CONTENTS OF THE FINANCIAL STATEMENTS

RESERVE BANK
OF NEW ZEALAND

19 August 2004

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 2004 fairly reflect the financial position and operations of the Bank.

Governor

Deputy Chief Executive

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Audit Report

To the readers of RESERVE BANK OF NEW ZEALAND'S FINANCIAL STATEMENTS For the year ended 30 June 2004

The Auditor-General is the auditor of the Reserve Bank of New Zealand (the Bank). The Auditor-General has appointed me, Jim Chin, using the staff and resources of PricewaterhouseCoopers, to carry out the audit of the financial statements of the Bank, on his behalf, for the year ended 30 June 2004.

Unqualified opinion

In our opinion:

- the financial statements of the Bank on pages 50 to 98:
  - comply with generally accepted accounting practice in New Zealand; and
  - fairly reflect:
    - the Bank's financial position as at 30 June 2004; and
    - the results of its operations and cash flows for the year ended on that date.
- Based on our examination the Bank kept proper accounting records.

The audit was completed on 15 September 2004, and is the date at which our opinion is expressed.

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

Basis of opinion

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

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

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

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

Audit procedures generally include:

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

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We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements.

We evaluated the overall adequacy of the presentation of information in the financial statements. We obtained all the information and explanations we required to support the opinion above.

Responsibilities of the Governor and the Auditor

The Governor is responsible for preparing financial statements in accordance with generally accepted accounting practice in New Zealand. Those financial statements must fairly reflect the financial position of the Bank as at 30 June 2004. They must also fairly reflect the results of its operations and cash flows for the year ended on that date. The Governor's responsibilities arise from the Reserve Bank of New Zealand Act 1989.

We are responsible for expressing an independent opinion on the financial statements and reporting that opinion to you. This responsibility arises from section 15 of the Public Audit Act 2001.

Independence

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

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

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

PricewaterhouseCoopers

<u>Matters Relating to the Electronic Presentation of the Audited Financial Statements</u>

This audit report relates to the financial statements of the Reserve Bank of New Zealand (the Bank) for the year ended 30 June 2004 included on the Reserve Bank of New Zealand's web-site. The Bank's Governor is responsible for the maintenance and integrity of the Reserve Bank of New Zealand's web site. We have not been engaged to report on the integrity of the Reserve Bank of New Zealand's web site. We accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

The audit report refers only to the financial statements named above. It does not provide an opinion on any other information which may have been hyperlinked to/from these financial statements. If readers of this report are concerned with the inherent risks arising from electronic data communication they should refer to the published hard copy of the audited financial statements and related audit report dated 15 September 2004 to confirm the information included in the audited financial statements presented on this web site.

Legislation in New Zealand governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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

Monetary Policy Formulation:

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

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.

Financial System Surveillance:

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:

Managing the Bank's foreign reserves held to support the functions of the Bank, including monetary policy objectives and the maintenance of orderly markets.

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.

Registry and Depository Services:

Providing high quality registry and depository services to the securities market.

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.

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 2004. They are prepared in accordance with part VI of the Act, and comply with generally accepted accounting practice in New Zealand.

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

The Governor of the Reserve Bank authorised these financial statements for issue on 19 August 2004.

(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 policies 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 assets and liabilities are translated to New Zealand dollars using mid-market exchange rates applying at balance date. The following New Zealand dollar exchange rates for major currencies are used to convert foreign currency assets and liabilities to New Zealand dollars for reporting purposes.

(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 and from dealings in foreign currency for monetary policy implementation purposes. Local currency activities mainly reflect the assets and liabilities associated with the Market Operations function and investment of the proceeds from issuing circulating currency.

The separate reporting of these activities is considered to provide a better presentation of the Bank's financial position, financial performance and risk profile. The Bank considers that the combined reporting of foreign and local currency activities would weaken the information value of the financial statements. Also refer to note 1 for an explanation of the nature and extent of the Bank's activities relating to financial assets and liabilities.

All financial assets and liabilities are recognised in the Statement of Financial Position on a trade date basis. 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 reported at market or fair value at quoted mid-market prices. Any premium or discount on purchase is capitalised and amortised over the term of the security on a constant yield to maturity basis. Changes in 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.

	2004	2003
euro	**0.5214**	0.5104
United States dollars	**0.6360**	0.5877
SDR[26]	**0.4330**	0.4155

26 SDR (Special Drawing Right) is the unit of account of the International Monetary Fund (IMF). The SDR's value is based on a basket of currencies (currently the United States dollar, euro, Japanese yen and pound sterling). The basket is reviewed by the IMF every five years to ensure the currencies included are representative of those used in international transactions and the weightings assigned to each currency reflect its relative importance in the world's trading and financial system.

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 are recorded as Marketable Securities in the Statement of Financial Position. The obligation to repurchase the securities 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 contracts, interest rate futures and interest rate swaps.

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.

Forward Foreign Exchange Contracts

Forward foreign exchange 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. Except as stated below, forward foreign exchange contracts are reported in the Statement of Financial Position in accordance with other derivative instruments.

Changes in fair value of foreign currency hedges relating to the shareholding in the Bank for International Settlements are recognised in the Statement of Financial Performance as Net Foreign Exchange Revaluation Gain/(Loss).

The Bank's Liquidity Management operations use forward foreign exchange contracts to effectively swap New Zealand dollars for foreign currency for a defined period of time. Interest receivable or payable and changes in fair value, relating to Liquidity Management forward foreign exchange contracts, are recognised in the Statement of Financial Performance as Liquidity Management Swap Income.

Forward foreign exchange contracts used to hedge selected expenditure commitments are not recognised in the Statement of Financial Position but are disclosed as off-balance sheet items.

Interest Rate Futures

Interest rate futures are reported in the Statement of Financial Position at quoted mid-market prices. Changes in value relating to market value movements are recognised in the Statement of Financial Performance as Other Foreign Currency Income/(Expense). Changes in value relating to foreign currency movements are recognised in the Statement of Financial Performance as Net Foreign Exchange Revaluation Gain/(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

Interest rate swaps are reported at fair value in the Statement of Financial Position. The fair value is derived by discounting the future cash flows based on the relevant market yield curves. Interest receivable or payable and changes in fair value relating to market value movements are recognised in the Statement of Financial Performance as Other Foreign Currency Income/(Expense). Changes in value relating to foreign currency movements are recognised in the Statement of Financial Performance as Net Foreign Exchange Revaluation Gain/(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.

Short Sales of Marketable Securities

A short sale is a sale of a security that the Bank does not own. Short sales arise as part of the Foreign Reserves Management function and the net returns on short sales are reported as Gain/(Loss) on Active Management Trading (see note 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.

Shareholding in the Bank for International Settlements

The Bank's investment in shares issued by the Bank for International Settlements (BIS) is valued at fair or market value, which is determined as being 70% of the Bank's interest in BIS's net asset value.

Dividends receivable are recognised in the Statement of Financial Performance under Income from Foreign Currency Financial Assets. Gains from changes in market value are recognised in the Statement of Movements in Equity. Where a write-down otherwise results in a deficit in the Shareholding Revaluation Reserve, the amount of the deficit is recognised in the Statement of Financial Performance as Gain/(Loss) from Market Value Changes under Income from Foreign Currency Financial Assets. Any subsequent revaluations are also recognised in the Statement of Financial Performance to the extent that the revaluation represents a recovery of deficits previously recognised in the Statement of Financial Performance. Gains or losses due to changes in foreign exchange rates and related foreign currency hedging are recognised in the Statement of Financial Performance as Net Foreign Exchange Revaluation Gain/(Loss).

Investment Portfolio – New Zealand Government Securities

The Bank's investment portfolio is accounted for on a constant yield to maturity basis. This reflects the intention to hold the portfolio until maturity, 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 historical cost adjusted for amortisation of any premium or discount on purchase. Interest is accrued in the Statement of Financial Performance as local currency Interest Income.

Market Test Activities

From time to time, the Bank may hold small trading positions in local currency securities as part of market test activities. These securities are valued at quoted market prices. Changes in 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, inclusive of any accrued interest.

(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. This portion is reported in Miscellaneous Liabilities.

(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 historical cost for this class of asset are recorded in the Properties Revaluation Reserve. Where the book value of this class of asset falls below historical cost, previous revaluations are reversed and any remaining balance is charged as an expense in the financial year it occurs. Independent valuations of this class of asset are obtained every five years. Valuations completed prior to 30 June 2002 are performed on an existing use basis and disposal costs are deducted. Valuations completed after that date are at highest and best use, and disposal costs are not 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
Property Improvements	8 years
Miscellaneous	expected useful life

(k) Leases

The Bank has operating and finance leases, which are accounted for as follows:

Operating Leases

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

Finance Leases

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

Future commitments relating to the operating and finance leases are disclosed in note 38.

(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 historical cost for this class of asset are recorded in the Currency and Artwork Collections and Archives Revaluation Reserve. Nominal values have been placed on items with no material commercial value. Collections are not depreciated. Additions are held at cost until subsequent revaluations.

(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 to Government

Under section 162 of the Reserve Bank of New Zealand Act 1989, the Minister of Finance determines the extent to which the Bank's Notional Surplus Income calculated under section 158 is to be distributed to the Government or retained by the Bank as equity. In determining the distribution amount the Minister must have regard for the capital requirements of the Bank, the views of the Bank's Board, and any other relevant matters. A provision for transfer of the surplus to the Government is recognised based on the Bank's best estimate of that amount.

(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. The provision includes only those expenses that are necessary for the restructuring. Any expenses that are associated with ongoing activities are excluded.

(q) Retirement Gratuity

Retirement gratuity liabilities are recorded at actuarial value. This is calculated annually by an independent actuary using a discounted cash flow model based on the relevant market yield curves. Changes in value are recognised in the Statement of Financial Performance as Personnel Expenses. Retirement gratuity liabilities are reported in the Statement of Financial Position as 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 Miscellaneous Liabilities, Accrued Employee Entitlements (see note 10).

(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 Allocated Between Functions

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 predetermined 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 operates 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. Income on investments funded by the Bank's equity in previous years was allocated equally to the Market Operations and Foreign Reserves Management functions. The allocation is no longer made. Comparative figures have been restated.

(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

There have been no material changes to the Reserve Bank's accounting policies for the year ended 30 June 2004, and uniform accounting policies have been applied throughout the Bank.

Consolidated Statement of Financial Position

As at 30 June	Note	2004 $000	2003 $000
Assets:			
Foreign Currency Financial Assets			
Cash Balances with Other Central Banks		89,204	67,465
Other Cash Balances		2,446	1,738
Marketable Securities	2	3,159,447	3,276,974
Short-Term Advances		-	42,540
Receivable from Unsettled Sales of Securities		28,303	43,195
Securities Purchased Under Agreements to Re-sell		2,286,586	2,759,011
Shareholding in the Bank for International Settlements	6	95,660	-
Dividend Receivable		990	-
Accrued Interest		18,574	24,728
Total Foreign Currency Financial Assets		5,681,210	6,215,651
Local Currency Financial Assets			
Cash on Hand		8	4
Securities Purchased Under Agreements to Re-sell		1,453,976	2,120,364
Investment Portfolio – New Zealand Government Securities		3,266,896	3,242,673
Accrued Interest		56,228	57,199
Other Local Currency Financial Assets		24	9,876
Total Local Currency Financial Assets		4,777,132	5,430,116
Total Financial Assets		10,458,342	11,645,767
Other Assets			
Accounts Receivable		1,409	2,051
Inventories	4	6,868	7,562
Fixed Assets	5	30,961	28,694
Total Other Assets		39,238	38,307
Total Assets		10,497,580	11,684,074

As at 30 June	Note	2004 $000	2003 $000
Liabilities:			
Foreign Currency Financial Liabilities			
Short-Term Deposits		2,597	1,335
Payable for Unsettled Purchases of Securities		30,135	42,610
Short Sales of Marketable Securities		418,263	93,706
Derivative Instruments in a Loss Position	3	174	3,078
Securities Sold Under Agreements to Repurchase		1,262,187	840,663
Term Liabilities	7	3,819,403	4,068,882
Accrued Interest		41,459	51,455
Total Foreign Currency Financial Liabilities		5,574,218	5,101,729
Local Currency Financial Liabilities			
Government Deposits		1,242,466	3,142,296
Other Deposits	8	139,640	22,730
Accrued Interest		215	468
Total Local Currency Financial Liabilities		1,382,321	3,165,494
Total Financial Liabilities		6,956,539	8,267,223
Other Liabilities			
Currency in Circulation	9	2,920,045	2,805,935
Provision for Transfer of Surplus to Government	12	191,748	184,419
Miscellaneous Liabilities	10	8,529	10,344
Total Other Liabilities		3,120,322	3,000,698
Total Liabilities		10,076,861	11,267,921
Equity	13	420,719	416,153
Total Liabilities and Equity		10,497,580	11,684,074

The above statement is to be read in conjunction with the notes on pages 63 to 98.

Consolidated Statement of Movements in Equity

For the year ended 30 June	Note	2004 $000	2003 $000
Net Surplus for the Year		**195,137**	189,100
Increase in Property Revaluation Reserve	13	**144**	-
Increase in Currency and Artwork Collections and Archives Revaluation Reserve	13	**1,033**	-
Total Recognised Revenues and Expenses for the Year		**196,314**	189,100
Provision for Transfer of Surplus to Government	12	**(191,748)**	(184,419)
Movement in Equity for the Year		**4,566**	4,681
Equity at Start of Year		**416,153**	411,472
Equity at End of Year		**420,719**	416,153

The above statement is to be read in conjunction with the notes on pages 63 to 98.

Consolidated Statement of Cost of Services

For the year ended 30 June	Note	Operating Income Actual 2004 $000	Operating Expenses Actual 2004 $000	Operating Surplus (Deficit) Actual 2004 $000	Operating Surplus (Deficit) Budget 2004 $000	Operating Surplus (Deficit) Actual 2003 $000
Functions:						
Monetary Policy Formulation		-	7,326	(7,326)	(7,550)	(7,125)
Market Operations		(781)	3,565	(4,346)	(4,983)	(5,256)
Financial System Surveillance		3	5,768	(5,765)	(5,613)	(4,352)
Currency Operations	24	195,880	8,767	187,113	193,618	181,382
Foreign Reserves Management	25	(1,459)	4,277	(5,736)	(2,908)	(9,438)
Settlement Services		2,067	2,137	(70)	(280)	(454)
Registry and Depository Services	27	4,791	3,842	949	1,145	1,421
Overseas Investment Commission Secretariat	26	829	864	(35)	(67)	153
Other Outputs		-	488	(488)	(566)	(739)
Total for Bank before Earnings on Investments Funded by Equity		201,330	37,034	164,296	172,796	155,592
Earnings on Investments Funded by Equity[27]		30,841	-	30,841	24,779	33,508
Total for Bank		232,171	37,034	195,137	197,575	189,100
Income Retained under Funding Agreement	12		9,423			
Net Expenditure under Funding Agreement	12		27,611			

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 63 to 98.

27 In previous years the Bank allocated earnings on investments funded by the Bank's equity equally to Market Operations and Foreign Reserves Management. The allocation is now no longer made and total Earnings on Investments Funded by Equity are disclosed separately. To ensure consistency with the current year comparative figures have been restated.

Consolidated Statement of Financial Performance

For the year ended 30 June	Note	Actual 2004 $000	Budget 2004 $000	Actual 2003 $000
Operating Income:				
Income from Foreign Currency Financial Assets				
Interest Income	28	64,584		108,731
Dividend Income		990		-
Gain/(Loss) from Market Value Changes	30	(10,383)		28,192
Other Foreign Currency Income/(Expenses)[28]		(4,979)		50,227
Total Income from Foreign Currency Financial Assets		50,212		187,150
Expenses on Foreign Currency Financial Liabilities				
Interest Expenses	29	140,267		141,216
Loss/(Gain) from Market Value Changes	30	(91,505)		51,342
Other Foreign Currency Expenses/(Income)		(23)		12
Total Expenses on Foreign Currency Financial Liabilities		48,739		192,570
Net Foreign Exchange Revaluation Gain/(Loss)	31	72		487
Foreign Currency Investment Income/(Expense)		1,545		(4,933)
Income from Local Currency Financial Assets				
Interest Income	28	338,678		386,251
Liquidity Management Swap Income		65,828		39,913
Gain from Market Test Activities		22		70
Total Income from Local Currency Financial Assets		404,528		426,234
Total Expenses on Local Currency Financial Liabilities	29	183,262		205,149
Local Currency Investment Income		221,266		221,085
Net Investment Income		222,811	226,247	216,152
Other Income	32	9,360	8,998	9,308
Total Operating Income		232,171	235,245	225,460
Operating Expenses:				
Personnel Expenses		17,732	16,741	15,635
New Currency Issued Expenses	24	5,424	6,439	6,041
Asset Management Expenses	33	3,547	3,642	3,992
Other Operating Expenses	34	10,331	10,848	10,692
Total Operating Expenses		37,034	37,670	36,360
Net Surplus for the Year	12	195,137	197,575	189,100

The above statement is to be read in conjunction with the notes on pages 63 to 98.

The Reserve Bank's operating expenditure was $37.0 million, which was 1.7 per cent below budget. In particular:

- Personnel Expenses were $1.0 million more than budgeted, mainly due to restructuring costs, recruitment of additional staff, and higher accrued leave.
- Costs of issuing new coins and bank notes were $1.0 million lower than budgeted, mainly due to lower-than-expected demand for notes.
- Other Operating Expenses were $0.5 million less than budgeted, mainly due to lower-than-expected communication expenses and computer expenses.

28 Commitment Fees on Credit Lines and Custody Account Charges have been reclassified as Other Operating Expenses. Previously, these were included in Other Foreign Currency Expenses, netted against Operating Income. Comparative figures have been restated to reflect this change ($548,000).

Consolidated Statement of Cash Flows

For the year ended 30 June	Note	2004 $000	2003 $000
Cash Flows From Operating Activities:			
Source:			
Interest Received - Foreign Currency		93,921	118,484
- Local Currency - Investment Portfolio		220,298	205,421
- Other		117,280	168,077
Liquidity Management Swap Income		82,516	37,702
Fees, Commission and Other Income Received		9,928	18,649
		523,943	548,333
Disbursements:			
Interest Paid - Foreign Currency		124,246	170,871
- Local Currency		183,514	206,027
Payments to Suppliers and Employees		36,885	34,454
Net GST Paid/(Received)		(58)	76
		344,587	411,428
Net Cash Flow From Operating Activities	36	179,356	136,905
Cash Flows From Investing Activities:			
Source:			
Net (Increase)/Decrease in Other Local Currency Financial Assets		9,850	(9,867)
Maturity of New Zealand Government Securities for Investment Portfolio		150,000	450,000
		159,850	440,133
Disbursements:			
Net Increase/(Decrease) in Foreign Currency Securities Purchased under Agreements to Re-sell		(472,425)	564,329
Net Increase in Foreign Currency Marketable Securities		53,536	614,798
Net Decrease in Other Foreign Currency Financial Assets		(54,412)	(276,066)
Net (Increase)/Decrease in Other Foreign Currency Financial Liabilities		(739,138)	130,614
Purchases of New Zealand Government Securities for Investment Portfolio		172,152	735,333
Purchase of Shares in the Bank for International Settlements		99,945	-
Purchase of Fixed Assets		3,224	1,137
		(937,118)	1,770,145
Net Cash Flow From Investing Activities		1,096,968	(1,330,012)

Consolidated Statement of Cash Flows continued

For the year ended 30 June	Note	2004 $000	2003 $000
Cash Flows From Financing Activities:			
Source:			
Issue of Circulating Currency		1,601,985	1,584,121
Withdrawal of Circulating Currency		1,487,875	1,436,857
Net Issue of Circulating Currency		114,110	147,264
Additional Foreign Currency Term Liabilities		630,819	799,421
		744,929	946,685
Disbursements:			
Payment for Demonetised Currency		34	34
Repayment of Foreign Currency Term Liabilities		601,776	358,086
Payment of Surplus to Government		184,419	168,929
		786,229	527,049
Net Cash Flow From Financing Activities		(41,300)	419,636
CASH FLOW FROM ALL ACTIVITIES		1,235,024	(773,471)
Plus Exchange Rate Effect		(152,982)	(141,830)
NET CASH FLOW FROM ALL ACTIVITIES		1,082,042	(915,301)
Opening Cash Balance		667,687	1,582,988
CLOSING CASH BALANCE	37	1,749,729	667,687

The above statement is to be read in conjunction with the notes on pages 63 to 98.

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 Resell 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 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 (the Act).

(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 mainly 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. Where policy considerations lead the Bank to intervene in the foreign exchange market, it may maintain an unhedged foreign currency position, with foreign currency amounts not being matched by funding in the same currencies. However, over time the Bank will manage its foreign exchange exposures such that the Bank's exposure to exchange rate movements will be close to neutral.

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 Bank's foreign reserves portfolio can be actively managed. Subject to liquidity and credit risk constraints, the Bank defines benchmark portfolios that represent a risk neutral asset and liability structure. The risk neutral position is established to minimise the Bank's exposure to interest rate risk and foreign currency risk, subject to meeting monetary policy foreign exchange intervention objectives. In general, liquidity and credit risk constraints mean that the risk neutral structure will return a loss, as the returns on assets will be less than the cost of funding those assets. The Bank's active management activities seek to minimise the overall costs of holding reserves.

Departures of the actual asset and liability portfolio from the risk neutral asset and liability structure are undertaken within defined risk boundaries, where there is an expected increase in returns. Departures from the risk 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 risk 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 domestic market operations. Any foreign currency exposures relating to market operations are fully hedged through the use of forward foreign exchange contracts.

For further information on the risk management policies relating to financial instruments, see notes 16 to 23.

(b) Derivative Instruments

The Bank's involvement in derivative instruments includes forward foreign exchange contracts, interest rate futures and interest rate swaps. Forward foreign exchange contracts are used as a part of hedged foreign exchange transactions for both Market Operations and Foreign Reserves Management. Any unrealised foreign exchange gain or loss on unsettled forward foreign exchange contracts is offset by the foreign exchange revaluation on the associated money market instruments.

The Bank has also entered into foreign currency forward transactions in order to hedge the foreign currency exposure of its shareholding in the Bank for International Settlements, and occasionally to hedge capital expenditure commitments denominated in foreign currency.

Interest rate futures and interest rate swaps are used to enhance expected returns on foreign currency assets and, from time to time, to hedge interest rate and foreign exchange risks.

(c) Securities Lending Programme

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

As at 30 June 2004, the market value of securities lent out under the programme was $763.1 million (2003 $728.0 million).

(d) Foreign Exchange Gains and Losses

Section 16 of the Act provides the Bank with the power to deal in foreign currency for the purpose of carrying out its functions and powers. At balance date no losses had been incurred from section 16 activities.

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 2004, there have been no payments to or from the Crown under section 21 of the Act (2003 nil).

(e) 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 are recorded as Marketable Securities in the Bank's Statement of Financial Position. At balance date, securities with a book value of $1,262.2 million (2003 $840.7 million) had been sold to counterparties under repurchase agreements. The fair value of these securities was $1,203.0 million (2003 $885.7 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 (2003 $nil).

(f) Local Currency Activities

The Bank's liquidity management largely involves offsetting the daily net flows to or from the Government by advancing funds to, or withdrawing funds from, the banking system. This is done mostly through daily open market operations. 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 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 Securities supports its liability for currency in circulation and the Bank's net equity. The Bank holds these investments until maturity. The Bank purchases Securities for the Investment Portfolio if the amount of currency in circulation increases or if one of the Bank's current holdings matures. The Bank manages this process by maintaining a portfolio of securities with relatively even maturities, where possible.

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

(g) Events during 2003/04

In August 2003, the Bank accepted an invitation to become a shareholder in the Bank for International Settlements. The 3,000 shares purchased represent approximately 1% of all shares on issue and cost $99.945 million.

In March 2004, pursuant to section 24 of the Act, the Minister of Finance approved an increase in the minimum holdings of foreign reserves held by the Bank to SDR 2.45 billion, to be achieved over the course of four years.

In April 2004, Parliament ratified an amendment to the Bank's existing five-year Funding Agreement. The principal change related to expenditure incurred under section 16 of the Act to facilitate certain dealings in foreign currency being excluded from the Funding Agreement. The variation did not amend the levels of operating expenditure previously agreed for the 2003/04 and 2004/05 years.

The Estimates of Appropriations for the year ended 30 June 2005, introduced by the Government to Parliament in May 2004, included an appropriation for a $1 billion capital injection to the Bank. The capital, received on 1 July 2004, provides the Bank with an enhanced capacity to finance intervention in foreign currency markets under section 16 of the Act.

At year end, the Bank was one of a number of banks of the Executives' Meeting of Asian and Pacific Central Banks (EMEAP)[29] considering a further investment in the Asian Bond Fund, to promote investment in fixed interest securities issued in the East Asian region.

29 EMEAP is a cooperative organisation of central banks and monetary authorities in the East Asia Pacific region. Its primary objective is to strengthen the cooperative relationship among its members.

Asset Notes

2. Foreign Currency Marketable Securities

	Note	2004 $000	2003 $000
Marketable Securities			
- Liquefiable within two days (considered cash equivalent)	37	1,586,201	1,643,142
- Liquefiable outside two days (not considered cash equivalent)		1,538,161	1,553,038
Derivative Instruments in a Gain Position	3	35,085	80,794
Total Marketable Securities		3,159,447	3,276,974

3. Derivative Instruments

	Book Value[30] 2004 $000	Notional Principal 2004 $000	Book Value 2003 $000	Notional Principal 2003 $000
Interest Rate Futures:				
Futures in a Gain Position	744	4,990	2,117	122,173
Net Futures Position	744	4,990	2,117	122,173
At 30 June 2004, the Bank had 882 open futures contracts (2003: 530).				
Interest Rate Swaps:				
Swaps in a Gain Position	28,382	607,201	61,989	657,104
Swaps in a Loss Position	(174)	115,079	(3,078)	186,136
Net Interest Rate Swap Position	28,208	722,280	58,911	843,240
Forward Foreign Exchange Contracts:				
Contracts in a Gain Position	5,959	97,122	16,688	1,098,923
Net Forward Foreign Exchange Contracts Position	5,959	97,122	16,688	1,098,923
Total Derivatives in a Gain Position	35,085	709,313	80,794	1,878,200
Total Derivatives in a Loss Position	(174)	115,079	(3,078)	186,136
Net Derivative Instruments	34,911	824,392	77,716	2,064,336

4. Inventories

	2004 $000	2003 $000
Bank Notes for Circulation	4,058	4,315
Coin for Circulation	2,730	3,149
Collectors' Currency	70	87
Stationery	10	11
Total Inventories	6,868	7,562

30 The book value of Derivative Instruments is the fair value of those instruments. Refer to the Statement of Accounting Policies, (f) Financial Assets and Liabilities, Derivative Instruments, for further information.

5. Fixed Assets

	Note	Total $000	Land and Buildings $000	Property Improvements $000	Computer Hardware and Software $000	Plant and Equipment $000	Currency and Artworks Collections and Archives $000
As at 30 June 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 Value		**28,694**	24,184	1,568	1,437	734	771
Year ended 30 June 2004							
Opening Net Book Value		**28,694**	24,184	1,568	1,437	734	771
Plus Additions		**3,404**	-	142	2,994	261	7
Plus Net Revaluations[31]	13	**1,177**	144	-	-	-	1,033
Plus/(Less) Transfers		**-**	-	-	52	(52)	-
Less Disposals		**182**	-	-	-	-	182
Less Depreciation		**2,132**	428	377	1,081	246	-
Closing Net Book Value		**30,961**	23,900	1,333	3,402	697	1,629
As at 30 June 2004							
Cost		**43,320**	25,100	3,192	9,765	3,634	1,629
Accumulated Depreciation		**12,359**	1,200	1,859	6,363	2,937	-
Net Book Value		**30,961**	23,900	1,333	3,402	697	1,629

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

The book values for land and buildings 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 $7.0 million (2003 $7.1 million) if the Bank had recorded these using historical cost less depreciation.

	Valuation Date	Registered Valuer
Wellington Head Office	June 2001	Jones Lang Lasalle Advisory Limited
Wellington Carparks	June 2004	DTZ New Zealand International Property Advisers

The Computer Hardware and Software category includes computers that are leased under finance leases, with a net book value of $464,000 (2003 $298,000). Future commitments relating to leases are disclosed in note 38.

6. Shareholding in the Bank for International Settlements

The Bank owns 3,000 shares issued by the Bank for International Settlements. This represents a shareholding of approximately 1% of all shares on issue. The shares have a par value of SDR 5,000 each and are paid up to SDR 1,250 each.

The Bank has taken out forward foreign currency contracts to hedge the foreign currency value of the shareholding.

31 Net Revaluations includes the write back of accumulated depreciation.

Liability and Equity Notes

7. Term Liabilities

	Total 2004 $000	Discount/ (Premium) 2004 $000	Weighted Average Interest Rate 2004 %	Total 2003 $000	Discount/ (Premium) 2003 $000	Weighted Average Interest Rate 2003 %
Unsecured Term Liabilities						
Due to be Repaid:						
One year or less	602,115	-	1.6%	646,440	-	1.7%
Between one and two years	704,380	1,118	2.2%	635,867	-	1.8%
Between two and five years	1,970,536	(59,204)	2.1%	2,105,156	(29,063)	2.1%
Over five years	542,372	-	1.3%	681,419	-	1.8%
Total Unsecured Term Liabilities	3,819,403	(58,086)		4,068,882	(29,063)	

The funding for foreign reserves is provided by 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.

8. Other Deposits

	2004 $000	2003 $000
Settlement Bank Deposits	71,051	1,815
Central Bank Deposits	11,144	13,625
International Monetary Fund Deposits	57,221	6,963
Other Deposits	224	327
Total Other Deposits	139,640	22,730

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 2004, the following bank notes and coins were in circulation:

Denomination	Number of Note Forms/ Coins 2004 000	Face Value 2004 $000	Number of Note Forms/ Coins 2003 000	Face Value 2003 $000
5c	277,500	13,875	249,240	12,462
10c	92,330	9,233	80,210	8,021
20c	30,730	6,146	25,225	5,045
50c	11,516	5,758	8,078	4,039
$1	60,437	60,437	57,329	57,329
$2	58,622	117,244	56,176	112,352
$5	17,156	85,780	16,220	81,102
$10	16,048	160,476	15,653	156,531
$20	50,773	1,015,457	50,639	1,012,786
$50	9,171	458,526	8,428	421,384
$100	9,871	987,113	9,349	934,884
Total Currency in Circulation		2,920,045		2,805,935

10. Miscellaneous Liabilities

	Note	2004 $000	2003 $000
Accounts Payable		**2,646**	4,774
Accrued Employee Entitlements		**3,437**	3,186
Provision for Restructuring	11	**294**	-
Demonetised Currency		**1,140**	1,171
Other Current Liabilities		**519**	924
Capitalised Lease Obligations	38	**493**	289
Total Miscellaneous Liabilities		**8,529**	10,344

Demonetised currency is recognised as a contingent liability (see note 42 (c)) except for $1.1 million (2003 $1.2 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

	2004 $000	2003 $000
Opening Balance for the Year	**-**	-
Additions to Provision	**575**	-
Less Expenses Incurred	**(281)**	-
Unused Balance Written Back	**-**	-
Total Provision for Restructuring	**294**	-

Restructuring costs were incurred principally with respect to the Bank's security operations and the Settlement, Depository and Registry functions.

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

The Bank recommends, and has provided for, a distribution to the Government of $191.7 million for the year ended 30 June 2004 (2003 $184.4 million), as set out below.

	2004 $000	2003 $000
Total Expenses[32]	37,034	35,812
Income Retained under Funding Agreement	9,423	9,493
Net Expenditure under Funding Agreement	27,611	26,319
Funding Level specified in Funding Agreement	31,000	31,000
Funding Agreement Under-Expenditure	3,389	4,681
Surplus Available for Appropriation	195,137	189,100
Less Funding Agreement Under-Expenditure Transferred to Equity	3,389	4,681
Provision for Transfer of Surplus to Government	191,748	184,419
Comprising:		
Section 158 Notional Surplus Income	191,748	207,569
Less Losses from Market Value Changes	-	23,150
Provision for Transfer of Surplus to Government	191,748	184,419

13. Equity

	2004 $000	2003 $000
Retained Earnings:		
Transfer to Retained Earnings	3,389	4,681
Transfer from Reserves	134	-
Movement in Retained Earnings	3,523	4,681
Opening Balance	399,786	395,105
Closing Balance	403,309	399,786
Properties Revaluation Reserve:		
Revaluation of Carparks	35	-
Accumulated Depreciation Transferred to Reserve	109	-
Movement in Properties Revaluation Reserve	144	-
Opening Balance	15,671	15,671
Closing Balance	15,815	15,671
Currency and Artwork Collections and Archives Revaluation Reserve:		
Revaluation of Currency Collection	1,033	-
Transfer to Retained Earnings	(134)	-
Movement in Currency and Artwork Collections and Archives Revaluation Reserve	899	-
Opening Balance	696	696
Closing Balance	1,595	696
Total Equity	420,719	416,153

32 Total Expenses for the year ended June 2003 differ from those reported in the Statement of Financial Performance due to the reclassification of Commitment Fees on Credit Lines and Custody Account Charges. Previously, these were included in Other Foreign Currency Expenses, netted against Operating Income.

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 arm's 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.

Financial Assets and Liabilities

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

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.

Shareholding in the Bank for International Settlements

The carrying value of the Shareholding in the Bank for International Settlements (BIS) is its estimated fair value based on past issues of new shares and court rulings, which determined that the fair value of those shares is 70% of BIS's net asset value.

Short-Term Advances

The reported value of short-term advances is considered to approximate their fair value due to the short term until maturity.

Investment Portfolio – New Zealand Government Securities

The investment portfolio is recorded at historical cost adjusted for amortisation of any premium or discount on purchase in the Statement of Financial Position. The fair value of the Bank's Investment Portfolio – New Zealand Government Securities is $3.325 billion (2003 $3.470 billion). This has been calculated by valuing the current holdings at 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 to Government

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:

	Total 2004 $000	New Zealand Government $000	New Zealand Public $000	Overseas Securities Trading Firms $000	Other $000
Foreign Currency Financial Liabilities					
Short-Term Deposits	**2,597**	-	-	2,060	537
Payable for Unsettled Purchases of Securities	**30,135**	-	-	30,135	-
Short Sales of Marketable Securities	**418,263**	-	-	-	418,263
Derivative Instruments in a Loss Position	**174**	-	-	174	-
Securities Sold Under Agreements to Repurchase	**1,262,187**	-	-	1,262,187	-
Term Liabilities	**3,819,403**	3,819,403	-	-	-
Accrued Interest	**41,459**	34,457	-	-	7,002
Total Foreign Currency Financial Liabilities	**5,574,218**	3,853,860	-	1,294,556	425,802
Local Currency Financial Liabilities					
Government Deposits	**1,242,466**	1,242,466	-	-	-
Other Deposits	**139,640**	-	-	-	139,640
Accrued Interest	**215**	192	-	-	23
Total Local Currency Financial Liabilities	**1,382,321**	1,242,658	-	-	139,663
Total Financial Liabilities	**6,956,539**	5,096,518	-	1,294,556	565,465
Other Liabilities					
Currency in Circulation	**2,920,045**	-	2,920,045	-	-
Provision for Transfer of Surplus to Government	**191,748**	191,748	-	-	-
Miscellaneous Liabilities	**8,529**	-	-	-	8,529
Total Other Liabilities	**3,120,322**	191,748	2,920,045	-	8,529
Total Liabilities	**10,076,861**	5,288,266	2,920,045	1,294,556	573,994

Comparative figures as at 30 June 2003 for significant end-of-year concentrations of funding were as follows:

	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	-	-	22,746
Total Financial Liabilities	8,267,223	7,263,085	-	883,516	120,622
Other Liabilities					
Currency in Circulation	2,805,935	-	2,805,935	-	-
Provision for Transfer of Surplus to Government	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	2,805,935	883,516	130,966

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 assets, 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 risks are outlined in notes 18 to 22. Like most other central banks, the nature of the Bank's operations creates exposure to a range of operational risks and reputational risks.

Bank management seeks to ensure that strong and effective risk analysis and management and control systems are in place for assessing, monitoring and managing risk exposure. An Asset and Liability Committee (ALCO), comprising the Governors and senior management, is responsible for advising on the monitoring and management of the business strategy, risks, and performance of all balance sheet related activities. This review includes the appropriateness of risk-return 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 ALCO.

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.

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

The Bank is subject to an annual external audit by the Office of the Controller and Auditor-General under the Public Audit Act 2001. Auditing arrangements are overseen by an Audit Committee comprising four of the Bank's non-executive directors, which meets regularly to monitor the financial reporting and audit functions within the Bank. The Committee 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 (eg, a project management template), and specific internal control systems designed around the particular characteristics of various Bank activities.

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

- an induction programme for new employees, 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 significant incidents that could adversely impact on the Bank. This is known as the Proactive Problem Management process. Its purpose is to notify senior management promptly of important unexpected issues and to provide them with an opportunity to give immediate advice.

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

18. Credit Risk

Credit risk is the 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 issuers. 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 AAA/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 Securities, 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 (2003 $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, classified by industry of the issuer and industry of the counterparty, were as follows:[33]

	Classified by Industry of Issuer		Classified by Industry of Counterparty	
	2004 $000	2003 $000	2004 $000	2003 $000
New Zealand Government	4,617,717	5,472,670	3,344,733	3,352,305
Other Sovereign Issuers	3,382,989	4,347,697	1,478,504	1,520,600
Supranational Financial Institutions	342,062	182,625	342,062	182,625
Foreign Banks	1,814,402	1,569,997	4,260,439	2,947,843
Securities Trading Firms	-	-	-	446,523
New Zealand Banks	175,740	-	946,513	3,123,093
Other	125,432	72,778	86,091	72,778
Total Financial Assets	10,458,342	11,645,767	10,458,342	11,645,767

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 fulfil 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 country in which the issuer's parent is located, were as follows:

	2004 $000	2003 $000
New Zealand	4,801,299	5,482,233
USA	1,794,767	3,146,490
Europe	3,468,498	2,811,274
Supranational Financial Institutions	342,062	182,625
Other	51,716	23,145
Total Financial Assets	10,458,342	11,645,767

(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.

33 The differences between amounts disclosed by industry and by counterparty relate to Securities Purchased Under Agreements to Re-sell.

	Credit Rating	2004 $000	% of 2004 Financial Assets	2003 $000	% of 2003 Financial Assets
Foreign Currency Financial Assets					
Cash Balances with Other Central Banks	AAA	84,760	0.8%	66,577	0.6%
	AA-	4,444	0.0%	888	0.0%
Other Cash Balances	AAA	796	0.0%	-	-
	AA+	752	0.0%	642	0.0%
	AA-	677	0.0%	1,066	0.0%
	N/R	221	0.0%	30	0.0%
Marketable Securities	AAA	1,946,228	18.6%	2,175,081	18.7%
	AA+	260,978	2.5%	107,614	0.9%
	AA	195,325	1.9%	212,476	1.8%
	AA-	756,092	7.2%	781,803	6.7%
	N/R	824	0.0%	-	-
Short-Term Advances	AAA	-	-	42,540	0.4%
Receivable from Unsettled Sales of Securities	BBB+	28,303	0.3%	-	-
	N/R	-	-	43,195	0.4%
Securities Purchased Under Agreements to Re-sell	AAA	1,846,133	17.7%	2,696,767	23.2%
	AA+	82,891	0.8%	62,244	0.5%
	A+	357,562	3.4%	-	-
Shareholding in the Bank for International Settlements	AAA	95,660	0.9%	-	-
Dividend Receivable	AAA	990	0.0%	-	-
Accrued Interest	Various	18,574	0.2%	24,728	0.2%
Total Foreign Currency Financial Assets		5,681,210	54.3%	6,215,651	53.4%
Local Currency Financial Assets					
Cash on Hand	AAA	8	0.0%	4	0.0%
Securities Purchased Under Agreements to Re-sell	AAA	1,270,723	12.2%	2,120,364	18.2%
	AA	107,317	1.0%	-	-
	A+	56,726	0.5%	-	-
	AA-	19,210	0.2%	-	-
Investment Portfolio – New Zealand Government Securities	AAA	3,266,896	31.2%	3,242,673	27.8%
Accrued Interest	AAA	56,228	0.5%	57,199	0.5%
Other Local Currency Financial Assets	AA+	20	0.0%	-	-
	AA-	-	-	9,871	0.1%
	N/R	4	0.0%	5	0.0%
Total Local Currency Financial Assets		4,777,132	45.7%	5,430,116	46.6%
Total Financial Assets		10,458,342	100.0%	11,645,767	100.0%
Summary by Major Credit Category					
Foreign Currency Financial Assets	AAA	3,974,567	38.0%	4,980,965	42.9%
	AA+/-	1,658,721	15.8%	1,166,733	9.9%
	BBB+	28,303	0.3%	-	-
	Various	18,574	0.2%	24,728	0.2%
	N/R	1,045	0.0%	43,225	0.4%
Total Foreign Currency Financial Assets		5,681,210	54.3%	6,215,651	53.4%
Local Currency Financial Assets					
	AAA	4,701,172	45.0%	5,420,240	46.5%
	AA+/-	75,956	0.7%	9,871	0.1%
	N/R	4	0.0%	5	0.0%
Total Local Currency Financial Assets		4,777,132	45.7%	5,430,116	46.6%
Total Financial Assets		10,458,342	100.0%	11,645,767	100.0%

(d) Credit Exposure by Counterparty as a Percentage of Bank Equity

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[34] 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 2004**	End-of-year 2003	**Peak end-of-day 2004**	Peak end-of-day 2003	**Peak local currency intra-day 2004**	Peak local currency intra-day 2003
10% to 19.9%	**7**	8	**32**	32	**-**	15
20% to 29.9%	**3**	4	**1**	1	**8**	-
30% to 39.9%	**2**	3	**-**	-	**10**	10
40% to 49.9%	**3**	1	**45**	47	**-**	-
50% to 59.9%	**1**	-	**-**	-	**-**	-
70% to 79.9%	**1**	1	**-**	-	**-**	-
80% to 89.9%	**-**	-	**23**	18	**-**	-
170% to 179.9%	**1**	-	**1**	-	**-**	-
190% to 199.9%	**1**	-	**8**	7	**-**	-
240% to 249.9%	**-**	-	**-**	1	**-**	-
280% to 289.9%	**-**	1	**-**	1	**-**	-
400% to 409.9%	**1**	-	**1**	-	**-**	-
540% to 549.9%	**-**	-	**-**	-	**-**	-
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 (eg, 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 for these sovereign issuers are based on end-of-year exposures.

34 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.

a) Foreign Currency Interest Rate Risk

The Reserve Bank's risk 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, French, and German domestic government instruments, which have different interest rate characteristics from 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 risk 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.

b) Local Currency Interest Rate Risk

As a matter of policy, interest rate risk on the Investment Portfolio – New Zealand Government Securities is not actively managed. This recognises that:

- active risk management could require the Bank to carry out transactions that conflict with its monetary policy stance; and
- the investment portfolio held by the Bank is 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 2004 was 5.2 years (2003 5.7 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:

	Weighted Average Interest Rate	Total 2004 $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	1.6%	**89,204**	-	89,204	-	-	-	-
Other Cash Balances	1.5%	**2,446**	-	2,446	-	-	-	-
Marketable Securities	1.6%	**3,159,447**	-	1,731,619	118,448	384,379	739,797	185,204
Receivable from Unsettled Sales of Securities	0%	**28,303**	-	28,303	-	-	-	-
Securities Purchased Under Agreements to Re-sell	1.5%	**2,286,586**	-	2,286,586	-	-	-	-
Shareholding in the Bank for								
International Settlements	0%	**95,660**	95,660	-	-	-	-	-
Dividend Receivable	0%	**990**	990	-	-	-	-	-
Accrued Interest	0%	**18,574**	-	18,574	-	-	-	-
Total Foreign Currency Financial Assets	1.5%	**5,681,210**	96,650	4,156,732	118,448	384,379	739,797	185,204
Foreign Currency Financial Liabilities								
Short-Term Deposits	2.6%	**2,597**	-	2,597	-	-	-	-
Payable for Unsettled Purchases of Securities	0%	**30,135**	-	30,135	-	-	-	-
Short Sales of Marketable Securities	3.1%	**418,263**	-	-	-	119,380	236,629	62,254
Derivative Instruments in a Loss Position	2.4%	**174**	-	(19,135)	-	-	-	19,309
Securities Sold Under Agreements to Repurchase	1.5%	**1,262,187**	-	1,262,187	-	-	-	-
Term Liabilities	1.9%	**3,819,403**	-	2,868,886	-	393,402	557,115	-
Accrued Interest	0%	**41,459**	-	41,459	-	-	-	-
Total Foreign Currency Financial Liabilities	1.9%	**5,574,218**	-	4,186,129	-	512,782	793,744	81,563
Foreign Currency Interest Rate Sensitivity Gap		**106,992**	96,650	(29,397)	118,448	(128,403)	(53,947)	103,641
Local Currency Financial Assets								
Cash on Hand	0%	**8**	-	8	-	-	-	-
Securities Purchased Under Agreements to Re-sell	5.8%	**1,453,976**	-	1,453,976	-	-	-	-
Investment Portfolio –								
New Zealand Government Securities	6.6%	**3,266,896**	-	-	576,992	430,712	447,653	1,811,539
Accrued Interest	0%	**56,228**	-	56,228	-	-	-	-
Other Local Currency Financial Assets	4.8%	**24**	-	24	-	-	-	-
Other Assets	0%	**39,238**	39,238	-	-	-	-	-
Total Local Currency Assets	6.2%	**4,816,370**	39,238	1,510,236	576,992	430,712	447,653	1,811,539
Local Currency Financial Liabilities								
Government Deposits	5.8%	**1,242,466**	-	1,242,466	-	-	-	-
Other Deposits	5.5%	**139,640**	-	139,640	-	-	-	-
Accrued Interest	0%	**215**	-	215	-	-	-	-
Other Liabilities	0%	**3,120,322**	3,120,322	-	-	-	-	-
Equity	0%	**420,719**	420,719	-	-	-	-	-
Total Local Currency Liabilities and Equity	1.6%	**4,923,362**	3,541,041	1,382,321	-	-	-	-
Local Currency Interest Rate Sensitivity Gap		**(106,992)**	(3,501,803)	127,915	576,992	430,712	447,653	1,811,539
On-Balance Sheet Interest Rate Sensitivity Gap		-	(3,405,153)	98,518	695,440	302,309	393,706	1,915,180
Off-Balance Sheet Instruments[35]		-	-	(638,343)	(1,179)	291,473	379,638	(31,589)
Total Interest Rate Sensitivity Gap		-	(3,405,153)	(539,825)	694,261	593,782	773,344	1,883,591
Interest Rate Sensitivity Gap by Currency								
New Zealand dollar		**(9,870)**	(3,501,803)	225,036	576,993	430,712	447,653	1,811,539
United States dollar		**4,254**	38,568	(652,731)	(1,053)	236,503	375,507	7,460
euro		**(3,536)**	33,844	(99,333)	118,321	(73,433)	(49,816)	66,881
Other		**9,152**	24,238	(12,797)	-	-	-	(2,289)

35 Forward foreign currency contracts relating to future expenditure commitments worth $2.7 million are not included in the above risk note.

Comparative figures as at 30 June 2003 were as follows:

	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	1.1%	**67,465**	-	67,465	-	-	-	-
Other Cash Balances	1.1%	**1,738**	-	1,738	-	-	-	-
Marketable Securities	1.6%	**3,276,974**	-	2,578,027	149,250	149,712	286,970	113,015
Short-Term Advances	1.1%	**42,540**	-	42,540	-	-	-	-
Receivable from Unsettled Sales of Securities	0%	**43,195**	-	43,195	-	-	-	-
Securities Purchased Under Agreements to Re-sell	1.2%	**2,759,011**	-	2,759,011	-	-	-	-
Accrued Interest	0%	**24,728**	-	24,728	-	-	-	-
Total Foreign Currency Financial Assets	1.4%	**6,215,651**	-	5,516,704	149,250	149,712	286,970	113,015
Foreign Currency Financial Liabilities								
Short-Term Deposits	0.3%	**1,335**	-	1,335	-	-	-	-
Payable for Unsettled Purchases of Securities	0%	**42,610**	-	42,610	-	-	-	-
Short Sales of Marketable Securities	2.9%	**93,706**	-	-	-	20,266	62,470	10,970
Derivative Instruments in a Loss Position	2.8%	**3,078**	-	3,078	-	-	-	-
Securities Sold Under Agreements to Repurchase	0.9%	**840,663**	-	840,663	-	-	-	-
Term Liabilities	1.8%	**4,068,882**	-	2,877,554	110,198	-	1,081,130	-
Accrued Interest	0%	**51,455**	-	51,455	-	-	-	-
Total Foreign Currency Financial Liabilities	1.6%	**5,101,729**	-	3,816,695	110,198	20,266	1,143,600	10,970
Foreign Currency Interest Rate Sensitivity Gap		**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	5.2%	**2,120,364**	-	2,120,364	-	-	-	-
Investment Portfolio –								
New Zealand Government Securities	6.7%	**3,242,673**	-	-	148,997	580,118	880,821	1,632,737
Accrued Interest	0%	**57,199**	-	57,199	-	-	-	-
Other Local Currency Financial Assets	5.2%	**9,876**	-	9,876	-	-	-	-
Other Assets	0%	**38,307**	38,307	-	-	-	-	-
Total Local Currency Assets	6.0%	**5,468,423**	38,307	2,187,443	148,997	580,118	880,821	1,632,737
Local Currency Financial Liabilities								
Government Deposits	5.3%	**3,142,296**	-	3,142,296	-	-	-	-
Other Deposits	0.5%	**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	2.5%	**6,582,345**	3,416,851	3,165,494	-	-	-	-
Local Currency Interest Rate Sensitivity Gap		**(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
Interest Rate Sensitivity Gap by Currency								
New Zealand dollar		**(15,000)**	(3,378,544)	120,871	148,997	580,118	880,821	1,632,737
United States dollar		**8,314**	-	121,113	(1,301)	16,550	(112,242)	(15,806)
euro		**(135)**	-	(73,285)	(39,721)	111,705	(89,497)	90,663
Other		**6,821**	-	8,229	-	-	-	(1,408)

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, subject to monetary policy foreign exchange intervention objectives. The Bank may maintain an unhedged foreign currency position consistent with its monetary policy foreign exchange objectives.

The Reserve Bank's exposure to foreign currency risk also arises from trading positions undertaken by specialist staff. Foreign currency risk is managed by way of Value at Risk (VaR) limits and stop-loss limits for the Bank's combined market risk as described in note 21.

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

The Bank has hedged foreign exchange risk on the investment in shares issued by the Bank for International Settlements using foreign currency forward contracts.

As at 30 June 2004, the Bank's net exposure to major currencies, including forward foreign exchange contracts and foreign currency swaps, was as follows:

	Currency of Denomination			
	Total All Currencies 2004 $000	United States dollar $000	euro $000	Other Currencies $000
Foreign Currency Financial Assets				
Cash Balances with Other Central Banks	**89,204**	43,661	34,834	10,709
Other Cash Balances	**2,446**	796	880	770
Marketable Securities	**3,159,447**	1,780,375	1,378,965	107
Receivable from Unsettled Sales of Securities	**28,303**	-	28,303	-
Securities Purchased Under Agreements to Re-sell	**2,286,586**	1,356,319	930,267	-
Shareholding in the Bank for International Settlements	**95,660**	37,578	33,844	24,238
Dividend Receivable	**990**	990	-	-
Accrued Interest	**18,574**	2,155	16,419	-
Total Foreign Currency Financial Assets	**5,681,210**	3,221,874	2,423,512	35,824
Foreign Currency Financial Liabilities				
Short-Term Deposits	**2,597**	537	-	2,060
Payable for Unsettled Purchases of Securities	**30,135**	-	30,135	-
Short Sales of Marketable Securities	**418,263**	134,843	283,420	-
Derivative Instruments in a Loss Position	**174**	-	174	-
Securities Sold Under Agreements to Repurchase	**1,262,187**	762,941	499,244	2
Term Liabilities	**3,819,403**	2,259,908	1,559,495	-
Accrued Interest	**41,459**	21,240	20,219	-
Total Foreign Currency Financial Liabilities	**5,574,218**	3,179,469	2,392,687	2,062
Off-Balance Sheet Instruments[36]	**(97,122)**	(38,151)	(34,361)	(24,610)
Net Foreign Currency Exposure	**9,870**	4,254	(3,536)	9,152

36 Forward foreign currency contracts relating to future expenditure commitments worth $2.7 million are not included in the above risk note.

	Total All Currencies 2003 $000	Currency of Denomination: United States dollar $000	euro $000	Other Currencies $000
Foreign Currency Financial Assets				
Cash Balances with Other Central Banks	**67,465**	54,236	7,103	6,126
Other Cash Balances	**1,738**	24	1,030	684
Marketable Securities	**3,276,974**	1,627,966	1,648,997	11
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**	2,241,181	517,830	-
Accrued Interest	**24,728**	4,056	20,672	-
Total Foreign Currency Financial Assets	**6,215,651**	3,970,003	2,238,827	6,821
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	**840,663**	696,926	143,737	-
Term Liabilities	**4,068,882**	2,144,740	1,924,142	-
Accrued Interest	**51,455**	19,766	31,689	-
Total Foreign Currency Financial Liabilities	**5,101,729**	2,862,767	2,238,962	-
Off-Balance Sheet Instruments	**(1,098,922)**	(1,098,922)	-	-
Net Foreign Currency Exposure	**15,000**	8,314	(135)	6,821

21. Market Risk

The Reserve Bank manages interest rate risk and foreign currency risk (excluding foreign currency risk arising from monetary policy objectives) 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 (2003 $75 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 (2003 $25 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 per cent 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 trading portfolios (actively managed). The VaR for the trading portfolios is calculated as the difference between the aggregate portfolios and risk neutral portfolios.

VaR	Aggregate Portfolios 2004 $000	2003 $000	Risk Neutral Portfolios 2004 $000	2003 $000	Trading Portfolios 2004 $000	2003 $000
Limit	**6,000**	6,000	**4,000**	4,000	**2,000**	2,000
As at 30 June	**248**	321	**186**	238	**62**	83
Peak over period	**591**	1,045	**289**	482	**365**	615
Low over period	**247**	177	**156**	159	**24**	(48)
Average over period	**367**	379	**230**	274	**137**	105

The Asian Bond Fund (ABF) investment, with a position of US$25 million, was entered into with other EMEAP countries on 3 July 2003. The fund is managed by the Bank for International Settlements. Positions and associated VaR are excluded from the table above. As at 30 June 2004, VaR for the ABF investment was estimated at NZ$270,000, with a peak VaR of NZ$290,000 during the year.

In the year to 30 June 2004, actual daily losses on the trading portfolios were within (predicted) VaR 98.8 per cent (2003 98.1 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 the Asset and Liability Committee.

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

VaR	Foreign Currency Risk $000	Interest Rate Risk $000	Correlation $000	Total Market Risk On Aggregate Portfolios 2004 $000	Total Market Risk On Aggregate Portfolios 2003 $000
Limit				**6,000**	6,000
As at 30 June	87	422	(261)	**248**	321
Peak over period	500	722	(134)	**591**	1,045
Low over period	48	325	(369)	**247**	177
Average over period	130	502	(265)	**367**	379

(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.

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.

(a) Foreign Currency Activities

Liquidity is a key criterion in determining the composition of the Reserve Bank's foreign currency assets. This reflects the potential requirement to 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:

a) Repurchase agreements with other central banks enabling the Bank to sell securities in exchange for foreign currency, while simultaneously agreeing to repurchase those same securities at a specified later date for an agreed amount. In essence, the arrangement allows the Bank to enhance the liquidity of its foreign reserves portfolio with minimal additional risks.

b) A committed credit line (US $100 million) that can be accessed quickly to augment the foreign currency.

(b) Local Currency Activities

The Bank is responsible for managing the daily liquidity of the banking system. This includes advancing funds to, and withdrawing funds from, the banking system 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

	Total 2004 $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	**89,204**	89,204	-	-	-	-
Other Cash Balances	**2,446**	2,446	-	-	-	-
Marketable Securities	**3,159,447**	2,346,007	118,448	131,593	378,195	185,204
Receivable from Unsettled Sales of Securities	**28,303**	28,303	-	-	-	-
Securities Purchased Under Agreements to Re-sell	**2,286,586**	2,286,586	-	-	-	-
Shareholding in the Bank for International Settlements[37]	**95,660**	-	-	-	-	95,660
Dividend Receivable	**990**	990	-	-	-	-
Accrued Interest	**18,574**	18,574	-	-	-	-
Total Foreign Currency Financial Assets	**5,681,210**	4,772,110	118,448	131,593	378,195	280,864
Foreign Currency Financial Liabilities						
Short-Term Deposits	**2,597**	2,597	-	-	-	-
Payable for Unsettled Purchases of Securities	**30,135**	30,135	-	-	-	-
Short Sales of Marketable Securities	**418,263**	-	-	119,380	236,629	62,254
Derivative Instruments in a Loss Position	**174**	95	-	-	-	79
Securities Sold Under Agreements to Repurchase	**1,262,187**	1,262,187	-	-	-	-
Term Liabilities	**3,819,403**	602,114	-	704,380	1,970,537	542,372
Accrued Interest	**41,459**	41,459	-	-	-	-
Total Foreign Currency Financial Liabilities	**5,574,218**	1,938,587	-	823,760	2,207,166	604,705
Foreign Currency Maturity Gap	**106,992**	2,833,523	118,448	(692,167)	(1,828,971)	(323,841)
Local Currency Financial Assets						
Cash on Hand	**8**	8	-	-	-	-
Securities Purchased Under Agreements to Re-sell	**1,453,976**	1,453,976	-	-	-	-
Investment Portfolio – New Zealand Government Securities	**3,266,896**	-	576,992	430,712	447,653	1,811,539
Accrued Interest	**56,228**	56,228	-	-	-	-
Other Local Currency Financial Assets	**24**	24	-	-	-	-
Other Assets	**39,238**	8,278	-	-	-	30,960
Total Local Currency Assets	**4,816,370**	1,518,514	576,992	430,712	447,653	1,842,499
Local Currency Financial Liabilities						
Government Deposits	**1,242,466**	1,242,466	-	-	-	-
Other Deposits	**139,640**	139,640	-	-	-	-
Accrued Interest	**215**	215	-	-	-	-
Other Liabilities[38]	**3,120,322**	197,215	-	-	-	2,923,107
Equity	**420,719**	-	-	-	-	420,719
Total Local Currency Liabilities and Equity	**4,923,362**	1,579,536	-	-	-	3,343,826
Local Currency Maturity Gap	**(106,992)**	(61,022)	576,992	430,712	447,653	(1,501,327)
Net Maturity Gap	**-**	2,772,501	695,440	(261,455)	(1,381,318)	(1,825,168)

37 The Shareholding in the Bank for International Settlements has no fixed maturity and is presented as maturing over five years.

38 Other Liabilities includes Currency in Circulation, which has no fixed maturity and is presented as maturing over five years.

	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 – New Zealand 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[39]	**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)

39 Other Liabilities includes Currency in Circulation, which has no fixed maturity and is presented as maturing over five years.

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 Investment Portfolio - New Zealand Government Securities 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 2004 was $632,000 (2003 $86,000) and included a currency stock write-off of $2,000 (2003 $183,000).

Currency Operations includes income and expenses associated with property management. The net surplus for this activity in 2004 was $133,000 (2003 $239,000 deficit).

	2004 $000	2003 $000
Seigniorage Income	195,226	190,532
Other Income	654	228
Total Operating Income	195,880	190,760
New Coin Issue Expenses	4,110	3,651
New Note Issue Expenses	1,305	2,198
Collectors' Currency Issue Expenses	9	192
Total New Currency Issued Expenses	5,424	6,041
Other Currency Expenses	3,343	3,337
Total Operating Expenses	8,767	9,378
Currency Operations Operating Surplus	187,113	181,382

25. Foreign Reserves Management

The Reserve Bank holds foreign currency assets to support the functions of the Bank, including monetary policy objectives and maintenance of orderly markets. These foreign reserves are fully funded by borrowing through The Treasury. New Zealand pays more to borrow in foreign currencies than it can earn investing in high quality assets that can 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 risk neutral asset and liability structure in terms of market risk. The risk neutral position is established to minimise the Bank's exposure to foreign currency risk and interest rate risk, subject to monetary policy foreign exchange intervention objectives. Departures from the risk 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 risk neutral portfolio represents the active management of reserves.

	2004 $000	2003[40] $000
Gain/(Loss) on Active Management Trading	681	(388)
Loss on Risk Neutral Asset/Liability Structure	(2,025)	(4,843)
Net Investment Income	(1,344)	(5,231)
Other	8	(11)
Foreign Exchange Difference on Translation	(123)	230
Total Operating Income	(1,459)	(5,012)
Total Operating Expenses	4,277	4,426
Foreign Reserves Management Operating Deficit	(5,736)	(9,438)

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 23.

26. Overseas Investment Commission Secretariat

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

The cost of services of the OIC for the year ended 30 June 2004 was as follows:

	2004 $000	2003 $000
Application Fees	827	816
Other Income	2	5
Total Operating Income	829	821
Personnel Expenses	542	350
Professional Service Fees	117	142
Computing Expenses	81	73
Asset Management Expenses	54	48
Legal Fees	34	11
Other Expenses	36	44
Total Operating Expenses	864	668
Overseas Investment Commission Secretariat Operating Surplus/(Deficit)	(35)	153

40 In previous years the Bank allocated 50% of earnings on investments funded by the Bank's equity to Foreign Reserves Management. The allocation is no longer made. To ensure consistency with the current year, comparative figures have been restated.

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 has been 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
2004	**829**	**(35)**
	6,023	**(430)**

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. The Bank is in the process of exiting the retail registry business and expects to complete this by December 2004.

	2004 $000	2003 $000
Registry and Depository Services Fees	**4,605**	5,081
Other Income	**186**	288
Total Operating Income	**4,791**	5,369
Personnel Expenses[41]	**1,008**	714
Other Expenses	**2,834**	3,234
Total Operating Expenses	**3,842**	3,948
Registry and Depository Services Operating Surplus	**949**	1,421

41 Personnel Expenses include restructuring expenses.

Consolidated Statement of Financial Performance Notes

28. Interest Income from Financial Assets

	2004 $000	2003 $000
Interest Income from Foreign Currency Financial Assets		
Cash Balances with Other Central Banks	1,451	2,038
Other Cash Balances	3	80
Marketable Securities	33,907	71,166
Securities Purchased Under Agreements to Re-sell	28,814	34,930
Securities Lending	409	517
Total Interest Income from Foreign Currency Financial Assets	64,584	108,731
Interest Income from Local Currency Financial Assets		
Securities Purchased Under Agreements to Re-sell	121,389	168,077
Investment Portfolio – New Zealand Government Securities	217,175	218,174
Government Bank Accounts	114	-
Total Interest Income from Local Currency Financial Assets	338,678	386,251
Total Interest Income from Financial Assets	403,262	494,982

29. Interest Expense on Financial Liabilities

	2004 $000	2003 $000
Interest Expense on Foreign Currency Financial Liabilities		
Securities Sold Under Agreements to Repurchase	4,342	3,247
Term Liabilities	135,912	137,969
Other	13	-
Total Interest Expense on Foreign Currency Financial Liabilities	140,267	141,216
Interest Expense on Local Currency Financial Liabilities		
Government Deposits	178,846	199,699
Other Deposits	4,416	5,450
Total Interest Expense on Local Currency Financial Liabilities	183,262	205,149
Total Interest Expense on Financial Liabilities	323,529	346,365

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.

	2004 $000	2003 $000
Market Value Changes on Financial Assets		
Gain/(Loss) from Unrealised Market Value Changes	(26,311)	21,839
Gain from Realised Market Value Changes	15,928	6,353
Total Gain/(Loss) from Market Value Changes on Financial Assets	(10,383)	28,192
Market Value Changes on Financial Liabilities		
Loss/(Gain) from Unrealised Market Value Changes	(96,003)	32,998
Loss from Realised Market Value Changes	4,498	18,344
Total Loss/(Gain) from Market Value Changes on Financial Liabilities	(91,505)	51,342

31. Net Foreign Exchange Revaluation Gain/(Loss)

	2004 $000	2003 $000
Foreign Exchange Revaluations		
Loss on Financial Assets	(217,230)	(471,881)
Gain on Financial Liabilities	217,302	472,368
Net Foreign Exchange Revaluation Gain	72	487

32. Other Income

	Actual 2004 $000	Budget 2004 $000	Actual 2003 $000
Registry and Depository Services Fees	4,605	4,571	5,081
Property Rental Income	1,528	1,594	1,552
Collectors' Currency Income	739	448	349
Overseas Investment Commission Fees	829	804	821
Registered Bank Fees	3	23	10
Miscellaneous Income	1,656	1,558	1,495
Total Other Income	9,360	8,998	9,308

33. Asset Management Expenses

	Note	Actual 2004 $000	Budget 2004 $000	Actual 2003 $000
Depreciation of Property, Plant and Equipment	5	2,132	2,188	2,410
Other Asset Management Expenses		1,410	1,454	1,579
Finance Charges Relating to Finance Leases		10	-	5
Loss on Disposal of Fixed Assets		(5)	-	(2)
Total Asset Management Expenses		3,547	3,642	3,992

34. Other Operating Expenses

Professional fees include $104,000 (2003 $46,000) paid to the Reserve Bank's auditors for other services in addition to the audit fee. This includes fees paid for contractual audits of the Austraclear depository system and Exchange Settlement Account System of $31,000 (2003 $24,000), and $64,000 (2003 $22,000) for advisory services with respect to the Bank's Funding Agreement and application of accounting policies.

Bank policy requires that the auditors must not be engaged for any work (other than work relating to the provision of an external audit opinion), unless advice is sought from the Chair of the Audit Committee and approval is given by the Governor.

	Note	Actual 2004 $000	Budget 2004 $000	Actual 2003 $000
Professional Fees		3,420	3,330	3,548
Agency and Commission Fees		1,788	1,735	2,080
Computer Expenses		1,267	1,364	1,430
Information Expenses		1,007	1,083	1,037
Administration Expenses		1,146	1,322	1,041
Operational Travel Expenses		732	700	696
Rental and Lease Expenses		220	476	325
Printing Expenses		179	209	184
Audit Fees		149	149	144
Non-Executive Directors' Remuneration Expenses	35	139	191	104
Bad Debt Expenses		-	-	6
Miscellaneous Expenses		284	289	97
Total Other Operating Expenses		10,331	10,848	10,692

35. Non-Executive Directors' Remuneration

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

	2004 $000	2003 $000
Non-Executive Directors		
A Paterson	22	15
W Wilson[42]	-	9
R Richardson[43]	10	15
J Goulter	17	15
P Baines	17	15
A Grimes	32	15
H Fletcher	17	15
Rt. Hon E Thomas[44]	17	5
M Waring[45]	7	-
Total Non-Executive Directors' Remuneration Expenses	139	104

Other Notes

36. Reconciliation of Net Cash Flows from Operating Activities with Reported Operating Surplus

	2004 $000	2003 $000
Reported Operating Surplus	195,137	189,100
Add/(Subtract) Non-Cash Items		
Depreciation	2,132	2,410
Amortisation of Premium/Discount on Purchase of Securities	23,945	(28,926)
Net Unrealised Market Value Changes	(19,761)	(9,509)
Currency Write-Offs	-	69
Net Unrealised Foreign Exchange (Gain)/Loss	(212,578)	(329,129)
	(206,262)	(365,085)
Add (Subtract) Movements in Other Working Capital Items		
Decrease in Accounts Receivable	643	361
Decrease in Miscellaneous Liabilities	(1,803)	(601)
Decrease in Inventories	713	(2,106)
Decrease in Interest Payable	(10,247)	(15,757)
Decrease in Interest Receivable	97	(9,642)
	(10,597)	(27,745)
Add (Subtract) Investing and Financing Activities		
Net Realised Foreign Exchange (Gain)/Loss	212,506	328,642
Net Realised Market Value Changes	(11,430)	11,991
Return of Demonetised Coin	2	2
	201,078	340,635
Net Cash Flow from Operating Activities	179,356	136,905

42 Term completed in January 2003.
43 Term completed in February 2004.
44 Appointed in March 2003.
45 Appointed in February 2004.

37. Cash Balances

	2004 $000	2003 $000
Foreign Currency Cash Assets		
Cash Balances with Other Central Banks	89,204	67,465
Other Cash Balances	2,446	1,738
Marketable Securities – Liquefiable Within Two Working Days	1,586,201	1,643,142
Total Foreign Currency Cash Assets	1,677,851	1,712,345
Local Currency Cash Assets		
Cash on Hand	8	4
Securities Purchased Under Agreements to Re-sell	1,453,976	2,120,364
Total Local Currency Cash Assets	1,453,984	2,120,368
Total Cash Assets	3,131,835	3,832,713
Demand Liabilities		
Government Deposits	1,242,466	3,142,296
Settlement Bank Deposits	71,051	1,815
Central Bank Deposits	11,144	13,625
International Monetary Fund Deposit	57,221	6,963
Other Deposits	224	327
Total Demand Liabilities	1,382,106	3,165,026
Closing Cash Balances	1,749,729	667,687

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.

	2004 $000	2003 $000
Computer Equipment Finance Leases		
Due within one year	307	139
Due within one to two years	174	119
Due within two to five years	12	31
Present Value of Minimum Lease Payments	493	289
Finance charge	26	9
Total Minimum Lease Payments	519	298
Comprising:		
Due within one year	326	145
Due within one to five years	193	153
Total Minimum Lease Payments	519	298

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.

	2004 $000	2003 $000
Office Equipment Operating Leases		
Due within one year	69	171
Due within one to two years	65	33
Due within two to five years	43	23
Total Office Equipment Operating Lease Commitments	177	227

Capital Expenditure and Inventory Commitments

	2004 $000	2003 $000
Capital Expenditure and Inventory		
Property, Plant and Equipment – Due within one year	3,915	1,120
Inventories – Due within one year	5,894	3,070
Total Capital Expenditure and Inventory Commitments	9,809	4,190

Lease Payments Receivable

The Bank owns its head office in Wellington and leases 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:

	2004 $000	2003 $000
Tenancy Lease Payments Receivable		
Receivable within one year	1,406	981
Receivable within one to five years	4,973	867
Receivable later than five years	1,285	662
Total Tenancy Lease Payments Receivable	7,664	2,510

39. Subsidiary Companies

The Reserve Bank has a wholly-owned New Zealand incorporated subsidiary, New Zealand Central Securities Depository Limited (NZCSD).

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

Up to 30 June 2001, RBNZ Registry Limited, a wholly-owned New Zealand incorporated subsidiary, 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 was wound up on 12 November 2003.

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 (the Fund), following each triennial review of the Fund.

On 2 February 1995, the Bank suspended making contributions to the defined benefit division of the Fund on the advice of the Fund's Actuary that such contributions were no longer necessary. The position is re-examined as part of each triennial review (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 2004 and reported on 6 July 2004 that, based on the Fund's annual accounts:

- The assets of the Fund were sufficient at 31 March 2004 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 2004 to provide for benefits to members, including existing pensioners, that are attributable to membership prior to 1 April 2004. 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 2004 and 30 June 2004 that would cause the Actuary to form a different opinion as at 30 June 2004.

(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 (2003 $87.6 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 $36.9 million (2003 $37.1 million). This includes coin issued by The Treasury with a face value of $12.9 million (2003 $12.9 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 $9.8 million (2003 $9.3 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, 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.

(f) At 30 June 2004, the Bank had a contingent liability of $26.37 million (SDR 11.25 million) in respect of uncalled and unpaid capital attached to its shareholding in the Bank for International Settlements.

(g) At 30 June 2004, a claim for AUD$530,000 was made against the Bank's wholly-owned subsidiary, New Zealand Central Securities Depository Limited. The Bank disputes the claim and legal advisers to the Bank consider it unlikely that any liability will arise. Accordingly, no provision has been recorded for the claim other than for expected legal fees required to resolve the issue.

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 value of securities held by NZCSD at 30 June 2004 was $76.1 billion (2003 $77.2 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. Refer to note 42 (g) for information on the claim made against NZCSD at 30 June 2004.

45. Significant Post Balance Date Events

On 1 July 2004, the Bank received a capital injection of $1 billion from the Government. The funds were invested in New Zealand Government Securities, with a face value of $974.8 million, a weighted average yield of 6.15%, and an average duration of 4.2 years.

Each security purchased will be accounted for on a constant yield to maturity basis.