2006, the Bank used \$500 million of proceeds received upon maturity of New Zealand government securities to invest in the Bank's holdings of foreign currency assets. Foreign currency swaps were entered into to hedge the foreign currency exchange risk. Prior to this, the Bank had only used foreign currency borrowings from the Treasury to finance the Bank's foreign reserves.

From February 2007, the Bank used a portion of its liabilities to financial institutions to fund core assets held for foreign reserves management purposes. This was achieved using foreign currency swaps entered into for longer terms (known as "cross currency basis swaps"). At 30 June 2007, funding for foreign reserves of \$1,369.2 million was provided from this source.

In June 2007, the Bank intervened in the foreign exchange market, purchasing foreign currency and selling New Zealand dollars. Note 19 sets out the Bank's exposure to foreign currency risk at balance date.

In July 2007, the Bank announced that it would hold part of its foreign reserves on an unhedged basis. This will mean that net interest income will be lower than in previous years. In addition, increased foreign currency risk will be incurred as a consequence. In future, Operating Income will be more volatile than in the past.

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Asset Notes

2. Foreign Currency Marketable Securities

	Note	2007 \$000	2006 \$000
Marketable Securities		11,810,027	3,980,450
Derivative Financial Instruments in a Gain Position	3	707,390	17,586
Total Marketable Securities		12,517,417	3,998,036

3. Derivative Financial Instruments

	Book Value 2007 ³¹ \$000	Notional Principal 2007 \$000	Book Value 2006 \$000	Notional Principal 2006 \$000
Interest Rate Futures:				
Interest Rate Futures in a Gain Position	329	54,272	520	82,364
Interest Rate Futures in a Loss Position	(53)	11,556	(990)	2,002
Net Futures Position	276	65,828	(470)	84,366
At 30 June 2007, the Bank had 413 open Interest Rate Futures contracts (2006: 450)				
Interest Rate Swaps:				
Interest Rate Swaps in a Gain Position	859	41,078	1,520	41,098
Interest Rate Swaps in a Loss Position	13	8,755	(2,065)	399,130
Net Interest Rate Swap Position	872	49,833	(545)	440,228
Foreign Currency Swaps and Forward Foreign Exchange Contracts:				
Foreign Currency Swaps and Forward Foreign Exchange Contracts in a Gain Position	706,202	11,434,170	15,546	916,100
Foreign Currency Swaps and Forward Foreign Exchange Contracts in a Loss Position	(51)	10,674	(146,253)	4,207,485
Net Forward Foreign Exchange Contracts Position	706,151	11,444,844	(130,707)	5,123,585
Total Derivative Financial Instruments in a Gain Position ³²	707,390	11,529,520	17,586	1,039,562
Total Derivative Financial Instruments in a Loss Position	(91)	30,985	(149,308)	4,608,617
Net Derivative Financial Instruments Recognised on Balance Sheet	707,299	11,560,505	(131,722)	5,648,179

At 30 June 2006, the Bank had entered into forward foreign exchange contracts and commodity futures contracts to hedge the expected revenue from the disposal of cupro-nickel coins in 2006/07. At 30 June 2006, the foreign exchange contracts outstanding had a nominal value of USD 6.3 million and the commodity futures contracts outstanding had a nominal value equivalent to the disposal of 1,781 tonnes of cupro-nickel. The net cost of these hedging contracts at 30 June 2006 was deferred and included in Accounts Receivable and Deferred Costs. These deferred hedging costs were recognised in the Statement of Financial Performance in 2007 and netted against the revenue received from the sale of the cupro-nickel. No hedging contracts for the proceeds from sale of cupro-nickel were outstanding at 30 June 2007. The table above does not include the cupro-nickel and related currency hedging contracts outstanding at 30 June 2006.

4. Inventories

	2007 \$000	2006 \$000
Bank Notes for Circulation	11,693	6,344
Coin for Circulation	6,298	4,751
Collectors' Currency	1	3
Total Inventories	17,992	11,098

31 The book value of Derivative Financial Instruments is the fair value of those instruments. For further information, refer to "Derivative financial instruments" in the Statement of Accounting Policies, paragraph (c) Financial Assets and Liabilities. Book value is reported in note 3: Derivative Financial Instruments, excluding interest that has accrued on the relevant derivative.

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

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 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
Year ended 30 June 2007						
Opening Net Book Value	53,724	37,700	2,986	8,582	2,579	1,877
Additions	6,769	-	1,660	4,519	590	-
Revaluation	14,779	13,159	-	-	-	1,620
Less Net Book Value of Disposals	777	-	213	559	5	-
Less Depreciation	4,279	559	614	2,535	571	-
Closing Net Book Value	70,216	50,300	3,819	10,007	2,593	3,497
As at 30 June 2007						
Cost	82,832	50,300	4,658	18,978	5,399	3,497
Accumulated Depreciation	12,616	-	839	8,971	2,806	-
Net Book Value	70,216	50,300	3,819	10,007	2,593	3,497

The Bank owns its head office in Wellington and leases seven of the 14 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 \$6.7 million (2006 \$6.8 million) if the Bank had recorded these using historical cost less depreciation.

	Valuation Date	Registered Valuer
Wellington Head Office	30 June 2007	Jones Lang Lasalle Advisory Limited
Wellington Carparks	30 June 2007	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 \$520,000 (2006 \$413,000). Liabilities relating to leases are disclosed in note 36: Statement of Commitments.

Work in Progress at 30 June 2007 was \$4.7 million (2006 \$3.6 million), comprising:

	2007 \$000	2006 \$000
Computer Hardware and Software	4,450	1,851
Plant and Equipment	2	162
Property Improvements	196	1,583
Total Work in Progress	4,648	3,596

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 (2006 3,211 shares) issued by the BIS. This represents a shareholding of approximately 1 percent 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 exchange contracts to hedge the foreign currency value of the shareholding.

Liability and Equity Notes

7. Term Liabilities

	Total Market Value 2007 \$000	Unamortised Discount/ (Premium) 2007 \$000	Weighted Average Interest Rate 2007 %	Total Market Value 2006 \$000	Unamortised Discount/ (Premium) 2006 \$000	Weighted Average Interest Rate 2006 %
Unsecured Term Liabilities:						
Due to be Repaid:						
One year or less	673,692	834	4.3%	635,939	-	6.0%
Between one and two years	504,939	-	4.4%	830,791	2,143	3.4%
Between two and five years	472,384	-	4.3%	799,488	-	3.9%
Over five years	2,294,898	-	4.3%	3,047,668	-	3.7%
Total Unsecured Term Liabilities	3,945,913	834		5,313,886	2,143	

These are loans from the Treasury that are used to finance foreign reserve assets. 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. As stated in note 1 (a) and 1 (g), foreign reserve assets are also partly financed by local currency liabilities and foreign currency swaps.

8. Other Deposits

	2007 \$000	2006 \$000
Settlement Bank Deposits	7,754,494	1,984,247
Central Bank Deposits	26,281	68,668
International Monetary Fund Deposits	21,085	33,968
Total Other Deposits	7,801,860	2,086,883

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.

As at 30 June 2007, the following bank notes and coins were in circulation:

Denomination	Number of Note Forms/ Coins 2007 000	Face Value 2007 \$000	Number of Note Forms/ Coins 2006 000	Face Value 2006 \$000
5c	-	-	574,140	28,707
10c	83,310	8,331	237,010	23,701
20c	81,305	16,261	152,895	30,579
50c	42,258	21,129	57,394	28,697
\$1	65,850	65,850	64,025	64,025
\$2	61,608	123,215	61,210	122,420
\$5	18,640	93,202	18,256	91,282
\$10	17,857	178,568	17,651	176,507
\$20	55,610	1,112,199	56,329	1,126,582
\$50	11,450	572,500	10,425	521,248
\$100	11,689	1,168,898	11,343	1,134,277
Total Currency in Circulation		3,360,153		3,348,025

10. Miscellaneous Liabilities

	Note	2007 \$000	2006 \$000
Accounts Payable		2,537	2,295
Accrued Employee Entitlements		4,500	4,453
Provision for Lease Obligations		94	-
Demonetised Currency		82,847	13,933
Other Current Liabilities		26	576
Capitalised Lease Obligations	36	535	439
Total Miscellaneous Liabilities		90,539	21,696

New 10 cent, 20 cent and 50 cent coins were issued on 31 July 2006, replacing the old 'silver' coins. The 5 cent coin was not replaced. From 1 November 2006, the old 'silver' coins were declared no longer legal tender. The face value of coins not returned to the Bank was transferred from the liability for Currency in Circulation to the liability for Demonetised Currency.

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

Notional surplus income calculated in accordance with the Act is \$328.1 million.

Notional surplus income is based on realised income and excludes those dealings in foreign currency assets and liabilities that arise under section 16 of the Act. In 2006/07, the Bank changed its interpretation of section 16 to include all dealings in foreign currency assets and liabilities. Notional surplus income also excludes any underspending of the amount available under the funding agreement to meet the Bank's net operating expenses for the year.

The Bank's Board has recommended that a dividend of \$193.0 million be paid for 2006/07. The difference between the notional surplus income and the recommended dividend takes into account the reduction in equity that will occur with the adoption of NZ IFRS. The impact of the transition to NZ IFRS is explained in note 44: Impact of Adopting New Zealand Equivalents to International Financial Reporting Standards.

The Minister of Finance has agreed with the recommendation of the Bank's Board and has directed that a dividend of \$193.0 million be paid.

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12. Equity

	Note	2007 \$000	2006 \$000
Retained Earnings:			
Net Surplus for the year		332,941	253,907
Provision for Transfer of Surplus to the New Zealand Government	11	(193,000)	(410,000)
Movement in Retained Earnings		139,941	(156,093)
Opening Balance		380,733	536,826
Closing Balance		520,674	380,733
Capital:			
Opening Balance		1,000,000	1,000,000
Closing Balance		1,000,000	1,000,000
Properties Revaluation Reserve:			
Revaluation of Property		13,159	15,290
Movement in Properties Revaluation Reserve		13,159	15,290
Opening Balance		31,048	15,758
Closing Balance		44,207	31,048
Bank for International Settlements Shareholding Revaluation Reserve:			
Revaluation of shareholding in the Bank for International Settlements		2,619	8,946
Losses recovered through profit and loss from prior years		-	(922)
Movement in Bank for International Settlements Shareholding Revaluation Reserve		2,619	8,024
Opening Balance		8,024	-
Closing Balance		10,643	8,024
Currency and Artwork Collections and Archives Revaluation Reserve:			
Revaluation of Currency and Artwork Collections and Archives		1,620	-
Movement in Currency and Artwork Collections and Archives Revaluation Reserve		1,620	-
Opening Balance		1,595	1,595
Closing Balance		3,215	1,595
Total Equity		1,578,739	1,421,400

13. 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 \$4.140 billion, exclusive of accrued interest (2006 \$4.895 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.

14. Concentrations of Funding

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

	Total 2007 \$000	New Zealand Government \$000	New Zealand Public \$000	Overseas Financial Institutions \$000	New Zealand Financial Institutions ³³ \$000	Other \$000
Foreign Currency Financial Liabilities:						
Short-Term Deposits	333,108	-	-	333,108	-	-
Derivative Financial Instruments in a Loss Position	91	-	-	91	-	-
Securities Sold Under Agreements to Repurchase	567,868	-	-	567,868	-	-
Term Liabilities	3,945,913	3,945,913	-	-	-	-
Accrued Interest	21,585	11,820	-	9,765	-	-
Total Foreign Currency Financial Liabilities	4,868,565	3,957,733	-	910,832	-	-
Local Currency Financial Liabilities:						
Government Deposits	3,150,309	3,150,309	-	-	-	-
Other Deposits	7,801,860	-	-	8,003	7,754,494	39,363
Securities Sold Under Agreements to Repurchase	52,324	-	-	52,324	-	-
Accrued Interest	4,810	1,381	-	30	3,399	-
Total Local Currency Financial Liabilities	11,009,303	3,151,690	-	60,357	7,757,893	39,363
Total Financial Liabilities	15,877,868	7,109,423	-	971,189	7,757,893	39,363
Other Liabilities:						
Currency in Circulation	3,360,153	-	3,360,153	-	-	-
Provision for Transfer of Surplus to the New Zealand Government	193,000	193,000	-	-	-	-
Miscellaneous Liabilities	90,539	-	82,848	-	-	7,691
Total Other Liabilities	3,643,692	193,000	3,443,001	-	-	7,691
Total Liabilities	19,521,560	7,302,423	3,443,001	971,189	7,757,893	47,054

³³ New Zealand Financial Institutions includes financial institutions incorporated in New Zealand and New Zealand branches of financial institutions incorporated overseas.

	Total 2006 \$000	New Zealand Government \$000	New Zealand Public \$000	Overseas Financial Institutions \$000	New Zealand Financial Institutions ³⁴ \$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	-	-	102,636	1,984,247	-
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	-	200,890	1,984,247	94,467
Total Financial Liabilities	11,658,742	7,595,756	-	470,605	1,984,247	1,608,134
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	470,605	1,984,247	1,615,897

34 New Zealand Financial Institutions includes financial institutions incorporated in New Zealand and New Zealand branches of financial institutions incorporated overseas.

Risk Management Notes

15 Risk Management³⁵

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, foreign exchange risk, and interest rate risk. 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 17 to 21. 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.

³⁵ 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.

16. Operational Risk

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

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

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

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

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

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

17. 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 is monitored and managed daily. Exposures are controlled through comprehensive individual counterparty and issuer credit limits. Individual credit limits are set on the basis of the rating of the counterparty or issuer. 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 exposures arising from Securities Purchased Under Agreements to Resell (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. Exposures to the New Zealand Government are not included in this credit framework. 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).

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 \$333.3 million (2006 \$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.

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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:³⁶

	Classified by Industry of Issuer		Classified by Industry of Counterparty	
	2007 \$000	2006 \$000	2007 \$000	2006 \$000
New Zealand Government	4,363,708	5,040,138	4,347,875	4,917,275
Other Sovereign Issuers	5,408,047	9,154,780	3,542,967	1,804,195
Supranational Financial Institutions	3,317,456	477,514	2,538,316	477,514
Overseas Financial Institutions	7,806,801	2,107,287	10,466,852	9,580,733
New Zealand Financial Institutions ³⁷	115,051	-	115,053	2
Other	25	25	25	25
Total Financial Assets	21,011,088	16,779,744	21,011,088	16,779,744

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: Derivative Financial Instruments.

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

	2007 \$000	2006 \$000
New Zealand	4,478,784	5,040,162
United States of America	3,564,607	7,146,609
Europe	8,317,962	3,664,904
Supranational Financial Institutions	3,317,456	477,514
Japan	294,484	323,538
Other	1,037,795	127,017
Total Financial Assets	21,011,088	16,779,744

(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 that 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.

³⁶ The differences between amounts disclosed by industry and by counterparty relate to Securities Purchased Under Agreements to Resell.

³⁷ New Zealand Financial Institutions includes financial institutions incorporated in New Zealand and New Zealand branches of financial institutions incorporated overseas.

	Credit Rating	2007 \$'000	% of 2007 Financial Assets	2006 \$'000	% of 2006 Financial Assets
Foreign Currency Financial Assets:					
Cash Balances with Other Central Banks	AAA	621,825	3.0%	82,147	0.5%
	AA-	44,875	0.2%	10,184	0.1%
	N/R	3,615	0.0%	4,322	0.0%
Other Cash Balances	AA+	1,772	0.0%	4,361	0.0%
	AA-	383	0.0%	2,225	0.0%
Marketable Securities	AAA	8,220,650	39.1%	1,957,348	11.7%
	AA+	608,877	2.9%	355,208	2.1%
	AA	1,717,598	8.2%	308,568	1.8%
	AA-	1,606,181	7.6%	1,106,048	6.6%
	A+	141,337	0.7%	41,902	0.2%
	A	110,694	0.5%	-	-
	Various ³⁸	112,080	0.5%	130,169	0.8%
	N/R	-	-	98,793	0.6%
Receivable from Unsettled Sales of Securities	AA-	-	-	76,398	0.5%
Securities Purchased Under Agreements to Resell	AAA	3,333,036	15.9%	7,408,670	44.2%
Shareholding in the Bank for International Settlements	N/R ³⁹	97,035	0.5%	117,364	0.7%
Dividend Receivable	N/R	1,603	0.0%	1,878	0.0%
Accrued Interest	Various	31,202	0.2%	39,080	0.2%
Total Foreign Currency Financial Assets		16,652,763	79.3%	11,744,665	70.0%
Local Currency Financial Assets:					
Cash on Hand	AAA	3	0.0%	2	0.0%
Securities Purchased Under Agreements to Resell	AAA	15,820	0.1%	122,787	0.7%
Investment Portfolio - New Zealand Government Securities	AAA	4,275,819	20.3%	4,839,781	28.8%
Accrued Interest	AAA	66,626	0.3%	72,451	0.4%
Other Local Currency Financial Assets	AA+	25	0.0%	25	0.0%
	AA	32	0.0%	-	-
	AA-	-	-	33	0.0%
Total Local Currency Financial Assets		4,358,325	20.7%	5,035,079	30.0%
Total Financial Assets		21,011,088	100.0%	16,779,744	100.0%
Summary by Major Credit Category:					
Foreign Currency Financial Assets	AAA	12,175,511	58.0%	9,448,165	56.3%
	AA+/-	4,231,717	20.1%	1,904,894	11.4%
	Various	143,282	0.7%	169,249	1.0%
	N/R	102,253	0.5%	222,357	1.3%
Total Foreign Currency Financial Assets		16,652,763	79.3%	11,744,665	70.0%
Local Currency Financial Assets	AAA	4,358,268	20.7%	5,035,021	30.0%
	AA+/-	57	0.0%	58	0.0%
Total Local Currency Financial Assets		4,358,325	20.7%	5,035,079	30.0%
Total Financial Assets		21,011,088	100.0%	16,779,744	100.0%

38 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.

39 The BIS has not been assessed by international rating agencies. For internal management purposes, the Reserve Bank assumes an AAA rating has been assigned to exposures to the BIS.

(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 percent 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 2007	End of year 2006
10% to 19.9%	13	7
20% to 29.9%	6	5
30% to 39.9%	6	-
40% to 49.9%	1	2
60% to 69.9%	2	-
80% to 89.9%	1	1
90% to 99.9%	1	-
270% to 279.9%	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.

18. 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 'passive' foreign reserves management asset portfolios are exposed to some interest rate risk because the Bank's foreign currency assets are funded by liabilities, whose interest rate characteristics cannot be exactly replicated because of the liquidity requirements for the assets. The Bank accepts the associated interest rate (spread) risk as inevitable, but seeks to closely limit additional, mainly duration-related, interest rate mismatches.

Foreign currency loans from the Treasury are provided at a fixed margin to a floating reference rate. As the Treasury has sourced these loans by borrowing New Zealand dollars, the valuation of those loans includes movements in New Zealand dollar swap spreads. The Bank has not hedged movements in New Zealand dollar swap spreads.

Interest rate risk arising from the investment of the foreign currency proceeds of liquidity management swaps is managed by aiming to match the duration of the assets and liabilities⁴⁰. The interest rate risk arising from this is also limited by a Value at Risk (VaR) limit.

Interest rate risk is managed by way of VaR limits and stop-loss limits for the Bank's combined market risk, as described in note 20: Market Risk.

40 Duration risk is managed by matching the maturity of assets with the maturity or interest rate resets of the liabilities used to fund those assets.

(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 and it is intended that these securities be held to maturity. 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 2007 was 4.0 years (2006 4.5 years).

The Bank's exposure to interest rate risk that arises from liquidity management operations is constrained by an effective duration limit, which ensures that interest rate exposures are of a short-term nature.

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

	Weighted Average Interest Rate	Total 2007 \$000	Non-Interest Sensitive \$000	6 Months or Less \$000	6 to 12 Months \$000	1 to 2 Years \$000	2 to 5 Years \$000	Over 5 Years \$000
Foreign Currency Financial Assets:								
Cash Balances with Other Central Banks	4.0%	670,315	-	670,315	-	-	-	-
Other Cash Balances	0%	2,155	-	2,155	-	-	-	-
Marketable Securities	5.5%	12,517,417	-	12,389,388	37,205	-	74,875	15,949
Securities Purchased Under Agreements to Resell	4.9%	3,333,036	-	3,333,036	-	-	-	-
Shareholding in the Bank for International Settlements	0%	97,035	97,035	-	-	-	-	-
Dividend Receivable	0%	1,603	1,603	-	-	-	-	-
Accrued Interest	0%	31,202	-	31,202	-	-	-	-
Total Foreign Currency Financial Assets	5.3%	16,652,763	98,638	16,426,096	37,205	-	74,875	15,949
Foreign Currency Financial Liabilities:								
Short-Term Deposits	5.3%	333,108	-	333,108	-	-	-	-
Derivative Financial Instruments in a Loss Position	4.5%	91	-	91	-	-	-	-
Securities Sold Under Agreements to Repurchase	3.5%	567,868	-	567,868	-	-	-	-
Term Liabilities	4.3%	3,945,913	-	3,911,003	34,910	-	-	-
Accrued Interest	0%	21,585	-	21,585	-	-	-	-
Total Foreign Currency Financial Liabilities	4.3%	4,868,565	-	4,833,655	34,910	-	-	-
Foreign Currency Interest Rate Sensitivity Gap		11,784,198	98,638	11,592,441	2,295	-	74,875	15,949
Local Currency Financial Assets:								
Cash on Hand	0%	3	-	3	-	-	-	-
Securities Purchased Under Agreements to Resell	8.0%	15,820	-	15,820	-	-	-	-
Investment Portfolio – New Zealand Government Securities	6.2%	4,275,819	-	-	-	638,317	1,574,391	2,063,111
Accrued Interest	0%	66,626	-	66,626	-	-	-	-
Other Local Currency Financial Assets	0%	57	-	57	-	-	-	-
Other Assets	0%	89,211	89,211	-	-	-	-	-
Total Local Currency Assets	6.0%	4,447,536	89,211	82,506	-	638,317	1,574,391	2,063,111
Local Currency Financial Liabilities:								
Government Deposits	8.0%	3,150,309	-	3,150,309	-	-	-	-
Other Deposits	8.0%	7,801,860	-	7,801,860	-	-	-	-
Securities Sold Under Agreements to Repurchase	6.9%	52,324	-	52,324	-	-	-	-
Accrued Interest	0%	4,810	-	4,810	-	-	-	-
Other Liabilities	0%	3,643,692	3,643,692	-	-	-	-	-
Equity	0%	1,578,739	1,578,739	-	-	-	-	-
Total Local Currency Liabilities and Equity	5.4%	16,231,734	5,222,431	11,009,303	-	-	-	-
Local Currency Interest Rate Sensitivity Gap		(11,784,198)	(5,133,220)	(10,926,797)	-	638,317	1,574,391	2,063,111
On-Balance Sheet Interest Rate Sensitivity Gap		-	(5,034,582)	665,644	2,295	638,317	1,649,266	2,079,060
Off-Balance Sheet Instruments		-	-	143,411	-	(59,826)	(46,545)	(37,040)
Total Interest Rate Sensitivity Gap		-	(5,034,582)	809,055	2,295	578,491	1,602,721	2,042,020
Interest Rate Sensitivity Gap by Currency:								
New Zealand dollar		(700,973)	(5,133,220)	156,428	-	638,317	1,574,391	2,063,111
United States dollar		285,547	41,999	321,787	2,295	(32,179)	(46,545)	(1,810)
euro		304,943	35,491	274,061	-	-	-	(4,609)
Japanese yen		35,440	9,556	65,087	-	(27,647)	-	(11,556)
Other		75,043	11,592	(8,308)	-	-	74,875	(3,116)

	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 Resell	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 Resell	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	3,112,996
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

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19. Foreign Currency Risk

Foreign currency risk is the risk of loss arising from changes in exchange rates.

In 2006/07, the Bank had foreign exchange exposures arising from:

- intervention in the foreign exchange market;
- trading portfolios; and
- the foreign currency term loans from the Treasury, being the portion of the loan value attributable to changes in New Zealand dollar swap spreads that was not hedged.

Foreign currency risk on trading portfolios 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 20: Market Risk.

As stated in note 1 (g) Events Since 30 June 2006, intervention in foreign exchange markets that occurred in June 2007, and the decision in July 2007 to hold part of foreign reserves on an unhedged basis, will mean that foreign currency risk incurred, and therefore income volatility, will be greater in future years.

As at 30 June 2007, the Bank's net exposure to major currencies, including forward foreign exchange contracts and foreign currency swaps, was as follows:

	Total All Currencies 2007 \$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	670,315	586,087	31,109	44,875	8,244
Other Cash Balances	2,155	191	568	820	576
Marketable Securities	12,517,417	10,846,553	1,340,278	253,659	76,927
Securities Purchased Under Agreements to Resell	3,333,036	2,673,247	659,789	-	-
Shareholding in the Bank for International Settlements	97,035	40,396	35,491	9,556	11,592
Dividend Receivable	1,603	1,603	-	-	-
Accrued Interest	31,202	26,858	4,344	-	-
Total Foreign Currency Financial Assets	16,652,763	14,174,935	2,071,579	308,910	97,339
Foreign Currency Financial Liabilities:					
Short-Term Deposits	333,108	333,108	-	-	-
Derivative Financial Instruments in a Loss Position	91	8	(13)	53	43
Securities Sold Under Agreements to Repurchase	567,868	551,028	16,840	-	-
Term Liabilities	3,945,913	2,247,894	1,698,019	-	-
Accrued Interest	21,585	11,959	9,626	-	-
Total Foreign Currency Financial Liabilities	4,868,565	3,143,997	1,724,472	53	43
Off-Balance Sheet Instruments	(11,083,225)	(10,745,391)	(42,164)	(273,417)	(22,253)
Net Foreign Currency Exposure	700,973	285,547	304,943	35,440	75,043

	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 Resell	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	139,720	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	3,961,363	2,719,524	1,081	448,294
Off-Balance Sheet Instruments	(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

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

	2007 \$000	2006 \$000
Australian dollar	5,400	9,039
British pound	1,939	1,446
Canadian dollar	(8,190)	(3,282)
Swiss francs	1,019	44
Various currencies (Asian Bond Fund 2)	74,875	86,062
Total Other Currencies	75,043	93,309

20. Market Risk

The Reserve Bank manages interest rate risk and foreign currency risk in its 'passive' foreign reserves management and 'trading' portfolios under the following market risk management arrangements.

Policy-related positions, both existing Asian Bond Fund investments, valuation changes in foreign currency loans from the Treasury due to New Zealand dollar swap spreads, and foreign exchange exposure that arises from policy-driven interventions are excluded from the scope of the limits in sections (a) to (c) below.

(a) Tolerance for Extreme Market Risk Losses

The Bank's tolerance for loss from interest rate risk and foreign currency risk is no more than \$75 million (2006 \$75 million) in aggregate in any financial year. Within this aggregate outer tolerance for market risk losses, the Bank's tolerance for market risk losses from actively managed positions is \$25 million (2006 \$25 million) in any financial year. These tolerances for loss do not include potential losses incurred from items (i) to (iii) in paragraph (d) below. 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

Except for the positions mentioned in items (i) to (iii) in paragraph (d) below, 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 percent 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.

From and including June 2007, the Bank removed the VaR limit for the 'passive' foreign reserves management portfolio and replaced this with position size and duration gap limits.

VaR	Trading Portfolios		Passive Foreign Reserves Management Portfolios		Trading and Passive Foreign Reserves Management Portfolios Combined			
	Total Market Risk		Total Market Risk		Foreign Currency Risk	Interest Rate Risk	Total Market Risk	
	2007 \$000	2006 \$000	2007 \$000	2006 \$000			2007 \$000	2006 \$000
Limit	2,000	2,000	n/a	4,000	n/a	n/a	n/a	6,000
As at 30 June	326	130	510	254	598	698	836	384
Peak over period	430	504	588	370	598	773	872	736
Low over period	34	48	221	119	58	305	326	280
Average over period	190	202	395	227	266	532	586	429

(c) Stop-Loss Limits

Stop-loss limits are set to control losses that may arise in trading portfolios. When market risk losses exceed the stop-loss limit, positions are closed down. The Governor must approve the re-establishment of positions.

(d) VaR on items excluded from (a) to (c) above

The Bank's VaR limits framework described in (a) to (c) above does not apply to:

- (i) Investments in the Asian Bond Fund;
- (ii) Interest rate and foreign exchange valuation of loans from the Treasury due to changes in New Zealand dollar swap spreads; and
- (iii) Foreign exchange positions arising from foreign exchange intervention and, from July 2007, funding of foreign reserves on an unhedged basis.

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)⁴¹ countries in July 2003. The fund is managed by the BIS. As at 30 June 2007, VaR for the ABF1 investment was \$137,000 (2006 \$199,000), with a peak VaR of \$199,000 (2006 \$224,000) during the year.

The Reserve Bank has an investment of USD 50 million in the Asian Bond Fund 2 (ABF2), which was established by EMEAP countries to promote local bond markets. 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. As at 30 June 2007, VaR for the ABF2 investment was \$540,000 (2006 \$770,000), with a peak VaR of \$808,000 (2006 \$932,000).

The VaR for valuation changes in foreign currency loans from the Treasury due to New Zealand dollar swap and basis spreads was \$8.5 million as at 30 June 2007.

The VaR for the Bank's overall portfolio, including the foreign exchange intervention position but excluding ABF1 and ABF2 and the valuation changes in foreign currency loans from the Treasury due to New Zealand dollar swap spreads, was \$10.4 million as at 30 June 2007.

21. 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 minimum requirements for holding the most liquid (government) securities, 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.

Refer to note 1 (g): Events since 30 June 2006, which describes significant changes to both foreign and local currency activities during the year.

41 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.

22. Maturity Analysis

	Total 2007 \$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	670,315	-	670,315	-	-	-	-
Other Cash Balances	2,155	-	2,155	-	-	-	-
Marketable Securities	12,517,417	112,080	12,066,150	60,962	43,681	149,597	84,947
Securities Purchased Under Agreements to Resell	3,333,036	-	3,333,036	-	-	-	-
Shareholding in the Bank for International Settlements	97,035	97,035	-	-	-	-	-
Dividend Receivable	1,603	-	1,603	-	-	-	-
Accrued Interest	31,202	-	31,202	-	-	-	-
Total Foreign Currency Financial Assets	16,652,763	209,115	16,104,461	60,962	43,681	149,597	84,947
Foreign Currency Financial Liabilities:							
Short-Term Deposits	333,108	-	333,108	-	-	-	-
Derivative Financial Instruments in a Loss Position	91	-	104	-	-	-	(13)
Securities Sold Under Agreements to Repurchase	567,868	-	567,868	-	-	-	-
Term Liabilities	3,945,913	-	197,115	476,577	504,939	472,384	2,294,898
Accrued Interest	21,585	-	21,585	-	-	-	-
Total Foreign Currency Financial Liabilities	4,868,565	-	1,119,780	476,577	504,939	472,384	2,294,885
Foreign Currency Maturity Difference	11,784,198	209,115	14,984,681	(415,615)	(461,258)	(322,787)	(2,209,938)
Local Currency Financial Assets:							
Cash on Hand	3	-	3	-	-	-	-
Securities Purchased Under Agreements to Resell	15,820	-	15,820	-	-	-	-
Investment Portfolio – New Zealand Government Securities	4,275,819	-	-	-	638,317	1,574,391	2,063,111
Accrued Interest	66,626	-	66,626	-	-	-	-
Other Local Currency Financial Assets	57	-	57	-	-	-	-
Other Assets	89,211	70,216	18,995	-	-	-	-
Total Local Currency Assets	4,447,536	70,216	101,501	-	638,317	1,574,391	2,063,111
Local Currency Financial Liabilities:							
Government Deposits	3,150,309	-	3,150,309	-	-	-	-
Other Deposits	7,801,860	-	7,801,860	-	-	-	-
Securities Sold Under Agreements to Repurchase	52,324	-	52,324	-	-	-	-
Accrued Interest	4,810	-	4,810	-	-	-	-
Other Liabilities	3,643,692	3,450,692	193,000	-	-	-	-
Equity	1,578,739	1,578,739	-	-	-	-	-
Total Local Currency Liabilities and Equity	16,231,734	5,029,431	11,202,303	-	-	-	-
Local Currency Maturity Difference	(11,784,198)	(4,959,215)	(11,100,802)	-	638,317	1,574,391	2,063,111
Net Maturity Difference	-	(4,750,100)	3,883,879	(415,615)	177,059	1,251,604	(146,827)

	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 Resell	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 Difference	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 Resell	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 Difference	(4,614,403)	(4,737,397)	(4,152,865)	-	-	1,318,000	2,957,859
Net Maturity Difference	-	(4,489,864)	4,869,194	21,329	(922,913)	532,151	(9,897)

Consolidated Statement of Cost of Services Notes

23. 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 and in foreign currency assets. Currency in Circulation is a non-interest-bearing liability. However, the Investment Portfolio – New Zealand Government Securities and foreign currency assets are 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 2007 was \$220,000 (2006 \$189,000).

Currency Operations includes income and expenses associated with property management. The net surplus (deficit) for this activity in 2007 was (\$1,842,000) (2006 \$300,000).

	2007 \$000	2006 \$000
Operating Income:		
Seigniorage Income	226,146	214,380
Other Income	16,011	1,533
Total Operating Income	242,157	215,913
Currency Issued Expenses:		
New Coin Issued Expenses	9,303	1,561
New Note Issued Expenses	1,807	2,413
Write-Down of Coin Inventory	2	2,162
Total Currency Issued Expenses	11,112	6,136
Other Currency Expenses	6,742	4,550
Total Operating Expenses	17,854	10,686
Currency Operations Operating Surplus	224,303	205,227

24. Foreign Reserves Management

The Reserve Bank holds foreign currency assets to support the functions of the Bank, including monetary policy objectives, management of aggregate liquidity in the New Zealand banking system and maintenance of orderly markets. These foreign reserves are funded by borrowing through the Treasury, foreign currency swaps and New Zealand dollar-denominated liabilities.

The Bank has established trading portfolios which involve discretionary trading and portfolio management decisions, and quantitative trading strategies undertaken by specialist staff with delegated authority from the Governor.

The Gain/(Loss) on Currency Intervention Activities includes foreign exchange losses of \$10.841 million recorded on the net open foreign exchange position established for currency intervention purposes. In addition, funding costs of \$0.729 million (2006: \$nil) were incurred in respect of the foreign exchange intervention.

	2007 \$000	2006 \$000
Gain/(Loss) on Active Management Trading	(3,308)	4,392
Gain/(Loss) on Passive Foreign Reserves Management Portfolios ⁴²	39,403	(55,353)
Gain/(Loss) on Currency Intervention Activities	(11,570)	-
Total Operating Income	24,525	(50,961)
Total Operating Expenses	7,645	6,729
Foreign Reserves Management Operating Surplus (Deficit)	16,880	(57,690)

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 15 to 22.

⁴² In 2006, the Bank revised the model and assumptions used to determine the fair value of foreign currency Term Liabilities. This revision resulted in a charge to operating income in 2006 of \$73.4 million, the impact of which was reflected in the operating deficit for the Foreign Reserves Management function.

25. Registry and Depository Services

The Bank operates the Austraclear New Zealand System, which provides the financial markets with depository, clearing, settlement and limited registry services for debt securities and equities.

	2007 \$000	2006 \$000
Operating Income:		
Registry and Depository Services Fees	3,572	3,860
Total Operating Income	3,572	3,860
Operating Expenses:		
Personnel Expenses	497	727
Other Expenses	2,241	2,461
Total Operating Expenses	2,738	3,188
Registry and Depository Services Operating Surplus	834	672

Consolidated Statement of Financial Performance Notes**26. Interest Income from Financial Assets**

	2007 \$000	2006 \$000
Interest Income from Foreign Currency Financial Assets:		
Cash Balances with Other Central Banks	10,212	3,476
Other Cash Balances	98	98
Marketable Securities	391,415	112,714
Securities Purchased Under Agreements to Resell	246,922	164,264
Securities Lending Programme	777	644
Amortised Interest on Foreign Currency Swaps	225,507	83,882
Total Interest Income from Foreign Currency Financial Assets	874,931	365,078
Interest Income from Local Currency Financial Assets:		
Securities Purchased Under Agreements to Resell	4,119	14,496
Investment Portfolio - New Zealand Government Securities	283,970	298,866
Government Bank Accounts	9,211	3,001
Interest Income from Local Currency Financial Assets	297,300	316,363
Total Interest Income from Financial Assets	1,172,231	681,441

27. Interest Expense on Financial Liabilities

	2007 \$000	2006 \$000
Interest Expense on Foreign Currency Financial Liabilities:		
Securities Sold Under Agreements to Repurchase	9,464	18,287
Term Liabilities	192,213	161,873
Other	5,134	1,821
Total Interest Expense on Foreign Currency Financial Liabilities	206,811	181,981
Interest Expense on Local Currency Financial Liabilities:		
Government Deposits	76,023	71,901
Other Deposits	535,081	62,055
Securities Sold Under Agreements to Repurchase	13,585	33,413
Other	17	254
Total Interest Expense on Local Currency Financial Liabilities	624,706	167,623
Total Interest Expense on Financial Liabilities	831,517	349,604

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28. Gain/(Loss) from Fair Value Changes

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

	2007 \$000	2006 \$000
Gain/(Loss) from Unrealised Fair Value Changes	2,260	(29,882)
Gain/(Loss) from Realised Fair Value Changes	1,495	20,465
Total Gain/(Loss) from Fair Value Changes on Foreign Currency Financial Assets	3,755	(9,417)
Loss/(Gain) from Unrealised Fair Value Changes	(10,320)	25,780
Total Loss/(Gain) from Fair Value Changes on Foreign Currency Financial Liabilities	(10,320)	25,780
Gain/(Loss) from Unrealised Fair Value Changes	63	(73)
Gain/(Loss) from Realised Fair Value Changes	23	-
Total Gain/(Loss) from Fair Value Changes on Local Currency Financial Assets	86	(73)
Loss/(Gain) from Unrealised Fair Value Changes	103	(139)
Total Loss/(Gain) from Fair Value Changes on Local Currency Financial Liabilities	103	(139)
Total Gain/(Loss) from Fair Value Changes	14,058	(35,131)

29. Net Foreign Exchange Revaluation Gain/(Loss)

	2007 \$000	2006 \$000
Unrealised Revaluation Gain/(Loss)	(364,116)	492,016
Realised Revaluation Gain/(Loss)	(894,058)	723,556
Total Foreign Exchange Revaluation Gain/(Loss) on Foreign Currency Assets	(1,258,174)	1,215,572
Unrealised Revaluation (Gain)/Loss	(1,199,096)	1,149,478
Realised Revaluation (Gain)/Loss	(64,714)	74,923
Foreign Exchange Revaluation Loss/(Gain) on Foreign Currency Liabilities	(1,263,810)	1,224,401
Net Foreign Exchange Revaluation Gain/(Loss)	5,636	(8,829)

30. Other Income

	Actual 2007 \$000	Unaudited Budget 2007 \$000	Actual 2006 \$000
Registry and Depository Services Fees	3,572	3,730	3,861
Property Rental Income	1,626	1,623	1,599
Currency Distribution Income	16,747	13,154	1,358
Exchange Settlement Account System Income	1,272	1,398	1,093
Overseas Investment Commission Fees	-	-	159
Collectors' Currency Income	50	-	73
Miscellaneous Income	51	48	24
Total Other Income	23,318	19,953	8,167

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31. Asset Management Expenses

	Note	Actual 2007 \$000	Unaudited Budget 2007 \$000	Actual 2006 \$000
Depreciation of Property, Plant and Equipment	5	4,279	4,552	3,622
Other Asset Management Expenses		2,153	1,899	1,557
Finance Charges Relating to Finance Leases		33	31	23
Loss/(Gain) on Disposal of Fixed Assets		194	-	(5)
Total Asset Management Expenses		6,659	6,482	5,197

32. Other Operating Expenses

	Note	Actual 2007 \$000	Unaudited Budget 2007 \$000	Actual 2006 \$000
Professional Fees		3,091	3,909	3,275
Computer Expenses		1,971	2,252	1,493
Information Expenses		1,400	1,237	1,147
Administration Expenses		1,342	1,682	1,352
Operational Travel Expenses		860	854	805
Agency and Commission Fees		1,460	2,334	818
Communication Expenses		1,110	909	576
Auditor Remuneration:				
Statutory Audit		197	200	197
Payments Systems Audits		51	40	36
Advisory Services		41	63	118
Non-Executive Directors' Remuneration Expenses	33	196	155	156
Rental and Lease Expenses		431	466	383
Bad Debt Expenses		-	-	-
Miscellaneous Expenses		644	516	713
		12,794	14,617	11,069

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. 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.

33. 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 Governor, who is an executive director.

	2007 \$000	2006 \$000
Non-Executive Directors:		
A Grimes (Chair)	48	36
A Paterson (Deputy Chair)	32	24
P Baines	24	20
H Fletcher	24	20
J Goulter	24	20
Rt. Hon E Thomas	22	18
M Waring	22	18
Total Non-Executive Directors' Remuneration Expenses	196	156

Other Notes**34. Reconciliation of Net Cash Flows from Operating Activities with Reported Operating Surplus**

	2007 \$000	2006 \$000
Reported Operating Surplus	332,941	253,907
Operating cash flow from changes in asset and liability balances	502,396	(449,031)
Add/(Subtract) Non-Cash Items:		
Depreciation	4,279	3,622
Amortisation of Premium/Discount on Financial Instruments	(73,767)	(9,170)
Net Unrealised Market Value Changes	(12,540)	55,596
Net Unrealised Foreign Exchange (Gain)/Loss	(834,980)	657,463
	(917,008)	707,511
Decrease/(Increase) in Current Assets:		
Movement in Accounts Receivable	14,569	(13,586)
Movement in Inventories	(6,894)	(4,877)
Movement in Interest Receivable	13,703	16,237
	21,378	(2,226)
Increase/(Decrease) in Current Liabilities:		
Movement in Miscellaneous Liabilities	(168)	12,639
Movement in Interest Payable	(11,303)	(16,439)
	(11,471)	(3,800)
Net Movements in Other Working Capital Items	9,907	(6,026)
Add/(Subtract) Investing and Financing Activities:		
Net Realised Foreign Exchange (Gain)/Loss	829,344	(648,634)
Net Realised Market Value Changes	(1,518)	(20,465)
Loss/(Gain) on Sale of Fixed Assets	194	(5)
	828,020	(669,104)
Net Cash Flow from Operating Activities	756,256	(162,743)

35. Cash Balances

	2007 \$000	2006 \$000
Foreign Currency Cash Assets:		
Cash Balances with Other Central Banks	670,315	96,653
Other Cash Balances	2,155	6,586
Total Foreign Currency Cash Assets	672,470	103,239
Local Currency Cash Assets:		
Cash on Hand	3	2
Total Local Currency Cash Assets	3	2
Total Cash Assets	672,473	103,241
Closing Cash Balances	672,473	103,241

36. Statement of Commitments**(a) Capitalised Finance Lease Liabilities**

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.

	2007 \$000	2006 \$000
Computer Equipment Finance Leases:		
Due within one year	331	256
Due within one to two years	146	133
Due within two to five years	58	50
Present Value of Minimum Lease Payments	535	439
Finance charge	33	24
Total Minimum Lease Payments	568	463
Comprising:		
Due within one year	354	273
Due within one to two years	154	140
Due within two to five years	60	50
Total Minimum Lease Payments	568	463

(b) Operating Lease Commitments

The Bank leases premises and 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.

	2007 \$000	2006 \$000
Premises and Office Equipment Operating Leases:		
Due within one year	276	48
Due within one to two years	276	-
Due within two to five years	590	-
Total Premises and Office Equipment Operating Lease Commitments	1,142	48

(c) Capital Expenditure and Inventory Commitments

	2007 \$000	2006 \$000
Capital Expenditure and Inventory:		
Property, Plant and Equipment – Due within one year	-	1,021
Inventories – Due within one year	3,041	10,131
Total Capital Expenditure and Inventory Commitments	3,041	11,152

(d) Lease Payments Receivable

The Bank owns its head office in Wellington and leases seven of the 14 floors to tenants under operating leases. Under the current non-cancellable lease agreements, the total minimum lease payments receivable are as follows:

	2007 \$000	2006 \$000
Tenancy Lease Payments Receivable:		
Receivable within one year	1,566	1,482
Receivable within one to five years	2,908	3,507
Total Tenancy Lease Payments Receivable	4,474	4,989

37. 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 42: Custodial Activities.

38. Free Services

The Act 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.

39. 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.

40. 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 was not wound up, the assets of the Fund were sufficient at 31 March 2006 to provide for benefits to members, including existing pensioners, that were 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 was 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 was 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 2007 that would cause the Actuary to form a different opinion as at 30 June 2007.

(b) The Bank has a contingent liability for currency in circulation that has been demonetised but not returned to the Bank, but only to the extent that the Bank has not recognised an actual liability. The total face value of demonetised currency is \$105.8 million (2006 \$36.8 million). Of the total face value of demonetised currency, \$82.9 million (2006 \$13.9 million) is recognised as a liability 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 \$10.4 million (2006 \$10.2 million).

(d) At 30 June 2007, the Bank had a contingent liability of \$23.63 million (SDR 12.04 million) (2006 \$29.38 million, SDR 12.04 million) in respect of uncalled and unpaid capital attached to its shareholding in the BIS.

41. Income Tax

Section CW 31 of the Income Tax Act 2004 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.

42. 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 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 2007 was \$99.1 billion (2006 \$94.2 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.

43. Significant Post-Balance-Date Events

At 27 August 2007, when the financial statements were authorised for issue, the Bank's net open foreign currency position was \$2,477.57 million (\$700.97 million at 30 June 2007).

In July 2007, the Bank announced that it had concluded the review of the structure of its balance sheet and that it would hold some portion of its foreign reserves assets on an unhedged basis. Previously, the Bank had substantially hedged its foreign currency positions other than very recent positions taken as part of foreign exchange intervention activities, some trading positions and a portion of the value of foreign currency term loans from the Treasury arising from changes in interest rate spreads. The Bank commenced implementation of this change to its foreign currency hedging of reserves in July 2007 and, as part of that process, it no longer hedges the foreign currency risk on its shareholding in the BIS.

Foreign currency intervention for monetary policy purposes and holding of foreign reserves on an unhedged basis together with foreign exchange rate fluctuations will result in reduced net interest income and greater volatility in reported earnings compared with previous financial years.

On 23 August 2007, the Bank announced that, in order to alleviate current market liquidity issues experienced following global events, as a temporary measure it would accept certain New Zealand bank bills as collateral for the overnight reverse-repurchase facility.

On 1 July 2007, the Bank adopted NZ IFRS. Details of the impact of this accounting change are provided in note 44: Impact of Adopting New Zealand Equivalents to International Financial Reporting Standards.

44. Impact of Adopting New Zealand Equivalents to International Financial Reporting Standards

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 managed 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.

Set out below are the key areas where accounting policies are expected to change on adoption of NZ IFRS and estimates of the quantitative impact on the financial statements. The differences identified are based on management's best estimates of the quantitative impact of the changes as at the date of preparing the Bank's financial statements for the year ended 30 June 2007. The information provided in this note addresses significant items but does not represent a complete list of expected adjustments and any differences may be material.

Reconciliation of Net Surplus Under NZ FRS to that expected under NZ IFRS

For the year ended 30 June	Note	2007 \$000
Net Surplus reported under NZ FRS		332,941
Add/(less) items included in Net Surplus under NZ FRS that are excluded under NZ IFRS:		
Hedging costs amortised in 2007 that had been deferred at 1 July 2006 under NZ FRS	(ii)	15,711
Property depreciation recognised under NZ FRS on buildings classified under NZ IFRS as investment property	(v)	215
Face value of collectors' currency recognised as income under NZ FRS and a liability under NZ IFRS	(vii)	(201)
		15,725
Other adjustments to Net Surplus required by NZ IFRS:		
Use of bid and offer prices rather than mid-market prices	(iii)	2,779
Defined benefit superannuation scheme expense	(iv)	(605)
Valuation of inventories of returned currency, at replacement cost under NZ IFRS	(vi)	(449)
Revaluation of investment property under NZ IFRS booked to the Statement of Financial Performance	(v)	4,238
		5,963
Expected Net Surplus calculated under NZ IFRS		354,629

Reconciliation of Equity as presented under NZ FRS to that expected under NZ IFRS

As at 30 June	Note	2007 \$000	2006 \$000
Capital provided by the New Zealand Government		1,000,000	1,000,000
Property Revaluation Reserve			
NZ FRS Balance		44,207	31,048
Revaluation of investment property under NZ IFRS booked to the Statement of Financial Performance	(v)	(4,238)	-
Property depreciation recognised under NZ FRS on buildings classified under NZ IFRS as investment property	(v)	(215)	-
Reclassification to Retained Earnings for that part of the reserve which relates to investment property under NZ IFRS	(v)	(6,869)	(6,869)
NZ IFRS Balance		32,885	24,179
Currency and Artwork Collections and Archives Revaluation Reserve		3,215	1,595
Available for Sale Investments Revaluation Reserve			
NZ FRS Balance		10,643	8,024
Unrealised gains/(losses) on New Zealand Government Securities classified as Available for Sale securities	(i)	(136,467)	53,943
NZ IFRS Balance		(125,824)	61,967
Retained Earnings			
NZ FRS Balance		520,674	380,733
Hedging costs amortised in 2007 that had been deferred at 1 July 2006 under NZ FRS	(ii)	-	(15,711)
Reclassification from Property Revaluation Reserve for investment property under NZ IFRS	(v)	11,322	6,869
Defined benefit superannuation scheme surplus recognised as an asset under NZ IFRS	(iv)	1,129	1,734
Valuation of inventories of returned currency, at replacement cost under NZ IFRS	(vi)	1,740	2,189
Face value of collectors' currency recognised as income under NZ FRS and a liability under NZ IFRS	(vii)	(624)	(423)
Use of bid and offer prices rather than mid-market prices	(iii)	(8,037)	(10,816)
NZ IFRS Balance		526,204	364,575
Expected Equity calculated under NZ IFRS		1,436,480	1,452,316

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(i) 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* 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.

The Bank has designated its investment in shares issued by the BIS 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 foreign exchange hedge on the BIS shares was removed on 4 July 2007. From that date, changes in the value of the BIS shares due to movement in foreign exchange rates will be recorded directly in Equity.

(ii) Deferred costs arising under NZ FRS from hedge transactions

The Bank has established that, under NZ IAS 39, the hedges of the proceeds receivable upon selling demonetised coins for their salvage value do not meet the criteria for hedge accounting under NZ IFRS. Amortisation of the deferred costs has been charged to the Statement of Financial Performance calculated under NZ FRS for the year ended 30 June 2007. That amortisation is excluded from the Statement of Financial Performance calculated under NZ IFRS.

(iii) 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. Under NZ FRS all foreign currency assets and liabilities of the Bank that 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 remeasure those assets and liabilities at either a bid or offer price, instead of mid-price.

(iv) Post-Employment Benefits

NZ IAS 19: *Employee Benefits* requires defined benefit pension and superannuation plan surpluses and deficits to be recognised in the Statement of Financial Position, with a corresponding entry made to retained earnings on initial transition to NZ IFRS.

The Bank will recognise an asset under NZ IFRS, with a corresponding increase in Equity. This represents the present value of reductions in future contributions to the Bank's defined benefit superannuation scheme.

(v) Investment property

Premises owned by the Bank that are let to tenants are classified under NZ IFRS as Investment Property. Under NZ IFRS, investment property is not depreciated, but changes in the valuation of investment property are recorded in the Statement of Financial Performance. Also, revaluations attributable to investment property will be reclassified as Retained Earnings under NZ IFRS.

(vi) Public Benefit Entity and Inventories

The Bank is a Public Benefit Entity (PBE), which is defined as a reporting entity whose primary objective is to provide goods and services for the community or social benefits, and where any equity provided has been provided with a view to supporting that primary objective rather than for a financial return to equity holders.

PBEs are required to comply with a number of requirements under NZ IFRS that are not included in the equivalent IFRSs. For instance, the Bank will be required to comply with the PBE requirements under NZ IAS 2: *Inventories* in respect of its inventories of notes and coins. Exposure Draft 111 proposes amendments to NZ IAS 2. Once amended, NZ IAS 2 will require inventories of notes and coins that have been repatriated to the Bank to be recorded at replacement cost at the date that currency is repatriated. When repatriated notes and coins are subsequently reissued, this cost is removed from Inventory and an expense is booked. Under NZ FRS, inventories are valued at the lower of cost or net realisable value, and notes and coins returned and held for reissue are not included in the value of Inventory.

(vii) 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.

(viii) Demonetised Currency

The Act states that the Bank has a liability for all currency in circulation, including notes and coins that are no longer legal tender and that are presented to the Bank for payment. Under NZ 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 that 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.

(ix) Impairment Losses

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

Five-year historical financial information

Table 7: Five-year financial position

	June 2003 (\$m)	June 2004 (\$m)	June 2005 (\$m)	June 2006 (\$m)	June 2007 (\$m)
Assets:					
Foreign Currency Financial	6,216	5,681	8,086	11,745	16,653
Local Currency Financial	5,430	4,777	4,866	5,035	4,358
Other Assets	38	39	44	80	89
Total Assets	11,684	10,497	12,996	16,860	21,100
Liabilities and Equity:					
Foreign Currency Financial	5,102	5,574	7,308	7,130	4,869
Local Currency Financial	3,165	1,382	790	4,529	11,009
Currency in Circulation	2,806	2,920	3,183	3,348	3,360
Other Liabilities	195	200	161	432	283
Equity	416	421	1,554	1,421	1,579
Total Liabilities and Equity	11,684	10,497	12,996	16,860	21,100

Table 8: Five-year financial performance

	June 2003 (\$m)	June 2004 (\$m)	June 2005 (\$m)	June 2006 (\$m)	June 2007 (\$m)
Operating Income:					
Net Investment Income	216.1	222.8	301.9	289.8	362.0
Other Income	9.3	9.4	8.4	8.1	23.3
Total Operating Income	225.4	232.2	310.3	297.9	385.3
Operating Expenses:					
Personnel Expenses	15.6	17.8	18.3	21.6	21.8
New Currency Issued Expenses	6.1	5.4	5.9	6.1	11.1
Asset Management Expenses	4.0	3.5	3.9	5.2	6.6
Other Operating Expenses	10.6	10.3	9.4	11.1	12.9
Total Operating Expenses	36.3	37.0	37.5	44.0	52.4
Net Surplus	189.1	195.2	272.8	253.9	332.9
Five-Year Outcomes under the Funding Agreement:					
Actual Net Expenses Under Funding Agreement	26.8	27.7	29.1	35.9	29.1
Net Expenditure Specified Under the Funding Agreement	31.0	31.0	33.0	39.0	34.0
Funding Agreement underexpenditure	4.2	3.3	3.9	3.1	4.9