MANAGEMENT STATEMENT

RESERVE BANK OF NEW ZEALAND

21 August 2012

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 2012 fairly reflect the financial position and operations of the Bank.

Alan Bollard

Governor

Deputy Governor

AUDIT REPORT

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Independent Auditors' report
To the readers of the Reserve Bank of New Zealand and Group's Financial Statements for the year ended 30 June 2012

The Auditor-General is the auditor of the Reserve Bank of New Zealand and Group (the 'Bank'). The Auditor-General has appointed me, Chris Barber, using the staff and resources of PricewaterhouseCoopers, to carry out the audit of the financial statements of the Bank on her behalf.

We have audited the financial statements of the Bank on pages 54 to 97 that comprise the statement of financial position as at 30 June 2012, the income statement, statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date and the notes to the financial statements that include accounting policies and other explanatory information.

Opinion
In our opinion the financial statements of the Bank on pages 54 to 97:
- comply with generally accepted accounting practice in New Zealand; and
- fairly reflect the Bank's:
  - financial position as at 30 June 2012; and
  - financial performance and cash flows for the year ended on that date.

Our audit was completed on 21 August 2012. This 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 our responsibilities, and explain our independence.

Basis of opinion
We carried out our audit in accordance with the Auditor-General's Auditing Standards, which incorporate the International Standards on Auditing (New Zealand). Those standards require that we comply with ethical requirements and plan and carry out our audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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.

An audit involves carrying out procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgement, including our assessment of risks of material misstatement of the financial statements whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the preparation of the Bank's financial statements that fairly reflect the matters to which they relate. We consider internal control in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.

Independent Auditors' report

An audit also involves evaluating:

- the appropriateness of accounting policies used and whether they have been consistently applied;
- the reasonableness of the significant accounting estimates and judgements made by the Governor;
- the adequacy of all disclosures in the financial statements; and
- the overall presentation of the financial statements.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements. We have obtained all the information and explanations we have required and we believe we have obtained sufficient and appropriate audit evidence to provide a basis for our audit opinion.

Responsibilities of the Governor

The Governor is responsible for preparing financial statements that:

- comply with generally accepted accounting practice in New Zealand; and
- fairly reflect the Bank's financial position, financial performance and cash flows.

The Governor is also responsible for such internal control as he determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The Governor's responsibilities arise from the Reserve Bank of New Zealand Act 1989.

Responsibilities of the Auditor

We are responsible for expressing an independent opinion on the financial statements and reporting that opinion to you based on our audit. Our responsibility arises from section 15 of the Public Audit Act 2001 and section 166 of the Reserve Bank of New Zealand Act 1989.

Independence

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

In addition to the audit we have carried out assignments in the areas of systems audits and advice on the operation and assessment of payment systems which are compatible with those independence requirements. Other than the audit and these assignments, we have no relationship with or interests in the Bank.

Chris Barber
Chris Barber
On behalf of the Auditor-General
Wellington, New Zealand

PricewaterhouseCoopers
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 (the 'Bank') and Group for the year ended 30 June 2012 included on the Bank's website. The Governor is responsible for the maintenance and integrity of the Bank's website. We have not been engaged to report on the integrity of the Bank'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 21 August 2012 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").

For the year ended 30 June 2012, the Bank classified its outputs according to its main functions in the ways described below.[22]

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.

PRUDENTIAL SUPERVISION:

Registering and supervising banks, licensing and supervising insurers, regulating non-bank deposit takers, overseeing payment systems, and undertaking policy development in all of these areas. These actions are for the purpose of promoting a sound and efficient New Zealand financial system by limiting damage to the financial system that could arise from bank, non-bank deposit taker or insurer failure(s) or other financial system distress. Supervising banks, non-bank deposit takers and life insurers for compliance with their anti-money laundering obligations.

MACRO-FINANCIAL STABILITY:

Analysing and managing financial system risks to promote a sound and efficient system that supports the functioning of the economy.

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 New Zealand dollar settlement accounts to financial institutions and the New Zealand government and providing securities settlement and depository services, mainly to financial institutions.

22. The Bank's classification of its main functions was revised from 1 July 2011. The principal changes included establishing a Macro–Financial Stability function, amalgamating the Settlement Services and Registry and Depository Services functions and renaming the Financial System Surveillance and Policy function, which is now known as the Prudential Supervision function.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 30 June	Note	2012 $M	2011 $M
ASSETS			
Foreign Currency Financial Assets			
Cash Balances		**2,785**	1,959
Securities Purchased under Agreements to Resell		**4,566**	3,803
Marketable Securities	3	**12,780**	16,574
Derivative Financial Assets	4	**1,700**	2,080
Other Foreign Currency Financial Assets	5	**140**	231
Total Foreign Currency Financial Assets		**21,971**	24,647
Local Currency Financial Assets			
Securities Purchased under Agreements to Resell		**1,501**	2,591
New Zealand Government Securities		**3,193**	3,768
Other Local Currency Financial Assets		**1**	1
Total Local Currency Financial Assets		**4,695**	6,360
Total Financial Assets		**26,666**	31,007
Other Assets	6	**78**	83
Total Assets		**26,744**	31,090
LIABILITIES			
Foreign Currency Financial Liabilities			
Short-term Foreign Currency Financial Liabilities	9	**1,069**	1,092
Securities Sold under Agreements to Repurchase		**606**	475
Derivative Financial Liabilities	4	**306**	466
Term Liabilities		**2,148**	2,448
Total Foreign Currency Financial Liabilities		**4,129**	4,481
Local Currency Financial Liabilities			
Deposits	10	**15,262**	19,627
Securities Sold under Agreements to Repurchase		**119**	-
Currency in Circulation		**4,375**	4,173
Other Local Currency Financial Liabilities	11	**85**	84
Total Local Currency Financial Liabilities		**19,841**	23,884
Total Financial Liabilities		**23,970**	28,365
Other Liabilities	12	**172**	216
Total Liabilities		**24,142**	28,581
EQUITY	14	**2,602**	2,509
Total Liabilities and Equity		**26,744**	31,090

The above statement is to be read in conjunction with the notes set out on pages 59 to 97.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Note	Capital $M	Available for Sale Reserve $M	Property, Currency and Artwork Collections Revaluation Reserve $M	Retained Earnings $M	Total $M
Equity as at 1 July 2010		1,600	216	47	711	2,574
Net Profit for the Year		-	-	-	144	144
Total Income and Expense Taken to Equity during the Year		-	1	-	-	1
Dividend Payable to the New Zealand Government		-	-	-	(210)	(210)
Equity as at 30 June 2011		1,600	217	47	645	2,509
Net Profit for the Year		**-**	**-**	**-**	**118**	**118**
Total Income and Expense Taken to Equity during the Year		**-**	**136**	**(1)**	**-**	**135**
Dividend Payable to the New Zealand Government	13	**-**	**-**	**-**	**(160)**	**(160)**
Equity as at 30 June 2012	14	**1,600**	**353**	**46**	**603**	**2,602**

The above statement is to be read in conjunction with the notes set out on pages 59 to 97.

CONSOLIDATED INCOME STATEMENT

For the year ended 30 June	Note	**2012 $M**	2011 $M
Interest Income		**655**	670
Interest Expense		**375**	368
Net Interest Income		**280**	302
Net Gains/(Losses) from Fair Value Changes		**(73)**	31
Net Losses from Foreign Exchange Rate Changes		**(38)**	(144)
Dividend Income		**2**	2
Total Net Investment Income	24	**171**	191
Other Income		**8**	8
Total Operating Income		**179**	199
Total Operating Expenses	26	**61**	55
Net Profit for the Year		**118**	144

The above statement is to be read in conjunction with the notes set out on pages 59 to 97.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 30 June	Note	**2012 $M**	2011 $M
Net Profit for the Year from the Consolidated Income Statement		**118**	144
Items Recognised Directly in the Consolidated Statement of Comprehensive Income			
Movement in Available-for-sale Revaluation Reserve Taken to Equity	14	**136**	1
Movement in Property Revaluation Reserve Taken to Equity	14	**(1)**	-
Total Income and Expense Taken to Equity during the Year		**135**	1
Total Comprehensive Income for the Year		**253**	145

The above statement is to be read in conjunction with the notes set out on pages 59 to 97.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 30 June	Note	2012 $M	2011 $M
CASH FLOWS FROM OPERATING ACTIVITIES			
Sources from Income			
Interest Received:			
Foreign Currency:			
Derivatives		**(34)**	(12)
Other		**64**	49
Local Currency:			
Derivatives		**415**	383
Available-for-sale Securities		**195**	204
Other		**32**	16
Dividend		**4**	5
Fees, Commission and Other Income Received		**8**	8
Total Sources of Cash Flows from Income		**684**	653
Disbursements for Expenses			
Interest Paid:			
Foreign Currency		**6**	-
Local Currency		**367**	367
Payments to Suppliers and Employees		**48**	45
Total Disbursements of Cash Flows from Expenses		**421**	412
Operating Cash Flows from Income and Expenses		**263**	241
Operating Cash Flows from Changes in Operating Asset Balances			
Net (Increase)/Decrease in Foreign Currency Operating Assets		**3,211**	(3,102)
Net (Increase)/Decrease in Local Currency Operating Assets		**1,090**	(2,390)
Total Operating Cash Flows from Changes in Asset Balances		**4,301**	(5,492)
Operating Cash Flows from Changes in Operating Liability Balances			
Net (Increase)/Decrease in Other Foreign Currency Operating Liabilities		**(103)**	(210)
Net (Increase)/Decrease in Local Currency Operating Liabilities		**4,249**	(5,696)
Total Operating Cash Flows from Changes in Liability Balances		**4,146**	(5,906)
Operating Cash Flows from Changes in Asset and Liability Balances		**155**	414
Net Cash Flows from Operating Activities	27	**418**	655
CASH FLOWS FROM INVESTING ACTIVITIES			
Sources			
Maturity of Available-for-sale Securities		**919**	-
Total Sources of Cash Flows from Investing Activities		**919**	-
Disbursements			
Purchases of Available-for-sale Securities		**217**	295
Purchase of Property, Plant and Equipment and Intangible Assets		**4**	6
Total Disbursements of Cash Flows from Investing Activities		**221**	301
Net Cash Flows from Investing Activities		**698**	(301)

CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)

For the year ended 30 June	Note	2012 $M	2011 $M
CASH FLOWS FROM FINANCING ACTIVITIES			
Sources			
Net Issue of Circulating Currency		**203**	234
Total Sources of Cash Flows from Financing Activities		**203**	234
Disbursements			
Repayment of Foreign Currency Term Liabilities		**321**	-
Dividend Payments to the New Zealand Government		**210**	290
Total Disbursements of Cash Flows from Financing Activities		**531**	290
Net Cash Flows from Financing Activities		**(328)**	(56)
NET CASH FLOWS		**788**	298
Plus Foreign Exchange Rate Effect on Cash Balances at the Beginning of the Year		**38**	(299)
NET CASH FLOWS FROM ALL ACTIVITIES		**826**	(1)
Cash Balances at the Beginning of the Year		**1,959**	1,960
Cash Balances at the End of the Year		**2,785**	1,959

The above statement is to be read in conjunction with the notes set out on pages 59 to 97.

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"). These consolidated financial statements apply to the financial year ended 30 June 2012. 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 21 August 2012.

(B) COMPLIANCE WITH NEW ZEALAND EQUIVALENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

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 community or social benefit 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 New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS), which differ from corresponding provisions of the equivalent International Financial Reporting Standards (IFRS). 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 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. Where that inventory is acquired at no cost, or for nominal consideration, it should 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.

Inventories of currency on hand include currency repatriated to the Bank at no cost. In accordance with NZ IAS 2, this portion of inventory is measured at the current replacement cost of that inventory at the time of repatriation. At 30 June 2012, the carrying value of inventory was $2.6 million more than that which would have been reported had IAS 2 been applied (2011: $1.9 million more).

(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.

Changes in Accounting Policies

There have been no changes in accounting policies and all accounting policies have been applied consistently by the Bank for all the financial years presented (unless otherwise stated).

Standards and Interpretations Applied with Effect from 1 July 2011

The Bank has applied the following new or updated accounting standards with effect from 1 July 2011:

- *Amendments to New Zealand Equivalents to International Financial Standards to Harmonise with International Financial Reporting Standards and Australian Accounting Standards ("Harmonisation Amendments")*
- *FRS 44 New Zealand Additional Disclosures*
- *Amendments to NZ IFRS 7 Disclosures – Transfers of Financial Assets*

Application of the Harmonisation Amendments, Amendments to NZ IFRS 7, and FRS 44 has not impacted the accounting policies that are applied by the Bank. These accounting standards have not impacted measurement of the Bank's reported net profit, financial position and cash flows, although they have had a minor impact on disclosures included in the Bank's financial statements.

Standards and Interpretations Issued but not yet Effective and not Early Adopted

The following standard has been issued and is expected to be relevant to the Bank:

NZ IFRS 9 *Financial Instruments* replaces part of NZ IAS 39 *Financial Instruments: Recognition and Measurement* and will be mandatory for the Bank's financial statements for the year beginning 1 July 2015 (if the Bank is still applying IFRS). It establishes two primary measurement categories for financial assets: amortised cost and fair value, with classification depending on an entity's business model and the contractual cash flow characteristics of the financial asset. Under NZ IFRS 9, liabilities may continue to be valued at amortised cost or at fair value if accounting using fair value either reflects the way the liability is managed or eliminates an accounting mismatch. Where liabilities are accounted for at fair value, changes in fair value relating to changes in the Bank's own credit risk are presented in other comprehensive income and are not included in reported net profit. The Bank is in the process of evaluating the potential effect of this standard.

Proposed Changes to Accounting Standards Applicable to Public Benefit Entities

The External Reporting Board (XRB) has announced that it intends to adopt a multi-standards framework for financial reporting. The XRB's intention is that, from 1 July 2014, Public Sector Public Benefit Entities will generally be required to apply new accounting standards based on International Public Sector Accounting Standards (IPSAS), while For-Profit Entities will continue to apply accounting standards that are based on International Financial Reporting Standards (IFRS). The Bank and other Crown-owned financial institutions are working with the XRB to determine whether the Bank will be required to apply IPSAS, or whether it may continue to apply IFRS.

In light of its decision to adopt a multi-standards approach, the XRB has determined that new IFRS-based accounting standards, or changes to existing IFRS-based accounting standards with a mandatory effective date of 1 January 2012 or later, may be applied by profit-oriented entities only. For example, Public Benefit Entities are prohibited from applying NZ IFRS 13 *Fair Value Measurement,* which was promulgated in 2011 and which has a mandatory application date for annual periods beginning on or after 1 January 2013.

Basis of Consolidation

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

Trust and Custodial Activities

Assets held for third parties under custodial arrangements and income arising thereon is excluded from these financial statements, as they are not assets or income of the Bank (see Note 34).

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 financial liabilities and foreign currency financial assets as part of its Foreign Reserves Management and Domestic Market Operations activities. While the Bank is required by the Reserve Bank Act to report revenue and expenses by reference to the functions carried out by the Bank, these activities do not constitute separate operating segments for the purposes of NZ IFRS 8.

Functional and Presentation Currency

The Bank's financial statements are presented in New Zealand dollars, the Bank's functional and presentation currency. Amounts in the financial statements are rounded to the nearest million dollars unless otherwise stated.

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.

(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.

Financial Assets at Fair Value through Profit or Loss

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

The bulk of the Bank's assets and liabilities are designated as fair value through profit or loss, as 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.

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.

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

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.

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.

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. As part of its liquidity management operations, the Bank purchases New Zealand government securities generally up to six months before these securities mature. Government securities purchased for liquidity management operations are classified as financial assets at fair value through profit or loss.

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.

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

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.

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. 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.

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 remeasured 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 the fair value of payments, both expressed in New Zealand dollars. The net fair value of each derivative contract is determined individually and carried as an asset if the net fair value is positive and as a liability if that value is negative.

The majority of the Bank's assets and liabilities are carried at fair value and managed on a fair value basis. Therefore, the Bank has not applied the hedge accounting rules of *NZ IAS 39 Financial Instruments: Recognition and Measurement.*

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 Bank records as an asset the consideration receivable from the agreement to resell the security.

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 financial 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, or a market downgrade in credit rating of the financial asset.

(E) OTHER ASSETS

Inventories

Inventories of currency on hand are recognised in the Statement of Financial Position at cost. Costs include the cost of bringing inventories to their present location and condition.

For the portion of inventories of currency on hand that relates to currency repatriated to the Bank, this cost is measured at the current replacement cost of producing the currency at the time of repatriation, and is recorded by crediting currency issue expense and increasing the value of inventory recognised in the Statement of Financial Position.

When currency is issued, the value of inventory is reduced and an expense is recorded for currency issuance costs. Currency issuance cost is determined on a first-in, first-out (FIFO) basis.

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.

The Bank obtains an independent valuation of land and buildings every three years. In the years between independent valuations, an annual assessment is made of whether or not there is likely to have been a material change in value. An independent valuation is obtained where a material change has occurred.

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 10 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 indicators of impairment annually. 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 60).

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.

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 in Operating Expenses.

Superannuation Obligations

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

A liability is recognised in the Statement of Financial Position where the present value of defined benefit obligations exceeds the fair value of the scheme's assets (as adjusted for unrecognised past-service costs).

An asset is recognised in the Statement of Financial Position where the present value of defined benefit obligations is less than the fair value of the scheme's assets (as adjusted for unrecognised past-service costs). Any net asset recognised in the Statement of Financial Position is limited to the estimated present value of reductions in future employer contributions to the defined benefit 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 the terms of the related superannuation liability. The calculation is performed annually by an independent qualified actuary using the projected unit credit method.

Staff expenses within Operating Expenses in the Income Statement includes the current-service cost, past-service cost, an interest cost and an expected return for the defined benefit superannuation scheme. The actuarial gain or loss on the defined benefit superannuation scheme is included as a separate item within Operating Expenses.

(H) INCOME AND EXPENSES

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. Earnings from the investment of the Bank's equity are allocated to each function based on the estimated amount of equity required for each 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 report more accurately 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 taxes.

(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 observable directly or are implied from instrument prices.

Judgement is applied also in assessing the extent of impairment of financial and other assets.

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 63 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

Every three years, 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, outright purchases of New Zealand government securities shortly before maturity and foreign currency swaps. The Bank uses securities from holdings of New Zealand government securities in repurchase transactions and issues Reserve Bank bills 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 NZClear 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 manage a significant portion of foreign currency risk. A proportion of foreign currency assets held for crisis management purposes are 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 would usually entail the Bank borrowing or lending New Zealand currency to finance the foreign currency transaction.

Financial instruments held within foreign currency portfolios consist mainly of sovereign securities, securities held under reverse-repurchase transactions, or balances held with other central banks, commercial banks, or highly-rated supranational institutions. Liquidity and credit risk are key criteria in determining the type of instruments held.

The Bank manages the foreign currency exposure arising from certain operating and capital expenditure commitments denominated in foreign currency. The Bank will purchase foreign currency cover for those foreign currency-denominated commitments that will fall due over the following financial year.

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 2012, there have been no directions from the Minister under section 17 or 18 and there have been no payments to or from the Crown under section 21 of the Reserve Bank Act (2011: 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, bond and 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. The arrangements are described in more detail above in (B) Foreign Currency Activities.

Bond and 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.

(E) TITLE TO ASSETS

As part 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 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.

3. ANALYSIS OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Foreign Currency Marketable Securities

Foreign Currency Marketable Securities of $12,780 million (2011: $16,574 million) comprise fixed interest securities issued by foreign governments, foreign near-government entities and supranational organisations. Further details, such as the credit rating and the country in which the issuer is resident, are provided in note 18 in respect of all financial assets including Foreign Currency Marketable Securities.

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. There have been no transfers between classes of financial instruments.

	Fair Value through Profit or Loss						
As at 30 June 2012	Total $M	Designated Upon Initial Recog-nition $M	Derivatives Deemed Held for Trading $M	Held for Trading $M	Available-for-sale Financial Assets $M	Loans and Receiv-ables $M	Financial Assets and Liabilities at Amortised Cost $M
ASSETS							
Foreign Currency Financial Assets							
Cash Balances	2,785	2,782	-	3	-	-	-
Securities Purchased under Agreements to Resell	4,566	4,566	-	-	-	-	-
Marketable Securities	12,780	12,780	-	-	-	-	-
Derivative Financial Assets	1,700	-	1,700	-	-	-	-
Other Foreign Currency Financial Assets	140	-	-	-	139	1	-
Total Foreign Currency Financial Assets	21,971	20,128	1,700	3	139	1	-
Local Currency Financial Assets							
Securities Purchased under Agreements to Resell	1,501	1,501	-	-	-	-	-
New Zealand Government Securities	3,193	-	-	-	3,193	-	-
Other Local Currency Financial Assets	1	-	-	-	-	1	-
Total Local Currency Financial Assets	4,695	1,501	-	-	3,193	1	-
Total Financial Assets	26,666	21,629	1,700	3	3,332	2	-
LIABILITIES							
Foreign Currency Financial Liabilities							
Short-term Foreign Currency Financial Liabilities	1,069	1,064	-	-	-	-	5
Securities Sold under Agreements to Repurchase	606	606	-	-	-	-	-
Derivative Financial Liabilities	306	-	306	-	-	-	-
Term Liabilities	2,148	2,148	-	-	-	-	-
Total Foreign Currency Financial Liabilities	4,129	3,818	306	-	-	-	5
Local Currency Financial Liabilities							
Deposits	15,262	15,262	-	-	-	-	-
Securities Sold under Agreements to Repurchase	119	119	-	-	-	-	-
Currency in Circulation	4,375	-	-	-	-	-	4,375
Other Local Currency Financial Liabilities	85	-	-	-	-	-	85
Total Local Currency Financial Liabilities	19,841	15,381	-	-	-	-	4,460
Total Financial Liabilities	23,970	19,199	306	-	-	-	4,465

As at 30 June 2011	Total $M	Fair Value through Profit or Loss: Designated Upon Initial Recog-nition $M	Fair Value through Profit or Loss: Derivatives Deemed Held for Trading $M	Fair Value through Profit or Loss: Held for Trading $M	Available-for-sale Financial Assets $M	Loans and Receiv-ables $M	Financial Assets and Liabilities at Amortised Cost $M
ASSETS							
Foreign Currency Financial Assets							
Cash Balances	1,959	1,959	-	-	-	-	-
Securities Purchased under Agreements to Resell	3,803	3,803	-	-	-	-	-
Marketable Securities	16,574	16,574	-	-	-	-	-
Derivative Financial Assets	2,080	-	2,080	-	-	-	-
Other Foreign Currency Financial Assets	231	-	-	-	134	97	-
Total Foreign Currency Financial Assets	24,647	22,336	2,080	-	134	97	-
Local Currency Financial Assets							
Securities Purchased under Agreements to Resell	2,591	2,591	-	-	-	-	-
New Zealand Government Securities	3,768	-	-	-	3,768	-	-
Other Local Currency Financial Assets	1	-	-	-	-	1	-
Total Local Currency Financial Assets	6,360	2,591	-	-	3,768	1	-
Total Financial Assets	31,007	24,927	2,080	-	3,902	98	-
LIABILITIES							
Foreign Currency Financial Liabilities							
Short-term Foreign Currency Financial Liabilities	1,092	1,092	-	-	-	-	-
Securities Sold under Agreements to Repurchase	475	475	-	-	-	-	-
Derivative Financial Liabilities	466	-	466	-	-	-	-
Term Liabilities	2,448	2,448	-	-	-	-	-
Total Foreign Currency Financial Liabilities	4,481	4,015	466	-	-	-	-
Local Currency Financial Liabilities							
Deposits	19,627	19,627	-	-	-	-	-
Currency in Circulation	4,173	-	-	-	-	-	4,173
Other Local Currency Financial Liabilities	84	-	-	-	-	-	84
Total Local Currency Financial Liabilities	23,884	19,627	-	-	-	-	4,257
Total Financial Liabilities	28,365	23,642	466	-	-	-	4,257

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. Refer to page 68 for details of the classification by valuation hierarchy of financial assets and financial liabilities carried at fair value.

(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.

DETERMINATION OF FAIR VALUE OF FINANCIAL INSTRUMENTS CARRIED AT FAIR VALUE

Each financial instrument carried at fair value is categorised within the hierarchy based on the lowest-level input that is significant to the fair value measurement of the whole instrument.

Fair values are determined according to the following hierarchy:

(a) Quoted Market Price

Financial instruments with quoted prices for identical instruments in active markets (level 1).

(b) Valuation Technique Using Observable Inputs

Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets, and financial instruments valued using models where all significant inputs are observable (level 2).

The determination of what constitutes 'observable' requires significant judgement by the Bank. The Bank considers observable data to be that market data that is available readily, distributed or updated regularly, reliable and verifiable, not proprietary, and provided by independent sources that are involved actively in the relevant market. Judgement is required to be exercised also in determining appropriate margins to representative forward prices and interest rate yield curves in order to model more accurately the market price of the specific instrument that is being valued.

Where necessary, valuation models include estimated future cash flows and discount rates that are calculated using forward prices and interest rate yield curves. Forward prices and interest rate yield curves are sourced from the relevant published market observable exchange rates and interest rates applicable to the remaining life of the instrument at the valuation date. Also, where necessary, margin adjustments are made to representative prices and interest rate yield curves in order to allow for features of the instrument that would be taken into account in valuing a financial instrument, where those features are not included or priced into representative forward prices and interest rate yield curves.

(c) Valuation Technique with Significant Non-observable Inputs

Financial instruments valued using models where one or more significant inputs are not observable (level 3).

CHANGE IN VALUATION CATEGORY FOR SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL AND SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

All securities purchased under agreements to resell and securities sold under agreements to repurchase are now classified as using level 2 (using observable inputs) rather than level 1 (quoted market price). Whilst the market quotes prices for securities purchased under agreements to resell and securities sold under agreements to repurchase for high-quality securities, there is no secondary market for existing agreements to repurchase or resell. Using level 2 classification for securities purchased under agreements to resell and securities sold under agreements to repurchase is consistent with market practice. In the Bank's 2011 financial statements, foreign currency securities purchased under agreements to resell with a market value of $3,803 million and local currency securities sold under agreements to repurchase with a market value of $475 million were classified as level 1. In the comparative figures within the 2012 financial statements, these financial instruments are classified as level 2.

The following table analyses the basis for the valuation of financial assets and financial liabilities measured at fair value:

As at 30 June 2012	Total $M	Valuation Techniques: Quoted Market Price $M	Using Observable Inputs $M	With Significant Non-observable Inputs $M
ASSETS				
Foreign Currency Financial Assets				
Cash Balances	**2,785**	**2,783**	**2**	**-**
Securities Purchased under Agreements to Resell	**4,566**	**-**	**4,566**	**-**
Marketable Securities	**12,780**	**5,464**	**7,316**	**-**
Derivative Financial Assets	**1,700**	**-**	**1,700**	**-**
Other Foreign Currency Financial Assets	**139**	**-**	**-**	**139**
Total Foreign Currency Financial Assets Carried at Fair Value	**21,970**	**8,247**	**13,584**	**139**
Local Currency Financial Assets				
Securities Purchased under Agreements to Resell	**1,501**	**-**	**1,501**	**-**
New Zealand Government Securities	**3,193**	**3,193**	**-**	**-**
Total Local Currency Financial Assets Carried at Fair Value	**4,694**	**3,193**	**1,501**	**-**
Total Financial Assets Carried at Fair Value	**26,664**	**11,440**	**15,085**	**139**
LIABILITIES				
Foreign Currency Financial Liabilities				
Short-term Foreign Currency Financial Liabilities	**1,064**	**-**	**1,064**	**-**
Securities Sold under Agreements to Repurchase	**606**	**-**	**606**	**-**
Derivative Financial Liabilities	**306**	**-**	**306**	**-**
Term Liabilities	**2,148**	**-**	**2,148**	**-**
Total Foreign Currency Financial Liabilities Carried at Fair Value	**4,124**	**-**	**4,124**	**-**
Local Currency Financial Liabilities				
Deposits	**15,262**	**15,262**	**-**	**-**
Securities Sold under Agreements to Repurchase	**119**	**-**	**119**	**-**
Total Local Currency Financial Liabilities Carried at Fair Value	**15,381**	**15,262**	**119**	**-**
Total Financial Liabilities Carried at Fair Value	**19,505**	**15,262**	**4,243**	**-**

As at 30 June 2011	Total $M	Valuation Techniques: Quoted Market Price $M	Using Observable Inputs $M	With Significant Non-observable Inputs $M
ASSETS				
Foreign Currency Financial Assets				
Cash Balances	1,959	1,958	1	-
Securities Purchased under Agreements to Resell	3,803	-	3,803	-
Marketable Securities	16,574	3,264	13,310	-
Derivative Financial Assets	2,080	-	2,080	-
Other Foreign Currency Financial Assets	134	-	-	134
Total Foreign Currency Financial Assets Carried at Fair Value	24,550	5,222	19,194	134
Local Currency Financial Assets				
Securities Purchased under Agreements to Resell	2,591	-	2,591	-
New Zealand Government Securities	3,768	3,768	-	-
Total Local Currency Financial Assets Carried at Fair Value	6,359	3,768	2,591	-
Total Financial Assets Carried at Fair Value	30,909	8,990	21,785	134
LIABILITIES				
Foreign Currency Financial Liabilities				
Short-term Foreign Currency Financial Liabilities	1,092	-	1,092	-
Securities Sold under Agreements to Repurchase	475	-	475	-
Derivative Financial Liabilities	466	-	466	-
Term Liabilities	2,448	-	2,448	-
Total Foreign Currency Financial Liabilities Carried at Fair Value	4,481	-	4,481	-
Local Currency Financial Liabilities				
Deposits	19,627	19,627	-	-
Total Local Currency Financial Liabilities Carried at Fair Value	19,627	19,627	-	-
Total Financial Liabilities Carried at Fair Value	24,108	19,627	4,481	-

ADDITIONAL INFORMATION FOR FINANCIAL INSTRUMENTS CARRIED AT FAIR VALUE WHERE THE VALUATION INCORPORATES NON-OBSERVABLE MARKET DATA

Financial instruments carried at fair value where the valuation incorporates non-observable market data comprise the Bank's shares in the Bank for International Settlements (BIS). The Bank's investment in shares issued by the BIS is valued at fair value, which is determined as being 70 percent of the Bank's interest in the BIS's net asset value. This is the valuation basis confirmed by the International Court at The Hague in 2002 for the acquisition of shares from former private shareholders of the BIS. While the Bank considers that the 30 percent discount against the BIS's net asset value continues to be the appropriate basis for valuation, the valuation inputs are not considered to be observable and, therefore, it has classified the shares as level 3: Valuation Technique with Significant Non-observable Inputs.

The following table details movements in the level 3 assets. There have been no transfers between level 1 and level 2 assets except that all Securities Purchases under Agreements to Resell are classified as level 2 assets.

	2012 $M	2011 $M
Opening Balance	**134**	140
New Purchases and Sales	**-**	-
Transfers into the Category	**-**	-
Transfers out of the Category	**-**	-
Fair Value Gain Recognised in the Consolidated Statement of Comprehensive Income Recorded in:		
Movement in Available-for-sale Revaluation Reserve taken to Equity	**5**	(6)
Closing Balance	**139**	134

COLLATERAL PLEDGED

The carrying amount of securities pledged as collateral for liabilities comprising Securities Sold under Agreements to Repurchase was $119 million (2011: $nil) and the fair value of collateral pledged was $117 million (2011: $nil). Cash collateral of $nil was provided (2011: $nil).

COLLATERAL RECEIVED

Residential Mortgage-backed Securities, Asset-backed Securities and Asset-backed Commercial Paper

The Bank has entered into reverse-repurchase agreements in respect of New Zealand dollar-denominated residential mortgage-backed securities, asset-backed securities and asset-backed commercial paper. At 30 June 2012, the principal amount subject to reverse-repurchase agreements for residential mortgage-backed securities was $nil (2011: $50 million), and asset-backed securities was $nil (2011: nil). Depending on the type of collateral received, the principal value of securities received as collateral for those repurchase agreements must be at least 105 percent (2011: 105 percent) in the case of residential mortgage-backed securities and at least 119 percent (2011: 119 percent) in the case of asset-backed securities and asset-backed commercial paper of the cash to be paid to the Bank when the securities are repurchased. The Bank does not sell or repledge that collateral unless the counterparty is in default of its obligations.

Marketable Securities

The Bank has entered into reverse-repurchase agreements in respect of New Zealand dollar-denominated marketable securities. The principal amount subject to reverse-repurchase agreements for New Zealand dollar-denominated marketable securities was $1,501 million (2011: $2,540 million) and the fair value of collateral received was $1,527 million (2011: $2,613 million). The Bank may sell or repledge that collateral even if the counterparty is not in default of its obligations.

The Bank has entered into reverse-repurchase agreements in respect of foreign currency-denominated marketable securities. The principal amount subject to reverse-repurchase agreements for foreign currency-denominated marketable securities was $3,962 million (2011: $3,326 million). The fair value of collateral received was $4,043 million (2011: $3,385 million). The Bank may sell or repledge that collateral even if the counterparty is not in default of its obligations.

Other Collateral Received

In addition, cash collateral received is $1,064 million (2011: $1,092 million). Cash collateral received is recorded in the Statement of Financial Position in Short-term Deposits within Short-term Foreign Currency Financial Liabilities.

Under the Bank's securities lending programme, the Bank has lent securities with a fair value of $606 million (2011: $475 million). The Bank has accepted securities with a fair value of $619 million (2011: $485 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, excluding derivatives, was $23 million less (2011: $27 million less) than the contractual amount at maturity.

Interest rates that are used as observable inputs in determining the fair value of financial liabilities will inherently include a component for credit risk. However, given the Bank's status as a sovereign issuer, it is difficult to isolate and accurately measure the change in interest rates and the resulting change in fair value of financial liabilities directly attributable to credit risk.

With respect to the credit ratings assigned to debt issued by the New Zealand government, in September 2011 Standard and Poor's cut its long-term foreign currency rating on New Zealand to AA from AA+ and its long-term local currency rating on New Zealand to AA+ from AAA.

Even with the change in formal credit rating, it is not practicable to accurately isolate the impact of changes in the fair values of the Bank's liabilities that are due to changes in the Bank's own credit risk.

Collateral has been pledged for all Securities Sold under Agreements to Repurchase. 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 2012 $M	Notional Principal 2012 $M	Book Value 2011 $M	Notional Principal 2011 $M
Bond/Rate Futures				
Bond/Rate Futures Assets	**-**	**4**	-	-
Bond/Rate Futures Liabilities	**-**	**-**	-	28
Net Bond/Rate Futures Position	**-**	**4**	-	28
As at 30 June 2012, the Bank had 20 open Interest Rate Futures contracts (2011: 134).				
Cross Currency Basis Swaps				
Cross Currency Basis Swaps Assets	**1,476**	**10,632**	1,648	9,004
Cross Currency Basis Swaps Liabilities	**(263)**	**2,224**	(446)	3,096
Net Foreign Currency Swaps Position	**1,213**	**12,856**	1,202	12,100
Foreign Exchange Swaps				
Foreign Exchange Swaps Assets	**224**	**5,604**	432	11,816
Foreign Exchange Swaps Liabilities	**(43)**	**3,232**	(20)	1,010
Net Foreign Exchange Contracts Position	**181**	**8,836**	412	12,826
Total Derivative Financial Assets	**1,700**	**16,240**	2,080	20,820
Total Derivative Financial Liabilities	**(306)**	**5,456**	(466)	4,134
Net Derivative Financial Instruments Recognised in the Statement of Financial Position	**1,394**	**21,696**	1,614	24,954

5. OTHER FOREIGN CURRENCY FINANCIAL ASSETS

	2012 $M	2011 $M
Shareholding in the Bank for International Settlements	**139**	134
Dividend Receivable	**-**	2
Receivable for Unsettled Sales of Securities	**1**	95
	140	231

As at 30 June 2012, the Bank owned 3,211 shares (2011: 3,211 shares) issued by the Bank for International Settlements (BIS). This represents approximately 0.6 percent of all shares on issue. The shares have a par value of SDR 5,000 each and are paid up to SDR 1,250 each. The Bank's investment in shares issued by the BIS is valued at fair value, which is determined as being 70 percent of the Bank's interest in the BIS's net asset value. This is the valuation basis confirmed by the International Court at The Hague for the acquisition of shares from former private shareholders of the BIS.

6. OTHER ASSETS

	Note	2012 $M	2011 $M
Property, Plant and Equipment	7	**56**	57
Intangible Assets	8	**6**	6
Inventory		**16**	20
		78	83

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 2011						
Cost (includes revaluations)	71	48	6	7	5	5
Accumulated Depreciation	14	2	3	6	3	-
Net Book Value	57	46	3	1	2	5
For the Year Ended 30 June 2012						
Net Book Value at the Beginning of the Year	**57**	**46**	**3**	**1**	**2**	**5**
Additions	**3**	**-**	**1**	**1**	**1**	**-**
Revaluation	**(4)**	**(4)**	**-**	**-**	**-**	**-**
Accumulated Depreciation Written Back	**3**	**3**	**-**	**-**	**-**	**-**
Less Depreciation	**3**	**1**	**-**	**1**	**1**	**-**
Net Book Value at the End of the Year	**56**	**44**	**4**	**1**	**2**	**5**
As at 30 June 2012						
Cost (includes revaluations)	**70**	**44**	**7**	**8**	**6**	**5**
Accumulated Depreciation	**14**	**-**	**3**	**7**	**4**	**-**
Net Book Value	**56**	**44**	**4**	**1**	**2**	**5**

The Bank obtains an independent valuation of land and buildings every three years. The most recent valuation of land and buildings, dated 30 June 2012, 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 8.5 percent. The aggregate market value of land and buildings was $44 million. The original cost was $10 million.

8. INTANGIBLE ASSETS

	Computer Software $M
As at 30 June 2011	
Cost	20
Accumulated Amortisation	14
Net Book Value	6
For the Year Ended 30 June 2012	
Net Book Value at the Beginning of the Year	**6**
Additions	**1**
Less Amortisation	**1**
Net Book Value at the End of the Year	**6**
As at 30 June 2012	
Cost	**21**
Accumulated Amortisation	**15**
Net Book Value	**6**

9. SHORT-TERM FOREIGN CURRENCY FINANCIAL LIABILITIES

	2012 $M	2011 $M
Payable for Unsettled Purchases of Securities	**5**	-
Short-term Deposits	**1,064**	1,092
	1,069	1,092

10. DEPOSITS

	2012 $M	2011 $M
New Zealand Government Deposits	**9,095**	13,099
Settlement Bank Deposits	**6,134**	6,470
Central Bank Deposits	**26**	51
International Monetary Fund Deposits	**7**	7
	15,262	19,627

11. OTHER LOCAL CURRENCY FINANCIAL LIABILITIES

	2012 $M	2011 $M
Accounts Payable	**3**	2
Demonetised Currency	**82**	82
	85	84

12. OTHER LIABILITIES

	Note	2012 $M	2011 $M
Dividend Payable to the New Zealand Government	13	**160**	210
Accrued Salaries and Holiday Pay		**1**	2
Accrued Retirement Gratuities		**3**	3
Superannuation Liability	29	**8**	1
		172	216

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.

13. PAYMENTS TO THE NEW ZEALAND GOVERNMENT

The Bank has recommended that a statutory dividend of $160 million be paid for the 2011-12 financial year. The Minister has given a direction that a dividend of $160 million (2011: $210 million) be paid. The dividend will be paid in September 2012.

In making dividend determinations, the Minister must have regard to the recommendations of the Bank, the views of the Board of Directors of the Bank and any other relevant matters.

The Bank's *Statement of Intent* includes a statement of the principles in accordance with which the Bank must determine the amount it recommends to the Minister as an annual dividend. Those principles are:

- The Bank should maintain sufficient equity for the financial risks of performing its functions. Equity in excess of that required to cover those risks will be distributed to the Crown.
- In general, unrealised gains should be retained by the Bank until they are realised in New Zealand dollars. However, the Bank may recommend the distribution of unrealised gains where the Bank believes that the probability of the gain being realised is high.

14. EQUITY

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

	Note	2012 $M	2011 $M
Capital			
Balance at the Beginning of the Year		**1,600**	1,600
Total Capital		**1,600**	1,600
Retained Earnings			
Balance at the Beginning of the Year		**645**	711
Net Profit for the Year		**118**	144
Dividend Payable to the New Zealand Government	13	**(160)**	(210)
Total Retained Earnings		**603**	645
Available-for-sale Revaluation Reserve			
Balance at the Beginning of the Year		**217**	216
Fair Value Movements during the Year		**136**	1
Total Available-for-sale Revaluation Reserve		**353**	217
Property Revaluation Reserve			
Balance at the Beginning of the Year		**42**	42
Fair Value Movements during the Year	7	**(1)**	-
Total Property Revaluation Reserve		**41**	42
Currency and Artwork Collections and Archives Revaluation Reserve			
Balance at the Beginning of the Year		**5**	5
Total Currency and Artwork Collections and Archives Revaluation Reserve		**5**	5
Total Equity		**2,602**	2,509

Retained Earnings comprises:

	2012 $M	2011 $M
Realised Gains not yet Distributed	**749**	682
Changes in the Market Value of Financial Instruments not yet Realised	**(29)**	43
Foreign Exchange Losses not yet Realised in New Zealand Dollars	**(117)**	(80)
Total Retained Earnings	**603**	645

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 dividend. The dividend is determined annually by the Minister of Finance under the provisions of the Reserve Bank Act and the principles referred to in Note 13.

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. The Bank assesses the appropriate ranges for capital by considering financial risks across the Statement of Financial Position, including the use of statistical models at varying levels of confidence, and supplements that analysis with judgement, where appropriate.

15. CONCENTRATIONS OF FUNDING

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

	Total 2012 $M	New Zealand Government $M	New Zealand Public $M	New Zealand Financial Institutions $M	Overseas Financial Institutions $M	Other $M
Financial Liabilities						
Term Liabilities	**2,148**	**2,148**	**-**	**-**	**-**	**-**
Securities Sold under Agreements to Repurchase	**725**	**-**	**-**	**-**	**725**	**-**
Deposits	**15,262**	**9,095**	**-**	**4,531**	**1,636**	**-**
Currency in Circulation	**4,375**	**-**	**4,375**	**-**	**-**	**-**
Other Liabilities	**1,460**	**-**	**82**	**505**	**870**	**3**
Total Financial Liabilities	**23,970**	**11,243**	**4,457**	**5,036**	**3,231**	**3**

	Total 2011 $M	New Zealand Government $M	New Zealand Public $M	New Zealand Financial Institutions $M	Overseas Financial Institutions $M	Other $M
Financial Liabilities						
Term Liabilities	2,448	2,448	-	-	-	-
Securities Sold under Agreements to Repurchase	475	-	-	-	475	-
Deposits	19,627	13,099	-	4,128	2,400	-
Currency in Circulation	4,173	-	4,173	-	-	-
Other Liabilities	1,642	-	82	683	875	2
Total Financial Liabilities	28,365	15,547	4,255	4,811	3,750	2

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

16. RISK MANAGEMENT

The Reserve Bank is involved in policy-oriented activities. Therefore, elements of the Bank's risk management framework might differ from the risk management frameworks for most other financial institutions. The main financial risks to which the Bank is exposed include credit risk, foreign currency 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 Bank's strategy, risks and performance of all balance sheet-related activities. This review includes the appropriateness of risk-return trade-offs underlying the Bank's 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 promote 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. 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 Head of Risk Assessment and Assurance and the Manager, Internal Audit have direct and independent access to the Audit Committee of the Board of Directors, comprising three of the Bank's non-executive directors. Summary information on the outcomes of internal audits is reported to the Audit Committee.

The Bank is subject to an annual external audit by the 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 to create awareness of policy and system 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 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 issuer. Additionally, sovereign and supranational issuers are assigned a higher limit than similarly rated corporates. Individual credit exposures are also aggregated and managed against 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 cash or by securities issued by sovereign states, 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.

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

As part of the arrangements for using financial instruments, credit risk is mitigated 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, residential mortgage-backed securities, asset-backed securities, asset-backed commercial paper and state-owned enterprises. Where funds are advanced by reverse-repurchase agreements, the amount advanced is subject to specified discounts depending upon the type of security 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 from, or excess collateral is returned to, the counterparty as required.

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

(C) CONCENTRATIONS OF CREDIT EXPOSURE

The following table presents the Bank's financial assets based on end-of-year concentrations of credit exposure, classified by the country in which the issuer is resident. For this table, where collateral is held for reverse-repurchase agreements, the exposure measured is that to the issuer of the collateral, as opposed to the counterparty to the reverse-repurchase agreement.

Country in which Issuer is Resident:	**Total 2012 $M**	**Sovereign 2012 $M**	**Financial Institutions 2012 $M**	Total 2011 $M	Sovereign 2011 $M	Financial Institutions 2011 $M
United States	**9,664**	**9,283**	**381**	5,722	5,414	308
New Zealand	**5,289**	**4,648**	**641**	7,192	5,977	1,215
France	**2,613**	**1,416**	**1,197**	3,176	384	2,792
Germany	**1,621**	**285**	**1,336**	4,923	2,089	2,834
Netherlands	**1,401**	**167**	**1,234**	2,603	210	2,393
Australia	**1,327**	**18**	**1,309**	1,842	20	1,822
Japan	**1,262**	**1,262**	**-**	862	862	-
Supranational	**1,104**	**-**	**1,104**	2,909	-	2,909
Sweden	**752**	**-**	**752**	639	-	639
Denmark	**485**	**-**	**485**	-	-	-
Austria	**378**	**-**	**378**	576	-	576
United Kingdom	**301**	**244**	**57**	212	22	190
Canada	**163**	**125**	**38**	37	20	17
Asian Bond Funds	**149**	**-**	**149**	137	-	137
Other Non-European	**115**	**-**	**115**	61	-	61
Switzerland	**42**	**-**	**42**	116	-	116
Total Financial Assets	**26,666**	**17,448**	**9,218**	31,007	14,998	16,009

The following table presents the Bank's financial assets based on end-of-year concentrations of credit exposure, classified by the country in which the counterparty is resident.[23] For this table, any collateral held is not included in determining exposures.

Country in which Counterparty is Resident:	**Total 2012 $M**	**Sovereign 2012 $M**	**Financial Institutions 2012 $M**	Total 2011 $M	Sovereign 2011 $M	Financial Institutions 2011 $M
United States	**5,386**	**4,719**	**667**	3,564	3,010	554
New Zealand	**4,509**	**3,193**	**1,316**	5,469	3,768	1,701
United Kingdom	**4,060**	**244**	**3,816**	3,213	22	3,191
France	**2,933**	**1,416**	**1,517**	3,731	384	3,347
Germany	**2,002**	**285**	**1,717**	3,942	690	3,252
Australia	**1,802**	**18**	**1,784**	3,180	20	3,160
Netherlands	**1,401**	**167**	**1,234**	2,603	210	2,393
Japan	**1,265**	**1,261**	**4**	862	862	-
Supranational	**1,059**	**-**	**1,059**	2,877	-	2,877
Sweden	**752**	**-**	**752**	639	-	639
Denmark	**485**	**-**	**485**	-	-	-
Austria	**378**	**-**	**378**	576	-	576
Switzerland	**207**	**-**	**207**	116	-	116
Canada	**163**	**125**	**38**	37	20	17
Asian Bond Funds	**149**	**-**	**149**	137	-	137
Other Non-European	**115**	**-**	**115**	61	-	61
Total Financial Assets	**26,666**	**11,428**	**15,238**	31,007	8,986	22,021

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 derivative assets as reported in Note 4.

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

(D) 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.

For this table, where collateral is held for reverse-repurchase agreements, the credit rating is that for the collateral and not the credit rating for the counterparty to the reverse-repurchase agreement.

Country in which Issuer is Resident:	**Total 2012 $M**	**AAA 2012 $M**	**AA+/- 2012 $M**	**A+/- 2012 $M**	**Various 2012 $M**	**N/R 2012 $M**
United States	**9,664**	**-**	**9,297**	**366**	**-**	**1**
New Zealand	**5,289**	**-**	**5,288**	**-**	**-**	**1**
France	**2,613**	**-**	**2,553**	**60**	**-**	**-**
Germany	**1,621**	**1,621**	**-**	**-**	**-**	**-**
Netherlands	**1,401**	**1,387**	**14**	**-**	**-**	**-**
Australia	**1,327**	**657**	**670**	**-**	**-**	**-**
Japan	**1,262**	**-**	**1,262**	**-**	**-**	**-**
Supranational[24]	**1,104**	**287**	**-**	**-**	**-**	**817**
Sweden	**752**	**752**	**-**	**-**	**-**	**-**
Denmark	**485**	**485**	**-**	**-**	**-**	**-**
Austria	**378**	**-**	**378**	**-**	**-**	**-**
United Kingdom	**301**	**245**	**-**	**56**	**-**	**-**
Canada	**163**	**125**	**38**	**-**	**-**	**-**
Asian Bond Funds	**149**	**-**	**-**	**-**	**149**	**-**
Other Non-European	**115**	**-**	**115**	**-**	**-**	**-**
Switzerland	**42**	**-**	**-**	**42**	**-**	**-**
Total Financial Assets	**26,666**	**5,559**	**19,615**	**524**	**149**	**819**

Country in which Issuer is Resident:	Total 2011 $M	AAA 2011 $M	AA+/- 2011 $M	A+/- 2011 $M	Various 2011 $M	N/R 2011 $M
New Zealand	7,192	6,028	1,164	-	-	-
United States	5,722	5,414	242	66	-	-
Germany	4,923	4,910	-	13	-	-
France	3,176	2,935	135	106	-	-
Supranational[24]	2,909	1,696	-	-	-	1,213
Netherlands	2,603	2,603	-	-	-	-
Australia	1,842	1,318	524	-	-	-
Japan	862	-	862	-	-	-
Sweden	639	639	-	-	-	-
Austria	576	576	-	-	-	-
United Kingdom	212	22	26	164	-	-
Asian Bond Funds	137	-	-	-	137	-
Switzerland	116	-	-	116	-	-
Other Non-European	61	-	61	-	-	-
Canada	37	20	17	-	-	-
Total Financial Assets	31,007	26,161	3,031	465	137	1,213

Collateral taken in reverse-repurchase agreements involving residential mortgage-backed securities with a carrying value of nil (2011: $50 million) is included in the table above as local currency financial assets that are AAA-rated securities. The issuers of these securities are special-purpose entities that are assigned credit ratings by rating agencies in their own right, and these ratings may differ from the credit ratings of the reverse-repurchase agreement counterparties.

Between the 2011 and 2012 years, there has been a significant movement in the value of assets with an AAA credit rating to an AA+/- credit rating. This is due principally to credit rating downgrades announced during the 2011/12 year for the United States, France and New Zealand governments.

24. Exposures to Supranational that do not have a credit rating are exposures to the Bank for International Settlements.

(E) 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 percent of the Bank's equity as at the end of the year. These exposures are measured without taking into account collateral held by the Bank for credit exposures to individual counterparties. Credit exposures are measured taking into account any enforceable rights of set-off.

Percentage of Equity	**End-of-year 2012**	End-of-year 2011
10% to 19.9%	**10**	9
20% to 29.9%	**2**	5
30% to 39.9%	**4**	3
40% to 49.9%	**2**	5
50% to 59.9%	**1**	2
60% to 69.9%	**-**	1
110% to 119.9%	**-**	1
120% to 129.9%	**1**	1
140% to 149.9%	**1**	-
150% to 159.9%	**-**	1
180% to 189.9%	**1**	-

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 measurement and mitigation of market risk. 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).

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.

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.

VAR LEVELS AND LIMITS

VaR estimates the potential daily loss from movements in market variables (security prices, 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 percent confidence interval. This means the Bank would expect to incur losses greater than those predicted by VaR estimates 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, generate a relatively small part of the Bank's aggregate exposure to market risk.

Market risk in respect of other non-trading portfolios, including positions held for crisis management and currency intervention, is managed through open position and duration-based limits augmented with monitoring of actual against expected VaR.

	Trading Portfolios		**Non-trading Portfolios**		**Trading and Non-trading Foreign Reserves Management Portfolios Combined**			
	Total Market Risk		**Total Market Risk**		**Foreign Currency Risk**	**Interest Rate Risk**	**Total Market Risk**	
VaR	**2012 $000**	2011 $000	**2012 $000**	2011 $000	**2012 $000**	**2012 $000**	**2012 $000**	2011 $000
Limit	**2,000**	2,000	**n/a**	n/a	**n/a**	**n/a**	**n/a**	n/a
As at 30 June	**574**	38	**31,175**	29,916	**28,432**	**10,410**	**31,572**	29,898
Peak over the Year	**700**	327	**36,932**	46,875	**32,747**	**12,804**	**37,011**	47,094
Low over the Year	**28**	31	**28,537**	29,916	**24,846**	**10,107**	**28,553**	29,842
Average over the Year	**197**	94	**33,460**	39,861	**29,570**	**11,218**	**33,564**	39,581

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 2012 $000	**Gain/(Loss) Reported in the Income Statement 2012 $000**	**Gain/(Loss) Reported Directly in Equity 2012 $000**	Total Gain/(Loss) Impacting Comprehen-sive Income 2011 $000	Gain/(Loss) Reported in the Income Statement 2011 $000	Gain/(Loss) Reported Directly in Equity 2011 $000
Impact of:						
A rise of 10% in the value of the New Zealand dollar	**(195,214)**	**(182,546)**	**(12,668)**	(202,469)	(190,232)	(12,237)
A fall of 10% in the value of the New Zealand dollar	**238,595**	**223,111**	**15,484**	247,462	232,506	14,956
A rise of one percentage point in the local currency yield curve	**(135,057)**	**(15,459)**	**(119,598)**	(142,769)	(26,218)	(116,551)
A fall of one percentage point in the local currency yield curve	**143,962**	**16,255**	**127,707**	150,059	26,230	123,829
A rise of one percentage point in the yield curve for all foreign currencies	**(3,900)**	**(3,900)**	**-**	(5,107)	(5,107)	-
A fall of one percentage point in the yield curve for all foreign currencies	**3,517**	**3,517**	**-**	2,826	2,826	-

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.

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 transacting foreign currency swaps in domestic market operations is constrained by an effective duration limit, which ensures that interest rate exposures are of a short-term nature. The exposure to interest rate risk arising from reverse-repurchase transactions in various liquidity facilities is managed by restricting the tenor of those transactions and by issuing Reserve Bank bills.

The average duration of the Bank's holding of New Zealand government securities in its investment portfolio (which excludes outright purchases of government securities for liquidity management purposes) as at 30 June 2012 was 3.9 years (2011: 3.2 years). Interest rate risk on New Zealand government securities is not dynamically managed and it is intended that these securities be held to maturity.

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

	Total 2012 $M	Non-interest Sensitive $M	Overnight $M	3 Months or Less $M	Between 3 and 12 Months $M	Between 1 and 2 Years $M	Between 2 and 5 Years $M	Over 5 Years $M
Assets								
Marketable Securities	12,780	-	-	11,928	703	-	52	97
Securities Purchased under Agreements to Resell	6,067	-	-	6,067	-	-	-	-
New Zealand Government Securities	3,193	-	-	-	824	-	685	1,684
Other Financial Assets	4,626	142	2,782	1,702	-	-	-	-
Other Assets	78	78	-	-	-	-	-	-
Total Assets	26,744	220	2,782	19,697	1,527	-	737	1,781
Liabilities								
Term Liabilities	2,148	-	-	2,148	-	-	-	-
Securities Sold under Agreements to Repurchase	725	-	-	725	-	-	-	-
Deposits	15,262	-	15,262	-	-	-	-	-
Currency in Circulation	4,375	4,375	-	-	-	-	-	-
Other Financial Liabilities	1,460	90	1,068	302	-	-	-	-
Other Liabilities	172	172	-	-	-	-	-	-
Equity	2,602	2,602	-	-	-	-	-	-
Total Liabilities and Equity	26,744	7,239	16,330	3,175	-	-	-	-
	-	(7,019)	(13,548)	16,522	1,527	-	737	1,781
Futures Contracts	4	-	-	-	-	3	-	1
Total Interest Rate Sensitivity Gap	4	(7,019)	(13,548)	16,522	1,527	3	737	1,782

Interest Rate Sensitivity Gap by Currency:[25]								
New Zealand dollar	(2,147)	(7,153)	(15,263)	17,076	824	-	685	1,684
United States dollar	549	56	1,475	(1,662)	624	3	52	1
Euro	490	48	168	195	79	-	-	-
Japanese yen	109	15	15	79	-	-	-	-
British pound	318	15	37	266	-	-	-	-
Australian dollar	393	1	18	374	-	-	-	-
Canadian dollar	198	(1)	2	197	-	-	-	-
Other	94	-	-	(3)	-	-	-	97
	4	(7,019)	(13,548)	16,522	1,527	3	737	1,782

25. The interest rate sensitivity gap by currency differs from the open foreign currency position by the notional principal on open futures contracts.

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

	Total 2011 $M	Non-interest Sensitive $M	Overnight $M	3 Months or Less $M	Between 3 and 12 Months $M	Between 1 and 2 Years $M	Between 2 and 5 Years $M	Over 5 Years $M
Assets								
Marketable Securities	16,574	-	-	14,392	2,045	-	137	-
Securities Purchased under Agreements to Resell	6,394	-	-	6,394	-	-	-	-
New Zealand Government Securities	3,768	-	-	-	936	845	670	1,317
Other Financial Assets	4,271	232	1,958	2,036	45	-	-	-
Other Assets	83	83	-	-	-	-	-	-
Total Assets	31,090	315	1,958	22,822	3,026	845	807	1,317
Liabilities								
Term Liabilities	2,448	-	-	2,448	-	-	-	-
Securities Sold under Agreements to Repurchase	475	-	-	475	-	-	-	-
Deposits	19,627	-	19,627	-	-	-	-	-
Currency in Circulation	4,173	4,173	-	-	-	-	-	-
Other Financial Liabilities	1,642	84	997	561	-	-	-	-
Other Liabilities	216	216	-	-	-	-	-	-
Equity	2,509	2,509	-	-	-	-	-	-
Total Liabilities and Equity	31,090	6,982	20,624	3,484	-	-	-	-
	-	(6,667)	(18,666)	19,338	3,026	845	807	1,317
Futures contracts	28	-	-	-	-	24	-	4
Total Interest Rate Sensitivity Gap	28	(6,667)	(18,666)	19,338	3,026	869	807	1,321
Interest Rate Sensitivity Gap by Currency:[26]								
New Zealand dollar	(2,227)	(6,898)	(19,627)	19,232	2,234	845	670	1,317
United States dollar	586	156	677	(674)	356	21	47	3
Euro	518	48	211	(177)	436	-	-	-
Japanese yen	117	16	11	90	-	-	-	-
British pound	236	17	22	193	-	3	-	1
Australian dollar	409	(5)	20	394	-	-	-	-
Canadian dollar	298	(1)	20	280	-	-	(1)	-
Other	91	-	-	-	-	-	91	-
	28	(6,667)	(18,666)	19,338	3,026	869	807	1,321

26. The interest rate sensitivity gap by currency differs from the open foreign currency position by the notional principal on open futures contracts.

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;
- currency intervention to meet monetary policy objectives; and
- active management undertaken in trading portfolios.

The Bank intends to hold some of its reserves on an unhedged basis through most of the exchange rate cycle. The Bank has a policy of maintaining a passive 'benchmark' open foreign exchange position of SDR 1 billion ($NZ1.9 billion), but can vary the actual open position, and thus the amount of unhedged reserves, around that benchmark level, depending on the behaviour of the exchange rate and foreign exchange markets. This variation might be significant.

For non-trading portfolios, foreign currency risk is managed by way of open position limits, target open-currency composition weights and deviation bands. 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 2012, the Bank's net exposure to major currencies, in New Zealand dollar terms, was:

	2012 $M	2011 $M
Australian dollar	**393**	409
British pound	**318**	232
Canadian dollar	**198**	298
Euro	**490**	518
Japanese yen	**109**	117
Swiss francs	**(3)**	-
United States dollar	**545**	562
Various currencies (Asian Bond Fund 2)	**97**	91
Total Net Open Foreign Exchange Position	**2,147**	2,227

At 30 June 2012, the net open foreign exchange position was SDR 1,130 million (2011: SDR 1,153 million). The quantum of the open position varies over time to the level the Bank determines is warranted by its policy objectives and economic conditions. The largest net open foreign exchange position (measured in SDR terms) during the 12 months ended 30 June 2012 was SDR 1,157 million ($NZ 2,133 million) (2011: SDR 1,393 million ($NZ 2,951 million)). The smallest net open foreign exchange position (measured in SDR terms) during the 12 months ended 30 June 2012 was SDR 1,110 million ($NZ 2,327 million) (2011: SDR 1,143 million ($NZ 2,256 million)).

22. LIQUIDITY RISK

Liquidity risk is the risk that the Bank will encounter difficulty in meeting financial obligations associated with financial liabilities that are settled by delivering cash or another financial asset. 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.

(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 a required composition of portfolios based on the liquidity characteristics of securities, with defined minimum levels, duration, and limits on the minimum and maximum proportion of reserves that may be held in any one currency. Day-to-day foreign currency liquidity is managed through forecasting cash inflows and outflows.

At 30 June 2012, foreign currency assets valued at $18,736 million were classified as being able to be settled within two business days of being liquidated (30 June 2011: $21,445 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, and by issuing Reserve Bank bills. 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.

Deposits, which are on-demand liabilities, are managed taking into account the Bank's ability to create New Zealand dollar liquidity through its daily market operations. In all other respects, the Bank manages liquidity on a contractual maturity basis, which is consistent with the expected maturities of financial instruments.

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.

Contractual maturities exclude the following assets, which have no fixed maturity dates: Asian Bond Fund 1, Asian Bond Fund 2, and shares in the Bank for International Settlements. The aggregate carrying value of these assets at 30 June 2012 was $288 million (2011: $272 million).

	Total 2012 $M	On Demand $M	3 Months or Less $M	3 to 12 Months $M	1 to 2 Years $M	2 to 5 Years $M	Over 5 Years $M
Foreign Currency Financial							
Assets							
Cash Balances	2,785	2,785	-	-	-	-	-
Securities Purchased under Agreements to Resell	4,569	-	4,569	-	-	-	-
Marketable Securities	12,643	-	11,940	703	-	-	-
Other Foreign Currency Financial Assets	1	-	1	-	-	-	-
	19,998	2,785	16,510	703	-	-	-
Foreign Currency Financial							
Liabilities							
Short-term Foreign Currency Financial Liabilities	1,069	1,069	-	-	-	-	-
Securities Sold under Agreements to Repurchase	606	-	606	-	-	-	-
Term Liabilities	2,155	-	-	344	144	747	920
	3,830	1,069	606	344	144	747	920
Foreign Currency Derivatives							
Contractual Inflows	4,764	-	1,831	1,259	1,040	559	75
Contractual Outflows	(19,381)	-	(9,170)	(3,200)	(1,894)	(3,366)	(1,751)
	(14,617)	-	(7,339)	(1,941)	(854)	(2,807)	(1,676)
Foreign Currency Net Gap in Contractual Maturities	1,551	1,716	8,565	(1,582)	(998)	(3,554)	(2,596)
Local Currency Financial Assets							
Securities Purchased under Agreements to Resell	1,501	-	1,501	-	-	-	-
New Zealand Government Securities	3,610	-	8	952	120	903	1,627
Other Local Currency Financial Assets	1	-	1	-	-	-	-
	5,112	-	1,510	952	120	903	1,627
Local Currency Financial Liabilities							
Deposits	15,262	15,262	-	-	-	-	-
Securities Sold under Agreements to Repurchase	119	-	119	-	-	-	-
Currency in Circulation	4,375	4,375	-	-	-	-	-
Other Local Currency Financial Liabilities	85	82	3	-	-	-	-
	19,841	19,719	122	-	-	-	-
Local Currency Derivatives							
Contractual Inflows	17,900	-	7,758	2,511	1,544	3,863	2,224
Contractual Outflows	(1,024)	-	(106)	(97)	(193)	(519)	(109)
	16,876	-	7,652	2,414	1,351	3,344	2,115
Local Currency Net Gap in Contractual Maturities	2,147	(19,719)	9,040	3,366	1,471	4,247	3,742
Total Net Gap in Contractual Maturities	3,698	(18,003)	17,605	1,784	473	693	1,146

	Total 2011 $M	On Demand $M	3 Months or Less $M	3 to 12 Months $M	1 to 2 Years $M	2 to 5 Years $M	Over 5 Years $M
Foreign Currency Financial							
Assets							
Cash Balances	1,959	1,959	-	-	-	-	-
Securities Purchased under Agreements to Resell	3,803	-	3,803	-	-	-	-
Marketable Securities	16,444	-	14,396	2,048	-	-	-
Other Foreign Currency Financial Assets	97	-	97	-	-	-	-
	22,303	1,959	18,296	2,048	-	-	-
Foreign Currency Financial							
Liabilities							
Short-term Foreign Currency Financial Liabilities	1,092	1,092	-	-	-	-	-
Securities Sold under Agreements to Repurchase	475	-	475	-	-	-	-
Term Liabilities	2,648	-	1	330	357	977	983
	4,215	1,092	476	330	357	977	983
Foreign Currency Derivatives							
Contractual Inflows	5,237	-	1,957	1,286	1,062	607	325
Contractual Outflows	(22,138)	-	(11,275)	(3,433)	(2,661)	(2,689)	(2,080)
	(16,901)	-	(9,318)	(2,147)	(1,599)	(2,082)	(1,755)
Foreign Currency Net Gap in Contractual Maturities	1,187	867	8,502	(429)	(1,956)	(3,059)	(2,738)
Local Currency Financial Assets							
Securities Purchased under Agreements to Resell	2,592	-	2,592	-	-	-	-
New Zealand Government Securities	4,395	-	52	1,054	949	907	1,433
Other Local Currency Financial Assets	1	-	1	-	-	-	-
	6,988	-	2,645	1,054	949	907	1,433
Local Currency Financial Liabilities							
Deposits	19,627	19,627	-	-	-	-	-
Currency in Circulation	4,173	4,173	-	-	-	-	-
Other Local Currency Financial Liabilities	84	82	2	-	-	-	-
	23,884	23,882	2	-	-	-	-
Local Currency Derivatives							
Contractual Inflows	21,360	-	9,867	3,226	2,204	3,297	2,766
Contractual Outflows	(1,971)	-	(112)	(885)	(112)	(358)	(504)
	19,389	-	9,755	2,341	2,092	2,939	2,262
Local Currency Net Gap in Contractual Maturities	2,493	(23,882)	12,398	3,395	3,041	3,846	3,695
Total Net Gap in Contractual Maturities	3,680	(23,015)	20,900	2,966	1,085	787	957

24. NET INVESTMENT INCOME

Net Investment Income includes:

	Total 2012 $M	Foreign Currency $M	Local Currency $M	Total 2011 $M	Foreign Currency $M	Local Currency $M
Interest Income						
Cash Balances	**5**	**5**	**-**	4	4	-
Securities Purchased Under Agreements to Resell	**27**	**8**	**19**	21	5	16
Marketable Securities	**43**	**43**	**-**	45	45	-
Derivative Financial Instruments	**377**	**(35)**	**412**	386	(13)	399
New Zealand Government Securities	**203**	**-**	**203**	214	-	214
Total Interest Income	**655**	**21**	**634**	670	41	629
Interest Expense						
Securities Sold Under Agreements to Repurchase	**3**	**-**	**3**	4	-	4
Term Liabilities	**4**	**4**	**-**	-	-	-
New Zealand Government Deposits	**186**	**-**	**186**	158	-	158
Settlement Bank Deposits	**180**	**-**	**180**	206	-	206
Other	**2**	**1**	**1**	-	-	-
Total Interest Expense	**375**	**5**	**370**	368	-	368
Net Interest Income	**280**	**16**	**264**	302	41	261
Net Gains/(Losses) from Fair Value Changes	**(73)**	**(77)**	**4**	31	31	-
Net Losses from Foreign Exchange Rate Changes	**(38)**	**(38)**	**-**	(144)	(144)	-
Dividend Income	**2**	**2**	**-**	2	2	-
Total Net Investment Income/(Loss)	**171**	**(97)**	**268**	191	(70)	261

Interest income from the New Zealand government (including entities controlled by the New Zealand government) comprised 31 percent (2011: 32 percent) of total interest received.

COMPONENTS OF NET INVESTMENT INCOME FROM FINANCIAL INSTRUMENTS

Net Investment Income includes net income/(expense) arising from:

	2012 $M	2011 $M
Financial Assets and Financial Liabilities Classified as Fair Value through Profit or Loss upon Initial Recognition	**(398)**	(409)
Derivative Instruments Deemed to be Classified as Held for Trading	**377**	386
Financial Assets and Financial Liabilities Classified as Held for Trading	**-**	(2)
Interest and Dividend Income from Available-for-sale Financial Assets	**192**	216
Total Net Investment Income/(Loss)	**171**	191

	2012 $M	2011 $M
Market Value Gains and Foreign Exchange Gains on Financial Assets Classified as Available-for-sale reported in the Income Statement	**-**	-
Interest Expense on Financial Liabilities Measured at Amortised Cost	**-**	-
Market Value Changes and Foreign Exchange Rate Changes on Financial Liabilities Measured at Amortised Cost reported in the Income Statement	**-**	-

25. INCOME AND EXPENDITURE BY FUNCTION

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

For the year ended 30 June	Operating Income 2012 $M	Attribution of Earnings on Investments Funded by Equity 2012 $M	Operating Expenses 2012 $M	Net Profit/ (Loss) 2012 $M
FUNCTIONS				
Monetary Policy Formulation	**-**	**-**	**12**	**(12)**
Domestic Market Operations	**11**	**24**	**6**	**29**
Prudential Supervision	**-**	**-**	**14**	**(14)**
Macro-Financial Stability	**-**	**-**	**4**	**(4)**
Currency Operations	**190**	**1**	**12**	**179**
Foreign Reserves Management	**(123)**	**68**	**8**	**(63)**
Settlement Services	**8**	**-**	**5**	**3**
Total for Bank before Earnings on Investments Funded by Equity	**86**	**93**	**61**	**118**
Earnings not Allocated to Functions:				
Earnings on Investments Funded by Equity	**93**	**(93)**	**-**	**-**
Total for Bank	**179**	**-**	**61**	**118**
Income Retained under the Funding Agreement			**8**	
Net Operating Expenses			**53**	

For the year ended 30 June	Operating Income 2011 $M	Attribution of Earnings on Investments Funded by Equity 2011 $M	Operating Expenses 2011 $M	Net Profit/(Loss) 2011 $M
FUNCTIONS				
Monetary Policy Formulation	-	-	10	(10)
Domestic Market Operations	22	15	6	31
Financial System Surveillance and Policy	-	-	13	(13)
Currency Operations	194	-	13	181
Foreign Reserves Management	(134)	94	7	(47)
Settlement Services	4	-	2	2
Registry and Depository Services	4	-	3	1
Other Outputs	-	-	1	(1)
Total for Bank before Earnings on Investments Funded by Equity	90	109	55	144
Earnings not Allocated to Functions:				
Earnings on Investments Funded by Equity	109	(109)	-	-
Total for Bank	199	-	55	144
Income Retained under the Funding Agreement			8	
Net Operating Expenses			47	

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 from the investment of equity are allocated to individual functions based on the estimated level of equity required for that function. The total operating expenses for each function include internal transfers between functions.

26. OPERATING EXPENSES

	Note	2012 $M	2011 $M
Staff Expenses		**28**	27
Net Currency-issued Expenses		**5**	7
Asset Management Expenses		**7**	7
Other Operating Expenses		**15**	14
Total Operating Expenses excluding Actuarial (Gain)/Loss on Defined Benefit Superannuation Scheme		**55**	55
Actuarial Loss on Defined Benefit Superannuation Scheme	29	**6**	-
Total Operating Expenses		**61**	55

	2012 $000	2011 $000
Operating Expenses includes:		
Depreciation of Property, Plant and Equipment	**3,154**	3,173
Amortisation of Intangible Assets	**1,286**	1,905
Impairment Charges for Property, Plant and Equipment	**-**	-
Impairment Charges for Intangible Assets	**-**	-
Bad Debt Expenses	**-**	-
Rental and Lease Expenses	**348**	502
Auditor's Remuneration:		
Statutory Audit	**235**	227
Payment Systems Audits	**122**	63
Advisory Services	**24**	8

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

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

The Advisory Services expense comprises fees for advice on financial reporting and the operation and assessment of 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, aggregate compensation paid to key management personnel comprised:

	2012 $000	2011 $000
Salaries, Superannuation Contributions and Other Short-term Benefits	**1,710**	1,668
Total Key Management Personnel Compensation	**1,710**	1,668

This table includes all compensation paid to key management personnel.

27. RECONCILIATION OF NET CASH FLOWS FROM OPERATING ACTIVITIES WITH NET PROFIT/(LOSS) FOR THE YEAR

	2012 $M	2011 $M
Net Profit/(Loss) for the Year	**118**	144
Add/(Subtract) Items included in Net Profit/(Loss) relating to cash flows from changes in Operating Assets and Operating Liability Balances, Investing and Financing Activities:		
Foreign Exchange (Gains)/Losses[27]	**38**	144
Market Value Changes	**73**	(31)
Add/(Subtract) Non-cash Items:		
Depreciation and Amortisation	**4**	5
Amortisation of Premium/Discount on Financial Instruments	**12**	(22)
Net Movement in Repatriated Currency Income and Expense	**(1)**	1
	126	97
Movements in Other Working Capital Items		
Decrease/(Increase) in Current Assets:		
Movement in Accounts Receivable	**2**	3
Movement in Inventories	**4**	5
Movement in Interest Receivable	**6**	(9)
	12	(1)
Increase/(Decrease) in Current Liabilities:		
Movement in Miscellaneous Liabilities	**5**	-
Movement in Interest Payable	**2**	1
	7	1
Net Movements in Other Working Capital Items	**19**	-
Operating Cash Flows from Income and Expenses	**263**	241
Cash Flows from Changes in Operating Assets and Operating Liability Balances	**155**	414
	155	414
Net Cash Flows from Operating Activities	**418**	655

27. Foreign Exchange (Gains)/Losses includes the Foreign Exchange Rate Effect on Cash Balances at the Beginning of the Year in the Consolidated Statement of Cash Flows on pages 57 and 58.

28. STATEMENT OF COMMITMENTS

(A) PROVISION OF FUNDING TO THE NEW ZEALAND FINANCIAL SYSTEM

As New Zealand's central bank, the Bank is able to create New Zealand dollar liquidity through its liquidity management operations, which include the daily open market operations. The Bank's open market operations include providing New Zealand dollar liquidity facilities to eligible borrowers on terms stipulated by the Bank, including the provision of approved collateral.

(B) RECIPROCAL FUNDING ARRANGEMENTS WITH FOREIGN CENTRAL BANKS

On 18 April 2011, the People's Bank of China (PBOC) and the Bank established a reciprocal currency arrangement (swap line) to support the settlement of trade transactions between New Zealand and Chinese businesses in circumstances where it might otherwise be difficult to settle obligations in Chinese renminbi (RMB). The swap facility provides for the PBOC and the Bank to enter into foreign exchange swap transactions that have a total value at any point in time of up to RMB 25 billion (NZD 5 billion), with the terms of the foreign exchange swaps to be agreed at the time the swaps are entered into. The swap line is for a term of three years, which may be extended if both parties agree. No drawings have been made under this arrangement in the year ended 30 June 2012 (2011: nil).

The Bank also has a reciprocal arrangement with the Hong Kong Monetary Authority, which allows either party to enter into repurchase agreements with the other to raise up to USD250 million, secured by US government securities. The existing arrangement expires on 31 March 2013, but may be extended by mutual agreement. No drawings have been made under this arrangement in the year ended 30 June 2012 (2011: nil).

(C) COMMITMENTS TO THE NEW ZEALAND GOVERNMENT

In January 2010, the Bank agreed to make available to the New Zealand government up to SDR 624.34 million from foreign reserves on an arm's length basis, if the International Monetary Fund (IMF) makes a call on the New Zealand government in respect of the government's commitment under the IMF's "New Arrangements to Borrow" facility and it is determined that this is the most efficient means of effecting settlement of the government's commitment. The Bank has increased its holdings of foreign reserves by SDR 200 million to partially reflect this contingent call on foreign reserves. In the event that the government is required to make payment to the IMF under this facility and the Bank provides the funds to the government, the Bank's foreign reserves intervention capacity will be reduced until such time as the government repays the Bank. During the year ended 30 June 2012, no funds had been made available to the government under this arrangement (year ended 30 June 2011: nil).

Further, the Bank is in discussions with the Treasury regarding similar settlement arrangements in respect of an additional USD $1 billion standby loan facility commitment to the IMF agreed to by the government in June 2012. When this proposed commitment is made, it will be a contingent call on foreign reserves. The Bank intends to increase its holdings of foreign reserves by a proportion of the commitment once the commitment is made.

(D) 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.

	2012 $000	2011 $000
Office Equipment and Premises Operating Leases		
Due within One Year	**149**	304
Due between One and Two Years	**115**	146
Due between Two and Five Years	**287**	343
Total Office Equipment Premises Operating Lease Commitments	**551**	793

(E) CAPITAL EXPENDITURE AND INVENTORY COMMITMENTS

	2012 $000	2011 $000
Capital Expenditure and Inventory		
Property, Plant and Equipment:		
Due within One Year	**900**	523
Intangible Assets:		
Due within One Year	**-**	225
Inventories:		
Due within One Year	**765**	2,802
Total Capital Expenditure and Inventory Commitments	**1,665**	3,550

(F) LEASE PAYMENTS RECEIVABLE

The Bank owns its head office in Wellington and leases six and one-half 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:

	2012 $000	2011 $000
Tenancy Lease Payments Receivable		
Receivable within One Year	**1,175**	1,459
Receivable between One and Five Years	**974**	2,341
Total Tenancy Lease Payments Receivable	**2,149**	3,800

29. 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. Statutory actuarial valuations of the schemes are undertaken every three years, with the last statutory valuation being undertaken as at 31 March 2012. Each year, the actuary provides an assessment of the value of the assets and liabilities of the superannuation fund, with the last valuation performed as at 31 March 2012. There have been no material changes to the fund's financial position between 31 March 2012 and 30 June 2012. Contributions to the defined benefit scheme are at a rate, reviewed annually, sufficient to keep the scheme solvent, based on actuarial assessments. The defined benefit scheme was closed to new members in 1991.

DEFINED BENEFIT SCHEME

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

As at 31 March	2012 $000	2011 $000
Superannuation Asset/Superannuation Liability Recognised in the Statement of Financial Position		
Present Value of Wholly Unfunded Obligations	**-**	-
Present Value of Wholly or Partly Funded Obligations	**43,242**	37,716
Fair Value of Plan Assets	**35,645**	36,369
Present Value of Net Obligations	**7,597**	1,347
Actuarial Gains Not Recognised in the Statement of Financial Position	**-**	-
Net Liability Recognised in the Statement of Financial Position	**7,597**	1,347
The net asset (if any) 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 nil (2011: nil).		
Movements in the Defined Benefit Obligation		
Current-service Cost	**112**	162
Interest Cost	**1,499**	1,586
Contributions by Plan Participants	**42**	51
Actuarial Losses on Defined Benefit Obligations	**6,477**	434
Benefits Paid	**(2,604)**	(4,129)
Movement for the Year	**5,526**	(1,896)
Present Value of Defined Benefit Obligations at the Start of the Year	**37,716**	39,612
Present Value of Defined Benefit Obligations at the End of the Year	**43,242**	37,716

	2012 $000	2011 $000
Movements in the Fair Value of Plan Assets		
Expected Return on Plan Assets	**1,578**	1,646
Actuarial Gains on Plan Assets	**136**	11
Contributions by Employer	**124**	138
Contributions by Plan Participants	**42**	51
Benefits Paid	**(2,604)**	(4,129)
Movement for the Year	**(724)**	(2,283)
Fair Value of Plan Assets at the Start of the Year	**36,369**	38,652
Fair Value of Plan Assets at the End of the Year	**35,645**	36,369

	2012 % of Plan Assets	2011 % of Plan Assets
Composition of Plan Assets by Type of Financial Instrument		
Cash and Short-term Securities	**19.8**	17.1
Domestic Fixed-interest Securities	**49.2**	51.4
Foreign Fixed-interest Securities	**0.0**	0.0
Domestic Equity Securities	**19.3**	19.9
Foreign Equity Securities	**11.7**	11.8
Other Assets	**0.0**	(0.2)

EXPENSE RECOGNISED IN THE INCOME STATEMENT

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

For the year ended 30 June	2012 $000	2011 $000
Past-service Cost	**-**	-
Current-service Cost	**112**	162
Interest Cost	**1,499**	1,586
Expected Return on Plan Assets	**(1,578)**	(1,646)
Defined Benefit Scheme Expense Recognised in Staff Expenses	**33**	102
Actuarial Losses on Plan Assets and Defined Benefit Obligations	**6,341**	423
Addition to/(Decrease in) Actuarial Gains Not Recognised in the Statement of Financial Position	**-**	-
Net Actuarial Loss Recognised in Operating Expenses	**6,341**	423
Total Defined Benefit Expense Recognised in Operating Expenses	**6,374**	525

The estimated employer contribution to be paid to the defined benefit scheme for the year ending 30 June 2013 is $180,000.

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

	2012 %	2011 %
Discount Rate at the Beginning of the Year	**2.92**	4.10
Expected Rate of Return on Plan Assets at the Beginning of the Year	**4.50**	4.50
Future Salary Increases	**3.50**	3.50
Other Material Actuarial Assumptions - Pension Increases	**2.50**	2.50

HISTORICAL DETAILS

The following table provides amounts for the defined benefit superannuation scheme for the current and previous four periods:

For the year ended 30 June	**2012 $000**	2011 $000	2010 $000	2009 $000	2008 $000
Present Value of Defined Benefit Obligations	**43,242**	37,716	39,612	39,383	39,117
Fair Value of Plan Assets	**35,645**	36,369	38,652	36,620	40,576
Present Value of Net Obligations	**(7,597)**	(1,347)	(960)	(2,763)	1,459
Actuarial Gains Not Recognised in the Statement of Financial Position	**-**	-	-	-	283
Superannuation Asset/(Liability)	**(7,597)**	(1,347)	(960)	(2,763)	1,176
Experience Adjustments					
Gain/(Loss) on Plan Liabilities due to Experience	**(995)**	53	(835)	279	(1,717)
Gain/(Loss) on Plan Assets due to Experience	**136**	11	2,721	(3,205)	(2,704)

DEFINED CONTRIBUTION SCHEME

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

	2012 $000	2011 $000
Bank's Defined Contribution Scheme	**86**	94
Other Defined Contribution Schemes	**933**	954
	1,019	1,048

30. 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 NZClear System, as described in Note 34.

31. 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	**2012 $M**	2011 $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	**203**	216
Rental Income	**1**	2
Receipts of a Capital Nature from Entities Controlled by the New Zealand Government		
Receipt of Proceeds on Maturity of New Zealand Government Securities - Available for Sale	**919**	-
Receipt of Proceeds on Maturity of New Zealand Government Securities - Fair Value through Profit or Loss	**2,962**	-
Payments of Expenses to Entities Controlled by the New Zealand Government		
Interest Expense	**193**	161
Payments of Capital to Entities Controlled by the New Zealand Government		
Net Decrease/(Increase) in Deposits	**3,982**	(6,066)
Repayment of Term Liabilities	**322**	-
Payment for Purchase of New Zealand Government Securities	**217**	295

As at 30 June	2012 $M	2011 $M
Balances with Entities Controlled by the New Zealand Government		
Assets that Comprise Claims on Entities Controlled by the New Zealand Government		
New Zealand Government Securities	**3,193**	3,768
Securities Purchased under Agreements to Resell	**25**	247
Liabilities that Comprise Claims by Entities Controlled by the New Zealand Government		
Deposits	**9,311**	13,292
Term Liabilities	**2,148**	2,448

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. Except as noted above, all amounts advanced under these agreements have been repaid. The table above also includes interest income received by the Bank from this activity.

32. 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).

The Actuary carried out a review of the financial position of the Fund as at 31 March 2012.

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.

(b) Five former employees of the Bank who either are, or at one time were, members of the Bank's Defined Benefit superannuation scheme commenced proceedings against the Bank. In February 2012, the Employment Court rejected the plaintiffs' claim and found in favour of the Bank. The Court of Appeal has granted the plaintiffs leave to appeal the decision of the Employment Court. Based on the legal advice received, the likelihood of the appeal being successful is considered to be remote and no provision has been made for any loss that may arise after balance date in respect of this matter. Provision has been made in the financial statements at 30 June 2012 for the estimated legal costs associated with the appeal.

(c) 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 2012 was $104.6 million (2011: $104.8 million). Of the total face value of demonetised currency, $81.6 million (2011: $81.8 million) is recognised as a liability in the Consolidated Statement of Financial Position.

(d) 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 that is not recognised as a liability is $9.8 million (2011: $9.8 million).

(e) As at 30 June 2012, the Bank had a contingent liability of $22.87 million (SDR 12.04 million) (2011: $23.26 million (SDR 12.04 million)) in respect of uncalled and unpaid capital attached to its shareholding in the Bank for International Settlements.

33. 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.

34. CUSTODIAL ACTIVITIES

The Bank operates the NZClear System (formerly 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. The Bank undertakes to accept liability for all costs and debts of NZCSD as a means of reinforcing that role. NZCSD is a non-trading company, but has legal ownership of securities beneficially owned by members of the NZClear 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 2012 was $160.9 billion (2011: $148.9 billion).

Under the NZClear System Rules, the Bank's and NZCSD's liability to any member of NZClear, arising out of, or in connection with, the system, is limited to direct losses, up to an aggregate of $5 million for any one event.

35. SIGNIFICANT POST-BALANCE DATE EVENTS

There have been no significant post-balance date events.

FIVE-YEAR HISTORICAL FINANCIAL INFORMATION

FIVE-YEAR FINANCIAL POSITION

As at 30 June	NZ IFRS Audited 2008 $M	NZ IFRS Audited 2009 $M	NZ IFRS Audited 2010 $M	NZ IFRS Audited 2011 $M	**NZ IFRS Audited 2012 $M**
Assets					
Foreign Currency Financial	20,754	19,460	22,612	24,647	**21,971**
Local Currency Financial	4,307	11,369	3,658	6,360	**4,695**
Other Assets	101	93	87	83	**78**
Total Assets	25,162	30,922	26,357	31,090	**26,744**
Liabilities and Equity					
Foreign Currency Financial	4,605	5,539	5,533	4,481	**4,129**
Local Currency Financial	18,458	21,777	17,953	23,884	**19,841**
Other Liabilities	173	639	297	216	**172**
Equity	1,926	2,967	2,574	2,509	**2,602**
Total Liabilities and Equity	25,162	30,922	26,357	31,090	**26,744**

FIVE-YEAR FINANCIAL PERFORMANCE

For the year ended 30 June	NZ IFRS Audited 2008 $M	NZ IFRS Audited 2009 $M	NZ IFRS Audited 2010 $M	NZ IFRS Audited 2011 $M	**NZ IFRS Audited 2012 $M**
Operating Income					
Net Investment Income	573	952	(69)	191	**171**
Other Income	8	8	8	8	**8**
Total Operating Income	581	960	(61)	199	**179**
Operating Expenses					
Staff Expenses	22	24	26	27	**28**
Currency-issued Expenses	4	6	4	7	**5**
Asset Management Expenses	7	7	8	7	**7**
Other Operating Expenses	13	13	14	14	**15**
Total Operating Expenses excluding Actuarial Loss on Defined Benefit Superannuation Scheme	46	50	52	55	**55**
Actuarial Loss/(Gain) on Defined Benefit Superannuation Scheme	-	4	(2)	-	**6**
Total Operating Expenses	46	54	50	55	**61**
Net Profit/(Loss) for the Year	535	906	(111)	144	**118**
Five-year Outcomes under the Funding Agreement					
Actual Net Expenses under the Funding Agreement[28]	38.1	45.7	41.2	46.8	**47.0**
Net Expenditure Specified under the Funding Agreement	41.0	43.3	46.9	47.8	**50.2**
Funding Agreement Under-expenditure/(Over-expenditure)	2.9	(2.4)	5.7	1.0	**3.2**

FIVE-YEAR DIVIDENDS PAID TO THE NEW ZEALAND GOVERNMENT

For the year ended 30 June	NZ IFRS Audited 2008 $M	NZ IFRS Audited 2009 $M	NZ IFRS Audited 2010 $M	NZ IFRS Audited 2011 $M	**NZ IFRS Audited 2012 $M**
Dividends Paid to the New Zealand Government	168	630	335	210	**160**

The dividend paid in 2010 includes a voluntary dividend to the Crown of $45 million that was paid in April 2010.

28. The five-year Funding Agreement that commenced 1 July 2010 excludes actuarial gains and losses from net operating expenses that are subject to the Funding Agreement. Prior to that date, actuarial gains and losses were included in net operating expenses subject to the Funding Agreement.

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