

Transparency in Central Bank Financial
Statement Disclosures

Edited by Kenneth Sullivan

IMF Working Paper

Monetary and Exchange Affairs Department

Transparency in Central Bank Financial Statements Disclosures

Edited by Kenneth Sullivan¹

Authorized for distribution by Arne B. Petersen

November 2000

Abstract

The views expressed in this Working Paper are those of the author(s) and do not necessarily represent those of the IMF or IMF policy. Working Papers describe research in progress by the author(s) and are published to elicit comments and to further debate.

The IMF's development of the code of good practices on transparency in monetary and financial policies and introduction of safeguard assessments has increased the importance of the transparency of the disclosures found in central bank financial statements. This study looks at the disclosure requirements for central banks under International Accounting Standards and provides practical guidance for those responsible for preparing central bank financial statements.

JEL Classification Numbers: G29

Keywords: central bank, financial statements, disclosure, transparency, IAS

Author's E-Mail Address: ksullivan@imf.org

¹ This working paper is based on the papers that were presented to a central bank accounting workshop held at the JVI, Vienna, in April 2000, by Ms. Janiet Cosier (Bank of Canada), Mr. Friedrich Karrer (Austrian National Bank), Mr. Richard Perry (Reserve Bank of New Zealand), Mr. Arne Petersen (IMF) and Mr. Kenneth Sullivan (IMF).

Contents

Page

I. Introduction	5
II. Transparency in Strengthening the International Monetary System and the Role of the IMF	6
A. Introduction	6
B. The <i>Code</i> —Its Underlying Rationale and Main Elements	7
C. Transparency in Financial Statements of Central Banks	8
III. Applying IAS 1 and IAS 30 to Central Bank Reporting	10
A. Introduction	10
A. Overview of the External Reporting Model	10
B. The Role and Components of Financial Statements	12
C. Users of Central Bank Financial Statements and their Needs	14
D. Accounting Policies	15
E. Balance Sheet	16
Current/non-current versus order of liquidity	17
Face of balance sheet versus notes to the accounts	17
Equity and reserves	18
F. Income Statement	18
G. Changes in Equity and Reserves	19
H. Explanatory Notes to the Accounts	20
I. Summary	21
IV. International Accounting Standard 32 Financial Instruments: Disclosure and Presentation—Case Study of the Reserve Bank of New Zealand	22
B. Introduction	22
A. Importance of Financial Instrument Risk Disclosures	23
B. Narrative and Qualitative Disclosures	26
Nature and extent of activities	26
Risk management policies	28
Accounting policies	30
Fair value disclosures	31
Other risks	31
C. Quantitative Disclosures for Financial Instruments	31
Interest rate risk	32
Credit risk	33
Foreign currency risk	34
Fair values	34
D. Offsetting Financial Assets and Liabilities	34
E. Summary	35

V. IAS 39 Financial Instruments: Recognition and Measurement	36
A. Introduction.....	36
B. Recognition	36
Categories of financial assets.....	36
Trade date vs. settlement date.....	37
C. Measurement.....	37
Initial measurement of financial assets and financial liabilities	37
Subsequent measurement of financial assets	38
Gains and losses on financial assets carried at fair value	38
Gains or losses on financial assets carried at amortized cost.....	39
Financial assets remeasured to fair value.....	39
Subsequent measurement of financial liabilities.....	39
D. Managing Income	39
Impact of change in standards.....	39
Selecting appropriate asset classifications	40
Impact of classifications on income and reserves.....	41
Impairment of assets	43
E. Disclosure	44
F. Effective Date	44
VI. International Accounting Standard 21 – The Effect of Changes in Foreign Exchange Rates.....	45
A. Introduction.....	45
B. Required Treatment under IAS 21	45
C. Treatment of Revaluation Gains and Losses.....	45
D. Disclosure Requirements under IAS 21.....	47
VII. International Accounting Standard 7—Statement of Cash Flows.....	49
C. Introduction	49
A. Purpose of the Statement of Cash Flows	49
B. How Should Cash be Defined?	51
C. Defining Investing and Financing Cash Flows	51
D. Presentation of Gross or Net Cash Flows	52
E. The Direct and Indirect Method of Preparation	52
F. Summary.....	53
VIII. Differences between the Accounting and Reporting Principles in the European System of Central Banks (ESCB) and the International Accounting Standards (IAS)	54
D. Introduction.....	54
A. General Remarks.....	54
B. Accruals—Amortisation for Securities	55
C. Recognition of Income—Treatment of Unrealized Gains and Losses at Balance Sheet Date	55
D. Accounting Rules for Off-Balance-Sheet Instruments	56
E. Trade Date versus Settlement Date Accounting.....	56

F. Reporting Obligations—Format of Balance Sheet and Profit and Loss Account	57
G. Reporting Obligations—Other Financial Reporting Formats.....	57
H. Disclosure Notes to the Annual Accounts	58
I. Recognition of Banknotes and Coins	58
Assets	67
Liabilities.....	68

Appendices

I. Summary of International Accounting Standard Disclosure Requirements.....	59
II. Reserve Bank of New Zealand 1999—Financial Statements.....	82

I. INTRODUCTION

The theme for this paper is *Transparency in Financial Reporting, Good Disclosure Practices for Central Banks*. While the emphasis is on transparency in the accounting framework and disclosure practices of central banks, it is appropriate to set the broader framework for transparency. The financial crisis in Asia convinced the IMF of the value of transparency, which it has set out to promote under the development of the *Code of Good Practices on Transparency in Monetary and Financial Policies*.²

The introduction of safeguard assessments for users of Fund resources has also increased the importance of transparent reporting in compliance with international standards. This paper offers practical guidance to those responsible for preparing central bank financial statements to enable the publication of statements consistent with international standards.

The working paper is based on the papers presented to a central bank accounting workshop held at the JVI in Vienna in April 2000. Contributors to the paper are Ms. Janet Cosier (Bank of Canada), Mr. Freidrich Karrer (Austrian National Bank), Mr. Richard Perry (Reserve Bank of New Zealand), Mr. Arne Petersen (IMF) and Mr. Kenneth Sullivan (IMF).

The paper draws heavily on the example of the 1999 Financial Statements for the Reserve Bank of New Zealand. These statements won first prize for the annual report in their category in the national competition run by the Institute of Chartered Accountants of New Zealand. Following the conceptual chapters, the paper presents an appendix that maps out how International Accounting Standards are reflected in the RBNZ 1999 Financial Statements. The final appendix is a replication of the RBNZ 1999 Financial Statements. The chapters, where appropriate, should be read with reference to these appendices. The RBNZ financial statements may also be viewed on the RBNZ web site at www.rbnz.govt.nz.

² Available on the IMF external web page, along with the supporting document at www.imf.org/external/np/mae/mft/index.htm.

II. TRANSPARENCY IN STRENGTHENING THE INTERNATIONAL MONETARY SYSTEM AND THE ROLE OF THE IMF³

A. Introduction

The successive financial crises in different regions of the world over the past two decades, and the more recent crises in Asia and Russia that spread across other regions in particular, have led to much reflection and analysis in various international bodies on ways to strengthen the international financial system. A special G-22 Working Group on Transparency and Accountability was formed in 1998 to focus particular attention on this topic, and it issued a comprehensive report.

A consensus has emerged that inadequate transparency by international organizations, national governmental units, and private sector entities was a contributing force to the serious financial disturbances that have plagued the global economy. The conclusion was reached that markets cannot function efficiently, and that they will continue to be highly vulnerable to instability, in the absence of adequate, reliable, and timely information from all quarters. Lack of accurate and timely information on economic and financial developments and policies, particularly in an environment of economic and financial weakness, aggravates the weakness and contributes to the emergence of crises situations.

From this discussion, the Fund produced the Code of Good Practices on Transparency in Monetary and Financial Policies. As well, the Fund continues to develop its Special Data Dissemination Standards (SDDS) as another avenue for enhancing international transparency.

A number of other standard-setting bodies dealing with other financial sector-related areas (such as accounting, auditing, banking regulation and supervision, bankruptcy, corporate governance, insurance regulation, payment system and securities market regulation) are also active in developing standards relevant for a better functioning financial system. The focus of these standards typically is broader than transparency. However, transparency and disclosure practices are covered in these standards as well, and thus have relevance to the Fund's Code of Good *Practices on Transparency in Monetary and Financial Policies*.

³ Prepared by Mr. Arne B. Petersen and Mr. Kenneth Sullivan.

B. The Code —Its Underlying Rationale and Main Elements

What is meant by transparency? For purposes of the Code, transparency for central banks refers to an environment in which the objectives of monetary policy, its legal, institutional, and policy framework, monetary policy decisions and their rationale, data and information related to monetary policies, and the terms of central bank accountability are provided to the public on an understandable, accessible and timely basis. Thus, the code covers a much wider area than transparent accounting. But transparency in accounting is the basis on which other elements rest.

The Code covers both monetary policies and financial policies (i.e., the policies related to the regulation, supervision and oversight of banking, insurance, securities, payment systems, and deposit insurance). These two sets of policies are interrelated and often mutually reinforcing. The full benefits to be derived from good transparency practices in the monetary policy area cannot be achieved without complementary good transparency practices in the financial policy area, and vice versa. This chapter focuses on the part related to central banks.

The first part of the Code, “Good Transparency Practices for Monetary Policy by Central Banks,” is organized into four sections, each representing an aspect of transparency practices: (1) clarity of roles, responsibilities, and objectives of central banks; (2) the processes for formulating and reporting monetary policy decisions; (3) public availability of information on monetary policies; and (4) accountability and assurances of integrity by the central bank.

The design of transparency practices for central banks in the Code rests on two principles. First, monetary policies can be made more effective if the public knows and understands the goals and instruments of policy and if the authorities make a credible commitment to meeting them. Second, good governance calls for central banks to be accountable, particularly where monetary authorities are granted a high degree of autonomy. By publishing adequate information about its activities, the central bank can establish a mechanism for strengthening its credibility by matching its actions to its public statements. It is here that the transparency code and the accounting function intersect. Central bank accounting and reporting systems must be set up in such a way that the central bank provides the public with meaningful and transparent information.

Chairman Alan Greenspan of the Federal Reserve Board, at the Tercentenary Symposium of the Bank of England in 1994, reflected on the case for transparency for central banks in the following insightful manner:

“.... if we are going to have independent central banks then implicit in that independence is accountability. You cannot in a democratic society have an institution which is fully or partly dissociated from the electoral process and which has powers that central

banks inherently have. So the question really amounts to how does one position the central bank with respect to the issue of disclosure and accountability—which are related questions.

“The position that we [the Federal Reserve] take is that the burden of proof is against the central bank: that is, we have to demonstrate that either delayed disclosure or non-disclosure is a policy which is required for us to implement our statutory goals. We have struggled with this, and have concluded that we should make available to the electorate what it is we think, why we are doing what we are doing and in a general way under what conditions we would behave differently,” (pp. 252-253, Forest Capie, Charles Goodhart, Stanley Fischer and Norbert Schnadt, *The Future of Central Banking*, Cambridge University Press, 1994).

Transparency for central banks is not an end in itself, nor should transparency be considered as a substitute for pursuing sound policies. Transparency and sound policies should be seen complements.

C. Transparency in Financial Statements of Central Banks

The annual report, including the annual financial statements, is a key for central banks to meet their accountability obligations. These statements reveal the results of the central bank’s functional activities on its balance sheet as well as the use it has made of the resources at its disposal. One does not need to look far to see examples of where the central bank’s financial reports have been used by opposition politicians to launch criticisms of both the government and central bank. As the ability to question performance is an essential component of accountability, those preparing annual financial statements carry the responsibility of presenting them so that they provide an accurate picture of the financial results of central bank operations in a manner that can be defended in terms of an internationally credible framework. Such presentation will direct criticism to appropriate areas, so reducing the possibility of the independence of the central bank being constrained and its operational effectiveness reduced.

Experience repeatedly shows that the best defense to criticism is through open and transparent disclosure as this removes the risk of the hugely damaging consequences that occur when it is revealed that disclosures have been less than total. It is difficult to overstate the importance of the role of transparency in ensuring the maintenance of central bank independence and discharging its accountability obligations.

The importance of transparent reporting practices for central banks extend beyond their immediate institutional interests as they make an important contribution to establishing the credibility of a nation’s financial system. As economies evolve and seek to establish their positions in the international market place, the national reporting framework becomes important to an expanded group of users. Central bank financial statements may be published or posted on the Internet where they can be read internationally. Opinions formed on the

robustness of financial reporting frameworks from reading such documents contribute to judgements about the integrity and stability of the national financial system.

In the absence of a well-developed set of generally accepted accounting practices (GAAP) within a country, the published reports of authoritative institutions are used to determine what is best practice. By default, central bank disclosures make a material contribution to what is accepted as the nation's GAAP, as commercial banks and other financial sector participants adopt them. Transparent central bank financial statements make it easier for bank supervisors to demand a similar level of disclosure from the commercial banks that they supervise. Transparent disclosures by commercial banks are an integral part of the process of establishing and maintaining a robust framework for the commercial banking system. In situations of emerging systems of GAAP, central banks have a valuable role to play in advancing the level of clarity and openness of disclosure.

For most transition economies the evolution of the accounting profession and the standard setting framework in terms of market based disclosures is still developing. This can create potential problems for the production of internationally credible financial reports. Those who are not market participants and who have a conflict of interest, such as maximizing taxable revenue, may control standard setting. The chapter recognizes these tensions and seeks to enhance understanding of the conceptual framework upon which central banks base their reporting.

The basis of the chapter's framework is International Accounting Standards as these provide an agreed minimum conceptual framework for reporting. IAS evolved from demands by the international marketplace and are gaining increasing acceptance as the foundation from which all national standards should evolve. Given their international credibility they provide a robust framework upon which to base and defend reporting disclosure upon.

III. APPLYING IAS 1 AND IAS 30 TO CENTRAL BANK REPORTING⁴

A. Introduction

This chapter provides an overview of issues associated in applying International Accounting Standard 1—Presentation of Financial Statements (IAS 1) and International Accounting Standard 30—Disclosures in the Financial Statements of Banks and Similar Financial Institutions (IAS 30) to central bank reporting. The issues discussed include:

- an overview of the external reporting model, types of information to be disclosed and the reasons it is required in market economies;
- the role and main components of financial statements including the fundamental concepts for preparing financial statements;
- users of central bank financial statements and their needs; and
- issues in applying aspects of IAS 1 and IAS 30 to each of the main components of the financial statements. This excludes the Statement of Cash Flows which is subsequently discussed.⁵

This chapter should be considered in conjunction with the detailed requirements of IAS 1 and IAS 30. These detailed requirements are presented in a separate chapter that has been designed to assist central bank accountants prepare financial statements in accordance with IAS 1 and IAS 30.⁶

A. Overview of the External Reporting Model

Public and private sector entities are in business for a variety of reasons such as profit maximization or the achievement of outcomes that can benefit society. The business process will involve each entity entering various business arrangements and transacting with one another in the exchange and consumption of economic resources. These business transactions can range from being relatively simple to extremely complex and can be completed in different countries with different laws governing the business arrangements and transactions.

⁴ Prepared by Mr. Richard Perry.

⁵ See Chapter VII, “International Accounting Standard 7—Statement of Cash Flows”.

⁶ See Appendix I., “Summary of International Accounting Standard Disclosure Requirements—IAS 1, IAS 7, IAS 21, IAS 30, IAS 32, and IAS 39.

Each party entering business arrangements will be concerned about the overall financial health of the entities they undertake business with. These concerns include the ability of the entity to pay any amounts owing to them, whether the entity will continue to exist in the future, how successful the entity has been in generating profits and the risks the entity has exposed itself to in various business undertakings. More specifically, external parties will seek information about an entity's business transactions and performance in order to:

- make decisions about providing resources to, or do business with, the entity;
- assess management's stewardship of the resources entrusted to it;
- assess the entity's current and potential ability to generate profits and cash flows; and
- assess the entity's compliance with laws and business contracts to the extent that these impact and affect the outcomes the entity is seeking to achieve.

External parties will generally obtain the above information from the entity's annual report that includes general-purpose financial statements. General-purpose financial statements are intended to provide information to users who are not in a position to demand tailored financial reports to meet their specific information needs. This reflects that some users are unable to extract relevant and timely information from their business partners in order to make decisions. Hence, they must rely on the information contained in the financial statements as their major source of financial information to assist them in their decision making. Users that have specific custodial or transaction monitoring requirements are usually able to contract for their specific information purposes as part of the business contract. An example of a specific financial information need is a commercial bank that can require a party to a loan agreement to provide specific information before the loan is provided.

The need for general-purpose financial statements is well recognized internationally. For example, several countries will require public companies to publish regular financial statements as a condition of company registration. This is to ensure that information is provided:

- that is useful to present and potential investors, creditors and other users in making rational investment, credit and similar decisions;
- to help current and potential investors, creditors and other users in assessing amounts, timing and uncertainty of prospective cash receipts from dividends or interest, the proceeds from the sale, redemption or maturity of securities or loans, the entity's capital transactions and other factors that affect liquidity;
- about the economic resources of an entity, the claims to those resources and the effects of transactions, events and circumstances that change resources and claims to those resources;
- about an entity's financial performance given by measures of earnings and its components in order to help in assessing the prospects of an entity;
- about how management has discharged its responsibility to shareholders for the stewardship of the entity's resources; and

- that is useful to management in making decisions in the interest of shareholders.

In addition, it is important to consider the connections between developments in financial markets and the consequences for financial reporting. It is generally accepted that, in an efficient market, security and share prices impound all publicly available information. Lack of timely and accurate information can distort prices and heighten uncertainty. This in turn can lead to increases in financial contracting costs as capital providers and capital users try to protect themselves against information uncertainties. It can also lead to increases in costly litigation after the fact, if it may be alleged that vital information was missing or presented an inaccurate picture of the state of the entity's affairs. In summary, information uncertainties can increase the cost of capital to an entity.

In order to reduce the likelihood of information uncertainties arising, common frameworks for financial reporting have been developed both domestically and internationally. These frameworks are designed to facilitate the provision of consistent and reliable financial information. Such frameworks include the International Accounting Standards that have been developed to assist in the preparation of general-purpose financial statements. Preparation of financial information using frameworks such as International Accounting Standards have been specifically developed to ensure that financial information meet the diverse needs of general users who cannot require the business entity to provide specific information. Compliance with such frameworks may assist entities to avoid the information uncertainties that can otherwise increase the cost of capital.

It should be noted that the coverage of International Accounting Standards is generally limited to financial statements and that annual reports will contain additional information in other sections of the annual report.

B. The Role and Components of Financial Statements

IAS 1 describes financial statements as a structured financial representation of the financial position of, and the transactions undertaken by, an entity. The objective is to provide information about the financial position, performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. Financial statements also show the results of management's stewardship of the resources entrusted to it. To meet this objective financial statements provide information about an entity's:

- (a) Assets;
- (b) Liabilities;
- (c) Equity;
- (d) Income and expenses, including gains and losses; and
- (e) Cash flows.

This information, along with other information in the notes to financial statements, assists users in predicting the entity's future cash flows and in particular the timing and certainty of the generation of cash and cash equivalents.

IAS 1 explains that a complete set of financial statements includes:

- accounting policies;
- a balance sheet;
- an income statement;
- a statement showing either all changes in equity or changes in equity other than those arising from capital transactions with owners and distributions to owners;
- a cash flow statement; and
- explanatory notes.

These financial statement components interrelate because they reflect different aspects of the same transactions or other events. Although each component provides information that is different from the others, none is likely to serve only a single purpose or provide all the information needs for all users. Hence, the information contained in the notes to the accounts is of equal importance as the major statements such as the balance sheet and income statement.

In addition, IAS 1 outlines fundamental concepts for account preparation including:

- **Going concern**—the assumption that the business will continue to operate into the future (i.e., the business will not be liquidated or cease trading).
- **Accrual basis**—transactions are recognized as they occur and reported in the periods to which they relate. This recognizes that some cash outlays will benefit several future periods—for example, the purchase of an asset will provide benefits to future reporting periods and the costs of the asset are allocated to each period through capitalization and depreciation of the asset.
- **Consistency**—presentation and classification of items in financial statements should be consistent between periods. Where the presentations or classifications are changed, the comparative information should be changed to reflect the new basis.
- **Materiality**—each material item should be presented in the financial statements and immaterial items should be aggregated. It is important to recognize that materiality encompasses both materiality by amount and materiality by nature. For example, entering a low value transaction may have extremely important risk consequences for the entity that are important to disclose to the users of the financial statements. In this context, information is material if non-disclosure is likely to influence the economic decisions of the financial statement users.

C. Users of Central Bank Financial Statements and their Needs

In order to better understand what we want central bank financial statements to say, we should identify the users of the financial statements and what information they require. For a central bank, the users might include:

- (a) **The stakeholders including taxpayers and government.** Stakeholders may be concerned with the central bank stewardship of public monies. As central banks use public money, they have a responsibility to display an appropriate level of care in managing these funds and using resources efficiently to perform their functions. In particular, these users may wish to assess the accountability of management when deciding whether or not to reappoint or replace them. Given the increasing independence being granted to central banks, governments may use financial statements as a major means of applying central banks accountability. Financial statements may also provide the basis for calculating the annual dividend to be paid to government.
- (b) **Commercial banks.** Many central banks prescribe the external reporting requirements of commercial banks. Commercial banks may look to the central bank for examples of appropriate and best practice disclosure.
- (c) **External suppliers and lenders.** The central bank may purchase goods and services, or borrow funds from, other domestic and international suppliers who are interested in the ability of the central bank to meet their obligations as they fall due.
- (d) **Credit rating agencies and financial markets.** The relative position of the central bank may provide information to credit rating agencies and financial markets on the resources of the central bank and the ability of the central bank to be effective in meeting its stated policy objectives. This may impact on the overall credit rating of the country or risk premium demanded by international financial markets. For example, specific information may be sought on foreign reserves and the ability of the central bank to meet exchange rate objectives.
- (e) **Purchasers of central bank services.** Central banks may provide certain services such as payment system mechanisms. Customers of these services will be interested in the extent to which the central bank provides these services on commercial terms and the level of profit generated by such services.

The needs of these users can generally be met by providing information on the:

- economic resources under control of the central bank;
- legal and economic obligations of the central bank;
- inflows and increases in economic resources and consumption or declines in economic resources of the central bank;

- cost information on central bank operations;
- future risks to the maintenance of the resources of the central bank;
- potential obligations and resources not yet measured by the central bank and why;
- level of transactions with parties related to the central bank including unconsolidated subsidiaries; and
- methods used to portray and measure the actual economic resources.

This information will generally be provided through various components of the central bank financial statements.

D. Accounting Policies

Accounting policies allow the users of central bank financial statements to understand how the economic resources of the central bank have been measured and portrayed in the financial statements. In particular, the accounting policies should describe the measurement basis used in preparing the financial statements and disclose each specific accounting policy that is necessary for a proper understanding of the financial statements.

It is suggested that the accounting policies should be the first component of the financial statements to be presented. This recognizes that the accounting policies will determine how the financial statements measure and portray the position and performance of the central bank. On this basis, they can be considered as the “window” through which the financial statements portray and interpret the actual events and transactions of the central bank.

In deciding whether a specific accounting policy should be disclosed, consideration should be given as to whether disclosure would assist users in understanding the way in which transactions and events are reflected in the reported performance and financial position. For example, it is important to understand the basis on which assets are valued and how both realized and unrealized gains and losses are treated in the income statement and balance sheet.

An objective for central bank accountants is to select accounting policies so that the financial statements comply with all the requirements of each applicable International Accounting Standard and Interpretations. Where there is no specific requirement, accounting policies should ensure that the financial statements provide information that is relevant to the decision-making needs of users and are reliable in that they:

- faithfully represent the results and financial position of the central bank;
- reflect the economic substance of events and transactions;
- are neutral, that is free from bias;
- are prudent; and
- are complete in all material respects.

Specific issues to consider in disclosing accounting policies include:

- (a) **Financial instruments.** Financial instruments will often comprise a significant proportion of a central bank's resources and account for a significant amount of the overall financial performance. Financial instruments can be subject to various measurement practices (such as historic cost or market value) or may not even be recorded within the financial statements (i.e., they are off balance sheet). Consideration should be given to including detailed disclosure in the accounting policies of the way in which these financial instruments are accounted for including the measurement base used and how they are recognized in the financial statements. This detailed disclosure may provide an appropriate example for commercial bank disclosure as information on financial instrument recognition and measurement is an integral part to understanding the profitability and health of commercial banks.
- (b) **Changes in accounting policies.** Accounting policies should also include an explanation on whether or not there have been changes made in any specific accounting policies. Where changes have been made, the reason should be disclosed and the impact on the current and prior periods should be explained.
- (c) **Disclosure of supplementary information.** The accounting policies are a useful component of the financial statements for disclosing information required by the International Accounting Standards, including the entity's name, legal status, the reporting group, whether the financial statements comply with International Accounting Standards and whether the fundamental accounting assumptions such as accrual accounting and going concern have been applied.

E. Balance Sheet

The balance sheet reflects the economic resources under the control of the central bank and the legal and economic obligations of the central bank. This provides information on the financial structure, liquidity and solvency of the central bank.

The application of IAS 1 and IAS 30 to central bank balance sheets raises several issues including disclosure:

- of current and long-term categories of assets and liabilities versus disclosure in broad order of liquidity;
- in the face of the balance sheet or notes to accounts; and
- of equity and reserves.

Current/non-current versus order of liquidity

IAS 1 requires an entity to determine, based on the nature of its operations, whether or not to present current and non-current assets and current and non-current liabilities as separate classifications on the face of the balance sheet. When an entity chooses not to make this classification, assets and liabilities should be presented broadly in order of their liquidity. However, IAS 30 suggests banks should present a balance sheet that groups assets and liabilities by nature and lists them in an order that reflects their relative liquidity.

Central banks will usually have significant levels of financial assets and liabilities. Hence, it is likely that presentation will be most appropriately made in broad order of liquidity, as many assets and liabilities will be able to be realized or settled in the near future.

Face of balance sheet versus notes to the accounts

Both IAS 1 and IAS 30 detail several items that should be considered for disclosure in the face of the balance sheet. In determining the appropriate presentation on the face of the balance sheet, consideration should be given to how the presentation could best reflect the underlying business operations of the central bank. The objective would be for a user of the financial statements to be able to understand the significant economic resources and obligations of the central bank by reviewing the balance sheet.

For example, the Reserve Bank of New Zealand (RBNZ) applies a distinction between local and foreign currency assets and liabilities. This reflects that the RBNZ holds foreign currency assets primarily for the purpose of managing New Zealand's foreign reserves. Local currency assets and liabilities arise from monetary policy implementation, banking operations and provision of circulating currency. Within the local and foreign currency splits, assets and liabilities are presented in broad order of liquidity and any specific items required to be disclosed by accounting standards are included either on the face of the balance sheet or in the notes to the accounts.

In addition, the RBNZ approach has been to identify a common set of balance sheet asset and liability definitions that are adopted throughout the notes to the accounts. Specifically, this allows disclosure relating to balance sheet risks (such as credit risk, interest rate risk and foreign currency risk) to be presented by a common set of balance sheet classifications. The conceptual rationale is that the same elements of the balance sheet can be considered in light of the different risks that arise. This allows users who seek information on specific risks, such as the RBNZ exposure to credit risk, to relate the balance sheet amounts to credit risk arising on those amounts.

It should be also noted that the RBNZ has deliberately attempted to increase transparency of balance sheet presentation through disclosure of summarized explanation of

major balance sheet changes and references to the notes to the accounts for further information.

Equity and reserves

IAS 1 details several disclosures required in the balance sheet with respect to share capital. These disclosures may not be applicable to central bank circumstances given that central banks are not always funded through share capital.

Disclosure of reserve information is very important in central bank circumstances to allow users to understand the reasons why reserves are maintained. This disclosure should be accompanied by a description of the nature and purpose of each reserve class.

F. Income Statement

The income statement provides information concerning the performance of the central bank and in particular its profitability. This information can assist understanding how economic resources have been increased and consumed by the central bank. The reporting of central bank profitability may be useful in those business circumstances where profit objectives exist. For example, the RBNZ provides security registry and transfer services on commercial terms with profit objectives. Profit information allows users to understand the extent to which profit objectives have been achieved.

In addition, central banks may charge for the provision of certain services (such as banking services to the public sector and government). Profit information allows users to understand the extent to which the profit generated from these activities is excessive or comparable to the profits generated by commercial suppliers of similar services.

However, the disclosure of central bank profit is often an inappropriate measure of central bank performance. This is relevant where central bank profit largely arises from the consequences of implementing monetary policy and from the monopoly provision of currency. The profit generated in these circumstances will usually arise as a consequence of the monetary policy actions of the central bank. The central bank may influence interest rates in order to achieve inflation objectives and the profit the central bank earns as a consequence of the monetary policy actions is secondary to achieving the inflation objectives. A better measure of performance in these circumstances is information that explains the inflation objectives and the success of the central bank in meeting the inflation objectives. The more important financial information is the operating costs the central bank has incurred in achieving these inflation objectives.

The disclosure of cost information is usually a better indicator of financial performance as it demonstrates whether the central bank has been efficient in achieving its policy objectives. For example, has central bank spending been excessive in trying to meet

the policy objectives. Disclosure of cost information allows users to review the central bank stewardship of public resources. This disclosure of cost information can be used to demonstrate that the central bank has been efficient and responsible in using public resources. This can enhance the central bank's creditability and reduce the potential for political interference. Hence, the disclosure of central bank cost information can contribute to obtaining and preserving greater central bank independence.

Consideration can be given to complimenting the traditional income statement with a statement that discloses financial performance by reference to the material business operations of the central bank. This approach can refer to the "outputs" or goods and services that the central bank produces. This approach may satisfy the functional presentation requirements suggested by IAS 1, but is not a specific requirement of IAS 1 or IAS 30. The RBNZ presents two income statements, one in the traditional fashion and one by reference to the outputs of the RBNZ. These statements include performance relative to budget and explain any significant budget variances to enhance transparency.

IAS 1 and IAS 30 prescribe certain information to be included on the face of the income statement or in the notes to the accounts. The IAS 30 classifications are more appropriate to central bank circumstances, as the IAS 1 approach is the more traditional approach designed for businesses that make and sell physical goods. The IAS 1 approach uses a "gross profit" concept where information is provided on income generated by sales of goods less the cost of purchasing or making those goods. The net of this income and cost is the "gross profit" of the entity that is available to meet operating costs before profit is calculated.

However, the actual application of the IAS 30 approach should be carefully considered as it facilitates analysis of profitability from a commercial bank perspective. In particular, the approach has been designed to allow analysis of commercial banks' interest rate margin (i.e., the margin earned through the lending and borrowing money in the banking process), commercial bank trading activities and fee income. These profit categories are usually not as relevant to central bank circumstances given the non-profit objectives of central banks. Hence, the application of the IAS 30 approach should be tailored to the specific circumstances of the central bank.

G. Changes in Equity and Reserves

This statement explains the changes in the central bank's equity and reserves, including distributions to stakeholders, increases of equity (by way of retained earnings or contributions by stakeholders) and changes in various reserves. It should be noted that there are currently proposals to combine this statement with the income statement in order to present a single statement dealing with comprehensive income.⁷

⁷ See the G4+1 position paper "Reporting Financial Performance: Proposals For Change", published by the G4+1 working group of accounting standard setters in August 1999. This is
(continued)

H. Explanatory Notes to the Accounts

The financial statements also contain notes, supplementary schedules, and other information that is relevant to the needs of users. This will include information concerning future risks to the maintenance of the resources of the central bank, potential obligations and resources not recognized in the financial statements of the central bank, and the reasons why these potential obligations are not recognized.

Information that is not included on the face of the balance sheet or income statement should be included in the notes to the accounts. Each item on the face of the balance sheet should be cross-referenced to any related information in the notes.

IAS 30 contains specific disclosures to be included in the notes to the accounts. While these disclosures may not be as relevant for central banks as commercial banks, careful consideration should be given to setting an appropriate example for commercial banks where relevant. The specific disclosures include:

- (a) **Contingencies and commitments (IAS 30, para. 26).** This is to report any obligations not recognized in the financial statements. This provides information concerning off balance sheet transactions, potential obligations that may impact on liquidity and solvency, and potential losses that are not recognized. This information is extremely important as it allows users to understand any potential obligations of the central bank that are not currently recognized in the financial statements. These potential obligations may impact on future central bank finances and it is very important that comprehensive and detailed information is provided so users can assess the probability and impact of the potential obligations. For example, a central bank may be subject to a legal claim that could have a material impact on the central bank if it was successful. Even if the likelihood of the claim being proved was considered very low, the financial statements should refer to the existence of the situation to alert users to the existence and the potential impact of the legal claim. This provides the central bank with some defense to critics in the event that a claim was proved that substantially reduced a future dividend payment to government.
- (b) **In addition,** central banks should carefully consider the rationale for recognizing transactions off balance sheet as this may not be an appropriate example to commercial banks.

- (c) **Maturity analysis of assets and liabilities (IAS 30, para. 30).** This information allows users to assess the ability of the entity to meet obligations as they fall due and understand the overall liquidity of the entity.
- (d) **Concentrations of assets and liabilities (IAS 30, para. 40).** Disclosure of significant concentrations by geography and industry assists users to assess the degree of exposure the entity has to any one sector. This is important to understand the risks the organization may face if a particular region/country or industry experiences financial difficulties. In addition, there is a requirement to disclose significant net foreign currency disclosures to provide information regarding the degree of foreign currency risk the entity faces. A significant net foreign currency concentration exposes an entity to the risk arising from changes in foreign currency rates.
- (e) **Losses on loans and advances (IAS 30, para. 43).** This allows users to assess the effectiveness of the entity in managing and providing for loan losses and in recovering outstanding loans to customers.
- (f) **General banking risks (IAS 30, para. 50).** This information provides users with an understanding of items such as general provisions for loan losses.
- (g) **Assets pledged as security (IAS 30, para. 53).** Banks will often pledge assets as collateral for borrowing money. A common example is repurchase agreements where money is advanced to external parties after an entity passes legal title of the assets (usually marketable securities) to the counterparty. The purpose of this disclosure is to allow readers to determine the value of assets available to creditors and the ability of the entity to dispose of assets to meet liquidity requirements.

I. Summary

This chapter has provided an overview of issues associated in applying IAS 1 and IAS 30 to central bank financial statements. Further disclosures concerning financial instruments are presented in the chapter for Chapter IV that discusses IAS 32.

**IV. INTERNATIONAL ACCOUNTING STANDARD 32 FINANCIAL INSTRUMENTS:
DISCLOSURE AND PRESENTATION—CASE STUDY OF THE RESERVE BANK OF NEW
ZEALAND⁸**

B. Introduction

This chapter discusses issues for central banks in applying International Accounting Standard 32 - Financial Instruments: Disclosure and Presentation (IAS 32). In addition, the chapter considers the broader issue of appropriate financial instrument risk disclosures for central banks. The issues discussed include:

- the importance of financial instrument risk disclosures including an overview of key risks associated with financial instruments;
- qualitative disclosures including disclosure of risk management policies and nature and extent of activities;
- quantitative risk disclosures including interest rate risk, foreign currency risk, credit risk, liquidity risk and fair values; and
- offsetting financial assets and liabilities in balance sheet presentation.

The Reserve Bank of New Zealand's (RBNZ's) 1998–99 financial statements, included as Appendix II, are used as a case study for various disclosures. However, it should be noted that:

- The RBNZ's financial statements are prepared in accordance with the requirements of New Zealand accounting standards. New Zealand accounting standards and disclosures reflect requirements considered appropriate to the New Zealand legal and economic situation and are not necessarily the same as the requirements of International Accounting Standards.
- New Zealand accounting standards have generally followed the developments of the Anglo-American standards with their strict standards of disclosures to provide relevant information for financial statement users. As such, they provide less room for discretion on the part of the preparer of financial statements than International Accounting Standards. New Zealand is an active participant in the development of International Accounting Standards through membership of the G4+1 group of standard setters and

⁸ Prepared by Mr. Richard Perry.

involvement in various working groups of the International Accounting Standards Committee.⁹

- The New Zealand disclosures have been developed to reflect the specific economic circumstances of the RBNZ operating under New Zealand laws. Laws and circumstances may be different for other central banks and different methods of disclosure may be appropriate. The objective should be to represent the underlying legal and economic substance of the central bank within the local laws and circumstances.

A. Importance of Financial Instrument Risk Disclosures

Financial risk management has evolved substantially during recent years. This reflects that the successful management of financial risks in a global economy has become a complex activity. An entity can substantially change its financial risks very quickly by entering into financial transactions including derivative instruments. For example, derivatives may be used to modify a particular financial risk, to reduce or even eliminate exposure to it. Alternatively, derivatives may be used as speculative tools to multiply the effects of changes in interest rates, foreign currency rates or security prices.¹⁰

The potential for large losses resulting from the use of financial instruments, including derivatives, has been well demonstrated. For example, the use of derivative transactions, combined with a poor risk management framework, contributed to the collapse of Barings Bank PLC. The failure of Barings and other similar situations have heightened public concern about the way in which the risks associated with financial instruments are managed, measured and controlled. The result is an increased demand for publicly available information on the way entities manage and control the risks associated with their holdings of financial instruments.

As previously discussed, relevant, reliable and timely financial information is of crucial importance to the efficient operation of modern capital markets.¹¹ Information uncertainties can increase the cost of capital to an entity. Accounting standard setters have

⁹ The G4+1 consists of standard-setters from Australia, Canada, New Zealand, the United Kingdom, the United States, and the IASC. The G4+1 is actively involved in seeking and developing common solutions to financial reporting issues.

¹⁰ It is noted that central banks do not typically enter into derivative instruments primarily for speculative purposes. Central bank objectives tend to be more policy orientated rather than profit orientated and derivative instruments are generally used to assist in the risk management of financial assets and liabilities held for policy purposes.

¹¹ See Chapter III, "Applying IAS 1 and IAS 30 to Central Bank Reporting"

sought to reduce information uncertainties arising from involvement in financial instruments by developing specific standards (including IAS 32) that detail disclosure requirements for financial instruments. The importance of disclosure concerning financial instruments is reinforced by a recent survey of trading and derivative disclosures published by the Basle Committee and International Organization of Securities Commissions (IOSCO). These two groups consider transparency of banks' and securities firms' activities and risks to be a key element of an effectively supervised financial system as follows:

“Transparency, based on meaningful public disclosure, plays an important role in reinforcing the efforts of supervisors in encouraging sound risk management practices and fostering financial market stability”.¹²

This report suggests that financial institutions should:

- Provide financial statement users with a clear picture of their trading and derivatives activities. They should disclose meaningful summary information, both qualitative and quantitative, on the scope and nature of their trading and derivatives activities and illustrate how these activities contribute to their earnings profile. They should also disclose information on the major risks associated with their trading and derivatives activities and their performance in managing these risks.
- Disclose information produced by their internal risk measurement and management systems on their risk exposures and their actual performance in managing these exposures. Linking public disclosure to internal risk management processes helps ensure that disclosure keeps pace with innovations in risk measurement and management techniques.

While these recommendations are for derivative instrument disclosures, they are equally relevant to disclosures concerning financial instruments in general.

The importance of disclosures concerning financial instruments is reflected in the requirements of IAS 32. The objective of IAS 32 is to enhance financial statement users' understanding of the significance of financial instruments to an entity's financial position, performance and cash flows. In particular, IAS 32 assists users to understand the risks associated with financial instruments including price risk, credit risk and liquidity risk. Each of these risk types is defined as follows:

- (a) **Price risk.** IAS 32 identifies three types of price risk as follows:

¹² See “Recommendations for public disclosure of trading and derivatives activities of banks and securities firms”, consultative paper issued jointly by the Basle Committee on Banking Supervision and Technical Committee of IOSCO, February 1999, Internet address www.iosco.org.

- Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates.
 - Foreign currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates.
 - Market risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices whether those changes are caused by factors specific to the individual security or its issuer or factors affecting all securities traded in the market.
- (b) **Credit risk.** The risk of loss arising from a counterparty to a financial contract failing to discharge its obligations.
- (c) **Liquidity risk.** The risk that an entity will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity risk may result from an inability to sell a financial asset quickly at close to its fair value.

Financial statement users can generally obtain the information they require on the risks arising from involvement in financial instruments through two types of disclosure:

- **Narrative or qualitative disclosures.** These explain the risks the entity is exposed to; how the entity evaluates these risks; how the entity uses financial instruments to manage financial risks and major policies adopted to limit and control risk. This information will allow financial statement users to understand why financial instruments are used and how the risks arising from financial instruments are identified and managed.
- **Quantitative disclosures.** This information is used for evaluating the extent to which the entity is exposed to interest rate risk, credit risk, foreign currency risk or liquidity risk. This information will allow the financial statement users to understand how much risk the entity is exposed to.

Central banks will typically hold financial instruments as part of their operations. Hence, central banks face financial risks in their own operations, so they need to be aware of these risks and be able to identify and control them. Users of central bank financial statements will be concerned with the extent to which the central bank is using financial instruments in appropriate circumstances and that the central bank is appropriately managing the risks that arise from involvement in financial instruments. Disclosures that demonstrate the central bank is appropriately managing financial risks is important as the central bank is managing public resources. The central bank can use these disclosures to demonstrate that appropriate care and responsibility is being taken to manage these public resources.

Transparent qualitative and quantitative disclosure can demonstrate that the central bank is aware of the risks associated with financial instruments and that these risks are being appropriately managed. Even if the central bank deliberately chooses not to manage specific risks arising from involvement in financial instruments, the disclosure of this information

may enhance the credibility of the central bank. For example, a central bank could explain the reasons why exposure to foreign currency risk is not managed in order to avoid external criticism in the event the central bank incurs large unrealized foreign currency gains or losses.

In addition, many central banks have a responsibility for supervision of commercial banks within their countries including the regulation of commercial bank disclosures. This provides central banks with an opportunity to promote best practice in disclosure and transparency concerning financial instruments in areas they have in common with commercial banks.

Similarly, the RBNZ is responsible for the supervision of commercial banks in New Zealand. The New Zealand approach to supervision is based around public disclosures of information. The failure of traditional supervisory approaches to prevent substantial bank failures and the risk of moral hazard has caused the RBNZ to adopt a public disclosure regime for commercial banks. As a result, commercial banks have, in some situations, looked to the RBNZ practices to gain illustrations of best practice disclosure. Therefore, the RBNZ has committed to preparing its financial statements according to best practice accounting and disclosure requirements as applicable to a central bank. In pursuing this objective, the RBNZ attempts to set an example for commercial banks to follow (where appropriate).

B. Narrative and Qualitative Disclosures

Qualitative disclosures provide management with an opportunity to explain the risk management objectives of the central bank and how these objectives fit into the overall central bank objectives. This can include information on the nature and extent of involvement in financial instruments, risk management policies in general, specific risk management policies for each of the major risk categories (i.e., the policies used for managing interest rate risk, credit risk, foreign currency risk and liquidity risk) and the accounting policies for financial instruments.

Nature and extent of activities

IAS 32 requires disclosure of information about the nature and extent of the involvement in financial instruments. Information on the nature and extent of involvement in financial instruments allows the financial statement users to understand the central bank's business reasons for using financial instruments. For example, the central bank may explain that financial instruments are used for specific policy purposes such as the implementation of monetary policy. Alternatively, the central bank may use derivative financial instruments, such as forward foreign exchange contracts, as a tool to reduce exposure to foreign currency risk. Disclosure of this type of information can assist financial statement users to understand the reasons why the central bank uses financial instruments and provide a better understanding of the overall risk taking philosophy of the central bank.

The approach taken by the RBNZ is to present this information as the first note to the financial statements. The disclosures provide specific information concerning:

- (a) the RBNZ's foreign currency activities (note 1(a)) providing an overview of financial instruments arising from the RBNZ's management of New Zealand's foreign reserve portfolio, the funding for these financial instruments and the management of these financial instruments;
- (b) departures from risk neutral positions (note 1(b)) outlining the RBNZ risk taking philosophy used in foreign reserves management;
- (c) significant events that impacted on the RBNZ's involvement in different types of foreign currency financial instruments during 1998–99 (note 1(c));
- (d) overview of the RBNZ's involvement in derivative instruments (note 1(d));¹³
- (e) overview of the involvement in a securities lending program (note 1(e)) including the amount lent out under the program at balance date;¹⁴
- (f) discussion of the RBNZ's involvement in financial instruments arising from local activities including monetary policy implementation (note 1(f));
- (g) disclosure of legal restrictions on assets (note 1(g)). The purpose of this disclosure is to allow readers to determine whether any assets that are recorded in the balance sheet have legal restrictions against them. For example, a central bank may have assets that have been pledged as security in repurchase transactions.¹⁵ This disclosure is also required by IAS 30 (para. 60); and

¹³ The RBNZ has only limited involvement in derivative instruments. Foreign currency swaps are used to manage exposure to foreign currency risk and as a tool for implementing monetary policy. In addition, the RBNZ has entered into a cross currency swap in order to increase the long-term return of the foreign reserve assets.

¹⁴ Under the securities lending program, the RBNZ contracts an external agent to lend out a portion of the RBNZ's foreign currency securities. The agent will lend these securities to financial market counterparties in order to generate income. This lending arrangement is completed in accordance with pre-defined terms and conditions designed to minimize the risks of the arrangements. The external agent and the RBNZ share the income earned through this program.

¹⁵ Under a repurchase transaction, the central bank may borrow cash and pledge financial securities as security to the borrowing arrangement. The typical accounting treatment results in the financial securities that have been pledged as security continuing to be recorded as assets in the central bank's balance sheet.

- (h) concentrations of funding (note 1 (h)) explaining the major sources of funding for the RBNZ's financial assets. This disclosure meets the requirement of IAS 30 (para. 40).

Risk management policies

IAS 32 requires an entity to describe its financial risk management objectives and policies. This discussion may include information on the principal internal control procedures in place such as the existence of a centralized risk management committee, a summary of any involvement in new financial instruments and the risks associated with new financial instruments. For example, a central bank may have specifically authorized procedures and policies governing the use of financial instruments. Summary disclosure of this information can be used to demonstrate that appropriate risk management processes and controls exist for each of the major financial risks that the central bank is exposed to. This disclosure demonstrates that the central bank has an appropriate risk management structure. This information is important in central bank circumstances as the central bank is managing public resources and can demonstrate that appropriate systems are in place to minimize financial risks. It is suggested that central banks specifically discuss:

Risks and management controls includes an overview of the key aspects of the organizational structure used in the risk management and control process. The discussion may explain the existence of a centralized risk management committee and whether separate divisions of the central bank are responsible for measuring and monitoring central bank financial risk. The disclosure can include a description of each major risk the central bank is exposed to, how these risks arise, and the methods used to manage and measure the risks.

For example, the RBNZ provides an overview of the RBNZ risk management structure in Note 12. Notes 13 to 16 then discuss the background to how the risks arise for interest rate risk, credit risk, foreign currency and liquidity risk. The techniques used to manage each of these risks are specifically considered including the major internal control processes.

Interest rate risk. Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. This reflects that changes in the level of interest rates will change the present value of financial instruments. Where financial instruments are accounted for on the basis of market values, changes in value will be recognized in the income statement of the central bank. Disclosure can summarize the policies used for measuring and managing interest rate risk and how the central bank reviews its effectiveness in managing interest rate risk. This allows the financial statement users to know that the central bank is aware of exposure to interest rate risk and that appropriate steps have been taken to manage exposure to changes in interest rates.

The RBNZ discloses the policies used for measuring and managing interest rate risk in note 13. This risk arises from the RBNZ's management of foreign reserves. The disclosure includes an overview of the "Funds at Risk" model that is used to manage the RBNZ's

exposure to interest rate risk. “Funds at Risk” is a statistical model that predicts the losses that would arise on the RBNZ’s foreign currency assets from a change in the level of interest rates. The loss prediction is calculated by statistically modeling historical interest rate movements and using these movements to predict exposure to future losses. This model is similar to the “Value at Risk” models developed by organizations such as JP Morgan.¹⁶ These types of “Value at Risk” models are often used by commercial banks to manage commercial bank interest rate risk.

The RBNZ disclosure includes the “Funds at Risk” model parameters and major model assumptions. This information is provided to facilitate an understanding of the effectiveness of the RBNZ model in managing interest rate risk.

Credit risk is the risk of loss arising from counterparty default. Qualitative credit risk disclosures can summarize the central bank policies for identifying, measuring and managing credit risk. The discussion might address the structure of the credit/loan review function (i.e., how does the central bank assess the creditworthiness of their counterparties), internal controls, risk limits and limit monitoring. Risk limits and limit monitoring refers to the risk management process of limiting the total assets held with any single counterparty. The process of limiting the total assets held with a single counterparty is only effective if it is supported by regular reporting of actual exposures compared to limits.

The qualitative credit risk disclosures should also discuss any mechanisms used to reduce credit exposure, including the use of collateral and any netting agreements. Central banks may require collateral before they are prepared to provide funding in situations such as the implementation of domestic monetary policy implementation.

The RBNZ credit risk management approach is outlined in note 14(a). This provides an overview of the credit risk management framework and limit framework. The analysis is extended to include a discussion of the collateral that is accepted by the RBNZ in the operation of New Zealand’s real time gross settlement system.

Foreign currency risk is the risk of loss arising from changes in the level of foreign currency rates. The narrative disclosure for foreign currency risk can explain the extent to which the central bank has exposure to foreign currency risk and whether any methods are used to manage and monitor foreign currency risk.

The RBNZ qualitative disclosure on foreign currency risk in note 15 explains how the RBNZ is not exposed to significant risk in this area and provides an overview of the daily reporting and monitoring of foreign currency positions. This daily reporting and monitoring is used to control and manage exposure to foreign currency risk.

¹⁶ For further information on the JP Morgan “Value at Risk” model refer to the JP Morgan “Riskmetrics” Internet web site at www.jpm.com.

Liquidity risk is the risk that an entity may not be able to meet obligations as they fall due. Disclosure can include how liquidity risk arises and practices undertaken to manage liquidity risk.

The RBNZ management of liquidity risk of foreign currency assets is explained in note 16. However, given the nature of the New Zealand central bank operations, the RBNZ is not subject to local currency liquidity risk.

Accounting policies

For each class of financial asset and liability, IAS 32 requires disclosure of the accounting policies. This includes valuation methods adopted, and the criteria used for recognizing gains and losses in the income statement.

Disclosures about accounting policies assist users to understand any important distinctions that exist in the accounting treatment of various types of financial instruments. International Accounting Standards permit a variety of methods to account for financial instruments.¹⁷ The accounting policies used for financial instruments will impact on how gains and losses are recognized in the income statement. For example, a mark-to-market method of accounting will immediately recognize any changes in the market value of financial assets and liabilities in the income statement. Conversely, historic cost accounting will only recognize interest paid and received on financial instruments in the income statement. Where financial instruments are marked-to-market, the disclosure should explain the basis used for calculating market values such as use of external market prices or internal valuation models. Because the accounting practices for derivatives are not always consistent across countries or between institutions, it is particularly important that the central bank describes the accounting treatment of derivative instruments.

The RBNZ's 1998–99 financial statements were significantly changed to enhance the disclosure of accounting policies for financial instruments. Previously, the majority of the accounting policies were concerned with the measurement of non-financial assets and liabilities. More detailed accounting policies were provided for all significant categories of financial instruments. This detail included information on the balance sheet presentation, income recognition and valuation basis. Expanded information on financial instruments was seen as an opportunity to promote transparency of disclosures of accounting policies for commercial banks. Accounting policies for financial instruments will have a significant impact on the presentation and measurement of assets and liabilities and commercial bank profitability.

¹⁷ This is further discussed in the session concerning IAS 39: Recognition and Measurement of Financial Instruments, Chapter V.

Fair value disclosures

Fair value disclosures allow the users to understand whether the financial instruments can be sold at more or less than the carrying balance in the balance sheet. The qualitative disclosures of fair values may discuss the methods used to determine the fair value of financial instruments. In the case of instrument categories for which there are no external market prices, the discussion should highlight the methods and assumptions used to estimate market value.

A specific fair value issue unique to central bank circumstances is the method used to assess the fair value of currency in circulation. This is typically calculated as the face value of currency issued.

The RBNZ discusses the methods used to calculate the fair value disclosures for each class of financial instrument in note 11. This includes discussion of relevant valuation methods and reasons why book value is considered to approximate fair value for certain instruments.

Other risks

Legal, operational and reputational risk often pose significant concerns to central banks but accurate measurement of these risks is often difficult. However, central banks can help financial statement users understand these risks by providing information on the nature of the risks and describing how they relate to the central bank's activities.

The RBNZ discusses operational risk in note 12. The discussion includes an overview of the internal audit function. However, there is limited discussion of the other risk types including the management of reputational risk.

C. Quantitative Disclosures for Financial Instruments

Quantitative information provides users with an understanding of the degree of risk exposure within each major risk category. IAS 32 requires certain quantitative information for interest rate risk, credit risk and fair values. IAS 30 requires quantitative information for liquidity risk and foreign currency risk. This section now provides an overview of the quantitative disclosures for the requirements of IAS 30 and IAS 32, excluding liquidity risk. The requirements for liquidity risk disclosures have been outlined in an earlier chapter.¹⁸

¹⁸ See Chapter III, "Applying IAS 1 and IAS 30 to Central Bank Reporting".

Interest rate risk

IAS 32 requires disclosure of information concerning the entity's exposure to interest rate risk. Financial statement users will want to understand the likely gains or losses that the entity will be exposed to from a change in the level of interest rates.

IAS 32 expects the disclosure to include information on the maturity or interest rate repricing dates for various financial instruments and information on effective interest rates. Interest rate repricing dates are the dates at which the interest rate on variable financial assets or liabilities will change. The basic idea is that the present value of financial assets and liabilities will change when there is a change in interest rates. An increase in the level of interest rates will result in a decrease in the present value of financial assets and liabilities, and vice versa. The magnitude of this change will generally depend on the remaining time to maturity of the financial instrument. All things being equal, financial instruments with longer terms to maturity will be subject to greater present value changes because of a change in interest rates. This logic evolves from the "time value of money" concept that underpins modern financial markets and it is outside the scope of this chapter to consider this concept in any further detail.

For banks, the IAS 32 disclosure is typically by way of an interest rate-repricing table. Assets and liabilities are grouped into various maturity periods based on the maturity or interest rate-repricing period. Interest rate risk increases if there is a mis-match between the repricing of financial assets and liabilities. A mis-match arises where the maturity or repricing dates for financial assets and liabilities are different. Where a mis-match exists, the present value of the assets and liabilities will change by different amounts when interest rates change.

For example, consider an asset with a remaining maturity of 5 years and a liability with a maturity of 1 year. If interest rates change, the value of the asset will change by a different amount to the value of the liability. The existence of this situation could be highlighted in the following table:

Maturity	1 year	2 years	3 years	4 years	5 years
Assets					100
Liabilities	100				
Gap (Assets less Liabilities)	(100)				100

A repricing schedule increases the understanding of interest rate risk because it compares the maturity or repricing of assets and liabilities over future periods. This allows users to identify any significant "gaps" in the repricing of financial assets and liabilities. Hence, the financial statement users may obtain an understanding of how much the entity would gain or lose because of a change in interest rates.

The RBNZ provides a comprehensive interest rate-repricing schedule, using the asset and liability categories presented on the face of the balance sheet (note 13). This has been extended to provide repricing “gap” information by currency to further enhance understanding of potential exposure to interest rate risk within specific currencies.

The balance sheet asset and liability categories have also been used to present the quantitative risk disclosures for credit risk and foreign currency risk. The approach of using the balance sheet asset and liability categories is intended to provide users with a comprehensive presentation of the RBNZ’s assets and liabilities and the risk profile for each category of assets and liabilities. This approach allows the financial statement user to understand the reasons why the central bank holds different assets and liabilities and the extent of the risk associated with each category of asset and liability.

As discussed in the section on qualitative disclosures, information can be provided on the exposure to interest rate risk as measured by models such as “Value-at-Risk” (VAR). VAR models predict the loss that would arise on financial assets because of changes in the level of interest rates.

Note 13 provides the RBNZ “Funds-at-Risk” measures as calculated by an internal model. This information includes the year-end “Funds-at-Risk” position, internal limits and peak exposure. The peak exposure is the maximum “Funds-at-Risk” position that has arisen during the financial year. Information on the peak exposure allows users to understand the extent to which risk limits have been utilized during the period.

Credit risk

The main credit risk disclosures required by IAS 32 include the amount that best represents the maximum credit risk exposure and any significant concentrations of credit risk. The disclosures of significant concentrations of credit risk are similar to the requirements IAS 30 (para. 40) to disclose significant concentrations of assets and liabilities by geography and industry. From a credit risk perspective, this information assists users to assess the degree of credit exposure a central bank may have to any specific sector. This is important to understand the risks the central bank may face if a particular region/country or industry experiences financial difficulties and was subsequently unable to meet debt obligations. In addition, these disclosures can be used to demonstrate that a central bank has very high credit quality. For example, if a central bank had significant levels of United States government financial assets, disclosure of this concentration would allow the financial statement users to be aware of the high credit quality of financial assets.

The RBNZ examples are provided in note 14 (b) which provides credit exposure by industry and geography. Additional quantitative credit exposure information is provided including:

- **Credit exposure by credit rating.** This analysis of financial assets by the credit rating of the issuers allows users to assess the overall credit quality of the RBNZ's financial assets.
- **Credit exposure by counterparty.** This includes the number of end-of-year and peak credit exposure to individual counterparties in excess of 10% of the RBNZ's equity. This allows users to assess credit exposure to individual counterparties and obtain an understanding of any large credit exposures. This is more important in a commercial banking environment where users can understand the impact that a default of a single large counterparty would have on the commercial bank's equity.

Foreign currency risk

IAS 32 does not specifically require disclosure on information concerning foreign currency risk. IAS 30 has a requirement to disclose significant net foreign currency disclosures to provide information regarding the degree of foreign currency risk the entity faces. A significant net foreign currency concentration exposes an entity to the risk arising from changes in foreign currency rates.

The RBNZ provides this information in note 15 including the amount of foreign currency held in each class of foreign financial assets and liability.

Fair values

IAS 32 requires disclosure of the fair value of financial assets and liabilities. Fair values reflect the present value of financial instruments and are usually based on current market prices. Hence, fair values can provide an indication of whether assets can be sold at the value reported in the balance sheet.

RBNZ fair values are presented in note 11.

D. Offsetting Financial Assets and Liabilities

Readers generally expect financial assets and liabilities to be presented on a gross basis in the balance sheet. This means assets and liabilities should not be netted against each other for reporting purposes. This approach ensures the balance sheet presents all the obligations and resources of the entity—netting obligations may understate actual assets and liabilities and mis-represent the underlying economic reality.

However, offsetting assets and liabilities is permitted under IAS 32 when the entity has a legal right to set-off the recognized amounts and the entity intends to settle the obligations on a net basis. A legal right of set-off will usually arise under either:

- contract law—where parties to the agreement explicitly acknowledge a right to set-off.

- common law—through the traditional acceptance of a right of set-off and the practice of doing so, or contract law.

To be recognized in the balance sheet, a legal right of set-off should be enforceable in a liquidation or bankruptcy.

The RBNZ follows the strict practice of not setting off assets and liabilities in the balance sheet unless a legal right of set-off exists.

E. Summary

This chapter has discussed issues for central banks in applying IAS 32. Central banks have an important role in disclosures of financial instruments, as central banks will typically hold financial instruments as part of their operations. Hence, users of central bank financial statements will be concerned with the extent to which the central bank is using financial instruments in appropriate circumstances and that the central banks are appropriately managing the risks that arise from involvement in financial instruments.

Transparent qualitative and quantitative disclosure can demonstrate that the central bank is aware of the risks associated with financial instruments and that these risks are being appropriately managed.

In addition, many central banks have a responsibility for supervision of commercial banks within their countries including the regulation of commercial bank disclosures. This provides central banks with an opportunity to promote best practice in disclosure concerning financial instruments.

V. IAS 39 FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT

(Effective 1st January 2001)¹⁹

A. Introduction

IAS 39 establishes standards for recognizing and measuring information about an organization's financial assets and financial liabilities. IAS 39 together with IAS 32 are the two main standards pertaining to financial instruments.

B. Recognition

A financial asset or a financial liability is recognized by an organization on its balance sheet when the organization becomes a party to a contract. The following are some examples:

- the organization has a legal right to receive, or a legal obligation to pay, cash; or
- goods and services have been delivered or rendered; or
- a commitment has been made to purchase or sell a financial instrument or commodity on a future date at a specified price.

Categories of financial assets

IAS 39 identifies four categories of financial assets. These are

1. Held-for-trading assets are assets acquired to generate a profit from short-term fluctuations in price.
2. Held-to-maturity investments are assets with fixed payments and fixed maturity that the organization intends to hold to maturity.
3. Loans and receivables are assets created by an organization by providing cash, goods or services directly to another organization who has agreed to repay the loan or pay the receivable.
4. Available-for-sale assets are assets that do not belong to the three other categories.

¹⁹ Prepared by Ms. Janet Cosier and Mr. Kenneth Sullivan.

When classifying assets for valuation under IAS 39, central banks need to make decisions reflecting the nature of the asset, the reason for holding it, the nature of any liability it is offsetting, the need to trade the asset against the intention to hold it to maturity and, inevitably, the profit distribution framework for the bank. IAS 39 provides limited scope to freely change assets between categories, as the definitions have been tightened and the available alternative treatments reduced. The presumption now is for a move to fair value accounting with limited exemptions. Fair value captures changes in the value of financial assets in the period they occur, potentially creating a source of greater volatility in the measurement of a bank's income. Consequently, management of the income statement will require more careful attention to the central bank's balance sheet.

Trade date vs. settlement date

A "regular way" *purchase* of financial assets should be recognized in the accounting records using **trade date accounting** or **settlement date accounting**. A "regular way" *sale* of financial assets should be recognized using settlement date accounting.

The trade date is the date an organization commits to purchase the asset. It is the date the organization recognizes the asset to be received and the liability to pay in the future. When the organization uses trade date accounting it will account for any change in the fair value of the assets classed as held for trading and available for sale to be received during the period between the trade date and the settlement date.

The settlement date is the date that the asset is delivered. It is the date that the asset is transferred to the organization.

C. Measurement

Initial measurement of financial assets and financial liabilities

A financial asset or financial liability is recognized initially by an organization at its cost. The cost of a financial asset or financial liability is the fair value given for the asset or the fair value received in the case of a liability.

The cost is determined by the transaction price and includes any transaction costs for fees and commissions paid to agents, brokers and dealers.

Subsequent measurement of financial assets

After initial recognition, financial assets, held for trading and available for sale, should be measured at their fair values. The following categories of financial assets should be measured at amortized cost.

- loans and receivables;
- held-to-maturity investments; and
- any financial asset that does not have a quoted market price in an active market and the fair value cannot be reliably measured.

The published price quotations in an active market are the best evidence of fair value. As well, the fair value of a financial asset that an organization has decided to sell is the amount that it expects to receive for the sale.

Gains and losses on financial assets carried at fair value

Held-for-trading and available-for-sale investments

A gain or loss on *held-for-trading* investments should be included in net profit or loss.

A gain or loss on *available-for-sale* assets can be: (i) included in net profit or loss; OR (ii) recognized directly in equity.

The following table summarizes the accounting treatment for measuring financial assets.

Category of Financial Asset	Initial Measurement	Subsequent Remeasurement	Gain or Loss on Remeasurement Reported in
Held for trading	Fair value (cost)	Fair value (published quotations)	Net Profit or Loss
Available for sale	Fair value (cost)	Fair value (amount expected to receive)	1) Net Profit or Loss or 2) Equity
Held to maturity	Fair value (cost)	Amortized cost	-*
Loans and receivables	Fair value (cost)	Amortized cost	-*

Gains or losses on financial assets carried at amortized cost

Held-to-maturity investments and loans and receivable

For financial assets and liabilities carried at amortized cost, a gain or loss is recognized in net profit or loss when the asset or liability is impaired.

The loss is the difference between the asset's carrying amount and the present value of expected future cash flows.

To recognize the loss, the carry value of the asset should be reduced to the estimated recoverable amount either directly or through the use of an allowance account. The amount of the loss should be reported in net profit or loss.

Financial assets remeasured to fair value

If a loss on a financial asset carried at fair value has been recognized directly in equity and there is objective evidence that the asset is impaired, the cumulative net loss in equity should be removed from equity and recognized in net profit or loss. How does the treatment differ from IAS 25?

Each of the four asset classes offers different options for the treatment of valuation changes. Note that the valuation changes referred to are price revaluations resulting from changes in interest rates and do not include changes arising from movements in exchange rates. These are addressed under IAS 21 The Effect of Changes in Foreign Exchange Rates.

Subsequent measurement of financial liabilities

After initial recognition, all financial liabilities should be measured at amortized cost *except for* liabilities held for trading which should be measured at fair value.

D. Managing Income

Impact of change in standards

The move to fair value increases the possibility for volatility of reported income. The following table compares the respective treatments of IAS 25 and IAS 39 and their impact on the measurement of income.

Financial Asset Category	Accounting Standard	
	IAS 25	IAS 39
Loans and Receivables:	Only accrued interest is recognized in the income statement	Both accrued interest and any changes in value arising from an impairment of the asset or its reversal are recognized in determining income.
Held for Trading:	Accrued interest goes to the income statement as well as the following valuation changes; <ul style="list-style-type: none"> - any change in value of assets valued at fair value - decrease in value for those held at lower of cost or market 	Accrued interest goes to income statement and the following valuation changes; <ul style="list-style-type: none"> - all changes in valuation as only fair value accounting is allowed for these assets.
Held to Maturity:	Only accrued interest is recognized in the income statement	Only accrued interest is recognized in the income statement. No change from IAS 25
Available for Sale:	Accrued interest and the following valuation changes are recognized in the income statement; <ul style="list-style-type: none"> - any change in value of assets valued at fair value - decrease in value for those held at lower of cost or market 	Accrued interest must go to income statement. Only fair value valuation allowed. Entity allowed to make once only, entity wide, decision on whether to take valuation changes to income statement or to revaluation reserve in equity until asset is sold or matures.

Selecting appropriate asset classifications

One option to reduce income volatility is to classify assets, where appropriate, as being Held to Maturity. This removes the need to record them at fair value (though fair value will still be required in the notes to the accounts). This will reduce the size of unrealized revaluation gains reported in the income statement and the related volatility. While the Held to Maturity facility is designed to satisfy the needs of specific types of financial institutions who hold assets to meet specific future liabilities, there is some rationale for central banks to adopt this position for that portion of their portfolio that backs the currency in circulation liability. As a zero rated liability, the currency in circulation liability has no offsetting valuation movements when interest rates change.

To comply with the Held to Maturity requirements central banks will need to be careful to ensure the criteria of the category are complied with. This may require the division of like securities in to trading and investing portfolios to enable differing valuations to be applied to the same security type, that may be held for differing purposes

Any attempts to minimize the impact of fair value on the income statement by using the Available for Sale (AFS) classification is likely to prove problematic. AFS, with its choice of treatments of the changes in fair value, is a residual class. By definition, an asset can only be classified as AFS after it has failed the tests for classification as one of the other three classes.

Despite its existence as a residual class, the AFS classification poses interesting questions for central banks as it could potentially significantly effect reported income. What financial assets held by a central bank, except loans and receivables, would qualify for classification as AFS? The definition of Held for Trading is designed to capture those assets held “for the purpose of generating a profit from short-term fluctuations in price or dealer’s margin.”²⁰ As this is not a prime purpose for central banks, there is the need to find another classification. The next test is to see if the assets meet the Held to Maturity criteria. Because the central bank may deal in these securities as part of its normal operations, it is likely that classes of assets do not meet these criteria. Having failed both tests, the assets become AFS. Examples may include foreign securities held as part of the reserve management and assets purchased as part of system liquidity management.

Impact of classifications on income and reserves

The decision to classify an asset as AFS will have no material impact if the bank decides to take all revaluation changes to the income statement. However, the introduction of the ability to assign unrealized revaluation gains and losses directly to equity raises interesting questions of managing central bank income and the effect of unrealized losses on the bank’s equity. Assuming that it is possible to establish the fair value for the assets, the choice of how to treat the unrealized valuation gains and losses needs to be carefully thought through. Taking the revaluations to reserves will reduce the volatility of reported profit. In times of falling interest rates, this will result in a growth of reserves and an effective understatement of accounting income. The effect will be to reduce the pool of dividends payable to the government. Conversely, in a situation of rising interest rates the opposite result will occur. The reserves will accumulate debit balances, eroding capital, while the reported profit will be effectively overstated. The profit for distribution to the government will not be reduced by the amount of the revaluation losses. The result, if the AFS quantity is significant, could be a situation where the government is receiving large profit disbursements from the central bank while it is showing a notional negative capital position. As entities are

²⁰ IAS 39, para. 10. Definitions of Four Categories of Financial Assets.

unable to switch between alternate treatments as circumstances change central banks will need to think through the issues very carefully regarding, firstly what assets they classify as Available for Sale and, second, how they decide to treat the fair value revaluation.

Traditionally accounting standards have avoided the maintenance of debit balances within equity accounts. Prudence and the capital maintenance concept required that debit balances should be accounted for through the income statement so to ensure that reductions of capital were resolved before any distributions of dividends occurred. This is reflected in the expectation that where revaluation accounts are maintained they may only exist if they have a credit balance. In the event that the credit balance is written down, any further revaluation losses were to be taken into the income statement.

Under IAS 39, it is now possible for the valuations of AFS assets to accumulate unrealized valuation losses that will create a debit balance within the revaluation reserve account. The chapter argues that best practices suggest that all fair value adjustments should, where possible, be reported directly through the income statement and that the use of holding unrealized revaluation gains and losses in reserves should be applied only in limited circumstances and for assets of short duration. The exception to this rule would be the situation where, as with foreign exchange revaluations, circumstances require the distribution of large unrealized revaluation gains to the budget without the central bank having the liquidity to fund it. This needs to be treated with care for such a policy could, as discussed, also require the retention of large unrealized revaluation losses.

Bank capital is the residual value between assets and liabilities. The income statement is the summary of changes in capital arising from Bank operations. Transparency suggests that the more information that can be disclosed through the income statement then the greater its value. This concept is supported by the work currently underway on a Statement of Comprehensive Income. Consequently, the prime focus of good reporting must be to take valuation adjustments through the income statement, which will enable a more effective monitoring of the bank's level of capital.

Financial assets held to maturity will always amortize away any valuation loss by the time they mature. In contrast, AFS assets that are sold before maturity require any related gain or loss transferred out of the reserve and recognized in the income statement at the time of the sale. Long dated asset, which has been accumulating revaluation losses over several years, may have significant accumulated losses. Rather than recognizing the loss in value over the life of the asset they are reported in one lump sum, which will distort reported income levels. The argument may be made that the net effect on bank equity is the same as the revaluation losses had been accumulating in the revaluation reserve. However, the practice reduces the efficacy of the income statement and may result in questions regarding the continued payment of dividends in a situation of negative or impaired capital. The ability to accumulate debit balances in the revaluation reserve for AFS assets should ideally only ever be a minor and transitional issue.

An issue that emerges from this discussion is the importance that central banks should place on an appropriate internal reporting framework to keep management informed of changes in the structure of the bank's balance sheet.

Impairment of assets

The requirement in IAS 39 to report Loans and Receivables at amortized cost less provision for impairment will impact on income recognition. The standard discusses the need to recognize impairment of asset values on an individual basis for significant items or on a group basis for minor items.²¹ Banks are now required to recognize impairment of financial assets either through direct write-downs to expenses or indirectly through provisions. Either way they are required to report the changes in value arising from impairment through the income statement. Besides the direct impact that this will have on income recognition there is now an increased duty to ensure that the loan portfolio is properly managed, valued and losses provided for. Compliance with IAS will now require the ability to demonstrate that this management of the loan portfolio is happening.

This strengthened requirement for reporting impairment of loans will assist bank supervisors develop an appropriate provisioning regime amongst commercial banks who should be complying with IAS as a minimum.

This will pose some problems for a number of central banks because of their holdings of non-performing government debt. A strict adherence to international standards requires the continued accrual of interest on this debt until it is deemed non-performing. Once it is deemed non-performing it is possible to stop accruing interest on it but the need then exists to make provisions for its write-off. The problem with writing off government debt by the central bank is that it is equivalent to publicly acknowledging government insolvency. While this is politically inexpedient, the alternatives are limited if one wishes to remain in compliance with IAS. If the debt is accounted for as a Held to Maturity instrument there is no need to write down its capital value though IAS 32 still requires a best estimate of its fair value to be given in the notes to the accounts. There are obvious incentives here to ensure that governments maintain the integrity of their financial obligations.

The main impacts of IAS 39 on the income statement lie in the move to a wider application of fair value valuation methodology and the consequential requirement to report the majority of these valuation changes in the income statement. Consequently, central banks will need to pay close attention to the income effects of these changes. Held for Trading financial assets must be valued at fair value and the valuation changes taken to income. Holding large portfolios of tradable securities could result in potentially large valuation impacts in the income statement. This will be problematic if the central bank is unable to

²¹ IAS 39, para. 111.

exclude unrealized revaluation gains from distribution as dividends. Even if it is able to remove these unrealized gains from distribution they could introduce volatility to reported income that could result in criticisms of the quality of central bank management. This is particularly so given that central banks are amongst the architects of the very movements in interest rates that cause the changes in values of the securities. The new standard removes the discretion to hold securities for trading but value them at cost or lower of cost and market. The challenge for central banks is to ensure that their balance sheet is appropriately classified so that the volatility can be explained when it occurs.

E. Disclosure

An organization should disclose the following information in the notes to the financial statements.

- the methods and significant assumptions in estimating fair values of financial assets and financial liabilities for significant classes of financial assets.
- if gains or losses arising from changes in fair value of available-for-sale assets are included in: net profit or loss OR are recognized directly in equity.
- for each of the four categories of financial assets whether “regular way” purchases are accounted for at the trade date or settlement date.
- if a gain or loss from remeasuring available-for-sale assets to fair value has been recognized directly in equity, through the statement of changes in equity, then the organization should disclose:
 - the amount that was recognized in equity during the current period; and
 - the amount that was removed from equity and reported in net profit or loss.
- if the fair value for held-for-trading investments and available-for-sale assets **cannot** be reliably measured and the organization is, therefore, measuring these assets at amortized cost, then an explanation of why fair value cannot be used should be disclosed and, if possible, the range of fair value estimates.
- disclose significant items of income, expense, and gains and losses.

F. Effective Date

IAS 39 comes into effect for financial statements beginning on or after January 1, 2001 though early application is permitted as of the beginning of the financial year that ends after March 15, 1999.

VI. INTERNATIONAL ACCOUNTING STANDARD 21 – THE EFFECT OF CHANGES IN FOREIGN EXCHANGE RATES²²

A. Introduction

This standard, while significant in determining the manner in which foreign currency transactions are recorded and valued within the accounts of a central bank has relatively limited effect on the disclosure requirements for a central bank. As the usual manager of nation's foreign exchange reserves, IAS 21 is an important standard for central banks. This chapter will summarize the significant accounting treatments prescribed by this standard for central banks will discuss the often thorny issue of the treatment of foreign exchange revaluation gains and losses before closing with a summary of the disclosure requirements required under this standard.

B. Required Treatment under IAS 21

All foreign exchange transactions undertaken by the central bank should be recorded at the exchange rate prevailing at the time of the transaction.

Subsequent revaluations of the transactions at the end of the period depend on whether the foreign currency item is classified as a monetary or non-monetary item.

Monetary items, defined as “money held and assets and liabilities to be received or paid in fixed or determinable amounts of money”²³, are to be revalued at balance sheet dates using the exchange rates prevailing at that time. Non-monetary items, which are everything else are not revalued and are reported at the exchange rate prevailing at the time of the transaction.

C. Treatment of Revaluation Gains and Losses

IAS 21 requires all gains and losses, both realized and unrealized, to be reported in the income statement.²⁴ Because of its special role in managing a country's foreign reserves, a central bank often carries significant open foreign exchange positions that can result in large movements of unrealized revaluation gains and losses. Ideally, the central bank should

²² Prepared by Mr. Kenneth Sullivan.

²³ IAS 21, para. 7.

²⁴ IAS 21, para. 15.

be able to recognize these revaluation movements in the income statement but exclude them from considerations of taxable income or for distribution to the government as dividends as discussed for price movements.

In the situation where this is not possible, and only in this situation, the IMF accepts the coding of unrealized foreign currency revaluation gains to reserves. While it is contrary to IAS 21, the concern is for the monetary policy implications of large unrealized revaluation gains finding their way into the government's budget by way of distribution of profits when reported in the income statement. Equal, or greater, losses may match these gains in the subsequent period as the exchange rate corrects. These fluctuations add volatility to the monetary policy framework for a country that it would be helpful to avoid.

In the case of large revaluation gains, the central bank may not hold the liquidity to fund the distribution to the government's budget. This would result in a monetary emission to the government if the bank was unable to gain the required liquidity from the market. The monetary policy implications of this justify the decision not to report unrealized gains in the income statement. However, there seems no reason preventing reporting realized profits and making them available for distribution to the government. For realized profits and losses the central bank has either gained or lost the funds associated with the transaction and so is in a position to distribute them, or faces the need to be able to offset the loss against other income.

The issue of unrealized losses is a little more problematic. In the event that the bank holds unrealized gains in a revaluation reserve, it should be able to offset losses against these reserves. In the situation where the losses continue once the revaluation reserve has reached a zero balance, the continued accumulation of losses in this reserve will create debit balances which will have the effect of eroding the capital of the bank. This raises a second issue of concern.

Any charge from operations that has the effect of reducing the capital of the bank should be included and disclosed through the income statement. This is very important as it allows the bank to offset losses against gains before it makes any distributions to the government's budget. The result is that the bank first applies its income to maintain its capital value before deciding any distributions.

The automatic accumulation of losses in a revaluation reserve means that the financial statements may not disclose them to bank management and may not gain attention until they have totally eroded the bank's statutory capital and other reserves. This practice will accelerate the erosion of the bank's capital because, at the same time that the debit balance is accumulating in the revaluation reserve, the bank is undertaking distributions of income to the government's budget. This is the same concern as expressed when discussing available-for-sale assets.

A common feature in transition economies is the accumulation of large foreign currency denominated liabilities as the nation attempts to stabilize its balance of payments situation. Pressures to devalue the currency usually accompany this. The combination of

these two situations produces revaluation losses. To reduce the impact of this on the bank's capital they need to be reported in the income statement rather than assigned to a revaluation reserve.

The provisions of IAS 39 and IAS 21 are different. IAS 39 allows the accumulation of unrealized revaluation gains and losses in reserves without being reported through the income statement while IAS 21 requires all revaluation movements to be reported. Not too much should be made of the difference as the provision is a limited one, allowed, one suspects as a concession to alternative international practices. Best practice remains the adoption of fair value and recognition through the income statement at the time of revaluation. The alternative treatment sanctioned by the chapter for central bank foreign reserves revaluations is very much a specific second best situation, limited to those situations where it is not possible to remove unrealized revaluation gains from the dividend calculation pool.

D. Disclosure Requirements under IAS 21

The relevant disclosure requirements for central banks relating to holdings of foreign exchange reserves are:

- (a) the amount of exchange differences included in the net profit or loss for the period; and
- (b) net exchange differences classified as equity as a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.

A significant disclosure requirement for a central bank that is not found in IAS 21 is the requirement in IAS 30 that a "bank should also disclose the amount of significant net foreign currency exposures".²⁵ This is as far as IAS goes in specifying disclosures of foreign currency positions though it does encourage disclosure of an enterprise's foreign currency risk management policy.²⁶

Given that central banks usually carry significant levels of foreign currency assets and liabilities the disclosure requirements of IAS are inadequate in specifying the full level of disclosures that a reader of a central bank's financial statements would find relevant. Readers would be interested in information about currency composition, the types of assets and liabilities and the nature and management of foreign currency risk faced by the central bank. An example an additional disclosure could be a note reconciling the net foreign currency

²⁵ IAS 30, para 40.

²⁶ IAS 21, para. 47.

position reported in the balance sheet with that reported to the IMF in the statement of Net International Reserves or through the special data dissemination standard, SDDS. Such a disclosure is found in the notes to the accounts of the National Bank of Ukraine 1999 financial statements. Other examples of foreign currency holding disclosures can be found in the RBNZ 1999 financial statements included in Appendix II of this publication in the statement of financial position and Notes 1, 13,14, 15, 16, 17,18, 19 and 25.

There are further disclosure requirements for those banks who hold investments in foreign entities but these are not covered in this chapter as they are a minor issue for a minority of central banks. Also, IAS 39 carries significant disclosure requirements for hedges on foreign currency exposures.

VII. INTERNATIONAL ACCOUNTING STANDARD 7—STATEMENT OF CASH FLOWS²⁷

C. Introduction

This chapter outlines some of the issues to be considered in the preparation of the statement of cash flows. International Accounting Standard 7: Cash Flow Statements (IAS 7) requires the presentation of the statement of cash flows. Some of the issues that can arise for a central bank include:

- the purpose of the statement of cash flows;
- how should cash be defined;
- defining investing and financing cash flows;
- presentation of gross or net cash flows; and
- the direct or indirect method of presenting operating activities.

A. Purpose of the Statement of Cash Flows

The accounting standards state that the purpose of the statement of cash flows is to “help users assess the entity’s ability to generate cash flows and to assess the entity’s financial performance and financial position”.

The statement of cash flows is based on the concept that the purpose of a business is to make a profit, realize it in cash and do this repeatedly. The entity’s cash flows are required to be classified according to the activity that gave rise to them. These are:

- Investing activities: “those activities relating to the acquisition and disposal of [non-cash] current and non-current securities and advances ... and any other non-current assets.”
- Financing activities: “those activities relating to changes in equity and debt capital structure of the entity and those activities relating to the cost of servicing the entity’s equity capital.”
- Operating activities: all activities that are not investing or financing activities.

These classifications can be thought of as an entity raises money (financing activity), invests this money in non-current assets (investing activity) and obtains income and expenses from operating those assets (operating activity). The statement of cash flows shows how the

²⁷ Prepared by Mr. Richard Perry.

institution generates cash flows and presents information on changes in the institution's investing and financing structure.

The accounting literature notes that the statement of cash flows presents only limited information for financial institutions. Due to the definition of cash in the accounting standards, a statement of cash flows does not always represent the actual liquidity of financial institutions. Moreover, a central bank will often be responsible for issuing circulating currency and managing the liquidity of the domestic banking system. Some commentators consider that these factors reduce the information value of the statement of cash flows in the central bank circumstances. For example, the Reserve Bank of Australia expresses presentation concerns in the opening introduction to their statement of cash flows:

“The following cash flow statement appears as a matter of record to meet the requirements of AAS28; in the Bank's view, it does not shed any additional light on the Bank's financial results. For the purpose of this statement, cash includes the notes and coin held at the Reserve Bank and overnight settlement system account balances with other banks.”

In addition, some central banks do not present a statement of cash flows because they do not think it is appropriate in central bank circumstances. Indeed, in the New Zealand situation, the Reserve Bank of New Zealand's (RBNZ's) 1996–97 published statement of cash flows was described as “daft and misleading” internally and “hopelessly opaque” externally. These comments have contributed to a substantial review of the RBNZ's statement of cash flows over the last two years to improve the presentation of the statement of cash flows and to ensure the statement of cash flows provides an improved indicator of the RBNZ's liquidity.

In central bank circumstances, the RBNZ view is that the statement of cash flows and related notes to the accounts can be used to provide information on:

- The extent to which operating income was generated in cash;
- The cash impact of the major changes in the RBNZ's balance sheet structure during the financial year. The 1998–99 statement of cash flows presents the net cash changes in the major balance sheet categories. This approach is intended to assist the financial statement users understand how cash has been generated and applied to change the RBNZ's balance sheet structure during the financial year.
- The “turnover” in currency in circulation during the financial year. This information is presented gross and allows the financial statement users to understand the volume of currency in circulation that passes between commercial banks and the RBNZ. This information is not provided in any other part of the financial statements.

- The liquidity of the RBNZ. This information is only possible following a revision in the RBNZ's definition of "cash".

B. How Should Cash be Defined?

Cash is generally defined to include cash on hand, demand deposits and highly liquid investments that are readily convertible cash. However, due to the high liquidity of most central bank assets a wide definition of cash could lead to nearly all the central bank's assets being considered cash.

This would mean that the disclosures of cash flows in the investing (how cash has been applied) and financing (how cash has been generated) sections would be contained entirely in the opening and closing cash positions. While this may be a better indicator of a central bank's liquidity it does reduce the ability of the SCF to provide information on how cash is generated and applied.

The RBNZ approach has been to consider cash as those financial instruments that are highly liquid and are used in the day-to-day cash management of the central bank. This definition has included the highly liquid foreign reserve assets of the RBNZ and local currency financial assets that arise from the RBNZ's management of the New Zealand Government account.

The definition of cash ensures that the RBNZ's cash balances provide an indicator of the actual liquidity of the RBNZ. Previously, the RBNZ defined cash in such a way that resulted in a negative cash balance being reported. This approach was not considered to provide a fair presentation of the actual liquidity of the RBNZ.

C. Defining Investing and Financing Cash Flows

IAS 7 suggest presentations of cash flows according to the following categories:

- *Operating activities* are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities;
- *Investing activities* are the acquisition and disposal of long-term assets and other investments not included in cash equivalents; and
- *Financing activities* are activities that result in changes in the size and composition of the entity capital and borrowings of the enterprise.

In a central bank, these definitions could be applied as follows:

- *Investing activities:* these could include investing the proceeds of issuing circulating currency, investment of the foreign reserves and sale and purchase of fixed assets.
- *Financing activities:* could include issue and repayment of circulating currency, loans used to fund holdings of foreign reserves (including SDRs), disbursement of the annual dividend.
- *Operating activities:* may include the main cash revenue and expense flows (such as paying and receiving of coupons, fee income and operating expenses). Remaining activities that have not been classified as investing or financing are usually included as operating activities.

The effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported in the cash flow statement in order to reconcile cash at the beginning and the end of the period. This amount is presented separately and includes the differences, if any, had those cash flows been reported at end of period exchange rates.

D. Presentation of Gross or Net Cash Flows

Statement of cash flows are generally expected to present gross flows of cash. However, financial institutions often present net cash flows as the cash movements may arise as a consequence of customer transactions or the gross number may be considered so large as to be meaningless. This is supported by IAS - with paragraph 24 permitting the net reporting of certain financial institution cash flows.

It is generally accepted that net cash flows are appropriate when the cash movements arise through external factors such as a client depositing funds with a retail financial institution. However, gross cash flows may be more useful to provide a scale of the risks facing the entity either in terms of cash handling (i.e., the business has handled this volume of cash) or in trading activities (i.e., the volume with which a portfolio is bought and sold).

E. The Direct and Indirect Method of Preparation

IAS 7 suggests that entities should report cash flows from operating activities using either the direct or the indirect method. Under the direct method major classes of gross cash receipts and gross cash payments are disclosed while using the indirect method the net profit or loss is adjusted for the effects of non-cash transactions including balance date accruals and unrealized gains and losses.

Entities are encouraged to use the direct method as this may provide information useful in estimating future cash flows. New Zealand accounting standards require the use of the direct method because this adds new information unavailable from the statement of financial performance and statement of financial position. In addition, the direct method is

considered to best reflect the gross inflows and outflows of cash from operating activities. New Zealand also requires the notes to the financial statements to include reconciliation between net cash from operating activities and net surplus after tax (which is effectively the indirect method).

F. Summary

It is suggested that a statement of cash flows can provide useful information on central bank activities that is not available in other sections of the financial statement. The statement of cash flows can be used to assist the financial statement users understand how cash has been generated and applied to change the central bank's balance sheet structure during the financial year and provide an indication of the liquidity of the central bank.

VIII. DIFFERENCES BETWEEN THE ACCOUNTING AND REPORTING PRINCIPLES IN THE EUROPEAN SYSTEM OF CENTRAL BANKS (ESCB) AND THE INTERNATIONAL ACCOUNTING STANDARDS (IAS)²⁸

D. Introduction

The European System of Central Banks (ESCB) is represented by the European Central Bank in Frankfurt, Germany, and the eleven National Central Banks (NCBs) participating in the European Monetary Union. The statute of the ESCB defines the financial reporting framework of the ESCB. For analytical and operational purposes the ECB must produce a consolidated balance sheet which is an aggregation of the balance sheets of the ECB and the participating NCBs. Furthermore, the ESCB publishes a consolidated weekly financial statement every Tuesday reporting the data of the previous Friday.

The statute requires the Governing Council of the ECB to establish a set of standard guidelines covering the accounting and reporting of operations undertaken by the participating NCBs. These Guidelines, covering the accounting and reporting regimes, are a legally binding instrument in the ESCB. The Guidelines are for the ESCB and therefore are not binding on NCB's national reports and accounts. However, in order to achieve consistency and comparability it is recommended that NCBs adopt these rules, which almost all of the participating NCBs have done since the beginning of the euro system either by legal obligation or on a voluntary basis.

A. General Remarks

The ESCB Guidelines were drawn up by an ESCB working group representing accounting experts from the 15 central banks of the European Union and the ECB. The European Accounting Directives, the International Accounting Standards and generally accepted accounting principles formed the basis for the considerations. Close attention was paid to the intention to formulate accounting standards that met both the specific needs of central bank accounting and the financial information requirements of the euro system.

The ESCB accounting and reporting principles have a very high degree of compliance with IAS. Those limited areas where the ESCB Guideline does not fully follow IAS are in areas where it was considered that IAS did not meet specific central bank accounting and reporting requirements. As the economic and financial environment is continually evolving

²⁸ Prepared by Mr. Freidrich Karrer.

the ESCB has committed itself to monitor the development of accounting and reporting standards and will review the present provisions in light of changing international standards

This chapter describes the areas where the ESCB accounting and reporting principles are deviating from the IAS. There is no discussion when policies and accounting techniques comply with IAS.

B. Accruals—Amortisation for Securities

Reference Guideline ESCB: Article 10, paragraphs 2 and 3

The ESCB gives detailed definitions about the method of calculation, date of calculation and recording in the accounts. The Amortisation for securities purchased below or above the nominal value is calculated by use of either the straight line or implicit rate of return method, depending on the type and remaining duration of the securities.

Reference IAS 36, paragraph 5; IAS 38, paragraph 7, and IAS 39, paragraph 10

IAS specifies only terms in accordance with Amortisation and the basic meanings.

C. Recognition of Income—Treatment of Unrealized Gains and Losses at Balance Sheet Date

Reference Guideline ESCB: Article 10, paragraph 1

Unrealized gains from price or currency revaluation, for each class of security, are posted directly to a revaluation account shown on the liability side of the balance sheet. These entries are therefore not recognized as income.

Unrealized losses are recorded to the profit and loss account when market price falls below average acquisition cost for each class of security. Unrealized losses transferred to the P&L account are not reversed in following years against new unrealized gains.

The rationale for this asymmetric treatment is based on the consideration that central banks should not record unrealized gains in the profit and loss account as they are not seen as distributable until they are realized. Paying dividends by central banks increases liquidity in the financial sector by enlarging the monetary base. Therefore, it is considered inappropriate to distribute unrealized gains unless as they are not based on a reliable and sustainable increase in the asset side of the central bank's balance sheet.

Reference IAS: Framework, paragraphs 74 to 77 (*income*), 78 to 80 (*expense*), 81 (*Capital Maintenance Adjustment*), 102 to 110 Concepts of Capital and Capital Maintenance

Unrealized gains: follows concept of capital maintenance:

Under this concept, a profit is earned only if the financial amount of the net assets at the end of the period exceeds the financial amount of net assets at the beginning of the period (Framework 92 and 94a).

Unrealized losses: Recognition of expenses occurs simultaneously with the recognition of an increase in liabilities or a decrease in assets (Framework 94).

IAS 21, paragraphs 13–16 require all exchange rate revaluation gains and losses to be reported in the P&L.

IAS 39 provides a range of valuation options depending on the reason for holding the security.

D. Accounting Rules for Off-Balance-Sheet Instruments

Reference Guideline ESCB: Article 12 (*general rules*), article 13 (*forward exchange transactions*), article 14 (*foreign exchange swaps*), article 15 (*interest futures*), article 16 (*interest rate swaps*), article 17 (*forward rate agreements*), and article 18 (*forward rate transactions in securities*).

For all these transactions the ESCB has specified rules how to record the instruments, how to recognize revaluation differences and the treatment of income. All the rules follow the general accounting principles of the ESCB (e.g., revaluation at market values, treatment of realized and unrealized gains and losses, accrual principle, etc.).

Reference IAS 39

IAS is far more detailed than ESCB standards.

The different treatment arises as the ESCB standards had to be finalized before the beginning of the European monetary union. IAS 39 was not yet an international standard. However, the ESCB standards will be reviewed in light of the new standard, IAS 39.

E. Trade Date versus Settlement Date Accounting

Reference Guideline ESCB: Article 5

Under the ESCB standards presently allows both trade date or settlement date approaches but, after a definite period of time, all NCBS have to change their accounting systems to trade date recording (economic approach).

Reference IAS: Article 39

IAS 39, paragraphs 30–34, discusses this issue but accepts recording a transaction on the trade date or settlement date basis.

F. Reporting Obligations—Format of Balance Sheet and Profit and Loss Account

Reference Guideline ECB; Article 19

- Weekly balance sheet of the NCB (published by NCB; Guideline ECB Annex 4).
- Weekly consolidated balance sheet of the Eurosystem (published by ECB; Guideline ECB Annex 6).
- Annual balance sheet of the NCB (published by NCB; Guideline ECB Annex 9).
- Annual consolidated balance sheet of the Eurosystem (published by ECB; Guideline ECB Annex 8).
- Profit and loss account (Guideline ECB Annex 10).

Reference IAS:

- Weekly balance sheet – not specified in IAS
- Weekly consolidated balance sheet – not specified in IAS
- Annual balance sheet – format completely different to IAS 30
- Annual consolidated balance sheet – completely different to IAS 30
- Profit and loss account – similar to IAS 30

The format of the weekly and the annual balance sheet for the ESCB was created to provide the user with a clear picture of the euro system related to the monetary policy decisions of the ESCB. The format is structured according to the monetary policy instruments established by the ESCB as well as to identify the items denominated in foreign currency or in euro. Also included is a split between assets and liabilities that are held against residents or non-residents of the euro area.

G. Reporting Obligations—Other Financial Reporting Formats

- Statement of changes in equity
- Cash flow statement

These reports are not required under the ESCB rules though they are required under the annual financial statements according to the IAS framework (IAS1). The ESCB is of the opinion that these two reports do not give any significant or useful additional information to the other existing financial and statistical information within the euro system.

H. Disclosure Notes to the Annual Accounts

Reference Guideline ESCB: none

No guidelines exist covering the content of notes to the annual accounts. This means that the NCBs have to follow their own legal requirements that in any case are based on the EC directives.

Most IAS contain detailed instructions on what information needs to be disclosed either as accounting policies or within the notes to the annual accounts.

This is a significant, but not irreconcilable, area of divergence between ESCB and IAS reporting requirements.

I. Recognition of Banknotes and Coins

Reference Guideline ESCB: Article 9

This provision gives detailed rules for the calculation and presentation of the bank note in circulation item in the balance sheet as well as for the recognition of coins. The accounting policies are referring to those banknotes and coins that are legal tender in the member states of the European Monetary Union.

Reference IAS: no specific regulation

Sources:

- ESCB: Guideline of the European Central Bank of December 1, 1998 on the Legal Framework for Accounting and Reporting in the European System of Central Banks as amended on December 15, 1999 (ECB/1999/9).
- IAS: International Accounting Standards 1999.

**SUMMARY OF INTERNATIONAL ACCOUNTING STANDARD DISCLOSURE REQUIREMENTS
IAS 1, IAS 7, IAS 21, IAS 30, IAS 32, AND IAS 39²⁹**

A. Introduction

This chapter provides a summary of the detailed International Accounting Standard disclosure requirements for:

- International Accounting Standard 1—Presentation of Financial Statements (IAS 1);
- International Accounting Standard 7—Cash Flow Statements (IAS 7);
- International Accounting Standard 30—Disclosures in the Financial Statements of Banks and Similar Financial Institutions (IAS 30); and
- International Accounting Standard 32—Financial Instruments: Disclosure and Presentation (IAS 32). IAS 32 specifies the main disclosure requirements for financial instruments.
- International Accounting Standard 39—Financial Instruments: Recognition and Measurement (IAS 39)—effective 1 January 2001.

This chapter has been designed to assist central bank accountants prepare financial statements in accordance with the requirements of IAS 1, IAS 7, IAS 21, IAS 30, IAS 32, and IAS 39 and sets out the disclosure requirements of each standard as at January 1, 2000.³⁰ The chapter has been set out in the form of a “check-list” to allow central bank accountants to review the components of their financial statements against the disclosures required by IAS 1, IAS 7, IAS 21, IAS 30, IAS 32, and IAS 39.

The Reserve Bank of New Zealand’s (RBNZ’s) 1998–99 financial statements are used as a case study for various disclosures. However, it should be noted that:

- The RBNZ’s financial statements are prepared in accordance with the requirements of New Zealand accounting standards. New Zealand accounting standards and disclosures reflect requirements considered appropriate to the New Zealand legal and economic situation and are not necessarily the same as the requirements of International Accounting Standards.
- New Zealand accounting standards have generally followed the developments of the Anglo-American standards with their strict standards of disclosures to provide relevant information for financial statement users. As such, they provide less room for discretion on the part of the preparer of financial statements than International Accounting

²⁹ Prepared by Mr. Richard Perry.

³⁰ Early application of IAS 39 is permitted for financial years that end after March 15, 1999.

Standards. New Zealand is an active participant in the development of International Accounting Standards through membership of the G4+1 group of standard setters and involvement in various working groups of the International Accounting Standards Committee.³¹

- The New Zealand disclosures have been developed to reflect the specific economic circumstances of the RBNZ operating under New Zealand laws. Laws and circumstances may be different for other central banks and different methods of disclosure may be appropriate. The objective should be to represent the underlying legal and economic substance of the central bank within the local laws and circumstances.

The disclosure examples are referenced as follows:

AP – Accounting Policies
BS – Balance Sheet or Statement of Financial Position
IS – Income Statements or Statement of Financial Performance
CS – Statement of Cost of Services
ME – Statement of Movements in Equity
CFS – Cash Flow Statement
N/A – Not Applicable.

³¹ The G4+1 consists of standard-setters from Australia, Canada, New Zealand, the United Kingdom, the United States and the IASC. The G4+1 is actively involved in seeking and developing common solutions to financial reporting issues.

B. Contents of Financial Statements

<i>IAS</i>	<i>Para</i>	<i>Requirements</i>	<i>RBNZ Example</i>	✓
IAS 1	7	A complete set of financial statements includes the following components:		
	7(e)	Accounting Policies	AP	
	7(a)	Balance Sheet	BS	
	7(b)	Income Statement	IS, CS	
	7(c)	A statement showing either: (i) All changes in equity; or (ii) Changes in equity other than those arising from capital transactions with owners and distributions to owners	ME	
	7(d)	Cash flow statement	CFS	
	7 (e)	Explanatory Notes	Notes to Accounts	
IAS 1	44	Financial Statements should be clearly identified and distinguished from other information in the same published document.	See RBNZ table of contents	
IAS 1	46	Each component of the financial statements should be clearly identified. In addition, the following information should be prominently displayed, and repeated when it is necessary for a proper understanding of the information presented:	In each statement	
IAS 1	49	Financial statements should be presented at least annually. When in exceptional circumstances, an enterprises balance sheet date changes and annual financial statements are presented for a period longer or shorter than one year, an enterprise should disclose, in addition to the period covered by the financial statements:	N/A	
		(a) The reason for a period other than one year being used; and	N/A	
		(b) The fact that comparative amounts for the income statement, changes in equity, cash flows and related notes are not comparable.	N/A	

C. Accounting Policies

IAS	Para	Requirements	RBNZ Example	✓
IAS 1	20	<p>Management should select and apply an enterprise's accounting policies so that the financial statements comply with all the requirements of each applicable International Accounting Standard and Interpretation of the Standing Interpretations Committee. Where there is no specific requirement, management should develop policies to ensure that the financial statements provide information that is:</p> <p>(a) Relevant to the decision-making needs of users; and</p> <p>(b) Reliable in that they:</p> <ul style="list-style-type: none"> (i) represent faithfully the results and financial position of the enterprise; (ii) reflect the economic substance of events and transactions and not merely the legal form; (iii) are neutral, that is free from bias; (iv) are prudent; and (v) are complete in all material respects. 	AP	
IAS 1	91	<p>The notes to the financial statements of an enterprise should:</p> <p>(a) Present information about the basis of preparation of the financial statements and the specific accounting policies selected and applied for significant transactions and events.</p>	AP (c) Financial instrument measurement	
IAS 1	11	<p>An enterprise whose financial statements comply with International Accounting Standards should disclose that fact. Financial statements should not be described as complying with International Accounting Standards unless they comply with all the requirements of each applicable Standard and each applicable Interpretation of the Standing Interpretations Committee.³²</p>	N/A	

³² See also SIC – 8, First-Time Application of IASs as the Primary Basis of Accounting.

IAS	Para	Requirements	RBNZ Example	✓
IAS 1	13	In the extremely rare circumstances when management concludes that compliance with a requirement in a Standard would be misleading, and therefore that departure from a requirement is necessary to achieve a fair presentation, an enterprise should disclose certain information as outlined in paragraph 13.	N/A	
IAS 1	97	The accounting policies of the notes to the financial statements should describe the following: (a) The measurement basis (or bases) used in preparing the financial statements; and (b) Each specific accounting policy required for a proper understanding of the financial statements.	AP AP	
IAS 1	99	The accounting policies that an enterprise might consider presenting include, but are not restricted to, the following: (a) Revenue recognition; (b) Consolidation principles, including subsidiaries and associates; (c) Business combinations; (d) Joint ventures; (e) Recognition and depreciation/Amortisation of tangible and intangible assets; (f) Capitalized borrowing costs and other expenditure; (g) Construction contracts; (h) Investment properties; (i) Financial instruments and investments; (j) Leases; (k) Research and development costs; (l) Inventories; (m) Taxes, including deferred taxes; (n) Provisions; (o) Employee benefit costs; (p) Foreign currency translation and hedging; (q) Definition of business, geographical segments and the basis for allocation of costs between segments; (r) Definition of cash and cash equivalents; (s) Inflation accounting; and (t) Government grants.	AP AP (a) N/A N/A AP (g) AP (d) N/A AP (f) AP (b) AP (h) N/A AP (i) AP (m) Note 8 AP (1) AP (b) AP (q) AP (o) N/A N/A	

IAS	Para	Requirements	RBNZ Example	✓
IAS 30	8	<p>Banks use differing methods for the recognition and measurement of items in their financial statements. The accounting policies of a bank should include:</p> <ul style="list-style-type: none"> (a) The recognition of the principal types of income (see paragraphs 10 and 11); (b) The valuation of investment and dealing securities (see paragraphs 24 and 25); (c) The distinction between those transactions and other events that result in the recognition of assets and liabilities on the balance sheet and those transactions and other events that only give rise to contingencies and commitments (see paragraphs 26 to 29); (d) The basis for the determination of losses on loans and advances and for writing off uncollectable loans and advances (see paragraphs 43 to 49); and (e) The basis for the determination of charges for general banking risks and the accounting treatment of such charges (see paragraphs 50 to 52). 	<p>AP (c)</p> <p>AP (c)</p> <p>N/A</p> <p>N/A</p> <p>N/A</p>	
IAS 1	102	<p>An Enterprise should disclose the following if not disclosed elsewhere in information published with the financial statements:</p> <ul style="list-style-type: none"> (a) The domicile and legal form of the enterprise, its country of incorporation and the address of the registered office (or principal place of business, if different from the registered office); (b) A description of the nature of the enterprise's operations and its principal activities; (c) The name of the parent enterprise and the ultimate parent enterprise of the group; and (d) Either the number of employees at the end of the period or the average for the period. 	<p>Disclosed in body of annual report</p> <p>Note 1</p> <p>N/A</p> <p>Disclosed in annual report</p>	
IAS 30	43	<p>A bank should disclose:</p> <ul style="list-style-type: none"> (a) The accounting policy which describes the basis on which uncollectable loans and advances are recognized as an expense and written off. 	<p>N/A</p>	

<i>IAS</i>	<i>Para</i>	<i>Requirements</i>	<i>RBNZ Example</i>	✓
IAS 32	47(b)	<p>For each class of financial asset, financial liability and equity instrument, both recognized and unrecognized, an enterprise should disclose the accounting policies and methods adopted, including the criteria for recognition and the basis of measurement applied.</p> <p>Interpretation of this requirement should include consideration of disclosure of the hedge accounting policies.</p>	AP (c)	
IAS 39	167	<p>The following should be included in the disclosures of the enterprise's accounting policies as part of the disclosure required by IAS 32 paragraph 47(b):</p> <p>(a) the methods and significant assumptions in estimating fair values of financial assets and financial liabilities for significant classes of financial assets.</p> <p>(b) whether gains or losses arising from changes in fair value of those available-for-sale assets are included in: net profit or loss OR are recognized directly in equity until the financial asset is disposed of; and.</p> <p>(c) for each of the four categories of financial assets whether 'regular way' purchases of financial assets are accounted for at the trade date or settlement date.</p>	<p>AP (c)</p> <p>AP (c)</p> <p>AP (c)</p>	

D. Balance Sheet

IAS1	53	<p>Each enterprise should determine, based on the nature of its operations, whether or not to present current and non-current assets and current and non-current liabilities as separate classifications on the face of the balance sheet. When an enterprise chooses not to make this classification, assets and liabilities should be presented broadly in order of their liquidity.</p>	RBNZ uses broad order of liquidity	
------	----	--	------------------------------------	--

<i>IAS</i>	<i>Para</i>	<i>Requirements</i>	<i>RBNZ Example</i>	✓
IAS 30	18	<p>A bank should present a balance sheet that groups assets and liabilities by nature and lists them in an order that reflects their relative liquidity.</p> <p>Current and non-current distinctions are outlined in IAS1 paragraphs 57 to 63.</p>	RBNZ uses broad order of liquidity	
IAS 30	23	<p>The amount at which any asset or liability is stated in the balance sheet should not be offset by the deduction of another liability or asset unless a legal right of set-off exists and the offsetting represents the expectation as to the realization or settlement of the asset or liability.</p> <p>This requirement means assets and liabilities should not be netted against each other unless a legal right of set-off exists and the net amount represents the expected settlement.</p>	N/A	
IAS 32	33	<p>A financial asset and a financial liability should be offset and the net amount reported in the balance sheet when an enterprise:</p> <ul style="list-style-type: none"> (a) has a legally enforceable right to set off the recognized amounts; and (b) Intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously. 	N/A	

IAS	Para	Requirements	RBNZ Example	✓
IAS 1	66	<p>As a minimum, the face of the balance sheet should include line items which present the following amounts:</p> <ul style="list-style-type: none"> (a) Property, plant and equipment; (b) Intangible assets; (c) Financial assets (excluding amounts shown under (d), (f) and (g)); (d) Investments accounted for using the equity method; (e) Inventories; (f) Trade and other receivables; (g) Cash and cash equivalents; (h) Trade and other payables; (i) Tax liabilities and assets as required by IAS12, Income Taxes; (j) Provisions; (k) Non-current interest-bearing liabilities; (l) Minority interest; and (m) Issued capital and reserves. 	<p>BS N/A BS N/A BS BS BS Note 7 BS Note 8 N/A N/A BS & Note 10</p>	
IAS 30	19	<p>In addition to the requirements of other International Accounting Standards, the disclosures in the balance sheet or the notes to the financial statements should include, but are not limited to, the following assets and liabilities:</p> <p>Assets</p> <ul style="list-style-type: none"> Cash and balances with the central bank; Treasury bills and other bills eligible for rediscounting with the central bank; Government and other securities held for dealing purposes; Placements with, and loans and advances to, other banks; Other money market placements; Loans and advances to customers; and Investment securities. 	<p>BS N/A BS BS BS Note 3 BS</p>	

<i>IAS</i>	<i>Para</i>	<i>Requirements</i>	<i>RBNZ Example</i>	✓
IAS 30	19	<p>Liabilities</p> <p>Deposits from other banks;</p> <p>Other money market deposits;</p> <p>Amounts owed to other depositors;</p> <p>Certificates of deposits;</p> <p>Promissory notes and other liabilities, and</p> <p>Other borrowed funds.</p>	<p>BS</p> <p>BS</p> <p>BS</p> <p>N/A</p> <p>N/A</p> <p>BS</p>	
IAS 1	72	<p>An enterprise should disclose, either on the face of the balance sheet or in the notes to the balance sheet, further sub-classifications of the line items presented, classified in a manner appropriate to the enterprise's operations. Each item should be sub-classified, when appropriate by its nature and, amounts payable to and receivable from the parent enterprise, fellow subsidiaries and associates and other related parties should be disclosed separately.</p> <p>This section highlights that further disclosure and sub-classification of balance sheet items should be made in a manner appropriate to the enterprises operations. These should include disclosures that distinguish between external customers, other members of the accounting group and related parties.</p>	Notes to accounts present sub-classifications.	
IAS 1	72	<p>An enterprise should disclose, either on the face of the balance sheet or in the notes to the balance sheet, further sub-classifications of the line items presented, classified in a manner appropriate to the enterprise's operations. Each item should be sub-classified, when appropriate by its nature and, amounts payable to and receivable from the parent enterprise, fellow subsidiaries and associates and other related parties should be disclosed separately.</p> <p>This section highlights that further disclosure and sub-classification of balance sheet items should be made in a manner appropriate to the enterprises operations. These should include disclosures that distinguish between external customers, other members of the accounting group and related parties.</p>	Notes to accounts present sub-classifications.	

<i>IAS</i>	<i>Para</i>	<i>Requirements</i>	<i>RBNZ Example</i>	✓
IAS 1	74(a)	Details information to be disclosed for each class of share capital. The balance sheet should include:	N/A	
IAS 1	74(b)	A description of the nature and purpose of each reserve within owners equity.	Note 10	
IAS 1	74(c)	When dividends have been proposed but not formally approved for payment, the amounts included (or not included) in liabilities.	Note 9	
IAS 1	74(d)	The amount of any cumulative preference dividends not recognized.	N/A	

E. Income Statement

IAS1	75	As a minimum, the face of the income statement should include line items which present the following amounts: (a) Revenue; (b) The results of operating activities; (c) Finance costs; (d) Share of profits and losses of associates and joint ventures accounted for using the equity method; (e) Tax expense; (f) Profit or loss from ordinary activities; (g) Extraordinary items; (h) Minority interest; and (i) Net profit or loss for the period. Additional line items, headings and sub-totals should be presented on the face of the income statement when required by an International Accounting Standard, or when such presentation is necessary to present fairly the enterprise's financial performance.	IS CS IS N/A IS IS N/A N/A IS IS and CS	
------	----	--	--	--

<i>IAS</i>	<i>Para</i>	<i>Requirements</i>	<i>RBNZ Example</i>	✓
IAS 30	9	A bank should present an income statement which groups income and expenses by nature and discloses the amounts of the principal types of income and expenses.	Note 17 and 18	
IAS 30	10	<p>In addition to the requirements of other International Accounting Standards, the disclosures in the income statement or the notes to the financial statements should include, but are not limited to, the following items of income and expenses:</p> <p>Interest and similar income; Interest expense and similar charges; Dividend income; Fee and commission income; Fee and commission expense; Gains less losses arising from dealing securities; Gains less losses arising from investment securities; Gains less losses arising from dealing in foreign currencies; Other operating income; Losses on loans and advances; General administrative expenses; and Other operating expenses.</p>	<p>Note 17 Note 18 N/A Note 20 Note 22 N/A Note 17 Note 17 Note 20 N/A IS Note 22</p>	
IAS 1	77	<p>An enterprise should present, either on the face of the income statement or in the notes to the income statement, an analysis of expenses using a classification based on either the nature of expenses or their function within the enterprise.</p> <p>This requires expenses to be sub-classified in a manner appropriate to the enterprise (see paragraph 80 and 82 for examples).</p>	CS	
IAS 1	83	Enterprises classifying expenses by function should disclose additional information on the nature of expenses, including depreciation and Amortisation expense and staff costs.	IS, Note 21	

<i>IAS</i>	<i>Para</i>	<i>Requirements</i>	<i>RBNZ Example</i>	✓
IAS 1	85	An enterprise should disclose, either on the face of the income statement, or in the notes, the amount of dividends per share declared, or proposed, for the period covered by the financial statements.	N/A	
IAS 30	13	Income and expense items should not be offset except for those relating to hedges and to assets and liabilities which have been offset in accordance with paragraph 23. This requirement should be interpreted by reference to IAS39 for hedge accounting principles.	N/A	
IAS 39	170(c)	Financial statements should disclose significant items of income, expense, and gains and losses resulting from financial assets and financial liabilities, whether included in net profit or as a separate component of equity. For this purpose: (a) total interest income and total interest expense should be disclosed separately (b) with respect to available-for-sale financial assets that are adjusted for fair value after initial recognition, total gains and losses of such financial assets included in net profit or loss for the period should be reported separately from total gains and losses for fair value adjustments of recognized assets and liabilities included in net profit or loss the period; (c) the enterprise should disclose the amount of interest income that has been accrued on impaired loans ... and that has not yet been received in cash	IS Notes 17 - 22 Notes 17 & 18 N/A N/A	
	170(f)	Disclose the nature and amount of any impairment loss or reversal of an impairment loss recognized for a financial asset, separately for each significant class of financial asset.	N/A	
IAS 21	42	An enterprise should disclose: (a) the amount of exchange differences included in the net profit or loss for the period;	IS, Note 19	

F. Statement of Changes in Equity

IAS	Para	Requirements	RBNZ Example	✓
IAS 1	86	<p>An enterprise should present, as a separate component of its financial statement, a statement showing:</p> <ul style="list-style-type: none"> (a) The net profit or loss for the period; (b) Each item of income and expense, gain or loss which, as required by other Standards, is recognized directly in equity, and the total of these items; and (c) The cumulative effect of changes in accounting policy and the correction of fundamental errors dealt with under the Benchmark treatments in IAS8. <p>In addition, an enterprise should present, either within this statement or in the notes:</p> <ul style="list-style-type: none"> (a) Capital transactions with owners and distributions to owners; (b) The balance of accumulated profit or loss at the beginning of the period and at the balance sheet date, and the movements for the period; and (c) A reconciliation between the carrying amount of each class of equity capital, share premium and each reserve at the beginning and the end of the period, separately disclosing each movement. 	<p>ME</p> <p>ME</p> <p>N/A</p> <p>N/A</p> <p>N/A</p> <p>Note 10</p> <p>Note 10</p>	
IAS 39	170(a)	<p>If a gain or loss from remeasuring available-for-sale assets to fair value (other than assets relating to hedges) has been recognized directly in equity, through the statement of changes in equity, disclose:</p> <ul style="list-style-type: none"> (a) the amount that was recognized in equity during the current period; and (b) the amount that was removed from equity and reported in net profit or loss. 	N/A	
IAS 21	42	<p>An enterprise should disclose:</p> <ul style="list-style-type: none"> (b) net exchange differences classified as equity as a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period; 	N/A	

G. Cash Flow Statement

<i>IAS</i>	<i>Para</i>	<i>Requirements</i>	<i>RBNZ Example</i>	✓
IAS 7	1	An enterprise should prepare a cash flow statement in accordance with the requirements of this Standard and should present it as an integral part of its financial statements for each period for which financial statements are presented.	CFS	
IAS 7	10	The cash flow statement should report cash flows, during the period classified by operating, investing and financing activities.	CFS	
IAS 7	18	An enterprise should report cash flows from operating activities using either: (a) The direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or (b) The indirect method, whereby net profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.	CFS CFS Note 24	
IAS 7	21	An enterprise should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraph 22 and 24 are reported on a net basis.	CFS	
IAS 7	22	Cash flows arising from the following operating, investing or financing activities may be reported on a net basis: (a) Cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the enterprise; and (b) Cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.	CFS	

<i>IAS</i>	<i>Para</i>	<i>Requirements</i>	<i>RBNZ Example</i>	✓
IAS 7	24	<p>Cash flows arising from each of the following activities of a financial institution may be reported on a net basis:</p> <p>(a) Cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;</p> <p>(b) The placement of deposits with and withdrawal of deposits from other financial institutions; and</p> <p>(c) Cash advances and loans made to customers and the repayment of those advances and loans.</p>	CFS	
IAS7	29	The cash flows associated with extraordinary items should be classified as arising from operating, investing or financing activities as appropriate and separately disclosed.	N/A	
IAS7	31	Cash flows from interest and dividends received and paid should each be disclosed separately. Each should be classified in a consistent manner from period to period as either operating, investing or financing activities.	CFS	
IAS7	39	The aggregate cash flows arising from acquisitions and from disposals of subsidiaries or other business units should be presented separately and classified as investing activities.	N/A	
IAS7	35	Cash flows arising from taxes on income should be separately disclosed and should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.	CFS	
IAS7	45	An enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the balance sheet.	Note 25	
IAS7	48	An enterprise should disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the enterprise that are not available for use by the group.	N/A	

H. Notes To The Accounts (Excluding Accounting Policies)

<i>IAS</i>	<i>Para</i>	<i>Requirements</i>	<i>RBNZ Example</i>	✓
IAS 1	91	The notes to the financial statements should:		
	91(b)	Disclose the information required by International Accounting Standards that is not presented elsewhere in the financial statements.	Each note reflects requirements of various standards Note 2 is an example.	
	91(c)	Provide additional information that is not presented on the face of the financials statements but that is necessary for a fair presentation.		
IAS 1	92	Notes to the financial statements should be presented in a systematic manner. Each item on the face of the balance sheet, income statement and cash flow statement should be cross-referenced to any related information in the notes.	Each note is referenced to the financial statements	
IAS 1	13	In the extremely rare circumstances when management concludes that compliance with a requirement in a Standard would be misleading, and therefore that departure from a requirement is necessary to achieve a fair presentation, an enterprise should disclose in accordance with IAS1 Paragraph 13.	N/A	
IAS 30	26	A bank should disclose the following contingencies and commitments required by IAS10, Contingencies and Events Occurring After the Balance Sheet Date: (a) The nature and amount of commitments to extend credit that are irrevocable because they cannot be withdrawn at the discretion of the bank without the risk of incurring significant penalty or expense; and (b) The nature and amount of contingencies and commitments arising from off balance sheet items including those relating to:	N/A N/A	

IAS	Para	Requirements	RBNZ Example	✓
		<ul style="list-style-type: none"> (i) Direct credit substitutes including general guarantees of indebtedness, bank acceptance guarantees and standby letters of credit serving as financial guarantees for loans and securities. (ii) Certain transaction-related contingencies including performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions; (iii) Short-term self-liquidating trade-related contingencies arising from the movement of goods, such as documentary credits where the underlying shipment is used as security. (iv) Those sale and repurchase agreements not recognized in the balance sheet; (v) Interest and foreign exchange rate related items including swaps, options and futures; and (vi) Other commitments, note issuance facilities and revolving underwriting facilities. 	<p>N/A</p> <p>N/A</p> <p>N/A</p> <p>N/A –Repos are recognized on balance sheet</p> <p>N/A</p>	
IAS 21	47	Disclosure is also encouraged of an enterprise's foreign currency risk management policy.	Notes 12, 13, 15 & 16	
IAS 30	30	A bank should disclose an analysis of assets and liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date.	Not complied with. See Note 16	
IAS 32	43(a)	An enterprise should describe its financial risk management objectives and policies, including its policy for hedging each major type of forecasted transaction for which hedge accounting is used.	Notes 12, 13, 14, 15, 16	
IAS 32	47(a)	Information about the extent and nature of the financial instruments, including significant terms and conditions that may affect the amount, timing and certainty of future cash flows.	Note 1	

<i>IAS</i>	<i>Para</i>	<i>Requirements</i>	<i>RBNZ Example</i>	✓
IAS 32	56	<p>For each class of financial asset and financial liability, both recognized and unrecognized, an enterprise should disclose information about its exposure to interest rate risk, including:</p> <p>(a) contractual repricing or maturity dates, whichever dates are earlier; and</p> <p>(b) Effective interest rates, when applicable.</p>	Note 13	
IAS 32	66	<p>For each class of financial asset, both recognized and unrecognized, an enterprise should disclose information about its exposure to credit risk, including:</p> <p>(a) The amount that best represents its maximum credit risk exposure at the balance sheet date, without taking account of the fair value of any collateral, in the event other parties fail to perform their obligations under financial instruments; and</p> <p>(b) Significant concentrations of credit risk.</p>	Note 14 (c) Note 14 (b)	
IAS 30	40	A bank should disclose any significant concentrations of its assets, liabilities and off balance sheet items. Such disclosures should be made in terms of geographical areas, customer or industry groups or other concentrations of risk. A bank should also disclose the amount of significant net foreign currency exposures.	Note 14 (b) Note 15	
IAS 30	43(b)	A bank should disclose: Details of the movements in the provision for losses on loans and advances during the period. It should disclose separately the amount recognized as an expense in the period for losses on uncollectable loans and advances, the amount charged in the period for loans and advances written off and the amount credited in the period for loans and advances previously written off that have been recovered.	N/A	
	43(c)	The aggregate amount of the provision for losses on loans and advances at the balance sheet date.	N/A	

IAS	Para	Requirements	RBNZ Example	✓
	43(d)	The aggregate amount included in the balance sheet for loans and advances on which interest is not being accrued and the basis used to determine the carrying amount of such loans and advances.	N/A	
IAS 30	44	Any amounts set aside in respect of losses on loans and advances in addition to those losses that have been specifically identified or potential losses which experience indicates are present in the portfolio of loans and advances should be accounted for as appropriations of retained earnings. Any credits resulting from the reduction of such amounts result in an increase in retained earnings and are not included in the determination of net profit or loss for the period.	N/A	
IAS 30	50	Any amounts set aside in respect of general banking risks, including future losses and other unforeseeable risks or contingencies in addition to those for which accrual must be made in accordance with IAS10. Contingencies and Events Occurring After the Balance Sheet Date, should be separately disclosed as appropriations of retained earnings. Any credits resulting from the reduction of such amounts result in an increase in retained earnings and are not included in the determination of net profit or loss for the period.	N/A	
IAS 30	53	A bank should disclose the aggregate amount of secured liabilities and the nature and carrying amount of the assets pledged as security.	Note 1 (g)	
IAS 32	77	For each class of financial asset and financial liability, both recognized and unrecognized, an enterprise should disclose information about fair value. When it is not practicable within constraints of timeliness or cost to determine the fair value of a financial asset or financial liability with sufficient reliability, that fact should be disclosed together with information about the principal characteristics of the underlying financial instrument that are pertinent to its fair value.	Note 11	

IAS	Para	Requirements	RBNZ Example	✓
IAS 32	88	<p>When an enterprise carries one or more financial assets at an amount in excess of their fair value, the enterprise should disclose:</p> <p>(a) The carrying amount and the fair value of either the individual assets or appropriate groupings of those individual assets; and</p> <p>(b) The reasons for not reducing the carrying amount, including the nature of the evidence that provides the basis for management's belief that the carrying amount will be recovered.</p>	N/A	
IAS 32	91	<p>When an enterprise has accounted for a financial instrument as a hedge of risks associated with anticipated future transactions, it should disclose:</p> <p>(a) A description of the anticipated transactions, including the period of time until they are expected to occur;</p> <p>(b) A description of the hedging instruments; and</p> <p>(c) The amount of any deferred or unrecognized gain or loss and the expected timing of recognition as income or expense.</p>	N/A	
IAS 39	169	<p>Financial Statements should include all the following disclosures relating to hedging:</p> <p>(a) Describe the enterprise's financial risk management objectives and policies, including its policy for hedging each major type of forecasted transaction</p>	N/A	

IAS	Para	Requirements	RBNZ Example	✓
IAS 39	169	<p>(a) Describe the enterprise's financial risk management objectives and policies, including its policy for hedging each major type of forecasted transaction</p> <p>(b) Disclose the following separately for designated fair value hedges, cash flow hedges, and hedges for a net investment in a foreign entity"</p> <p>(i) a description of the hedge;</p> <p>(ii) a description of the financial instruments designated as hedging instruments for the hedge and their fair values at the balance sheet date;</p> <p>(iii) the nature of the risks being hedged; and</p> <p>(iv) for hedges of forecasted transactions, the periods in which the forecasted transactions are expected to occur, when they are expected to enter into the determination of net profit or loss, and a description of any forecasted transaction for which hedge accounting had previously been used but that is no longer expected to occur; and</p> <p>(c) if a gain or loss on derivative and non-derivative financial assets and liabilities designated as hedging instruments in cash flow hedges has been recognized directly in equity, through the statement of changes in equity, disclose:</p> <p>(i) the amount that was so recognized in equity during the current period;</p> <p>(ii) the amount that was removed from equity and reported in net profit or loss for the period; and</p> <p>(iii) the amount that was removed from equity and added to the initial measurement of the acquisition cost or other carrying amount of the asset or liability in a hedged forecasted transaction during the current period (see paragraph 160).</p>	<p>Note 12</p> <p>N/A</p> <p>N/A</p>	<p>✓</p>

<i>IAS</i>	<i>Para</i>	<i>Requirements</i>	<i>RBNZ Example</i>	✓
	170(b)	If the fair value for held-for-trading investments and available-for-sale assets cannot be reliably measured and the organization is, therefore, measuring these assets at amortized cost, then an explanation of why fair value cannot be used should be disclosed and, if possible, the range of fair value estimates.	N/A	
	170(d)	<p>If the enterprise has entered into a securitisation or repurchase agreement, disclose, separately for such transactions occurring in the current financial reporting period and for remaining retained interests from transactions occurring in prior financial reporting periods:</p> <ul style="list-style-type: none"> (i) the nature and extent of such transactions, including a description of any collateral and quantitative information about the key assumptions used in calculating the fair values of new and retained interests; (ii) whether the financial assets have been derecognised; 	N/A	
	170(e)	If the enterprise has reclassified a financial assets as one required to be reported at amortized cost rather than fair value, disclose the reason for that classification	N/A	

RESERVE BANK OF NEW ZEALAND 1999—FINANCIAL STATEMENTS

Replication of
Reserve Bank of New Zealand
1999 Financial Statements

Contents of Financial Statements

84	Guide to the Main Functions of the Reserve Bank
85	Five Year Financial Summary
87	1999/2000 Budget Information
87	Budget Assumptions
88	Budgeted Cost of Services
89	Consolidated Budgeted Statement of Financial Performance
90	Management Statement
91	Audit Report
93	1998/99 Financial Statements
93	Accounting Policies
98	Consolidated Statement of Financial Position
100	Consolidated Statement of Financial Performance
101	Consolidated Statement of Cost of Services
102	Consolidated Statement of Cash Flows
104	Consolidated Statement of Movements in Equity
105	Notes to be read as part of the Consolidated Financial Statements
105	1. Nature and Extent of Activities
107	Asset Notes
107	2. Marketable Securities
107	3. Other Local Currency Financial Assets
107	4. Inventories
108	5. Fixed Assets
109	Liability and Equity Notes
109	6. Other Deposits
109	7. Other Liabilities
109	8. Provision for Restructuring
109	9. Transfers to Retained Earnings and Provision for Transfer of Surplus
110	10. Equity
111	11. Fair Value of Financial Instruments
112	Risk Management Notes
112	12. Risk Management
112	13. Interest Rate Risk
116	14. Credit Risk
119	15. Foreign Currency Risk
120	16. Liquidity Risk
121	Consolidated Statement of Financial Performance Notes
121	17. Income from Financial Assets
122	18. Expenses on Financial Liabilities
122	19. Net Foreign Exchange Revaluation Gain (Loss)
122	20. Other Income
123	21. Asset Management Expenses
123	22. Other Operating Expenses
124	Other Notes
124	23. Currency Operations
125	24. Reconciliation of Operating Cash Flows with Reported Operating Surplus
125	25. Consolidated Cash Balances
126	26. Statement of Commitments
126	27. Free Services
126	28. Related Parties
127	29. Contingent Liabilities
128	RBNZ Registry Limited Notes
128	30. RBNZ Registry Limited
130	31. Taxation
131	32. Custodial Activities

Guide to the Main Functions of the Reserve Bank

The Reserve Bank's outputs are classified according to the major functions of the Bank. Definitions of each output are provided below and where necessary further explanation is provided to enhance the reader's understanding.

Monetary Policy Formulation

Formulating and publicly presenting an ongoing monetary policy strategy to enable the Bank to maintain price stability, in the most efficient manner possible.

Market Operations

Trading, liaising with and monitoring financial markets, for effective implementation of monetary policy, and maintenance of the Bank's capacity to intervene in financial markets in support of the orderly and competitive functioning of those financial markets.

Financial System Oversight

Registering and supervising banks, promoting the efficiency and soundness of the New Zealand financial system and avoiding 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 in order to facilitate cash transactions in the community. Registered banks pay the Reserve Bank the face value of the currency being issued to them. These funds are invested in New Zealand government securities, which are included in local currency financial assets on the Reserve Bank's balance sheet to offset the liability on currency in circulation. Currency in circulation is a non-interest bearing liability. However, the New Zealand government securities investment portfolio asset is interest-bearing. The income directly associated with the issue of currency is referred to as seigniorage and provides the Bank with its main source of income.

Foreign Reserves Management

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

The Crown has advanced foreign currency funds to the Reserve Bank. The Bank has invested these funds in foreign currency assets that are held as foreign reserves. These assets and liabilities are closely matched by currency, duration, and value. As a result the Bank limits its exposure to interest and exchange rate movements in these overseas markets.

Banking Services

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

Overseas Investment Commission Secretariat

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

Registry Services

Providing high quality depository, registry and settlement services to the securities market, in order to contribute to an efficient and sound financial sector.

The Bank's registry services are provided through a wholly-owned subsidiary company, RBNZ Registry Limited. The function is required, under the Reserve Bank of New Zealand Act 1989, to be self-funding.

Other Outputs

Producing other outputs which cannot be classified under our main functions. These include sundry economic policy advice and overseas representation and liaison that relates to the general purposes of the Bank rather than to a particular function.

Five Year Financial Summary

<i>Financial Position as at:</i>	1995 June (\$m)	1996 June (\$m)	1997 June (\$m)	1998 June (\$m)	1999 June (\$m)	
Assets:						
Foreign Currency Financial	4,002	4,474	5,255	6,353	5,885	
Local Currency Financial	3,545	3,915	4,029	4,413	5,321	
Other Assets	65	66	62	61	60	
Total Assets	7,612	8,455	9,346	10,827	11,266	
Liabilities and Equity:						
Foreign Currency Financial	4,002	4,473	5,254	6,350	5,879	
Local Currency Financial	1,571	1,818	1,880	2,176	2,926	
Currency in Circulation	1,516	1,599	1,665	1,733	1,885	
Other Liabilities	142	174	151	164	171	
Equity	381	391	396	404	405	
Total Liabilities and Equity	7,612	8,455	9,346	10,827	11,266	
<i>Consolidated Income and Expenditure Financial Year Ending:</i>	1995 June (\$m)	1996 June (\$m)	1997 June (\$m)	1998 June (\$m)	1999 June (\$m)	2000 June Budget (\$m)
Net Investment Income	159.1	171.7	170.4	187.4	186.1	171.2
Other Income	10.4	34.4	10.7	10.7	11.7	12.9
Total Income	169.5	206.1	181.1	198.1	197.8	184.1
Operating Expenses	39.7	38.6	37.8	37.0	44.2	43.0
Tax for Current Year	0.6	0.8	0.9	0.8	0.6	0.3
Surplus for Appropriation	129.2	166.8	142.5	160.3	153.0	140.8
Transfers to Equity	22.8	5.3	6.4	8.4	2.2	3.1
Payment to Government	106.4	161.4	136.0	151.9	150.8	137.7

<i>Cost of Services</i> ³³ <i>Financial Year Ending:</i>	1995 June	1996 June	1997 June	1998 June	1999 June	2000 June Budget
	(\$m)	(\$m)	(\$m)	(\$m)	(\$m)	(\$m)
Monetary Policy Formulation	6.2	6.5	6.1	6.7	7.2	7.4
Market Operations	3.0	2.9	2.8	2.8	2.8	2.9
Financial System Oversight	3.2	3.2	2.8	2.8	2.7	3.1
Currency Operations	17.6	16.7	15.8	14.0	19.6	18.0
Foreign Reserves Management	3.8	3.5	3.7	3.7	4.0	3.6
Banking Services	0.3	0.4	0.8	0.8	1.1	1.2
Overseas Investment Commission Secretariat	0.6	0.6	0.7	0.9	0.7	0.6
Other Outputs	0.5	0.5	0.7	0.6	1.3	1.0
Total for Functions within Funding Agreement	35.1	34.3	33.4	32.3	39.4	37.8
Registry Services ³⁴	5.2	4.9	5.5	5.7	5.9	5.8
Less Intercompany Transactions	-	(0.2)	0.2	0.2	0.4	0.3
Total Expenditure	40.3	39.4	38.7	37.8	44.9	43.3

The Statement of Cost of Services shows the total cost of providing each function, including internal transfers between functions. It includes fees charged by the Registry Services function to other functions, which are netted off against Registry income in the Consolidated Statement of Financial Performance.

³³ Figures in this section have been rounded. Totals have not been adjusted for rounding error.

³⁴ Includes tax payable.

1999/2000 Budget Information

The Reserve Bank's budget has been prepared for a 12 month period and is consistent with the Bank's accounting policies.

The 1999/2000 budget has been prepared using April 1999 interest rates. No allowance has been made for future changes in interest and exchange rates.

Budget Assumptions

The major assumptions underlying the preparation of the 1999/2000 budget are that:

1. The Bank performs the functions prescribed in the Reserve Bank of New Zealand Act 1989, and existing functions not directly specified in the legislation.
2. The levels of activity in the Foreign Reserves Management and Market Operations functions in 1999/2000 will be similar to the 1998/99 levels.

Budgeted Cost of Services

The Bank has budgeted to provide the following functions in 1999/2000.

	Operating Income Budget 2000 \$000	Operating Income Actual 1999 \$000	Operating Expenses Budget 2000 \$000	Operating Expenses Actual 1999 \$000	Operating Surplus (Deficit) Budget 2000 \$000	Operating Surplus (Deficit) Actual 1999 \$000
<i>For the year ended 30 June</i>						
Function						
Monetary Policy Formulation	41	26	7,366	7,230	(7,325)	(7,204)
Market Operations	8,421	17,667	2,941	2,761	5,480	14,906
Financial System Oversight	5	8	3,072	2,695	(3,067)	(2,687)
Currency Operations	155,642	145,517	17,960	19,636	137,682	125,881
Foreign Reserves Management ³⁵	13,505	26,952	3,606	3,955	9,899	22,997
Banking Services	1,590	1,853	1,212	1,102	378	751
Overseas Investment Commission Secretariat	711	764	643	723	68	41
Other Outputs	-	231	1,011	1,252	(1,011)	(1,021)
Total for Functions within Funding Agreement	179,915	193,018	37,811	39,354	142,104	153,664
Registry Services	6,465	7,175	5,770	5,868	695	1,307
Less Intercompany Transactions ³⁶	2,245	2,362	245	362	2,000	2,000
Total for Bank	184,135	197,831	43,336	44,860	140,799	152,971

³⁵ The 1998/1999 actual operating income for Foreign Reserves Management includes \$8,900,000 arising from the Bank's role as holder of international Monetary Fund Special Drawing Rights (SDR). During 1998/1999, the SDR assets and liabilities (and associated income streams) were transferred to the Treasury. Hence, the 1999/2000 budgeted income for Foreign Reserves Management has declined.

³⁶ Intercompany transactions for 1999/2000 includes a budgeted dividend from the Registry Services function to other Bank functions. Other intercompany transactions are mainly for the purchase of Registry Services by other bank functions.

Consolidated Budgeted Statement of Financial Performance

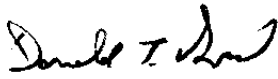
<i>For the year ended 30 June</i>	Budget 2000 \$000	Actual 1999 \$000
Operating Income:		
Net Investment Income	171,263	186,114
Other Income	12,872	11,717
Total Operating Income	184,135	197,831
Operating Expenses:		
Personnel	19,624	21,391
Asset Management	6,379	6,041
New Currency Issued	8,159	8,323
Administration	1,789	1,602
Other	7,042	6,858
Total Operating Expenses	42,993	44,215
Operating Surplus	141,142	153,616
Taxation	343	645
Surplus Available for Appropriation	140,799	152,971

19 August 1999

MANAGEMENT STATEMENT

Pursuant to section 165 of the Reserve Bank of New Zealand Act 1989, we hereby certify that:

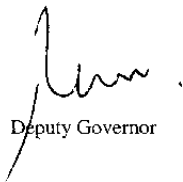
1. We have been responsible for the preparation of the annual financial statements and for the judgements used in them.
2. We have been responsible for establishing and maintaining a system of internal controls designed to provide reasonable assurance as to the integrity and reliability of the Bank's financial reporting.
3. In our opinion, the annual financial statements for the year ended 30 June 1999 fairly reflect the financial position and operations of the Bank.



Governor



Deputy Chief Executive



Deputy Governor



Audit report

To the Readers of the Financial Statements of the Reserve Bank of New Zealand

We have audited the financial statements on pages 41 to 79. The financial statements provide information about the past financial performance of the Reserve Bank of New Zealand and group and its financial position as at 30 June 1999. This information is stated in accordance with the accounting policies set out on pages 41 to 45.

Governors' responsibilities

The Governors are responsible for the preparation of financial statements which give a true and fair view of the financial position of the Reserve Bank of New Zealand and group as at 30 June 1999 and the results of its operations and cash flows for the year ended on that date.

Auditors' responsibilities

It is our responsibility to express an independent opinion on the financial statements presented by the Governors and report our opinion to you.

Basis of opinion

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

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

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

Our firm carries out other assignments for the Reserve Bank of New Zealand and group in the area of taxation advice and special consultancy projects. The firm has no other interest in the Reserve Bank of New Zealand and group.

Unqualified opinion

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

In our opinion:

- proper accounting records have been kept by the Reserve Bank of New Zealand as far as appears from our examination of those records; and
- the financial statements on pages 41 to 79:
 - comply with generally accepted accounting practice; and
 - give a true and fair view of the financial position of the Reserve Bank of New Zealand and group as at 30 June 1999 and the results of its operations and cash flows for the year ended on that date.

Our audit was completed on 19 August 1999 and our unqualified opinion is expressed as at that date.

Wellington



Reserve Bank of New Zealand 1999 Financial Statements

Accounting Policies

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. These statements apply to the financial year ended 30 June 1999. They have been prepared in accordance with part VI of the Reserve Bank of New Zealand Act 1989. Unless otherwise stated, the measurement base is historic cost.

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

(a) Basis of Consolidation

The Reserve Bank accounts for its Registry Services function through a wholly-owned subsidiary company (RBNZ Registry Limited). The consolidated financial statements include this subsidiary company. The purchase method of consolidation is used. All material inter-company balances and transactions have been eliminated. (Separate financial statements for RBNZ Registry Limited appear in note 30.) Parent financial statements are not produced because the difference between the parent and group accounts is not material.

(b) Foreign Currency Conversions

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

	1999	1998
Euro	0.5138	-
German marks	-	0.9265
Japanese yen	64.05	72.11
United States dollars	0.531	0.5125

(c) Financial Assets and Liabilities

The Bank presents financial assets and financial liabilities, and the associated income and expense streams, by distinguishing between foreign currency and local currency activities. Foreign currency activities mainly arise from the Bank's foreign reserves management function. Local currency activities mainly reflect the assets and liabilities associated with monetary policy implementation, investment of the proceeds of issuing circulating currency and banking activities.

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 informational value of the financial statements.

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

Foreign Currency Marketable Securities

Foreign currency marketable securities are valued at quoted market prices. Changes in market value are recognised as an increase or decrease in the value of the Marketable Securities asset in the Statement of Financial Position.

Gains and losses on marketable securities are recognised immediately in the Statement of Financial Performance as Unrealised Price Revaluation Income (where the revaluation gains or losses have not been realised) and as Realised Gains (Losses) from Price Changes where the gains or losses have been realised by selling the security.

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. Hence, 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 on foreign currency term liabilities are recognised immediately in the Statement of Financial Performance as Unrealised Price Revaluation expenses (where the revaluation gains or losses have not been realised) and as Realised Gains (Losses) from Price Changes where the gains or losses have been realised through repayment of the liability.

Repurchase and Reverse-Repurchase Transactions

Securities sold under agreements to repurchase are retained as Marketable Securities in the Statement of Financial Position. The obligation to repurchase (Securities Sold Under Agreements to Repurchase) is disclosed as a liability. 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 as an asset (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 original transaction value.

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 derivatives comprises forward foreign exchange swap transactions and a cross currency interest rate swap.

Foreign exchange swap contracts are used as part of hedged foreign exchange transactions for both monetary policy implementation and foreign reserves management. The unrealised foreign exchange gain (loss) on unsettled swap forward transactions are offset by the foreign exchange revaluation on the associated money market instruments. These are both included within the balance of Short-Term Advances. Premiums and discounts relating to the forward contracts are amortised over the term of the contract.

The cross currency interest rate swap is part of a series of hedged transactions that enhance the yield on foreign currency marketable securities. The market value of the principal components of the swap is derived by discounting the future cashflows based on the appropriate market yield curves. Changes in the market value of the principal components are recognised immediately as an increase or decrease in the value of Marketable Securities in the Statement of Financial Position. Gains and losses are recognised immediately in the Statement of Financial Performance as Unrealised Price Revaluation Income (as the gains and losses are not realised). Net interest income on the principal amounts is reported as Interest Income from Marketable Securities. The accrued interest on the principal amounts is reported within the balance of Foreign Currency Accrued Interest.

Short Sales of Securities

A short sale is a sale of a security that we do not own. Securities which are sold short are recorded at quoted market prices and reported as Short Sales within the balance of Marketable Securities. Any gains or losses are recognised immediately in the Statement of Financial Performance on the same basis as foreign currency marketable securities.

Unsettled Transactions

Amounts due from unsettled sales of securities (transactions not yet due for settlement) are reported as assets under the title Receivable from Unsettled Sales of Securities. Amounts payable for unsettled purchases of securities are reported as liabilities under the title Payable for Unsettled Purchases of Securities.

Unsettled transactions are reported at the contract amounts.

Investment Portfolio - NZ Government Securities

The Bank's investment portfolio is accounted for on a 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.

Market Test Activities

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

Transaction Value

The following financial assets and liabilities are valued at transaction date value:

- a) local and foreign currency cash;
- b) short-term advances; and
- c) current account deposits.

(d) 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.

(e) Commemorative and Demonetised Currency

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

The Bank has a liability for the face value of demonetised currency still in circulation. Except for a portion retained in the Statement of Financial Position to cover expected future redemption, this is also recognised as a contingent liability.

(f) Land and Buildings

Land is carried at market value. Property intended for sale is valued at the lower of book value or market value. Buildings are valued at market value except for the specialised basements and ground floors occupied by the Reserve Bank, which are valued at adjusted replacement cost when the property is intended to be held for the longer term. Surpluses of book value over historic cost for this class of asset are recorded in the Properties Revaluation Account. Where the book value of this class of asset falls below historic cost, previous revaluations are reversed and the remaining balance is charged as an expense in the financial year it occurs. Independent valuations of this class of asset are obtained triennially. Because of this policy of regular valuation, buildings are not depreciated.

(g) Other Fixed Assets

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

Computer Hardware	4 years
Computer Software	5 years
Plant and Equipment	5 years

Motor vehicles are depreciated on a diminishing value basis at a rate of 26 percent per annum. Other assets are depreciated on a straight line basis over their expected useful lives. Computer software is capitalised when total costs exceed \$100,000.

(h) Operating Leases

Lease rentals payable on operating leases are recognised in the Statement of Financial Performance over the term of the lease.

(i) 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.

(j) Accounts Receivable

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

(k) 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 valued at estimated market values. Nominal values have been placed on items with no material commercial value. Collections are not depreciated. Additions are held at cost until subsequent revaluations.

(l) 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 as Accrued Employee Entitlements.

(m) Taxation

Only RBNZ Registry Limited is liable for income tax.

The taxation charged against profit includes both current and deferred taxation calculated under the comprehensive method.

Deferred taxation arises from items of income and expenditure being included in taxation computations in periods different from those in which they are recorded in the financial statements.

(n) Income Allocated Between Functions

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

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

(o) 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 Bank.

Investing activities include the cash movements, including realised gains and losses, in the Reserve Bank's financial asset portfolios. Also included are cash flows arising from movements in fixed assets, and loans to staff.

Financing activities are those 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 as investing or financing activities.

(p) Custodial Activities

Securities held by the Reserve Bank through a subsidiary company under custodial arrangements are not included in these financial statements (see note 32).

(q) Segmental Reporting

The Bank presents financial assets and financial liabilities, and the 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.

(r) Comparative Amounts

To ensure consistency with the current year, comparative figures have been restated where appropriate. The material change is in Foreign Currency Financial Assets, where \$242,732,000 of Short-Term Advances were re-classified as Cash Balances with Other Central Banks.

(s) Changes in Accounting Policies

There has been no change in the Reserve Bank's accounting policies for the year ended 30 June 1999.

Consolidated Statement of Financial Position

<i>As at 30 June</i>	Note	1999 \$000	1998 \$000
Assets:			
Foreign Currency Financial Assets			
Cash Balances with Other Central Banks		381,118	250,513
Marketable Securities	2	3,539,726	4,419,325
Short-Term Advances		-	84,778
Receivable from Unsettled Sales of Securities		41,435	93,031
Securities Purchased Under Agreements to Re-sell		1,860,245	1,431,814
Accrued Interest		62,640	71,610
International Monetary Fund Special Drawing Rights		-	2,172
Total Foreign Currency Financial Assets		5,885,164	6,353,243
Local Currency Financial Assets			
Cash on Hand		78	94
Securities Purchased Under Agreements to Re-sell		3,063,648	1,058,000
Advances to Government		-	1,194,982
Investment Portfolio - NZ Government Securities		2,205,712	2,098,051
Accrued Interest		50,579	61,020
Other Local Currency Financial Assets	3	1,265	547
Total Local Currency Financial Assets		5,321,282	4,412,694
Total Financial Assets		11,206,446	10,765,937
Non-Financial Assets			
Accounts Receivable		2,180	1,952
Inventories	4	7,122	6,330
Deferred Taxation		60	76
Currency & Artwork Collection		767	767
Fixed Assets	5	49,372	52,393
Total Non-Financial Assets		59,501	61,518
Total Assets		11,265,947	10,827,455

	Note	1999 \$000	1998 \$000
Liabilities:			
Foreign Currency Financial Liabilities			
Short-Term Deposits		-	30,509
Payable for Unsettled Purchases of Securities		283,221	22,082
Securities Sold Under Agreements to Repurchase		1,190,600	1,213,666
Term Liabilities		4,313,042	4,601,986
Accrued Interest		91,949	114,516
International Monetary Fund Special Drawing Rights ³⁷		-	367,070
Total Foreign Currency Financial Liabilities		5,878,812	6,349,829
Local Currency Financial Liabilities			
Government Deposits		2,880,976	956,473
Other Deposits	6	45,169	16,148
Reserve Bank Bills ³⁸		-	1,203,586
Accrued Interest		408	344
Total Local Currency Financial Liabilities		2,926,553	2,176,551
Total Financial Liabilities		8,805,365	8,526,380
Non-Financial Liabilities			
Currency in Circulation		1,884,816	1,733,306
Provision for Transfer of Surplus	9	150,818	151,890
Other Liabilities	7	20,058	11,637
Total Non-Financial Liabilities		2,055,692	1,896,833
Total Liabilities		10,861,057	10,423,213
Equity	10	404,890	404,242
Total Liabilities and Equity		11,265,947	10,827,455

The above statement is to be read in conjunction with the notes on pages 105 to 131.

³⁷ Since New Zealand joined the International Monetary Fund (IMF) in the 1960s, the Reserve Bank has been the agent responsible for holding New Zealand's allocation of IMF Special Drawing Rights (SDRs). New Zealand's allocation of SDR assets represented a liability on the Reserve Bank balance sheet, while holdings of SDRs provided the counterpart asset. During 1998/1999, the SDR assets and liabilities were transferred to the Treasury. SDR's are now directly accounted for on the crown balance sheet (see note 1.(c) (ii)).

³⁸ The Bank ceased issuing Reserve bank bills on 5 February 1999. All Reserve Bank bills and the related Advances to Government were repaid by 9 April 1999 (see note 1.(f)(i)).

Consolidated Statement of Financial Performance

<i>For the year ended 30 June</i>	Note	Actual 1999 \$000	Budget 1999 \$000	Actual 1998 \$000
Operating Income:				
Income from Financial Assets	17	455,909		633,992
Expenses on Financial Liabilities	18	(268,894)		(457,656)
Net Foreign Exchange Revaluation Gain (Loss)	19	(901)		11,035
Net Investment Income		186,114	158,720	187,371
Other Income	20	11,717	11,425	10,683
Total Operating Income		197,831	170,145	198,054
Operating Expenses:				
Personnel ³⁹		21,391	19,277	18,435
Asset Management	21	6,041	6,803	6,268
New Currency Issued ⁴⁰	23	8,323	6,173	4,214
Administration		1,602	1,776	1,943
Other	22	6,858	6,668	6,140
Total Operating Expenses		44,215	40,697	37,000
Operating Surplus		153,616	129,448	161,054
Taxation	31	645	330	750
Surplus Available for Appropriation	9	152,971	129,118	160,304

The above statement is to be read in conjunction with the notes on pages 105 to 131.

³⁹ The increase in Personnel expenses in the 1998/1999 year mainly reflects the expense arising from the provision for restructuring the currency Operations function over the next 12 to 18 months (see note 8).

⁴⁰ New Currency Issued expenses were above budget due to a higher than expected demand for the new \$20 polymer bank notes.

Consolidated Statement of Cost of Services

	Note	Operating	Operating	Operating	Operating	Operating
		Income	Expenses	Surplus	Surplus	Surplus
		Actual	Actual	(Deficit)	(Deficit)	(Deficit)
<i>For the year ended 30 June</i>		1999	1999	1999	1999	1998
		\$000	\$000	\$000	\$000	\$000
Functions:						
Monetary Policy Formulation		26	7,230	(7,204)	(7,170)	(6,681)
Market Operations		17,667	2,761	14,906	9,599	11,946
Financial System Oversight		8	2,695	(2,687)	(2,713)	(2,765)
Currency Operations	23	145,517	19,636	125,881	118,448	132,453
Foreign Reserves Management		26,952	3,955	22,997	10,554	24,616
Banking Services		1,853	1,102	751	633	123
Overseas Investment Commission Secretariat		764	723	41	32	(279)
Other Outputs		231	1,252	(1,021)	(934)	(629)
Total for Functions within Funding Agreement		193,018	39,354	153,664	128,449	158,784
Registry Services	30	7,175	5,868	1,307	669	1,520
Less Intercompany Transactions ⁴¹		2,362	362	2,000	-	-
Surplus Available for Appropriation		197,831	44,860	152,971	129,118	160,304

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 105 to 131.

⁴¹ Intercompany transactions include \$2,000,000 dividend paid from the Registry Services function. Other intercompany transactions are mainly for the purchase of Registry Services by other Bank Functions

Consolidated Statement of Cash Flows

<i>For the year ended 30 June</i>	Note	1999 \$000	1998 \$000
Cash Flows From Operating Activities:			
Source:			
Interest Received			
Foreign Currency		190,016	243,753
Local Currency - Investment Portfolio		162,646	157,396
Local Currency - Other		109,540	125,170
Fees, Commission and Other Income Received		6,975	16,380
		469,177	542,699
Disbursements:			
Interest Paid			
Foreign Currency		218,577	198,406
Local Currency		70,009	126,916
Payments to Suppliers and Employees		32,569	40,034
Income Tax Paid		693	810
GST Paid (Received)		77	(29)
		321,925	366,137
Net Cash Flow From Operating Activities	24	147,252	176,562
Cash Flows From Investing Activities:			
Source:			
Net Decrease in Foreign Currency Marketable Securities			
		931,019	116,216
Net Decrease in Other Foreign Currency Financial Assets			
		118,690	124,312
Net Repayment of Advance to Government			
		1,194,982	33,646
Net Decrease in Other Local Currency Financial Assets			
		277	586
Net Increase in Other Foreign Currency Financial Liabilities			
		199,681	331,148
Sale of Fixed Assets			
		77	39
		2,444,726	605,947
Disbursements:			
Net Increase in Foreign Currency Securities Purchased under Agreements to Re-sell			
		428,431	547,240
Net Purchases of NZ Government Securities for Investment Portfolio			
		116,843	91,990
Purchase of Fixed Assets			
		1,931	2,837
		547,205	642,067
Net Cash Flow From Investing Activities		1,897,521	(36,120)

	Note	1999 \$000	1998 \$000
Cash Flows From Financing Activities:			
Source:			
Issue of Circulating Currency		11,618,884	11,174,840
Withdrawal of Circulating Currency		11,467,454	11,106,848
Net Issue of Circulating Currency		151,430	67,992
Disbursements:			
Net Repayment of Foreign Currency Term Liabilities		301,738	(107,589)
Transfer of SDRs to Treasury		367,070	-
Net Repayment of Reserve Bank Bills		1,213,000	30,000
Payment of Surplus to Government		151,890	136,015
		2,033,698	58,426
Net Cash Flow From Financing Activities		(1,882,268)	9,566
Cash Flows from All Activities		162,505	150,008
Plus Exchange Rate Effect		23,168	328,758
Net Cash Flows from All Activities		185,673	478,766
Opening Cash Balance		3,548,909	3,070,143
Closing Cash Balance	25	3,734,582	3,548,909

The above statement is to be read in conjunction with the notes on pages 105 to 131.

Cash is defined in the Statement of Cash Flows as those items that could be liquidated in two working days and are used in the day to day cash management of the 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).

Previously, cash was defined as those items that were convertible "at call". The change in definition resulted in an increase in reported cash balances of \$6,638,100,000 (1998 \$4,513,655,000) and an increase in investing cash flows of \$2,124,445,000 (1998 \$526,739,000).

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

For further information on the management of the Bank's liquidity, see Note 16 Liquidity Risk.

Consolidated Statement of Movements in Equity

<i>For the year ended 30 June</i>	Note	1999 \$000	1998 \$000
Equity at Start of Year		404,242	396,408
Net Surplus for the Year		152,971	160,304
Movement in Properties Revaluation Account	10	(1,505)	(580)
Total Recognised Revenues and Expenses for the Year		151,466	159,724
Provision for Transfer of Surplus to Government	9	(150,818)	(151,890)
Equity at End of Year		404,890	404,242

The above statement is to be read in conjunction with the notes on pages 105 to 131.

Notes to be read as part of the Consolidated Financial Statements

1. Nature and Extent of Activities

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

(a) Foreign Currency Activities

Foreign currency activities result mainly from the Reserve Bank's holdings of foreign currency assets under its foreign reserves management function. These assets are held in various currencies. The majority are denominated in United States dollars, Japanese yen and euros. The overall level of these assets is determined by the Treasurer on advice from the Bank.

The 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 and settlement institutions. Liquidity and credit risk are key criteria in determining the type of instruments held.

The funding for these assets is provided by foreign currency loans from the Treasury. These loans incur interest at market rates. The overall currency composition of the assets and liabilities is determined in consultation with the Treasury. 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.

Subject to liquidity and credit risk constraints being satisfied, the Bank defines benchmark portfolios that represent a "neutral" asset structure in terms of market risk relative to the funding structure. The neutral position is established to minimise the Bank's exposure to foreign currency risk and interest rate risk arising from changes in the yield curve. In general, liquidity and credit risk constraints dictate that the return on the neutral asset structure will be less than the cost of funding.

The Reserve Bank also holds, from time to time, foreign currency assets and liabilities that arise from the implementation of domestic monetary policy. Any foreign currency exposures related to domestic monetary policy implementation activity are fully hedged through the use of foreign currency swaps.

The Bank also participates in the foreign exchange dealing markets on its own account and to meet the foreign currency needs of public sector customers.

(b) Departures from Neutral Positions

Departures of the asset portfolio from the neutral asset structure are undertaken where there is an expected increase in returns, within defined risk boundaries. Exposures are also incurred by short sales of assets, again for expected return enhancement within defined risk boundaries.

Decision-making for departures from neutral asset positions typically involves delegated discretion to specialist staff or trading strategies pre-agreed with the Bank's senior management.

For further information on the risk management policies relating to financial instruments, see notes 12 to 16.

(c) Events during 1998/1999

- (i) On 1 January 1999, the new euro currency was launched. This currency replaced a number of European currencies for financial transactions, including the German mark. All the financial assets and liabilities held by the Bank that were denominated in these currencies were redenominated into euro currency during the first week of January 1999.
- (ii) During 1998/99, the Bank's role as holder of International Monetary Fund Special Drawing Rights (SDRs) was transferred from the Bank to the Treasury. This reflected the increased efficiency of one organisation managing the Crown's net SDR position. The foreign currency assets and liabilities transferred to the Treasury were of equal value.

(d) Derivatives

The Bank's involvement in derivatives comprises forward foreign exchange swap transactions and a cross currency interest rate swap.

The Bank uses forward foreign exchange swap contracts as part of hedged foreign exchange transactions for both monetary policy implementation and foreign reserves management. The Bank did not have any forward foreign exchange swap transactions at 30 June 1999 (1998 US \$55 million).

In November 1997 the Bank entered into a cross currency interest rate swap (exchanging principal of US \$110 million) as part of a series of hedged transactions to enhance the yield on the US dollar fixed rate portfolio.

(e) Securities Lending Programme

As part of its foreign reserves operations, the Reserve Bank participates in a securities lending programme managed by The Chase Manhattan Bank. Under the programme, The Chase Manhattan 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.

The total market value of securities which have been made available to participate in this programme is limited to US \$700 million. As at 30 June 1999, the market value of securities lent out under the programme was US \$400.8 million (1998 US \$389.5 million).

(f) Local Currency Activities

Local currency activities arise on two main counts:

(i) Liquidity management operations.

Liquidity management largely involves the Reserve Bank offsetting the daily net flows through Government Deposits by advancing funds to or withdrawing funds from the banking system. Most of this business is undertaken through daily open market operations, but arrangements for handling the residual liquidity flows have changed during the year. Under the Official Cash Rate scheme (OCR) (introduced on 17 March 1999), the Bank advances or withdraws cash at a margin to the OCR. Before the OCR, the Bank sold Reserve Bank bills to the market and undertook to buy these bills from the market when additional liquidity was needed. Proceeds from the sale of Reserve Bank bills were advanced to the government. These were recorded as liabilities (Reserve Bank Bills) and assets (Advances to Government). The Bank ceased issuing Reserve Bank bills on 5 February 1999. All Reserve Bank bills and advances to government were repaid by 9 April 1999.

(ii) Holding assets representing the investment of the Reserve Bank's net equity and supporting the liability for currency in circulation. This investment portfolio comprises holdings of New Zealand government bonds. The Bank's policy is to hold these investments until maturity.

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

(g) Restrictions on Title to Assets

As part of the active management of its foreign currency operations, the Reserve Bank enters into security repurchase transactions. The securities sold by the Bank under repurchase agreements continue to be recorded as Marketable Securities in the Bank's Statement of Financial Position. At balance date, securities with a book value of \$1,191 million (1998 \$1,214 million) had been sold to counterparties under repurchase agreements. 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.

(h) Concentrations of Funding

The Bank has a concentration of funding from the New Zealand government. The funding for foreign currency assets is provided by foreign currency loans from the Treasury. Funding for local currency assets is from government deposits, bank deposits and the issue of circulating currency.

Asset Notes

2. Marketable Securities	1999 \$000	1998 \$000
Marketable Securities		
- Liquifiable within two days (considered cash equivalent)	3,215,883	3,212,923
- Liquifiable outside two days (not considered cash equivalent)	719,793	1,158,586
Short Sales	(599,588)	(168,789)
Cross Currency Swap position	203,638	216,605
	3,539,726	4,419,325
Cross Currency Swap position comprises		
- Swap derivative components	(35,531)	596
- Government securities	239,169	216,009

The change in the value of the Cross Currency Swap position is largely offset by changes in the value of the Bank's liabilities. This is consistent with the Bank's risk management practice of matching assets and liabilities.

3. Other Local Currency Financial Assets	1999 \$000	1998 \$000
Receivable from Unsettled Foreign Exchange Transactions	1,000	-
Advances to Staff	174	334
Term Loans	91	213
	1,265	547

4. Inventories	1999 \$000	1998 \$000
Bank Notes for Circulation	4,087	2,880
Coin for Circulation	2,716	3,157
Commemorative Currency	319	290
Office Supplies	-	3
Total Inventories	7,122	6,330

5. Fixed Assets	1999	1999	1999	1998	1998	1998
	Historic Cost \$000	Accumulated Depreciation \$000	Book Value \$000	Historic Cost \$000	Accumulated Depreciation \$000	Book Value \$000
Freehold Land			8,080			14,510
Buildings			17,835			25,910
Property Intended for Sale			13,000			-
			38,915			40,420
Computer Hardware	4,538	3,116	1,422	4,583	3,970	613
Plant	5,643	5,343	300	5,627	5,303	324
Office Equipment	6,543	5,481	1,062	7,044	5,391	1,653
Software	7,747	5,266	2,481	7,131	4,568	2,563
Currency Processing Equipment	5,019	3,294	1,725	5,019	2,667	2,352
Motor Vehicles	186	116	70	296	138	158
Building Improvements	5,155	2,660	2,495	4,039	2,004	2,035
Tenancy Inducements	1,659	1,116	543	1,761	1,020	741
Work in Progress	359	-	359	1,534	-	1,534
			10,457			11,973
Total Fixed Assets			49,372			52,393

The book values for land and buildings are market values based on existing use with the exception of the Wellington specialised basement and ground floors occupied by the Bank, which are valued at adjusted replacement cost. The market value of the Wellington Head Office to a purchaser not requiring the Bank's specialised facilities is \$22,600,000 (1998 \$22,600,000).

	Valuation Date	Registered Valuer	Last Valuation \$000
Auckland Property	June 1998	Jones Lang Wooton Limited	13,000
Wellington Head Office	June 1998	Jones Lang Wooton Limited	24,350
Wellington Carparks	June 1999	Darroch Limited	1,565
			38,915

Liability and Equity Notes

6. Other Deposits

	1999 \$000	1998 \$000
Settlement Bank Deposits	1,141	1,652
Central Bank Deposits	2,030	2,564
Staff Deposits	4,818	7,660
International Monetary Fund Deposits	37,180	4,272
	45,169	16,148

7. Other Liabilities

	Note	1999 \$000	1998 \$000
Accounts Payable		14,925	7,024
Accrued Employee Entitlements		2,021	2,540
Other Current Liabilities		401	750
Provision for Restructuring	8	1,466	-
Demonetised Currency		1,245	1,323
		20,058	11,637

Demonetised currency is recognised as a contingent liability (see note 29(c)) except for \$1,245,000 (1998 \$1,323,000), which has been retained to cover future expected redemption.

Pre-decimal-currency coin was issued by the Treasury and is included in the Bank's contingent liabilities (see note 29(b)).

8. Provision for Restructuring

	1999 \$000	1998 \$000
Balance at Start	-	-
Provision Made	1,466	-
Balance at End	1,466	-

The Bank has made a provision for the restructuring of its currency operations. This has resulted in an increase in personnel expenses for the year ended 30 June 1999. This provision includes payments to currency staff who will become redundant over the next year or so, as the volume of bank note processing diminishes. The decline in bank note processing arises from the introduction of the more durable polymer notes that will enable the Bank to become less directly involved in the circulation of cash in the community. The precise timing of these payments will depend on the pace with which the banks are able to set up alternative distribution systems, but is expected to occur during the next twelve to eighteen months.

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

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

Transfers to or from the Reserve Bank's Equity reflect the difference between actual operating expenses and the level of expenditure specified under the Bank's Funding Agreement with government plus the RBNZ Registry net surplus. Under-spending by the Bank in relation to the Funding Agreement results in a transfer to Equity. Over-spending by the Bank results in a transfer from Equity. In the current year, under-expenditure by the Bank of \$846,000 (1998 \$6,894,000) has consequently been transferred to the Bank's Equity. In addition, the RBNZ Registry net surplus of \$1,307,000 (1998 \$1,520,000) forms part of the Bank's consolidated equity.

The Bank's subsidiary, RBNZ Registry Limited, proposes to pay the Bank a dividend of \$2,000,000 (1998 \$2,000,000) in respect of the year ended 30 June 1999.

The Treasurer may authorise additional transfers to Equity. In the current year, no additional transfers have been made and the Bank's consolidated surplus, net of the transfers noted above, has been recorded in the Provision for Transfer of Surplus.

	1999: \$000	1998 \$000
Allowable Expenditure under Funding Agreement	40,200	39,195
Operating Expenses for Functions Covered by the Funding Agreement	39,354	32,301
Under-expenditure Transferred to Equity	846	6,894
Surplus Available for Appropriation	152,971	160,304
Less Transfers to Equity:		
Under-expenditure under Funding Agreement	846	6,894
RBNZ Registry Limited Surplus	1,307	1,520
Total Transfer to Equity	2,153	8,414
Provision for Transfer of Surplus	150,818	151,890

10. Equity

	1999: \$000	1998 \$000
Retained Earnings		
Opening Balance	395,510	387,096
Add Transfers to Retained Earnings:		
Reserve Bank of New Zealand	846	6,894
RBNZ Registry Limited	1,307	1,520
Closing Balance	397,663	395,510
Properties Revaluation Account		
Opening Balance	8,052	8,632
Decrease in Value of Auckland Property	(1,500)	(645)
Increase (Decrease) in Value of Wellington Property	(5)	65
Closing Balance	6,547	8,052
Collections Revaluation Account		
Closing Balance	680	680
Total Equity	404,890	404,242

The Properties Revaluation Account recognises the surplus of book value over cost of the Bank's properties in Auckland and Wellington.

11. Fair Value of Financial Instruments

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

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, quoted market values represent fair value.

(a) Derivatives

The fair value of derivatives is calculated using discounted cash flow models based on current interest rates for the type and maturity of the underlying instrument.

The Bank had no forward foreign exchange swap contracts at 30 June 1999. Hence, there was no unrealised foreign exchange gain (loss) at 30 June 1999 (1998 \$564,000).

The fair value of the derivative components of the cross currency swap at 30 June 1999 was -\$35.5 million (1998 +\$0.6 million). The swap is part of a series of hedged transactions that enhance the yield on the US dollar portfolio. The total value of the Cross Currency Swap position was \$203,638,000 (1998 216,605,000) (see note 2).

(b) Financial Assets and Liabilities

All other financial assets and liabilities are valued at either quoted market prices or prices derived from market yield curves, as described in the 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.

Investment Portfolio - NZ Government Securities

The Bank's holdings of NZ government securities have a fair value of \$2,298,421,000 (1998 \$2,187,366,000). This has been calculated by discounting the current holdings of NZ government securities at 30 June 1999 market rates.

Short-Term Advances and Current Account Deposits

The carrying values of the above instruments are considered to approximate their fair value as they are short term in nature or are receivable on demand.

(c) Currency in Circulation

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

Risk Management Notes

12. Risk Management

In its financial activities, the Bank is subject to interest rate, credit, foreign currency, liquidity and operating risk. The policies for managing interest rate, credit, foreign currency and liquidity risk are outlined in notes 13 to 16. A Risk Management Committee comprised of senior management is responsible for advising the Governor on the monitoring and management of all risks to which the Bank is exposed.

Comprehensive guidelines control the manner in which the Reserve Bank conducts its local currency, foreign currency reserves management, and foreign exchange dealing operations. These guidelines contain specific provisions designed to minimise the risk associated with each operation.

Operating risk is the risk of loss arising from the breakdown of internal controls. These risks are managed as part of the day-to-day running of all business operations.

A separate Risk Unit maintains the Bank's financial risk management framework. This is outlined in notes 13 to 16. The Risk Unit and Accounting Services Department are responsible for the daily monitoring of the Bank's financial risk exposures.

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

An Audit Committee, comprised of three non-executive members of the Board of Directors, monitors the accounting practices and policies and internal control systems of the Bank on behalf of the Board of Directors. The Committee also reviews the internal audit function and has direct access to the external auditor.

13. Interest Rate Risk

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

Foreign Currency Interest Rate Risk

Because the Bank's foreign currency assets are funded by foreign currency liabilities whose interest rate characteristics cannot be exactly replicated, even "neutral" asset portfolios involve interest rate risk. The interest rate characteristics of the liabilities are similar to those of high rated bank and corporate instruments, but liquidity considerations require that most investments are in United States, Japanese and German domestic government instruments. The Bank accepts the associated spread risk as inevitable, but seeks to closely limit additional (mainly duration-related) interest rate mismatches. As at 30 June 1999, the calculated potential annual income variance inherent in the neutral asset/liability structure was approximately plus or minus \$53 million (1998 plus or minus \$40 million) at a 95% probability. Recent annual variances have been substantially smaller.

Interest rate risk arising from departures from the neutral position is managed in three ways (and monitored daily). Discretionary positions adopted by specialist staff are controlled by "Funds at Risk" limits. Funds at Risk measures the potential daily income variance from most movements in market interest rates. The Funds at Risk limits are set to constrain daily income variance to remain under 3 basis points on 19 out of 20 days. Given the Funds at Risk positions on 30 June 1999, the likely (19 days out of 20 probability) loss from any adverse interest rate movements would have been less than plus or minus \$0.2 million (1998 plus or minus \$0.4 million).

Secondly, interest rate risk arising from trading strategies or positions pre-agreed with the Bank's senior management are constrained by limits on position size. The scale of income variance from interest rate risk arising from these strategies was plus or minus \$0.7 million as at 30 June 1999 (1998 plus or minus \$0.6 million) at the same probability as used for Funds at Risk.

Thirdly, stop-loss limits are set for the various departures from the neutral position. Separate stop-loss limits of \$2 million in any calendar month are applied to both discretionary and strategic departures from the neutral position. Therefore, in the worst case, the maximum total loss before stop loss-limits would be triggered is \$4 million in any calendar month.

Funds at Risk limits for the foreign currency asset portfolios, actual Funds at Risk as at 30 June 1999 and the peak Funds at Risk values over the period were:

Funds at Risk	United States Dollar Portfolio Basis Points	Euro Portfolio Basis Points	Japanese Yen Portfolio Basis Points	1999 Total Basis Points	1998 Total Basis Points
Limit	3.00	2.50	2.50		
As at 30 June 1999	0.32	0.42	0.72	0.46	0.78
Peak over period	1.92	2.47	2.44	1.79	1.20

Local Currency Interest Rate Risk

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

- (a) That active risk management could require the Bank to carry out transactions that may seem in conflict with the Bank's monetary policy stance.
- (b) That 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 Reserve 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:

<i>As at 30 June 1999</i>	Weighted Average Interest Rate	1999 Total \$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	4.78%	381,118	-	381,118	-	-	-	-
Marketable Securities	3.50%	3,539,726	-	394,681	468,652	386,448	896,552	1,393,393
Short-Term Advances	-	-	-	-	-	-	-	-
Receivable from Unsettled Sales of Securities	0%	41,435	-	41,435	-	-	-	-
Securities Purchased Under Agreements to Re-sell	1.48%	1,860,245	-	1,860,245	-	-	-	-
Accrued Interest	0%	62,640	-	62,640	-	-	-	-
International Monetary Fund Special Drawing Rights	-	-	-	-	-	-	-	-
Total Foreign Currency Financial Assets	2.88%	5,885,164	-	2,740,119	468,652	386,448	896,552	1,393,393
Foreign Currency Financial Liabilities								
Short-Term Deposits	-	-	-	-	-	-	-	-
Payable for Unsettled Purchases of Securities	0%	283,221	-	283,221	-	-	-	-
Securities Sold Under Agreements to Repurchase	1.03%	1,190,600	-	1,190,600	-	-	-	-
Term Liabilities	3.44%	4,313,042	-	1,135,374	283,878	702,425	773,688	1,417,677
Accrued Interest	0%	91,949	-	91,949	-	-	-	-
International Monetary Fund Special Drawing Rights	-	-	-	-	-	-	-	-
Total Foreign Currency Financial Liabilities	2.73%	5,878,812	-	2,701,144	283,878	702,425	773,688	1,417,677
Foreign Currency Interest Rate Sensitivity Gap		6,352	-	38,975	184,774	(315,977)	122,864	(24,284)
Local Currency Financial Assets								
Cash on Hand	0.14%	78	-	78	-	-	-	-
Securities Purchased Under Agreements to Re-sell	4.49%	3,063,648	-	3,063,648	-	-	-	-
Advances to Government	-	-	-	-	-	-	-	-
Investment Portfolio - NZ Government Securities	7.58%	2,205,712	-	-	446,758	503,304	452,163	803,487
Accrued Interest	0%	50,579	-	50,579	-	-	-	-
Other Local Currency Financial Assets	1.25%	1,265	-	1,000	86	37	142	-
Non-Financial Assets	0%	59,501	59,501	-	-	-	-	-
Total Local Currency Assets	5.66%	5,380,783	59,501	3,115,305	446,844	503,341	452,305	803,487
Local Currency Financial Liabilities								
Government Deposits	4.50%	2,880,976	-	2,880,976	-	-	-	-
Other Deposits	0.57%	45,169	-	45,169	-	-	-	-
Reserve Bank Bills	-	-	-	-	-	-	-	-
Accrued Interest	0%	408	-	408	-	-	-	-
Non-Financial Liabilities	0%	2,055,692	2,055,692	-	-	-	-	-
Equity	0%	404,890	404,890	-	-	-	-	-
Total Local Currency Liabilities and Equity	2.41%	5,387,135	2,460,582	2,926,553	-	-	-	-
Local Currency Interest Rate Sensitivity Gap		(6,352)	(2,401,081)	188,752	446,844	503,341	452,305	803,487
Total Interest Rate Sensitivity Gap								
All Currencies		-	(2,401,081)	227,727	631,618	187,364	575,169	779,203
New Zealand		(6,352)	(2,401,081)	188,752	446,844	503,341	452,305	803,487
United States		3,219	-	165,812	(57,626)	(189,670)	71,039	13,664
Euro		1,400	-	(215,286)	242,400	(126,307)	88,285	12,308
Japan		1,500	-	88,216	-	-	(36,460)	(50,256)
Other		233	-	233	-	-	-	-

Comparative figures as at 30 June 1998 were:

<i>As at 30 June 1998</i>	Weighted Average Interest Rate	1998 Total \$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	5.80%	250,513	-	250,513	-	-	-	-
Marketable Securities	4.03%	4,419,325	-	752,140	307,897	729,249	1,154,747	1,475,292
Short-Term Advances	5.21%	84,778	-	84,778	-	-	-	-
Receivable from Unsettled Sales of Securities	0%	93,031	-	93,031	-	-	-	-
Securities Purchased Under Agreements to Re-sell	1.76%	1,431,814	-	1,431,814	-	-	-	-
Accrued Interest	0%	71,610	-	71,610	-	-	-	-
International Monetary Fund Special Drawing Rights	4.28%	2,172	-	2,172	-	-	-	-
Total Foreign Currency Financial Assets	3.51%	6,353,243	-	2,686,058	307,897	729,249	1,154,747	1,475,292
Foreign Currency Financial Liabilities								
Short-Term Deposits	0.55%	30,509	-	30,509	-	-	-	-
Payable for Unsettled Purchases of Securities	0%	22,082	-	22,082	-	-	-	-
Securities Sold Under Agreements to Repurchase	0.28%	1,213,666	-	1,213,666	-	-	-	-
Term Liabilities	4.05%	4,601,986	-	821,566	156,877	726,609	1,457,054	1,439,880
Accrued Interest	0%	114,516	-	114,516	-	-	-	-
International Monetary Fund Special Drawing Rights	4.28%	367,070	-	367,070	-	-	-	-
Total Foreign Currency Financial Liabilities	3.24%	6,349,829	-	2,569,409	156,877	726,609	1,457,054	1,439,880
Foreign Currency Interest Rate Sensitivity Gap		3,414	-	116,649	151,020	2,640	-302,307	35,412
Local Currency Financial Assets								
Cash on Hand	0%	94	-	94	-	-	-	-
Securities Purchased Under Agreements to Re-sell	8.83%	1,058,000	-	1,058,000	-	-	-	-
Advances to Government	8.74%	1,194,982	-	1,194,982	-	-	-	-
Investment Portfolio - NZ Government Securities	7.85%	2,098,051	-	149,962	-	441,951	659,599	846,539
Accrued Interest	0%	61,020	-	61,020	-	-	-	-
Other Local Currency Financial Assets	6.32%	547	-	94	56	107	255	35
Non-Financial Assets	0%	61,518	61,518	-	-	-	-	-
Total Local Currency Assets	8.10%	4,474,212	61,518	2,464,152	56	442,058	659,854	846,574
Local Currency Financial Liabilities								
Government Deposits	8.40%	956,473	-	956,473	-	-	-	-
Other Deposits	4.33%	16,148	-	16,148	-	-	-	-
Reserve Bank Bills	8.74%	1,203,586	-	1,203,586	-	-	-	-
Accrued Interest	0%	344	-	344	-	-	-	-
Non-Financial Liabilities	0%	1,896,833	1,896,833	-	-	-	-	-
Equity	0%	404,242	404,242	-	-	-	-	-
Total Local Currency Liabilities and Equity	4.15%	4,477,626	2,301,075	2,176,551	-	-	-	-
Local Currency Interest Rate Sensitivity Gap		(3,414)	(2,239,557)	287,601	56	442,058	659,854	846,574
Total Interest Rate Sensitivity Gap								
All Currencies		-	(2,239,557)	404,250	151,076	444,698	357,547	881,986
New Zealand		(3,414)	(2,239,557)	287,601	56	442,058	659,854	846,574
United States		163,182	-	34,960	-	187,402	(98,982)	39,802
Germany		69,241	-	219,897	142,351	(164,927)	(105,383)	(22,697)
Japan		53,173	-	143,974	8,669	(19,835)	(97,942)	18,307
Other		(282,182)	-	(282,182)	-	-	-	-

14. 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. These limits are measured in credit-equivalent terms depending on the nature of the exposure. Exposures to particular classes of counterparty are constrained by aggregate credit limits. Counterparties are allocated to a particular class based mainly on their credit rating. Geographical exposures are controlled by country limits. Limits are updated as necessary when new market information emerges, with all limits formally reviewed on an annual basis.

Credit risk in the 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 under the real time gross settlement system. Securities that the Bank accepts under intra-day reverse-repurchase agreements include New Zealand government bonds, Treasury bills, and short term paper issued by registered banks 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 but are not subject to formal limits. The Bank usually only accepts New Zealand government paper in its inter-day liquidity management operations. However, as part of the year 2000 contingency plan, the Bank has advised financial market participants that it will accept (two name) bank paper in open market operations and overnight reverse-repurchase transactions from around the start of December until mid January 2000.

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

(b) Concentrations of Credit Exposure

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

	1999 \$000	1998 \$000
New Zealand Government	5,286,108	4,406,003
Other Sovereign Issuers (excluding New Zealand Government)	5,237,006	5,335,114
Supranational Financial Institutions	182,197	250,572
Foreign Banks	436,705	578,348
Other	64,430	195,900
Total Financial Assets	11,206,446	10,765,937

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 purposes. An alternative approach is to classify credit exposures arising from securities purchased under agreements to re-sell according to the counterparty to the transaction. Using this approach would result in credit exposures of \$1.86 billion (1998 \$1.43 billion) being reported against securities trading firms and \$3.06 billion (1998 \$1.06 billion) reported against New Zealand banks instead of against Other Sovereign Issuers and the New Zealand Government respectively.

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 their obligations. This cost is the fair value of the derivatives as reported in Note 11. Fair Value of Financial Instruments.

The Bank's significant end-of-year concentrations of credit exposure by geographical area (based on the entity's country of ownership) were as follows:

	1999 \$000	1998 \$000
New Zealand	5,286,357	4,406,341
USA	2,140,192	2,353,916
Japan	1,745,722	1,723,654
Germany	1,659,993	1,685,226
Supranational Financial Institutions	182,197	250,572
Other	191,985	346,228
Total Financial Assets	11,206,446	10,765,937

(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.

	Credit Rating	1999 \$000	% of 1999 financial assets	1998 \$000	% of 1998 financial assets
Foreign Currency Financial Assets					
Cash Balances with Other Central Banks	AAA	380,953	3.4%	250,326	2.3%
	AA+	165	0%	187	0%
Marketable Securities	AAA	3,196,488	28.5%	3,877,292	36.0%
	AA+	63,793	0.6%	221,354	2.1%
	AA	81,820	0.7%	219,368	2.0%
	AA-	197,625	1.8%	101,311	0.9%
Short-Term Advances	AA+	-	-	84,778	0.8%
Receivable from Unsettled Sales of Securities	AAA	41,435	0.4%	93,031	0.9%
Securities Purchased Under Agreements to Re-sell	AAA	1,860,245	16.6%	760,162	7.1%
	AA	-	-	381,470	3.5%
	N/R	-	-	290,182	2.7%
Accrued Interest	Various	62,640	0.5%	71,610	0.7%
International Monetary Fund Special Drawing Rights	AAA	-	-	2,172	0%
		5,885,164	52.5%	6,353,243	59.0%
Local Currency Financial Assets:					
Cash on Hand	AA	78	0%	94	0%
Advances to Government	AA+	-	-	1,194,982	11.1%
Securities Purchased Under Agreements to Re-sell	AA+	3,063,648	27.3%	1,058,000	9.8%
Investment Portfolio - NZ Government Securities	AA+	2,205,712	19.7%	2,098,051	19.5%
Accrued Interest	Various	50,579	0.5%	61,020	0.6%
Other Local Currency Financial Assets	AA	1,000	0%	-	-
	N/R	265	0%	547	0%
		5,321,282	47.5%	4,412,694	41.0%
Total Financial Assets		11,206,446	100.0%	10,765,937	100.0%

(d) Credit Exposure by Counterparty

The table below shows the number of issuers where the Bank's credit exposures⁴² equalled or exceeded 10% of equity 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 under the real time gross settlement system.

% of equity	End-of-year 1999	End-of-year 1998	Peak end-of-day 1999	Peak end-of-day 1998	Peak local currency intra-day 1999	Peak local currency intra-day 1998
10% to 19.9%	7	6	28	31	21	23
20% to 29.9%	1	5	1	1	1	1
30% to 39.9%	-	1	16	14	1	1
40% to 49.9%	-	-	2	6	10	14
50% to 59.9%	-	-	-	-	-	-
60% to 69.9%	-	-	19	17	-	-
70% to 79.9%	-	-	1	-	-	-
80% to 89.9%	-	-	-	1	-	-
90% to 99.9%	-	-	16	30	-	-
100% to 109.9%	-	-	-	-	-	-
110% to 119.9%	-	-	3	2	-	-
120% to 129.9%	-	-	3	2	-	-
140% to 149.9%	-	-	2	-	-	-
150% to 159.9%	-	-	-	1	-	-
160% to 169.9%	-	-	-	-	-	-
	-	-	9	9	-	-
200% to 209.9%	-	-	-	-	-	-
240% to 249.9%	-	-	1	-	-	-
310% to 319.9%	-	1	-	-	-	-
320% to 329.9%	-	-	-	-	-	-
350% to 359.9%	1	-	-	-	-	-
420% to 429.9%	-	1	-	-	-	-
430% to 439.9%	1	-	-	-	-	-
490% to 499.9%	1	-	2	2	-	-
510% to 519.9%	-	1	-	-	-	-
590% to 599.9%	-	-	-	1	-	-
610% to 619.9%	-	-	1	-	-	-
740% to 749.9%	-	-	1	-	-	-
770% to 779.9%	-	-	-	1	-	-

Peak-end-of-day exposures greater than 100% are to foreign banks, supranational financial institutions and sovereign issuers. End-of-year exposures greater than 100% are to highly-rated sovereign issuers.

⁴² Excludes exposures to the New Zealand government.

15. Foreign Currency Risk

Foreign currency risk is the risk of loss arising from changes in exchange rates. The Reserve Bank is not exposed to any significant foreign currency risk. The assets held in foreign currency portfolios are matched by foreign currency liabilities of approximately equal value. All foreign exchange trading exposures are constrained by low intra-day and overnight position limits and stop-loss limits (monitored on a daily basis). Foreign currency assets and liabilities arising from domestic monetary policy implementation activity are fully hedged using foreign currency swaps.

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

	Currency of Denomination				Total All Currencies \$000
	United States Dollar \$000	Euro \$000	Japanese Yen \$000	Other Currencies \$000	
<i>As at 30 June 1999</i>					
Foreign Currency Financial Assets					
Cash Balances with Other Central Banks	363,734	357	16,794	233	381,118
Marketable Securities	1,482,458	889,345	1,167,923	-	3,539,726
Short-Term Advances	-	-	-	-	-
Receivable from Unsettled Sales of Securities	-	41,435	-	-	41,435
Securities Purchased Under Agreements to Re-sell	829,965	721,385	308,895	-	1,860,245
Accrued Interest	24,927	26,656	11,057	-	62,640
International Monetary Fund Special Drawing Rights	-	-	-	-	-
Total Foreign Currency Financial Assets	2,701,084	1,679,178	1,504,669	233	5,885,164
Foreign Currency Financial Liabilities					
Short-Term Deposits	-	-	-	-	-
Payable for Unsettled Purchases of Securities	-	283,221	-	-	283,221
Securities Sold Under Agreements to Repurchase	754,830	204,127	231,643	-	1,190,600
Term Liabilities	1,903,804	1,154,599	1,254,639	-	4,313,042
Accrued Interest	39,231	35,831	16,887	-	91,949
International Monetary Fund Special Drawing Rights	-	-	-	-	-
Total Foreign Currency Financial Liabilities	2,697,865	1,677,778	1,503,169	-	5,878,812
Off Balance Sheet Instruments	-	-	-	-	-
Net Currency Exposure	3,219	1,400	1,500	233	6,352

	Currency of Denomination				Total All Currencies \$000
	United States Dollar \$000	Euro \$000	Japanese Yen \$000	Other Currencies \$000	
<i>As at 30 June 1998⁴³</i>					
Foreign Currency Financial Assets					
Cash Balances with Other Central Banks	247,670	1,882	54	907	250,513
Marketable Securities	1,895,800	1,464,051	1,059,474	-	4,419,325
Short-Term Advances	2,698	-	(2,135)	84,215	84,778
Receivable from Unsettled Sales of Securities	-	-	93,031	-	93,031
Securities Purchased Under Agreements to Re-sell	910,030	140,313	381,471	-	1,431,814
Accrued Interest	29,643	32,380	9,374	213	71,610
International Monetary Fund Special Drawing Rights	950	403	315	504	2,172
Total Foreign Currency Financial Assets	3,086,791	1,639,029	1,541,584	85,839	6,353,243
Foreign Currency Financial Liabilities					
Short-Term Deposits	-	-	30,509	-	30,509
Payable for Unsettled Purchases of Securities	-	-	22,082	-	22,082
Securities Sold Under Agreements to Repurchase	791,849	31,366	390,451	-	1,213,666
Term Liabilities	1,968,773	1,492,365	1,140,848	-	4,601,986
Accrued Interest	52,380	46,139	15,388	609	114,516
International Monetary Fund Special Drawing Rights	160,486	68,031	53,310	85,243	367,070
Total Foreign Currency Financial Liabilities	2,973,488	1,637,901	1,652,588	85,852	6,349,829
Off Balance Sheet Instruments	(110,805)	-	110,805	-	-
Net Currency Exposure	2,498	1,128	(199)	(13)	3,414

16. Liquidity Risk

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

Foreign Currency Activities

Liquidity is a key criterion in determining the composition of the 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 on a daily basis.

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

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

Local Currency Activities

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

⁴³ SDRs have been disaggregated into their composite currencies for net currency exposure, see note 1(c) (ii).

Consolidated Statement of Financial Performance Notes

17. Income from Financial Assets

	1999 \$000	1998 \$000
Income from Foreign Currency Assets		
Interest Income:		
Cash Balances with Other Central Banks	11,811	9,725
Marketable Securities	154,760	191,828
Short-Term Advances	2,130	7,726
Securities Purchased Under Agreements to Re-sell	19,862	11,517
Securities Lending	737	796
International Monetary Fund	8,783	8,252
Total Interest Income	198,083	229,844
Unrealised Price Revaluations	(26,045)	51,555
Realised Gains from Price Changes	34,598	54,726
Gains from Foreign Exchange Trading	191	132
Other Income	(4,202)	139
Total Income from Foreign Currency Assets	202,625	336,396
Income from Local Currency Assets		
Interest Income:		
Securities Purchased Under Agreements to Re-sell	42,544	34,924
Advances to Government	44,837	99,346
Investment Portfolio - NZ Government Securities	164,079	161,097
Government Bank Accounts	1,027	851
Advances to Staff	24	55
Term Loans	5	10
Other Securities	46	171
Total Interest Income	252,562	296,454
Gain from Liquidity Management Swaps	697	1,136
Gain from Market Test Activities	25	6
Total Income from Local Currency Assets	253,284	297,596
Total Income from Financial Assets	455,909	633,992

18. Expenses on Financial Liabilities

	1999 \$000	1998 \$000
Expenses on Foreign Currency Liabilities		
Interest Expense:		
Securities Sold Under Agreements to Repurchase	11,132	10,744
Term Liabilities	178,205	225,119
IMF Special Drawing Rights	6,672	14,103
Total Interest Expense	196,009	249,966
Unrealised Price Revaluations	3,238	48,858
Realised (Gain) Loss from Price Changes	(10,206)	33,213
Other Expenses	375	384
Total Expenses on Foreign Currency Liabilities	189,416	332,421
Expenses on Local Currency Liabilities		
Interest Expense:		
Government Deposits	33,326	26,212
Other Deposits	1,950	938
Reserve Bank Bills	44,202	98,085
Total Expenses on Local Currency Liabilities	79,478	125,235
Total Expenses on Financial Liabilities	268,894	457,656

19. Net Foreign Exchange Revaluation Gain (Loss)

	1999 \$000	1998 \$000
Foreign Exchange Revaluations:		
Gain (Loss) on Financial Assets	26,746	1,046,179
Gain (Loss) on Financial Liabilities	(27,647)	(1,035,144)
Net Foreign Exchange Revaluation Gain (Loss)	(901)	11,035

20. Other Income

	Actual 1999 \$000	Budget 1999 \$000	Actual 1998 \$000
Fees for Registry Services	6,225	6,114	6,084
Sales of Commemorative Currency	1,539	1,458	1,380
Rental Income from Properties	1,731	1,699	1,810
Registered Bank Fees	5	8	3
Currency Distribution Income	499	488	491
Overseas Investment Commission Fees	763	824	581
Miscellaneous	955	834	334
Total Other Income	11,717	11,425	10,683

21. Asset Management Expenses

Asset Management Expenses include depreciation charged against assets of \$3,372,000 (1998 \$3,144,000).

The following depreciation methods and/or rates have changed from those used in 1998:

	1999 Method	Rate	1998 Method	Rate
Computer Hardware	Straight Line	4 years	Diminishing Value	50%
Computer Software	Straight Line	5 years	Straight Line	3 years
Plant and Equipment	Straight Line	5 years	Diminishing Value	30%
Motor Vehicles	Diminishing Value	26%	Diminishing Value	30%

The Bank considers the new depreciation methods result in a more appropriate allocation of depreciation expenses.

Using the previous methods/rates, the Bank's depreciation expense would have been approximately \$4,528,000 for the 1999 year.

22. Other Operating Expenses

	Actual 1999 \$000	Budget 1999 \$000	Actual 1998 \$000
Other Professional Fees	1,722	1,897	1,976
Computer Expenses	1,732	1,636	1,461
Information	940	878	841
Operational Travel	667	632	549
Rental	254	229	251
Printing	306	251	214
Agency and Commissions	293	434	243
Audit Fees	235	232	214
Non-Executive Directors' Remuneration	100	88	88
Miscellaneous	609	391	303
Total Other Operating Expenses	6,858	6,668	6,140

Other Operating Expenses include \$117,000 (1998 \$155,000) paid to the Bank's auditors for work undertaken outside their capacity as auditors of the Bank.

Other Notes

23. Currency Operations

The Reserve Bank owns properties in Auckland and Wellington. The Bank's buildings are primarily designed for secure currency operations, so their operating costs are reported as part of the Currency Operations function.

The buildings also provide office accommodation for other Bank functions. These functions pay market rentals via internal costing systems. Surplus office space is rented to other parties on market terms.

As part of the Currency Operations function, the Bank issues commemorative currency. The net loss for this activity in 1999 was \$44,000 (1998 \$359,000 profit). The 1999 result includes redundancy expenses of \$305,000 arising from providing for restructuring Collectors' Currency Operations during the next financial year (see note 8).

Packaging and handling fees are charged to banks for the provision of currency distribution services.

	1999 \$000	1998 \$000
Seigniorage	141,705	142,731
Commemorative Currency Sales	1,538	1,380
Rental Income from Properties	1,731	1,810
Packaging and Handling Fees	499	491
Other Income	44	32
Operating Income	145,517	146,444
New Note Issue Expenses	6,180	2,179
New Coin Issue Expenses	1,410	1,409
Commemorative Currency Issue Expenses	733	626
Total Currency Issue Expenses	8,323	4,214
Currency Processing Expenses	11,605	10,217
Net Property Management Expenses (Income)	(292)	(440)
Operating Expenses	19,636	13,991

24. Reconciliation of Operating Cash Flows with Reported Operating Surplus

	1999: \$000	1998 \$000
Reported Operating Surplus	152,971	160,304
Add (Subtract) Non-Cash Items:		
Depreciation	3,372	3,144
Capital Accretion	1,557	19,675
Revaluations	29,283	46,675
Net Change in Foreign Currency Balance ⁴⁴	(117,280)	223,129
	(83,068)	292,623
Add (Subtract) Movements in Other Working Capital Items:		
Increase in Accounts Receivable	(228)	1,351
increase in Accounts Payable	8,499	(3,389)
Increase in Inventories	(792)	(880)
Decrease in Interest Payable	(22,503)	52,162
Decrease in Interest Receivable	19,411	(23,137)
Decrease in Deferred Taxation	16	-
	4,403	26,107
Add (Subtract) Investing and Financing Activities:		
Realised (Gains) Losses	72,946	(302,472)
Net Cash Flow from Operating Activities	147,252	176,562

25. Consolidated Cash Balances

	1999: \$000	1998 \$000
Foreign Currency Assets:		
Cash Balances with Other Central Banks	381,118	250,513
Marketable Securities – Liquifiable Within Two Working Days	3,215,883	3,212,923
Local Currency Assets:		
Cash on Hand	78	94
Securities Purchased Under Agreements to Re-sell	3,063,648	1,058,000
	6,660,727	4,521,530
Demand Liabilities:		
Government Deposits	2,880,976	956,473
Settlement Bank Deposits	1,141	1,652
Central Bank Deposits	2,030	2,564
Staff Deposits	4,818	7,660
International Monetary Fund Deposit	37,180	4,272
	2,926,145	972,621
Closing Cash Balances	3,734,582	3,548,909

⁴⁴ The net change in the foreign currency balance represents the unrealised effect of exchange rate movements on the Bank's foreign currency assets and liabilities. The net effect of the Bank's overall results, after allowing for realised exchange rate gains and losses, is a net loss of \$901,000 (1998 \$11,035,000 gain).

26. Statement of Commitments

The Reserve Bank's commitments in relation to outstanding forward foreign exchange contracts at balance date were as follows:

	Foreign Exchange Transactions	
	1999: \$000	1998 \$000
The Bank will receive	-	110,805
The Bank will pay	-	110,805

The Bank leases office and storage space in Christchurch, and is committed to pay an annual rental of \$232,595 until 30 June 2000.

27. 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 services such as 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 Reserve Bank receives some free services from other organisations. In general these relate to the provision of information necessary to perform the Bank's functions.

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

28. Related Parties

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

Transactions entered into include:

- (a) banking services;
- (b) short-term advances;
- (c) agency transactions (at no charge);
- (d) foreign exchange transactions; and
- (e) funding from the Treasury as part of the foreign reserves management operations.

The Bank does not present 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 is not expected to provide useful or material additional information.

29. Contingent Liabilities

- (a) In terms of a Trust Deed dated 16 May 1980, the Reserve Bank has a contingent liability to maintain the actuarial soundness of the Reserve Bank of New Zealand Staff Superannuation and Provident Fund, following each triennial review of the Fund.

On 2 February 1995 the Bank ceased making contributions to the defined benefit division of the Fund on the advice of the Fund's Actuary that such contributions were no longer necessary. The position is re-examined as part of each triennial review.

The Actuary investigated the financial position of the Fund as at 31 March 1999 and reported on 22 July 1999 that, based on the Fund's annual accounts:

- (i) the assets of the Fund would have been sufficient at 31 March 1999 to provide for the benefits payable to or in respect of all members, including existing pensioners, in the event of the Fund being wound up at that time;
 - (ii) the assets of the Fund would have been sufficient at 31 March 1999 to provide for benefits to members, including existing pensioners, that are attributable to membership prior to 1 April 1999; and
 - (iii) to their knowledge, there have been no circumstances between 31 March 1999 and 30 June 1999 that would cause them to form a different opinion as at 30 June 1999.
- (b) Coin issued by the Treasury prior to July 1989 is not recorded by the Reserve 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 Reserve Bank, the liability for the excess would revert to the Treasury. The face value of coin issued by the Treasury is \$87,702,000.
- (c) The Bank has a contingent liability for currency in circulation that has been demonetised but not returned to the Bank.
- (d) The Bank has a liability for the face value of commemorative currency. However, it is most unlikely that significant amounts of commemorative currency will be returned for redemption at face value. The face value of all commemorative currency issued by the Bank to date is \$7,399,000 (1998 \$6,799,000).

Commemorative 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 commemorative coin, but part of this liability could revert to the Treasury should large quantities of coin be returned.

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

Previous Year's Contingent Liabilities

The above five contingent liabilities were recorded in the Reserve Bank's 1998 Annual Report. The only liabilities to arise during the year were:

- (i) demonetised currency with a face value of \$77,918 was returned to the Bank for redemption at face value; and
- (ii) commemorative currency with a face value of \$6,629 was returned to the Bank for redemption at face value.

RBNZ Registry Limited Notes

30. RBNZ Registry Limited

The Reserve Bank operates registry services through a wholly-owned subsidiary company, RBNZ Registry Limited. The Bank provides various support services to RBNZ Registry Limited and charges for these services at their cost to the Bank.

(a) RBNZ Registry Limited Statement of Financial Position

<i>As at 30 June</i>	1999 \$000	1998 \$000
Assets:		
Current Assets:		
Bank Accounts	9,939	9,130
Accounts Receivable	1,368	1,288
Prepayments	49	19
Deferred Taxation	60	76
Fixed Assets	586	752
Total Assets	12,002	11,265
Liabilities		
Current Liabilities:		
Accounts Payable	874	813
Funds held in Trust for Stockholders	638	225
Withholding Tax	4,396	1,561
Funds Received in Advance from Issuers	151	872
Funds Due to the Treasury	514	1,718
Fees Received in Advance	231	194
Goods and Services Tax Payable	24	15
Provision for Dividend	2,000	2,000
Equity:		
Issued Capital	3,000	3,000
Retained Earnings	174	867
Total Liabilities and Equity	12,002	11,265

(b) RBNZ Registry Limited Statement of Financial Performance

For the year ended 30 June	1999 \$000	1998 \$000
Operating Income:		
Fees for Registry Services	6,424	6,171
Interest	544	889
Foreign Exchange Gain	2	18
Other Income	205	125
Total Operating Income	7,175	7,203
Operating Expenses:		
Personnel	2,132	1,881
Administration	1,272	1,253
Computer Expenses	985	910
Asset Management	312	400
Depreciation	341	350
Audit Fees	30	25
Other ⁴⁵	151	114
Total Operating Expenses	5,223	4,933
Net Operating Profit Before Tax	1,952	2,270
Taxation	645	750
Net Profit After Tax	1,307	1,520

⁴⁵ Other expenses include \$35,000 (1998 \$74,000) paid to RBNZ Registry Limited's auditors for work undertaken outside their capacity as auditors.

(c) **RBNZ Registry Limited Statement of Movements in Equity**

<i>For the year ended 30 June</i>	1999	1998
	\$000	\$000
Equity at Start of Year	3,867	4,347
Net Surplus for the Year	1,307	1,520
Less Dividend provided for	2,000	2,000
Equity at End of Year	3,174	3,867

31. Taxation

Section 180 of the Reserve Bank of New Zealand Act 1989 exempts the Reserve Bank from income tax. The Bank incurs and meets liabilities for goods and services tax and fringe benefit tax.

The Bank's subsidiary company, RBNZ Registry Limited, is liable for income tax. The table below relates only to RBNZ Registry Limited.

<i>For the year ended 30 June</i>	1999: \$000	1998 \$000
Income Tax Expense:		
Net Profit Before Tax	1,952	2,270
Add Back Permanent Difference	3	2
	1,955	2,272
Income Tax Expense at 33%	645	750
Current Tax Charge:		
Tax Effect of Timing Differences	(15)	(7)
Current Tax Charge	630	743
Deferred Taxation:		
Opening Balance	(76)	(93)
Deferred Portion of Current Tax Charge	16	6
1997/98 IRD Tax Assessment Adjustment	-	11
Deferred Taxation Liability (Asset)	(60)	(76)

32. Custodial Activities

The Reserve Bank of New Zealand 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 Reserve Bank of New Zealand, which in terms of a Deed of Appointment between the Reserve Bank of New Zealand and NZCSD dated 19 May 1995 is incorporated solely for the purpose of acting as a custodian trustee. With the exception of the local currency securities owned by the Bank and held through NZCSD, the Reserve Bank has no beneficial interest in the securities which it holds, or any management obligations apart from safe keeping.

The total of securities held by NZCSD at 30 June 1999 was \$83.0 billion (1998 \$84.2 billion).