
Reserve Bank of New Zealand

Statement of Intent

For the period 1 July 2005 to 30 June 2008

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Introduction

Under section 162A of the Reserve Bank of New Zealand Act 1989 (the Act), the Reserve Bank is required, prior to each financial year, to provide the Minister of Finance with a *Statement of Intent* traversing the following three years.

Section 162B of the Act states that the Reserve Bank's *Statement of Intent* must contain:

- key background information about the Reserve Bank and its operating environment;
- the nature and scope of the Bank's functions and its principal areas of operations;
- the nature of the Bank's specific objectives;
- the proposed strategies for achieving objectives and carrying out operations;
- the proposed strategies for managing the organisational health and capability of the Bank; and
- a statement of the projected income and expenditure for the first financial year in the period to which the *Statement of Intent* relates.

Foreword

This *Statement of Intent* is the product of an extensive strategic planning process that began late last year, leading to a series of outlooks for our activities and funding. These outlooks range from a new five-year Funding Agreement; to this three-year *Statement of Intent (SOI)*; and through to the one-year strategic priorities, which are included in this *SOI*.

The five-year Funding Agreement reflects a substantially changed environment: where we see more demands on policy outputs; where obsolete systems need to be replaced; and where effective risk mitigation strategies need to be implemented. While activities are scoped over the five-year period of the Agreement, there is flexibility to re-prioritise activities within the period of the Agreement.

This *SOI* outlines the directions the Reserve Bank is heading over the next three years and how we aim to get there. Much of the detail is on what we will be doing during the first of those three years.

Typically, the Reserve Bank's performance of its monetary policy function dominates public perceptions of the Bank's role, while it performs its other functions quietly in the background. However, 2005/06 will see major activity in all three main functions, as set out in the Reserve Bank of New Zealand Act 1989: These are:

- operating monetary policy to maintain price stability;
- promoting the maintenance of a sound and efficient financial system; and
- meeting the currency needs of the public.

As we carry out these changing functions, there will be strong demand on our expertise, our risk-mitigation strategies, and our back-office systems.

In monetary policy, the Bank is carrying out its responsibility to maintain price stability at a turning point in the economic cycle. The economy has continued to grow strongly over the past year, prompting us to tighten monetary conditions. Growth is expected to slow gradually as the lagged effects of last year's tightening in monetary policy, slower population growth, and the high exchange rate increasingly constrain demand. However, there are significant signs of inflation pressures.

In banking oversight, the Bank has been implementing additional regulatory policies to maintain global standards for financial institutions, and bolster financial crisis management capabilities. Key initiatives include the implementation of the new Basel capital framework (Basel II), new International Financial Reporting Standards (IFRS), a more formal role in the oversight of the payment systems, the implementation of local incorporation policy, and the formation of an outsourcing policy.

Following the creation of ANZ National Bank, 85 per cent of New Zealand's banking assets are now concentrated in the four major Australian banks, lifting the potential of systemic risk in the event of a major bank failure. This has been partly behind an increase in regulatory capacity, so as to ensure that New Zealand has a resilient and

efficient financial system, in which the failure of a single institution or critical system should not lead to a systemic financial crisis.

The Bank is also improving coordination with relevant Australian regulatory counterparts. The Bank will contribute to the recently established Trans-Tasman Council on Banking Supervision to oversee regulatory and supervision issues between New Zealand and Australia.

To better meet the public's currency needs, the most significant changes to New Zealand's 'silver' coinage since decimalisation in 1967 will be implemented in 2006. These changes will see the 10c, 20c and 50c coins reduced in size and made in different, lighter and cheaper metals, while the 5c coin will be withdrawn from circulation.

In meeting the challenges outlined in this *SOI*, we can no longer sustain past decisions to defer investment. Over the last 10 years, our average funding each year has been a little over \$30 million. This will increase to almost \$40 million a year under the new Funding Agreement. The new Agreement includes \$23 million in capital expenditure to be incurred over the five years ending 30 June 2010.

The Bank's ability to operate in the current demanding environment will be supported by changes to several back-office systems. We are upgrading our treasury, financial reporting, document management, forecasting and data systems, while further investment is needed to ensure continuity of operation in the event of major disasters. We are also planning a renovation of our ground floor to improve access, security and display of information.

The Bank is acutely aware of the need to manage all these significant changes effectively and efficiently, in a manner that builds national and international confidence in the stability and integrity of New Zealand's money and monetary system. We will invest in the development of leadership by our people so as to support best practice, high achievement, change, innovation and productivity.



Alan Bollard
Governor



Adrian Orr
Deputy Governor

Governance and structure

Board of Directors

The Reserve Bank has a Board of Directors whose primary function is to review the performance of the Governor and the Bank. The Board holds regular meetings at which it receives extensive briefings on the Bank's activities, decisions and policies. At these meetings the Board also provides advice to the Governor.

The Board, through an Audit Committee, also reviews the Bank's financial statements. Each year the Board writes an assessment of the Bank's and the Governor's performance, which is provided as advice to the Minister of Finance and made public later in the Bank's *Annual Report*.

When required, the Board makes recommendations to the Minister of Finance on the appointment or reappointment of the Governor. The Minister of Finance can only appoint a Governor recommended by the Board. The Board can recommend to the Minister of Finance that the Governor be dismissed if the Board believes that the Governor's performance has been 'inadequate' in various respects. The Board appoints the Deputy Governor on the Governor's recommendation.

The Board typically meets nine times a year. The current Board is Dr Arthur Grimes (Chair); Mr Paul Baines; Mr Hugh Fletcher; Mr John Goulter, DCNZM, JP; Mrs Alison Paterson, QSO (Deputy Chair); The Rt Hon Edmund Thomas, DCNZM, PC, QC; Dr Marilyn Waring; and, as Governor, Dr Alan Bollard. Board members are appointed for five-year terms and are eligible for reappointment for a further five years.

Management structure

Under the Act, the Governor – who is also the Bank's Chief Executive – is accountable for the Bank's actions. In monetary policy, and in most other matters, decision-making authority resides with the Governor alone. The Governor is appointed for a five-year term. The Act sets specific procedures for the appointment, reappointment and dismissal of the Governor. The Governor can also be reappointed for a further five years.

The Reserve Bank's senior management team is made up of the Governor, a Deputy Governor, a Head of Operations, and the heads of the Bank's various departments, as outlined on page 6. The posts of Governor and Deputy Governor are required by statute. Two other members of the senior management team are designated Assistant Governors, these being the Head of Operations and the Head of Economics. Currently the Head of Financial Stability is also the Deputy Governor.

The Governor receives advice from a number of internal committees within the Reserve Bank.

Reserve Bank organisational structure

Governors	Department/Heads	Functions	Internal services	
Governor <i>Alan Bollard</i>	Assistant Governor/ Head of Economics <i>Grant Spencer</i>	Economics	Monetary policy formulation	
	Deputy Governor/ Head of Financial Stability <i>Adrian Orr</i>	Financial Stability	Market operations Foreign reserves management Financial system surveillance	
		Currency and Building Services <i>Brian Lang</i>	Currency operations	Property management Security
		Financial Services <i>Mike Wolyncewicz</i>	Settlement services Registry and depository services	Accounting services Treasury services
		Knowledge Services <i>Yogesh Anand</i>		Library services Data services Computer services
	Assistant Governor/ Head of Operations <i>Don Abel</i>	Human Resources <i>Tanya Harris</i>		Human resources strategy and services
		Communications <i>Mike Hannah</i>		Reputation management Communications
		Risk Assessment and Assurance <i>Steve Anderson</i>		Audit services Risk assessment and assurance

Reserve Bank priorities and key projects for 2005/06

	Department	Priority
1	Bank-wide	Strengthen the Bank's performance by: <ul style="list-style-type: none"> improving leadership competencies through training; and improving organisational communications.
2	Bank-wide	Implement an improved Business Continuity Plan (BCP) for the operations of the Bank.
3	Currency and Building Services	Implement the modernisation of New Zealand's 'silver' coins in 2006/07.
4	Financial Stability	Develop and implement institutional arrangements for the prudential regulation of the New Zealand financial system, including: <ul style="list-style-type: none"> assess the scope for wider prudential regulation of the non-bank financial sector and identify the role of the Bank in this area; and implement home-host cooperation practices and frameworks for bank regulators that have interests in New Zealand.
5	Financial Stability	Implement the Bank's policies on outsourcing, Basel II, local incorporation, and bank failure management, within the context of home-host bank regulator cooperation.
6	Financial Stability	Ensure that adequate liquidity is being provided to the banking system, with collateral requirements and risks being balanced appropriately between the Reserve Bank and the New Zealand banking sector.
7	Economics	Strengthen the Bank's economic modelling capability to improve its forecasting and monetary policy decision making under uncertainty; as well as to provide a basis for the redevelopment of the Forecasting and Policy System (FPS).

Functions and operations

Monetary policy formulation

Objective statement

To achieve and maintain stability in the general level of prices. A published Policy Targets Agreement (PTA) requires the Bank to maintain inflation, as measured by the Consumers Price Index, between 1 and 3 per cent per annum on average over the medium term. It also requires that: “In pursuing its price stability objective, the Bank shall ... seek to avoid unnecessary instability in output, interest rates and the exchange rate.”

Scope of operations

Every six weeks the Bank sets an Official Cash Rate (OCR) around which it lends to, and borrows from, registered banks, directly influencing other short-term interest rates. Four OCR decisions are announced at the same time as the Bank’s quarterly *Monetary Policy Statements (MPSs)*, which set out the Bank’s views on the economy and inflationary pressures, and the basis for the OCR decision. Four other OCR decisions are made approximately halfway between each *MPS*.

Issues

- Ensuring that best practice modelling methods and a wide range of data are used in generating forecasts and monetary policy advice.
- Ensuring the monetary policy framework allows for uncertainty.
- Better understanding household consumption/savings behaviour and its interaction with household balance sheets.
- Understanding the growth potential of the economy and its implications for monetary policy.
- Determining whether monetary policy can be modified to reduce currency volatility without compromising the medium-term price stability objective.
- Improving understanding of the formation of inflation expectations.
- Understanding the implications of different currency arrangements.
- Ensuring monetary policy is communicated to the widest group in the most appropriate manner.

Initiatives and strategies

- Strengthen the Bank’s economic modelling capability to improve its forecasting and monetary policy decision making under uncertainty; as well as to re-develop the Forecasting and Policy System (FPS) in 2006–08.
- Incorporate alternative models in the forecasting and monetary policy process.
- Improve understanding of household spending decisions in relation to household balance sheets, and incorporate results in FPS.
- Review recent business cycles and assess changes in the relationship between output growth and inflation.
- Improve representation of inflation expectations and modelling in monetary policy transmission, including reviewing the RBNZ Survey of Expectations.
- Prepare the *Post-Election Briefing* jointly with the Financial Stability Department.
- Review data availability and act to remedy any shortcomings in the Economics database.

Market operations and foreign reserves management

Objective statement

To assist in the efficient functioning of the New Zealand financial system, to manage the Crown's financial liquidity, and to implement monetary policy.

Scope of operations

- Managing official foreign reserves for use in times of financial distress and/or where foreign exchange intervention is needed; managing liquidity in the banking system; providing and managing the Crown Settlement Account; and monitoring and reporting developments in the financial market to enhance monetary policy decision making and financial stability monitoring.
- Acting as lender of last resort to the financial system, as well as play a key role in any financial market or banking crisis.
- Day-to-day activities to ensure the effective implementation of monetary policy, and ensuring the banking system has adequate liquidity.

Issues

- Increasing the Bank's foreign exchange intervention capacity and capability.
- Reassessing the optimal balance sheet structure for the Bank.
- Assessing whether the Bank should be more active in the bond 'repo' market if significant price distortions arise from time to time.
- Finalising policies for implementation of lender of last resort facilities for a banking system in stress.
- Providing advice to the Governor on financial market developments and issues for the formulation of monetary policy.

Initiatives and strategies

- Review the liquidity management operation to ensure the banking system has adequate liquidity, with collateral requirements and risks being balanced appropriately.
- Formulate and communicate clearly to stakeholders our foreign exchange intervention criteria and processes.
- Assist in assessing the Bank's optimal balance sheet structure.
- Review the current bond tendering system and recommend replacement options.
- Work closely with the Debt Management Office (DMO) to establish the comparative advantages offered by the two agencies in managing Crown business.

Financial system surveillance and policy

Objective statement

To register and supervise banks so as to maintain a sound and efficient financial system, and to limit damage to the financial system that could result from a bank failure.

Scope of operations

- Setting specific criteria for bank registration.
- Subjecting banks to a specific monitoring regime.
- Publishing regular *Financial Stability Reports* assessing the state of the New Zealand financial system in terms of soundness and efficiency.
- Having a capacity to respond if a bank fails or gets into financial distress, including giving directions to a registered bank; recommending to the Minister that a bank be placed in statutory management; and acting as 'lender of last resort' to the financial system, providing liquidity in a crisis.
- Responsible for overseeing the payment system.

Issues

- Completing and implementing the Bank's outsourcing policy.
- Implementing Basel II.
- Ensuring the Bank's capability to manage a bank failure or wider crisis.
- Ensuring appropriate mutual recognition, harmonisation, coordination and cooperation with home regulators, the Trans-Tasman Council on Banking Supervision being a particularly important forum.
- Accommodating updates in global regulatory standards.
- Improving monitoring of non-bank financial institutions (NBFIs).
- Reviewing the efficiency of the banking sector and the Reserve Bank's supervision methods.

Initiatives and strategies

- Assess the scope for wider prudential regulation of the non-bank financial sector and the role of the Bank in this area.
- Finalise and implement institutional arrangements for home regulators with interests in New Zealand, especially the Australian Prudential Regulation Authority (APRA).
- Complete the implementation of the Bank's policies on outsourcing, Basel II, and local incorporation.
- Complete the formulation and implementation of the Bank's crisis management capabilities, assessing their robustness through failure management scenarios.
- Review the efficiency of the banking system.

Currency operations

Objective statement

To meet the currency needs of the public by ensuring the supply and integrity of bank notes and coins.

Scope of operations

- As the sole issuer of currency, acting as a distributor of bank notes and coins to the banking system; this does not include the daily redistribution of bank notes and coins between banks and other financial institutions.
- Providing collectors' currency (currently marketed by New Zealand Post).

Issues

- Modernising 'silver' coins by reducing their size and weight and removing the 5c coin from circulation.
- Reducing the cost of currency.

Initiatives and strategies

- Implement the modernisation of the 'silver' coins.
- Improve the forecasting of currency demand.
- Report on currency trends and electronic money developments.
- Commission a state-of-the-art bank note processing machine for checking quality and authenticity by December 2005.

Depository and settlement services

Objective statement

To ensure that payments system infrastructure services are provided efficiently and meet international standards.

Scope of operations

Operate the Exchange Settlement Account System (ESAS) and Austraclear systems (including infrastructure required for settlement of continuous linked settlement (CLS) transactions through CLS Bank).

Issues

- Undertake a significant systems upgrade to ensure that the payments infrastructure continues to operate efficiently.
- Have regard to the possibility that a new entrant could emerge and offer depository services.
- Improve business continuity planning and disaster recovery capabilities, and respond to higher international operating standards.
- Respond to changing industry requirements regarding the times at which payment settlements take place.

Initiatives and strategies

- Improve business continuity planning and disaster recovery capability by arranging for out-of-Wellington business support for payment systems, and ensure greater flexibility in back-up computing arrangements.
- Engage with the settlements industry to define long-term needs and to evaluate options for delivering the services required.
- Complete the upgrade for ESAS and Austraclear before 31 December 2007.

Organisational health and capabilities

Human resources

Objective statement

To provide strategic human resource advice and support services.

Scope of operations

- Assist departments with recruitment, contract negotiation, employment relations, legislative advice and terminations.
- Organise specific bank-wide training and development programmes, key person risk planning, secondment and study arrangements.
- Facilitate the annual remuneration review and performance management programmes.

Issues

- The bulk of the Bank's work is conceptual or technical in nature. The most crucial capacity-building issue for the Bank is the quality of its staff.
- It is vital, in both the policy and operational departments, that we identify areas where skills can be enhanced and developed to meet future business requirements.

Initiatives and strategies

- Provide leadership training to support managers to be high-performing individuals and leaders within the Bank.
- Revitalise the Bank's organisational communications.
- Continue to undertake a formal review of key person risk within the Bank and how it can be mitigated.
- Continue our appraisal system that incorporates a development plan detailing individual training and development activities for each staff member.
- Continue to undertake an extensive staff survey to assess overall staff satisfaction and improve the Bank's human resource procedures.

Knowledge services

Objective statement

To provide information management (IM) and information technology (IT) services.

Scope of operations

Core technology infrastructure, business analysis and applications development, helpdesk and web support, data collection and management, library and records management, and project and portfolio management services.

Issues

Knowledge Services Group (KSG) is projecting a continued increase in capital expenditure to upgrade IT capability, largely for business continuity purposes and the provision of efficient payments services.

Initiatives and strategies

- Review data strategy, data coverage and collection processes, with a view to making it more relevant and widely accessible.
- Enhance the Bank's web functional capability to provide a more secure information-sharing medium.
- Extend the Bank's knowledge management strategy. The Bank has recently replaced its document management system and is to implement the collaboration and work-flow tool sets provided with this solution. Further, it will evaluate the costs and benefits of digitally capturing archive records and physical documents.
- Upgrade all internally developed computer applications over the next three years in order to ensure the versions of software used are fully supported and, where possible, use standardised language.
- Significantly enhance the Bank's business continuity infrastructure. The Bank will upgrade its existing computer room, arrange for out-of-Wellington business support for payment systems, and ensure greater flexibility in back-up computing arrangements.
- Complete the upgrade for ESAS and Austraclear before 31 December 2007.

Financial services

Objective statement

To provide support services for the Bank's key financial operations, including financial reporting and management reporting; compliance with corporate governance and accountability responsibilities; settlement operations; and treasury accounting/compliance reporting.

Scope of operations

- Settlement operations and treasury accounting/compliance reporting in support of liquidity management and foreign reserves functions.
- Financial reporting (including audited financial statements), and monthly management and Board reporting.
- Facilitation of the Bank's strategic planning and annual budgeting processes.
- Delivery of financial support services and balance sheet management advice.

Issues

- Elimination of settlement risk for the Bank's own foreign exchange transactions.
- Adoption of International Financial Reporting Standards (IFRS).
- Ensuring the smooth introduction of the new treasury system and maximising benefits from this investment.

Initiatives and strategies

- Evaluate options for the Bank to access alternative means for utilising the services of CLS Bank, and implement the preferred option.
- Adopt IFRS from 1 July 2007.
- Progressively review and redesign work flows, reports and processes for securities trading activities.
- Evaluate the merits of serving other government entities' processing requirements using the Bank's treasury system.

Communications

Objective statement

To provide strategic advice and management for the Bank's external and internal communications, and the maintenance of its reputation and credibility.

Scope of operations

Development of strategies for the Bank's key stakeholder relationships, day-to-day liaison with stakeholders, issues management, education initiatives, writing, editing and publishing Bank documents, editorial management of the Bank's website.

Issues

- The Bank has built a strong reputation with a wide variety of key stakeholders and audiences across all facets of the economy. Maintaining its reputation and credibility is critical to the effective and efficient operation of its functions with those stakeholders.
- Developing an internal communications strategy to support the leadership development programme, in order to maintain a high-achieving organisation.

Initiatives and strategies

- Ensure that the Bank's public presentation of its policies and decisions reflects the Bank's evolving policy focus and the wider political, social, economic and media context that the Bank operates in.
- Ensure that the Bank's public presentation of its policies and decisions supports the Bank's objectives, reputation and credibility.
- Assist in the revitalisation of the Bank's organisational communications.
- Develop the Bank's own methods and e-technologies for information dissemination to augment the Bank's mass media profile and to target discrete audiences/stakeholders.
- Determine the existing constituencies for monetary policy and prepare a plan for developing further stakeholder relationships.
- Provide the Bank with timely advice on reputational risks and opportunities, and strategies for their mitigation or utilisation.

Risk assessment and assurance

Objective statement

To assist in the evaluation of the effectiveness and efficiency of risk management, and to audit internal control systems.

Scope of operations

- Assist line management with identifying and analysing sources of risks.
- Work with line management to design risk management systems and processes.
- Monitor risk management implementation and provide risk management advice to Governors.
- Provide ongoing audit review and evaluation of the Bank's operations and internal control systems.

Issues

Ensuring risks are being managed by line management in a proactive, coordinated, prioritised and cost-effective manner.

Initiatives and strategies

- Review the approach to risk assessment and assurance.
- Audit Services will continue to carry out a comprehensive internal audit programme to provide assurance on the Bank's internal control environment.

Property management and Security

Objective statement

To maintain the Bank-owned building at 2 The Terrace, Wellington, ensuring that staff are appropriately accommodated and that the building is secure so that Bank functions, including cash operations, can be conducted unimpeded at all times.

Scope of operations

The Bank owns its building in Wellington and sub-lets space on eight of the 14 floors. The Bank also has unit title to a number of carparks in an adjacent building, some of which are leased out.

Issues

- Plan and refurbish the building to meet current and future needs for accommodation, including a public heritage museum/school visiting area.
- Assist in establishment and maintenance of offsite accommodation for business continuity planning.

Initiatives and strategies

- Plan and refurbish the building to meet current and future Bank needs for accommodation.
- Provide appropriate space and fit-out for a public heritage museum/school visiting area on the ground floor.
- Upgrade the security of the building and vaults to provide a safe and secure working environment.
- Assist in the establishment and maintenance of off-site accommodation for business continuity planning purposes.
- Maintain the building at the required standard, with fully-let tenanted areas.
- Arrange for the sale of some carparks.

Financial management

Drivers of financial performance

The principal drivers of the Bank's financial performance are:

- the amount of equity retained by the Bank;
- the value of currency in circulation;
- interest rates earned on the Bank's investment in government stock. That investment is funded by the level of Bank equity and the amount of currency in circulation;
- the performance of the Bank's foreign reserve management function in minimising the costs of holding reserves; and
- operating expenditure incurred by the Bank.

In recent years the Bank has been able to produce significant increases in net income, and in turn increase its dividend to the Crown. In particular, the funds available to the Bank have grown considerably, firstly as a result of sustained growth in currency in circulation, and secondly as a result of a \$1 billion equity injection on 1 July 2004, which enabled the Bank to extend its foreign exchange intervention capability. The cost of holding foreign reserves and volatility of foreign currency earnings have declined in recent years, as the Bank has adopted a strategy of restructuring the reserves portfolio from fixed-rate investments into floating rate/short-term investments. The Bank has also been able to access funding for the holding of its foreign reserves at less cost, again increasing margins, reported income and distributions.

During the 1990s the Bank reduced average net operating costs from \$50 million per annum to \$33 million per annum through extensive restructuring, particularly with respect to currency operations. In the period 2000–2005 average operating costs were held. However, average annual net operating costs are expected to rise during 2005–2010. This change in the Bank's net cost base reflects:

- Depreciation of major investments in systems for treasury operations, electronic data management, currency processing, payment systems, tendering, and cash forecasting and security. The capital expenditure for these systems will occur in the period 2004–2006, with depreciation expensed over the subsequent five years.
- Improvement of business continuity capability in line with international standards.
- Costs, including those of additional staff and legal advice associated with the Bank's reinvigoration of prudential supervision capabilities.

These additional costs are expected to be partially offset by savings that will be generated as a result of changes in the Bank's currency function, in particular from the modernisation of 'silver' coinage.

The following table sets out forecast net expenditure for each function for the four financial years between 2005 and 2008. The increase in the Bank's cost profile reflects the primary factors referred to above, together with the costs of initiatives to be undertaken in respect of those functions during the next three years.

Projected net expenditure by function 2005–2008

	Budget	Net expenditure*		
		Forecast	Forecast	Forecast
For the year ended 30 June	2005	2006	2007	2008
	\$000	\$000	\$000	\$000
Functions:				
Monetary policy formulation	7,636	8,320	8,843	9,630
Market operations	3,961	4,469	6,192	5,412
Financial system surveillance	6,400	8,303	9,486	9,385
Currency operations**	7,457	9,569	257	7,617
Foreign Reserves management	4,326	6,562	7,202	6,644
Settlement services	517	671	779	902
Registry and depository services	(822)	(880)	(596)	(839)
Overseas Investment Commission secretariat	3	0	0	0
Other outputs	502	498	585	711
Net expenditure	29,980	37,512	32,748	39,462

* Net expenditure comprises operating expenses less income earned from certain Bank operations as specified in the Funding Agreement.

** The material reduction in Currency Operations expenses in 2006/07 is a function of expected proceeds to be received from salvaging demonetised coins.

Financial management processes

The Bank, through its Asset and Liability Committee (ALCO), determines the Bank's balance sheet management strategy. This committee formulates financial objectives and policies for the investment of funds, and the extent of risk-taking permitted.

The Bank's investment income provides the source of funds required to finance the Bank's operating expenses. Capital expenditure is funded by the Bank from its own resources with depreciation included in annual operating expenditure. While this provides the Bank with a degree of financial autonomy, the Bank's operating expenditure is subject to constraints established in the five-year Funding Agreement agreed between the Minister of Finance and the Governor, which is subsequently required to be ratified by Parliament.

If operating expenditure (net of specified revenue) in any year exceeds the amount provided in the Funding Agreement, the Bank is required to fund that excess from equity. Where actual net expenditure is less than the amount provided in the Funding Agreement, the amount of that underspending is retained by the Bank and added to equity.

Each year, as part of the Bank's annual planning cycle, the Bank determines its priorities for the coming year and establishes a budget for that period. The Governor approves the annual budget after receiving advice from the Bank's Board. The budget for the period ended 30 June 2006 is set out below.

The Bank will continue to invest its equity and proceeds from issuing currency by purchasing New Zealand government securities. It intends to hold those securities to maturity. Foreign reserves management is undertaken with liquidity being the key criterion in determining the composition of the Bank's foreign currency assets.

Projected income and expenditure for the year to 30 June 2006

The following outlines the Reserve Bank's projected financial performance for 2005/06. Except as noted below, the projected financial performance has been prepared using the accounting policies used in the preparation of the Bank's financial statements for the year ended 30 June 2004. Those accounting policies are disclosed on pages 50–55 of the Bank's 2004 *Annual Report*. In addition to defining medium-term funding arrangements, the Bank undertakes an annual planning and budgeting process.

The key assumptions underlying the budget for the year ended 30 June 2006 are that:

- the Bank's current functions will continue;
- activity in the Foreign Reserves Management and Liquidity Management functions will be similar to the previous year;
- interest and exchange rates will be those prevailing as at 31 March 2005; and
- the Bank has no material open foreign currency positions during the year.

Key changes from the budget for 2004/05 are:

- increased personnel costs, as a result of staff costs incurred in developing systems being capitalised in 2004/05, and more staff employed in the Financial Stability Department;
- increased currency costs, as a result of more currency in circulation and lower stocks of coins available for reissue than in the previous year;
- a full year's depreciation has been provided for in 2005/06 for the treasury and electronic data management systems, together with part-year depreciation on a new currency processing machine; and
- additional legal and advisory fees have been provided for with respect to regulatory matters.

Projected financial performance 2005–2006

<i>For the year ended 30 June</i>	Forecast	Estimated actual*	Budget
	2006 \$m	2005 \$m	2005 \$m
Operating income:			
Foreign currency investment margin	15.7	1.8	4.3
Local currency investment margin	296.4	290.5	276.4
Net investment income	312.1	292.3	280.7
Other income	6.8	8.1	8.3
Total operating income	318.9	300.4	289.0
Operating expenses:			
Personnel	20.1	18.2	18.3
New currency issued	6.6	5.6	6.0
Asset management	5.6	3.8	3.8
Administration	1.6	1.3	1.3
Other	10.4	9.0	9.1
Total operating expenses	44.3	37.9	38.5
Operating surplus	274.6	262.5	250.5
Funding agreement Underexpenditure**	1.5	3.1	2.9

* Estimated actual expenditure for 2004/05 incorporates actual results to 31 March 2005, together with an estimate of results for the three months ended 30 June 2005.

** The Funding Agreement for 2005–2010 is subject to ratification by Parliament. For 2005/06, the Funding Agreement specifies a net expenditure level of \$39 million.

Monitoring the Bank's performance

The Reserve Bank has been and will continue to be a world leader in the openness and transparency of its processes and policies. Openness allows others to scrutinise the Bank's performance and to provide feedback, which helps the Bank improve the way it works.

The principal mechanisms for communicating the Bank's views include:

- the regular Official Cash Rate decisions and quarterly *Monetary Policy Statements*;
- the Bank's *Annual Report* and financial statements;
- the quarterly *Bulletin*;
- occasional publications such as issue-specific brochures; and
- addresses given by the Governor and other senior Bank staff.

The Reserve Bank formally assesses its performance or is externally assessed in the following ways:

The Reserve Bank's Board of Directors reviews the Bank's performance and the discharge of its statutory obligations. In addition to providing the Governor with ongoing advice and feedback, the Board is also required to report annually on the Bank's performance. The Board's report is published in the Bank's *Annual Report*.

The Reserve Bank publishes a *Statement of Intent (SOI)* at the commencement of each year. The *SOI* sets out the Bank's principal functions and objectives for the next three years; comments on strategies for managing organisational health and capability; and sets out projected income and expenditure for the first year of that three-year period.

The Reserve Bank's *Annual Report* includes a detailed assessment of the performance of the Bank's various functions, in terms of the both the day-to-day responsibilities and progress against priorities set previously.

Parliament's Finance and Expenditure Committee reviews each quarterly *Monetary Policy Statement* and the Bank's *Annual Report*.

The Reserve Bank's financial statements are audited by an external auditor who is the agent of the Controller and Auditor-General. The Audit Committee of the Board reviews those financial statements and provides advice to the Governor before the Governor and Deputy Governor sign the related management statement. The critical payment systems operated by the Reserve Bank are subject to review by external auditors, quarterly in respect of the Austraclear depository system and annually in respect of the Exchange Settlement Account System (ESAS).

From time to time the Reserve Bank engages experts to assess the Bank's processes, research and technical performance. In the past, assessments have been provided in the fields of monetary policy development, forecasting processes, bank failure management, computer systems and network security, management, and leadership assessment and development. Also, two external advisers assist in the provision of advice to the Governor regarding his interest rate decisions. During the week prior to the release of the quarterly *Monetary Policy Statement* these two advisers fully participate in the deliberations leading to the formulation of the *MPS*.

The Reserve Bank's performance is also subject to international scrutiny. Every 12–18 months the International Monetary Fund undertakes an 'Article IV' assessment of the New Zealand economy, which includes sections on monetary policy and financial system stability. The resultant report is made public. Likewise, every two years the OECD undertakes a similar assessment, which is also published. The recent IMF Financial Sector Assessment Programme (FSAP) investigation is expected to be repeated in New Zealand every six or seven years.

Appendix A

Key document references

Title	Purpose	Location
<i>Annual Report*</i>	Key accountability document, plus presentation of financial statements	www.rbnz.govt.nz/about/whatwedo/0094054.html
Board of Directors' Annual Report	Board of Directors' report on the Bank's performance	Reproduced in Bank's <i>Annual Report</i>
<i>Briefing on the Reserve Bank of New Zealand*</i>	Description of the role and functions of the Reserve Bank, prepared for an incoming government	www.rbnz.govt.nz/about/whatwedo/0122541.html
<i>Central Banking in New Zealand*</i>	Brochure about the Reserve Bank and its governance arrangements	www.rbnz.govt.nz/publications/index.html
<i>Financial Stability Report*</i>	Six-monthly publication of the Bank's view on the soundness and efficiency of the New Zealand financial system	www.rbnz.govt.nz/publications/finstab/
Funding Agreement	Basis of Bank's funding, setting how much of the Bank's revenues can be retained by the Bank	www.rbnz.govt.nz/about/whatwedo/0090769.html
Letter to Minister of Finance on foreign exchange market intervention policy	Description of how the Bank may intervene in the foreign exchange market under section 16 of the Reserve Bank Act to influence the exchange rate	http://www.rbnz.govt.nz/foreignreserves/intervention/0148214.html
Letter from Minister of Finance to the Bank on foreign exchange intervention	Provision of delegated authority for the Bank to intervene in the foreign exchange market under section 17 of the Reserve Bank Act, should that market become dysfunctional.	http://www.rbnz.govt.nz/foreignreserves/intervention/0148293.html
Mission Statement and Values	Expression of the Bank's modus operandi	Inside front cover of <i>Annual Report</i>
<i>Monetary Policy Statement*</i>	Quarterly publication of the Bank's view of how the Bank proposes to meet its monetary policy targets, including extensive economic projections	www.rbnz.govt.nz/monpol/statements/index.html
Policy Targets Agreement	Agreement between the Governor and the Minister of Finance specifying the inflation target in detail.	www.rbnz.govt.nz/monpol/pta
<i>Reserve Bank Bulletin*</i>	Quarterly publication of articles relevant to central banking in New Zealand	www.rbnz.govt.nz/research/bulletin/index.html
Reserve Bank of New Zealand Act 1989	Reserve Bank's statutory authority	www.legislation.govt.nz
<i>Statement of Intent*</i>	A statement of what the Bank intends to achieve over the next three years, with forecast income and expenditure for one financial year	http://www.rbnz.govt.nz/publications/
Statement of Principles*	Explanation of the Reserve Bank's approach to bank registration and supervision	http://www.rbnz.govt.nz/banking/regulation/bs1.pdf
<i>This is the Reserve Bank*</i>	Introductory brochure about the Reserve Bank	www.rbnz.govt.nz/about/whatwedo/0109157.html

* Also available in print from: The Librarian, Reserve Bank of New Zealand, PO Box 2498, Wellington, New Zealand.
rbnz-info@rbnz.govt.nz
www.rbnz.govt.nz