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26 August 2008

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 2008 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 read "Sue Gunson".

Deputy Governor

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



Auditors' report

To the readers of the Reserve Bank of New Zealand and Group's Financial Statements for the year ended 30 June 2008

The Auditor-General is the auditor of the Reserve Bank of New Zealand (the 'Bank') 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 Bank and Group, on his behalf, for the year ended 30 June 2008.

Unqualified Opinion

In our opinion the financial statements of the Reserve Bank of New Zealand and Group on pages 56 to 105:

- comply with generally accepted accounting practice in New Zealand; and
- fairly reflect:
 - the Reserve Bank of New Zealand and Group's financial position as at 30 June 2008; and
 - the results of their operations and cash flows for the year ended on that date.

The audit was completed on 26 August 2008 and is the date at which our opinion is expressed.

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

Basis of Opinion

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

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

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

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

Audit procedures generally include:

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

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 the financial statements in accordance with generally accepted accounting practice in New Zealand. The financial statements must fairly reflect the financial position of the Bank and Group as at 30 June 2008 and the results of their operations and cash flows for the year ended on that date. The Governor's responsibilities arise from the Reserve Bank 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 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 Bank or its subsidiary.

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 2008 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 or from the 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 as well as the related audit report dated 26 August 2008 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 information may differ from legislation in other jurisdictions.

GUIDE TO THE MAIN FUNCTIONS OF THE RESERVE BANK

The Reserve Bank's role is defined by the Reserve Bank of New Zealand Act 1989 (the Reserve Bank Act).

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, facilitating payments and monitoring financial stability.

Financial System Surveillance:

Registering and supervising banks and overseeing payment systems, to promote a sound and efficient New Zealand financial system; and 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 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.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 30 June	Note	2008 \$M	2007 \$M
ASSETS			
Foreign Currency Financial Assets			
Cash Balances		491	672
Securities Purchased Under Agreements to Resell		2,007	3,351
Marketable Securities		17,812	11,806
Derivative Financial Instruments in a Gain Position	4	329	719
Other Foreign Currency Financial Assets	5	115	99
Total Foreign Currency Financial Assets		20,754	16,647
Local Currency Financial Assets			
Securities Purchased Under Agreements to Resell		-	16
New Zealand Government Securities		4,307	4,206
Total Local Currency Financial Assets		4,307	4,222
Total Financial Assets		25,061	20,869
Other Assets	6	101	92
Total Assets		25,162	20,961
LIABILITIES			
Foreign Currency Financial Liabilities			
Short-term Foreign Currency Financial Liabilities	9	290	333
Securities Sold Under Agreements to Repurchase		573	568
Derivative Financial Instruments in a Loss Position	4	176	-
Term Liabilities		3,566	3,969
Total Foreign Currency Financial Liabilities		4,605	4,870
Local Currency Financial Liabilities			
Deposits	10	14,888	10,957
Securities Sold Under Agreements to Repurchase		37	52
Currency in Circulation		3,448	3,361
Other Local Currency Financial Liabilities	11	258	285
Total Local Currency Financial Liabilities		18,631	14,655
Total Liabilities		23,236	19,525
EQUITY	14	1,926	1,436
Total Liabilities and Equity		25,162	20,961

The above statement is to be read in conjunction with the notes set out on pages 61 to 105.

Derivative Instruments are used to manage the Bank's exposure to foreign currency risk. The effective foreign currency exposure as at balance date is recorded in Note 21.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 30 June	Note	2008 \$M	2007 \$M
Total Comprehensive Income for the Year		658	177
Distribution Payable to the New Zealand Government	13	(168)	(193)
Movement in Equity for the Year		490	(16)
Equity at the Beginning of the Year		1,436	1,452
Equity at the End of the Year		1,926	1,436

The above statement is to be read in conjunction with the notes set out on pages 61 to 105.

CONSOLIDATED INCOME STATEMENT

For the year ended 30 June	Note	2008 \$M	2007 \$M
Interest Income		1,408	1,172
Interest Expense		1,174	832
Net Interest Income		234	340
Net Gains/(Losses) from Fair Value Changes		(7)	14
Net Gains/(Losses) from Foreign Exchange Rate Changes		344	9
Dividend Income		2	2
Total Net Investment Income	24	573	365
Other Income	26	8	39
Total Operating Income		581	404
Total Operating Expenses	27	46	53
Net Profit for the Year		535	351

The above statement is to be read in conjunction with the notes set out on pages 61 to 105.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 30 June	Note	2008 \$M	2007 \$M
Net Profit for the Year from the Consolidated Income Statement		535	351
Items Recognised Directly in the Consolidated Statement of Comprehensive Income			
Movement in Available-for-sale Revaluation Reserve taken to Equity	14	118	(188)
Movement in Property Revaluation Reserve taken to Equity	14	3	13
Movement in Currency and Artwork Collections and Archives Revaluation Reserve taken to Equity	14	2	1
Total Income and Expense Taken to Equity During the Year		123	(174)
Total Comprehensive Income for the Year		658	177

The above statement is to be read in conjunction with the notes set out on pages 61 to 105.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 30 June	Note	2008 \$M	2007 \$M
CASH FLOWS FROM OPERATING ACTIVITIES			
Sources from Income			
Interest Received:			
Foreign Currency		975	795
Local Currency:			
Available-for-sale Securities		267	290
Other		118	27
Dividend		2	2
Fees, Commission and Other Income Received		8	37
Total Sources of Cash Flows from Income		1,370	1,151
Disbursements for Expenses			
Interest Paid:			
Foreign Currency		174	221
Local Currency		1,012	621
Payments to Suppliers and Employees		48	55
Total Disbursements of Cash Flows from Expenses		1,234	897
Operating Cash Flows from Income and Expenses		136	254
Operating Cash Flows from Changes in Operating Asset Balances:			
Net (Increase)/Decrease in Foreign Currency Operating Assets		(3,481)	(5,278)
Net (Increase)/Decrease in Other Local Currency Operating Assets		16	107
Total Operating Cash Flows from Changes in Asset Balances		(3,465)	(5,171)
Operating Cash Flows from Changes in Operating Liability Balances:			
Net (Increase)/Decrease in Other Foreign Currency Operating Liabilities		22	803
Net (Increase)/Decrease in Local Currency Operating Liabilities		(3,918)	(6,477)
Total Operating Cash Flows from Changes in Liability Balances		(3,896)	(5,674)
Operating Cash Flows from Changes in Asset and Liability Balances		431	503
Net Cash Flows from Operating Activities	28	567	757

CONSOLIDATED STATEMENT OF CASH FLOWS CONTINUED

For the year ended 30 June	Note	2008 \$M	2007 \$M
CASH FLOWS FROM INVESTING ACTIVITIES			
Sources			
Maturity of Available-for-sale Securities		-	564
Total Sources of Cash Flows from Investing Activities		-	564
Disbursements			
Purchase of Property, Plant and Equipment and Intangible Assets		1	6
Total Disbursements of Cash Flows from Investing Activities		1	6
Net Cash Flows from Investing Activities		(1)	558
CASH FLOWS FROM FINANCING ACTIVITIES			
Sources			
Net Issue of Circulating Currency		87	87
Additional Foreign Currency Term Liabilities		-	200
Total Sources of Cash Flows from Financing Activities		87	287
Disbursements			
Repayment of Foreign Currency Term Liabilities		687	570
Payment of Distribution to the New Zealand Government		193	410
Payment for Demonetised Currency		1	7
Total Disbursements of Cash Flows from Financing Activities		881	987
Net Cash Flows from Financing Activities		(794)	(700)
NET CASH FLOWS		(228)	615
Plus Foreign Exchange Rate Effect		47	(46)
NET CASH FLOWS FROM ALL ACTIVITIES		(181)	569
Cash Balances at the Beginning of the Year		672	103
Cash Balances at the End of the Year		491	672

The above statement is to be read in conjunction with the notes set out on pages 61 to 105.

NOTES TO BE READ AS PART OF THE CONSOLIDATED FINANCIAL STATEMENTS

1. 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 Reserve Bank Act and its amendments). These consolidated financial statements apply to the financial year ended 30 June 2008. They are prepared in accordance with part VI of the Reserve Bank Act and comply with Generally Accepted Accounting Practice in New Zealand.

In these financial statements, the Reserve Bank of New Zealand is also referred to as the "Reserve Bank" or the "Bank". The Bank's parent entity is the Government of New Zealand.

The Governor and Deputy Governor of the Reserve Bank authorised these financial statements for issue on 26 August 2008.

b Compliance with New Zealand Equivalents to International Financial Reporting Standards

These financial statements are the first annual financial statements to be prepared by the Bank in accordance with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS). Reconciliations and descriptions of the impact of the transition from previous New Zealand Financial Reporting Standards (NZ FRS) to NZ IFRS on the Bank's reported Statement of Financial Position, Income Statement and Statement of Cash Flows are provided in Note 37.

Comparative figures presented in these financial statements have been restated to reflect valuation methods and accounting classifications that apply under NZ IFRS.

Under NZ IAS 1 *Presentation of Financial Statements*, the Bank is classified as a Public Benefit Entity (PBE). A PBE is a reporting entity whose primary objective is to provide goods and services for the community or social benefits and where any equity 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 requirements under NZ IFRSs, which differ from corresponding provisions of the equivalent IFRSs. For the reasons set out below, while the Bank asserts full compliance with Generally Accepted Accounting Practice in New Zealand and NZ IFRS, it is unable to make an unreserved statement of compliance with International Financial Reporting Standards (IFRS).

The following accounting practice adopted in accordance with the Bank's PBE status has prevented the Bank from asserting full compliance with IFRS. NZ IAS 2 Inventories requires that inventories of currency that are held for distribution be measured at cost. NZ IAS 2 requires that inventory that is acquired at no cost, or for nominal consideration, be measured at current replacement cost. The corresponding IFRS provision in IAS 2 requires that inventories be measured at the lower of cost and net realisable value.

c Basis of Preparation of Financial Statements

Measurement Base

These financial statements have been prepared using the general principles of historical cost accounting, modified by fair value accounting for available-for-sale financial assets, all derivative contracts, financial assets and liabilities that are held at fair value through profit or loss, land and buildings, and currency and artwork collections.

Transition to NZ IFRS

NZ IFRS 1 *First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards* has been applied in preparing these consolidated financial statements.

The Bank has not elected to use any of the optional exemptions from certain NZ IFRSs or any of the exemptions to retrospective applications of certain NZ IFRSs that are available under NZ IFRS 1. The Bank has complied with all mandatory exemptions that apply on transition to NZ IFRSs.

These accounting policies have been consistently applied by the Bank for all the financial years presented (unless otherwise stated).

From 1 July 2007, the Bank adopted the following new standards and interpretations, which have been issued by the Accounting Standards Review Board but which only come into force in subsequent accounting periods:

- NZ IAS 1 *Presentation of Financial Statements* (revised 2007);
- NZ IFRS 8 *Operating Segments*; and
- NZ IFRIC 14 *NZ IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*.

In all cases, adoption of these standards and interpretations has had no impact on reported profits or financial position.

Basis of Consolidation

These 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.

Trust and Custodial Activities

Assets held for third parties under custodial arrangements and income arising thereon are excluded from these financial statements, as they are not assets or income of the Bank (see Note 35).

Segment Reporting

The Bank's operations comprise a single operating segment for the purposes of NZ IFRS 8 *Operating Segments*. The Bank has significant foreign currency liabilities and foreign currency financial assets as part of its Foreign Reserves Management and Domestic Market Operations activities. These activities do not constitute separate operating segments for the purposes of NZ IFRS 8.

The Bank is required by the Reserve Bank Act to report revenue and expenses by reference to the functions carried out by the Bank.

Functional and Presentation Currency

The Bank's financial statements are presented in New Zealand dollars, the Bank's functional and presentation currency.

Foreign Currency Conversions

Transactions denominated in foreign currency are translated to New Zealand dollars using exchange rates applied on the trade date of the transaction.

Foreign currency assets and liabilities are translated to New Zealand dollars at the relevant market bid or offer foreign exchange rate as at balance date.

Foreign exchange gains and losses resulting from settlement of foreign currency transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currency are recognised in the Income Statement. Where a gain or loss on a non-monetary item is recognised directly in equity, such as equity investments classified as financial assets that are available for sale, the related exchange gain or loss is also recognised in equity.

Rounding

Amounts in the financial statements are rounded to the nearest million dollars unless otherwise stated.

d Financial Assets

Classification of Financial Assets

The Bank classifies its financial assets into the following categories: financial assets at fair value through profit or loss, loans and receivables, and available-for-sale financial assets. Bank management determines the classification of its financial assets at initial recognition.

The Bank prepares a daily profit or loss report applying the accounting policies described herein. In broad terms, compliance with the Bank's investment mandates and performance of the Bank's Foreign Reserves Management and Domestic Market Operations functions are assessed daily on the basis of the fair value of assets and related liabilities funding those assets. Accordingly, the bulk of assets and liabilities are designated as fair value through profit or loss.

The Bank also has active management portfolios, which are classified as held for trading.

Available-for-sale financial assets include the Bank's holdings of New Zealand government bonds and its shareholding in the Bank for International Settlements. These assets are intended to be held either to maturity or for an indefinite period of time, and in the case of New Zealand government bonds, these may be sold in the course of the Bank's operations.

Financial Assets at Fair Value Through Profit or Loss

This category has two sub-categories: financial assets held for trading and those designated as fair value through profit or loss at inception. A financial asset

is classified as held for trading if acquired or incurred principally for selling it in the near term; if it is part of a portfolio of identical financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit taking; if it is a derivative that is not a designated hedging instrument; or if it is so designated on acquisition by management.

This designation may only be made if the financial asset either contains an embedded derivative or will be managed on a fair value basis in accordance with a documented risk management strategy, or if designating it (and any financial liability) at fair value will reduce an accounting mismatch.

Available-for-sale Financial Assets

Available-for-sale financial securities are those non-derivative financial assets that are designated as available for sale or that are not classified as financial assets at fair value through profit or loss, or loans and receivables.

Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides goods or services directly to a debtor with no intention of trading the receivable.

Recognition and Measurement of Financial Assets

Purchases and sales of financial assets are recognised on trade date, the date on which the Bank commits to purchase or sell the asset. Financial assets are recognised initially at fair value. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all the risks and rewards of ownership.

Available-for-sale financial assets and financial assets through profit or loss are subsequently carried at fair value.

The fair values of quoted investments in active markets are based on current bid prices. In other cases, the Bank establishes fair value by using appropriate valuation techniques.

Loans and receivables are carried at amortised cost less impairment losses.

Realised and unrealised gains and losses arising from changes in the fair value of financial assets at fair value through profit or loss are included in the Income Statement in the year in which they arise. These

realised and unrealised gains and losses exclude interest and dividends.

Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in equity until the financial asset is derecognised or impaired, at which time the cumulative gain or loss previously recognised in equity is recognised in the Income Statement.

Interest income on all assets is calculated using the effective interest method and is recognised in the Income Statement. Dividends on available-for-sale equity instruments are recognised in the Income Statement when the right to receive payment is established.

Derivative Financial Instruments

Derivatives are initially recognised in the Statement of Financial Position at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, or valuation techniques, as appropriate. The best evidence of the fair value of a derivative at initial recognition is the transaction price (i.e., the fair value of the consideration given or received).

Derivative transactions, such as foreign currency swaps, and the payment and receipt of different currencies are stated in the Statement of Financial Position at the net of the fair value of receipts less fair value of payments, both expressed in New Zealand dollars. The net fair value of each derivative contract is determined individually and carried as assets if the net fair value is positive and as a liability if that value is negative.

From July 2007, the Bank has not applied the hedge accounting rules of NZ IAS 39 *Financial Instruments: Recognition and Measurement*. Before that date, the Bank applied hedge accounting for designated forward foreign exchange contracts used to manage foreign currency risk on the Bank's shareholding in the Bank for International Settlements.

Gains and losses on all derivatives are recognised in the Income Statement.

Securities Purchased Under Agreements to Resell

Where the Bank purchases securities under agreements to resell ("reverse repurchase agreements"), the security is not included as an asset in the Bank's Statement of Financial Position.

The consideration receivable under the agreement to resell is recorded at fair value. Movements in the fair value of reverse repurchase agreements are reported in the Income Statement.

Securities Lending Programme

The Bank operates a securities lending programme. Where securities are lent, the Bank receives collateral in the form of cash or other securities and the securities continue to be recorded as assets in the Bank's Statement of Financial Position.

The Bank's agent administers the securities lending programme and monitors the securities lending and related collateral against requirements agreed with the Bank.

The Bank records an asset being the market value of the securities lent and a liability for the same amount in respect of the collateral to be returned by the Bank at the conclusion of the loan.

The Bank records income from securities lending as it accrues. Changes in the value of the asset are reflected by a change in the corresponding liability.

Impairment of Financial Assets

For assets that are not classified as fair value through profit or loss, the Bank assesses as at each balance date whether there is objective evidence that a financial asset or group of financial assets is impaired. Objective evidence of impairment would include observable data that comes to the attention of the Bank such as significant financial difficulty of the issuer or counterparty, the disappearance of an active market for the financial asset because of financial difficulties, and a market downgrade in credit rating of the financial asset.

e Other Assets

Inventories

Inventories are recognised in the Statement of Financial Position at cost.

When currency is issued, inventory is reduced and an expense is recorded for currency issuance costs. When currency is repatriated to the Bank, currency issue expense is credited with the replacement cost of producing the currency, with a corresponding increase in inventory recognised in the Statement of Financial Position. Currency issuance cost is determined on a weighted average basis. Costs include the cost of bringing inventories to their present location and condition.

Property, Plant and Equipment

Land and Buildings

Land and buildings owned by the Bank are classified as Property, Plant and Equipment.

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 Property 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. Buildings are depreciated on a straight-line basis over 40 years.

Currency and Artwork Collections and Archives

Items held in the Bank's currency and artwork collections and archives that have a material commercial value are independently assessed to determine estimated fair values. 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 Property, Plant and Equipment

Other Property, Plant and Equipment is carried at cost less depreciation and impairment losses. The following assets held by the Bank are depreciated on a straight-line basis over the following terms:

Computer Hardware	3-5 years
Plant and Equipment	5-10 years
Property Improvements	8 years
Miscellaneous	expected useful life

Intangible Assets

Intangible assets comprise acquired and internally developed computer software. Intangible assets are stated at cost less accumulated amortisation and impairment losses. Costs include all direct expenses incurred to acquire and bring to use the specific software.

Costs incurred in bringing to use enhancements to an existing software programme are capitalised only if the enhancement will produce additional future economic benefits exceeding costs over more than one year.

Capitalised software development costs are amortised on a straight-line basis over the estimated useful life

of the software (three to five years). Costs associated with maintaining computer software are recognised as expenses when incurred.

Leases

Leases of plant and equipment where the Bank has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the lease's inception at the lower of the fair value of the leased property and the present value of the minimum lease payments. The corresponding rental obligations, net of finance charges, are included in Other Liabilities. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate of return on the finance balance outstanding. Plant and equipment acquired under finance leases is depreciated over the shorter of the asset's useful life and the lease term.

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Minimum payments made under operating leases (net of any incentives received from the lessor) are charged to the Income Statement on a straight-line basis over the period of the lease.

Impairment of Non-financial Assets

Non-financial assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units).

f Financial Liabilities

Recognition of Financial Liabilities

Financial liabilities are recognised initially at fair value. Except for liabilities classified as financial liabilities at fair value through profit or loss, financial liabilities are subsequently stated at amortised cost.

Financial liabilities are derecognised only when the obligation is discharged, cancelled or expired.

Financial liabilities are recorded on trade date, the date on which the Bank commits to borrow or repay the relevant funds.

Financial Liabilities at Fair Value Through Profit or Loss

This category has two sub-categories: financial liabilities held for trading and those designated as fair value through profit or loss at inception. Financial liabilities that are classified as financial liabilities through profit or loss are included in those sub-categories on the same basis as financial assets at fair value through profit or loss (see page 62).

Securities Sold under Agreements to Repurchase

Where the Bank sells securities under agreements to repurchase ("repurchase agreements"), the security continues to be included as an asset in the Bank's Statement of Financial Position.

The consideration payable under the agreement to repurchase is recorded at fair value. Movements in the fair value of repurchase agreements are reported in the Income Statement.

Short Sales of Marketable Securities

A short sale is a sale of a security that the Bank does not own. Securities that are sold short are recorded at fair value through profit or loss using quoted market offer prices.

Any gains or losses are recognised in the Income Statement.

Currency in Circulation

Currency issued by the 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.

Demonetised Currency

The Bank has a liability for the face value of demonetised currency still in circulation. For currency demonetised before 1 July 2004, this is recognised as a contingent liability except for a provision retained in the Statement of Financial Position to cover expected future redemptions. For currency demonetised from 1 July 2004, the Bank records a liability equal to the face value of that currency still in circulation.

Collectors' Currency

The Bank has a liability for the face value of collectors' currency. The face value of collectors' currency issued before 1 July 2004 is recognised as a contingent liability. For collectors' currency issued from 1 July 2004, the Bank records a liability equal to the face value of that currency.

Offsetting of Financial Assets and Financial Liabilities

Financial assets and liabilities are offset and the net amount reported in the Statement of Financial Position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

g Other Liabilities**Employee Entitlements***Wages and Salaries, Annual and Sick Leave*

Liabilities for wages and salaries, including non-monetary benefits and annual leave, are recognised in Other Liabilities in respect of employees' services and are measured at the amounts expected to be paid when liabilities are settled.

No provision is made for non-vesting sick leave, as the pattern of sick leave taken indicates that no additional liability will arise for non-vesting sick leave.

Retirement Gratuity

Retirement gratuities and post-retirement benefits are recognised in Other Liabilities in respect of employees' services and are measured at the present value of future payments expected to be made in respect of services provided by employees up to balance date. This is calculated by an independent actuary using a discounted cash flow model. Expected future payments are discounted to their net present value using market yields at the reporting date on government bonds with terms that match as closely as possible the estimated timing of future cash flows.

Changes in the value of the liability for retirement gratuities and post-retirement benefits are included in the Income Statement in staff expenses.

Superannuation Obligations

Obligations for contributions to defined benefit superannuation schemes are recognised as an expense in the Income Statement as incurred.

The asset or liability recognised in the Statement of Financial Position in respect of the defined benefit superannuation scheme is the present value of the defined benefit obligation at the reporting date less the fair value at the reporting date of the scheme's assets (as adjusted for unrecognised past service costs). The carrying value of an asset or liability recognised in respect of a defined benefit superannuation scheme is restricted to the total of any unrecognised past service

cost and the present value of reductions in future contributions from the scheme. The present value of the defined benefit obligation is determined by discounting the estimated future cash flows using interest rates of New Zealand government bonds that have terms to maturity approximating to the terms of the related superannuation liability. The calculation is performed annually by an independent qualified actuary using the projected unit credit method.

The cost recognised in the Income Statement in respect of the defined benefit superannuation scheme comprises the current service cost, an interest cost and an expected return on the scheme's assets.

h Income and Expenses**Interest Income and Interest Expense**

Interest income and expense are recognised in the Income Statement for all instruments measured at amortised cost using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument. The calculation includes all fees paid or received between parties, transaction costs and all other premiums or discounts.

Fee Income

Fee income earned from provision of services is recognised as revenue on an accruals basis as the service is provided.

Income and Expenses Allocated to Functions

The Reserve Bank Act requires the 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.

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 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.

Income Tax

Section CW38 of the Income Tax Act 2007 exempts the Bank from income tax. Accordingly, no provisions are raised for current or deferred income tax liabilities.

i Cash Flows

For the purposes of the Statement of Cash Flows, cash and cash equivalents include balances with other central banks and amounts available at call with other institutions.

Certain cash flows have been netted in order to provide more meaningful disclosure. Netting of cash flows occurs where cash receipts and payments on behalf of customers reflect the activities of the customer rather than the Bank, or where cash receipts or payments are for items in which turnover is quick, amounts are large, and maturities are short.

j Significant Accounting Estimates and Judgements in Applying Accounting Policies

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Fair Value of Financial Instruments

Financial instruments classified as held for trading or designated at fair value through profit or loss and financial assets classified as available for sale are recognised in the financial statements at fair value. All derivatives are measured and recognised at fair value.

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Financial instruments are priced either with reference to a quoted market price for that instrument or by

using a valuation model. Where the fair value is calculated using financial market pricing models, the methodology used is to calculate the expected cash flows under the terms of each specific contract and then discount these values back to the present value. These models use as their basis independently sourced market parameters including, for example, interest rate yield curves and currency rates. Most market parameters are either directly observable or are implied from instrument prices.

Superannuation and Post-retirement Obligation

The Bank has obligations under the defined benefit superannuation plan and for certain post-retirement obligations as described on page 66 above. The carrying amount of these obligations is based upon actuarial valuations, which in turn are dependent upon a series of assumptions. Key valuation assumptions include price inflation, earnings growth, employee retirement dates, and investment returns. Valuations are performed on the basis that the scheme will not be wound up.

Valuation of Land and Buildings

The fair value of the Bank's land and buildings is assessed by an independent registered property valuer. Estimated fair value is arrived at by the valuer, based on a number of assumptions, principally with respect to market rates of rental and market capitalisation rates.

2. Nature and Extent of Activities

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

a Local Currency Activities

The Bank provides exchange settlement account facilities to financial institutions and to the New Zealand Government. The Bank manages the aggregate level of liquidity held by financial institutions in their exchange settlement accounts.

The financial instruments used to inject funds into the banking system include local currency reverse-repurchase transactions and foreign currency swaps. The Bank uses securities from holdings of New Zealand Government Securities in repurchase transactions to withdraw funds from the banking system for liquidity management purposes.

Balances in exchange settlement accounts are repayable on demand and the Bank pays interest on overnight balances. 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.

The Bank issues notes and coins to registered banks in order to meet the currency needs of the public. When currency is issued to a registered bank, that bank's settlement account is debited with the face value of currency issued.

The Bank also operates the Austraclear New Zealand System. This includes carrying out securities registry and paying agent responsibilities.

b 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.

Foreign reserve assets held for crisis management purposes are funded by a combination of foreign currency loans from The Treasury which are made on arm's length terms, 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 a significant portion of foreign currency risk. In July 2007, the Bank decided that a proportion of foreign currency assets held for crisis management purposes should be maintained without hedging their foreign currency risk. The hedged/unhedged position will vary over time as the Bank determines appropriate.

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 that are funded by repurchase transactions with foreign securities trading firms.

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 16 to 23.

c Foreign Exchange Dealing

Section 16 of the Reserve Bank Act provides the Bank with 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 Reserve Bank 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 Reserve Bank 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 Reserve Bank Act. For the year ended 30 June 2008, there have been no payments to or from the Crown under section 21 of the Reserve Bank Act (2007: nil).

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

d 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 manage transactions for foreign exchange 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 manage interest rate and foreign exchange risks.

The Bank has entered into forward foreign exchange contracts in order to manage the foreign currency exposure arising from certain operating and capital expenditure commitments denominated in foreign currency. These contracts are not accounted for using the hedge accounting provisions of NZ IAS 39.

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-denominated transactions are also recognised as a liability within Securities Sold Under Agreements to Repurchase in the Bank's Statement of Financial Position.

The Bank enters into security repurchase transactions as part of its liquidity management operations and market testing activities. These local currency-denominated securities sold by the Bank under repurchase agreements are recorded as an asset in New Zealand Government Securities in the Bank's Statement of Financial Position.

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

The Bank can be required to deliver collateral under interest rate swap arrangements. Any collateral delivered by the Bank remains in the Statement of Financial Position.

Note 3 gives details of the collateral taken or provided as at balance date.

FINANCIAL POSITION NOTES

3. Analysis of Financial Assets and Financial Liabilities

Analysis of Financial Assets and Liabilities by Measurement Basis

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The summary of significant accounting policies describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the financial assets and liabilities in the Statement of Financial Position by class and by category as defined by NZ IAS 39:

As at 30 June 2008	Fair Value Through Profit or Loss					Loans and Receivables \$M	Financial Assets and Liabilities at Amortised Cost \$M	Derivatives Designated as Fair Value Hedging Instruments \$M
	Total \$M	Designated Upon Initial Recognition \$M	Derivatives Deemed Held for Trading \$M	Held for Trading \$M	Available-for-sale Securities \$M			
ASSETS								
Foreign Currency Financial Assets	20,754	20,291	328	20	113	2	-	-
Local Currency Financial Assets	4,307	-	-	-	4,307	-	-	-
Total Financial Assets	25,061	20,291	328	20	4,420	2	-	-
LIABILITIES								
Foreign Currency Financial Liabilities	4,605	4,264	175	1	-	-	165	-
Local Currency Financial Liabilities	18,631	14,933	-	-	-	-	3,698	-
Total Financial Liabilities	23,236	19,197	175	1	-	-	3,863	-

As at 30 June 2007	Fair Value Through Profit or Loss					Loans and Receivables \$M	Financial Assets and Liabilities at Amortised Cost \$M	Derivatives Designated as Fair Value Hedging Instruments \$M
	Total \$M	Designated Upon Initial Recognition \$M	Derivatives Deemed Held for Trading \$M	Held for Trading \$M	Available-for-sale Securities \$M			
ASSETS								
Foreign Currency Financial Assets	16,647	15,812	695	17	97	2	-	24
Local Currency Financial Assets	4,222	16	-	-	4,206	-	-	-
Total Financial Assets	20,869	15,828	695	17	4,303	2	-	24
LIABILITIES								
Foreign Currency Financial Liabilities	4,870	4,853	-	17	-	-	-	-
Local Currency Financial Liabilities	14,655	11,018	-	-	-	-	3,637	-
Total Financial Liabilities	19,525	15,871	-	17	-	-	3,637	-

Fair Value of 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 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 the settlement date.

b Short-term Deposits

The carrying value of short-term deposits is considered to approximate their fair value as they are payable on demand.

c Currency in Circulation

Currency in Circulation is reported at its face value as currency in circulation is payable on demand. NZ IAS 39 requires that the fair value cannot be less than the face value.

d Distribution Payable to the New Zealand Government

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

Collateral Pledged or Accepted

The carrying amount of securities pledged as collateral for liabilities was \$36 million (2007: \$68 million). No collateral had been provided in the form of cash (2007: nil).

The fair value of securities accepted as collateral that the Bank is permitted to sell or repledge in the absence of default is \$1,442 million (2007: \$2,841 million). In addition, cash collateral received is \$125 million (2007: \$333 million). Cash collateral received is recorded in the Statement of Financial Position in Short Term Deposits. The fair value of any such collateral that has been sold or repledged is nil (2007: nil).

Under the Bank's securities lending programme, the Bank has lent securities with a fair value of \$573 million (2007: \$551 million). The Bank has accepted assets with a fair value of \$584 million (2007: \$558 million) as collateral for the securities lent under this programme.

These transactions are conducted under terms that are usual and customary to standard securities borrowing and reverse repurchase agreements.

Additional Information for Financial Liabilities

The carrying amount as at balance date of financial liabilities designated at fair value through profit or loss was \$69 million more (2007: \$53 million more) than the contractual amount at maturity.

All changes in the fair value of financial liabilities designated as fair value through profit or loss are considered attributable to changes in prevailing interest rates.

With the exception of Securities Sold Under Agreements to Repurchase, for which collateral has been pledged, all other liabilities of the Bank are unsecured and rank equally in the event that the Bank ceases to trade.

4. Derivative Financial Instruments

	Book Value 2008 \$M	Notional Principal 2008 \$M	Book Value 2007 \$M	Notional Principal 2007 \$M
Interest Rate Futures				
Interest Rate Futures in a Gain Position	-	5	-	54
Interest Rate Futures in a Loss Position	-	70	-	12
Net Interest Rate Futures Position	-	75	-	66
As at 30 June 2008, the Bank had 514 open Interest Rate Futures contracts (2007: 413).				
Interest Rate Swaps				
Interest Rate Swaps in a Gain Position	-	10	1	41
Interest Rate Swaps in a Loss Position	(1)	43	-	9
Net Interest Rate Swaps Position	(1)	53	1	50
Foreign Currency Swaps and Forward Exchange Contracts				
Foreign Currency Swaps and Forward Exchange Contracts in a Gain Position	329	8,381	718	11,434
Foreign Currency Swaps and Forward Exchange Contracts in a Loss Position	(175)	8,532	-	11
Net Foreign Exchange Swaps and Forward Exchange Contracts Position	154	16,913	718	11,445
Total Derivative Financial Instruments in a Gain Position	329	8,396	719	11,529
Total Derivative Financial Instruments in a Loss Position	(176)	8,645	-	32
Net Derivative Financial Instruments Recognised in the Statement of Financial Position	153	17,041	719	11,561

5. Other Foreign Currency Financial Assets

	2008 \$M	2007 \$M
Shareholding in the Bank for International Settlements	113	97
Dividend Receivable	2	2
	115	99

As at 30 June 2008, the Bank owned 3,211 shares (2007: 3,211 shares) issued by the Bank for International Settlements (BIS). This represents approximately 0.6% 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's investment in shares issued by the BIS is valued at fair value, which is determined as being 70% of the Bank's interest in the BIS's net asset value.

6. Other Assets

	Note	2008 \$M	2007 \$M
Receivables from Sales of Services		1	1
Property, Plant and Equipment	7	65	62
Intangible Assets	8	7	8
Inventory		27	20
Superannuation Asset	30	1	1
		101	92

7. Property, Plant and Equipment

	Total \$M	Land and Buildings \$M	Property Improve- ments \$M	Computer Hardware \$M	Plant and Equipment \$M	Currency and Artworks Collections and Archives \$M
As at 30 June 2007						
Cost	67	50	5	4	5	3
Accumulated Depreciation	5	-	1	2	2	-
Net Book Value	62	50	4	2	3	3
For the Year Ended 30 June 2008						
Net Book Value at the Beginning of the Year	62	50	4	2	3	3
Revaluation	5	3	-	-	-	2
Accumulated Depreciation Written Back	1	1	-	-	-	-
Less Depreciation	3	1	-	1	1	-
Net Book Value at the End of the Year	65	53	4	1	2	5
As at 30 June 2008						
Cost	72	53	5	4	5	5
Accumulated Depreciation	7	-	1	3	3	-
Net Book Value	65	53	4	1	2	5

The valuation of Land and Buildings dated 9 June 2008 and effective 30 June 2008 was prepared by Jones Lang LaSalle Limited, an independent registered valuer. The valuation was prepared by discounting rental and nominal rental flows at current market capitalisation rates. The valuation report included details of recent sales of broadly comparable premises. The capitalisation rate applied in valuing property was a weighted average of 7.2% (2007: 6.7%). The aggregate market value of Land and Buildings was \$53 million (2007: \$50 million). The original cost was \$10 million.

8. Intangible Assets

	Computer Software \$M
As at 30 June 2007	
Cost	15
Accumulated Amortisation	7
Net Book Value	8
For the Year Ended 30 June 2008	
Net Book Value at the Beginning of the Year	8
Additions	1
Less Amortisation	2
Net Book Value at the End of the Year	7
As at 30 June 2008	
Cost	16
Accumulated Amortisation	9
Net Book Value	7

9. Short-term Foreign Currency Financial Liabilities

	2008 \$M	2007 \$M
Payable for Unsettled Purchases of Securities	165	-
Short-term Deposits	125	333
	290	333

10. Deposits

	2008 \$M	2007 \$M
New Zealand Government Deposits	6,905	3,151
Settlement Bank Deposits	7,955	7,757
Central Bank Deposits	17	27
International Monetary Fund Deposits	11	22
	14,888	10,957

11. Other Local Currency Financial Liabilities

	Note	2008 \$M	2007 \$M
Distribution Payable to the New Zealand Government	13	168	193
Accounts Payable		3	3
Accrued Employee Entitlements	12	5	5
Demonetised Currency		82	83
Capitalised Lease Obligations		-	1
		258	285

12. Accrued Employee Entitlements

	2008 \$M	2007 \$M
Accrued Salaries and Holiday Pay	2	2
Accrued Retirement Gratuities	3	3
Total Accrued Employee Entitlements	5	5

13. Distribution Payable to the New Zealand Government

The Notional Surplus Income calculated in accordance with the Reserve Bank Act as at 30 June 2008 is \$168 million (2007: \$328 million). The Bank's Board has recommended that a distribution of \$168 million be paid for the 2007/08 financial year. The Minister has given a direction that a distribution of \$168 million (2007: \$193 million) be paid.

14. Equity

The Bank's Equity as at balance date together with the movements for the financial year comprised:

	Note	2008 \$M	2007 \$M
Capital			
Balance at the Beginning of the Year		1,000	1,000
Total Capital		1,000	1,000
Retained Earnings			
Balance at the Beginning of the Year		514	356
Net Profit for the Year		535	351
Distribution Payable to the New Zealand Government	13	(168)	(193)
Total Retained Earnings		881	514
Available-for-sale Revaluation Reserve			
Balance at the Beginning of the Year		(125)	63
Fair Value Movements During the Year		118	(188)
Total Available-for-sale Revaluation Reserve		(7)	(125)
Property Revaluation Reserve			
Balance at the Beginning of the Year		44	31
Fair Value Movements During the Year		3	13
Total Property Revaluation Reserve		47	44
Currency and Artwork Collections and Archives Revaluation Reserve			
Balance at the Beginning of the Year		3	2
Fair Value Movements During the Year		2	1
Total Currency and Artwork Collections and Archives Revaluation Reserve		5	3
Total Equity		1,926	1,436

Management of the Bank's Capital

The Bank's capital management framework focuses on the Bank's total equity reported in its financial statements.

The main drivers of reported equity are reported financial results and the Bank's distribution. The distribution is determined annually by the Minister of Finance under the provisions of the Reserve Bank Act. The Reserve Bank Act provides a statutory formula for the calculation of notional surplus income. The Minister directs how much of the notional surplus income for any year is to be distributed to the Crown and how much is to be retained by the Bank. In determining the amount to be distributed to the Crown, the Minister is required to take into account the views of the Bank's Board, the capital needs of the Bank and any other relevant matters.

The Bank's primary capital management objective is to have sufficient capital to carry out effectively its statutory responsibilities. In determining whether the Bank has sufficient capital for those purposes, it assesses the extent of financial risks and the resulting potential for losses arising from its operations. From the 2007/08 financial year, the Bank commenced assessing the appropriate ranges for capital by considering financial risks across the balance sheet in a more formal manner, including the use of statistical models at varying levels of confidence, supplemented with judgement, where appropriate.

From 1 July 2007, the Bank adopted NZ IFRS. The most significant impact was that the Bank classified its holdings of New Zealand Government Securities as available-for-sale assets. Unrealised changes in the market value of these securities are recorded in Equity. This accounting change will result in additional volatility in reported equity and was the principal reason the Bank sought additional capital of \$600 million, which was received on 2 July 2008.

15. Concentrations of Funding

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

	Total 2008 \$M	New Zealand Government \$M	New Zealand Public \$M	New Zealand Financial Institutions \$M	Overseas Financial Institutions \$M	Other \$M
Financial Liabilities						
Term Liabilities	3,566	3,566	-	-	-	-
Securities Sold Under Agreements to Repurchase	610	-	-	-	610	-
Deposits	14,888	6,905	-	7,955	28	-
Currency in Circulation	3,448	-	3,448	-	-	-
Other Liabilities	724	169	83	2	462	8
Total Financial Liabilities	23,236	10,640	3,531	7,957	1,100	8

	Total 2007 \$M	New Zealand Government \$M	New Zealand Public \$M	New Zealand Financial Institutions \$M	Overseas Financial Institutions \$M	Other \$M
Financial Liabilities						
Term Liabilities	3,969	3,969	-	-	-	-
Securities Sold Under Agreements to Repurchase	620	-	-	-	620	-
Deposits	10,957	3,151	-	7,757	49	-
Currency in Circulation	3,361	-	3,361	-	-	-
Other Liabilities	618	194	83	-	333	8
Total Financial Liabilities	19,525	7,314	3,444	7,757	1,002	8

All figures are stated at carrying values in the Statement of Financial Position.

RISK MANAGEMENT NOTES

16. Risk Management

The Reserve Bank is involved in policy-oriented 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 foreign currency risk, credit risk, and interest rate risk on both foreign and local currency assets. In the management of foreign reserves, minimising liquidity risk is a major consideration in order to maintain an effective foreign exchange intervention capability. Policies for managing credit, interest rate, foreign currency, and liquidity risks are outlined in Notes 18 to 22. Like most other central banks, the nature of the Bank's operations creates exposure to a range of operational and reputational risks.

The Bank seeks to ensure that strong and effective risk management and control systems are in place for identifying, assessing, monitoring, and managing risk exposures. An Asset and Liability Committee (ALCO), comprising the governors and senior management, is responsible for advising the Governor on the management and monitoring 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. 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 delegated authorities and limits set by the Governor. The risk management framework is subject to regular review by ALCO. The overall risk management framework is designed to encourage strongly the sound and prudent management of the Bank's risks.

The majority of the Bank's financial risks arise from the Foreign Reserves Management and Domestic Market Operations units of the Bank's Financial Markets 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 an internal audit unit) reports on internal audit and related issues to the governors and the Audit Committee of the Board of Directors, comprising four of the Bank's non-executive directors. 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 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 the Audit Committee of the Board of 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 Board of Directors monitors the Bank's management of risk as part of its role of keeping the Bank's performance and use of resources under constant review.

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

17. Operational Risk

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

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

Compliance with corporate policies and departmental internal control systems is supported 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;

- a proactive problem management process whereby problems and incidents are reported and analysed for potential risk management improvements;
- periodic review of each department's risks and internal controls; and
- an active internal audit function.

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

18. Credit Risk

Credit risk is the potential for loss arising from the failure of a debtor or counterparty to meet their contractual obligations. Within the Bank, credit risk arises principally through the investment of funds and related derivative contracts entered into for the Foreign Reserves Management and Domestic Market Operations functions.

Credit risks arising from the various Bank activities are aggregated for limit and monitoring purposes.

a Foreign Reserves Management Credit Risk Management

Credit risk for Foreign Reserves Management 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 issuers. Additionally, sovereign and supranational issuers/counterparties are assigned a higher limit than similarly rated corporates. Individual credit exposures are also aggregated and managed by cumulative limits, such as country exposure limits. The credit risk framework recognises differences in short-term (settlement risk) and longer-term credit risk.

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.

The Bank does not constrain credit exposure to certain sovereign issuers (e.g., the United States of America). 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 instruments, the Bank manages credit risk by receiving collateral. Collateral is likely to take the form of cash or government securities. The value of collateral held is required to be within a prescribed range of the value of the exposure to the counterparty. Valuations are updated daily and, as a result, additional collateral may be called for or excess collateral returned to the counterparty.

b Domestic Market Operations Credit Risk Management

The Domestic Market Operations function gives rise to credit risk primarily by transacting foreign currency swaps and reverse repurchase transactions. The Bank accepts a wide range of pre-approved securities for reverse repurchase transactions. Acceptable securities include government securities, securities issued by registered banks, highly-rated entities including supranational organisations, local authorities and state-owned enterprises. Where funds are advanced by reverse repurchase agreements, the amount advanced is subject to a discount so as to ensure that the value of security held exceeds the amount advanced. The value of security held is monitored daily and calls are made for additional collateral or excess collateral is returned to the counterparty as required.

Exposures to the New Zealand Government are not included in this credit framework.

From July 2008, residential mortgage-backed securities that meet certain criteria became acceptable for use in reverse repurchase transactions. Limits are applied to the amounts that can be advanced using an issuer's residential mortgage-backed securities as collateral.

c **Changes to Credit Risk Management**

The credit risk management framework has been refined over the course of the 2007/08 financial year with limits and measurement of exposures in credit equivalent terms changed as required. The Bank has offered a securities repurchase facility in which it accepts a wider range of securities as collateral in Domestic Market Operations. The amounts advanced under the facility are subject to higher discounts than where the Bank receives New Zealand government securities as collateral. The Bank's decision to accept the wider range of collateral is a temporary response to liquidity pressures in global financial markets experienced since August 2007. These additional liquidity facilities were not utilised by financial institutions in the period ended 30 June 2008.

On 30 June 2008, the Bank became a member of the Continuous Linked Settlement system operated by CLS Bank. This system facilitates the simultaneous settlement of both legs of foreign exchange transactions that are entered into the system by both parties. This mitigates the risk that the Bank will suffer losses as a result of having performed its contractual settlement obligations and the counterparty failing to perform its obligations. Under the credit framework, transactions that are settled using CLS Bank's system utilise less credit limit over the period until settlement than transactions that settle outside the CLS Bank system. The CLS Bank system is used by the Bank for transactions involving the exchange of New Zealand dollars and United States dollars where both parties agree to use that system. It is envisaged that the range of currencies settled via CLS will increase over time.

d **Concentrations of Credit Exposure**

The Bank's significant end-of-year concentrations of credit exposure, classified by issuer and by counterparty, were as follows:¹⁹

	Classified by Issuer		Classified by Counterparty	
	2008 \$M	2007 \$M	2008 \$M	2007 \$M
New Zealand Government	4,307	4,228	4,307	4,212
Other Sovereign Issuers	7,761	5,408	5,754	3,543
Supranational Financial Institutions	2,195	3,317	2,195	2,538
Overseas Financial Institutions	10,726	7,801	12,733	10,461
New Zealand Financial Institutions	72	115	72	115
Total Financial Assets	25,061	20,869	25,061	20,869

The carrying value of financial assets is the Bank's maximum exposure to credit risk as at balance date. 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 4.

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

	2008 \$M	2007 \$M
New Zealand	4,379	4,343
United States of America	3,294	3,565
Europe	12,879	8,318
Supranational Financial Institutions	2,091	3,317
Japan	1,552	294
Other	866	1,032
Total Financial Assets	25,061	20,869

¹⁹ The differences between amounts disclosed by issuer and by counterparty relate to Securities Purchased Under Agreements to Resell.

e Credit Exposure by Credit Rating

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

	Credit Rating	2008 \$M	Financial Assets	2007 \$M	Financial Assets
SUMMARY BY MAJOR CREDIT CATEGORY					
Foreign Currency Financial Assets	AAA	15,706	62.7%	12,169	58.3%
	AA +/-	4,802	19.1%	3,980	19.1%
	A +/-	10	0.0%	252	1.2%
	Various ²⁰	119	0.5%	143	0.7%
	N/R	117	0.5%	103	0.5%
Total Foreign Currency Financial Assets		20,754	82.8%	16,647	79.8%
Local Currency Financial Assets	AAA	4,307	17.2%	4,222	20.2%
Total Local Currency Financial Assets		4,307	17.2%	4,222	20.2%
Total Financial Assets		25,061	100.0%	20,869	100.0%

f Credit Exposure by Counterparty as a Percentage of Bank's 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% 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.

Percentage of Equity	End-of-year 2008	End-of-year 2007
10% to 19.9%	19	13
20% to 29.9%	4	6
30% to 39.9%	7	6
40% to 49.9%	-	1
50% to 59.9%	2	-
60% to 69.9%	1	2
70% to 79.9%	1	-
80% to 89.9%	1	1
90% to 99.9%	-	1
220% to 229.9%	1	-
270% to 279.9%	-	1

²⁰ 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 investments owned by the Funds have various credit ratings.

19. Market Risk

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. In respect of the Bank, market risk comprises interest rate risk and foreign currency risk.

The Bank uses a range of position size, duration and stop-loss limits, together with Value at Risk (VaR) methodology for measuring and managing market risks. Actual limits and measures differ according to whether the relevant portfolio is established for trading purposes or for policy-related purposes (such as foreign reserves management, foreign exchange intervention or domestic market operations).

Foreign Currency Risk-Position Limits

Limits are established for the aggregate net foreign currency position that may be taken, together with limits for the net exposure to individual foreign currency positions.

Interest Rate Risk-Effective Duration Limits

For policy-related portfolios (i.e., portfolios that are not trading portfolios), the Bank controls interest rate risk with effective duration limits.

VaR Levels and 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 VaR model based on equally weighted data for the previous year (250 trading days), a one-day time horizon, and a 99% confidence interval. This means the Bank would expect to incur losses greater than that 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.

VaR limits are utilised for the management of market risk arising from the Bank's trading portfolios, and for market risk arising in respect of the investment of foreign currency swaps proceeds received as part of the Domestic Market Operations function. Trading portfolios, in which the Bank actively manages positions to derive short-term returns as well as for market testing and training purposes, generate a relatively small part of the Bank's aggregate exposure to market risk.

VaR is measured in respect of other (non-trading) portfolios, including positions held for crisis management and currency intervention. While actual daily profit and loss outcomes for these portfolios are compared with VaR levels for these positions, VaR limits do not apply, as these positions are held principally for monetary policy or crisis management policy reasons. As noted above, market risk for non-trading portfolios is primarily managed through open position and duration-based limits augmented with monitoring of actual against expected VaR outcomes for the actual position.

	Trading Portfolios		Non-trading Portfolios		Trading and Non-trading Foreign Reserves Management Portfolios Combined			
	Total Market Risk		Total Market Risk		Foreign Currency	Interest Rate Risk	Total Market Risk	
	2008 \$000	2007 \$000	2008 \$000	2007 \$000	2008 \$000	2008 \$000	2008 \$000	2007 \$000
VaR								
Limit	2,000	2,000	n/a	n/a	n/a	n/a	n/a	n/a
As at 30 June	333	326	78,077	510	78,040	1,317	78,210	836
Peak Over the Year	1,625	430	78,687	588	79,240	3,261	79,250	872
Low Over the Year	128	34	1,510	221	2,102	674	2,094	326
Average Over the Year	516	190	53,059	395	53,423	1,446	53,345	586

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, trading positions are closed down. The Governor must approve the re-establishment of trading positions.

Sensitivity to Interest Rate Risk and Foreign Currency Risk

The sensitivity of the Bank's financial assets and liabilities to assumed across-the-board changes in interest rates and the exchange rate is shown below.

	Total Gain/(Loss) Impacting Comprehen- sive Income 2008 \$000	Gain/(Loss) Reported in the Income Statement 2008 \$000	Gain/(Loss) Reported Directly in Equity 2008 \$000	Total Gain/(Loss) Impacting Comprehen- sive Income 2007 \$000	Gain/(Loss) Reported in the Income Statement 2007 \$000	Gain/(Loss) Reported Directly in Equity 2007 \$000
Impact of:						
A rise of 10% in the value of the New Zealand dollar	(444,324)	(433,003)	(11,321)	(70,097)	(70,097)	-
A fall of 10% in the value of the New Zealand dollar	444,324	433,003	11,321	70,097	70,097	-
A rise of one percentage point in the local currency yield curve	(151,963)	(11,927)	(140,036)	(178,949)	(13,980)	(164,969)
A fall of one percentage point in the local currency yield curve	160,802	11,971	148,831	190,059	14,035	176,024
A rise of one percentage point in the yield curve for all foreign currencies	3,900	3,900	-	5,121	5,121	-
A fall of one percentage point in the yield curve for all foreign currencies	(3,455)	(3,455)	-	(5,167)	(5,167)	-

The Bank's exposures to foreign currency risk and interest rate risk can change materially over time depending on the Bank's policy objectives and economic conditions. In particular, foreign currency risk has increased significantly as the net exposure to foreign currency has increased to \$4.4 billion at 30 June 2008 from \$0.7 billion at 30 June 2007.

20. Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes to market interest rates.

Foreign Reserves Management Interest Rate Risk Management

The Bank holds an open foreign currency position, effectively financing a portion of its foreign currency assets using New Zealand dollar funding. This exposes the Bank to the risk of changes in the relative interest rates between New Zealand and overseas currencies. Interest rate risk also arises as a result of mismatches between the maturity or interest rate resets of assets and liabilities, where the assets and liabilities are denominated in the same currency. The Bank manages this interest rate risk through effective duration mismatch limits between assets and the corresponding liabilities.

Domestic Market Operations Interest Rate Risk Management

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

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.

The average duration of the Bank's holding of New Zealand Government Securities as at 30 June 2008 was 3.5 years (2007: 4.2 years).

Assets and liabilities will mature or reprice within the following periods:

	Total 2008 \$M	Non- Interest Sensitive \$M	Overnight \$M	6 Months or Less \$M	Between 6 and 12 Months \$M	Between 1 and 2 Years \$M	Between 2 and 5 Years \$M	Over 5 Years \$M
Assets								
Marketable Securities	17,812	-	-	17,674	-	79	40	19
Securities Purchased Under								
Agreements to Resell	2,007	-	-	2,007	-	-	-	-
New Zealand Government Securities	4,307	-	-	653	-	691	1,721	1,242
Other Financial Assets	935	115	491	329	-	-	-	-
Other Assets	101	101	-	-	-	-	-	-
Total Assets	25,162	216	491	20,663	-	770	1,761	1,261
Liabilities								
Term Liabilities	3,566	-	-	3,566	-	-	-	-
Securities Sold Under								
Agreements to Repurchase	610	-	-	610	-	-	-	-
Deposits	14,888	-	14,888	-	-	-	-	-
Currency in Circulation	3,448	3,448	-	-	-	-	-	-
Other Liabilities	724	423	125	176	-	-	-	-
Equity	1,926	1,926	-	-	-	-	-	-
Total Liabilities and Equity	25,162	5,797	15,013	4,352	-	-	-	-
	-	(5,581)	(14,522)	16,311	-	770	1,761	1,261
Derivative Financial Instruments	-	-	-	(31)	(10)	(33)	61	13
Total Interest Rate Sensitivity Gap	-	(5,581)	(14,522)	16,280	(10)	737	1,822	1,274
Interest Rate Sensitivity Gap by Currency								
New Zealand dollar	(4,444)	(5,906)	(14,888)	12,696	-	691	1,721	1,242
United States dollar	1,089	420	132	438	-	-	101	(2)
Euro	1,156	(119)	27	1,236	(10)	-	-	22
Japanese yen	180	12	69	123	-	(33)	-	9
British pound	658	12	51	592	-	-	-	3
Australian dollar	863	-	58	805	-	-	-	-
Canadian dollar	419	-	29	390	-	-	-	-
Other	79	-	-	-	-	79	-	-
	-	(5,581)	(14,522)	16,280	(10)	737	1,822	1,274

Assets and liabilities will mature or reprice within the following periods:

	Total 2007 \$M	Non- Interest Sensitive \$M	Overnight \$M	6 Months or Less \$M	Between 6 and 12 Months \$M	Between 1 and 2 Years \$M	Between 2 and 5 Years \$M	Over 5 Years \$M
Assets								
Marketable Securities	11,806	-	-	11,678	37	-	75	16
Securities Purchased Under								
Agreements to Resell	3,367	-	-	3,367	-	-	-	-
New Zealand Government Securities	4,206	-	-	67	-	638	1,574	1,927
Other Financial Assets	1,490	99	672	719	-	-	-	-
Other Assets	92	92	-	-	-	-	-	-
Total Assets	20,961	191	672	15,831	37	638	1,649	1,943
Liabilities								
Term Liabilities	3,969	-	-	3,934	35	-	-	-
Securities Sold Under								
Agreements to Repurchase	620	-	-	620	-	-	-	-
Deposits	10,957	-	10,957	-	-	-	-	-
Currency in Circulation	3,361	3,361	-	-	-	-	-	-
Other Liabilities	618	285	333	-	-	-	-	-
Equity	1,436	1,436	-	-	-	-	-	-
Total Liabilities and Equity	20,961	5,082	11,290	4,554	35	-	-	-
	-	(4,891)	(10,618)	11,277	2	638	1,649	1,943
Derivative Financial Instruments	-	-	-	144	-	(60)	(47)	(37)
Total Interest Rate Sensitivity Gap	-	(4,891)	(10,618)	11,421	2	578	1,602	1,906
Interest Rate Sensitivity Gap by Currency								
New Zealand dollar	(701)	(4,990)	(10,957)	11,106	-	638	1,574	1,928
United States dollar	286	42	252	71	2	(32)	(47)	(2)
Euro	305	35	32	243	-	-	-	(5)
Japanese yen	35	10	46	19	-	(28)	-	(12)
British pound	2	12	2	(9)	-	-	-	(3)
Australian dollar	5	-	5	-	-	-	-	-
Canadian dollar	(8)	-	1	(9)	-	-	-	-
Other	76	-	1	-	-	-	75	-
	-	(4,891)	(10,618)	11,421	2	578	1,602	1,906

21. Foreign Currency Risk

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

Foreign exchange risk arises from:

- maintenance of a portion of foreign currency reserves on an unhedged basis for crisis management purposes. The open position varies over time as the Bank determines is warranted by its policy objectives and economic conditions;
- currency intervention to meet monetary policy objectives; and
- active management undertaken in trading portfolios.

For non-trading portfolios, foreign currency risk is managed by way of open position limits for various currencies and aggregate open position limits. Additionally, the Bank monitors actual and expected VaR outcomes for these portfolios.

Stop-loss and VaR limits are also used to assist in managing the Bank's trading portfolios, which account for a minor proportion of the Bank's total open foreign exchange position.

As at 30 June 2008, the Bank's net exposure to major currencies was:

	2008 \$M	2007 \$M
Australian dollar	863	5
British pound	658	2
Canadian dollar	419	(8)
Euro	1,156	305
Japanese yen	180	35
Swiss francs	-	1
United States dollar	1,089	286
Various currencies (Asian Bond Fund 2)	79	75
Total	4,444	701

22. Liquidity Risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting its financial obligations as they fall due. Liquidity risk also includes the risk that the Bank may have to sell a financial asset quickly at less than its fair value.

The objectives of the Bank's liquidity policy are to:

- ensure all financial obligations are met when due;
- ensure foreign reserves assets held for currency intervention purposes are able to be liquidated in an orderly fashion, within agreed timeframes; and
- ensure the Bank manages the aggregate level of New Zealand dollar liquidity in the New Zealand banking system, so as to, in turn, ensure that interest rates in inter-bank markets are consistent with monetary policy settings, and to facilitate the smooth operation of the inter-bank payment system.

The Bank manages its liquidity risk primarily by forecasting future cash flows, ensuring that cash inflows and cash outflows are matched appropriately.

a **Foreign Currency Activities**

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

At 30 June 2008, foreign currency assets valued at \$18,710 million were classified as being able to be liquidated within two business days (30 June 2007: \$15,724 million).

The Bank also manages refinancing risk on foreign reserves funded from borrowing by applying limits on the amount of borrowing maturing in any 12-month period.

b **Local Currency Activities**

The Bank's management of its own New Zealand dollar liquidity risk is a function of the Bank's management of the daily aggregate liquidity that is available within the New Zealand banking system.

The Bank manages its own New Zealand dollar cash flows by advancing funds to, and withdrawing funds from, the New Zealand banking system. This is achieved through a range of financial transactions including entering into foreign exchange swap and basis swap transactions, and repurchase and reverse repurchase agreements. As New Zealand's central bank, the Bank is able to create New Zealand dollar liquidity through its daily market operations. Therefore, the Bank is not required to maintain a certain level of liquid assets in order to meet its New Zealand dollar obligations.

23. Cash Flows by Remaining Contractual Maturities

The following table sets out the maturity profile of the Bank's financial assets and liabilities. The table discloses the contractual principal receivable or due at the maturity date, together with interest receivable or payable for the period to the maturity date based on interest rates and foreign exchange rates prevailing as at balance date. Financial liabilities payable on demand includes Currency in Circulation. However, historical experience has shown such balances provide a stable source of long-term funding for the Bank.

The balances in this table do not equate with the balances in the Consolidated Statement of Financial Position, as the table incorporates all cash flows on an undiscounted basis.

	Total 2008 \$M	On Demand \$M	6 Months or Less \$M	6 to 12 Months \$M	1 to 2 Years \$M	2 to 5 Years \$M	Over 5 Years \$M
Foreign Currency Financial Assets							
Cash Balances	491	491	-	-	-	-	-
Securities Purchased Under Agreements to Resell	2,010	-	2,010	-	-	-	-
Marketable Securities	17,762	-	17,729	-	1	3	29
Other Foreign Currency Financial Assets	2	-	2	-	-	-	-
	20,265	491	19,741	-	1	3	29
Foreign Currency Financial Liabilities							
Short-term Foreign Currency Financial Liabilities	290	290	-	-	-	-	-
Securities Sold Under Agreements to Repurchase	573	-	573	-	-	-	-
Term Liabilities	4,317	-	336	332	247	1,081	2,321
	5,180	290	909	332	247	1,081	2,321
Foreign Currency Derivatives							
Contractual inflows	4,986	-	4,060	15	773	109	29
Contractual outflows	(17,501)	-	(11,876)	(1,070)	(1,417)	(2,420)	(718)
	(12,515)	-	(7,816)	(1,055)	(644)	(2,311)	(689)
Foreign Currency Net Gap in Contractual Maturities	2,570	201	11,016	(1,387)	(890)	(3,389)	(2,981)
Local Currency Financial Assets							
New Zealand Government Securities	5,438	-	773	114	874	2,171	1,506
	5,438	-	773	114	874	2,171	1,506
Local Currency Financial Liabilities							
Deposits	14,888	14,888	-	-	-	-	-
Securities Sold Under Agreements to Repurchase	37	-	37	-	-	-	-
Currency in Circulation	3,448	3,448	-	-	-	-	-
Other Local Currency Financial Liabilities	258	82	176	-	-	-	-
	18,631	18,418	213	-	-	-	-
Local Currency Derivatives	13,231	-	7,949	1,160	787	2,556	779
Local Currency Net Gap in Contractual Maturities	38	(18,418)	8,509	1,274	1,661	4,727	2,285
Total Net Gap in Contractual Maturities	2,608	(18,217)	19,525	(113)	771	1,338	(696)

	Total 2007 \$M	On Demand \$M	6 Months or Less \$M	6 to 12 Months \$M	1 to 2 Years \$M	2 to 5 Years \$M	Over 5 Years \$M
Foreign Currency Financial Assets							
Cash Balances	672	672	-	-	-	-	-
Securities Purchased Under Agreements to Resell	3,362	-	3,362	-	-	-	-
Marketable Securities	11,795	-	11,766	-	1	3	25
Other Foreign Currency Financial Assets	2	-	2	-	-	-	-
	15,831	672	15,130	-	1	3	25
Foreign Currency Financial Liabilities							
Short-term Foreign Currency Financial Liabilities	333	333	-	-	-	-	-
Securities Sold Under Agreements to Repurchase	568	-	568	-	-	-	-
Term Liabilities	4,944	-	281	554	632	822	2,655
	5,845	333	849	554	632	822	2,655
Foreign Currency Derivatives							
Contractual inflows	434	-	28	9	17	355	25
Contractual outflows	(11,327)	-	(7,939)	(556)	(665)	(1,481)	(686)
	(10,893)	-	(7,911)	(547)	(648)	(1,126)	(661)
Foreign Currency Net Gap in Contractual Maturities	(907)	339	6,370	(1,101)	(1,279)	(1,945)	(3,291)
Local Currency Financial Assets							
Securities Purchased Under Agreements to Resell	16	-	16	-	-	-	-
New Zealand Government Securities	5,706	-	134	134	887	2,130	2,421
	5,722	-	150	134	887	2,130	2,421
Local Currency Financial Liabilities							
Deposits	10,957	10,957	-	-	-	-	-
Securities Sold Under Agreements to Repurchase	52	-	52	-	-	-	-
Currency in Circulation	3,361	3,361	-	-	-	-	-
Other Local Currency Financial Liabilities	285	83	202	-	-	-	-
	14,655	14,401	254	-	-	-	-
Local Currency Derivatives	12,004	-	8,384	663	780	1,408	769
Local Currency Net Gap in Contractual Maturities	3,071	(14,401)	8,280	797	1,667	3,538	3,190
Total Net Gap in Contractual Maturities	2,164	(14,062)	14,650	(304)	388	1,593	(101)

CONSOLIDATED INCOME STATEMENT NOTES

24. Net Investment Income

Net Investment Income includes:

	Total 2008 \$M	Foreign Currency \$M	Local Currency \$M	Total 2007 \$M	Foreign Currency \$M	Local Currency \$M
Interest Income						
Cash Balances	22	22	-	10	10	-
Securities Purchased Under Agreements to Resell	72	64	8	252	248	4
Marketable Securities	562	562	-	391	391	-
Derivative Financial Instruments	485	485	-	226	226	-
New Zealand Government Securities	267	-	267	284	-	284
Other	-	-	-	9	-	9
Total Interest Income	1,408	1,133	275	1,172	875	297
Interest Expense						
Securities Sold Under Agreements to Repurchase	11	1	10	23	9	14
Term Liabilities	152	152	-	192	192	-
New Zealand Government Deposits	339	-	339	76	-	76
Settlement Bank Deposits	662	-	662	536	-	536
Other	10	10	-	5	5	-
Total Interest Expense	1,174	163	1,011	832	206	626
Net Gains/(Losses) from Fair Value Changes	(7)	(7)	-	14	14	-
Net Gains/(Losses) from Foreign Exchange Rate Changes	344	344	-	9	9	-
Dividend Income	2	2	-	2	2	-
Total Net Investment Income	573	1,309	(736)	365	694	(329)

Components of Net Investment Income from Financial Instruments

Net investment income includes net income/(expense) arising from:

	2008 \$M	2007 \$M
Financial Assets and Financial Liabilities Classified as Fair Value Through Profit or Loss Upon Initial Recognition	(183)	(152)
Derivative Instruments Deemed to be Classified as Held For Trading	485	226
Financial Assets and Financial Liabilities Classified as Held for Trading	2	5

Net Income/(Expense) reported above has been calculated including:

- interest income;
- interest expense;
- gains/(losses) from fair value changes; and
- gains/(losses) from foreign exchange rate changes.

Net investment income also includes earnings arising from financial assets and financial liabilities that are not classified as fair value through profit or loss as follows:

	2008	2007
	\$M	\$M
Interest and Dividend Income from Available-for-sale Financial Assets	269	286

25. Income and Expenditure by Function

The following table sets out operating income and operating expenditure for each of the Bank's main functions.

	Income	Expenses	Profit/(Loss)	Profit/(Loss)
	2008	2008	2008	2007
For the year ended 30 June	\$M	\$M	\$M	\$M
FUNCTIONS				
Monetary Policy Formulation	-	9	(9)	(9)
Domestic Market Operations	14	6	8	10
Financial System Surveillance and Policy	-	8	(8)	(8)
Currency Operations	237	9	228	224
Foreign Reserves Management	208	8	200	33
Settlement Services	4	2	2	7
Registry and Depository Services	4	3	1	1
Other Outputs	-	1	(1)	(1)
Total for Bank before Earnings on Investments Funded by Equity	467	46	421	257
Earnings not Allocated to Functions:				
Earnings on Investments Funded by Equity	114	-	114	94
Total for Bank	581	46	535	351
Income Retained Under the Funding Agreement		8		
Net Operating Expenses		38		

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.

26. Other Income

	2008 \$M	2007 \$M
Registry and Depository Services Fees	4	4
Property Rental Income	2	2
Currency Operations Income	-	32
Exchange Settlement Account System Income	2	1
	8	39

Currency Operations Income includes the proceeds from the disposal of cupro-nickel coins. Under the former NZFRS, hedging costs relating to the disposal of cupro-nickel coins, of \$16 million, were deferred and offset against revenue received in 2007. As these costs did not meet the criterion for hedge accounting under IFRS, these costs would not have been offset against income received in 2007, but would have been expensed in earlier accounting periods.

27. Operating Expenses

	2008 \$M	2007 \$M
Staff Expenses	22	23
Net Currency Issued Expenses	4	11
Asset Management Expenses	7	7
Other Operating Expenses	13	12
Total Operating Expenses	46	53

	2008 \$000	2007 \$000
Operating Expenses includes:		
Depreciation of Property, Plant and Equipment	2,890	2,599
Amortisation of Intangible Assets	2,400	1,680
Impairment Charges for Property, Plant and Equipment	-	-
Impairment Charges for Intangible Assets	-	-
Bad Debt Expenses	-	-
Rental and Lease Expenses	409	431
Auditor's Remuneration:		
Statutory Audit	194	197
Payment Systems Audits	57	51
Advisory Services	30	41

The Statutory Audit expense comprises the fee for the audit of the annual financial statements of the Bank.

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

The Advisory Services expense comprises fees for advice with respect to the application of accounting policies to the financial statements and for advice regarding payment systems. 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.

Key Management Personnel

Key management personnel comprise the Governor, Deputy Governor and Assistant Governors. Because non-executive Board members are not responsible for decision-making by the Bank, and their statutory role is to monitor the performance of the Bank, they are not considered to be key management personnel as defined in NZ IAS 24 Related Party Disclosures. For the year ended 30 June 2008, aggregate compensation paid to key management personnel comprised:

	2008 \$000	2007 \$000
Salaries, Superannuation Contributions and Other Short-term Benefits	1,565	1,426
Total Key Management Personnel Compensation	1,565	1,426

In 2007, one key management position was vacant for five months.

OTHER NOTES

28. Reconciliation of Net Cash Flows from Operating Activities with Net Profit for the Year

	2008 \$M	2007 \$M
Net Profit for the Year	535	351
Cash Flows from Changes in Operating Asset and Operating Liability Balances	431	503
Add/(Subtract) Non-cash Items:		
Depreciation and Amortisation	5	4
Amortisation of Premium/Discount on Financial Instruments	(66)	(74)
Net Movement in Repatriated Currency Income and Expense	(1)	-
Net Unrealised Market Value Changes	1	(13)
Net Unrealised Foreign Exchange Losses/(Gains)	6	(835)
	(55)	(918)
Movements in Other Working Capital Items		
Decrease/(Increase) in Current Assets:		
Movement in Accounts Receivable	-	(2)
Movement in Inventories	(7)	(7)
Movement in Interest Receivable	(9)	14
	(16)	5
Increase/(Decrease) in Current Liabilities:		
Movement in Interest Payable	(13)	(11)
	(13)	(11)
Net Movements in Other Working Capital Items	(29)	(6)
Add/(Subtract) Investing and Financing Activities:		
Net Realised Foreign Exchange (Gains)/Losses	(321)	828
Net Realised Market Value Changes	6	(1)
	(315)	827
Net Cash Flows from Operating Activities	567	757

29. 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.

	2008 \$000	2007 \$000
Computer Equipment Finance Leases		
Due Within One Year	151	331
Due Between One and Two Years	62	146
Due Between Two and Five Years	2	58
Present Value of Minimum Lease Payments	215	535
Finance Charge	11	33
Total Minimum Lease Payments	226	568
Comprised:		
Due Within One Year	160	354
Due Between One and Two Years	64	154
Due Between Two and Five Years	2	60
Total Minimum Lease Payments	226	568

b Operating Lease Commitments

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

	2008 \$000	2007 \$000
Office Equipment and Premises Operating Leases		
Due Within One Year	277	276
Due Between One and Two Years	264	276
Due Between Two and Five Years	323	590
Total Office Equipment Premises Operating Lease Commitments	864	1,142

c Capital Expenditure and Inventory Commitments

	2008 \$000	2007 \$000
Capital Expenditure and Inventory		
Property, Plant and Equipment:		
Due Within One Year	1,198	-
Due Between One and Three Years	-	-
Inventories:		
Due Within One Year	2,356	3,041
Total Capital Expenditure and Inventory Commitments	3,554	3,041

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:

	2008 \$000	2007 \$000
Tenancy Lease Payments Receivable		
Receivable Within One Year	1,631	1,566
Receivable Between One and Five Years	1,716	2,908
Total Tenancy Lease Payments Receivable	3,347	4,474

30. Superannuation Commitments

The Bank has a superannuation fund for staff. The superannuation fund includes both a defined contribution scheme and a defined benefit scheme. Contributions, as specified in the rules of the respective schemes, are made by the Bank as required. Actuarial valuations of the schemes are undertaken triennially, with the last full valuation being undertaken as at 31 March 2008. Contributions to the defined benefit scheme are at a rate, reviewed annually, sufficient to keep the scheme solvent, based on actuarial assessments.

Defined Benefit Scheme

The following information is provided in respect of the defined benefit scheme.

	2008 \$000	2007 \$000
As at 31 March		
Present Value of Wholly Unfunded Obligations	-	-
Present Value of Wholly or Partly Funded Obligations	39,117	37,120
Fair Value of Plan Assets	40,576	44,489
Present Value of Net Obligations	(1,459)	(7,369)
Actuarial Gains Not Recognised in the Statement of Financial Position	283	6,240
Net Liability/(Asset) Recognised in the Statement of Financial Position	(1,176)	(1,129)
Movements in the Net Asset Recognised in the Statement of Financial Position		
Net Asset at the Beginning of the Year	1,129	1,734
Net Expense Recognised in the Income Statement	47	(605)
Contributions Paid	-	-
Net Asset Recognised at the End of the Year	1,176	1,129

The net asset recognised at the end of the year is limited to the estimated present value of reductions in future employer contributions to the defined benefit plan. The value of net assets of the defined benefit superannuation scheme not recognised as an asset of the Bank was \$0.3 million (2007: \$6.2 million).

	2008 \$000	2007 \$000
As at 31 March		
Return on Plan Assets:		
Expected Return on Plan Assets	1,930	1,980
Actuarial Gains on Plan Assets	(2,640)	298
Actual Return on Plan Assets	(710)	2,278

Expense Recognised in the Income Statement

The amounts recognised in Staff Expenses in the Income Statement as operating expenses for the financial year in respect of the defined benefit superannuation scheme are as follows:

Year ended 30 June	2008 \$000	2007 \$000
Current Service Cost	173	246
Interest Cost	1,606	1,574
Expected Return on Plan Assets	(1,930)	(1,980)
Actuarial (Gains)/Losses on Plan Assets	104	765
Past Service Cost	-	-
Net Defined Benefit Expense	(47)	605

The primary actuarial assumptions used in the above calculations expressed as weighted averages are as follows:

	2008 %	2007 %
Discount Rate at the Beginning of the Year	4.50	4.60
Expected Rate of Return on Plan Assets at the Beginning of the Year	4.50	4.50
Future Salary Increases	3.50	3.25
Other Material Actuarial Assumptions - Pension Increases	2.50	2.25

Defined Contribution Scheme

The Bank recognised as an expense the following contributions to defined contribution superannuation schemes:

	2008 \$000	2007 \$000
Bank's Defined Contribution Scheme	110	134
Other Defined Contribution Schemes	781	535
	891	669

31. Subsidiary Companies

The 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 35.

32. Related Parties

In the normal course of its operations, the Bank enters into transactions with related parties. Related parties include the Crown, various government departments, and Crown entities. Unless stated otherwise, all transactions with related parties take place at arm's length.

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.

Material transactions with entities controlled by the Crown and balances with entities controlled by the Crown were:

Year ended 30 June	2008 \$M	2007 \$M
Receipts from and Payments to Entities Controlled by the New Zealand Government		
Receipts of Income from Entities Controlled by the New Zealand Government		
Interest Income	269	293
Rental Income	2	2
Receipts of Capital from Entities Controlled by the New Zealand Government		
Receipt of Term Liabilities	-	200
Receipt of Proceeds on Maturity of New Zealand Government Securities	-	564
Payments of Expenses to Entities Controlled by the New Zealand Government		
Interest Expense	501	274
Payments of Capital to Entities Controlled by the New Zealand Government		
Net Decrease/(Increase) in Deposits	(3,708)	(1,132)
Repayment of Term Liabilities	687	570
As at 30 June		
Balances with Entities Controlled by the New Zealand Government		
Assets that Comprise Claims on Entities Controlled by the New Zealand Government		
Derivative Financial Instruments in a Gain Position	-	5
New Zealand Government Securities	4,307	4,206
Liabilities that Comprise Claims by Entities Controlled by the New Zealand Government		
Derivative Financial Instruments in a Loss Position	1	-
Deposits	7,110	3,402
Term Liabilities	3,566	3,969

In addition, during the year, as part of the Bank's domestic market operations, the Bank entered into securities reverse repurchase agreements with Crown-owned entities on standard commercial terms. All amounts advanced under these agreements have been repaid. The table above includes interest income received by the Bank from this activity.

33. 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.

In 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 2008 and reported on 23 July 2008 that, based on the Fund's annual accounts:

- Assuming the Fund was not wound up, the assets of the Fund were sufficient as at 31 March 2008 to provide for benefits to members, including existing pensioners, that were attributable to membership prior to 1 April 2008. 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 is wound up, the purchase cost of annuities would exceed the value of Defined Benefit assets of the Fund. On winding up, the Bank is required by the Trust Deed to make good any shortfall. The Bank considers that the likelihood of the Fund being wound up is remote.

The Actuary reported that, to his knowledge, there had been no circumstances between 31 March 2008 and 30 June 2008 that would cause the Actuary to form a different opinion as at 30 June 2008.

- 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 as at 30 June 2008 was \$105.3 million (2007: \$105.8 million). Of the total face value of demonetised currency, \$82.3 million (2007: \$82.9 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 of collectors' currency issued before 1 July 2004 and which is not recognised as a liability is \$9.8 million (2007: \$9.8 million).
- d As at 30 June 2008, the Bank had a contingent liability of \$25.79 million (SDR 12.04 million) (2007: \$23.63 million, SDR 12.04 million) in respect of uncalled and unpaid capital attached to its shareholding in the Bank for International Settlements.

34. Income Tax

Section CW38 of the Income Tax Act 2007 exempts the Bank from income tax. The Bank incurs and meets liabilities for goods and services tax, fringe benefit tax, and other withholding tax.

35. Custodial Activities

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

NZCSD is a wholly-owned New Zealand incorporated 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 as at 30 June 2008 was \$100.5 billion (2007: \$99.1 billion).

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

36. Significant Post-balance Date Events

On 2 July 2008, the Bank received a capital injection of \$600 million from the Government. The funds were invested in securities issued by the New Zealand Government, with a face value of \$610 million, a weighted average yield of 7.70%, and an average duration of 0.2 years. The securities purchased have been classified as available-for-sale financial assets.

37. Explanation of Transition to NZ IFRS

This is the first period that the Bank has presented its financial statements in accordance with NZ IFRS. The last financial statements under NZ FRS were for the year ended 30 June 2007, and the date of transition to NZ IFRS was 1 July 2006.

Comparative Information

The opening Statement of Financial Position and comparative figures for the year ended 30 June 2007 have been presented under NZ IFRS. The main adjustments and reconciliations between the financial statements issued as at 30 June 2007 and comparative information under NZ IFRS are set out below.

Reconciliation of Equity as at 1 July 2006

	Note	Effect of Transition to NZ IFRS			Opening NZ IFRS 1 July 2006 \$M
		Previous NZ FRS 30 June 2006 \$M	Presentation Changes 30 June 2006 \$M	Recognition and Measurement Changes 30 June 2006 \$M	
ASSETS					
Foreign Currency Financial Assets					
Cash Balances		104	-	-	104
Derivative Financial Instruments in a Gain Position		18	1	-	19
Receivable from Unsettled Sales of Securities		76	-	-	76
Securities Purchased Under Agreements to Resell	iii)	7,409	21	(6)	7,424
Marketable Securities		3,980	17	-	3,997
Shareholding in the Bank for International Settlements		117	-	-	117
Other Assets		2	-	-	2
Accrued Interest		39	(39)	-	-
Total Foreign Currency Financial Assets		11,745	-	(6)	11,739
Local Currency Financial Assets					
Securities Purchased Under Agreements to Resell		123	-	-	123
New Zealand Government Securities	ii)	4,840	72	55	4,967
Accrued Interest		72	(72)	-	-
Total Local Currency Financial Assets		5,035	-	55	5,090
Total Financial Assets		16,780	-	49	16,829
Other Assets					
Inventories	v)	11	-	2	13
Property, Plant and Equipment	i)	54	(7)	-	47
Other Assets	i), iv), vi)	15	7	(14)	8
Total Other Assets		80	-	(12)	68
Total Assets		16,860	-	37	16,897

For the accompanying notes to the Reconciliation of Equity for the Bank as at 1 July 2006 and 30 June 2007, refer to page 104.

Reconciliation of Equity as at 1 July 2006

	Note	Effect of Transition to NZ IFRS			Opening NZ IFRS 1 July 2006 \$M
		Previous NZ FRS 30 June 2006 \$M	Presentation Changes 30 June 2006 \$M	Recognition and Measurement Changes 30 June 2006 \$M	
LIABILITIES					
Foreign Currency Financial Liabilities					
Payable for Unsettled Purchases of Securities		76	-	-	76
Short Sales of Marketable Securities		342	4	-	346
Derivative Financial Instruments in a Loss Position		149	(9)	-	140
Securities Sold Under Agreements to Repurchase		1,212	1	-	1,213
Term Liabilities	iii)	5,314	41	5	5,360
Accrued Interest		37	(37)	-	-
Total Foreign Currency Financial Liabilities		7,130	-	5	7,135
Local Currency Financial Liabilities					
Government Deposits		2,248	1	-	2,249
Other Deposits		2,087	-	-	2,087
Securities Sold Under Agreements to Repurchase		193	-	-	193
Accrued Interest		1	(1)	-	-
Total Local Currency Financial Liabilities		4,529	-	-	4,529
Total Financial Liabilities		11,659	-	5	11,664
Other Liabilities					
Currency in Circulation	vii)	3,348	-	1	3,349
Distribution Payable to the New Zealand Government		410	-	-	410
Miscellaneous Liabilities		22	-	-	22
Total Other Liabilities		3,780	-	1	3,781
Total Liabilities		15,439	-	6	15,445
EQUITY					
Capital		1,000	-	-	1,000
Retained Earnings	iii), iv), v), vi), vii)	380	-	(24)	356
Available-for-sale Revaluation Reserve	ii)	8	-	55	63
Other Reserves		33	-	-	33
Total Equity		1,421	-	31	1,452
Total Liabilities and Equity		16,860	-	37	16,897

For the accompanying notes to the Reconciliation of Equity for the Bank as at 1 July 2006 and 30 June 2007, refer to page 104.

Reconciliation of Equity as at 30 June 2007

	Note	Effect of Transition to NZ IFRS			NZ IFRS Balances 30 June 2007 \$M
		Previous NZ FRS 30 June 2007 \$M	Presentation Changes 30 June 2007 \$M	Recognition and Measurement Changes 30 June 2007 \$M	
ASSETS					
Foreign Currency Financial Assets					
Cash Balances		672	-	-	672
Derivative Financial Instruments in a Gain Position	iii)	707	13	(1)	719
Securities Purchased Under Agreements to Resell		3,333	18	-	3,351
Marketable Securities	iii)	11,810	1	(5)	11,806
Shareholding in the Bank for International Settlements		97	-	-	97
Other Assets		2	-	-	2
Accrued Interest		32	(32)	-	-
Total Foreign Currency Financial Assets		16,653	-	(6)	16,647
Local Currency Financial Assets					
Securities Purchased Under Agreements to Resell		16	-	-	16
New Zealand Government Securities	ii)	4,276	66	(136)	4,206
Accrued Interest		66	(66)	-	-
Total Local Currency Financial Assets		4,358	-	(136)	4,222
Total Financial Assets		21,011	-	(142)	20,869
Other Assets					
Inventories	v)	18	-	2	20
Property, Plant and Equipment	i)	70	(8)	-	62
Other Assets	i), iv)	1	8	1	10
Total Other Assets		89	-	3	92
Total Assets		21,100	-	(139)	20,961

For the accompanying notes to the Reconciliation of Equity for the Bank as at 1 July 2006 and 30 June 2007, refer to page 104.

Reconciliation of Equity as at 30 June 2007

	Note	Effect of Transition to NZ IFRS			NZ IFRS Balances 30 June 2007 \$M
		Previous NZ FRS 30 June 2007 \$M	Presentation Changes 30 June 2007 \$M	Recognition and Measurement Changes 30 June 2007 \$M	
LIABILITIES					
Foreign Currency Financial Liabilities					
Short-term Deposits		333	-	-	333
Securities Sold Under Agreements to Repurchase		568	-	-	568
Term Liabilities	iii)	3,946	21	2	3,969
Accrued Interest		21	(21)	-	-
Total Foreign Currency Financial Liabilities		4,868	-	2	4,870
Local Currency Financial Liabilities					
Government Deposits		3,150	1	-	3,151
Other Deposits		7,802	4	-	7,806
Securities Sold Under Agreements to Repurchase		52	-	-	52
Accrued Interest		5	(5)	-	-
Total Local Currency Financial Liabilities		11,009	-	-	11,009
Total Financial Liabilities		15,877	-	2	15,879
Other Liabilities					
Currency in Circulation	vii)	3,360	-	1	3,361
Distribution Payable to the New Zealand Government		193	-	-	193
Miscellaneous Liabilities		92	-	-	92
Total Other Liabilities		3,645	-	1	3,646
Total Liabilities		19,522	-	3	19,525
EQUITY					
Capital		1,000	-	-	1,000
Retained Earnings	iii), iv), v), vi), vii)	520	-	(6)	514
Available-for-sale Revaluation Reserve	ii)	11	-	(136)	(125)
Other Reserves		47	-	-	47
Total Equity		1,578	-	(142)	1,436
Total Liabilities and Equity		21,100	-	(139)	20,961

For the accompanying notes to the Reconciliation of Equity for the Bank as at 1 July 2006 and 30 June 2007, refer to page 104.

37. Explanation of Transition to NZ IFRS (continued)

Notes to the Reconciliation of Equity as at 1 July 2006 and 30 June 2007

Presentation changes

All presentation changes related to the reclassification of accrued interest to the assets and liabilities from which the interest is derived, except:

- i) Capitalised software costs, net of accumulated amortisation, of \$7 million at 30 June 2006 and \$8 million at 30 June 2007 have been reclassified from Property, Plant and Equipment to Other Assets.

Measurement changes

- ii) New Zealand Government Securities have been designated as available-for-sale securities. These securities are carried at fair value under NZ IFRS and were recorded at amortised cost under NZ FRS. The adjustment as at 1 July 2006 increased the carrying value of New Zealand Government Securities and Equity by \$55 million. As at 30 June 2007, the carrying value of New Zealand Government Securities under NZ IFRS was \$136 million less than the carrying value reported under NZ FRS at that date.
- iii) Under NZ IFRS, assets must be valued at bid price and liabilities at offer price. Under NZ FRS, assets and liabilities were carried at mid-market prices. The adjustment as at 1 July 2006 reduced the carrying value of assets by \$6 million, increased the carrying value of liabilities by \$5 million and reduced the Bank's Equity by \$11 million. As at 30 June 2007, the carrying value of assets under NZ IFRS was \$6 million less than the carrying value reported under NZ FRS at that date and the carrying value of liabilities under NZ IFRS was \$2 million more than the carrying value reported under NZ FRS at that date.
- iv) Under NZ IFRS, the Bank records on the face of the Statement of Financial Position the capitalised value of the contribution holiday arising from the actuarial surplus in the Bank's defined benefit superannuation scheme. The adjustment as at 1 July 2006 increased Other Assets and Equity by \$2 million. As at 30 June 2007, the carrying value of assets under NZ IFRS was \$1 million more than the carrying value reported under NZ FRS at that date.
- v) Under NZ IFRS, the Bank must recognise within inventories the replacement cost of notes and coins that have been repatriated to the Bank. Under NZ FRS, repatriated notes and coins were not included in the valuation of inventory. The adjustment at 1 July 2006 increased Inventory and Equity by \$2 million. As at 30 June 2007, the carrying value of inventories under NZ IFRS was \$2 million more than the carrying value reported under NZ FRS at that date.
- vi) Under NZ IFRS, the Bank cannot recognise as an asset deferred costs on derivative contracts used to hedge the proceeds of future sales of demonetised coins. Under NZ FRS, these costs were deferred and offset against sale proceeds received in subsequent periods. The adjustment as at 1 July 2006 reduced Other Assets and Equity by \$16 million. No difference existed as at 30 June 2007.
- vii) Under NZ IFRS, the Bank must recognise a liability for the face value of collectors' currency that is sold. Under NZ FRS, the face value on sales of collectors' currency was recognised as revenue, with a corresponding amount reported as a contingent liability. The adjustment as at 1 July 2006 increased liabilities and decreased Equity by \$1 million. As at 30 June 2007, the carrying value of liabilities under NZ IFRS was \$1 million more than the carrying value reported under NZ FRS at that date.

37. Explanation of Transition to NZ IFRS (continued)

Reconciliation of Net Profit for the Year Ended 30 June 2007

	Note	Year Ended 30 June 2007 Effect of Transition to NZ IFRS			Restated NZ IFRS \$M
		Previous NZ FRS \$M	Presentation Changes \$M	Recognition and Measurement Changes \$M	
Interest Income		1,172	-	-	1,172
Interest Expense		832	-	-	832
Net Interest Income		340	-	-	340
Net Gains/(Losses) on Fair Value Changes	ii)	14	-	-	14
Net Gains/(Losses) from Foreign Exchange Rate Changes	i)	6	-	3	9
Other Investment Income		2	-	-	2
Net Investment Income		362	-	3	365
Other Income	v), vi)	23	-	16	39
Total Operating Income		385	-	19	404
Operating Expenses:					
Staff Expenses	iii)	22	-	1	23
Currency Issued Expenses	iv)	11	-	-	11
Asset Management Expenses		7	-	-	7
Other Operating Expenses		12	-	-	12
Total Operating Expenses		52	-	1	53
Net Profit for the Year		333	-	18	351

Notes to the Reconciliation of Net Profit for the Year Ended 30 June 2007

- i) Net Gains/(Losses) from Foreign Exchange Rate Changes has been adjusted for the difference between bid rates (for assets), offer rates (for liabilities), and mid-market exchange rates. The net movement in this difference for the year was an increase in net income of \$2.6 million.
- ii) Net Gains/(Losses) Due to Fair Value Changes has been adjusted for the difference between bid prices (for assets), offer prices (for liabilities) and mid-market prices. The net movement in this difference for the year was an increase in net income of \$0.2 million.
- iii) Staff Expenses under NZ IFRS includes an expense related to the defined benefit superannuation scheme. The net movement for the year was a reduction in net income of \$0.6 million.
- iv) Currency Issued Expenses under NZ IFRS reflects the change in valuation basis of inventory, which includes the replacement cost of notes and coins repatriated to the Bank. The net movement for the year was a reduction in net income of \$0.4 million.
- v) Under NZ FRS, Other Income has been reduced by the amortisation of deferred hedging costs related to the sale of demonetised coins. These costs were not deferred under NZ IFRS and the amortisation recognised under NZ FRS is not recognised under NZ IFRS, resulting in an increase in net income of \$15.7 million.
- vi) Under NZ FRS, Other Income included the face value of collectors' currency that is sold. Under NZ IFRS, the face value of collectors' currency is included in liabilities. The net movement for the year was a reduction in net income of \$0.2 million.

Reconciliation of Cash Flows

There were no differences in reported cash flows under NZ IFRS and NZ FRS.

FIVE-YEAR HISTORICAL FINANCIAL INFORMATION

On 1 July 2007, the Bank adopted NZ IFRS. In accordance with NZ IFRS, the comparative information was restated using the new accounting standards from 1 July 2006. Historical financial information for the 2004, 2005 and 2006 financial years is presented applying previous NZ FRS.

Refer to Note 37 Explanation of Transition to NZ IFRS for an explanation of the Bank's transition to NZ IFRS and the nature of the main adjustments required to comply with NZ IFRS.

Five-year Financial Position

As at 30 June	Previous NZ FRS Audited 2004 \$M	Previous NZ FRS Audited 2005 \$M	Previous NZ FRS Audited 2006 \$M	Previous NZ FRS Audited 2007 \$M	NZ IFRS Audited 2007 \$M	NZ IFRS Audited 2008 \$M
Assets						
Foreign Currency Financial	5,681	8,086	11,745	16,653	16,647	20,754
Local Currency Financial	4,777	4,866	5,035	4,358	4,222	4,307
Other Assets	39	44	80	89	92	101
Total Assets	10,497	12,996	16,860	21,100	20,961	25,162
Liabilities and Equity						
Foreign Currency Financial	5,574	7,308	7,130	4,868	4,870	4,605
Local Currency Financial	1,382	790	4,529	11,009	11,009	14,925
Currency in Circulation	2,920	3,183	3,348	3,360	3,361	3,448
Other Liabilities	200	161	432	285	285	258
Equity	421	1,554	1,421	1,578	1,436	1,926
Total Liabilities and Equity	10,497	12,996	16,860	21,100	20,961	25,162

Five-year Financial Performance

For the year ended 30 June	Previous NZ FRS Audited 2004 \$M	Previous NZ FRS Audited 2005 \$M	Previous NZ FRS Audited 2006 \$M	Previous NZ FRS Audited 2007 \$M	NZ IFRS Audited 2007 \$M	NZ IFRS Audited 2008 \$M
Operating Income						
Net Investment Income	223	302	290	362	365	573
Other Income	9	8	8	23	39	8
Total Operating Income	232	310	298	385	404	581
Operating Expenses						
Staff Expenses	18	18	22	22	23	22
Currency Issued Expenses	5	6	6	11	11	4
Asset Management Expenses	4	4	5	7	7	7
Other Operating Expenses	10	9	11	12	12	13
Total Operating Expenses	37	37	44	52	53	46
Net Profit for the Year	195	273	254	333	351	535
Five-year Outcomes Under the Funding Agreement						
Actual Net Expenses Under the Funding Agreement	27.7	29.1	35.9	29.1	30.4	38.1
Net Expenditure Specified Under the Funding Agreement	31.0	33.0	39.0	34.0	34.0	41.0
Funding Agreement Under-Expenditure	3.3	3.9	3.1	4.9	3.6	2.9

Actual Net Expenses Under the Funding Agreement for 2007 excludes a \$16 million timing adjustment required by NZ IFRS. Under NZ IFRS, hedging costs associated with income arising from the disposal of recovered 'silver' coins were required to be expensed in 2006. Under FRS, these costs were deferred and expensed in 2007. Given this was a timing difference that straddled the change-over to NZ IFRS, we have assumed that the FRS treatment applied for the purposes of reporting five-year outcomes under the Funding Agreement.

Five-year Distributions Paid to the New Zealand Government

For the year ended 30 June	Previous NZ FRS Audited 2004 \$M	Previous NZ FRS Audited 2005 \$M	Previous NZ FRS Audited 2006 \$M	Previous NZ FRS Audited 2007 \$M	NZ IFRS Audited 2007 \$M	NZ IFRS Audited 2008 \$M
Distributions Paid to the New Zealand Government	192	139	410	193	193	168

