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RESERVE BANK
OF NEW ZEALAND

15 August 2003

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 2003 fairly reflect the financial position and operations of the Bank.

Alan Bollard

Governor

Deputy Chief Executive

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REPORT OF THE AUDITOR-GENERAL

TO THE READERS OF THE FINANCIAL STATEMENTS OF THE RESERVE BANK OF NEW ZEALAND AND GROUP FOR THE YEAR ENDED 30 JUNE 2003

We have audited the financial statements on pages 53 to 100. The financial statements provide information about the past financial performance and financial position of the Reserve Bank of New Zealand and group as at 30 June 2003. This information is stated in accordance with the accounting policies set out on page 53 to 57.

Responsibilities of the Governor
The Reserve Bank Act 1989 requires the Governor to prepare financial statements in accordance with generally accepted accounting practice in New Zealand that give a true and fair view of the financial position of the Reserve Bank of New Zealand and group as at 30 June 2003 and the results of operations and cash flows for the year ended on that date.

Auditor's Responsibilities
Section 15 of the Public Audit Act 2001 requires the Auditor-General to audit the financial statements presented by the Governor. It is the responsibility of the Auditor-General to express an independent opinion on the financial statements and report that opinion to you.

The Auditor-General has appointed Jim Chin of PricewaterhouseCoopers to undertake the audit.

Basis of Opinion
An audit includes examining, on a test basis, evidence relevant to the amounts and disclosures in the financial statements. It also includes assessing:

- the significant estimates and judgements made by the Governor in the preparation of the financial statements; and
- whether the accounting policies are appropriate to the Reserve Bank of New Zealand and group's circumstances, consistently applied and adequately disclosed.

We conducted our audit in accordance with the Auditing Standards published by the Auditor-General, which incorporate the Auditing Standards issued by the Institute of Chartered Accountants of New Zealand. We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatements, whether caused by fraud or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements.

We carried out other assignments for the Reserve Bank of New Zealand in the areas of systems audits. Other than these assignments and in our capacity as auditor acting on behalf of the Auditor-General, we have no relationship with or interests in the Reserve Bank of New Zealand or any of its subsidiaries.

Unqualified Opinion
We have obtained all the information and explanations we have required.

In our opinion:

- proper accounting records have been kept by the Reserve Bank of New Zealand and group as far as appears from our examination of those records; and
- the financial statements of the Reserve Bank of New Zealand and group on pages 53 to 100:
  - comply with generally accepted accounting practice in New Zealand; and
  - give a true and fair view of:
    - the Reserve Bank of New Zealand and group's financial position as at 30 June 2003; and
    - the results of operations and cash flows for the year ended on that date.

Our audit was completed on 15 August 2003 and our unqualified opinion is expressed as at that date.

Jim Chin

Jim Chin
On behalf of the Auditor-General
Wellington, New Zealand

PricewaterhouseCoopers

PricewaterhouseCoopers

For the purpose of this *Annual Report* and for the Reserve Bank's planning and budgeting processes the Bank classifies its outputs according to the main functions in the ways described below. Definitions of each output are described below.

Monetary Policy Formulation:
Formulating and publicly presenting monetary policy to enable the Bank to maintain price stability, in the most efficient manner possible.

Market Operations:
Trading, liaising with and monitoring financial markets, to effectively implement monetary policy and maintain the Bank's capacity to intervene in financial markets in support of the orderly and competitive functioning of those markets.

Financial System Oversight:
Registering and supervising banks, promoting the efficiency and soundness of the New Zealand financial system and limiting the significant damage to the financial system that could arise from a bank failure or other financial system distress.

Currency Operations:
Maintaining the supply and integrity of legal tender currency to facilitate cash transactions in the community.

Foreign Reserves Management:
Maintaining the capability to counter circumstances of severe illiquidity in our foreign exchange market and maintaining the Bank's foreign reserves at a level and in a form suitable for foreign exchange market intervention.

Settlement Services:
Providing settlement services to the government, financial institutions and appropriate overseas institutions to meet their banking needs and to facilitate effective implementation of monetary policy.

Overseas Investment Commission Secretariat:
Providing the secretariat of the Overseas Investment Commission. The Commission administers New Zealand's legislative controls on major inward foreign direct investment.

Registry and Depository Services:
Providing high quality depository, registry and settlement services to the securities market.

Other Outputs:
Producing other outputs which cannot be classified under the Bank's main functions. These include sundry economic policy advice and overseas representation and liaison.

STATEMENT OF ACCOUNTING POLICIES

(a) Reporting Entity and Statutory Base

These are the consolidated financial statements of the Reserve Bank of New Zealand, a body corporate under the Reserve Bank of New Zealand Act 1989 (the "Act"). These statements apply to the financial year ended 30 June 2003. They are prepared in accordance with part VI of the Act and comply with generally accepted accounting practice in New Zealand. In addition, the Reserve Bank's financial statements contain disclosure requirements required under International Financial Reporting Standards. However, the financial statements have not been prepared in accordance with the measurement and recognition requirements of International Financial Reporting Standards. Therefore, the disclosures which are specific to those measurement and recognition requirements have not been made.

In these financial statements, the Reserve Bank of New Zealand is also referred to as the "Reserve Bank" or the "Bank".

The Governor of the Reserve Bank authorised these financial statements for issue on 15 August 2003.

(b) Measurement Base

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

(c) Currency of Presentation

All amounts are expressed in New Zealand dollars unless otherwise stated.

(d) Basis of Consolidation

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

(e) Foreign Currency Conversions

Transactions in foreign currencies are translated to New Zealand dollars using exchange rates applying on the trade date of transactions. Foreign currency financial assets and financial liabilities are translated to New Zealand dollars using mid-market exchange rates applying at balance date. The following New Zealand dollar exchange rates for major currencies are used to convert foreign currency assets and liabilities to New Zealand dollars for reporting purposes:

	2003	2002
Euro	0.5104	0.4923
Japanese yen	78.38	58.44
United States dollars	0.5877	0.4880

(f) Financial Assets and Liabilities

The Bank presents financial assets and liabilities, and the associated income and expense streams, by distinguishing between foreign currency and local currency activities. Foreign currency activities mainly arise from the Bank's Foreign Reserves Management function. Local currency activities mainly reflect the assets and liabilities associated with the Market Operations function and investment of the proceeds of issuing circulating currency.

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

All financial assets and liabilities are recognised in the Statement of Financial Position on a trade date basis. This means that purchases and sales of financial instruments are recognised from the date at which the purchase or sale is agreed.

Foreign Currency Marketable Securities

Foreign currency marketable securities are valued at quoted mid-market prices. Any premium or discount on purchase is capitalised and amortised over the term of the security on a constant yield to maturity basis. Changes in market value are recognised as an increase or decrease in the value of Marketable Securities in the Statement of Financial Position.

Gains and losses arising from changes in the market value of foreign currency marketable securities are recognised in the Statement of Financial Performance as Gain (Loss) from Market Value Changes.

Foreign Currency Term Liabilities

Foreign Currency Term Liabilities are reported at market or fair value. The funds from these liabilities are invested in foreign currency marketable securities. This valuation policy ensures consistency with the policy adopted for the corresponding assets. Market or fair value is imputed by deriving the fair value rate from the relevant market yield curve of similar liabilities and discounting the future cash flows of the liabilities at this rate. Changes in the value of these liabilities are recognised as an increase or decrease in the value of the Term Liabilities in the Statement of Financial Position.

Gains and losses arising from changes in market value of foreign currency term liabilities are recognised in the Statement of Financial Performance as Loss (Gain) from Market Value Changes.

Repurchase and Reverse-Repurchase Transactions

Securities sold under agreements to repurchase continue to be recorded as Marketable Securities in the Statement of Financial Position. The obligation to repurchase is disclosed within liabilities as Securities Sold Under Agreements to Repurchase. The difference between the sale and repurchase price represents an expense and is amortised over the term of the contract and reported in the Statement of Financial Performance.

Securities held under reverse-repurchase agreements are recorded within assets as Securities Purchased Under Agreements to Re-sell. The difference between the purchase price and sale price represents income and is amortised over the term of the contract and reported in the Statement of Financial Performance.

Both repurchase and reverse-repurchase transactions are reported at the transaction value inclusive of any accrued income or expense.

Securities Lending Programme

Securities lent out under the securities lending programme are accounted for on the same basis as repurchase and reverse-repurchase transactions.

Derivative Instruments

The Bank's involvement in derivative instruments comprises forward foreign exchange swap contracts, interest rate futures and interest rate swaps.

Forward foreign exchange swap contracts are revalued for changes in exchange rates and are reported at fair value. This revaluation is imputed by deriving the fair value rate from the relevant market yield curve of similar contracts and discounting the future cash flows of the contracts at this rate. Interest receivable or payable and changes in fair value are recognised in the Statement of Financial Performance as Liquidity Management Swap Income.

Interest rate futures are reported in the Statement of Financial Position at quoted mid-market prices. Changes in market value are recognised in the Statement of Financial Performance as Other Foreign Currency Income (Loss). Margin and cash accounts arising from interest rate futures are recognised in the Statement of Financial Position as Other Cash Balances.

Interest rate swaps are reported at fair value in the Statement of Financial Position. The fair value is derived by discounting the future cash flows based on the relevant market yield curves. Interest receivable or payable and changes in fair value are recognised in the Statement of Financial Performance as Other Foreign Currency Income (Loss). Collateral taken under an interest rate swap arrangement is not recognised by the Bank in the Statement of Financial Position. Collateral delivered under an interest rate swap arrangement remains in the Statement of Financial Position.

All derivative instruments in a gain position are reported within the balance of foreign currency Marketable Securities in the Statement of Financial Position. Derivative instruments in a loss position are reported in the Statement of Financial Position as Derivative Instruments in a Loss Position. Derivative instruments in a loss position are offset against derivative instruments in a gain position where a legal right of set-off exists.

Short Sales of Marketable Securities

A "short sale" is a sale of a security that the Bank does not own. Short sales arise as part of the foreign reserves management function (see note 1) and the net returns on short sales are reported as income generated through active management trading (see note 25). Securities that are sold short are recorded at quoted market prices and reported as Short Sales of Marketable Securities in the Statement of Financial Position. Any gains or losses are recognised in the Statement of Financial Performance on the same basis as foreign currency Marketable Securities.

Unsettled Transactions

Unsettled transactions are security purchases or sales that have been agreed but are yet to be settled. Amounts payable for unsettled purchases of securities are reported as liabilities under the title Payable for Unsettled Purchases of Securities. Amounts due from unsettled sales of securities are reported as assets under the title Receivable from Unsettled Sales of Securities.

Unsettled transactions are reported at the contract value.

Investment Portfolio - NZ Government Securities

The Bank's investment portfolio is accounted for on a constant yield to maturity basis. This reflects the intention to hold the portfolio until maturity as these assets represent the investment of the proceeds from issuing currency and the Bank's equity. Any premium or discount on purchase is capitalised and amortised over the term of the security on a constant yield to maturity basis. The portfolio is recorded in the Statement of Financial Position at historic cost adjusted for amortisation of any premium or discount on purchase. Interest is accrued in the Statement of Financial Performance as Local Currency Interest Income.

Market Test Activities

From time to time, the Bank may hold small trading positions in local currency securities as part of market test activities. These are valued at quoted market prices. Changes in market value are recognised as an increase or decrease in the value of Other Local Currency Financial Assets. Gains or losses are recognised in the Statement of Financial Performance as Gain (Loss) from Market Test Activities.

Other Financial Assets and Liabilities

Local and foreign currency cash, deposits and short-term advances are valued at transaction date value.

(g) Currency in Circulation

Currency issued by the Reserve Bank represents a claim on the Bank in favour of the holder. The liability for currency in circulation is recorded at face value in the Statement of Financial Position.

(h) Collectors' and Demonetised Currency

The Reserve Bank has a liability for the face value of collectors' currency. However, it is most unlikely that significant amounts of collectors' currency will be returned for redemption. Therefore, the face value of collectors' currency is recognised as a contingent liability.

The Bank has a liability for the face value of demonetised currency still in circulation. This is recognised as a contingent liability except for a portion retained in the Statement of Financial Position to cover expected future redemptions.

(i) Land and Buildings

Land is carried at market value. Buildings are carried at depreciated market value. In respect of the specialised basement and ground floor occupied by the Reserve Bank, market value is determined based on depreciated replacement cost. Surpluses of book value over historic cost for this class of asset are recorded in the Properties Revaluation Reserve. Where the book value of this class of asset falls below historic cost, previous revaluations are reversed and any remaining balance is charged as an expense in the financial year it occurs. Independent valuations of this class of asset are obtained every five years. Future valuations will be performed at highest and best use rather than existing use, and disposal costs will not be deducted. Buildings are depreciated on a straight line basis over 40 years.

(j) Other Fixed Assets

Other Fixed Assets are carried at cost less depreciation. The following assets held by the Reserve Bank are depreciated on a straight line basis over the following terms:

Computer Hardware and Software	3-5 years
Plant and Equipment	5 years
Building Improvements	8 years
Miscellaneous	expected useful life

(k) Leases

Operating Leases

Where the Reserve Bank is the lessee, the lease rentals payable on operating leases are recognised in the Statement of Financial Performance over the term of the lease on a basis consistent with the expected benefits derived from the leased assets.

Finance Leases

Assets under finance leases are recognised as fixed assets in the Statement of Financial Position. Leased assets are recognised initially at the lower of the present value of the minimum lease payments or their fair value. A corresponding liability is established and each lease payment is allocated between the liability and interest expense. Leased assets are depreciated on the same basis as equivalent property, plant and equipment.

(l) Currency and Artwork Collections and Archives

Items held in the Reserve Bank's currency and artwork collections and archives that have a material commercial value are independently valued at estimated market values. Revaluations are performed every five years. Surpluses of book value over historic cost for this class of asset are recorded in the Currency and Artwork Collections 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.

(m) Inventories

Inventories are carried at the lower of cost or realisable value. Cost is determined on a weighted average basis. Unissued currency stocks are recorded as inventory at the cost of acquisition and expensed when issued.

(n) Accounts Receivable

Accounts receivable are carried at expected realisable value after making due allowance for doubtful debts.

(o) Provision for Transfer of Surplus

The Reserve Bank's notional surplus income, as calculated under section 158 of the Reserve Bank of New Zealand Act 1989, is recorded in the Statement of Financial Performance as Provision for Transfer of Surplus. Under section 162 of the Act, the Minister of Finance directs whether the notional surplus income is paid to the Crown or credited to the Bank's reserves after having regard to the Bank's capital requirements and the views of the Board of Directors. As the full notional surplus is required to be paid to the Crown unless otherwise directed by the Minister of Finance, the full notional surplus is shown as a liability at balance date.

(p) Provision for Restructuring

A provision for restructuring is recognised only when the Reserve Bank has a detailed restructuring plan and the plan has either started to be implemented or has been communicated to those affected by it. Only those expenses that are necessarily entailed by the restructuring and are not associated with ongoing activities are included in the provision.

(q) Retirement Gratuity

Retirement gratuity liabilities are recorded at actuarial value. This is calculated by an independent actuary using a discounted cash flow model based on the relevant market yield curves. Changes in value are recognised in the Statement of Financial Performance as Personnel Expenses. Retirement gratuity liabilities are reported in the Statement of Financial Position as Accrued Employee Entitlements.

(r) Personnel Expenses

Personnel Expenses include the full cost of all staff benefits, including any applicable Fringe Benefit Tax. Salaries and leave accrued at year-end are reported in the Statement of Financial Position as Accrued Employee Entitlements.

(s) Income Tax

Section CB3 of the Income Tax Act 1994 exempts the Reserve Bank from income tax.

(t) Custodial Activities

Securities held by the Reserve Bank under custodial arrangements are not included in these financial statements (see note 44).

(u) Segmental Reporting

The Reserve Bank presents financial assets and financial liabilities, and their associated income and expense streams, by distinguishing between foreign currency and local currency activities. In addition, the Bank provides operating results by function. The Bank considers that these reporting approaches provide appropriate segmental reporting of the Bank's activities.

(v) Cost Allocation

The Reserve Bank of New Zealand Act 1989 requires the Reserve Bank to account for revenue and expenses by reference to the functions the Bank performs. The Bank has systems in place to allocate costs to functions. Costs are allocated as closely as possible to reflect their consumption. Direct costs are assigned directly to functions. Indirect costs are allocated to functions based on pre-determined cost drivers and related activity/usage information.

(w) Income Allocated Between Functions

Each function receives income and incurs expenses relating directly to the assets and liabilities used exclusively by that function. These income and expenses are presented in the Statement of Cost of Services. Notional balance sheets are calculated for each of the Reserve Bank's functions as though each function operated autonomously. Income and expense flows are also attached to the notional funding for each function. This structure enables each function to more accurately report the financial outcome of the services provided.

The income earned from the assets funded by the Bank's net equity is allocated equally to the Foreign Reserves Management and Market Operations functions.

(x) Cash Flows

Cash is defined as those items that are convertible to cash within two working days and are used in the day-to-day cash management of the Reserve Bank. This definition includes local currency securities purchased under agreements to re-sell and a substantial portion of the Bank's foreign reserves portfolio (see note 2).

Investing activities include cash movements, including realised gains and losses, in the Bank's financial asset portfolios and cash flows arising from movements in fixed assets.

Financing activities include cash flows arising from the issue of circulating currency, borrowing from the Treasury, and payment of the net operating surplus to the Crown.

Operating activities include income and expenditure cash flows not included in investing or financing activities.

(y) Comparative Amounts

To ensure consistency with the current year, comparative figures have been restated where appropriate.

(z) Changes in Accounting Policies

The Bank now reports its forward foreign exchange swap contracts at fair value. Previously, the Bank reported the contracts at yield to maturity. The Bank changed its accounting treatment of these contracts to ensure all derivative instruments were accounted for on a fair value basis. This change in accounting policy decreased Derivatives in a Gain Position in the Statement of Financial Position by $0.1 million and decreased Other Foreign Currency Income in the Statement of Financial Performance by $0.1 million.

This change does not affect the Cash Flow Statement.

There have been no other material changes to the Reserve Bank's accounting policies for the year ended 30 June 2003 and uniform accounting policies have been applied throughout the Bank.

Consolidated Statement of Financial Position

As at 30 June	Note	2003 $000	2002 $000
Assets:			
Foreign Currency Financial Assets			
Cash Balances with Other Central Banks		67,465	186,025
Other Cash Balances		1,738	6,223
Marketable Securities	2	3,276,974	2,822,359
Short-Term Advances		42,540	348,361
Receivable from Unsettled Sales of Securities		43,195	24,725
Securities Purchased Under Agreements to Re-sell		2,759,011	2,194,682
Accrued Interest		24,728	24,052
Total Foreign Currency Financial Assets[1]		6,215,651	5,606,427
Local Currency Financial Assets			
Cash on Hand		4	4
Securities Purchased Under Agreements to Re-sell		2,120,364	2,818,939
Investment Portfolio - NZ Government Securities		3,242,673	2,953,554
Accrued Interest		57,199	48,233
Other Local Currency Financial Assets	4	9,876	8
Total Local Currency Financial Assets		5,430,116	5,820,738
Total Financial Assets		11,645,767	11,427,165
Other Assets			
Accounts Receivable		2,051	2,413
Inventories	5	7,562	5,709
Fixed Assets	6	28,694	29,968
Total Other Assets		38,307	38,090
Total Assets		11,684,074	11,465,255

1 Foreign currency assets and liabilities do not match due to $1.1 billion (2002 $348 million) of assets arising from forward foreign exchange swap contracts for Market Operations. These assets are fully hedged through forward transactions.

As at 30 June	Note	2003 $000	2002 $000
Liabilities:			
Foreign Currency Financial Liabilities			
Short-Term Deposits		1,335	-
Payable for Unsettled Purchases of Securities		42,610	55,254
Short Sales of Marketable Securities		93,706	61,344
Derivative Instruments in a Loss Position	3	3,078	14,533
Securities Sold Under Agreements to Repurchase		840,663	991,740
Term Liabilities	7	4,068,882	4,063,936
Accrued Interest		51,455	66,334
Total Foreign Currency Financial Liabilities[1]		5,101,729	5,253,141
Local Currency Financial Liabilities			
Government Deposits		3,142,296	2,945,860
Other Deposits	8	22,730	14,673
Accrued Interest		468	1,346
Total Local Currency Financial Liabilities		3,165,494	2,961,879
Total Financial Liabilities		8,267,223	8,215,020
Other Liabilities			
Currency in Circulation	9	2,805,935	2,658,671
Provision for Transfer of Surplus	12	184,419	168,929
Miscellaneous Liabilities	10	10,344	11,163
Total Other Liabilities		3,000,698	2,838,763
Total Liabilities	15	11,267,921	11,053,783
Equity	13	416,153	411,472
Total Liabilities and Equity		11,684,074	11,465,255

The above statement is to be read in conjunction with the notes on pages 66 to 100.

Consolidated Statement of Movements in Equity

For the year ended 30 June	Note	2003 $000	2002 $000
Net Surplus for the Year		189,100	175,006
Total Recognised Revenues and Expenses for the Year		189,100	175,006
Provision for Transfer of Surplus to Government	12	(184,419)	(168,929)
Movements in Equity for the Year		4,681	6,077
Equity at Start of Year		411,472	405,395
Equity at End of Year	13	416,153	411,472

The above statement is to be read in conjunction with the notes on pages 66 to 100.

Consolidated Statement of Cost of Services

For the year ended 30 June	Note	Operating Income Actual 2003 $000	Operating Expenses Actual 2003 $000	Operating Surplus (Deficit) Actual 2003 $000	Operating Surplus (Deficit) Budget 2003 $000	Operating Surplus (Deficit) Actual 2002 $000
Functions:						
Monetary Policy Formulation		-	7,125	(7,125)	(8,048)	(7,245)
Market Operations[2]		14,882	3,384	11,498	11,315	10,111
Financial System Oversight		10	4,362	(4,352)	(4,298)	(3,857)
Currency Operations	24	190,760	9,378	181,382	184,397	175,850
Foreign Reserves Management[2]	25	11,194	3,878	7,316	9,901	(781)
Settlement Services		1,876	2,330	(454)	42	(191)
Overseas Investment Commission Secretariat	26	821	668	153	-	(83)
Registry and Depository Services	27	5,369	3,948	1,421	1,057	1,881
Other Outputs		-	739	(739)	(799)	(679)
Total for Bank		224,912	35,812	189,100	193,567	175,006
Income Retained under Funding Agreement[3]			9,493			
Net Expenditure under Funding Agreement			26,319			

The Consolidated Statement of Cost of Services shows the total cost of providing each function, including internal transfers between functions.

The above statement is to be read in conjunction with the notes on pages 66 to 100.

2 The income for Market Operations and Foreign Reserves Management includes an allocation of $16.8 million (2002 $13.3 million) in income earned from the assets funded by the Bank's net equity.

3 The Funding Agreement commencing 1 July 2000 allows the Bank to retain revenue from specified revenue-generating activities and net this revenue against expenses for the calculation of Net Expenditure under Funding Agreement.

Consolidated Statement of Financial Performance

For the year ended 30 June	Note	Actual 2003 $000	Budget 2003 $000	Actual 2002 $000
Operating Income:				
Income from Foreign Currency Financial Assets				
Interest Income	28	108,731		166,891
Gain from Market Value Changes	30	28,192		10,326
Other Foreign Currency Income		50,227		17,814
Total Income from Foreign Currency Financial Assets		187,150		195,031
Expenses on Foreign Currency Financial Liabilities				
Interest Expense	29	141,216		159,060
Loss from Market Value Changes	30	51,342		46,760
Other Foreign Currency Expenses		560		945
Total Expenses on Foreign Currency Financial Liabilities		193,118		206,765
Net Foreign Exchange Revaluation Gain	31	487		1,530
Foreign Currency Investment Income (Loss)		(5,481)		(10,204)
Income from Local Currency Financial Assets				
Interest Income	28	386,251		323,079
Liquidity Management Swap Income		39,913		5,204
Gain from Market Test Activities		70		86
Total Income from Local Currency Financial Assets		426,234		328,369
Total Expenses on Local Currency Financial Liabilities	29	205,149		117,461
Local Currency Investment Income		221,085		210,908
Net Investment Income		215,604	220,973	200,704
Other Income	32	9,308	8,981	10,334
Total Operating Income		224,912	229,954	211,038

For the year ended 30 June	Note	Actual 2003 $000	Budget 2003 $000	Actual 2002 $000
Operating Expenses:				
Personnel		15,635	16,031	15,588
Asset Management	33	3,992	4,046	4,992
New Currency Issued	24	6,041	4,438	4,720
Administration		1,041	1,360	1,073
Other	34	9,103	10,512	9,299
Total Operating Expenses		35,812	36,387	35,672
Loss on Revaluation or Disposal of Bank Properties		-	-	360
Total Expenses		35,812	36,387	36,032
Surplus Available for Appropriation	12	189,100	193,567	175,006

The above statement is to be read in conjunction with the notes on pages 66 to 100.

The Reserve Bank's operating expenditure was $35.8 million, which was 1.6 per cent below budget. In particular:

- Personnel expenses were $0.4 million less than budgeted, mainly due to staff departures. Personnel expenses included $0.9 million in superannuation contributions to staff's defined contribution superannuation schemes.
- Costs of issuing new coins and bank notes were $1.6 million more than budgeted, mainly due to higher-than-expected demand.
- Administration expenses were $0.3 million less than budget, mainly due to lower-than-expected communications expenses, postage costs and stationery purchases.
- Other expenses were $1.4 million less than budgeted, mainly due to reduced professional services and computer expenses.

Consolidated Statement of Cash Flows

For the year ended 30 June	Note	2003 $000	2002 $000
Cash Flows From Operating Activities:			
Source:			
Interest Received - Foreign Currency		118,484	193,384
- Local Currency - Investment Portfolio		205,421	192,107
- Other		168,077	125,163
Liquidity Management Swap Income		37,702	8,600
Fees, Commission and Other Income Received		18,649	9,674
		548,333	528,928
Disbursements:			
Interest Paid - Foreign Currency		170,871	232,534
- Local Currency		206,027	116,912
Payments to Suppliers and Employees		34,454	39,160
Other Foreign Currency Expenses		-	17,025
Net GST Paid (Received)		76	(49)
Income Tax Paid (Received)		-	(132)
		411,428	405,450
Net Cash Flow From Operating Activities	36	136,905	123,478
Cash Flows From Investing Activities:			
Source:			
Net (Increase) Decrease in Other Local Currency Financial Assets		(9,867)	33
Maturity of New Zealand Government Securities for Investment Portfolio		450,000	150,000
Sale of Fixed Assets		-	5,890
		440,133	155,923
Disbursements:			
Net Increase (Decrease) in Foreign Currency Securities Purchased under Agreements to Re-sell		564,329	682,444
Net Increase (Decrease) in Foreign Currency Marketable Securities		614,798	53,411
Net Increase (Decrease) in Other Foreign Currency Financial Assets		(276,066)	224,002
Net (Increase) Decrease in Other Foreign Currency Financial Liabilities		130,614	37,981
Purchases of NZ Government Securities for Investment Portfolio		735,333	437,979
Purchase of Fixed Assets		1,137	1,104
		1,770,145	1,436,921
Net Cash Flow From Investing Activities		(1,330,012)	(1,280,998)

For the year ended 30 June	Note	2003 $000	2002 $000
Cash Flows From Financing Activities:			
Source:			
Issue of Circulating Currency		1,584,121	1,359,937
Withdrawal of Circulating Currency		1,436,857	1,164,003
Net Issue of Circulating Currency		147,264	195,934
Additional Foreign Currency Term Liabilities		799,421	1,217,532
		946,685	1,413,466
Disbursements:			
Payment for Demonetised Currency		34	13
Repayment of Foreign Currency Term Liabilities		358,086	1,187,251
Payment of Surplus to Government		168,929	154,138
		527,049	1,341,402
Net Cash Flow From Financing Activities		419,636	72,064
CASH FLOW FROM ALL ACTIVITIES		(773,471)	(1,085,456)
Plus Exchange Rate Effect		(141,830)	(330,948)
NET CASH FLOW FROM ALL ACTIVITIES		(915,301)	(1,416,404)
Opening Cash Balance		1,582,988	2,999,392
CLOSING CASH BALANCE	37	667,687	1,582,988

The above statement is to be read in conjunction with the notes on pages 66 to 100.

Cash is defined in the Statement of Cash Flows as those items that are convertible to cash within two working days and are used in the day-to-day cash management of the Reserve Bank. This definition includes local currency securities purchased under agreements to re-sell and a substantial portion of the Bank's foreign reserves portfolio (see note 2).

Cash movements in some portfolios have been presented net as this is considered to provide a fairer presentation of the movements in the Bank's cash profile.

For further information on the management of the Bank's liquidity, see note 22.

1. Nature and Extent of Activities

The Reserve Bank's role as a central bank determines the nature and extent of its activities with respect to financial instruments. This role is defined by the Reserve Bank of New Zealand Act 1989.

(a) Foreign Currency Activities

Foreign currency activities result mainly from the Bank's holdings of foreign currency assets under its foreign reserves management function. The foreign reserves management portfolio comprises foreign currency assets held for foreign exchange intervention purposes ("foreign reserves"), pursuant to section 24 of the Act, and other foreign currency assets held for trading purposes. The level of foreign reserve intervention assets is determined by the Minister of Finance on advice from the Bank. The funding for foreign reserves is provided by foreign currency loans from the Treasury. These loans incur interest at market rates. Generally these loans are held to maturity, though from time-to-time the opportunity to repay early may be taken at the instigation of either the Bank or the Treasury, where this is expected to reduce the cost of funding. Funding for other foreign currency assets held for trading purposes usually arises through repurchase transactions with foreign securities trading firms.

Foreign currency assets are held in various currencies. The majority are denominated in United States dollars and euros. Financial instruments held within these foreign currency portfolios consist mainly of sovereign securities, securities held under reverse-repurchase transactions or balances held with other central banks, commercial banks, highly rated corporates and settlement institutions. Liquidity and credit risk are key criteria in determining the type of instruments held.

The foreign reserves portfolio is actively managed. Subject to liquidity and credit risk constraints, the Bank defines benchmark portfolios that represent a "neutral" asset and liability structure in terms of market risk. The neutral position is established to minimise the Bank's exposure to foreign currency risk and interest rate risk. In general, liquidity and credit risk constraints mean that the neutral structure will return a loss - the returns on assets will be less than the cost of funding those assets.

Departures of the actual asset and liability portfolio from the neutral asset and liability structure are undertaken within defined risk boundaries where there is an expected increase in returns. Departures from the neutral structure also arise when the Bank trades in the foreign exchange markets on its own account and when marketable securities are short sold, again for expected return enhancement, within defined risk boundaries. Departures from the neutral structure involve discretionary trading and portfolio management decisions undertaken by specialist staff with delegated authority from the Governor.

The Bank also holds, from time-to-time, foreign currency assets and liabilities that arise from market operations. Any foreign currency exposures related to market operations are fully hedged through the use of forward foreign exchange swap contracts.

For further information on the risk management policies relating to financial instruments, see notes 16 to 22.

(b) Events during 2002/03

- In October 2002, the Bank closed the operation of the quantitative rule-based trading strategies previously undertaken in the foreign reserves portfolio as these previously profitable strategies became less successful.
- In June 2003, the Bank announced that it would be investing US $25 million in the newly created EMEAP[4]- Bank for International Settlements Asian Bond Fund. The investment in the Asian Bond Fund will occur over the first quarter of the 2003/04 financial year.
- The Bank has entered into two new foreign currency loans for US $181 million from the Treasury that will be drawn in early July 2003. These loans largely replace maturing loans with the Treasury.
- In June 2003, the Bank received an invitation to become a shareholder of the Bank for International Settlements for an investment of $100 million. The Bank accepted the invitation in August 2003.

(c) Derivative Instruments

The Bank's involvement in derivative instruments comprises forward foreign exchange swap contracts, interest rate futures and interest rate swaps. Forward foreign exchange swap contracts are used as a part of hedged foreign exchange transactions for both market operations and foreign reserves management. Any unrealised foreign exchange gain (loss) on unsettled forward foreign exchange swap contracts is offset by the foreign exchange revaluation on the associated money market instruments. Interest rate futures and interest rate swaps are used to enhance expected returns on foreign currency assets and, from time-to-time, to hedge interest rate and foreign exchange risk.

4 EMEAP is the Executive Meeting of Asian and Pacific central banks.

(d) Securities Lending Programme

As part of its foreign reserves operations, the Bank participates in a securities lending programme managed by JPMorgan Chase Bank. Under the programme, JPMorgan Chase Bank lends out securities owned by the Bank in exchange for cash or alternative securities. The range of financial assets that can be acquired under the programme is constrained by guidelines compatible with those that apply to the Bank's own foreign currency asset portfolios.

As at 30 June 2003, the market value of securities lent out under the programme was US $399.6 million (2002 US $440.5 million).

(e) Foreign Exchange Gains and Losses

Section 17 and 18 of the Act provide for the Minister of Finance to direct the Bank to deal in foreign exchange or for the Minister of Finance to fix the foreign exchange rates for foreign exchange dealing by the Bank. Section 21 of the Act requires the Bank to either pay any foreign currency exchange gains to the Crown or to be reimbursed for any foreign exchange losses as a result of dealing in foreign exchange under sections 17 or 18 of the Act. For the year to 30 June 2003, there have been no payments to or from the Crown under section 21 of the Act (2002 nil).

(f) Restrictions on Title to Assets

As part of the active management of its foreign currency operations, the Bank enters into security repurchase transactions. The securities sold by the Bank under repurchase agreements continue to be recorded as Marketable Securities in the Bank's Statement of Financial Position. At balance date, securities with a book value of $840.7 million (2002 $991.7 million) had been sold to counterparties under repurchase agreements. The fair value of these securities was $828.3 million (2002 $999.8 million). These transactions are also recognised as a liability for Securities Sold under Agreements to Repurchase 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 Re-sell in the Bank's Statement of Financial Position.

The Bank can be required to deliver collateral under interest rate swap arrangements. Any collateral delivered by the Bank remains in the Statement of Financial Position. At balance date, collateral delivered by the Bank was $nil (2002 $nil).

(g) Local Currency Activities

Local currency activities arise as a result of:

- The Bank's liquidity management that largely involves offsetting the daily net flows to or from government by advancing funds to or withdrawing funds from the banking system. This is done mostly through daily open market operations. Any residual banking system liquidity is advanced or withdrawn using the Official Cash Rate scheme (OCR). Under the OCR scheme, the Bank advances or withdraws cash at a margin to the OCR. The financial instruments used in these operations include local currency reverse-repurchase transactions and forward foreign exchange swap contracts. The Bank periodically uses securities from its investment portfolio of New Zealand government securities in repurchase transactions, to withdraw funds from the banking system, for liquidity management purposes.
- The Bank's investment portfolio of New Zealand government bonds supports its liability for currency in circulation and the Bank's net equity. The Bank holds these investments until maturity. The Bank purchases bonds for the investment portfolio if the amount of currency in circulation increases or if one of the Bank's current holdings matures. The Bank only purchases those government bonds that are currently being tendered by the Crown. However, the Bank manages this process to maintain a relatively even holding of each bond maturity where possible.

From time-to-time, the Bank may also hold small trading positions in Crown or registered bank securities as part of market test activities.

Asset Notes

2. Foreign Currency Marketable Securities

	Note	2003 $000	2002 $000
Marketable Securities			
- Liquifiable within two days (considered cash equivalent)	37	1,643,142	1,532,330
- Liquifiable outside two days (not considered cash equivalent)		1,553,038	1,237,501
Derivative Instruments in a Gain Position	3	80,794	52,528
Total Marketable Securities		3,276,974	2,822,359

3. Derivative Instruments

	Book Value 2003 $000	Notional Principal 2003 $000	Book Value 2002 $000	Notional Principal 2002 $000
Interest Rate Futures				
Futures in a Gain Position	2,117	122,173	2,384	291,941
Net Futures Position	2,117	122,173	2,384	291,941

At 30 June 2003, the Bank had 530 open futures contracts (2002 441).

	Book Value 2003 $000	Notional Principal 2003 $000	Book Value 2002 $000	Notional Principal 2002 $000
Interest Rate Swaps				
Swaps in a Gain Position	61,989	657,104	29,722	791,352
Swaps in a Loss Position	(3,078)	186,136	(1,263)	101,562
Net Interest Rate Swap Position	58,911	843,240	28,459	892,914
Forward Foreign Exchange Swaps				
Swaps in a Gain Position	16,688	1,098,923	20,422	506,500
Swaps in a Loss Position	-	-	(13,270)	112,917
Net Forward Foreign Exchange Swap Position	16,688	1,098,923	7,152	619,417
Total Derivatives in a Gain Position	80,794	1,878,200	52,528	1,589,793
Total Derivatives in a Loss Position	(3,078)	186,136	(14,533)	214,479
Net Derivative Instruments	77,716	2,064,336	37,995	1,804,272

4. Other Local Currency Financial Assets

	2003 $000	2002 $000
Advances to Staff	-	4
Other Financial Assets	9,876	4
Total Other Local Currency Financial Assets	9,876	8

5. Inventories

	2003 $000	2002 $000
Bank Notes for Circulation	4,315	3,567
Coin for Circulation	3,149	1,711
Collectors' Currency	87	424
Stationery	11	7
Total Inventories	7,562	5,709

6. Fixed Assets

	Total	Land & Buildings $000	Property Improvements $000	Computer Hardware & Software $000	Plant & Equipment $000	Currency & Art Collection $000
As at 30 June 2002						
Cost	40,728	25,065	4,624	6,951	3,326	762
Accumulated depreciation	10,760	454	2,541	4,873	2,892	-
Net book amount	29,968	24,611	2,083	2,078	434	762
Year ended 30 June 2003						
Opening net book amount	29,968	24,611	2,083	2,078	434	762
Additions	1,136	-	-	621	506	9
Disposals at book amount	-	-	-	-	-	-
Depreciation	2,410	427	515	1,262	206	-
Closing net book amount	28,694	24,184	1,568	1,437	734	771
As at 30 June 2003						
Cost	40,569	25,065	4,108	7,013	3,612	771
Accumulated depreciation	11,875	881	2,540	5,576	2,878	-
Net book amount	28,694	24,184	1,568	1,437	734	771

The Bank owns its head office in Wellington and leases out seven of the fourteen floors to tenants under operating leases.

The book values for land and buildings (comprising the Wellington Head Office and Wellington Carparks) are depreciated market values based on existing use with the exception of the Wellington specialised basement and ground floor occupied by the Reserve Bank, which are valued at depreciated replacement cost. The market value of the Bank's land and buildings to a purchaser not requiring the Bank's specialised facilities was assessed at $23.6 million at the last valuation date. The book value of the land and buildings would have been $7.1 million (2002 $7.2 million) if the Bank had recorded these using historic cost less depreciation.

	Valuation Date	Registered Valuer
Wellington Head Office	June 2001	Jones Lang Lasalle Advisory Limited
Wellington Carparks	June 1999	Darroch Limited

Computer hardware and software includes computer hardware, which cost $390,000 less the accumulated depreciation of $92,000, which is leased under a finance lease.

Liability and Equity Notes

7. Term Liabilities

The funding for foreign reserves is provided by foreign currency loans from the Treasury. These loans are unsecured and incur interest at market rates. The weighted average interest rates do not include the impact of the Bank's interest rate swaps.

	Total 2003 $000	Unamortised Discount/ (Premium) 2003 $000	Weighted Average Interest Rate 2003 %	Total 2002 $000	Unamortised Discount/ (Premium) 2002 $000	Weighted Average Interest Rate 2002 %
Unsecured Term Liabilities						
One year or less	646,440	-	1.7%	415,316	(193)	1.4%
Between one and two years	635,867	-	1.8%	727,244	-	2.8%
Between two and five years	2,105,156	(29,063)	2.1%	2,369,947	(57,386)	3.4%
Over five years	681,419	-	1.8%	551,429	-	2.9%
Total Unsecured Term Liabilities	4,068,882	(29,063)		4,063,936	(57,579)	

8. Other Deposits

	2003 $000	2002 $000
Settlement Bank Deposits	1,815	4,387
Central Bank Deposits	13,625	1,917
International Monetary Fund Deposits	6,963	8,163
Other Deposits	327	206
Total Other Deposits	22,730	14,673

9. Currency in Circulation

The exclusive rights of national currency issue are vested with the Reserve Bank. Currency in circulation comprises bank notes and coins issued by the Reserve Bank and does not include coin issued by the Treasury prior to July 1989 (see note 42 (b)).

As at 30 June 2003, the following bank notes and coins were in circulation.

Denomination	Number of Note Forms/Coins 2003 000	Face Value 2003 $000	Number of Note Forms/Coins 2002 000	Face Value 2002 $000
5c	249,240	12,462	225,460	11,273
10c	80,210	8,021	70,170	7,017
20c	25,225	5,045	20,375	4,075
50c	8,078	4,039	5,086	2,543
$1	57,329	57,329	53,614	53,614
$2	56,176	112,352	52,730	105,460
$5	16,220	81,102	15,290	76,450
$10	15,653	156,531	15,730	157,304
$20	50,639	1,012,786	51,094	1,021,879
$50	8,428	421,384	6,588	329,378
$100	9,349	934,884	8,897	889,678
Total Currency in Circulation	576,547	2,805,935	525,034	2,658,671

10. Miscellaneous Liabilities

	Note	2003 $000	2002 $000
Accounts Payable		4,774	6,835
Accrued Employee Entitlements		3,186	2,587
Other Current Liabilities		913	605
Demonetised Currency		1,171	1,136
Capitalised Lease Obligations (unsecured)	38	300	-
Total Miscellaneous Liabilities		10,344	11,163

Demonetised currency is recognised as a contingent liability (see note 42(c)) except for $1.2 million (2002 $1.1 million), which has been retained to cover future expected redemptions.

Pre-decimal coin was issued by the Treasury and is included in the Reserve Bank's contingent liabilities (see note 42(b)).

11. Provision for Restructuring

	2003 $000	2002 $000
Registry and Depository Services		
Balance at Start	-	130
Less Expenses Incurred	-	(99)
Unused Balance Written Back	-	(31)
Total Provision for Restructuring	-	-

During 1999/2000, the Reserve Bank provided for restructuring RBNZ Registry Limited. This included provision for payments to staff who would be made redundant as a result of the out-sourcing of registry processing activities. Payments relating to out-sourcing of registry processing activities were completed during the 2001/02 financial year.

12. Transfers to Retained Earnings and Provision for Transfer of Surplus

Under section 162 of the Reserve Bank of New Zealand Act 1989, the Reserve Bank's surplus, after any transfers to or from Equity, is paid to the Crown.

Transfers to or from the Bank's Equity reflect the difference between actual net expenditure and the level of net expenditure specified under the Funding Agreement with the Crown. Under-spending by the Bank in relation to the Funding Agreement results in a transfer to Equity. Over-spending by the Bank results in a transfer from Equity. In the current year, under-expenditure by the Bank of $4.7 million (2002 $6.1 million) has consequently been transferred to the Bank's Equity.

The Minister of Finance may authorise additional transfers to Equity. In the year under review, no additional transfers were made and the Bank's surplus, net of the transfers noted above, has been recorded in the Provision for Transfer of Surplus.

	2003 $000	2002 $000
Total Expenses	35,812	36,032
Income Retained under Funding Agreement	9,493	11,109
Net Expenditure under Funding Agreement	26,319	24,923
Funding Level specified in Funding Agreement	31,000	31,000
Funding Agreement Under-Expenditure	4,681	6,077
Surplus Available for Appropriation	189,100	175,006
Less Transfers to Equity		
Funding Agreement Under-Expenditure	4,681	6,077
Provision for Transfer of Surplus	184,419	168,929

13. Equity

	2003 $000	2002 $000
Retained Earnings		
Transfers to Retained Earnings	4,681	6,077
Transfer to Properties Revaluation Reserve	-	(15,671)
Movements in Retained Earnings for the Year	4,681	(9,594)
Opening Balance	395,105	404,699
Closing Balance	399,786	395,105
Properties Revaluation Reserve		
Transfer from Retained Earnings	-	15,671
Movements in Properties Revaluation Reserve	-	15,671
Opening Balance	15,671	-
Closing Balance	15,671	15,671
Currency and Artwork Collections Revaluation Reserve		
Opening Balance	696	696
Closing Balance	696	696
Total Equity	416,153	411,472

14. Fair Value of Financial Instruments

The fair value of a financial instrument is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms-length transaction.

Quoted market values represent fair value when a financial instrument is traded in an organised and liquid market that is able to absorb a significant transaction without moving the price against the trader.

Derivative Instruments

Where quoted market prices for derivative instruments are unavailable, the fair value is calculated using discounted cash flow models based on current interest rates for the type and maturity of the underlying instrument. The fair value of all derivative instruments is presented in note 3.

Financial Assets and Liabilities

All other financial assets and liabilities are valued at either quoted market prices or prices derived from market yield curves, as described in the Reserve Bank's accounting policies, except as detailed below.

Repurchase and Reverse-Repurchase Agreements

The carrying value of repurchase and reverse-repurchase agreements is considered to approximate their fair value due to the short-term nature of the agreements.

Unsettled Transactions

The carrying value of unsettled sales and purchases is considered to approximate their fair value due to the very short term until settlement occurs.

Short-Term Advances

The carrying value of Short-Term Advances is considered to approximate their fair value due to the short term until maturity.

Investment Portfolio - NZ Government Securities

The fair value of the Bank's Investment Portfolio - NZ Government Securities is $3.47 billion (2002 $3.01 billion). This has been calculated by valuing the current holdings at 30 June 2003 market prices.

Short-Term Deposits

The carrying values of deposits are considered to approximate their fair value as they are payable on demand.

Currency in Circulation

The fair value of Currency in Circulation is considered to be its face value as reported in the accounts.

Provision for Transfer of Surplus

The carrying value of the provision is considered to approximate its fair value due to the short period between balance date and expected payment date.

15. Concentrations of Funding

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

As at 30 June 2003	Total 2003 $000	New Zealand Government $000	New Zealand Public $000	Overseas Securities Trading Firms $000	Other $000
Foreign Currency Financial Liabilities					
Short-Term Deposits	1,335	-	-	-	1,335
Payable for Unsettled Purchases of Securities	42,610	-	-	42,610	-
Short Sales of Marketable Securities	93,706	-	-	-	93,706
Derivative Instruments in a Loss Position	3,078	-	-	243	2,835
Securities Sold Under Agreements to Repurchase	840,663	-	-	840,663	-
Term Liabilities	4,068,882	4,068,882	-	-	-
Accrued Interest	51,455	51,455	-	-	-
Total Foreign Currency Financial Liabilities	5,101,729	4,120,337	-	883,516	97,876
Local Currency Financial Liabilities					
Government Deposits	3,142,296	3,142,296	-	-	-
Other Deposits	22,730	-	-	-	22,730
Accrued Interest	468	452	16	-	-
Total Local Currency Financial Liabilities	3,165,494	3,142,748	16	-	22,730
Total Financial Liabilities	8,267,223	7,263,085	16	883,516	120,606
Other Liabilities					
Currency in Circulation	2,805,935	-	2,805,935	-	-
Provision for Transfer of Surplus	184,419	184,419	-	-	-
Miscellaneous Liabilities	10,344	-	-	-	10,344
Total Other Liabilities	3,000,698	184,419	2,805,935	-	10,344
Total Liabilities	11,267,921	7,447,504	2,805,951	883,516	130,950

Comparative figures as at 30 June 2002 were as follows.

As at 30 June 2002	Total 2002 $000	New Zealand Government $000	New Zealand Public $000	Overseas Securities Trading Firms $000	Other $000
Foreign Currency Financial Liabilities					
Payable for Unsettled Purchases of Securities	55,254	-	-	-	55,254
Short Sales of Marketable Securities	61,344	-	-	-	61,344
Derivative Instruments in a Loss Position	14,533	-	-	-	14,533
Securities Sold Under Agreements to Repurchase	991,740	-	-	991,740	-
Term Liabilities	4,063,936	4,063,936	-	-	-
Accrued Interest	66,334	66,334	-	-	-
Total Foreign Currency Financial Liabilities	5,253,141	4,130,270	-	991,740	131,131
Local Currency Financial Liabilities					
Government Deposits	2,945,860	2,945,860	-	-	-
Other Deposits	14,673	-	-	-	14,673
Accrued Interest	1,346	1,332	-	-	14
Total Local Currency Financial Liabilities	2,961,879	2,947,192	-	-	14,687
Total Financial Liabilities	8,215,020	7,077,462	-	991,740	145,818
Other Liabilities					
Currency in Circulation	2,658,671	-	2,658,671	-	-
Provision for Transfer of Surplus	168,929	168,929	-	-	-
Miscellaneous Liabilities	11,163	-	1,136	-	10,027
Total Other Liabilities	2,838,763	168,929	2,659,807	-	10,027
Total Liabilities	11,053,783	7,246,391	2,659,807	991,740	155,845

Risk Management Notes

16. Risk Management

The Reserve Bank is involved in policy-orientated activities. Therefore, the Bank's risk management framework differs from the risk management frameworks for most other financial institutions. The main financial risks that the Bank is exposed to include credit risk on foreign currency reserves and interest rate risk on both foreign and local currency assets and liabilities. In the management of foreign reserves, minimising liquidity risk is the prime consideration in order to maintain an effective foreign exchange intervention capability. Policies for managing interest rate, credit, foreign currency and liquidity risk are outlined in notes 18 to 22. Like most other central banks, the nature of the Bank's operations creates exposure to a range of operational risks and reputational risks.

Bank management seeks to ensure that strong and effective risk-analysis, management and control systems are in place for assessing, monitoring and managing risk exposure. A Risk Management Committee, comprising the Governors and senior management, is responsible for advising on the monitoring and management of all risks that the Bank faces. A Reserves Oversight Committee comprising Governors and senior management reviews the foreign reserves business strategy and portfolio structure. This review includes the appropriateness of risk-return trade-offs underlying the business strategy and portfolio structure. Specialist staff conduct the Bank's local currency, foreign currency reserves management and foreign exchange dealing operations in accordance with a clearly defined risk management framework including limits and delegated authorities set by the Governor. The risk management framework is subject to regular review by the Risk Management Committee.

The majority of the Bank's financial risks arise from the foreign reserves and financial market operations of the Bank's Financial Stability Department. Within this department, a Risk Unit is responsible for maintaining the Bank's financial risk management framework. A separate department of the Bank (Financial Services Group) operates independent risk reporting systems that monitor and report compliance with various risk limits and policies.

The Risk Assessment and Assurance Department (which includes Internal Audit) reports to the Governors and the Audit Committee of the Board of Directors on internal audit and related issues. A risk-based framework, which evaluates key business risks and internal controls, is used to determine the extent and frequency of internal audits conducted. All Bank departments are subject to periodic internal audit review.

From July 2003, the Bank will self-insure all property plant and equipment including the Bank's Wellington building.

The Bank is subject to annual external audit by the Office of the Controller and Auditor-General under the Public Audit Act 2001. Auditing arrangements are overseen by an Audit Committee comprising three of the Bank's non-executive directors, which meets regularly to monitor the financial reporting and audit functions within the Bank. The Committee also reviews the internal audit function and has direct access to the external auditor. The Committee reports to the Board of Directors on its activities.

The overall risk management framework is designed to strongly encourage the sound and prudent management of the Bank's risks. The Bank seeks to ensure the risk management framework is consistent with financial market best practice and it periodically engages external experts to assist in reviewing and modifying risk management practices and processes.

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 which describe the standard of conduct required of staff, a number of mandated generic 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, generic requirements and departmental internal control systems are managed by:

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

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

The above policies and procedures for managing operational risk are reinforced by the requirements of section 165 of the Reserve Bank of New Zealand Act 1989, which requires the financial statements of the Bank to include a statement signed by the Governor and Deputy Chief Executive accepting responsibility for, among other things, the establishment and maintenance of a system of effective internal control within the Bank.

18. Credit Risk

Credit risk is the risk of loss arising from a counterparty to a financial contract failing to discharge its obligations.

(a) Credit Risk Management

Credit risk in the foreign currency portfolios is monitored and managed daily. End-of-day exposures are controlled through comprehensive individual counterparty and issuer credit limits. Exposure concentrations to geographical location are controlled by aggregate credit limits. Exposures against these limits are measured in credit-equivalent terms depending on the nature of the exposure. Individual credit limits are set on the basis of the rating of the counterparty or issuer. Aggregate credit limits are set on the basis of country ratings and views on the likelihood of a default of one entity affecting the credit worthiness of other entities. Limits are updated as necessary when new market information emerges, with all limits formally reviewed on an annual basis. The Governor's tolerance for foreign reserve credit risk is a maximum possible loss in the event of default of an AA+ rated non-sovereign counterparty/issuer of no more than $350 million.

Credit risk in local currency portfolios is also monitored and managed daily. Intra-day and inter-day exposures are controlled through comprehensive individual counterparty and issuer limits. Exposures to the New Zealand government are not included in this credit framework. Most exposures arise under intra-day reverse-repurchase agreements entered into with settlement account holders as part of the real time gross settlement system. Securities that the Reserve Bank accepts under intra-day reverse-repurchase agreements include New Zealand government bonds, Treasury bills, and short-term paper issued by registered banks, local authorities and highly rated corporates. The securities are held in the Bank's name for the duration of the exposure and there is no charge for this intra-day liquidity. The exposures to the counterparty from whom securities are purchased under reverse-repurchase agreements are monitored daily and in certain cases are subject to formal limits. The Bank only accepts New Zealand government paper in its inter-day liquidity management operations. Credit exposures arising from securities purchased under agreements to re-sell (reverse-repurchase agreements) are classified according to the issuer of the security for credit exposure concentration purposes. This is consistent with the Bank's view of the substance of the credit exposure and internal risk management.

As part of the arrangements for using derivatives, the Bank manages credit risk by providing or receiving collateral as derivatives are revalued over time. This collateral is likely to take the form of cash or government securities. The collateral taken at balance date was $nil (2002 $nil).

The maximum loss that the Bank would suffer as a result of a security issuer defaulting is the value reported in the accounts.

(b) Concentrations of Credit Exposure

The Bank's significant end-of-year concentrations of credit exposure by industry type were as follows.

	2003 $000	2002 $000
New Zealand Government	5,472,670	5,850,452
Other Sovereign Issuers (excluding New Zealand Government)	4,347,697	3,667,632
Supranational Financial Institutions	182,625	262,354
Foreign Banks	1,569,997	1,642,045
Other	72,778	4,682
Total Financial Assets	11,645,767	11,427,165

An alternative approach would be to classify credit exposures arising from securities purchased under agreements to re-sell according to the counterparty to the transaction. Using this approach would result in credit exposures of:

- $2.4 billion (2002 $1.5 billion) and $0.4 billion (2002 $0.7 billion) being reported against securities trading firms[5] and foreign banks respectively, instead of against Other Sovereign Issuers; and
- $0.7 billion (2002 $2.7 billion) and $1.4 billion (2002 $0.1 billion) being reported against security trading firms and banks respectively, instead of against New Zealand Government.

The Bank's maximum credit risk exposure in relation to derivatives is the cost of re-establishing the derivative contracts in the market in the event of the failure of the counterparty to fulfill its obligations. This cost is the fair value of the derivatives as reported in note 3.

The Bank's significant end-of-year concentrations of credit exposure based on the entity's country of ownership were as follows.

	2003 $000	2002 $000
New Zealand	5,482,233	5,850,460
USA	3,146,490	2,283,216
Japan	892	8,569
Europe	2,811,274	2,850,069
Supranational Financial Institutions	182,625	262,354
Other	22,253	172,497
Total Financial Assets	11,645,767	11,427,165

(c) Credit Exposure by Credit Rating

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

5 Securities trading firms are non-bank money market participants.

	Credit Rating	2003 $000	% of 2003 Financial Assets	2002 $000	% of 2002 Financial Assets
Foreign Currency Financial Assets					
Cash Balances with Other Central Banks	AAA	66,577	0.6%	173,207	1.5%
	AA+	-	0%	4,422	0%
	AA-	888	0%	8,396	0.1%
Other Cash Balances	AA+	642	0%	3,696	0%
	AA-	1,066	0%	1,271	0%
	N/R	30	0%	1,256	0%
Marketable Securities	AAA	2,175,081	18.7%	1,821,313	15.9%
	AA+	107,614	0.9%	247,031	2.3%
	AA	212,476	1.8%	328,581	2.9%
	AA-	781,803	6.7%	425,434	3.7%
Short-Term Advances	AAA	42,540	0.4%	184,426	1.6%
	AA-	-	0%	163,935	1.4%
Receivable from Unsettled Sales of Securities	AA+	-	0%	24,725	0.2%
	N/R	43,195	0.4%	-	0%
Securities Purchased Under Agreements to Re-sell	AAA	2,696,767	23.2%	2,194,682	19.3%
	AA+	62,244	0.5%	-	0%
Accrued Interest	Various	24,728	0.2%	24,052	0.2%
		6,215,651	53.4%	5,606,427	49.1%
Local Currency Financial Assets					
Cash on Hand	AAA	4	0%	4	0%
Securities Purchased Under Agreements to Re-sell	AAA	2,120,364	18.2%	2,818,939	24.7%
Investment Portfolio - NZ Government Securities	AAA	3,242,673	27.8%	2,953,554	25.8%
Accrued Interest	AAA	57,199	0.5%	48,233	0.4%
Other Local Currency Financial Assets	AA-	9,871	0.1%	-	0%
	N/R	5	0%	8	0%
		5,430,116	46.6%	5,820,738	50.9%
Total Financial Assets		11,645,767	100.0%	11,427,165	100.0%
Summary by Major Credit Category					
Foreign Currency Financial Assets	AAA	4,980,965	42.9%	4,189,202	36.7%
	AA+/-	1,166,733	9.9%	1,391,917	12.2%
	Various	24,728	0.2%	24,052	0.2%
	N/R	43,225	0.4%	1,256	0%
Total Foreign Currency Financial Assets		6,215,651	53.4%	5,606,427	49.1%
Local Currency Financial Assets	AAA	5,420,240	46.5%	5,820,726	50.9%
	AA-	9,871	0.1%	8	0%
	N/R	5	0%	4	0%
Total Local Currency Financial Assets		5,430,116	46.6%	5,820,738	50.9%
Total Financial Assets		11,645,767	100.0%	11,427,165	100.0%

(d) Credit Exposure by Counterparty

The table below shows the number of individual counterparties or groups of closely related counterparties where the Bank's credit exposures equalled or exceeded 10 per cent of the Bank's equity[6] for:

- End-of-year actual credit exposure.
- Peak end-of-day credit exposure (on the basis of limits).
- Peak local currency intra-day credit exposures (on the basis of limits). These exposures arise through intra-day reverse-repurchase agreements entered into with settlement account holders as part of the real time gross settlement system.

% of equity	End-of-year 2003	End-of-year 2002	Peak end-of-day 2003	Peak end-of-day 2002	Peak local currency intra-day 2003	Peak local currency intra-day 2002
10% to 19.9%	8	6	27	22	15	14
20% to 29.9%	4	3	2	1	-	1
30% to 39.9%	3	1	-	1	10	10
40% to 49.9%	1	1	18	20	-	-
50% to 59.9%	-	1	-	1	-	-
60% to 69.9%	-	2	-	-	-	-
70% to 79.9%	1	-	-	-	-	-
80% to 89.9%	-	-	18	16	-	-
90% to 99.9%	-	-	4	4	-	-
100% to 109.9%	-	-	3	4	-	-
110% to 119.9%	-	-	-	-	-	-
120% to 129.9%	-	-	2	1	-	-
130% to 139.9%	-	-	2	2	-	-
190% to 199.9%	-	-	7	6	-	-
210% to 219.9%	-	-	-	-	-	-
240% to 249.9%	-	-	1	1	-	-
280% to 289.9%	1	-	1	-	-	-
330% to 339.9%	-	1	-	1	-	-
470% to 479.9%	-	-	-	-	-	-
490% to 499.9%	-	-	-	-	-	-
520% to 529.9%	-	-	-	-	-	-
540% to 549.9%	-	1	-	1	-	-
720% to 729.9%	1	-	1	-	-	-

Peak end-of-day exposures greater than 100 per cent of the Bank's equity were to sovereign issuers and supranational financial institutions. The Bank does not constrain credit exposure to certain sovereign issuers (e.g. the United States of America). Exposures to these sovereign issuers are managed through other limits and controls (such as currency composition limits). End-of-year exposures greater than 100 per cent were to highly-rated sovereign issuers. Peak end-of-day exposures to these sovereign issuers are based on end-of-year exposures.

6 Excludes exposures to the New Zealand government.

19. Interest Rate Risk

Interest rate risk is the risk of loss arising from changes in interest rates.

Foreign Currency Interest Rate Risk

The Reserve Bank's "neutral" asset portfolios involve some interest rate risk because the Bank's foreign currency assets are funded by foreign currency liabilities whose interest rate characteristics cannot be exactly replicated. The interest rate characteristics of the liabilities are similar to those of highly-rated bank and corporate instruments, but liquidity considerations require that a significant proportion of investments are in United States and German domestic government instruments, which have different interest rate characteristics to the liabilities. The Bank accepts the associated interest rate risk as inevitable, but seeks to closely limit additional, mainly duration-related, interest rate mismatches. The Bank is continually reviewing investment opportunities for ways to reduce the costs and risks associated with holding reserves, while maintaining the liquidity of its intervention assets.

Interest rate risk arising from departures from the neutral position is managed by way of Value at Risk limits and stop-loss limits for the Bank's combined market risk as described in note 21.

Local Currency Interest Rate Risk

Interest rate risk on the Investment Portfolio - New Zealand Government Securities is not actively managed as a matter of policy. This recognises that:

- active risk management could require the Bank to carry out transactions that conflict with the Bank's monetary policy stance; and
- the investment portfolio held by the Bank is exactly matched by liabilities held by the Crown, so from a consolidated Crown position the interest rate risk is eliminated.

The duration of the investment portfolio at 30 June 2003 was 5.7 years (2002 5.6 years).

The Bank's exposure to interest rate risk that arises from liquidity management operations is minimal, due to the very short-term nature of the exposures created and because the exposures are offset by other interest-bearing assets and liabilities.

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

As at 30 June 2003	Weighted Average Interest Rate	Total 2003 $000	Non-Interest Sensitive $000	6 Months or Less $000	6 to 12 Months $000	1 to 2 Years $000	2 to 5 Years $000	Over 5 Years $000
Foreign Currency Financial Assets								
Cash Balances with Other Central Banks	1.13%	67,465	-	67,465	-	-	-	-
Other Cash Balances	1.12%	1,738	-	1,738	-	-	-	-
Marketable Securities	1.62%	3,276,974	-	2,578,027	149,250	149,712	286,970	113,015
Short-Term Advances	1.08%	42,540	-	42,540	-	-	-	-
Receivable from Unsettled Sales of Securities	0%	43,195	-	43,195	-	-	-	-
Securities Purchased Under Agreements to Re-sell	1.22%	2,759,011	-	2,759,011	-	-	-	-
Accrued Interest	0%	24,728	-	24,728	-	-	-	-
Total Foreign Currency Financial Assets	1.42%	6,215,651	-	5,516,704	149,250	149,712	286,970	113,015
Foreign Currency Financial Liabilities								
Short-Term Deposits	0.30%	1,335	-	1,335	-	-	-	-
Payable for Unsettled Purchases of Securities	0%	42,610	-	42,610	-	-	-	-
Short Sales of Marketable Securities	2.93%	93,706	-	-	-	20,266	62,470	10,970
Derivative Instruments in a Loss Position	2.77%	3,078	-	3,078	-	-	-	-
Securities Sold Under Agreements to Repurchase	0.89%	840,663	-	840,663	-	-	-	-
Term Liabilities	1.80%	4,068,882	-	2,877,554	110,198	-	1,081,130	-
Accrued Interest	0%	51,455	-	51,455	-	-	-	-
Total Foreign Currency Financial Liabilities	1.64%	5,101,729	-	3,816,695	110,198	20,266	1,143,600	10,970
Foreign Currency Interest Rate Sensitivity Gap[7]		1,113,922	-	1,700,009	39,052	129,446	(856,630)	102,045
Local Currency Financial Assets								
Cash on Hand	0%	4	-	4	-	-	-	-
Securities Purchased Under Agreements to Re-sell	5.18%	2,120,364	-	2,120,364	-	-	-	-
Investment Portfolio - NZ Government Securities	6.70%	3,242,673	-	-	148,997	580,118	880,821	1,632,737
Accrued Interest	0%	57,199	-	57,199	-	-	-	-
Other Local Currency Financial Assets	5.22%	9,876	-	9,876	-	-	-	-
Other Assets	0%	38,307	38,307	-	-	-	-	-
Total Local Currency Assets	5.99%	5,468,423	38,307	2,187,443	148,997	580,118	880,821	1,632,737
Local Currency Financial Liabilities								
Government Deposits	5.25%	3,142,296	-	3,142,296	-	-	-	-
Other Deposits	0.45%	22,730	-	22,730	-	-	-	-
Accrued Interest	0%	468	-	468	-	-	-	-
Other Liabilities	0%	3,000,698	3,000,698	-	-	-	-	-
Equity	0%	416,153	416,153	-	-	-	-	-
Total Local Currency Liabilities and Equity	2.51%	6,582,345	3,416,851	3,165,494	-	-	-	-
Local Currency Interest Rate Sensitivity Gap[7]		(1,113,922)	(3,378,544)	(978,051)	148,997	580,118	880,821	1,632,737
On-Balance Sheet Interest Rate Sensitivity Gap		-	(3,378,544)	721,958	188,049	709,564	24,191	1,734,782
Off-Balance Sheet Instruments		-	-	(545,030)	(80,074)	(1,191)	654,891	(28,596)
Total Interest Rate Sensitivity Gap		-	(3,378,544)	176,928	107,975	708,373	679,082	1,706,186
All Currencies								
New Zealand		(15,000)	(3,378,544)	120,871	148,997	580,118	880,821	1,632,737
United States		8,314	-	121,113	(1,301)	16,550	(112,242)	(15,806)
Euro		(135)	-	(73,285)	(39,721)	111,705	(89,497)	90,663
Japan		1,106	-	1,106	-	-	-	-
Other		5,715	-	7,123	-	-	-	(1,408)

7 Foreign currency assets and liabilities do not match due to $1.1 billion (2002 $348 million) of assets arising from forward foreign exchange swap contracts for Market Operations. These assets are fully hedged through forward transactions.

Comparative figures as at 30 June 2002 were as follows.

As at 30 June 2002	Weighted Average Interest Rate	Total 2002 $000	Non-Interest Sensitive $000	6 Months Or Less $000	6 to 12 Months $000	1 to 2 Years $000	2 to 5 Years $000	Over 5 Years $000
Foreign Currency Financial Assets								
Cash Balances with Other Central Banks	2.79%	186,025	-	186,025	-	-	-	-
Other Cash Balances	2.25%	6,223	-	6,223	-	-	-	-
Marketable Securities	2.43%	2,822,359	-	2,124,257	6,839	336,552	273,725	80,986
Short-Term Advances	1.77%	348,361	-	348,361	-	-	-	-
Receivable from Unsettled Sales of Securities	0%	24,725	-	24,725	-	-	-	-
Securities Purchased Under Agreements to Re-sell	2.37%	2,194,682	-	2,194,682	-	-	-	-
Accrued Interest	0%	24,052	-	24,052	-	-	-	-
Total Foreign Currency Financial Assets	2.36%	5,606,427	-	4,908,325	6,839	336,552	273,725	80,986
Foreign Currency Financial Liabilities								
Payable for Unsettled Purchases of Securities	0%	55,254	-	55,254	-	-	-	-
Short Sales of Marketable Securities	3.91%	61,344	-	-	-	-	61,344	-
Derivative Instruments in a Loss Position	0%	14,533	-	14,533	-	-	-	-
Securities Sold Under Agreements to Repurchase	2.05%	991,740	-	991,740	-	-	-	-
Term Liabilities	2.56%	4,063,936	-	2,554,913	-	337,956	1,171,067	-
Accrued Interest	0%	66,334	-	66,334	-	-	-	-
Total Foreign Currency Financial Liabilities	2.41%	5,253,141	-	3,682,774	-	337,956	1,232,411	-
Foreign Currency Interest Rate Sensitivity Gap		353,286	-	1,225,551	6,839	(1,404)	(958,686)	80,986
Local Currency Financial Assets								
Cash on Hand	0%	4	-	4	-	-	-	-
Securities Purchased Under Agreements to Re-sell	5.58%	2,818,939	-	2,818,939	-	-	-	-
Investment Portfolio - NZ Government Securities	6.93%	2,953,554	-	-	445,865	149,564	1,029,109	1,329,016
Accrued Interest	0%	48,233	-	48,233	-	-	-	-
Other Local Currency Financial Assets	6.89%	8	-	4	3	1	-	-
Other Assets	0%	38,090	38,090	-	-	-	-	-
Total Local Currency Assets	6.18%	5,858,828	38,090	2,867,180	445,868	149,565	1,029,109	1,329,016
Local Currency Financial Liabilities								
Government Deposits	5.50%	2,945,860	-	2,945,860	-	-	-	-
Other Deposits	5.25%	14,673	-	14,673	-	-	-	-
Accrued Interest	0%	1,346	-	1,346	-	-	-	-
Other Liabilities	0%	2,838,763	2,838,763	-	-	-	-	-
Equity	0%	411,472	411,472	-	-	-	-	-
Total Local Currency Liabilities and Equity	2.62%	6,212,114	3,250,235	2,961,879	-	-	-	-
Local Currency Interest Rate Sensitivity Gap		(353,286)	(3,212,145)	(94,699)	445,868	149,565	1,029,109	1,329,016
On-Balance Sheet Interest Rate Sensitivity Gap		-	(3,212,145)	1,130,852	452,707	148,161	70,423	1,410,002
Off-Balance Sheet Instruments		-	-	(794,662)	(32,787)	(35,988)	812,059	51,378
Total Interest Rate Sensitivity Gap		-	(3,212,145)	336,190	419,920	112,173	882,482	1,461,380
All Currencies								
New Zealand		(1,233)	(3,212,145)	257,354	445,868	149,565	1,029,109	1,329,016
United States		(1,894)	-	39,196	(32,303)	65,967	(74,754)	-
Euro		(2,236)	-	58,233	6,355	(103,359)	(71,873)	108,408
Japan		1,512	-	(22,444)	-	-	-	23,956
Other		3,851	-	3,851	-	-	-	-

20. Foreign Currency Risk

Foreign currency risk is the risk of loss arising from changes in exchange rates. The assets held in foreign currency portfolios are largely matched by foreign currency liabilities of approximately equal value. The Reserve Bank's exposure to foreign currency risk arises from trading positions undertaken by specialist staff. Foreign currency risk is managed by way of Value at Risk limits and stop-loss limits for the Bank's combined market risk as described in note 21.

Foreign currency assets and liabilities arising from domestic Market Operations are fully hedged using forward foreign currency swaps.

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

	Currency of Denomination				
As at 30 June 2003	United States Dollar $000	Euro $000	Japanese Yen $000	Other Currencies $000	Total All Currencies $000
Foreign Currency Financial Assets					
Cash Balances with Other Central Banks	54,236	7,103	888	5,238	67,465
Other Cash Balances	24	1,030	218	466	1,738
Marketable Securities	1,627,966	1,648,997	-	11	3,276,974
Short-Term Advances	42,540	-	-	-	42,540
Receivable from Unsettled Sales of Securities	-	43,195	-	-	43,195
Securities Purchased Under Agreements to Re-sell	2,241,181	517,830	-	-	2,759,011
Accrued Interest	4,056	20,672	-	-	24,728
Total Foreign Currency Financial Assets	3,970,003	2,238,827	1,106	5,715	6,215,651
Foreign Currency Financial Liabilities					
Short-Term Deposits	1,335	-	-	-	1,335
Payable for Unsettled Purchases of Securities	-	42,610	-	-	42,610
Short Sales of Marketable Securities	-	93,706	-	-	93,706
Derivative Instruments in a Loss Position	-	3,078	-	-	3,078
Securities Sold Under Agreements to Repurchase	696,926	143,737	-	-	840,663
Term Liabilities	2,144,740	1,924,142	-	-	4,068,882
Accrued Interest	19,766	31,689	-	-	51,455
Total Foreign Currency Financial Liabilities	2,862,767	2,238,962	-	-	5,101,729
Off-Balance Sheet Instruments	(1,098,922)	-	-	-	(1,098,922)
Net Currency Exposure	8,314	(135)	1,106	5,715	15,000

All net currency exposures were within approved limits at balance date.

As at 30 June 2002	United States Dollar $000	Euro $000	Japanese Yen $000	Other Currencies $000	Total All Currencies $000
	Currency of Denomination				
Foreign Currency Financial Assets					
Cash Balances with Other Central Banks	44,064	127,731	8,396	5,834	186,025
Other Cash Balances	992	2,394	1,462	1,375	6,223
Marketable Securities	1,848,035	957,229	17,095	-	2,822,359
Short-Term Advances	348,361	-	-	-	348,361
Receivable from Unsettled Sales of Securities	-	24,725	-	-	24,725
Securities Purchased Under Agreements to Re-sell	1,412,225	782,457	-	-	2,194,682
Accrued Interest	6,648	17,404	-	-	24,052
Total Foreign Currency Financial Assets	3,660,325	1,911,940	26,953	7,209	5,606,427
Foreign Currency Financial Liabilities					
Payable for Unsettled Purchases of Securities	-	55,254	-	-	55,254
Short Sales of Marketable Securities	-	61,344	-	-	61,344
Derivative Instruments in a Loss Position	-	14,021	296	216	14,533
Securities Sold Under Agreements to Repurchase	902,709	89,031	-	-	991,740
Term Liabilities	2,339,056	1,562,937	161,943	-	4,063,936
Accrued Interest	26,872	30,026	9,436	-	66,334
Total Foreign Currency Financial Liabilities	3,268,637	1,812,613	171,675	216	5,253,141
Off-Balance Sheet Instruments	(393,582)	(101,563)	146,234	(3,142)	(352,053)
Net Currency Exposure	(1,894)	(2,236)	1,512	3,851	1,233

21. Market Risk

The Reserve Bank manages interest rate risk and foreign currency risk in an integrated manner under the following market risk management arrangements.

(a) Tolerance for Extreme Market Risk Losses

The Governor's tolerance for loss from interest rate risk and foreign currency risk is no more than $75 million (2002 $100 million) in aggregate in any financial year. Within this aggregate outer tolerance for market risk losses, the Governor's tolerance for market risk losses from actively managed positions is $25 million (2002 $50 million) in any financial year. Stress testing (outlined below) is used to verify the robustness of the loss tolerances in times of extreme global financial market crises.

(b) VaR Limits and Stress Testing

Interest rate and foreign exchange risks are controlled on a day-to-day basis by way of Value at Risk (VaR) limits. VaR estimates the potential daily loss from movements in market risks (interest rates and foreign currencies movements) in normal market conditions. The Bank uses a parametric VaR model based on equally weighted data for the previous year (260 trading days), a one day time horizon and a 99% confidence interval. This means the Bank would expect to incur losses greater than predicted by VaR estimates only once every 100 trading days, or about 2.5 times a year. VaR does not capture market risk losses arising from the extreme price volatility associated with financial market crises so VaR limits are set well inside outer tolerances for market risk losses to allow for losses arising from extreme financial crises. The Bank calibrates the allowance for extreme market risk losses by modelling the impact of previous global financial crises on a representative diversified portfolio that fully utilises VaR limits.

VaR limits are set for the aggregate portfolios (total foreign reserves assets and liabilities), risk-neutral portfolios, and actively managed portfolios (trading portfolios). The VaR for the trading portfolios is calculated as the difference between the actual portfolios and neutral portfolios.

VaR	Actual Portfolios 2003 $000	2002 $000	Neutral Portfolios 2003 $000	2002 $000	Trading Portfolios 2003 $000	2002 $000
Limit	6,000	10,000	4,000	4,000	2,000	6,000
As at 30 June	321	390	238	342	83	48
Peak over period	1,045	2,063	482	2,069	615	1,303
Low over period	177	373	159	343	(48)	(103)
Average over period	379	1,228	274	1,153	105	75

In the year to 30 June 2003, actual daily losses on the traded portfolios were within (predicted) VaR 99 per cent (2002 97 per cent) of the time. Losses which exceed VaR more frequently than expected are analysed to verify the integrity of the VaR model and the results of analysis are reported to senior management at Risk Management Committee.

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

VaR	Foreign Currency Risk $000	Interest Rate Risk $000	Correlation[8] $000	Total Market Risk 2003 $000	Total Market Risk 2002 $000
Limit				6,000	10,000
As at 30 June	73	431	(183)	321	390
Peak over period	109	1,286	(350)	1,045	2,063
Low over period	72	225	(120)	177	373
Average over period	113	519	(253)	379	1,228

(c) Stop-Loss Limits

Stop-loss limits are set to control losses that may arise from departures from the risk neutral position. A stop-loss limit of $6 million in any rolling 20-day trading period and $9 million in any rolling 250 day trading period is applied to the aggregate interest rate and foreign currency losses from trading positions. When aggregate market risk losses exceed the stop-loss limit, positions are closed down. The Governor must approve the re-establishment of positions.

8 Correlation is the reduction in overall risk due to risks in one portfolio offsetting risks in another portfolio.

22. Liquidity Risk

Liquidity risk is the risk that an entity will encounter difficulty in raising funds at short notice to meet commitments associated with financial instruments. Liquidity risk is also the risk that an entity will have to sell a financial asset quickly at much less than its fair value.

Foreign Currency Activities

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

The Bank has additional liquidity arrangements for foreign currency assets including:

- Repurchase agreements with other central banks enabling the Bank to sell securities in exchange for foreign currency, while simultaneously agreeing to repurchase those same securities at a specified later date for an agreed amount. In essence, the arrangement allows the Bank to enhance the liquidity of its foreign reserves portfolio with minimum additional risks.
- A committed credit line (US $100 million) to augment the foreign currency that can be accessed quickly.

Local Currency Activities

The Bank is responsible for managing the daily liquidity of the banking system. This includes advancing funds to and withdrawing funds from the banking system to smooth out daily liquidity peaks and troughs. The nature of these activities, which mostly involve offsetting the flow of funds from the Crown to settlement banks, is such that the Bank is not subject to the liquidity constraints that impact on other organisations.

23. Maturity Analysis

As at 30 June 2003	Total 2003 $000	6 Months or Less $000	6 to 12 Months $000	1 to 2 Years $000	2 to 5 Years $000	Over 5 Years $000
Foreign Currency Financial Assets						
Cash Balances with Other Central Banks	67,465	67,465	-	-	-	-
Other Cash Balances	1,738	1,738	-	-	-	-
Marketable Securities	3,276,974	2,578,028	149,249	149,712	286,969	113,016
Short-Term Advances	42,540	42,540	-	-	-	-
Receivable from Unsettled Sales of Securities	43,195	43,195	-	-	-	-
Securities Purchased Under Agreements to Re-sell	2,759,011	2,759,011	-	-	-	-
Accrued Interest	24,728	24,728	-	-	-	-
Total Foreign Currency Financial Assets	6,215,651	5,516,705	149,249	149,712	286,969	113,016
Foreign Currency Financial Liabilities						
Short-Term Deposits	1,335	1,335	-	-	-	-
Payable for Unsettled Purchases of Securities	42,610	42,610	-	-	-	-
Short Sales of Marketable Securities	93,706	-	-	20,266	62,470	10,970
Derivative Instruments in a Loss Position	3,078	1,155	1,627	-	-	296
Securities Sold Under Agreements to Repurchase	840,663	840,663	-	-	-	-
Term Liabilities	4,068,882	468,199	178,241	635,867	2,105,156	681,419
Accrued Interest	51,455	51,455	-	-	-	-
Total Foreign Currency Financial Liabilities	5,101,729	1,405,417	179,868	656,133	2,167,626	692,685
Foreign Currency Maturity Gap	1,113,922	4,111,288	(30,619)	(506,421)	(1,880,657)	(579,669)
Local Currency Financial Assets						
Cash on Hand	4	4	-	-	-	-
Securities Purchased Under Agreements to Re-sell	2,120,364	2,120,364	-	-	-	-
Investment Portfolio - NZ Government Securities	3,242,673	-	148,997	580,118	880,821	1,632,737
Accrued Interest	57,199	57,199	-	-	-	-
Other Local Currency Financial Assets	9,876	9,876	-	-	-	-
Other Assets	38,307	9,612	-	-	4,511	24,184
Total Local Currency Assets	5,468,423	2,197,055	148,997	580,118	885,332	1,656,921
Local Currency Financial Liabilities						
Government Deposits	3,142,296	3,142,296	-	-	-	-
Other Deposits	22,730	22,730	-	-	-	-
Accrued Interest	468	468	-	-	-	-
Other Liabilities	3,000,698	190,436	133	-	1,079	2,809,050
Equity	416,153	-	-	-	-	416,153
Total Local Currency Liabilities and Equity	6,582,345	3,355,930	133	-	1,079	3,225,203
Local Currency Maturity Gap	(1,113,922)	(1,158,875)	148,864	580,118	884,253	(1,568,282)
Net Maturity Gap	-	2,952,413	118,245	73,697	(996,404)	(2,147,951)

As at 30 June 2002	Total 2002 $000	6 Months or Less $000	6 to 12 Months $000	1 to 2 Years $000	2 to 5 Years $000	Over 5 Years $000
Foreign Currency Financial Assets						
Cash Balances with Other Central Banks	186,025	186,025	-	-	-	-
Other Cash Balances	6,223	6,223	-	-	-	-
Marketable Securities	2,822,359	2,107,344	6,839	336,552	290,638	80,986
Short-Term Advances	348,361	348,361	-	-	-	-
Receivable from Unsettled Sales of Securities	24,725	24,725	-	-	-	-
Securities Purchased Under Agreements to Re-sell	2,194,682	2,194,682	-	-	-	-
Accrued Interest	24,052	24,052	-	-	-	-
Total Foreign Currency Financial Assets	5,606,427	4,891,412	6,839	336,552	290,638	80,986
Foreign Currency Financial Liabilities						
Short-Term Deposits	-	-	-	-	-	-
Payable for Unsettled Purchases of Securities	55,254	55,254	-	-	-	-
Short Sales of Marketable Securities	61,344	-	-	-	61,344	-
Derivative Instruments in a Loss Position	14,533	12,792	-	1,741	-	-
Securities Sold Under Agreements to Repurchase	991,740	991,740	-	-	-	-
Term Liabilities	4,063,936	161,943	253,373	727,244	2,369,947	551,429
Accrued Interest	66,334	66,334	-	-	-	-
Total Foreign Currency Financial Liabilities	5,253,141	1,288,063	253,373	728,985	2,431,291	551,429
Foreign Currency Maturity Gap	353,286	3,603,349	(246,534)	(392,433)	(2,140,653)	(470,443)
Local Currency Financial Assets						
Cash on Hand	4	4	-	-	-	-
Securities Purchased Under Agreements to Re-sell	2,818,939	2,818,939	-	-	-	-
Investment Portfolio - NZ Government Securities	2,953,554	-	445,865	149,564	1,029,109	1,329,016
Accrued Interest	48,233	48,233	-	-	-	-
Other Local Currency Financial Assets	8	4	3	1	-	-
Other Assets	38,090	8,122	-	-	5,357	24,611
Total Local Currency Assets	5,858,828	2,875,302	445,868	149,565	1,034,466	1,353,627
Local Currency Financial Liabilities						
Government Deposits	2,945,860	2,945,860	-	-	-	-
Other Deposits	14,673	14,673	-	-	-	-
Accrued Interest	1,346	1,346	-	-	-	-
Other Liabilities	2,838,763	176,722	-	-	605	2,661,436
Equity	411,472	-	-	-	-	411,472
Total Local Currency Liabilities and Equity	6,212,114	3,138,601	-	-	605	3,072,908
Local Currency Maturity Gap	(353,286)	(263,299)	445,868	149,565	1,033,861	(1,719,281)
Net Maturity Gap	-	3,340,050	199,334	(242,868)	(1,106,792)	(2,189,724)

Consolidated Statement of Cost of Services Notes

24. Currency Operations

Seigniorage is the income directly associated with the issue of currency and provides the Reserve Bank with its main source of income. Registered banks pay the Bank the face value of the currency issued to them. These funds are invested in New Zealand government securities, which are included in local currency financial assets, to back the currency in circulation liability. Currency in circulation is a non-interest bearing liability. However, the New Zealand government securities investment portfolio is interest bearing. The resulting interest income is seigniorage.

As part of the Currency Operations function, the Bank issues collectors' currency. The net profit for this activity in 2003 was $86,000 (2002 $229,000 profit) this included a currency stock write-off of $183,000.

	2003 $000	2002 $000
Seigniorage	190,754	183,220
Other Income[9]	6	2,677
Operating Income	190,760	185,897
New Note Issue Expenses	2,198	1,119
New Coin Issue Expenses	3,651	3,064
Collectors' Currency Issue Expenses	192	537
Currency Issue Expenses	6,041	4,720
Other Currency Expenses	3,337	5,327
Operating Expenses	9,378	10,047
Currency Operations Operating Surplus	181,382	175,850

25. Foreign Reserves Management

The Reserve Bank holds foreign currency assets to enable intervention in the foreign exchange market, should that ever prove necessary. These foreign reserves are fully funded by foreign currency borrowings through the Treasury. New Zealand pays more to borrow overseas than it can earn investing in high quality assets able to be realised quickly. As a result, holding reserves involves a small net cost, although some reduction in that cost is possible through active management of the holdings.

Subject to liquidity and credit risk constraints being satisfied, the Bank defines benchmark portfolios that represent a "neutral" asset and liability structure in terms of market risk. The neutral position is established to minimise the Bank's exposure to foreign currency risk and interest rate risk. Departures from the neutral position involve discretionary trading and portfolio management decisions, and quantitative trading strategies, undertaken by specialist staff with delegated authority from the Governor. The net gain or loss arising from departures from the neutral portfolio represents the active management of reserves.

9 The decrease in other income reflects a reduction in property management income due to the introduction of a capital charge in 2002/03 on the book value of the Bank's property.

	2003 $000	2002 $000
Active Management Trading Gain (Loss)	(388)	1,882
Gain (Loss) on Neutral Asset/Liability Structure	(4,843)	(11,674)
Net Investment Income	(5,231)	(9,792)
Other	(559)	(886)
Foreign Exchange Difference on Translation	230	491
Foreign Reserves Management Gain (Loss)	(5,560)	(10,187)
Residual Income Allocation[10]	16,754	13,321
Operating Income	11,194	3,134
Operating Expenses	3,878	3,915
Foreign Reserves Management Operating Surplus	7,316	(781)

For further information on the Foreign Reserves Management Function, see note 1, parts (a) to (f). Further information on risk management is contained in notes 16 to 22.

26. Overseas Investment Commission Secretariat

The Overseas Investment Commission (Commission) administers New Zealand's legislative controls on major inward foreign direct investment. The Reserve Bank provides the secretariat of the Commission and funds its activities to the extent these are not covered by application fees.

The cost of services of the Overseas Investment Commission Secretariat (the "OIC") for the year ended 30 June 2003 was as follows.

	2003 $000	2002 $000
Application Fees	816	848
Other	5	7
Operating Income	821	855
Personnel	350	363
Administration	29	30
Asset Management	48	66
Professional Services	142	64
Legal Fees	11	287
Computing Expenses	73	72
Other	15	56
Operating Expenses	668	938
Overseas Investment Commission Secretariat Operating Surplus (Deficit)	153	(83)

The 2002 legal fees arose from a judicial review of an Overseas Investment Commission ruling.

10 Residual Income Allocation represents the income earned from the assets funded by the Bank's net equity, which is allocated equally to the Foreign Reserves Management and Market Operations functions.

Fees for the OIC were introduced on 15 January 1996. Under the Funding Agreement from 1 July 2000, the OIC operating surplus (deficit) is retained by the Bank. The annual operating income and surplus (deficit) since 15 January 1996 was as follows.

	Operating Income $000	Operating Surplus (Deficit) $000
1996 (six months)	373	46
1997	589	(116)
1998	583	(279)
1999	764	41
2000	628	(63)
2001	581	(94)
2002	855	(83)
2003	821	153
	5,194	(395)

27. Registry and Depository Services

The Reserve Bank provides registrar and paying agency services to issuers of fixed interest securities. The Bank also operates the Austraclear New Zealand System, which provides the financial markets with depository, clearing, and settlement services for debt securities and equities.

Though the Bank outsourced the processing of registry services to Computershare Investor Services (NZ) Limited, the Bank remains responsible for the services now carried out on its behalf.

	2003 $000	2002 $000
Fees for Registry and Depository Services	5,081	5,162
Other Income	288	653
Operating Income	5,369	5,815
Personnel	714	830
Other	3,234	3,104
Operating Expenses	3,948	3,934
Registry and Depository Services Operating Surplus	1,421	1,881

Consolidated Statement of Financial Performance Notes

28. Interest Income from Financial Assets

	2003 $000	2002 $000
Interest Income from Foreign Currency Financial Assets		
Cash Balances with Other Central Banks	2,038	4,189
Other Cash Balances	80	2,864
Marketable Securities	71,166	132,742
Securities Purchased Under Agreements to Re-sell	34,930	26,616
Securities Lending	517	480
Total Interest Income from Foreign Currency Financial Assets	108,731	166,891
Interest Income from Local Currency Financial Assets		
Securities Purchased Under Agreements to Re-sell	168,077	125,161
Investment Portfolio - NZ Government Securities	218,174	197,916
Advances to Staff	-	2
Total Interest Income from Local Currency Financial Assets	386,251	323,079
Total Interest Income from Financial Assets	494,982	489,970

29. Interest Expense on Financial Liabilities

	2003 $000	2002 $000
Interest Expense on Foreign Currency Financial Liabilities		
Securities Sold Under Agreements to Repurchase	3,247	4,196
Term Liabilities	137,969	154,864
Total Interest Expense on Foreign Currency Financial Liabilities	141,216	159,060
Interest Expense on Local Currency Financial Liabilities		
Government Deposits	199,699	111,326
Other Deposits	5,450	6,135
Total Interest Expense on Local Currency Financial Liabilities	205,149	117,461
Total Interest Expense on Financial Liabilities	346,365	276,521

30. Gain/Loss from Market Value Changes

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

	2003 $000	2002 $000
Market Value Changes - Financial Assets		
(Loss) Gain from Unrealised Market Value Changes	21,839	(22,574)
Gain from Realised Market Value Changes	6,353	32,900
Total Gain from Market Value Changes from Financial Assets	28,192	10,326
Market Value Changes - Financial Liabilities		
Loss from Unrealised Market Value Changes	32,998	30,419
Loss from Realised Market Value Changes	18,344	16,341
Total Loss from Market Value Changes on Financial Liabilities	51,342	46,760

31. Net Foreign Exchange Revaluation Gain (Loss)

	2003 $000	2002 $000
Foreign Exchange Revaluations		
Gain (Loss) on Financial Assets	(471,881)	(623,321)
Gain (Loss) on Financial Liabilities	472,368	624,851
Net Foreign Exchange Revaluation Gain (Loss)	487	1,530

32. Other Income

	Actual 2003 $000	Budget 2003 $000	Actual 2002 $000
Fees for Registry and Depository Services	5,081	4,875	5,162
Sales of Collectors' Currency	349	431	897
Rental Income from Properties	1,552	1,566	1,979
Registered Bank Fees	10	23	10
Overseas Investment Commission Fees	821	799	853
Miscellaneous	1,495	1,287	1,433
Total Other Income	9,308	8,981	10,334

33. Asset Management Expenses

	Note	Actual 2003 $000	Budget 2003 $000	Actual 2002 $000
Depreciation of Property, Plant and Equipment	6	2,410	2,376	2,941
Finance Charges Relating to Finance Leases		5	-	-
(Gain) Loss on Disposal of Fixed Assets		(2)	-	15
Other Asset Management Expenses		1,579	1,670	2,036
Total Asset Management Expenses		3,992	4,046	4,992

34. Other Operating Expenses

	Note	Actual 2003 $000	Budget 2003 $000	Actual 2002 $000
Other Professional Fees		3,548	4,161	3,595
Computer Expenses		1,430	1,715	1,499
Information		1,037	1,076	1,026
Operational Travel		696	839	752
Rental and Lease Expenses		325	321	366
Printing		184	227	207
Agency and Commissions		1,532	1,588	1,386
Audit Fees		144	144	144
Non-Executive Directors' Remuneration	35	104	131	105
Donations		-	-	-
Bad Debts		6	-	-
Miscellaneous		97	310	219
Total Other Operating Expenses		9,103	10,512	9,299

Other Professional Fees include $45,000 (2002 $28,000) paid to the Reserve Bank's auditors for audit services in addition to the audit fee and $5,000 (2002 $31,000) paid to the Reserve Bank's auditors for work undertaken outside their capacity as auditors of the Bank.

In March 2002, the Bank policy was changed so that the auditors are not engaged for any work other than work related to the provision of an external audit opinion, except after seeking the advice of the Chair of the Audit Committee and with the prior approval of the Governor.

35. Non-Executive Directors' Remuneration

	Remuneration 2003 $000	Remuneration 2002 $000
Non-Executive Directors		
G Simpson (to 8 June 2002)	-	14
A Paterson	15	15
V Hall (to 28 February 2002)	-	10
W Wilson (to 31 January 2003)	9	15
R Richardson	15	15
J Goulter	15	15
P Baines	15	15
A Grimes (from 1 March 2002)	15	5
H Fletcher (from 10 June 2002)	15	1
Rt. Hon E Thomas (from 1 March 2003)	5	-
Total Non-Executive Directors' Remuneration	104	105

Non-Executive Directors' Remuneration consists of director's fees. Director's fees represent consideration for services provided to the Bank for acting as a director of the Bank. There are no fees paid to the executive directors of the Bank.

Other Notes

36. Reconciliation of Operating Cash Flows with Reported Operating Surplus

	2003 $000	2002 $000
Reported Operating Surplus	189,100	175,006
Add (Subtract) Non-Cash Items		
Depreciation	2,410	2,941
Amortisation of Premium/Discount on Purchase of Securities	(28,926)	(57,315)
Net Unrealised Market Value Changes[11]	(9,509)	17,041
Currency Write-Off	69	-
Net Unrealised Foreign Exchange (Gain) Loss	(329,129)	(324,161)
	(365,085)	(361,494)
Add (Subtract) Movements in Other Working Capital Items		
(Increase)/Decrease in Accounts Receivable	361	(874)
Decrease in Miscellaneous Liabilities	(601)	(5,019)
Decrease in Inventories	(2,106)	983
Decrease in Interest Payable	(15,757)	(20,357)
Decrease in Interest Receivable	(9,642)	29,159
	(27,745)	3,892
Add (Subtract) Investing and Financing Activities		
Net Realised Foreign Exchange (Gain) Loss	328,642	322,631
Net Realised Market Value Changes	11,991	(16,559)
Return of Demonetised Coin	2	2
	340,635	306,074
Net Cash Flow from Operating Activities	136,905	123,478

11 Net unrealised market value changes include unrealised gains on derivatives, which are reported in the Statement of Financial Performance as Other Foreign Currency Income (Loss).

37. Consolidated Cash Balances

	2003 $000	2002 $000
Foreign Currency Assets		
Cash Balances with Other Central Banks	67,465	186,025
Other Cash Balances	1,738	6,223
Marketable Securities - Liquifiable Within Two Working Days	1,643,142	1,532,330
Local Currency Assets		
Cash on Hand	4	4
Securities Purchased Under Agreements to Re-sell	2,120,364	2,818,939
	3,832,713	4,543,521
Demand Liabilities		
Government Deposits	3,142,296	2,945,860
Settlement Bank Deposits	1,815	4,387
Central Bank Deposits	13,625	1,917
International Monetary Fund Deposit	6,963	8,163
Other Deposits	327	206
	3,165,026	2,960,533
Closing Cash Balances[12]	667,687	1,582,988

38. Statement of Commitments

Capitalised finance lease commitments

The Bank leases computer equipment under non-cancellable finance leases. The payments are determined at the beginning of the lease agreements and remain constant during the term of the lease. There are no terms of renewal or purchase options attached to the lease agreements. There are no further restrictions imposed by the agreements such as dividends, additional debt and further leasing.

	2003 $000	2002 $000
Computer equipment		
• Due within one year	133	-
• Due within one to two years	112	-
• Due within two to five years	55	-
Fair value of finance lease/present value of minimum lease payments	300	-
Finance charges	10	-
Total minimum lease payments	310	-
Comprising of:		
• Due within one year	140	-
• Due within one to five years	170	-
Total minimum lease payments	310	-

12 The movement in closing cash balances largely arises from the increase in foreign currency assets of $1.1 billion arising from Market Operations. These foreign currency assets are not classified as cash in the Consolidated Statement of Cash Flows.

Operating Lease Commitments

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

	2003 $000	2002 $000
Office equipment		
• Due within one year	171	359
• Due within one to two years	33	181
• Due within two to five years	23	24
Total operating lease commitments	227	564
Capital expenditure commitments		
• Property, Plant & Equipment - Due within one year	1,120	2
• Inventories - Due within one year	3,070	4,727
Total capital expenditure commitments	4,190	4,729

Lease Payments Receivable

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

	2003 $000	2002 $000
• Receivable within one year	1,384	1,384
• Receivable within one to five years	3,466	4,460
• Receivable later than five years	1,434	1,823
Total lease payments receivable	6,284	7,667

39. Subsidiary Companies

The Reserve Bank has two wholly-owned New Zealand-incorporated subsidiaries, RBNZ Registry Limited and New Zealand Central Securities Depository Limited (NZCSD).

Up to 30 June 2001, RBNZ Registry Limited provided the Bank's Registry and Depository Services function under an agency agreement with the Bank. Since 1 July 2001 these services have been provided directly by the Bank. RBNZ Registry Limited ceased trading on 30 June 2001 and is being wound up.

NZCSD is a non-trading company, incorporated solely for the purpose of acting as a custodian trustee. It holds assets on behalf of the participants in the Austraclear New Zealand System, as described in note 44.

40. Free Services

The Reserve Bank of New Zealand Act 1989 empowers the Bank to charge directly for some of its functions.

Some services are provided free of charge. These include providing information to Ministers and Parliament, contributing to policy and briefing papers, providing information to the public, storing official documents securely, and providing information and library facilities to parties such as government departments and economic research organisations.

The Bank receives some free services from other organisations, generally involving the provision of information.

The Bank liaises closely with other central banks and international agencies. Information and staff training are exchanged free of charge with these institutions.

41. Related Parties

In the normal course of its operations, the Reserve Bank enters into transactions with related parties. Related parties include the Crown, as ultimate owner of the Bank, various government departments, and Crown entities.

Transactions entered into include:

- banking services;
- agency transactions (at no charge);
- foreign exchange transactions;
- funding from the Treasury as part of the foreign reserves management operations; and
- purchases of New Zealand government securities.

The Bank does not disclose the values of transactions and outstanding balances with Crown-related parties due to the large volume of transactions and the large number of related parties. Unless otherwise stated, all transactions take place with reference to market rates. Therefore, disclosure of the values of transactions and outstanding balances with Crown entities would not provide useful or material additional information.

42. 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, following each triennial review of the Fund.

On 2 February 1995, the Bank ceased making contributions to the defined benefit division of the Fund on the advice of the Fund's Actuary that such contributions were no longer necessary. The position is re-examined as part of each triennial review (last completed for the period ended 31 March 2002).

The Actuary carried out a limited scope investigation into the financial position of the Fund as at 31 March 2003 and reported on 8 July 2003 that, based on the Fund's annual accounts:

- The assets of the Fund were sufficient at 31 March 2003 to meet the benefits obligations in respect of all members, including existing pensioners, in the event of the Fund being wound up at that time.
- The assets of the Fund were sufficient at 31 March 2003 to provide for benefits to members, including existing pensioners, that are attributable to membership prior to 1 April 2003. In assessing the expected cost of those benefits the Actuary allowed for appropriate provisions for future salary growth in respect of active members and increases in the Consumer Price Index for pensioner members.
- That it is appropriate for the Bank to continue its contribution holiday.
- To the Actuary's knowledge, there had been no circumstances between 31 March 2003 and 30 June 2003 that would cause the Actuary to form a different opinion as at 30 June 2003.

(b) Coin issued by the Treasury prior to July 1989 is not recorded by the Bank within the total of currency in circulation. The Bank has accepted liability for all coin in the first instance, whether issued by the Treasury or the Bank. However, should coin returned to the Bank exceed that issued by the Bank, the liability for the excess would revert to the Treasury. The face value of coin issued by the Treasury is $87.6 million (2002 $87.7 million).

(c) The Bank has a contingent liability for currency in circulation that has been demonetised but not returned to the Bank. The face value of demonetised currency is $37.1 million (2002 $37.1 million). This includes coin issued by Treasury with a face value of $12.9 million (2002 $1.3 million).

(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 all collectors' currency issued by the Bank to date is $9.3 million (2002 $9.0 million).

Collectors' coin was issued by the Treasury prior to July 1989. Particular specimens of series issued both before and after 1989 are not generally distinguishable. The Bank has in practice accepted a contingent liability for all collectors' coin, but part of this liability could revert to the Treasury should large quantities of coin be returned.

(e) The Bank has indemnified the statutory managers of DFC New Zealand Limited against liability arising from the statutory management of DFC New Zealand Limited, which essentially ended on 15 October 1997. However, these indemnities continue and were given under sections 5 and 39 of the Reserve Bank of New Zealand Act 1989, on substantially the same terms as those provided by the Crown under Part V of the Act.

Previous Year's Contingent Liabilities

The above five contingent liabilities were recorded in the Reserve Bank's 2002 Annual Report. The only liabilities to arise during the year were:

- Demonetised currency with a face value of $34,000 returned to the Bank for redemption at face value.
- Collectors' currency with a face value of $686 returned to the Bank for redemption at face value.

43. Income Tax

Section CB3 of the Income Tax Act 1994 exempts the Reserve Bank from income tax. The Bank incurs and meets liabilities for goods and services tax, fringe benefit tax and other withholding tax.

Until 30 June 2001, the Bank provided Registry and Depository Services through its wholly-owned subsidiary RBNZ Registry Limited. The subsidiary was liable for income tax on its net earnings. From 1 July 2001, these services were provided directly by the Bank, which, as stated above, is exempt from income tax.

44. Custodial Activities

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

NZCSD is a wholly-owned subsidiary of the Bank, which, in terms of a Deed of Appointment between the Bank and NZCSD, is incorporated solely for the purpose of acting as a custodian trustee. NZCSD is a non-trading company but has legal ownership of securities beneficially owned by members of the Austraclear 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 safe-keeping or acting as paying agent in certain circumstances.

The total of securities held by NZCSD at 30 June 2003 was $77.2 billion (2002 $74.2 billion).

The Bank undertakes to accept liability for all costs and debts of NZCSD and all liabilities of NZCSD in the event of a claim by a third party. No claims have been notified or advised at balance date.