



RESERVE BANK
OF AUSTRALIA

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OF AUSTRALIA
ANNUAL REPORT

2014

Reserve Bank

RESERVE BANK OF AUSTRALIA



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G.R. Stevens
GOVERNOR

12 September 2014

The Hon Joe Hockey MP
Treasurer
Parliament House
CANBERRA ACT 2600

Dear Treasurer

RESERVE BANK ANNUAL REPORT 2014

In accordance with section 9 of the *Commonwealth Authorities and Companies Act 1997* (CAC Act), I am pleased to submit the Reserve Bank's Annual Report for 2014 for presentation to the Parliament. The annual report has been prepared in accordance with Part 1 of Schedule 1 of the CAC Act.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'G.R. Stevens'.

Reserve Bank of Australia

ANNUAL REPORT 2014

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Reserve Bank

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Some graphs in this report were generated using Mathematica.

ISSN 1448-5303 (Print)
ISSN 1448-5192 (Online)

Governor's Foreword

The year 2013/14 was one of relative stability in terms of monetary policy. The Reserve Bank Board changed the cash rate only once (in August 2013), the lowest number of changes for eight years. With interest rates at a five-decade low, the Board judged monetary policy to be appropriately configured to support demand, consistent with the inflation target, as investment in the mining sector turned down from unprecedentedly high levels.

A stable cash rate did not prevent financing conditions in the economy from easing a little. As intermediaries have faced easier conditions in wholesale funding and securitisation markets, competition to lend has increased and interest rates faced by savers and borrowers have declined slightly relative to the cash rate.

These trends have resulted mainly from the very benign funding conditions in global capital markets. Yields on long-dated sovereign debt in major countries are as low as, or lower than, they were a year ago, even though economic growth in the advanced economies has generally improved somewhat over that period. Credit spreads are approaching the lows seen up to 2007. Most borrowers of standing can access credit cheaply. Countries in 'peripheral' Europe that faced exploding borrowing costs two years ago are once again accessing markets at remarkably low yields. Volatility in financial prices has likewise fallen to very low levels. At the time of writing, financial markets seem to attribute a very low probability to any rise in global interest rates that might be prompted by, for example, stronger growth or higher inflation.

Put another way, for asset managers the 'search for yield' continues to be challenging. Many investors have moved out along the risk spectrum, driven by the desire to produce an income for their clients – hence the compression in spreads. Those asset holders are receiving virtually no compensation for credit, liquidity or interest rate risks.

The very low yields around the world also mean that the Reserve Bank's earnings, which are derived from holdings of obligations of the most creditworthy governments, continue to be historically low. 'Underlying' earnings, which are essentially net interest earnings less the Bank's operating costs, declined to \$442 million in 2013/14, from around \$700 million in the previous two years. But the biggest effects on the Bank's balance sheet and earnings over the past year stem from some major decisions taken in Australia, and two in particular.

First, the Reserve Bank's capital has been strengthened. Though it had begun to be replenished after absorbing the large losses from the earlier rise in the exchange rate of the Australian dollar, the Bank's capital was still at the inappropriately low level of \$2.4 billion (3.6 per cent of assets at risk) at the start of the year in review. This has been explained in previous annual reports and the Bank faced the likelihood of a long process of rebuilding capital, given the low interest earnings on its assets. The Australian Government's decision in October 2013 to make a one-time grant to the Bank of \$8.8 billion means that the rebuilding process has been effected in one step. The grant was received in May 2014 and it is treated as revenue and recognised in the Bank's profit and earnings available for distribution for the 2013/14 financial year. The final step was for the Treasurer to determine

that this sum was to be transferred from profit to the Reserve Bank Reserve Fund (RBRF), which means it became available to absorb future losses. As a result, as at 30 June 2014 the RBRF was equivalent to 15.7 per cent of assets at risk, a most satisfactory position.

Second, the achievement of an important milestone in lessening risk in the settlements process has had implications for the Reserve Bank's own operations. As agreed with industry and consistent with objectives set by the Payments System Board, certain payments that had been settled on a 'next-day' basis are now settled on a 'same-day' basis, including some in the evening after the cash market has closed. As a result, there is a greater demand for settlement balances by banks. The Bank has accommodated this demand with the introduction of 'open repos', as described in the chapter on 'Operations in Financial Markets'. This involves a substantial rise in the Reserve Bank's balance sheet and additional dealing on some days, but with no additional cost to industry and no material increase in the Bank's risk profile.

As identified in previous annual reports, the Reserve Bank has a number of projects under way, including introduction of the Next Generation Banknote series, an overhaul of RBA banking systems, introduction of the Committed Liquidity Facility and development of the New Payments Platform. These projects are materially increasing the Reserve Bank's costs of operation and especially its capital spending. They require additional resources in the Bank's Information Technology Department, in project management and in some other specialised skills in order to deliver the necessary outcomes in a timely way, with due management of the associated risks. The Bank also upgraded its compliance function, to keep pace with modern practice.

These imperatives were reflected in a further rise in staff numbers, of about 8 per cent in 2013/14. Most of the additional staffing was in the Information Technology Department, as well as in project management and compliance roles. The staffing complement of the Reserve Bank's 'charter' areas was little changed. Project-related operating costs also contributed substantially to the rise in general operating costs of 10.7 per cent in 2013/14. A smaller, though still significant, rise is expected in 2014/15.

The projects in progress involve substantial expenditure, but are, in the Reserve Bank's view, in the public interest. They have to be completed if the Bank is to meet its 'charter' obligations to issue secure banknotes, offer modern, reliable banking systems for its customers, perform its proper role in liquidity provision and support the private sector's initiatives towards offering faster payments.

At the same time, the Reserve Bank has achieved worthwhile savings in administrative and travel costs, with savings in procurement expenses likely over the next couple of years.

One source of greater efficiency has been the decision to outsource much of the administration of the Officers' Superannuation Fund (OSF) to an external provider. The Bank also took the decision to close the defined benefit component of the OSF to new staff, effective 1 August 2014, in line with community standards for pension benefits. That benefit for existing staff remains fully funded on an actuarial basis. The Bank now provides a defined contribution superannuation benefit to new staff.

The Reserve Bank's international engagement continued to increase, with a particular focus on support for the Australian presidency of the G20 in 2014.

Also worth noting this year is that the Reserve Bank contributed to the Financial System Inquiry, via a detailed and substantive submission and staff secondments. The demand for submissions to various parliamentary inquiries continued to expand. These demands were largely met with existing resources.

The staff and management of the Reserve Bank have met all the demands of their roles with their usual calm professionalism and exemplary standards of quality. Once again, the Board joins me in thanking them sincerely for their contribution to the welfare of the Australian people.

A handwritten signature in blue ink, appearing to read 'Glenn Stevens', written in a cursive style.

Glenn Stevens
Governor and Chair, Reserve Bank Board
21 August 2014

Functions and Objectives

The Reserve Bank of Australia is established by statute as Australia's central bank. Under its enabling legislation, the *Reserve Bank Act 1959*, the Bank's responsibilities include determining and implementing monetary policy, promoting financial stability, issuing banknotes, providing banking services to government, managing Australia's foreign reserves, setting payments system policy and operating the high-value payments system.

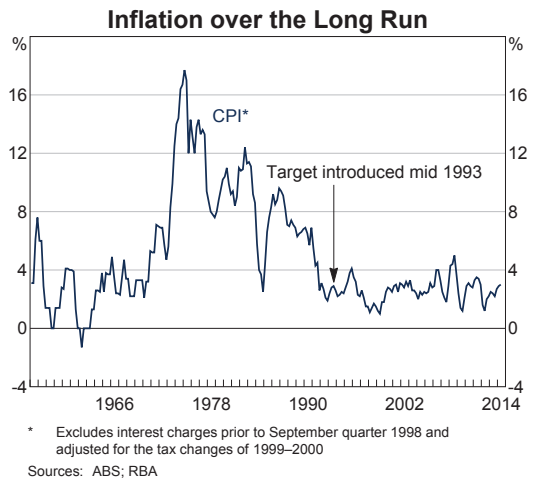
The Reserve Bank's responsibility for monetary policy is set out in section 10(2) of the Reserve Bank Act, which states:

It is the duty of the Reserve Bank Board, within the limits of its powers, to ensure that the monetary and banking policy of the Bank is directed to the greatest advantage of the people of Australia and that the powers of the Bank ... are exercised in such a manner as, in the opinion of the Reserve Bank Board, will best contribute to:

- (a) the stability of the currency of Australia;
- (b) the maintenance of full employment in Australia; and
- (c) the economic prosperity and welfare of the people of Australia.

Policies in pursuit of these objectives have found practical expression in a flexible, medium-term inflation target, which has formed the basis of Australia's monetary policy framework since the early 1990s. The policy objective is to keep consumer price inflation between 2 and 3 per cent, on average, over the business cycle. Monetary policy aims to achieve this over the medium term as a crucial precondition for the promotion of sustainable economic growth and employment. The sixth *Statement on the Conduct of Monetary Policy*, signed by the Treasurer and the Governor in October 2013, following the election of the Coalition Government, records the common understanding of the government and the Reserve Bank on key aspects of the monetary policy framework.

The Reserve Bank conducts operations in financial markets, operates Australia's main high-value payments system and undertakes analysis of markets and institutional developments. It also participates in discussions with government and other domestic regulators about regulatory design initiatives, largely through the Council of Financial Regulators (CFR). The CFR is chaired by the Governor and brings together the Bank, the Australian Prudential Regulation Authority, the Australian Securities and Investments Commission and the Australian Treasury so as to contribute to the efficiency and effectiveness of regulation and the stability of the financial system.



Under the *Corporations Act 2001*, the Reserve Bank, overseen by the Payments System Board, has responsibility for determining financial stability standards for licensed clearing and settlement facilities and assessing facilities' compliance with those standards. The Corporations Act also establishes a regime for the regulation of over-the-counter derivatives markets, which includes an advisory role for the Bank on a range of matters.

These diverse roles assist the Reserve Bank in promoting the overall stability of the financial system. The Bank does not have responsibility for the prudential supervision of financial institutions, but in the event of a financial system disturbance, the Bank and relevant agencies would work to mitigate the risk of systemic consequences.

The Reserve Bank also:

- designs, produces and issues Australia's banknotes, with the objective of ensuring public confidence in banknotes as an effective payment mechanism and a secure store of wealth
- provides specialised banking services to government and foreign official institutions, including payments and collections as well as general account maintenance and reporting
- holds and manages Australia's foreign currency reserves, and operates in the foreign exchange market to meet the foreign exchange needs of its clients and to assist with domestic liquidity management.

The Reserve Bank has responsibility for ensuring the stability, efficiency and competitiveness of the payments system through the Payments System Board, which was established in 1998. The Bank's powers in relation to the payments system are set out in a number of other statutes, including the *Payment Systems (Regulation) Act 1998* and the Corporations Act.

Governance

The activities undertaken by the Reserve Bank in fulfilment of its responsibilities are overseen by two boards and several board and management committees.

Reserve Bank Board

The Reserve Bank Board has responsibility for monetary and banking policy and the Reserve Bank's policy on all other matters except payments system policy, as well as a range of other statutory obligations. The Board comprises the Governor (Chair), Deputy Governor (Deputy Chair), Secretary to the Treasury and six external members appointed by the Treasurer, a total of nine members. Details of their qualifications and experience are provided on pages 11–15.

The Board meets 11 times a year, on the first Tuesday of each month except in January. Five members form a quorum. Members of the Board and their attendance at meetings during 2013/14 are shown in the table opposite.

Most meetings are held at the Head Office in Sydney. Twice each calendar year, Board meetings are held in

Reserve Bank offices in other Australian cities, once in Melbourne and once in another location. In 2013/14, the Board met in Brisbane in July 2013 and Melbourne in April 2014.

The Board has an Audit Committee and a Remuneration Committee. The Board reviewed the charters of both committees in 2013/14 and endorsed changes to each, mostly to streamline their key elements and to ensure their consistency with statutory requirements and industry best practice.

Payments System Board

The responsibilities of the Payments System Board are set out in the *Reserve Bank Act 1959*. In particular, the Act requires the Board to ensure, within the limits of its powers, that the Reserve Bank's payments system policy is directed to the greatest advantage of the people of Australia and that its related powers are exercised in such a way that, in the Board's opinion, will best contribute to:

- controlling risk in the financial system
- promoting the efficiency of the payments system

Board Meetings in 2013/14 – Attendance by Members Number of meetings

	Attended	Eligible to attend
Glenn Stevens (Governor)	11	11
Philip Lowe (Deputy Governor)	11	11
Martin Parkinson (Secretary to the Treasury)	11	11
John Akehurst	10	11
Roger Corbett	11	11
John Edwards	11	11
Kathryn Fagg	11	11
Heather Ridout	11	11
Catherine Tanna	11	11

- promoting competition in the market for payment services, consistent with the overall stability of the financial system.

The Payments System Board also has responsibility to ensure that the powers and functions of the Bank under Part 7.3 of the *Corporations Act 2001* (dealing with licensing of clearing and settlement facilities) are exercised in a way that will best contribute to the overall stability of the financial system.

The Payments System Board is distinct from the Reserve Bank Board and issues a separate annual report.

Conduct of Reserve Bank Board Members

On appointment to the Reserve Bank Board, each member is required under the Reserve Bank Act to sign a declaration to maintain confidentiality in relation to the affairs of the Board and the Reserve Bank. Further, members must comply with the general obligations of directors of Commonwealth authorities, including, until 30 June 2014, those set out in the *Commonwealth Authorities and Companies Act 1997* (CAC Act). Under the CAC Act members were required to:

- discharge their duties with care and diligence
- act in good faith in the best interests of the Reserve Bank, and for a proper purpose
- not use their position to benefit themselves or any other person, or to cause detriment to the Reserve Bank or any other person
- not use any information obtained by virtue of their position to benefit themselves or any other person, or to cause detriment to the Reserve Bank or any other person
- declare any material personal interest in a matter that relates to the affairs of the Reserve Bank.

From 1 July 2014, members must comply with very similar obligations under the *Public Governance, Performance and Accountability Act 2013* (PGPA Act).¹

Over and above these statutory requirements, members recognise their responsibility for maintaining a reputation for integrity and propriety on the part of the Board and the Reserve Bank in all respects. Members have therefore adopted a Code of Conduct that provides a number of general principles as a guide for their conduct in fulfilling their duties and responsibilities as members of the Board; a copy of the Code is on the Bank's website.

Audit Committee

The primary objective of the Audit Committee of the Reserve Bank Board is to assist the Board in fulfilling its obligations under the Reserve Bank Act and, until 30 June 2014, the CAC Act. In particular, the Committee assists the Board in relation to:

- preparing the annual report, including a report of operations and the financial statements
- the Bank's internal control environment
- the operational and financial risks inherent in the Bank's activities.

The above requirements of the Audit Committee under the CAC Act until 30 June 2014 have been slightly modified under the PGPA Act.

¹ Further details in relation to the PGPA Act are provided in the chapter on 'Statutory Reporting Obligations'.

John Akehurst, a member of the Reserve Bank Board, chairs the Audit Committee. Other members of the Committee are Roger Corbett AO, a member of the Reserve Bank Board, and Michael Coleman and Terry Williamson, both of whom are company directors and former senior audit partners of major accounting firms who have extensive experience in the finance sector. Consistent with contemporary governance standards, no executive is a member of the Audit Committee. The Deputy Governor attends meetings of the Committee as the chief management representative.

During 2013/14, the Audit Committee met on four occasions. At its July 2014 meeting, the Committee considered the draft consolidated financial statements for the Reserve Bank for the year ended 30 June 2014 and agreed that the statements be presented to the Reserve Bank Board with its endorsement. The Committee meets at least annually with the external auditors without management present; in 2014 this occurred immediately following the July 2014 meeting.

Audit Committee Meetings in 2013/14 – Attendance by Members
Number of meetings

	Attended	Eligible to attend
John Akehurst	3	4
Michael Coleman	4	4
Roger Corbett	4	4
Terry Williamson	4	4

Remuneration Committee

The Remuneration Committee of the Reserve Bank Board is established in terms of section 24A of the Reserve Bank Act to recommend to the Board ‘terms and conditions relating to the remuneration and allowances’ for the Governor and Deputy Governor. Membership of the Committee is drawn from the non-executive members of the Board and comprises Roger Corbett AO (Chair), John Edwards and Catherine Tanna. During 2013/14, the Committee met on six occasions.

Remuneration Committee Meetings in 2013/14 – Attendance by Members
Number of meetings

	Attended	Eligible to attend
Roger Corbett	6	6
John Edwards	6	6
Catherine Tanna	6	6

The offices of Governor and Deputy Governor are Principal Executive Offices in terms of the *Remuneration Tribunal Act 1973*, which provides for the Remuneration Tribunal to determine the applicable remuneration reference rate for these offices. The Remuneration Committee reviews the terms and conditions (including remuneration and allowances) applying to the Governor and Deputy Governor annually and recommends adjustments to the Board for approval, providing that such terms and conditions are consistent with the framework for Principal Executive Offices determined by the Remuneration Tribunal. The Remuneration Committee is also kept informed of the general remuneration arrangements for Reserve Bank staff. The Governor attends meetings of the Committee at the invitation of the Chairman to discuss remuneration matters in the Bank, but not those relating to his own remuneration. The Committee communicates with the Remuneration Tribunal as required.

In accordance with section 21A of the Reserve Bank Act, neither the Governor nor the Deputy Governor takes part in decisions of the Board relating to the determination or application of any terms or conditions on which either of them holds office.

Remuneration and Allowances

Remuneration and travel allowances for the non-executive members of the Reserve Bank Board are set by the Remuneration Tribunal. Remuneration of members of the Audit Committee is consistent with relevant determinations of the Remuneration Tribunal. Membership of the Remuneration Committee is not remunerated.

Induction of Board Members

The induction program assists newly appointed Board and Committee members in understanding their role and responsibilities, and provides them with an overview of the Reserve Bank's policy framework and operations. Separate briefing sessions are tailored to meet particular needs or interests.

Executive Committee

The Executive Committee is the key decision-making committee of the Reserve Bank for matters that are administrative or managerial in nature. It is a management committee, whose role is to assist and support the Governor in fulfilling his responsibilities to manage the Bank (in particular under the Reserve Bank Act and, from 1 July 2014, the PGPA Act). The Committee, which is chaired by the Governor and comprises the Bank's most senior executives, meets weekly.

Risk Management Committee

The Reserve Bank's Risk Management Committee has responsibility for ensuring that operational and financial risks are identified, assessed and properly managed across the Bank in accordance with its Risk Management Policy. It is a management committee chaired by the Deputy Governor and comprises senior executives drawn mainly from the operational areas of the Bank. During 2013/14, the Committee met on six occasions and kept the Executive Committee and Reserve Bank Board Audit Committee informed of its activities.

Indemnities for Members of Boards and Senior Staff

During 2013/14, members of the Reserve Bank Board and the Payments System Board continued to be indemnified in accordance with section 27M of the CAC Act against liabilities incurred by reason of their appointment to the relevant Board or by virtue of holding and discharging such office.

Indemnities in accordance with section 27M of the CAC Act provided by the Reserve Bank to other officers of the Bank in relation to liabilities they may incur in the conduct of their duties at the Bank, and to current senior staff and Reserve Bank Board members who, at the request of the Bank, are serving on the Board of Note Printing Australia Limited or formerly served on that board or the Board of Securrency International Pty Ltd (now called Innovia Security Pty Ltd) continue.

As the Reserve Bank does not take out directors' and officers' insurance in relation to its Board members or other officers, no premiums were paid for any such insurance in 2013/14.

Other Policy Matters

The Governor reports annually to the Reserve Bank Board on the process of review and implementation of key Reserve Bank policies, including compliance arrangements. In August 2014, annual reports were also presented to the Board covering the Bank's large procurements, its Anti-Money Laundering and Counter-Terrorism Financing Program and work health and safety matters during 2013/14.

Reserve Bank Board

August 2014



Glenn Stevens

B^{Ec} (Hons) (Sydney), MA (Western)

Governor and Chair

Governor since 18 September 2006

Reappointed from 18 September 2013 until 17 September 2016

Glenn Stevens has held various senior positions at the Reserve Bank, including Head of Economic Analysis and International Departments and Assistant Governor (Economic), where he was responsible for overseeing economic and policy advice to the then Governor and Reserve Bank Board. He was Deputy Governor from 2001 to 2006. In June 2014, Mr Stevens was awarded a Doctor of Laws honoris causa (LLD) by Western University in Ontario, Canada.

Other Roles

Chair – Payments System Board

Chair – Council of Financial Regulators

Chair – Financial Markets Foundation for Children

Member – Financial Stability Board

Director – The Anika Foundation



Philip Lowe

B^{Com} (Hons) (UNSW), PhD (MIT)

Deputy Governor and Deputy Chair

Member since 14 February 2012

Present term ends 13 February 2019

Philip Lowe has held various senior positions at the Reserve Bank, including Assistant Governor (Economic) and Assistant Governor (Financial System). He spent two years at the Bank for International Settlements, where he worked on financial stability issues. Dr Lowe has authored numerous papers, including on the linkages between monetary policy and financial stability.



John Akehurst

MA (Oxon)

Non-Executive Member

Member since 31 August 2007

Present term ends 30 August 2017

John Akehurst has had extensive experience in the oil and gas industry. He held a number of engineering and management positions with Royal Dutch Shell (1976–1996) and as CEO of Woodside Petroleum Ltd (1996–2003). Mr Akehurst is a Fellow of the Institution of Mechanical Engineers.

Directorships

Chairman – National Centre for Asbestos Related Diseases

Chairman – Transform Exploration Pty Ltd

Director – CSL Limited

Director – Origin Energy Limited

Reserve Bank Board Committee membership

Chair – Audit Committee



Roger Corbett AO

BCom (UNSW)

Non-Executive Member

Member since 2 December 2005

Present term ends 1 December 2015

Roger Corbett has had extensive experience in the retailing industry, both within Australia and overseas. He served as the CEO of Woolworths Limited and has held numerous board positions. Mr Corbett is a Fellow of the Australian Institute of Management and the Risk Management Institution of Australasia.

Directorships

Chairman – Fairfax Media Limited

Chairman – Mayne Pharma Group Limited

Director – Wal-Mart Stores Inc

Reserve Bank Board Committee membership

Chair – Remuneration Committee

Member – Audit Committee



John Edwards

BA (Sydney), MPhil, PhD (George Washington)

Non-Executive Member

Member since 31 July 2011

Present term ends 30 July 2016

John Edwards brings a combination of business, academic and professional economic experience to the Board. He was Chief Economist for Australia and New Zealand at HSBC Bank for over a decade prior to taking the appointment of Executive Director of Economic Planning and Development for the Bahrain Economic Development Board (2009–2011).

Other Roles

Adjunct Professor – John Curtin Institute of Public Policy, Curtin Business School, Curtin University

Adjunct Professor – University of Sydney School of Business

Visiting Fellow – Lowy Institute for International Policy

Director – Committee for the Economic Development of Australia

Reserve Bank Board Committee membership

Member – Remuneration Committee



Kathryn Fagg

BE (Hons) (Queensland), MCom (Hons) (UNSW)

Non-Executive Member

Member since 7 May 2013

Present term ends 6 May 2018

Kathryn Fagg has broad and diverse experience across a range of industries, having worked in senior executive roles at Linfox, BlueScope Steel and the ANZ Bank. Earlier, she worked at McKinsey & Co after commencing her career as a petroleum engineer with Esso Australia. She has led businesses in Australia, New Zealand and Asia.

Directorships

Chair – Melbourne Recital Centre

Director – Breast Cancer Network of Australia

Director – Djerriwarrh Investments Limited

Director – Incitec Pivot Limited



Martin Parkinson PSM

BEc (Hons) (Adelaide), **M**Ec (ANU), **M**A, **P**hD (Princeton)

Ex Officio Member

Secretary to the Treasury

Member since 27 April 2011

Martin Parkinson was appointed Secretary to the Treasury in 2011. He was Secretary of the Department of Climate Change from its establishment in December 2007, and between 2001 and 2006 was Deputy Secretary of the Australian Treasury, with responsibility for domestic and international macroeconomic issues. In his Treasury career he has worked on issues including taxation policy, labour market and structural reform, and macroeconomic policy and forecasting.

Other Roles

Chair – Advisory Board of the Australian Office of Financial Management

Member – Council of Financial Regulators

Member – Infrastructure Australia

Member – Prime Minister’s Business Advisory Council



Heather Ridout AO

BEc (Hons) (Sydney)

Non-Executive Member

Member since 14 February 2012

Present term ends 13 February 2017

Heather Ridout has a strong understanding of public policy and of the manufacturing sector, having previously been Chief Executive of the Australian Industry Group. She has had appointments to key national policy-setting and consultative groups, including as a member of the Henry Tax Review panel, board member of Infrastructure Australia, member of the Prime Minister’s Taskforce on Manufacturing and member of the Australian Workforce and Productivity Agency.

Directorships

Chair – AustralianSuper Trustee Board

Director – Australian Securities Exchange Limited

Director – Note Printing Australia Limited

Director – Sims Metal Management Limited



Catherine Tanna

LLB (Queensland)

Non-Executive Member

Member since 30 March 2011

Present term ends 29 March 2016

Catherine Tanna has extensive experience in the resources sector with BG Group, Royal Dutch Shell and BHP Billiton. She has held senior executive roles with responsibility for LNG, gas transmission and power-generation businesses across Africa, North Asia, Russia, North America, Latin America and Australia. From April 2012 to the end of June 2014, Ms Tanna was Chairman of BG Australia.

Executive Role

Managing Director – EnergyAustralia

Reserve Bank Board Committee membership

Member – Remuneration Committee

Accountability and Communication

Relationship with Government

The Reserve Bank is established under federal legislation as a body corporate distinct from the Commonwealth of Australia. The Governor, Deputy Governor and members of the Reserve Bank Board are appointed by the Treasurer. The Board is afforded substantial independence under the *Reserve Bank Act 1959* to determine and implement the monetary and banking policy of the Bank, as will best contribute to the objectives of the Bank set out in the Act. The *Statement on the Conduct of Monetary Policy*, as updated from time to time, has recorded the common understanding of the Governor, as Chair of the Reserve Bank Board, and the government on key aspects of Australia's monetary and central banking policy framework since 1996. The Statement, which seeks to foster a sound understanding of the nature of the relationship between the Reserve Bank and the government, records that the government recognises and continues to respect the Reserve Bank's operational independence.

The Reserve Bank's independence is accompanied by an obligation to inform the government of its monetary and banking policy 'from time to time'. The Reserve Bank Act sets out a clear process for managing differences of opinion between the Board and the government on monetary and banking policy matters. Regular discussions between the Governor and the Treasurer (at the date of signing, The Hon Joe Hockey MP, and earlier in the year in review, The Hon Chris Bowen MP) served to keep the government informed.

Reporting Obligations

For the purposes of the preparation and contents of this Annual Report, the Reserve Bank is a Commonwealth authority and the members of the Reserve Bank Board are the directors of the Bank under the *Commonwealth Authorities and Companies Act 1997* (CAC Act). At its meeting on 5 August 2014, the Board resolved that the Governor sign the annual report and financial statements as at 30 June 2014 and provide them to the Treasurer for presentation to the Parliament, in accordance with the provisions of the CAC Act.

From 1 July 2014, the Reserve Bank became a corporate Commonwealth entity under the *Public Governance, Performance and Accountability Act 2013* (PGPA Act). Under the PGPA Act, the Governor became the 'accountable authority' of the Bank, although the Reserve Bank Board must also approve the Bank's financial statements. Future annual reports will be prepared in terms of provisions of the PGPA Act.

The House of Representatives Standing Committee on Economics has, in its Standing Orders, an obligation to review the Annual Report of the Reserve Bank and the Annual Report of the Payments System Board. The Committee holds twice-yearly public hearings, at which the Bank presents its views on the economy and financial markets and other matters pertaining to the Bank's operations, and responds to questions from Committee members. In 2013/14, the Governor and senior Bank officers attended Committee hearings for this purpose in Canberra in December 2013 and in Sydney in March 2014. The Committee issued a report on 3 March 2014, *Review of the Reserve Bank Annual Report 2013 (First Report)*, which covered the December 2013



Assistant Governor (Economic) Christopher Kent, Governor Glenn Stevens and Deputy Governor Philip Lowe at a hearing of the House of Representatives Economics Committee in March 2014

hearing, and a report on 16 June 2014, *Review of the Reserve Bank Annual Report 2013 (Second Report)*, which covered the March 2014 hearing.

The regular twice-yearly appearances before the House of Representatives Standing Committee on Economics and the quarterly *Statement on Monetary Policy* (see below) are important elements of the arrangements embodied in the understandings between the Governor and the Treasurer (outlined in the sixth *Statement on the Conduct of Monetary Policy*, which was issued in October 2013).

In addition to these appearances, the Reserve Bank made four public written submissions to Parliamentary inquiries during the year:

- in February 2014, to the inquiry by the Senate Economics Legislation Committee into the Reserve Bank Amendment (Australian Reconstruction and Development Board) Bill 2013
- in February 2014, to the inquiry by the Senate Economics References Committee into affordable housing
- in March 2014, to the inquiry by the Joint Committee of Public Accounts and Audit into *Public Governance, Performance and Accountability Act 2013* rules development. Following completion of the inquiry, the Joint Committee's report was tabled on 13 May 2014
- in May 2014, to the inquiry by the House of Representatives Standing Committee on Economics into foreign investment in residential real estate. In June 2014, senior officers appeared at a hearing of this inquiry in Sydney.

Communication

The Reserve Bank seeks to ensure a high degree of transparency about its activities, goals, decision-making processes and the basis of its policy decisions. Transparency facilitates the Bank's accountability and aligns with its operational independence. Importantly, it also increases the effectiveness of policy decisions by promoting a better understanding of those decisions in the wider community.

In addition to the regular announcements about the monetary policy decisions of the Reserve Bank Board, the Bank has an active communication program.

Publications

The quarterly *Statement on Monetary Policy* provides information to the general public, financial markets and media about the Reserve Bank's views on monetary policy and developments in financial markets. It also provides a basis for the Parliamentary Committee's questioning of the Bank. The *Statement* contains a detailed analysis of conditions in the economy and financial markets and describes the outlook for inflation and the economy more generally.

The *Financial Stability Review*, published each March and September, provides a detailed assessment of the condition of Australia's financial system, along with analysis of financial system issues of special interest. During the year in review, these issues included discussion of self-managed superannuation funds and mortgage insurance, drivers of profit in the Chinese banking system and falls in non-performing loans of Asian banks. More generally, the *Review* reports on international regulatory reforms, the Reserve Bank's involvement in these reforms and their potential effects. In addition, the *Review* reports on domestic regulatory issues, including through the Bank's work with the Council of Financial Regulators (CFR), which is the coordinating body for Australia's main financial regulatory agencies.¹

Australia's financial stability policy framework includes mandates for financial stability for several of the CFR agencies. The Reserve Bank is responsible for promoting overall financial system stability; the prudential elements of that framework rest with the Australian Prudential Regulation Authority (APRA). During the year in review and together with other CFR agencies, the Bank prepared two papers about the Australian over-the-counter derivatives market and one on regulation of cross-border clearing and settlement facilities in Australia.

The Reserve Bank's quarterly *Bulletin* contains analysis of a broad range of economic and financial developments as well as aspects of the Bank's operations. *Bulletin* articles during the year in review ranged from regular subjects such as bank fees and bank margins through to other topical issues such as foreign investment in property markets. There were also articles on developments in household saving, patterns of cash use and an explanation of the Next Generation Banknote program. Some articles explored aspects of the economies of China and India, and with Australia's terms of trade declining from its historical peak, other articles explored the implications of this and structural change in the Australian economy. There were also items that complemented the *Statement on Monetary Policy* by providing more detail about specific economic developments and measurement issues.

The Reserve Bank made a substantial submission covering a range of topics to the Financial System Inquiry in March 2014. The submission outlined the key developments in the Australian financial system over the 17-year period since the Wallis Inquiry, while exploring in more detail those areas where the Bank had a larger influence in shaping the system. The latter included areas where the Bank had been given an explicit mandate following the Wallis Inquiry, particularly the oversight of payments and settlements matters, and the Bank's submission included an account of its activities in the payments system over those years.

The *Financial System Inquiry Interim Report* was released on 15 July 2014, seeking views and further information on a number of issues and policy options. The Reserve Bank prepared a supplementary submission, responding to the issues that most closely related to the responsibilities of the Bank for the stability of the financial system

¹ The CFR is a non-statutory body whose role is to contribute to the efficiency and effectiveness of financial regulation and to promote stability of the Australian financial system. Its members share information, discuss regulatory matters and, if the need arises, coordinate responses to potential threats to financial stability. The CFR also advises the Australian Government on Australia's financial regulatory arrangements.



1.

Photo: Pat Rick Hamilton



2.

Photo: Jason McCormack/CEDA



3.

Photo: G20 Taskforce, Department of Prime Minister and Cabinet



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Photo: G20 Taskforce, Department of Prime Minister and Cabinet



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6.

Photo: Daryl Charles Photography/CFIR



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Photo: Lesley Parker, UTS Business School

1. Governor Glenn Stevens at an Economic Society of Australia (Queensland) Business Luncheon, July 2013 2. Assistant Governor (Economic) Christopher Kent addresses a CEDA conference, February 2014 3. Deputy Governor Philip Lowe at a G20 meeting, February 2014 4. Deputy Governor Philip Lowe and Governor Glenn Stevens with Treasurer The Hon Joe Hockey MP and Barry Sterland PSM, Australia's G20 Finance Deputy, at a G20 meeting, February 2014 5. The then Head of Economic Research Department, Alexandra Heath, speaks at the Bank's annual conference on 'Financial Flows and Infrastructure Financing', March 2014 6. Assistant Governor (Financial Markets) Guy Debelle at the Forum on Perspectives on Financial Markets, November 2013 7. The Head of Financial Stability Department, Luci Ellis, speaks at the Paul Woolley Centre for the Study of Capital Market Dysfunctionality Conference, October 2013

and the efficiency and stability of the payments system. The Committee is expected to provide its Final Report, including its recommendations, to the Treasurer in November 2014.

Speeches

During 2013/14, the Governor, Deputy Governor and senior officers gave 42 speeches on various topics, the same number as in the previous year. Questions were taken after all speeches. Senior staff also participated in a number of public panel discussions. In addition to explaining current economic and financial conditions, many speeches addressed the longer-term influences on the economy and the challenges associated with adapting to structural change and raising productivity. There were also speeches devoted to innovation and reform in the payments system along with reflections on financial system stability in the post-crisis environment. Audio files of these speeches, the associated Q&A sessions and panel discussions were published on the Reserve Bank's website to improve accountability and communication.

Research

The Reserve Bank disseminates the results of longer-term research conducted by staff in the form of Research Discussion Papers (RDPs). The aim of the RDP series is to promote deeper understanding of policy-relevant issues. The views expressed in RDPs are those of the authors and do not necessarily represent those of the Bank. During 2013/14, 12 RDPs were published on a range of topics, including: the impact of the terms of trade on the Australian economy; the housing market; trends in the Australian banking sector; and developments in payment systems. Bank staff also published their research in various external journals, including the *Journal of Financial Market Infrastructures*, the *Journal of Macroeconomics*, the *International Journal of Central Banking* (IJC) and *JASSA: The Finsia Journal of Applied Finance*.

Research undertaken at the Reserve Bank is frequently presented at external conferences and seminars. In 2013/14, Bank staff presented at a number of domestic conferences, including: the 42nd Australian Conference of Economists, in Perth; the Econometric Society Australasian Meeting, in Sydney; the Annual Conference of the Chinese Economists' Society of Australia, in Brisbane; the Workshop on Macroeconomic Dynamics, in Melbourne; the CAMA Commodity Cycles Workshop, in Canberra; and the HILDA Survey Research Conference, in Melbourne. Bank staff also presented the results of their research work at seminars at a number of domestic institutions, including Monash University, the University of New South Wales, the Australian Treasury and the Australian Bureau of Statistics. Research papers were presented at a number of international conferences and workshops, including: the Annual IJC Research Conference, at the National Bank of Poland; the Central Bank Conference on Business Liaison, at the Federal Reserve Bank of Atlanta; the 17th Annual Conference of the Central Bank of Chile, in Santiago; the Chinese Economics Society Australia Conference, in Guangzhou; and the Bank of Korea Conference, in Seoul.

The Reserve Bank hosts regular conferences, which foster interaction between academics, central bankers and other economic practitioners on topical policy issues. To support one of the main items on the agenda during Australia's presidency of the G20 in 2014, the Bank's annual conference focused on financial flows and infrastructure financing. The conference was held in March 2014 in Sydney jointly with the Productivity Commission and the Lowy Institute for International Policy. A volume containing the conference papers and discussions was published in July 2014. More detail on the Bank's involvement in G20 meetings during 2013/14 can be found in the chapter on 'International Financial Cooperation'. In December 2013, the Bank hosted the annual Quantitative Macroeconomics workshop, which featured 10 papers by international and Australian academics and central bankers. Another macroeconomic workshop will be held in December 2014.

In 2013/14, the Reserve Bank hosted visits from a number of central bankers from the Bank of Canada, the Reserve Bank of New Zealand and Sveriges Riksbank, as well as academics from a range of institutions, including the Center for Monetary and Financial Studies in Spain, Monash University and the University of Tasmania. These visitors presented seminars, taught short courses and participated in research activities at the Bank.

Online communication

The Reserve Bank publishes information in both electronic and hardcopy formats, though most information is now accessed online. The website is heavily visited, with over 62 million page views and downloads during 2013/14, and large spikes in visitation at the time of release of market-related information. The number of followers on Twitter has grown to 20 000, while the number of subscribers to the website's conventional email alert service continued to fall (to around 11 000 at the end of June 2014). Visitors to the website also made greater use of the RSS feeds, which allowed them to receive alerts about updates to selected data, media releases, speeches, research papers and other publications.

Efforts to improve public understanding of the Reserve Bank's role included the publication of videos on the Bank's main website. One explains the Bank's role and functions, while another explains the framework for monetary policy. A video about the Bank's business liaison program was also published. In June 2014, a new web portal was launched to assist banknote equipment manufacturers prepare for the Next Generation Banknote series. The banknotes microsite, which had been separated from the Bank's main website and launched in August 2012 as www.banknotes.rba.gov.au, was further developed as an education resource during 2013/14.

Operations in Financial Markets

Balance Sheet

The Reserve Bank's balance sheet is affected by domestic and international transactions undertaken to meet the Bank's policy objectives. These transactions include implementing the Board's monetary policy decisions, facilitating the smooth functioning of the payments system, managing the nation's foreign reserve assets, providing banking services to clients (mainly the Australian Government and its agencies and foreign central banks) and issuing Australia's banknotes.

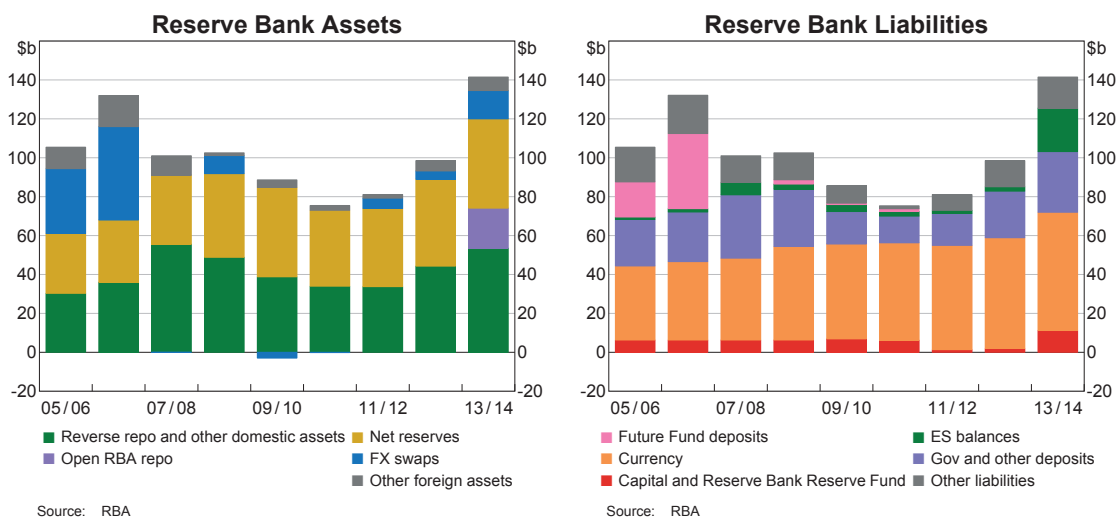
The Reserve Bank's balance sheet grew by around \$43 billion over 2013/14 to about \$141 billion. The increase was driven by three main factors: an increase in Exchange Settlement (ES) balances held by authorised deposit-taking institutions (ADIs) with the Bank; a rise in balances held by the Australian Government on deposit; and a Commonwealth grant to the Bank.

To facilitate the faster settlement of a number of electronic payments, financial institutions are now holding higher balances with the Reserve Bank in their ES accounts. These balances have increased by around \$21 billion following the introduction in November 2013 of new arrangements to ensure that ES account holders have sufficient liquidity buffers to meet their interbank payment obligations and facilitate same-day settlement after normal banking hours (see below). ADIs fund these balances using reverse repurchase agreements with the Bank that do not have a maturity date (known as open repo positions).

Balances held by the Australian Government on deposit with the Reserve Bank increased by around \$9 billion over the financial year. These deposits are predominantly used by the government to manage the mismatch in timing between its receipts and outlays and can vary considerably over the course of the year. In May, the government also made an \$8.8 billion grant to the Reserve Bank to bolster the Bank's capital position. When the transfer to the Bank occurred, Australian Government deposits declined and funds available for distribution to the government increased.

To ensure that the large withdrawal of liquidity from the financial system implied by the sizeable run-up in government deposits was offset, the Reserve Bank increased its holdings of domestic securities (mainly under repo) and Australian dollar foreign exchange swaps. There was no increase in foreign exchange reserves.

The Reserve Bank has not needed to set aside additional capital against the increase in its balance sheet associated with the larger ES balances and Australian Government deposits as there has been no material effect on the Bank's risk profile. In the case of higher ES balances, the Bank's interest rate risk has not changed, as the interest rates on the additional ES balances and associated open repo positions are identical and reset each day at the cash rate target. The credit risk associated with the repo positions is managed by imposing haircuts on those assets purchased under repo, thereby limiting the Bank's exposure in the event of counterparty default. For Australian Government deposits (a liability of the Bank), the interest rate risk of the associated repo assets is generally limited to no more than six months.



Domestic Market Operations

Management of system liquidity

The Reserve Bank Board’s operational target for monetary policy is the cash rate – the rate at which banks borrow from and lend to each other on an overnight, unsecured basis. Since August 2013, the Board has maintained the cash rate target at 2.5 per cent.

To assess whether the target has been achieved, the Reserve Bank collects data from ES account holders on their unsecured borrowing and lending in the overnight interbank market. The Bank publishes these data each day on the total volume of transactions in the cash market and the weighted-average rate at which those transactions were executed. Aggregate activity within the cash market averaged around \$5 billion each business day during the year in review. The weighted-average cash rate was equal to the Board’s target on all days. In 2013, the Bank changed its methodology for measuring the cash rate. A sample of the largest market participants on their unsecured borrowing and lending in the overnight interbank market was replaced by a survey of all ES account holders. Prior to this change, the Bank had still been capturing around 85 per cent of market activity in the unsecured interbank overnight market.

To implement the cash rate target, the Reserve Bank operates in financial markets to maintain an appropriate level of ES balances, which are liabilities of the Bank used by financial institutions to settle their payment obligations with each other and the Bank. Of the 152 financial institutions that are members of the Reserve Bank Information and Transfer System (RITS), around 55 per cent hold ES accounts.

The Reserve Bank transacts in financial markets each day to influence the cash rate in the unsecured interbank market. The supply of ES balances is altered by payments between ES account holders (mainly financial institutions) and the Bank (including its customers, principally the Australian Government). To offset these, the Bank can buy or sell government securities, undertake transactions in the repo market or use foreign exchange swaps.

The Reserve Bank announces its dealing intentions each morning at 9.30 am. Those RITS members wanting to participate in the Bank’s open market operations have a 15-minute window in which to approach the Bank. The results of the Bank’s first round of open market operations are announced shortly after 9.45 am. To ensure that unforeseen payments do not adversely affect the Bank’s ability to implement monetary policy, the Bank has the option of undertaking additional rounds of market operations late in the afternoon.

The shift to same-day settlement of direct entry (DE) payments in November 2013 has resulted in some changes to the Reserve Bank's operations. This reflects the increased uncertainty around the exact timing of payment flows across Government accounts related to the much faster settlement of these payments. Prior to November 2013, DE transactions were batched and settled the following morning. Since then, these payments have been settled through several intraday batches, with some of these batches occurring when the interbank cash market is closed (see also the chapter on 'Banking and Payments').

Given the size and uncertainty surrounding the value of DE payments made after the close of the interbank market, participants in the DE payments exchange are required to hold higher minimum ES balances. These balances act as a buffer, ensuring that ADIs hold sufficient liquidity to complete their payments after the close of the cash market. The 10 ADIs that are participants in the DE payments exchange increased their ES balances by around \$20 billion in aggregate during the year, establishing open repo positions with the Reserve Bank by a corresponding amount. In net terms, there is no interest cost to holding an open repo position matched by ES balances; open repos accrue interest at the cash rate target, and to the extent that an ES account holder has matching funds in its ES account, the institution also earns interest at the cash rate target. An allowance is made for variations in ES balances arising from DE payments that settle during the evening. Minimum required open repo positions are reviewed annually by the Bank and seek to provide a buffer above the largest payment obligations that have arisen in recent times.

The size of the open repo positions, and their ES balance counterpart, has no implications for the interpretation of the stance of monetary policy in Australia. While required local currency-denominated central bank reserves are used as an instrument for monetary policy in other countries, their purpose in Australia is purely to meet liquidity requirements for the smooth functioning of the payments system. Although the aggregate amount of ES balances has increased substantially from the previous financial year, the system's liquidity buffer – that is, ES balances at the Reserve Bank, which earn an interest rate 25 basis points below the cash rate – has been maintained around \$1 billion, in line with the average in the previous year.

The introduction of the Fast Settlement Service (FSS) in 2016 is expected to provide near-instantaneous settlement of certain retail payments across the entire day, including on weekends (see also the chapter on 'Banking and Payments'). From a liquidity management viewpoint, this change will be accommodated within the open repo framework.

One consequence of the new arrangements is that they largely remove the need for an ES account holder to contract intraday repos with the Reserve Bank, because the higher balance held in their ES account allows them to meet intraday liquidity needs. The Bank also allows other ADIs that operate ES accounts to contract open repos, not only those participating in the direct entry exchanges. Provided any drawings on the ES accounts are repaid same-day there is no cost to using the facility in this way. As at 30 June 2014, 12 institutions had an open repo position with the RBA as part of these arrangements. Since the introduction of the new arrangements in November 2013, intraday repos outstanding have averaged around \$3 billion, compared with an average of \$12 billion in the 12 months prior to the change.

As a result of the increased uncertainty around the timing of payments, the Reserve Bank has also introduced a routine second round of dealing at 5.15 pm. The additional operations are designed to address any large imbalances in the cash market that are the result of an unforeseen change in the magnitude of payments and which affect system liquidity or the timing of such payments. These operations are designed to ensure that aggregate ES balances remain at a level consistent with the achievement of the cash rate target. There have been 46 such dealing rounds since November 2013, with a roughly even split between operations to inject and withdraw liquidity.

Additional Rounds of Open Market Operations under Same-day Settlement

November 2013 to June 2014

Operation	Number	Average size offered \$ million	Coverage ratio	Average size dealt \$ million	Average number of counterparties	Spread to OIS ^(a) Basis points
Cash injection	20	540	1.0	440	2	-4
Cash withdrawal	26	420	0.6	210	1	10

(a) Overnight index swap rate
Source: RBA

The new arrangements preserve the corridor framework for the implementation of monetary policy by providing an incentive for ES account holders to participate in the interbank cash market, lend surplus balances or borrow to cover any shortfall. ES balances in excess of the open repo position earn 25 basis points less than the cash rate target and any shortfall between ES balances and the open repo position is charged a 25 basis points margin, with an allowance being made for variations in ES balances arising from DE transactions during the evening.

ES account holders are not permitted to overdraw their accounts, although the Reserve Bank remains willing to advance funds overnight against eligible securities to account holders at an interest rate 25 basis points above the cash rate target. In general, this occurs only when banks have to meet unforeseen payments late in the day and are unable to source funds elsewhere. During 2013/14, overnight repos at an interest rate 25 basis points above the cash rate target were undertaken by ES account holders on six separate occasions, mostly for small amounts.

The Australian Prudential Regulation Authority (APRA) will implement the Basel III liquidity standard in Australia from January 2015. The standard requires ADIs subject to the liquidity coverage ratio (LCR ADIs) to hold sufficient high-quality liquid assets (HQLA) to meet outflows during a 30-day period of stress. Given that there is a shortage of HQLA in Australia for LCR ADIs to be able to satisfy the LCR, the Bank will introduce a committed liquidity facility (CLF) in 2015. Under this facility, LCR ADIs will pay a fee of 15 basis points per annum to obtain a commitment from the Bank to provide funding through its repo facilities up to an amount approved by APRA for the purpose of the LCR. LCR ADIs will be able to contract these repos using eligible securities (including self-securitisations). In January 2014, APRA announced the results of a trial exercise to determine the size of individual CLF requirements. Based on this exercise, the total size of all CLF amounts was estimated to be around \$280 billion. APRA will determine the CLF amounts applicable in 2015 towards the end of 2014.

Management of domestic assets

Over the past year, the Bank's holdings of domestic assets have increased as the counterpart to higher government deposits and the establishment of open repo positions. The domestic assets are either purchased outright or held under repo.

Most of the Reserve Bank's transactions in the domestic market are contracted as repos. Under reverse repos, the Bank is willing to purchase both government-related debt securities and certain private debt securities. In many respects, the transaction is similar to a secured loan, with the difference between the purchase and repurchase prices representing the interest earned on the transaction. To protect against a decline in the value of these securities should the Bank's counterparty not be able to meet its repurchase obligation, the Bank requires that the value of the security exceeds the cash lent by a certain margin. These margins, which are listed on the Bank's website (www.rba.gov.au/mkt-operations/resources/tech-notes/eligible-securities.html), are considerably higher for private securities than for government-related securities.

The stock outstanding of cash lent through the Bank's open market operations has ranged between \$22 billion and \$53 billion over the financial year. With the stock of repos outstanding in the domestic market generally around \$100 billion, the Reserve Bank's operations have, at times, accounted for a significant portion of the market. The most active users of repos tend to be the fixed-income trading desks of banks and securities firms seeking to finance their inventories of Commonwealth Government Securities (CGS) and semi-government securities (semis). Reflecting this, around 70 per cent of the securities held by the Bank (excluding those under open repo) are government obligations. The average term of reverse repos contracted via open market operations over the past year was around one month, slightly longer than in recent years.

Australian Dollar Securities Held under Repurchase Agreements

	June 2012		June 2013		June 2014	
	\$ billion	Per cent of total	\$ billion	Per cent of total	\$ billion	Per cent of total
CGS	8.5	35	15.5	42	17.6	25
Semis	8.6	35	9.4	30	15.5	22
Supras	0.6	2	1.4	4	3.3	5
Government guaranteed	0.3	1	0.2	1	0.0	0
ADI issued	5.6	23	8.0	19	8.8	12
RMBS	0.8	3	0.6	4	25.1	35
Other	0.0	0	0.0	0	0.6	1
Total	24.4	100	35.2	100	70.9	100

Source: RBA

Securities that are eligible in the Reserve Bank's open market operations are also eligible for open repo positions. In addition, the Bank has permitted the use of certain related-party assets issued by bankruptcy remote vehicles, such as self-securitised residential mortgage-backed securities (RMBS), as security against open repo positions for participants in the DE payments exchange. Around 90 per cent of the outstanding amount of open repos is backed by these self-securitised assets.

Self-securitised RMBS used in open repos do not have observable market prices as they are retained in full by the originating institutions and are therefore not traded. As a result, the Reserve Bank makes an internal estimate of their prices to determine their value. The Bank has developed an internal valuation model for self-securitised RMBS, which estimates certain key parameters of the securities and uses these, together with observed market prices of public RMBS, to infer prices for self-securitised RMBS. In May 2014, the Bank engaged an external consultant to conduct an independent review of its pricing model and the Bank's overall framework, including the use of margins. The high-level assessment indicated that the Bank's pricing model and overall framework was fit for purpose, while indicating a number of possible minor improvements.

With asset-backed securities becoming an increasing share of assets held under repo, as a result of the change in the payments arrangements described above, as well as the potential use of self-securitised RMBS as collateral for the CLF, the Reserve Bank has introduced new eligibility requirements for securitisations used in repurchase agreements with the Bank. New information, which will be required to be reported to the Bank for RMBS, commercial mortgage-backed securities and other asset-backed securities, includes transaction-related data as well as information on the underlying assets. The information will allow the Bank to value securitised assets more precisely and better assess and manage risk. This will likely result in more granularity

of the adjustments that the Bank makes to manage its credit risk. Reflecting the Bank's interest in promoting increased transparency in asset-backed securities, the information will also be made available to members of the public with a legitimate interest, although some information will be aggregated or redacted to protect borrower privacy. The Bank is working with an external contractor selected via an open tender process to develop the Securitisation System to collect, validate and store the securitisation data submitted to the Bank. The reporting requirements have been developed in consultation with market participants, and the Bank will continue to communicate with these participants throughout the implementation process to facilitate a smooth transition to the new reporting requirements in 2015.

Domestic securities purchased by the Reserve Bank are held in an account that the Bank maintains in Austraclear, the securities depository of the Australian Securities Exchange (ASX). In April 2013, the Bank agreed to become a Foundation Customer of ASX Collateral, a collateral management service that allows the ASX to act as tri-party agent to the Bank's repos. As agent, the ASX is responsible for ensuring that securities delivered to the Bank's Austraclear account are appropriately valued and meet the Bank's eligibility requirements. Tri-party arrangements can make it more efficient for those with a large number of small-denomination holdings to fund their securities via repo. As agent, the ASX also offers optimisation tools that can determine the most efficient allocation of securities against each exposure that a user is managing. The Bank settled its first tri-party repo in early 2014. Bank counterparties continue to have the option of using existing arrangements, which involve confirming each individual security and its value bilaterally with the Reserve Bank prior to settlement.

The Reserve Bank continues to operate a Securities Lending Facility on behalf of the Australian Office of Financial Management (AOFM). The securities available through the facility comprise all Treasury Bonds and Treasury Indexed Bonds currently on issue. The Bank sells these securities under open repos to RITS members eligible to participate in the Bank's domestic market operations.

The Reserve Bank holds both CGS and semis on an outright basis in its domestic portfolio. These are used for the Bank's management of system liquidity and are also available to be posted as collateral for repos.

An important influence on the composition of the Reserve Bank's holdings of CGS has been management of the impact of large CGS maturities on system liquidity. This reflects the Bank's need to reduce or offset the large volume of funds that are paid out of the Australian Government's account at the Bank into ES accounts (for the credit of the security holder) on the maturity date. In addition to using reverse repos and foreign exchange (FX) swaps – both contracted to unwind and therefore withdraw liquidity on the same day as the CGS maturity – the Bank makes purchases of CGS ahead of their maturity date. Over the course of 2013/14, the Bank offset the liquidity effects of two large CGS maturities – the \$9.3 billion maturity of the December 2013 bond and the \$13.3 billion maturity of the June 2014 bond. To do this, the Bank purchased almost \$1.6 billion of the December 2013 bond and \$3.2 billion of the June 2014 bond in the 12 months preceding each maturity. These sterilisation operations will increase in size in the future as large CGS issues mature. Reflecting these operations, the Bank's holdings of CGS at any point in time are only close-to-maturity issues. The size of these holdings generally increases up to the point of maturity and in aggregate will fluctuate noticeably through time as maturities occur.

At present, the Reserve Bank holds around \$3 billion of semis. This is similar to the level of earlier years. These securities are generally purchased as part of the Bank's daily open market operations or separately through occasional outright purchase operations. The latter, which are conducted over Yieldbroker DEBTS, occurred once in 2013/14.

In January 2014, the Reserve Bank closed its small-investor facility when the AOFM outsourced the registry for CGS to a commercial service provider. As a result, over the first half of 2014 the Bank sold a number of small holdings of longer-dated CGS that it held for sale to small investors.

In December 2013, the Bank commenced publishing monthly indicator rates for Australian corporate bond spreads. The decision reflected a lack of publicly available data on bond market conditions faced by non-financial corporations, particularly at longer maturities. The estimation method is described in the December 2013 edition of the *Bulletin*.

Foreign Exchange Operations

The Reserve Bank transacts in the foreign exchange market on most business days, principally to facilitate its customer business. The Australian Government remains the Bank's largest foreign currency customer. Excluding transactions related to International Monetary Fund (IMF) financing, the Bank sold \$7.2 billion of foreign currency to the Australian Government during 2013/14, with these sales funded by the Bank purchasing the required foreign currency in the spot market.

It is only in periods where the market for Australian dollars is severely stressed that the Reserve Bank is likely to use its existing stock of foreign currency reserves to fund its normal customer business. In such an instance, these reserves would be subsequently replenished at a time when the Bank judged that market conditions had stabilised. This has not been considered necessary since late 2008, a period when global financial markets were significantly impaired.

Likewise, not since 2008 has the Reserve Bank transacted in the foreign exchange market to address dislocated trading conditions for the Australian dollar. While Australia has now operated a floating exchange rate regime for more than 30 years, the Bank has always retained the discretion to intervene in the market for Australian dollars to address market dysfunction and/or a significant misalignment in the value of the currency. Over time, the Bank's intervention in the foreign exchange market has become less common as the market has deepened and participants' use of hedging instruments has made them more resilient to episodes of volatility.¹ During the past year, the Australian dollar remained high by historic standards, while trading conditions were generally characterised by low volatility.

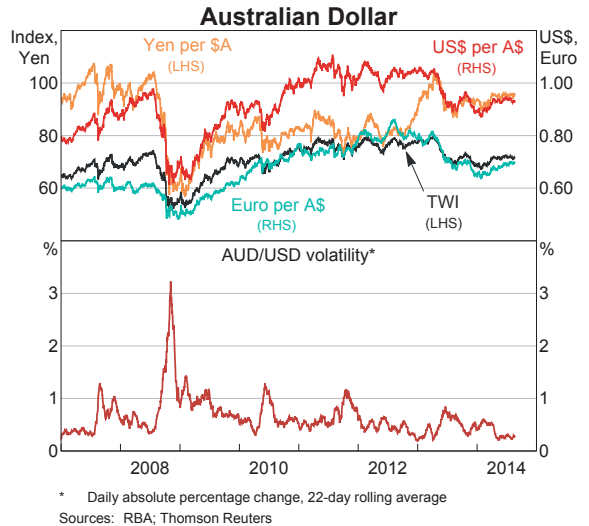
The Reserve Bank also transacts in the foreign exchange market when managing its foreign currency reserves. In late 2013, these operations included the purchase of Chinese renminbi for the first time. A series of foreign exchange transactions were undertaken with the People's Bank of China (against US dollars) to reallocate part of the foreign currency portfolio into renminbi.

To maintain the currency composition of foreign currency reserves at their benchmark weights (discussed below), the Reserve Bank regularly operates in the spot foreign exchange market. The settlement of these rebalancing flows may also be managed through FX swaps (whereby one currency is exchanged for another, with a commitment to unwind the exchange at a subsequent date at an agreed (forward) rate). By themselves, swaps do not alter the Bank's exposure to any currency, but are often used as an efficient way to manage the cash held within the foreign currency reserves portfolio. During 2013/14, swaps transacted for this purpose totalled around US\$34 billion.

¹ For further details, see Newman V, C Potter and M Wright (2011), 'Foreign Exchange Market Intervention', RBA *Bulletin*, December, pp 67–76. Intervention data are published, with a lag, on the Bank's website at www.rba.gov.au/statistics/tables/xls/a05hist.xls.

As mentioned above, the Reserve Bank is also an active user of FX swaps against Australian dollars. As these transactions alter the supply of ES balances (without affecting the exchange rate), they complement the other operational tools used by the Bank to implement monetary policy. FX swaps are particularly useful at times when the Bank needs to offset large projected changes in aggregate ES balances (such as those associated with government bond maturities) as the swap market is much larger and generally more liquid than the domestic repo market. In 2013/14, turnover in FX swaps undertaken for domestic liquidity management totalled \$77.2 billion.

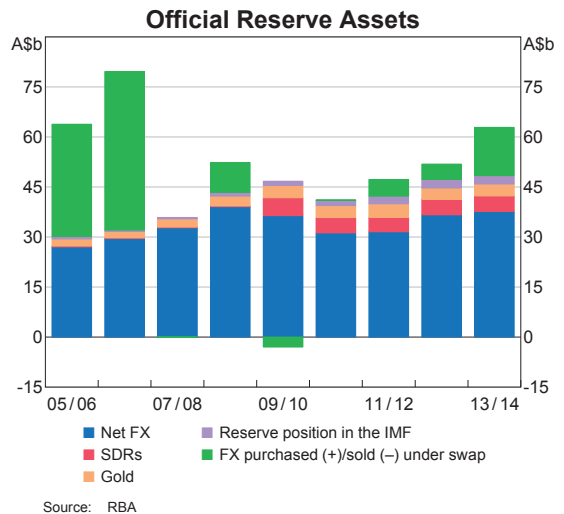
All foreign currency swaps executed by the Reserve Bank are for short periods, being generally no more than three months' duration. The risk associated with forward FX positions is mitigated by receiving collateral from (or, where appropriate, posting collateral to) the Bank's counterparties against changes in the market value of these positions. The conditions for such exchanges of collateral are defined in two-way Credit Support Annexes to the ISDA Master Agreements that the Bank has executed with each of its counterparties.



Reserves Management

Australia's official reserve assets encompass foreign currency assets, gold, Special Drawing Rights (SDRs – a liability of the IMF) and Australia's reserve position in the IMF. Reserve assets are held primarily to facilitate policy operations in the FX market (as discussed above). The capacity to undertake such operations is best measured by 'net' reserve assets, with the amount of foreign currency subject to forward commitments (such as foreign currency that the Reserve Bank has obtained in short-term swaps against Australian dollars) excluded.

Australia's reserve position in the IMF is an asset of the Australian Government. All other components of Australia's official reserve assets are held on the Reserve Bank's balance sheet, and the Bank is responsible for managing the level and composition of those reserves. As these assets can expose the Bank to various risks (such as market, liquidity and credit risk), the level held represents only the amount assessed to meet expected policy requirements. The Bank also attempts to mitigate risks to its balance sheet where possible, chiefly through holding a diversified portfolio of assets and only investing in assets of high credit quality and appropriate liquidity.



The investment of the Reserve Bank's foreign currency assets is guided by an internally constructed benchmark. This benchmark is judged to be the combination of foreign currencies and foreign currency assets that will maximise the Bank's returns over the long run, subject to the Bank's policy-driven need to maintain the liquidity of the portfolio and its general appetite for risk. The structure of the benchmark is reviewed from time to time to take account of significant changes in market conditions and the Bank's risk tolerance.

During 2013/14, the Reserve Bank reallocated around 3 per cent of its foreign currency benchmark from the US dollar to the Chinese renminbi. This portfolio shift recognised the growing importance of China in the global economy and the broadening financial relationship between Australia and China. From a portfolio perspective, the shift increased the diversification of the Bank's foreign currency investments and is expected to enhance returns over the long run.

Notwithstanding the recent allocation to Chinese renminbi, more than 50 per cent of the benchmark remains in US dollars. Reflecting the current low level of global interest rates, the duration targets for the foreign currency portfolios remain short, mitigating the risk of capital losses when bond yields return to more normal levels.

Benchmark Foreign Currency Portfolio

30 June 2014

	US	Europe	Japan	Canada	China
Asset allocation (per cent of total)	52	35	5	5	3
Duration (months)	6	18	6	6	18

Source: RBA

Investments within the benchmark currencies are limited to deposits at official institutions (such as central banks) and debt instruments issued or guaranteed by sovereigns, supranational agencies and (under reverse repos only) quasi sovereigns. Sovereign credit exposures are currently limited to the United States, Germany, France, the Netherlands, Canada, Japan and China.

Foreign Currency Assets^(a)

A\$ million, 30 June 2014

Currency	Securities held outright	Securities held under reverse repos	Deposits at official institutions ^(b)	Total	Forward FX commitments		Net
					Against AUD	Against other currencies	
US dollar	15 401	1 569	1 649	18 619	-335	1 111	19 395
Euro	8 548	594	6	9 148	-	3 856	13 004
Japanese yen	20 995	-	18	21 013	-14 079	-5 072	1 862
Canadian dollar	1 780	-	7	1 787	-	71	1 858
Chinese yuan	1 034	-	21	1 055	-	-	1 055
Total	47 759	2 163	1 700	51 623	-14 414	-35	37 174

(a) Excludes investments in the Asian Bond Funds

(b) Includes deposits at foreign central banks and the Bank for International Settlements

Source: RBA

The amount of foreign currency reserves held by the Reserve Bank is affected by foreign exchange swaps contracted against Australian dollars. At the end of June 2014, the Bank's gross reserves included \$14 billion of foreign currency sourced from such swaps. Foreign currency obtained in this manner does not comprise part of the benchmark portfolio, but is invested to ensure that the Bank's forward commitments to sell foreign currency are fully hedged.

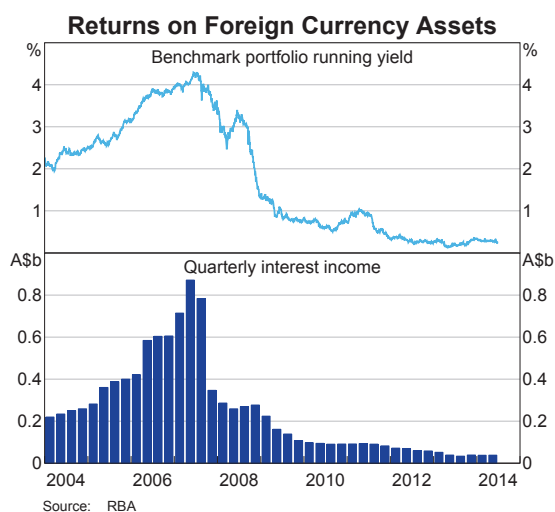
In recent years, returns on short-dated Japanese investments, taking into account the cost of hedging the currency risk, have been higher than the historically low returns available on the US and euro portfolios. Reflecting this, the Bank has also executed swaps of US dollars and euro against the Japanese yen, helping to raise overall returns on the reserves portfolio. While the Bank's exposure to changes in the value of the yen remains small (consistent with the yen's share of the benchmark), almost half of foreign currency reserves were invested in yen-denominated assets at the end of June 2014.

A small component of the Reserve Bank's net foreign currency reserves sits outside the benchmark framework. This encompasses investments in a number of Asian debt markets through participation in the EMEAP Asian Bond Fund (ABF) Initiative. This initiative was established in the wake of the Asian currency crisis in the late 1990s to assist in the development of bond markets in the region. The Bank has modest holdings in the US dollar-denominated fund (ABF1) and the local currency-denominated fund (ABF2). At the end of June 2014, the total allocation of reserves to these funds was \$476 million. The return on these investments over 2013/14 was 0.8 per cent when measured in SDR terms.

The overall return on foreign currency assets over 2013/14 was -0.6 per cent, measured in SDRs, down from the previous year and well below historical norms. This outcome reflected currency valuation effects and the low interest rate environment globally. At the end of June 2014, the running yield on the benchmark portfolio was only 0.2 per cent, compared with over 4 per cent prior to the financial crisis.

The Reserve Bank's holdings of SDRs at 30 June 2014 amounted to \$4.7 billion, \$0.1 billion lower than a year earlier. Under voluntary arrangements with the IMF, the Reserve Bank is willing to transact in SDRs upon request from other countries or prescribed holders. In these transactions, the Bank will generally either buy or sell SDRs in exchange for foreign currencies (such as euros or US dollars). Such transactions do not alter the level of Australia's reserve assets, only the proportions held in SDRs and foreign currency. In late 2013, to accommodate a larger than normal request to purchase SDRs (equivalent to \$320 million), the Bank decided to replenish the foreign currency used in the transaction by selling Australian dollars in the spot market.

Australia's reserve position in the IMF was \$2.5 billion at the end of June 2014, \$0.2 billion lower than a year earlier. The reserve position comprises that part of Australia's quota in the IMF that was paid in foreign currency as well as other credit that Australia has extended to the IMF in support of the Fund's lending programs. As noted above, this asset is not held on the Reserve Bank's balance sheet. However, the Reserve Bank will sell to (or purchase from) the Australian Treasury the foreign currency the Treasury needs to complete its transactions



with the IMF. Unlike the normal customer business transacted with the Australian Government, the Bank will typically draw on (or add to) its foreign currency reserves when providing foreign currency for this purpose. This is because any change to the Bank's holdings of foreign currency assets will be offset by an equivalent change in Australia's reserve position in the IMF, leaving total official reserve assets unchanged. Nevertheless, as with SDR transactions, on certain occasions the Bank may decide to offset the impact on foreign currency asset holdings of IMF transactions.

Gold holdings at the end of June 2014 were around 80 tonnes, unchanged from the previous year. Gold prices rose by 9 per cent in Australian dollar terms in 2013/14, increasing the value of the Reserve Bank's holdings of gold by around \$0.3 billion to \$3.6 billion. Activity in the gold lending market remained subdued, with the Bank having only 1 tonne of gold on loan during the year. Income earned on that loan amounted to \$0.2 million. During the year in review, the Bank audited its gold holdings, including that portion held in safe custody at the Bank of England.

Bilateral Currency Swap

In February 2014, the Reserve Bank signed a bilateral local currency swap agreement with the Bank of Korea for an initial period of three years. The agreement can be activated by either party and allows for the exchange of local currencies between the two central banks of up to \$5 billion. As with the local currency swap agreement signed between the Reserve Bank and the People's Bank of China in 2012, the agreement with the Bank of Korea is designed to promote bilateral trade between the two countries by ensuring that transactions could continue to be settled in local currency during periods of stress.



Photo: Peter Tabor

Governor Glenn Stevens and Bank of Korea Governor Choongsoo Kim shake hands after signing a bilateral local currency swap agreement between the Reserve Bank and the Bank of Korea, Sydney, February 2014

Banking and Payments

The Reserve Bank provides a range of banking and settlement services to participants in the Australian financial system, the Australian Government and other central banks and international bodies. These include services associated with the operation of the government's principal public accounts; transactional banking services to government agencies; custodial, registry and related services; and the operation of the real-time gross settlement (RTGS) system for high-value Australian dollar payments.

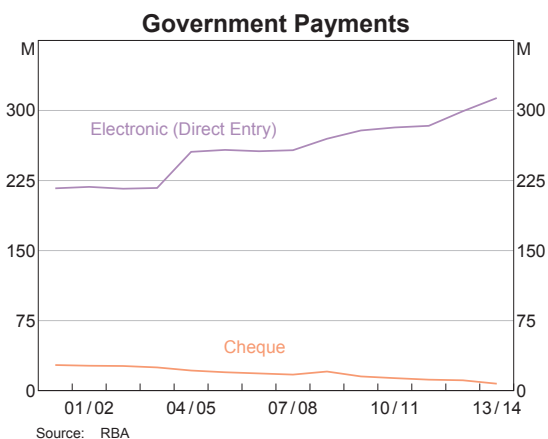
Banking

The Reserve Bank's banking services comprise two broad components: core and transactional banking services. Both are provided with the common objective of delivering secure and efficient arrangements to meet the banking and payment needs of the Australian Government and its agencies. In addition, the Bank provides banking and related services to a number of overseas central banks and official institutions.

Core banking services are provided to the Department of Finance on behalf of the Australian Government and the Australian Office of Financial Management (AOFM). These services derive directly from the Reserve Bank's role as Australia's central bank and require the Bank to manage the consolidation of government agency account balances – irrespective of which financial institution each agency banks with – into the government's Official Public Accounts (OPA) at the Bank on a daily basis. This involves 'sweeping' balances from agency accounts at transactional banks to the OPA at the end of each business day and returning balances required to meet agencies' day-to-day payment obligations the following morning. The average daily sweep to and from the OPA was around \$3 billion in 2013/14. The Reserve Bank also provides the government with a term-deposit facility for investment of its excess cash reserves, as well as a short-term overdraft facility to cater for occasions when there is unexpected demand on Commonwealth cash balances. The overdraft facility was used on two occasions during the financial year.

While the Reserve Bank manages the consolidation of the government's accounts, the AOFM has day-to-day responsibility for ensuring there are sufficient cash balances in the OPA and for investing excess funds in approved investments, including term deposits with the Bank.

The Reserve Bank's transactional banking services are associated with more traditional banking activities. Principal among these are services for making payments from government agencies to recipients' accounts. The Bank processed some 325 million payments, totalling \$490 billion, for government agencies in 2013/14. Most of these were made via



direct entry. The Australian Government also makes payments by eftpos, the RTGS system and cheque, though its use of cheques has fallen significantly in recent years relative to electronic payment methods. Cheques now make up less than 3 per cent of agency payments compared with around 10 per cent a decade ago. In addition to payments, the Bank provides its government agency customers with access to a number of services through which they can collect funds, including Electronic Funds Transfer, BPAY, eftpos, and card-based services via the phone and internet. The Bank processed 25 million collections-related transactions for the Australian Government in 2013/14, amounting to \$445 billion.

The provision of transactional banking services is consistent with the Reserve Bank's responsibilities under the *Reserve Bank Act 1959*. These services are offered in line with the Australian Government's competitive neutrality guidelines. To deliver the services, the Bank must compete with other commercial financial institutions, in many instances bidding for business at tenders conducted by the agencies themselves. It must also cost and price the services separately from the Bank's other activities, including its core banking services, and meet a prescribed minimum rate of return. Some 90 government agencies are transactional banking customers of the Bank. Pro forma business accounts for transactional banking are provided on page 81.

After-tax earnings from the Reserve Bank's transactional banking services were \$5.1 million in 2013/14. This is higher than in the previous year owing to increased transaction volumes through the Bank's online collection services.

The Reserve Bank works closely with its agency customers and with the Australian Government more generally to ensure that they have access to services that are consistent with their needs and those of the public. In 2013/14, the Bank added prepaid and corporate card products to the suite of services available to its agency customers. The prepaid card product is intended to assist agencies in managing their day-to-day running expenses, reducing their reliance on, and the cost of, using cash, while the corporate card product offers a level of convenience to agencies for managing larger expenditures. For some services, the Bank combines its specialist knowledge of the government sector with specific payment services and products from commercial providers to meet the government's banking needs. Many of the collection services mentioned above and the newly introduced card products are examples of this. The Bank will continue to make use of combined service arrangements as the government's banking needs evolve.

In order to meet the government's changing service needs, the Reserve Bank must ensure that its underlying banking systems continue to provide the highest levels of reliability and efficiency. Consistent with this, the Bank is undertaking a program of work to upgrade its banking systems, moving them to a contemporary programming language and architecture, and re-engineering a number of business processes to ensure that they remain cost effective. The work is occurring in stages over several years. The first stage, involving the processing of RTGS payments for government agencies, was completed in mid 2014, and work on the second stage, which involves redevelopment of systems for processing payments to the government and its agencies, has commenced. Undertaking the work is a dedicated team of business analysts, application developers, testers and project managers, of which a number have been recruited externally to complement the Bank's existing resources. The work is overseen by a Steering Committee comprising senior Bank staff.

Registry

The Reserve Bank has for many years provided registry services for Commonwealth Government Securities (CGS) under agreement with the AOFM and for securities issued under Australian dollar debt programs by foreign official institutions. These services typically involve registration of new issues, ongoing maintenance of ownership records, distribution of interest payments and redemption of securities at maturity. In early 2014,

the AOFM transferred the registry services for CGS from the Bank to a commercial service provider. The transfer was consistent with announcements by the Australian Government in 2010 that it was looking to improve access to the bond market for retail investors, and by the AOFM in May 2013 that retail investors could thereafter buy and sell entitlements to CGS through an electronic platform provided by the Australian Securities Exchange (ASX).

The Reserve Bank had also for many years provided a facility that enabled retail investors to buy and sell CGS over the counter. The new arrangements announced by the AOFM for buying and selling entitlements to CGS on an electronic platform meant that the Bank's facility was no longer required. As noted in last year's Annual Report, the Bank closed its facility for selling CGS to retail investors in May 2013 as part of the initial stages of the changeover to the new platform. The Bank's facility to purchase CGS from retail investors was closed in early 2014 when the CGS registry moved to an external provider.

While the Reserve Bank no longer conducts the registry business for CGS, it continues to offer services to foreign official institutions with Australian dollar debt programs. Some 60 foreign institutions are customers of the Bank.

Earnings after tax for the registry business were \$0.1 million in 2013/14, a little lower than in the previous year reflecting the transfer of the CGS registry business.

Settlement Services

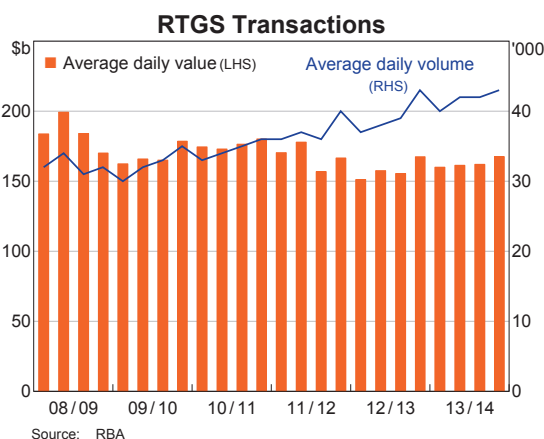
The Reserve Bank owns and operates the Reserve Bank Information and Transfer System (RITS), which effects settlement of payment obligations across Exchange Settlement (ES) accounts held with the Reserve Bank. Payments settled individually on an RTGS basis in RITS include time-critical customer and other bank payments, wholesale debt and money market transactions and the Australian dollar legs of foreign exchange transactions. The latter includes Australian dollar trades settled through CLS, a multi-currency settlement system designed to reduce foreign exchange settlement risk for which net amounts are paid to and received from CLS Bank International each day. Around 90 per cent of payments in Australia by value are settled in RITS on an RTGS basis.

At end June 2014, there were 60 institutions approved to operate an ES account. Another 27 institutions hold ES accounts but have appointed another ES account holder to settle RTGS transactions on their behalf in RITS. A further 65 institutions were Non-Transaction Members of RITS in order to participate in the Reserve Bank's domestic open market operations.

Close to 42 000 RTGS transactions worth \$163 billion were settled in RITS, on average, each day during 2013/14. While RTGS volumes have continued to grow steadily, values have remained broadly unchanged over recent years.

RITS also settles some payments on a net basis. One such arrangement – the daily CHES batch – is for settlement of payments arising from stock market transactions, and is managed by the ASX as Batch Administrator. CHES batch settlement averaged around \$930 million each day in 2013/14.

Obligations arising from cheques, debit and credit cards and direct entry transactions are exchanged



through clearing systems administered by the Australian Payments Clearing Association (APCA). These are largely low value and settle on a multilaterally netted basis in RITS. Prior to 25 November 2013, all of these obligations were settled at 9.00 am the next business day. Since 25 November 2013, direct entry obligations are able to be settled on a same-day basis.¹ This occurs shortly after the official industry clearing exchange times, in five multilaterally netted batches at 10.45 am, 1.45 pm, 4.45 pm, 7.15 pm and 9.15 pm. Around \$17 billion per day in total is cleared through the direct entry system, with around 60 per cent of that in the final two exchanges of the day.

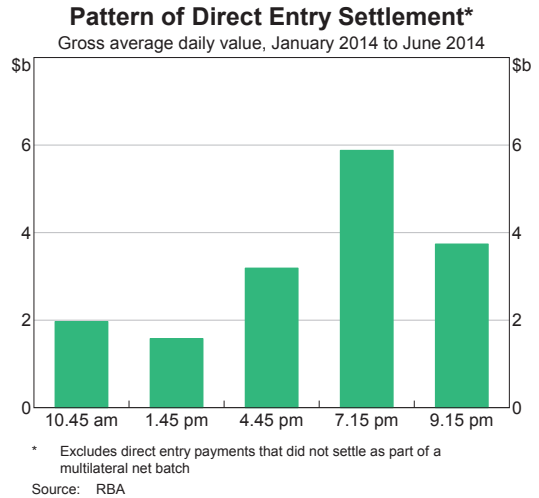
The more timely settlement of direct entry obligations has reduced the credit risk that can arise when financial institutions post payments to customer accounts ahead of interbank settlement. This outcome built on prior work by the Reserve Bank, industry bodies and financial institutions to establish the RITS Low Value Settlement Service, and met one of the objectives set by the Payments System Board as outlined in the *Strategic Review of Innovation in the Payments System: Conclusions*, released in June 2012.²

Significant changes to operational and liquidity arrangements, including extending the RITS Evening Settlement Session, were required to facilitate settlement of obligations arising from the final two clearing exchanges. The Reserve Bank also introduced a new liquidity instrument – an open RBA repo – to assist direct entry participants to obtain sufficient ES funds to meet their evening direct entry obligations.³

The transition to the new arrangements has progressed smoothly although, as expected, there has been some decline in netting efficiency in moving from settling direct entry obligations in one batch with cheques and credit and debit card obligations, to five separate batches. The daily average of net retail obligations settled in RITS (the five new multilateral settlements and the remaining 9.00 am settlement) has grown from around \$4 billion per day in 2012/13 to \$7 billion in the first half of 2014. These settlements covered about 14 million underlying transactions worth around \$22 billion on average each day.

The changes to liquidity arrangements for same-day settlement have resulted in a substantial increase in system liquidity in RITS. Open RBA repos are mostly used by ES account holders that participate in evening direct entry settlement, and have largely replaced their use of intraday repos. Participants now have around \$21 billion outstanding in open RBA repos, while the use of intraday repos has declined by \$9 billion since 2012/13. The changes have resulted in system liquidity increasing to a new high of around \$24 billion, or 15 per cent of RTGS payments.

Reflecting the critical importance of RITS to the Australian financial system, the Reserve Bank invests significantly in its technical and business infrastructure and in operational resourcing. This ensures that RITS operates to appropriately high standards of availability and resilience and that its settlement services evolve to meet the



1 For more detailed information, see Fraser S and A Gatty (2014), 'The Introduction of Same-day Settlement of Direct Entry Obligations in Australia', *RBA Bulletin*, June, pp 55–64.

2 See RBA (2012), *Strategic Review of Innovation in the Payments System: Conclusions*, June.

3 More detail on the changes to liquidity arrangements is provided in the chapter on 'Operations in Financial Markets'.

changing needs of the payments system. In addition to the introduction of same-day settlement of direct entry obligations, major project work undertaken in 2013/14 included the completion of an upgrade to the RITS core infrastructure in June 2014. This project upgraded RITS servers, operating system and databases, and enhanced network and system infrastructure monitoring capabilities.

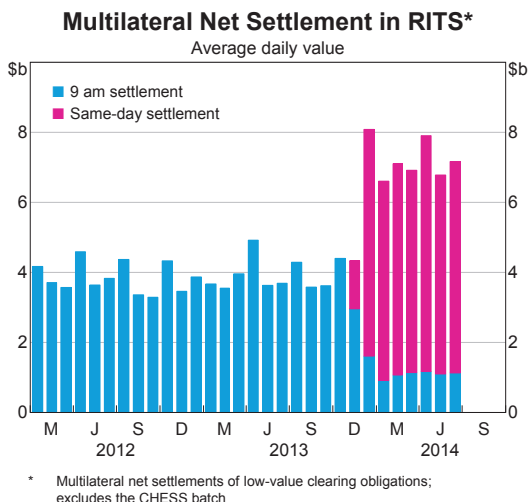
The Reserve Bank also carried out development work on two significant new infrastructure projects in 2013/14. The first of these is the development of functionality in RITS to settle the interbank cash settlement leg of property transactions. This forms part of a single national e-conveyancing solution for the Australian property industry being delivered by Property Exchange Australia Limited (PEXA).⁴ The initiative is intended to remove the existing manual processes and paperwork associated with property transactions by moving to an electronic platform, and is expected to deliver significant benefits to consumers and property industry participants through efficiency gains and cost savings. The new functionality in RITS is expected to be implemented in late 2014.

The second important initiative, which is likely to facilitate future payments innovation and efficiency improvements for Australian consumers and businesses, is the New Payments Platform (NPP). The program to develop the NPP by 2016 is an industry collaboration in response to the objectives outlined in the *Strategic Review of Innovation in the Payments System: Conclusions*, released in June 2012. The NPP is expected to operate on a 24/7 basis and provide real-time bank account transfers with immediate funds availability, facilities for the remittance of information with payments, and more user-friendly ways to address payments, for example, through the use of mobile phone numbers and email addresses.

The Reserve Bank is supporting the industry program by developing the RITS Fast Settlement Service (FSS). The FSS will settle individual NPP payments immediately across ES accounts, removing the need for financial institutions to manage credit risk, and enabling clearing and settlement of customer payments in a matter of seconds.

The Reserve Bank recovers its operating costs from RITS members through a combination of annual and transaction-based fees. There was a major restructure of RITS fees in July 2012, which sought to provide a more representative distribution of costs among members. A further small adjustment to the structure of RITS fees took effect from July 2014, but this does not materially affect the total of fees collected.

Around 60 overseas central banks and official institutions hold accounts at the Reserve Bank for settlement of their Australian dollar transactions and safe custody services. Overseas demand for Australian dollar investments remains strong, with the amount held in custody by the Bank for these institutions increasing by \$2.9 billion to \$71.6 billion by 30 June 2014.



⁴ PEXA (formerly National E-Conveyancing Development Limited) was created by the Council of Australian Governments (COAG) in 2010 to deliver a national e-conveyancing solution in line with COAG's *National Partnership Agreement to Deliver a Seamless National Economy*.

The Reserve Bank also provides settlement services for banknote lodgements and withdrawals by commercial banks and for RTGS settlement of (mainly high-value) transactions undertaken by the Bank and its customers, including the Australian Government, overseas central banks and official institutions.

Banknotes

The Reserve Bank is responsible for ensuring that there are sufficient high-quality banknotes in circulation to meet public demand. This demand stems from the role of banknotes as a payment mechanism and store of wealth. To preserve public confidence in the capacity of banknotes to perform these roles, the Bank:

- issues sufficient banknotes to meet public demand
- maintains the quality of banknotes in circulation by withdrawing old, worn banknotes and replacing them with new banknotes
- conducts research and development to ensure that Australian banknotes remain secure against counterfeiting.

Banknotes on Issue

At the end of June 2014 there were 1.3 billion banknotes, worth \$60.8 billion, in circulation. The value of banknotes in circulation increased by 7 per cent in 2013/14, slightly above the long-term growth rate of 6 per cent. This growth was driven by high-denomination banknotes, with the number of \$100 banknotes increasing by 8 per cent in 2013/14 and the number of \$50 banknotes increasing by over 6 per cent. Together, these banknotes accounted for 92 per cent of the value and 66 per cent of the number of banknotes in circulation at the end of 2013/14.

The number of \$5 banknotes in circulation in 2013/14 increased by 5 per cent, which was also more than its long-term growth rate of 4 per cent, while growth in \$10 and \$20 banknotes in 2013/14 was below their respective long-term growth rates of 3 per cent and 2 per cent.

New Banknote Purchases

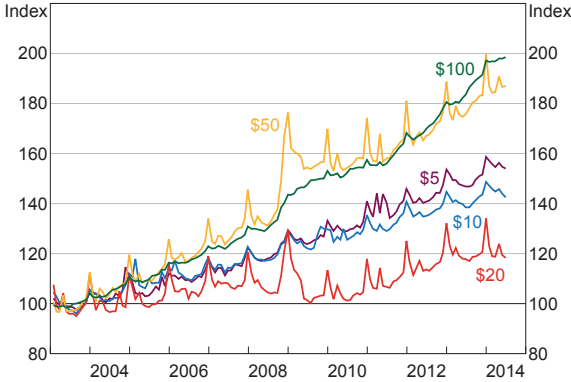
The Reserve Bank purchased 30 million banknotes from Note Printing Australia Limited (NPA) in 2013/14, considerably less than the 197 million banknotes purchased in 2012/13. This reflects the Bank's intention to reduce its contingency holdings of the current banknotes series in the lead up to the issuance of the new banknote series. All banknotes purchases from NPA in 2013/14 were of the \$100 denomination.

Distribution

The Reserve Bank holds banknotes to accommodate the growth in the number of banknotes in circulation and seasonal fluctuations in demand, as well as for contingency purposes in the event of systemic shocks and production disruptions. The Bank has agreements with the commercial banks to enable them to access these banknotes. Commercial banks also maintain their own holdings of banknotes in their branches and cash-in-transit depots around Australia. The Reserve Bank issued banknotes worth \$9.3 billion in 2013/14, of which \$3.7 billion had previously been in circulation and \$5.6 billion were new.

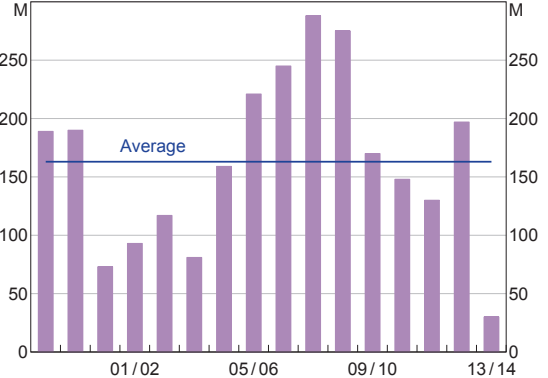
Number of Banknotes in Circulation

2003 average = 100



Source: RBA

Banknote Purchases



Source: RBA

The Reserve Bank aims to maintain a high quality of banknotes in circulation to ensure public confidence in Australia’s banknotes. High-quality banknotes reduce problems with machine acceptance and make it more difficult for counterfeits to be passed. For this reason, the Bank provides incentives to major commercial banks and their carriers to reissue fit banknotes into circulation and return those that are unfit to the National Note Processing and Distribution Centre (NNPDC), operated by NPA, where their authenticity and quality are confirmed. In 2013/14 the NNPDC received \$2 billion worth of banknotes deemed unfit for recirculation.

The Reserve Bank also removes unfit banknotes from circulation through its Damaged Banknotes Facility. In January 2014, the Bank updated its Damaged Banknotes Policy, which governs whether and how damaged banknotes are assessed. Under the Policy, members of the public who have unwittingly come into possession of damaged banknotes or whose banknotes are accidentally damaged can ask the Bank to examine and verify their damaged or contaminated banknotes. Payment is then made, based on the assessed value of each claim. The Bank processed more than 15 000 claims and made \$6.9 million in payments in 2013/14. This was a reduction from 2012/13, which was boosted by claims arising from floods in Queensland and New South Wales.

Counterfeiting in Australia

In 2013/14, a total of 18 657 counterfeits were detected in circulation, with a nominal value of \$1 083 680. This corresponds to around 15 counterfeits detected per million genuine banknotes in circulation. The majority of counterfeits in 2013/14 were \$50 and \$100 banknotes. Although this represents an increase in counterfeiting activity from recent years, the level of counterfeiting remains low by international standards.

Counterfeit Banknotes in Australia

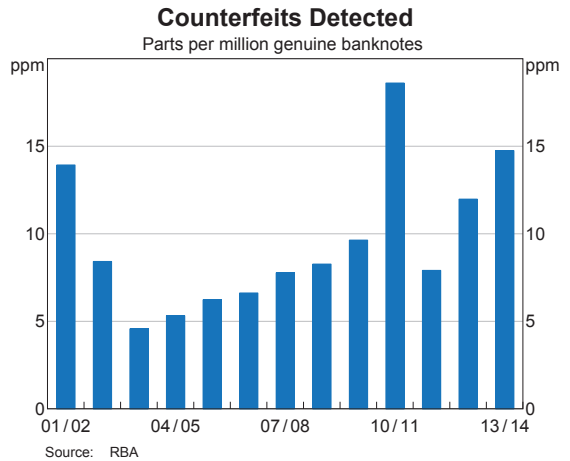
2013/14

	\$5	\$10	\$20	\$50	\$100	Total
Number	16	45	440	14 825	3 331	18 657
Nominal value (\$)	80	450	8 800	741 250	333 100	1 083 680
Parts per million	0.1	0.4	2.8	26.0	12.6	14.8

Source: RBA

The Reserve Bank works closely with law enforcement agencies to monitor trends in counterfeiting and identify emerging counterfeiting threats. The Bank's Counterfeit Examination Laboratory, located in Craigieburn, Victoria, also assists police by providing counterfeit examination services, including preparing expert witness statements and court testimonies.

During 2013/14, the Bank conducted Counterfeit Deterrence Workshops in Melbourne and Perth in partnership with the Australian Federal Police. These workshops provided participants with an opportunity to discuss counterfeit deterrence initiatives as well as develop a broader understanding of banknote security features. Both workshops were well attended by a broad cross-section of organisations, including the Australian Federal and State Police, cash-in-transit companies, financial institutions, casinos and retailers.



Next Generation Banknote (NGB) Project

While Australia has experienced relatively low levels of counterfeiting – both in absolute terms and compared with other countries – the Reserve Bank has an ongoing commitment to ensure that Australia's counterfeiting level remains low into the future. As a part of this commitment, in 2012 the Bank announced plans to upgrade the security features on Australia's banknotes as part of the NGB project.

The current series has been in circulation for around 20 years, whereas many countries tend to upgrade their banknotes every seven to ten years. The longevity of the current series is a direct payoff from the investment made in developing polymer banknotes, which have been a key contributor to Australia's low counterfeiting rates.

Since the project to upgrade the security of Australia's banknotes was established in 2007, considerable work has been undertaken, including the development, testing and review of banknote designs and production trials of new security features. While the new banknotes will retain many of the key design elements of the current banknote series, including the people portrayed, size, general colour palette and denominational structure, there will be design changes to accommodate new security features. The Reserve Bank has consulted extensively with key users of banknotes, including banknote equipment manufacturers, retail organisations, financial institutions and the vision-impaired community. These ongoing consultations provide an opportunity to ensure that the new banknotes will continue to meet the various needs of the whole community.

It is anticipated that it will be several years before the full series of upgraded banknotes will be issued into circulation, with the issuance of the denominations staged across a number of years. The time required to complete the project reflects the complexity of the process of designing and producing a new banknote, extensive community consultation and the need to make sure that the design produces a secure, functional and durable banknote.

As at the end of June 2014, \$16.6 million had been spent on design, development and testing. This investment will help maintain the security of Australia's banknotes.

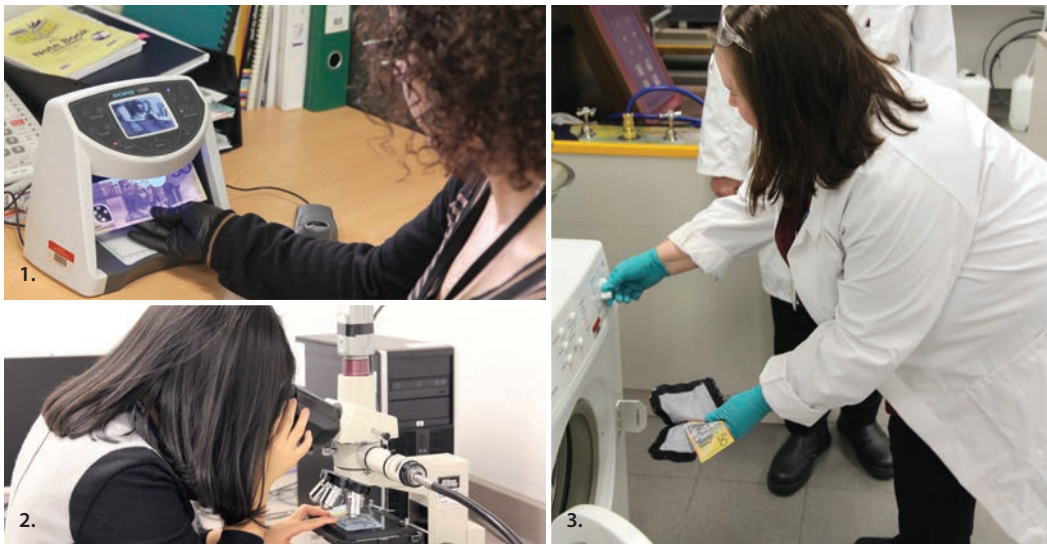
Banknote Infrastructure Modernisation Project

In preparation for the logistical demands arising from the introduction of a new series of banknotes, the Reserve Bank has begun work to upgrade its existing banknote infrastructure. The main objectives of the upgrade are to increase banknote storage and processing capacity, and to introduce new technologies and systems to improve banknote logistics processes and simplify distribution arrangements with the cash-in-transit companies. The upgrade will include the construction of the National Banknote Site (NBS), which will be built on the Bank's existing Craigieburn property to accommodate the storage, processing and distribution functions of the banknote operation. The new two-storey building was approved by the Parliamentary Public Works Committee in March 2014, with a budget of \$72 million, and is scheduled for completion in 2017.

The Reserve Bank is also undertaking a banknote logistics improvement program that will simplify manual processes in the Bank's existing sites and introduce automated processes at the NBS. This will allow for more efficient workflows and a reduction in work health and safety risks, and further improve the security associated with the handling of banknotes. The program will also enhance the Bank's existing information technology systems. In parallel, the Bank will increase its capacity to process unfit banknotes through the purchase of two additional high-speed banknote processing machines.

Banknote Research and Development

The Research and Development program conducted by the Reserve Bank aims to ensure that Australian banknotes remain both secure against counterfeiting and functional for a wide variety of users. Innovative new technologies that can help achieve this objective are identified and developed into new security features for banknotes through a range of collaborations with third parties, including universities, public and private companies, research institutes and other central banks. The Bank also contributes to several international forums concerned with banknote security, including the Central Bank Counterfeit Deterrence Group, which examines emerging threats in counterfeiting technologies, and the Reproduction Research Centre, which provides facilities to test anti-counterfeiting technologies.



1, 2. R&D staff performing forensic analysis of counterfeits 3. R&D staff conducting quality assurance of banknotes

Located in the NPA building in Craigieburn, Victoria, the Research and Development section works closely with the Reserve Bank's partners and suppliers to introduce new technologies and features into the banknote production process. The staff also provide extensive technical services in the areas of finished banknote quality assurance, assessment of damaged banknotes and the evaluation of suspected counterfeit banknotes.

In 2013/14, the research program focused heavily on the development of the NGB series, conducting extensive trialling to ensure the new features are secure and durable, along with the development of new testing methodologies that will form part of the quality assurance program.

Community Liaison

The Reserve Bank actively consults and liaises with a broad range of stakeholders, which includes users and manufacturers of banknote equipment, representative groups from the vision-impaired community, law enforcement agencies, retail organisations, schools and financial institutions. More than 110 presentations were made to these groups during 2013/14, with the aim of increasing knowledge about banknotes in the community and, in some cases, receiving feedback.

The Reserve Bank's banknotes microsite continues to play an important role in providing information about banknotes to the general public and has been updated to include additional activities for younger audiences.

An online school education resource aimed at educating primary school students about Australia's banknotes was also developed as a collaborative project between the New South Wales Department of Education and Communities and the Reserve Bank. The resource, which provides engaging and interactive information about banknotes through history and mathematics activities aligned to the Australian curriculum as well as comprehensive teaching notes, is expected to be launched later in 2014.

Numismatic Banknote Sales

The Reserve Bank conducted numismatic banknote sales in July and August 2014 for all denominations of banknotes produced in 2013. These banknotes were sold to the public at set prices during a six-week sale period.

Note Printing Australia Limited (NPA)

NPA is a wholly owned subsidiary of the Reserve Bank that produces banknotes and operates the NNPDC on behalf of the Bank. NPA operates under a charter reviewed and approved annually by the Reserve Bank Board. Specifically, NPA's prime function is the efficient and cost-effective production of high-quality and secure Australian banknotes, in accordance with the specifications and requirements of the Bank. The charter also permits NPA to undertake other activities, including developing and producing passports for the Department of Foreign Affairs and Trade (DFAT), producing banknotes for other issuing authorities and producing some other security products. In recent years, these activities have included the production of banknotes for some countries in the Asia-Pacific region. In all cases, NPA dealt directly with the relevant central banks.

NPA is governed by a Board of Directors appointed by the Reserve Bank. As at 30 June 2014, the Board comprised four Bank executives and a member of the Reserve Bank Board: Michele Bullock, Assistant Governor (Currency) as Chair; Keith Hall, Assistant Governor (Banking and Payments); Lindsay Boulton, Head of Banking Department; Michelle McPhee, Head of Risk and Compliance Department; and Heather Ridout AO, a member of the Reserve Bank Board. The NPA Board has an Audit and Risk Committee, whose membership comprises

Keith Hall (Chair), Lindsay Boulton and an external member, Alan Beckett, a company director and former senior audit partner of a major accounting firm with extensive experience in the corporate sector, including manufacturing.

In late June 2014, NPA's Chief Executive Officer, Bernhard Imbach, resigned to take up a position elsewhere in the industry. The NPA Board appointed NPA's Chief Financial Officer, Malcolm McDowell, as Acting Chief Executive Officer until such time as the Board appoints a new chief executive. Six business units report to NPA's Chief Executive Officer: Financial Services, Manufacturing Operations, Passports Business and Support Services, Quality Management, Risk Management and Security, and Human Resources. The Chief Executive Officer and the heads of these business areas constitute NPA's Executive Committee. As at the end of June 2014, NPA employed 225 permanent staff.

In 2013/14, NPA delivered 30.1 million Australian banknotes to the Reserve Bank under a contract entered into in 2011. NPA also provided banknote distribution and banknote processing services to the Bank during the year, under a contract entered into in 2001. The aggregate amount paid by the Bank to NPA in 2013/14 for the supply of banknotes and related services under the above contracts was \$48.9 million. The Reserve Bank Board did not take any decisions in 2013/14 in relation to these two supply contracts between NPA and the Bank.

In addition, NPA delivered 141.4 million banknotes to other countries in 2013/14, including Brunei, New Zealand and Papua New Guinea. NPA also produced 1.2 million passports for DFAT during the year in review, including 0.8 million of the new P series passports introduced in June 2014.

The financial accounts of NPA are consolidated with those of the Reserve Bank.

International Financial Cooperation

The Reserve Bank actively participates in work addressing the challenges facing the global economy and improving the global financial architecture. It does so through its membership of global and regional forums and its close bilateral relationships with other central banks.

Group of Twenty (G20)

The G20 facilitates international cooperation on economic and financial policy issues. In December 2013, Australia officially commenced its 2014 presidency of the G20, with the year culminating in a Leaders Summit to be held in Brisbane in November 2014. In the lead-up to this Summit, there have been a range of G20 meetings held in Australia and overseas, including a meeting of Finance Ministers and Central Bank Governors in Sydney in February, with another to take place in Cairns in September. The Governor and Deputy Governor have been responsible for chairing meeting sessions covering recent developments in the global economy and financial stability issues, with Reserve Bank staff in the International and Financial Stability Departments working with Australian Treasury officials to help set the agenda for these meetings.

At the November 2014 Summit, G20 Leaders will release an 'Action Plan', which will be based on comprehensive growth strategies from each G20 member. These strategies will aim collectively to lift the level of GDP by 2 per cent over the next five years compared with the trajectory as at October 2013. In addition to details on macroeconomic policies, it is intended that the growth strategies will consist of concrete actions across the G20 that aim to increase investment, lift employment and participation, enhance trade and promote competition. The Reserve Bank and the Australian Treasury are members of a working group supporting this exercise.

Investment, particularly in infrastructure, is a focus for the G20 in 2014. G20 members have been preparing individual plans that will feed into the Brisbane Action Plan outlining policies intended to increase investment in the coming years. In addition to spending measures, these plans include reforms to remove constraints to private investment by establishing sound and predictable policy and regulatory frameworks to promote investment. The Reserve Bank, alongside the Australian Treasury, has made regular contributions to the Investment and Infrastructure Working Group created to carry on the work of a study group established in 2013. The working group is examining collective ways to better channel global savings to productive investments, including ways to harness the resources of the multilateral development banks. The Bank held its annual research conference on the topic of 'Financial Flows and Infrastructure Financing' (hosted jointly with the Lowy Institute for International Policy and the Productivity Commission) to support the work on infrastructure during Australia's G20 presidency. The Bank is also a member of the G20/OECD Taskforce on Institutional Investors and Long-term Financing, which has worked closely with the G20 Investment and Infrastructure Working Group. The taskforce has engaged with institutional investors in developing high-level principles for long-term investment financing and has more recently been examining the implementation of these principles in member countries.

Reform of the international monetary system continues to be a priority for the G20. However, work in this area has been delayed because the United States is yet to pass the International Monetary Fund (IMF) quota and

governance reforms agreed to in 2010. The G20 remains committed to maintaining a strong and adequately resourced IMF and has urged ratification of the reforms at the earliest opportunity. If the 2010 quota and governance reforms are not ratified by the end of 2014, the G20 will call on the IMF to develop options for these reforms in 2015.

An important element of the G20's agenda over recent years has been reform of financial regulation, to address the problems revealed by the global financial crisis. As G20 chair, Australia has supported the Financial Stability Board's focus on the following core reform areas: (1) building resilient financial institutions; (2) ending 'too big to fail'; (3) addressing 'shadow banking' risks; and (4) making derivatives markets safer. The focus is to set priorities for the regulatory reform effort and bring some key aspects in these core reform areas to completion. As outlined below, several international bodies, working together with national authorities, including the Reserve Bank, have made good progress in advancing financial regulation reforms in these four core areas.



G20 Finance Ministers and Central Bank Governors in Sydney, February 2014

Financial Stability Board (FSB)

During the year in review, the FSB has continued to play an important role in overseeing the international financial regulatory reform agenda. FSB members include representatives from 24 economies (including all the G20 economies), as well as the main international financial institutions (including the IMF and the Bank for International Settlements) and standard-setting bodies, such as the Basel Committee on Banking Supervision (BCBS).

The Reserve Bank, together with the Australian Treasury, represents Australia on the FSB. The Governor is a member of the FSB Plenary (the decision-making body of the FSB) and two FSB committees. The Head of Financial Stability Department is a member of an analytical group that assesses global financial vulnerabilities. A senior officer in Domestic Markets Department continues to participate in the Financial Innovations Network, which operates under this analytical group and provides structured monitoring of financial innovations in order to assess, at an early stage, potential systemic risks to countries, markets and sectors, and potential cross-border impacts. The Bank is also involved in several specific FSB working groups.

In addition to regularly assessing vulnerabilities in the global financial system, the FSB coordinates international financial regulatory reform in several areas. A high priority for the FSB in recent years has been to develop, in cooperation with key international standard-setting bodies, a policy framework for addressing the 'too big to fail' problem associated with systemically important financial institutions (SIFIs). Enhancing resolution regimes is a key component of this framework, and a senior officer in Financial Stability Department has joined an FSB group developing important aspects of its work on resolution, such as crisis management arrangements, cross-border recognition of resolution actions and proposals on loss-absorbing capacity.

Another priority has been addressing the risks posed by 'shadow banking', credit intermediation involving entities and activities outside the regular banking system. In Australia, the shadow banking sector is a relatively small share of the financial system compared with a number of other jurisdictions. The FSB presented recommendations in this area to the G20 Leaders Summit in September 2013, with the focus now on implementation. Reserve Bank officers are members of two FSB working groups looking at dealing with the risks posed by shadow banking entities other than money market funds and by securities-financing transactions.

The FSB continues to monitor the implementation of the G20 commitments to reform over-the-counter (OTC) derivatives markets and to highlight areas where further international work is needed to reduce the scope for contagion in these markets. The Australian Securities and Investments Commission (ASIC) is the main domestic regulator involved in this work, but there is a high degree of cooperation with the Reserve Bank on issues of common interest. ASIC represents Australia on an International Organization of Securities Commissions (IOSCO) working group that is developing risk mitigation standards for OTC derivatives and was represented on the BCBS-IOSCO working group that finalised margin requirements for non-centrally cleared OTC derivatives in September 2013. ASIC has consulted closely with the Bank as these workstreams have progressed. The Bank and ASIC participate in the OTC Derivatives Regulators' Forum, an international group that facilitates cooperation and information sharing between regulators of OTC derivatives markets and infrastructure.

The FSB has embarked on a review of the structure of its representation, to strengthen the group's effectiveness and ensure the views of its members are taken into consideration when developing reform proposals. This is an issue on Australia's G20 agenda this year and both the Reserve Bank and the Australian Treasury have provided input to the review; the final report will be prepared for the G20 Leaders Summit in November 2014.

The FSB's Regional Consultative Group (RCG) for Asia is one of six regional groups established to expand the FSB's outreach activities with non-member economies. The Reserve Bank, together with the Australian Treasury, participated in two working groups established by the RCG for Asia, one on the impact of the SIFI framework on Asia and the second on the structure of shadow banking in Asia.

Other areas of the FSB's work over the past year include:¹

- reforming the setting of interbank and other financial benchmark rates. Through an Official Sector Steering Group (OSSG), the FSB has guided work on reforms to short-term interest rate benchmarks and set out processes by which suitable alternatives to existing benchmarks may be identified. The report of the OSSG was published in July. The Assistant Governor (Financial Markets) is a member of the OSSG and also co-chairs an OSSG sub-group on foreign exchange benchmarks, which released its report for public consultation in July. The final report will be presented at a FSB Plenary meeting in Cairns in September 2014
- continuing its program of peer reviews, with a thematic review on reducing reliance on credit rating agency ratings released in May 2014. The FSB also conducts country peer reviews, which focus on the

¹ For further details, see RBA (2014), *Financial Stability Review*, March.

implementation and effectiveness of regulatory, supervisory or other financial sector standards and policies within individual FSB member jurisdictions. A peer review of the United Kingdom, in which the Head of Financial Stability Department participated, released its report in September 2013

- releasing jointly with IOSCO a consultation paper in January 2014 on assessment methodologies for identifying non-bank non-insurer global SIFIs, covering entities such as finance companies and investment funds. A Reserve Bank officer is on the FSB working group that developed these methodologies
- conducting a feasibility study of options for aggregating information from trade repositories.

Since late 2012, a senior officer in Payments Policy Department has been on secondment to the FSB, to work in the area of OTC derivatives market reforms and more recently on the cross-border effects of structural banking reforms undertaken, or proposed, in recent years by several jurisdictions.

Bank for International Settlements (BIS)

The BIS and its associated committees play an important role in supporting collaboration among central banks and other financial regulatory bodies by bringing together high-level officials to exchange information and views about the global economy, vulnerabilities in the global financial system and other issues affecting the operations of central banks. The Governor or Deputy Governor attend the regular bimonthly meetings of governors at the BIS, which are the main forums for discussing those issues. They also participate in meetings of the Asian Consultative Council, which focuses on financial and monetary developments in Asia and provides direction for the work of the BIS in Asia.

The Assistant Governor (Financial Markets) represents the Reserve Bank on two BIS committees, as chair of the Markets Committee and a member of the Committee on the Global Financial System (CGFS). The Markets Committee considers how financial regulations and economic developments may affect central bank operations and broader financial markets. In the past year, it has discussed the changing execution structure of the foreign exchange market, the European money market and developments in pricing benchmarks for interest rates and foreign exchange. The CGFS monitors developments in financial markets, focusing on potential vulnerabilities in the global financial system. In recent times there has been extensive discussion in both groups of the influence of unconventional monetary policies, and their eventual withdrawal, on capital flows to and from emerging market economies.

In the past year, Reserve Bank staff members have participated in a number of CGFS and Markets Committee groups.

- The Head of Domestic Markets Department is participating in a joint CGFS-Markets Committee Study Group on central bank operating frameworks and collateral markets. A report is expected to be produced by November 2014, which will examine how the choice of monetary policy framework influences collateral markets.
- A senior officer in Domestic Markets Department is participating in a CGFS Study Group on market making and proprietary trading. The group will produce a report on trends, drivers and implications of developments in market making and proprietary trading for the CGFS meeting in September 2014.
- A senior officer in International Department participated in a CGFS Study Group that considered recent structural changes in the provision of trade finance. The group released its report in January 2014.²
- A senior officer in International Department is participating in a joint CGFS-Markets Committee working group assessing the impact of global regulatory initiatives on how central banks implement monetary policy. A draft report will be discussed by Governors in May 2015 at a BIS Economic Consultative Committee meeting.

2 See CGFS (2014), 'Trade Finance: Developments and Issues', CGFS Papers No 50. Available at <<http://www.bis.org/publ/cgfs50.pdf>>.

- A senior officer in Financial Stability Department participated in a CGFS working group that analysed the implications of international expansion by regionally focused banking groups in emerging market economies. The group released its report in March 2014.³

Basel Committee on Banking Supervision (BCBS)

Following the financial crisis, the BCBS developed new capital and liquidity standards for banks (known as Basel III) to increase the resilience of banks to financial and economic shocks. The Australian Prudential Regulation Authority (APRA) implemented the bulk of the capital reforms in January 2013 and will implement the short-term liquidity standard in full in January 2015. Other countries are also continuing to implement Basel III capital and liquidity reforms. This implementation is the subject of comprehensive monitoring by the BCBS, which regularly reports its findings to both the FSB and the G20. The Assistant Governor (Financial System) and the Chairman of APRA represent Australia on the BCBS, while the Governor and Chairman of APRA represent Australia on the oversight body of the BCBS, the Group of Governors and Heads of Supervision.

Following work by a BCBS taskforce co-chaired by the Assistant Governor (Financial System), the BCBS announced in January that a restricted version of a committed liquidity facility may be used by all jurisdictions (not just those with an insufficient stock of high-quality liquid assets such as Australia), subject to the discretion of the central bank.

A senior officer in Financial Stability Department continues to be a member of the Macroprudential Supervision Group of the BCBS. Over the past year, this group again worked mainly on aspects of the BCBS' methodology for global systemically important banks (G-SIBs), such as reviewing the results of the annual G-SIB data collection exercise and assessment. It also commenced discussions of practical issues that are arising as jurisdictions start to develop their countercyclical capital buffer frameworks.

Committee on Payment and Settlement Systems (CPSS)

The Reserve Bank is a member of the CPSS, which serves as a forum for central banks to monitor and analyse developments in payment and settlement infrastructures and set standards for them. The CPSS met four times over the year to the end of June 2014, with a senior officer in Payments Policy Department representing the Bank. This officer also represents the Reserve Bank as a member of the CPSS-IOSCO Steering Group, which brings together members of both the CPSS and IOSCO to advance policy work on the regulation and oversight of financial market infrastructures (FMIs). This group met twice during the year in review. Reserve Bank staff participate in a number of workstreams arising from the CPSS and the Steering Group.

A taskforce monitoring the international implementation of the *Principles for Financial Market Infrastructures* (PFMIs) published an initial assessment report in August 2013. This was updated in May 2014. Further work will assess the consistency of implementation measures across jurisdictions.

To complement adoption of the PFMIs as regulatory standards, CPSS and IOSCO continue to work on a framework for public disclosures by FMIs. This is intended to provide objective fact-based disclosure to enable independent assessment of the risk characteristics of FMIs, including their compliance with the PFMIs.

The PFMIs establish a comprehensive framework for day-to-day risk management and also require FMIs to consider recovery actions in extreme circumstances. The CPSS and IOSCO are jointly drafting guidance on how to meet the PFMI requirements for recovery. Guidance was issued for consultation in August 2013. Final guidance is expected to be released later in 2014.

3 See CGFS (2014), 'EME Banking Systems and Regional Financial Integration', CGFS Papers No 51. Available at <<http://www.bis.org/publ/cgfs51.pdf>>.

A CPSS working group has surveyed the use of centralised services to manage the collateral of financial market participants. A report noting the benefits and potential risks across the range of services currently being offered is expected to be released later in 2014.

The CPSS also conducts research on retail payments issues and issued a report on innovations in retail payments in May 2012, which identified the increasing importance of non-banks in retail payment systems. Subsequently, a working group was established to prepare a report on the role of non-banks in retail payments and the implications for risk, efficiency and competition. The report is expected later in 2014.

International Monetary Fund (IMF)

The IMF carries out assessments of the global economic outlook and the risks to financial stability and provides policy advice to countries based on its country surveillance missions. Over the past year, the IMF has provided financial assistance to a number of member countries and made progress on refining its precautionary facilities.

Australia holds a 1.36 per cent quota share in the IMF and is part of the Asia and the Pacific Constituency, which is represented by one of the IMF's 24 Executive Directors. The Reserve Bank works with the Australian Treasury to provide support to the Constituency Office at the IMF on issues that are to be discussed by the IMF's Executive Board. The Bank also supports the Constituency Office directly by seconding an advisor with expertise in financial markets and financial sector issues.

The IMF continued to support its member countries through financial assistance programs, although new lending arrangements were much smaller in the past year than in the years following the onset of the financial crisis, when large programs were provided to Greece, Ireland and Portugal.

Among the larger programs approved during the year in review were a SDR 10.98 billion stand-by facility provided to Ukraine and a SDR 4.39 billion extended arrangement to Pakistan. The IMF has provided ongoing support to members with existing lending arrangements by making scheduled loan disbursements. As at July 2014, the IMF's outstanding credit was around SDR 88 billion. Lending to Greece, Ireland and Portugal accounted for the bulk of this, with these countries accounting for outstanding credit of SDR 66 billion. Ireland and Portugal have recently exited their assistance arrangements and are scheduled to begin repaying outstanding credit in 2015.

Executives' Meeting of East Asia-Pacific Central Banks (EMEAP)

EMEAP brings together central banks from 11 economies in the east Asia-Pacific region – Australia, China, Hong Kong SAR, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand – to discuss issues relevant for monetary and financial stability, foster closer cooperation and exchange information and expertise on issues of common interest. The Reserve Bank participates in EMEAP at a number of levels, including at those of governor and deputy governor.

At the Governors' and Deputies' meetings during the year in review, members discussed a range of topics, including economic and financial developments and the implications of international regulatory developments for the EMEAP region.

At the Deputy Governor level, the Monetary and Financial Stability Committee (MFSC) focused on strengthening regional cooperation and monitoring economic and systemic risks. The Reserve Bank also continued to participate in the three working groups that report to the Deputies and support the surveillance work of the MFSC, namely the Working Group on Financial Markets (WGFM), the Working Group on Banking Supervision (WGBS), and the Working Group on Payment and Settlement Systems (WGPSS). There are also regular meetings of IT Directors from EMEAP member central banks.

For the two years ending July 2014, the Assistant Governor (Financial Markets) chaired the WGFM, which has responsibility for the analysis and development of foreign exchange, money and bond markets in the region. It is closely involved at a working level with the operation and development of the Asian Bond Funds (ABF1 and ABF2), which includes maintaining dialogue between EMEAP and each of the fund managers on issues such as the performance of the funds. Over the past two years, an area on which the group has focused attention has been to enhance EMEAP's interaction with these fund managers. The working group has held regular discussions on the impact of regulatory reform measures on regional financial markets and on developments in financial benchmarks. It has also produced a report assessing the state of repo markets in the region.⁴

EMEAP deputy governors are responsible for the ongoing oversight of AFB1, a US dollar-denominated Asian bond fund, and also AFB2, comprising eight local currency-denominated bond funds and a Pan Asia Index Bond Fund (see the chapter on 'Operations in Financial Markets' for further details).

The Head of Financial Stability Department represents the Reserve Bank on the WGBS, together with a senior representative from APRA, while a senior officer in Payments Policy Department is the Bank's representative on the WGPSS. The WGBS provides a regional forum for sharing experiences about best practices in banking supervision and implementation of international reforms. The WGBS has also carried out work on a variety of issues, including resolution and recovery planning and macroprudential analysis. Work of the WGPSS has included monitoring progress of members' implementation of the G20 OTC derivatives market reforms, surveying members on the adoption of the PFMLs, assessing financial inclusion across the region and considering issues associated with virtual currencies such as Bitcoin. The WGPSS has also invited a number of external organisations to share with the group information on their financial infrastructure or cross-border initiatives.

Organisation for Economic Co-operation and Development (OECD)

The OECD comprises the governments of 34 countries and is committed to promoting policies that improve economic and social development globally.

The Assistant Governor (Financial System) continues to chair the OECD Committee on Financial Markets, which is the main OECD body dealing with issues in financial markets, such as banking, securities and derivatives. The Reserve Bank's Chief Representative in Europe is also a member of the Committee. Recent topics of discussion at the Committee included implicit government support for banks, financial consumer protection and longevity risk. Since early 2013, an officer in Economic Group has been on secondment to the OECD, working in the area of macroeconomic policy.

Hong Kong-Australia Renminbi Trade and Investment Dialogue

The Reserve Bank co-facilitated the second Hong Kong-Australia Renminbi Trade and Investment Dialogue, together with the Australian Treasury and the Hong Kong Monetary Authority. The Dialogue, which was held in Hong Kong on 22 May 2014, sought to build further awareness of renminbi (RMB) trade and investment opportunities, and to identify opportunities for collaboration between the Hong Kong and Australian banking sectors to develop the offshore RMB market. Representatives from a number of banks, firms and official sector organisations participated in the Dialogue, including the Bank's Deputy Governor. The event included a meeting of the industry-led RMB Working Group, which was established as a result of the inaugural Dialogue with the aim of identifying practical steps that could be taken to foster the development of the market for RMB

⁴ See EMEAP Working Group on Financial Markets (2014), 'EMEAP Repo Markets: State of Play'. Available at <<http://www.emeap.org/index.asp?menu=publications>>.

banking products in Australia and Hong Kong. In addition to increasing awareness among Australian corporations of RMB trade settlement and investment and supporting initiatives to ensure adequate supply of RMB banking products to the market, the RMB Working Group will also aim to encourage the development of infrastructure to support RMB clearing and settlement, and to collaborate with the Australian and Hong Kong funds management sectors. The Bank will continue to engage with the RMB Working Group on these matters.

Government Partnership Fund (GPF)

The Reserve Bank has continued its involvement with Bank Indonesia (BI) under the auspices of the GPF. This program has supported an exchange of skills and knowledge between Australian public sector institutions and their Indonesian counterparts through a series of attachments and workshops since it began in 2005/06. In 2013, a total of 12 BI officers were attached to the Bank, bringing the total number of attachments since the start of the program to 175. The attachments cover policy and operational areas of the Bank, including economic research, financial markets and financial stability, as well as auditing and human resources.

South Pacific Central Bank Cooperation

In December 2013, the Deputy Governor attended the annual meeting of the South Pacific Central Bank Governors held in Papua New Guinea. This meeting brings together the central bank governors within the Pacific region – Australia, Fiji, New Zealand, Papua New Guinea, Samoa, Solomon Islands, Tonga and Vanuatu – to discuss economic issues of particular interest. The main issues discussed at the annual meeting focused on recent economic developments and financial inclusion. The governors also met with the major regional commercial banks to discuss banking issues.

The Reserve Bank continued to foster closer ties with the South Pacific countries through an exchange of staff. A Bank officer recently completed a two-year secondment to the National Reserve Bank of Tonga.

In addition, the Reserve Bank provided financial support to an officer of the Bank of Papua New Guinea (BPNG) undertaking postgraduate studies at an Australian university. The Reserve Bank of Australia Graduate Scholarship, which was first awarded in 1992, provides financial support to an officer of BPNG to undertake studies at an Australian university in the areas of economics, finance or computing.

Cooperative Oversight Arrangements

Senior officers in Payments Policy Department are engaged in a number of cooperative oversight arrangements for FMI's that operate across borders. The Reserve Bank has for some time participated in an arrangement, led by the Federal Reserve Bank of New York, to oversee CLS Bank, which provides a settlement service for foreign exchange transactions. In 2012, the Bank was invited to join two new cooperative oversight arrangements: the SWIFT Oversight Forum and a LCH SwapClear Oversight College for LCH.Clearnet Limited's SwapClear service for OTC interest rate derivatives.

Bilateral Relations and Cooperation

As in previous years, the Reserve Bank received a number of visitors from overseas. Predominantly from foreign central banks, the visits covered the full range of the Bank's activities and included delegations from China, Malaysia, Mozambique, Russia, Sri Lanka, Thailand and Vietnam.

Community Engagement

Activities of the State Offices

In addition to its Head Office located in Sydney, the Reserve Bank has offices in Adelaide, Brisbane, Melbourne and Perth. These offices play an important role in the Bank's liaison program and form a key component of the Bank's communication with members of the public, business, government, community organisations and academia in their respective states.

The Reserve Bank devotes significant resources to building relationships across a broad cross-section of the community, with a view to gaining firsthand insights into conditions in different industries and regions in the national economy. The staff involved in the liaison program conducted almost 1 000 interviews around the country during the year in review, with information from these meetings reported to Head Office and incorporated in the material prepared for the monthly Reserve Bank Board meetings and the quarterly *Statement on Monetary Policy*. In this way, information obtained from liaison is used to complement standard sources, such as data from the Australian Bureau of Statistics and business surveys, in forming the Bank's assessments of the economy.

Staff in the State Offices also play a role in the Reserve Bank's efforts to keep the public informed of its evolving views on the economy. They interact with a broad cross-section of the community, regularly giving presentations on economic developments to business groups, community organisations and educational institutions in state capitals and regional centres. They facilitate regular visits by senior staff from Head Office's Economic Group to meet with liaison contacts and provide briefings on the economy to various groups in the community. Staff from the State Offices also visit Tasmania and the Northern Territory to gather information on economic conditions in those parts of Australia.

Liaison with Small Businesses

The Reserve Bank continues to convene its Small Business Finance Advisory Panel, which was established in 1993 and meets annually to discuss issues relating to the provision of finance and the broader economic environment for small businesses. Membership of the Panel is drawn from a range of industries across the country. The Panel provides a valuable source of information on the financial and economic conditions faced by small businesses. The Bank's liaison program also involves Bank staff meeting with a number of small businesses and small business groups.

Museum of Australian Currency Notes

The Reserve Bank's Museum houses a permanent collection of artefacts, hosts periodic exhibitions and offers regular talks and tours. The permanent collection portrays the story of Australia's banknotes against the backdrop of the nation's broader social and economic history. It welcomes visitors with a display of the types of money used before Federation – from an early colonial rum bottle through to Australia's first gold coins.

Visitors can then view various banknotes produced since the first Australian note series in 1913–1915. Finally, the Museum focuses on Australia’s polymer banknotes, describing their design, security features and potential for recycling. When viewing the collection, visitors can observe the evolution of the nation’s identity as expressed through its banknotes and learn about the influential women and men depicted on them and the intricate artwork used in banknote design.



1. Information Department and Note Issue Department staff on Australia Day 2014 in the Reserve Bank’s Museum of Australian Currency Notes (from left) Anita Siu, Rose Kenney, Amanda Evans, Jeff Connors, Bronwyn Nicholas, Kimberly Francis, Kaja Troa, Silvana Scelsi and Rebecca Dredge **2, 3, 4.** Visitors to the Museum included locals, tourists and family groups **5.** Note Issue Department staff Betty Velovski (left) and Silvana Scelsi (right) help out at the ‘chatterbox’ station, one of the activities available in the Museum on Australia Day 2014 that aimed to teach children about the security features on Australia’s banknotes **6.** Children were keen to learn about the history of Australia’s banknotes

An exhibition introduced in 2012, entitled 'Pocket Money', remains a focus of tours in the Museum, particularly for school groups. It captures the relationship between children, money and banking and depicts changing social attitudes to saving. Among the items on display are rare and unusual money boxes dating from the early 20th century. This exhibition has been accompanied by a range of activities in the Museum connected to the school curriculum, which are designed to increase children's understanding of the role of money and the characteristics of the nation's banknotes.

More than 15 000 people visited the Museum over the year to the end of June 2014, higher than in the previous two years. There were over 2 000 visitors on Australia Day 2014, a record for one day. More generally, Museum attendance was boosted by the Reserve Bank's participation in the NSW Office of Communities' 'Go Play' initiative, NAIDOC Week, History Week and its collaboration with other museums in the precinct through 'The History Trail' program. A wide cross-section of the public visited the Museum, with educational groups accounting for around one-third of total visitors. Presentations and tours have been prepared to cater for more stages of learning. As a result, in addition to talks to senior high school students on the economy and the role of the Bank, there has been a significant increase in the number of talks to students in primary and junior high school, with a school holiday program also having been introduced. Furthermore, the Museum is increasingly receiving organised visits by groups of new migrants, those with English as a second language and those from remote communities, all of whom are interested in learning about the nation's currency. Most of the information in the Museum is depicted on the Museum's website.

Assistance for Research and Education

The Reserve Bank sponsors Australian and international economic research in areas that are closely aligned with its primary responsibilities. This sponsorship includes financial support for conferences, workshops, data gathering, journals and special research projects, and encompasses areas of study such as macroeconomics, econometrics and finance. In addition, the Bank provides financial support for the activities of the Sydney Institute and the Centre for Independent Studies.

In 2013/14, the Reserve Bank continued its longstanding contribution towards the cost of a monthly survey of inflation expectations undertaken by the Melbourne Institute of Applied Economic and Social Research at the University of Melbourne, and a quarterly survey of union inflation and wage expectations undertaken by the Workplace Research Centre at the University of Sydney.

The Reserve Bank continued to provide financial support for the *International Journal of Central Banking*, the primary objectives of which are to disseminate first-class, policy-relevant and applied research on central banking and to promote communication among researchers both inside and outside central banks. The Bank continued its support of the International Accounting Standards Board and also its longstanding practice of supporting the Group of Thirty's program of research into issues of importance to global financial markets.

Financial assistance to Australian universities each year includes contributions towards the costs of conferences on economics and closely related fields. In 2013/14, these conferences included: the 26th Conference for PhD Students in Economics and Business, held at the Australian National University; the Economic Society of Australia's Conference of Economists, held jointly with the Australasian Meeting of the Econometric Society at the University of Tasmania; the 19th Melbourne Money and Finance Conference; the University of New South Wales 26th Australasian Finance and Banking Conference; the Paul Woolley Centre's Study of Capital Market Dysfunctionality Conference 2013, held at the University of Technology, Sydney; the 2014 Asia Pacific Productivity Conference, hosted by the University of Queensland; and the inaugural Workshop of the

Australasian Macroeconomics Society at the University of Melbourne (the latter represents a joining of the former Workshop on Macroeconomic Dynamics and the Australian Macroeconomic Workshop). The Reserve Bank also supports the discussion of economic issues in the community by providing a venue for the Economic Society of Australia's Lunch Time Seminar Series and the Emerging Economist Series.

The total value of support offered for research and education in 2013/14 was \$306 500.

The Reserve Bank sponsors an annual essay competition across Australia designed to engage and support undergraduate students of economics. The competition is organised jointly with the University of New South Wales Economics Society and the Economic Society of Australia. In 2013, students were invited to discuss trends in household saving and the implications for macroeconomic policy and financial stability in Australia. Supriya Mehta (University of Wollongong) wrote the winning essay, the runner-up was



Governor Glenn Stevens presented the winners of the annual Reserve Bank of Australia and Economic Society of Australia essay competition with their prizes in October 2013 (from left) Isabel Hartstein (best first-year essay), Michael Read (runner-up) and Supriya Mehta (winner)

Michael Read (University of Sydney) and the best essay from a first-year student was written by Isabel Hartstein (University of New South Wales). These students were presented with prizes by the Governor at a ceremony at the Bank in October 2013. For the 2014 competition, students have been invited to submit an essay on factors explaining slowing productivity growth in Australia.

In conjunction with the Australian Prudential Regulation Authority (APRA), the Reserve Bank has continued to sponsor the Brian Gray Scholarship Program, initiated in 2002 in memory of a former senior officer of the Bank and APRA. Three scholarships were awarded under this program in 2014, for honours studies in economics and law at the University of Western Sydney, in commerce at the University of New South Wales and commerce and business at Flinders University. The cost to the Bank of these scholarships in 2014 was \$22 500.

Over the past year, the Reserve Bank hosted visits by numerous researchers (including academics, postgraduate students, authors, journalists, numismatists, heritage architects and designers) interested in accessing the Bank's archives. The archives contain a rich collection of records about the Bank's own activities as well as those of financial institutions in Australia that predate the creation of the central bank as a separate institution. Because the central bank was formerly the government printer for materials other than banknotes, the Bank's archives also include a historical collection of Australian stamps, posters and vouchers (including wartime ration tickets). There has been a substantial increase in the number of requests to view records from the 1980s and early 1990s, with particular interest in records relating to the floating of the Australian dollar and the commencement of inflation targeting. There has also been increased interest in earlier records relating to episodes of financial crisis. And there were numerous requests relating to historical design images to be reproduced in publications. The program to digitise the Bank's most significant historical records is progressing, with thousands of records scanned and made available electronically to researchers in recent years. The Bank's

Historian, Professor Selwyn Cornish of the Australian National University, is at an advanced stage of his research for the next volume of the official history of the Reserve Bank, which covers the period from 1975 to 2000.

Charitable Activities

During the year in review, the Reserve Bank made its 12th annual contribution of \$50 000 to the Financial Markets Foundation for Children, of which the Governor is Chairman. In July 2014, in its ninth public event to raise funds, the Governor addressed the Anika Foundation, which was established in 2005 to support research into adolescent depression and suicide.

The Reserve Bank's corporate philanthropy program involves several initiatives, key among which involves dollar-matching staff payroll deductions (totalling \$69 000 in 2013/14) to the Reserve Bank Benevolent Fund. In late 2013, the Bank also matched a donation of \$1 420 to the MS Society, which was raised by Bank staff participating in the 'Sydney to the Gong' charity bike ride. Staff donations of \$3 800 to the NSW Bushfire Appeal were also matched by the Bank.

Reserve Bank staff participated in a number of volunteering activities during the year in review, including the Cancer Council's Biggest Morning Tea fundraiser, the Smith Family Skilled Volunteer Program, Pink Ribbon and Daffodil Days and Foodbank.

The Reserve Bank's contributions under all these initiatives in 2013/14 totalled \$135 175. In addition, the Bank facilitates staff salary sacrificing under a Workplace Giving Program.

Management of the Reserve Bank

Financial Costs

Further progress was made on the program of major work that began in 2012/13. Some new services were delivered in banking and settlements and a number of other large projects moved to a more mature stage of development. This extensive program is based on responding to the material influences likely to shape the Reserve Bank's activities in the foreseeable future: changing policy-related operating demands; strategic risks that will become more threatening if left unattended; and the objective of providing better, more efficient and more resilient services to customers and users of the Bank's systems, many of which are critical to sustaining a stable and efficient financial system. Contemporary information and communication technologies are at the core of much, but not all, of this program. The Next Generation Banknote project, the largest of these initiatives, has comparatively little dependence on IT; the purpose of this project is to ensure confidence in Australia's banknotes is maintained.

While some of the program of work will produce assets that will earn significant revenue streams, much of it is justified in terms of the public interest. Without this work, key parts of Australia's financial infrastructure that the Reserve Bank is responsible for maintaining would fall behind good practice and accepted international norms or would not support evolving policy objectives, particularly in the payments area. Systemic risk would rise or be inadequately managed. Important parts of the program complement industry initiatives that have the objective of providing infrastructure to deliver improved services to the public.

The work ranges across most of the Reserve Bank's core activities, including in the financial markets, banking, note issue, payments and settlements and policy areas. In payments and settlements, infrastructure is being developed to allow low-value payments between banks to be cleared and settled in 'real time'. The Bank is establishing a central 'hub' to clear and settle these payments, as well as a payments platform for consumers and businesses to use for their everyday transactions. The core platform for the real-time interbank payments system, RITS (Reserve Bank Information and Transfer System), has been renewed and will provide the foundation for these new services. The Bank will also adapt its own banking services to participate in these system-wide initiatives. At the same time, the major project to introduce new banking systems for the Bank's own customers, the largest of which is the Australian Government, is being progressively implemented.

In financial markets, a platform is being developed to value residential mortgage-backed securities efficiently, and assess and manage the risk of the Reserve Bank holding these instruments. This will support the Bank's market operations in these assets, including for same-day settlement of direct entry payments, and reduce costs for counterparties. This platform will also support the introduction in January 2015 of the Committed Liquidity Facility, which will be available to provide liquidity to banks at times of financial stress. A strategy on managing business information is being implemented, mainly in policy areas, to provide secure and efficient systems to assist the analysis of economic and market information, the basis for the Bank's consideration of policy action. This strategy will result in a significantly lower-cost system than if individual information systems were replaced in a more fragmentary way as they need to be upgraded.

Introducing the new generation of banknotes, while a major strategic initiative in its own right, will also require highly secure storage facilities on a scale that is not currently available. Such a facility has been approved by the Parliamentary Public Works Committee. This facility, to be built on the Reserve Bank's site at Craigieburn, Victoria, will also provide an opportunity to modernise the logistics of storage, distribution and destruction of banknotes, bringing this into line with current international practice. Design of the facility is under way and construction is expected to begin early in 2015.

These individual projects are complex and the portfolio of work would carry material risk for the Reserve Bank if a major component failed. Accordingly, while the costs of this work are heavily concentrated in developing new assets, new resources have also been made available in areas of risk management, compliance and project governance to ensure that the initiatives proceed efficiently and with careful control of risk. In the long term, strong governance is expected to lower the cost of this portfolio by encouraging more efficient use of resources in the development phase, and provide assurance that complex projects will be delivered as specified. These resources are, nevertheless, reflected in a rise in 'business-as-usual' costs in 2013/14.

More generally, the portfolio of initiatives is contributing substantially to increased capital and operating costs, as summarised in the tables below. General operating costs – the costs associated with running the Reserve Bank, as opposed to those associated with holding assets, making transactions or purchasing banknotes – rose by 10.7 per cent in 2013/14, with operating costs, excluding spending on projects, increasing by 7.7 per cent. Staff costs continue to represent about two-thirds of operating costs. Given the stage at which most of the new initiatives currently stand and the work still to come, project-related expenditure is expected to rise significantly further over the next two years or so before it recedes. As noted, as these initiatives are progressively completed, some will deliver a permanent boost to revenue that will partially or fully offset their cost.

General Operating Costs^(a) \$ million

	2009/10	2010/11	2011/12	2012/13	2013/14
Staff costs	141.6	148.1	156.7	169.0	184.6
Other costs	68.3	72.1	72.7	76.8	87.4
General operating costs	209.9	220.2	229.4	245.8	272.0
<i>of which:</i>					
Cost of projects	5.2	6.3	9.1	11.8	19.9

(a) Excluding NPA and banknote management expenses, and costs directly linked with transaction-based revenue
Source: RBA

The focus on resourcing new projects is also evident in capital outlays, with the rise in spending on new assets in 2013/14 heavily concentrated in major initiatives to develop IT and communications systems for banking, payments and settlements. Significant alteration of the main printing facility at Craigieburn, including to strengthen security, has also been required in preparation for printing the next generation banknotes.

Capital Costs^(a) \$ million

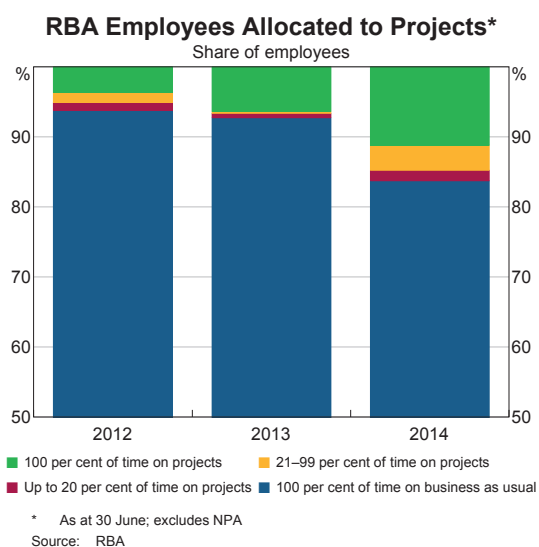
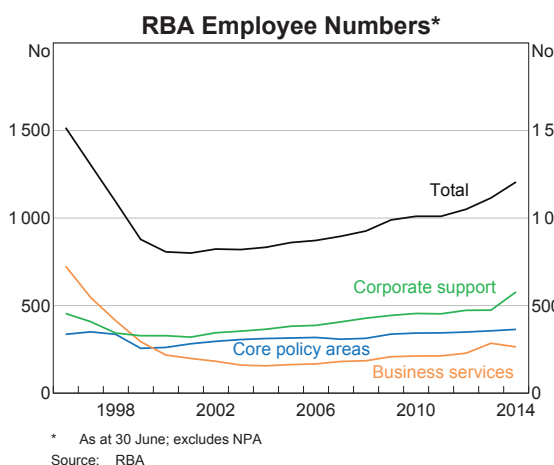
	2009/10	2010/11	2011/12	2012/13	2013/14
Capital costs	21.8	24.9	19.4	29.8	44.2
<i>of which:</i>					
Cost of projects	2.2	2.9	1.7	7.8	18.6

(a) Excluding NPA
Source: RBA

Our People

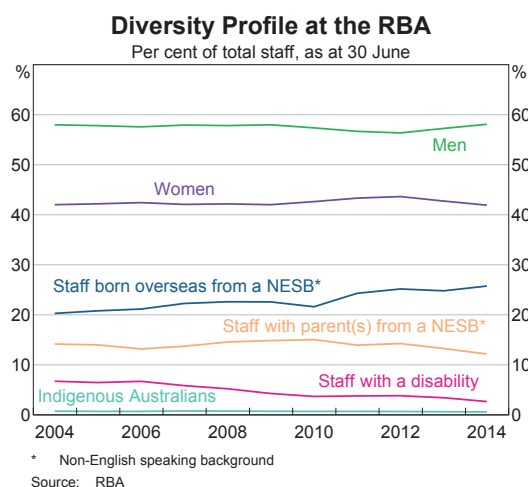
Staff profile

Over the year to June 2014, the total number of employees at the Reserve Bank (excluding Note Printing Australia Limited) increased by 91 to 1 206, a rise of around 8 per cent. This is indicative of the additional resources required for the major, multi-year projects that the Bank is currently undertaking to support its responsibilities. The increasing importance of project-related work at the Bank has meant that the proportion of employees that have had some involvement in such work has risen from 6 per cent in 2012 to 16 per cent in 2014. With the projects entering a more intensive period during 2014/15, this trend is expected to continue.



The Reserve Bank reviews its workforce diversity profile each year and reports on developments in its *Equity & Diversity Annual Report*. Over the past decade, within a relatively stable diversity profile in the Bank overall, there has been an increase in the share of employees from a non-English speaking background and a decline in the share of employees with a disability.

Over 2013/14, the Reserve Bank recruited 214 new staff members, in part reflecting natural turnover but also as a result of newly created positions. A significant proportion of this recruitment was for IT professionals, who accounted for just under half of all new hires. An important recruitment channel for the Bank continues to be the graduate and cadetship programs. In the year to June 2014, the Bank hired 31 graduates and 22 cadets (students in their final year of study who undertake vacation work at the Bank), representing one-quarter of all new employees. These employees work in the Bank's policy, business and corporate service areas and hold degrees in economics, finance, accounting, law, science and other relevant disciplines.



People and culture

The Reserve Bank needs high-quality people working productively together to be able to fulfil its responsibilities. To support this, in 2013 the Bank developed a multi-year strategy for People and Culture. The key objectives of the People and Culture strategy are to:

- identify aspects of the Bank's culture and work environment that are our strengths, as well as areas in which we need to improve, and measure our progress in making improvements
- develop a deep and diverse pool of well-trained potential leaders
- fully utilise the talents of our people
- foster an inclusive and flexible work environment.

Progress was made during the year in meeting these objectives. To support the first objective, all employees were invited to participate in an employee engagement survey. The survey showed that employees are reporting a high level of engagement and also highlighted some potential opportunities to enhance this engagement. Employees across the Reserve Bank have contributed to the development of departmental and enterprise-wide action plans. A follow-up survey will be conducted in around two years to assess progress and identify new opportunities.

The People and Culture strategy also places emphasis on ensuring that the talents of employees are being utilised and the Reserve Bank has a deep and diverse pool of well-trained potential leaders. Accordingly, the Bank has in place a range of development opportunities for employees. While on-the-job training is an important component of this, it is supplemented by formal training programs, such as:

- a two-year Graduate Development Program, consisting of a range of tailored training programs to develop effective business writing, critical thinking, presentation and communication and negotiation skills. A total of 45 graduates are in this program for 2014/15
- programs supporting technical and professional development, including training in project management and change management
- training in management and leadership skills, as well as other general competencies, such as communication skills
- training in the Bank's compliance obligations, including in relation to work health and safety, fraud awareness and anti-money laundering and counter-terrorism financing.



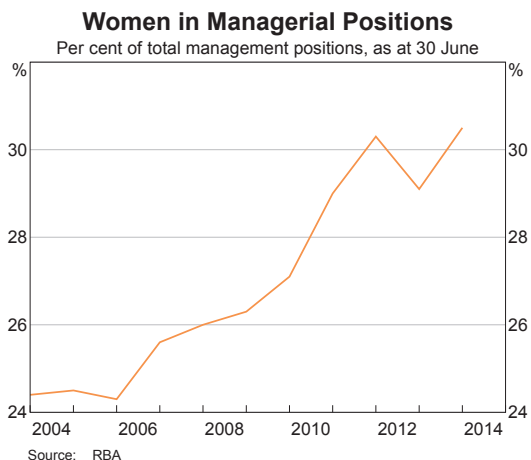
The 2014 graduates at their offsite induction program, February 2014

For a limited number of employees there has also been on-the-job training through attachments to other organisations, including the Departments of the Treasury and the Prime Minister and Cabinet, International Monetary Fund, Organisation for Economic Co-operation and Development, Bank of England and Federal Reserve Bank of New York. At the same time, the Reserve Bank has hosted secondees from the Departments of the Treasury and the Prime Minister and Cabinet and the Australian Competition and Consumer Commission.

Financial support was provided to current employees for part-time study in disciplines related to their work, with around 74 employees studying part-time. In addition, the Reserve Bank provides support for full-time postgraduate study at universities in Australia and overseas; in December 2013, three employees were awarded such assistance. Employees who are supported for full-time study are required to reimburse these costs if they resign either while studying or before completing an agreed period of work after returning from study.

The ongoing development of leadership capabilities at the Reserve Bank was a focus during 2013/14. Key work in this area related to better identifying the competencies required for success in leadership positions and making changes to the way in which the performance of senior staff is assessed. The Bank also implemented an annual multi-rater feedback process for senior staff to help identify any development needs and provide additional input into the assessments of performance. New elements were also introduced to the Bank's leadership development programs.

As part of its People and Culture strategy, the Reserve Bank is committed to achieving an inclusive work environment, including greater representation of women in management positions. Women currently hold 31 per cent of managerial positions, up from 24 per cent a decade ago. While the ongoing development of leadership capabilities (as noted above) should assist women to advance to managerial roles, the Bank will continue to explore additional initiatives that would assist with further progress.



Reserve Bank staff were among the 2 000 participants at the International Women's Day breakfast in Sydney, March 2014

Values and ethics

The Reserve Bank's requirements for its staff and others who are involved in its activities are outlined in the Bank's Code of Conduct, the current version of which was launched in late 2012. The Code sets out the Bank's values, as follows:

- *Promotion of the public interest.* We serve the public interest. We ensure that our efforts are directed to this objective, and not to serving our own interests or the interests of any other person or group.
- *Integrity.* We are honest in our dealings with others within and outside the Bank. We are open and clear in our dealings with our colleagues. We take appropriate action if we are aware of others who are not acting properly.
- *Excellence.* We strive for technical and professional excellence.
- *Intelligent inquiry.* We think carefully about the work we do and how we undertake it. We encourage debate, ask questions and speak up when we have concerns.
- *Respect.* We treat each other with respect and courtesy. We value each other's views and contributions.

During 2013/14, the Bank provided employees with training opportunities to support the requirements of the Code and its values, including training in ethical and fraud awareness.

Remuneration

The Reserve Bank strives to offer a total remuneration package that attracts and engages high-calibre employees. During 2013/14, a review of the employee superannuation arrangements was undertaken and as a result, from 1 August 2014, the defined benefit superannuation scheme was closed to new employees and replaced with a defined contribution scheme more in keeping with current practices in both the private and public sectors.

The Reserve Bank's Workplace Agreement provided for a 4 per cent increase in salaries in 2013/14 for the employees it covers, with scope for a modest additional lump sum payment in recognition of good performance. Employees on individual contracts received, on average, a salary increase comparable to that provided by the Workplace Agreement. The Bank will commence discussions with the Finance Sector Union regarding a new workplace agreement in 2014.

Facilities

The Reserve Bank owns premises in locations where there is a business need to do so, including its Head Office in Sydney; the HC Coombs Centre for Financial Studies in Kirribilli, Sydney; office buildings in Melbourne and Canberra; the note printing facility at Craigieburn, north of Melbourne; and the Business Resumption Site in outer Sydney. In addition to the buildings it owns, the Bank leases accommodation for its State Offices in Adelaide, Brisbane and Perth – where its requirements for space are modest – and for its offices in London, New York and Beijing.

The value of the Reserve Bank's property assets increased by almost \$8 million to about \$333 million in 2013/14, primarily because of an increase in the value of the Melbourne and Kirribilli facilities. A residential property at Kirribilli was sold for \$5.2 million in June 2014. Surplus accommodation in the Bank's properties is leased to external tenants. Gross income from these leases in 2013/14 amounted to \$10.1 million.

During the year in review, the Reserve Bank continued to strengthen the resilience of facilities supporting critical operations. In Sydney, infrastructure associated with the data centre chilled-water system was upgraded to provide greater reliability and capacity. At Craigieburn, work continued to replace and upgrade the mechanical infrastructure supporting the facility's air conditioning and heating system.

Other work in 2013/14 addressed life-cycle replacements or the refurbishment of accommodation in response to changing business needs. At Head Office, work in the basements provided more accessible and more efficient storage areas and better amenities. Some office accommodation was refurbished and a more efficient and lower-cost domestic water heating system was installed in Head Office. Planning is well under way for the National Banknote Site, which, as noted above and in the chapter on 'Banknotes', will entail the construction, on surplus land the Bank owns at Craigieburn, of a new facility for the storage, distribution and processing of banknotes as part of the Next Generation Banknote project.

Environmental Management

The Reserve Bank is committed to improving the environmental performance of its operations. The Environmental Management Committee (EMC) in the facilities management function of the Bank has developed policies that are in accordance with the principles of ecologically sustainable development as set out in the *Environment Protection and Biodiversity Conservation Act 1999*. These policies reduce the impact of the Bank's operations on the environment and include the following initiatives:

- reducing energy, water and paper consumption
- procuring 10 per cent of electricity needs from renewable (green) sources
- increasing the recycling of paper, co-mingled waste and printing cartridges
- adopting environmentally sustainable designs for office fit-outs
- use of 50/50 recycled paper
- greater use of fuel-efficient vehicles.

Electricity consumption declined by 3 per cent in 2013/14, compared with the five-year average. The biggest reduction in electricity consumption occurred at Craigieburn, which was associated with lower levels of production activity at Note Printing Australia Limited.

Gas consumption during 2013/14 was 5 per cent lower than the average for the previous five years, mainly reflecting the new gas heaters for hot water at Head Office. Use of water fell by 12 per cent, as a result of improved metering arrangements, and was 16 per cent lower than the average of the previous five years.

The amount of waste produced by the Reserve Bank fell by 6 per cent compared with the five-year average.

The Reserve Bank's EMC will continue to set targets and pursue lower energy and water consumption. Some of the initiatives being investigated currently include extending sub-metering systems and seeking greater energy efficiency in IT operations.

Consultancies

The Reserve Bank employs outside contractors and professional service providers to carry out specific tasks where necessary and also, from time to time, uses consultants. Consultants are engaged where the Bank lacks specialist expertise or when independent research, review or assessment is required. Consultants are typically engaged to investigate or diagnose a defined issue or problem; carry out defined reviews or evaluations; or provide independent advice or information to assist in the Bank's decision-making. Prior to engaging consultants, the Bank takes into account the skills and resources required for the task, the skills available internally and the cost-effectiveness of engaging external expertise.

Spending on consultancies over the past seven years is shown in the table above.

As in previous years, consultancies during 2013/14 covered a range of activities, including corporate governance, risk management and the Bank's operations, with spending again significantly boosted by ongoing work on several major projects.

Spending on Consultancies^(a) \$

2007/08	260 000
2008/09	63 000
2009/10	61 000
2010/11	102 000
2011/12	535 000
2012/13	1 190 000
2013/14	387 000

(a) Sum of individual consultancies that cost \$10 000 or more
Source: RBA

Risk Management

Objectives and Governance Structure

Risk management is integral to all aspects of the Reserve Bank's activities and is the responsibility of all employees. Managers have a particular responsibility to evaluate their risk environment, to put in place appropriate controls and monitor the effectiveness of these controls. The Reserve Bank identifies, assesses and manages risk at both an enterprise ('top-down') and business ('bottom-up') level, a process that is subject to ongoing review. Controls put in place to manage the Bank's risk environment are carefully assessed to ensure they are well developed and implemented effectively. This process is supported through the development and maintenance of an active risk management culture, which acknowledges the need for careful analysis and management of risk in all business processes.

Oversight of the Reserve Bank's arrangements for risk management is undertaken by the Risk Management Committee. This Committee is chaired by the Deputy Governor and comprises the Assistant Governors for the Banking and Payments, Corporate Services, Currency and Financial Markets Groups; the Chief Financial Officer; the Chief Information Officer; the Heads of the Audit, Human Resources and Risk and Compliance Departments; and the Deputy Secretary and General Counsel. The Risk Management Committee is responsible for ensuring that all the risks the organisation faces, with the exception of those arising directly from the Bank's monetary policy, financial stability and payments policy functions, are properly assessed and effectively managed. The Committee meets six times a year, or more frequently if required, and informs the Executive Committee and Reserve Bank Board Audit Committee of its activities.

The Risk Management Committee is assisted in its responsibilities by the Risk and Compliance Department (RM). The Department's main role is to assist individual business areas to manage their risk environment effectively within a broadly consistent framework. RM also monitors risk and performance associated with the Reserve Bank's activities in financial markets and provides support to the business areas in the implementation of fraud control and business continuity systems, and the management of compliance-related risks. The Head of RM reports directly to the Deputy Governor.

The Audit Department also supports the framework for managing risk, complementing but remaining separate from the work of RM. In addition to providing assurance that the Reserve Bank's risk management policies are effective, the Audit Department has a separate, independent brief to test the adequacy of procedures and controls at all levels of the Bank. RM itself is subject to audit review. The Head of Audit Department reports to the Deputy Governor and the Reserve Bank Board Audit Committee, which meets at least four times a year.

As noted above, the Reserve Bank's risk management framework covers a broad range of financial and operational risks, but not those inherent to the Bank's core monetary policy, financial stability and payments policy functions. These risks remain the responsibility of the Governor, the Reserve Bank Board and the Payments System Board. The risks associated with the Bank's ownership of Note Printing Australia Limited (NPA) – the Bank's wholly owned subsidiary – are also covered by the risk framework, though the responsibility for the day-to-day activities of NPA rests with its management and the NPA Board.

Portfolio Risks

The Reserve Bank holds domestic and foreign currency-denominated financial instruments to support its operations in financial markets in pursuit of its policy objectives. These instruments comprise the bulk of the Bank's assets and expose the balance sheet to a number of financial risks, of which the largest is exchange rate risk. These risks are managed to an acceptable level through a number of controls, which are discussed below.

The primary responsibility for managing these risks rests with the Financial Markets Group. The role of RM is to monitor these risks and report on compliance with approved authorities and limits. In that regard, the Assistant Governor (Financial Markets), the Head of RM and other senior staff are provided with real-time and daily reports on limits compliance, portfolio risks and performance.

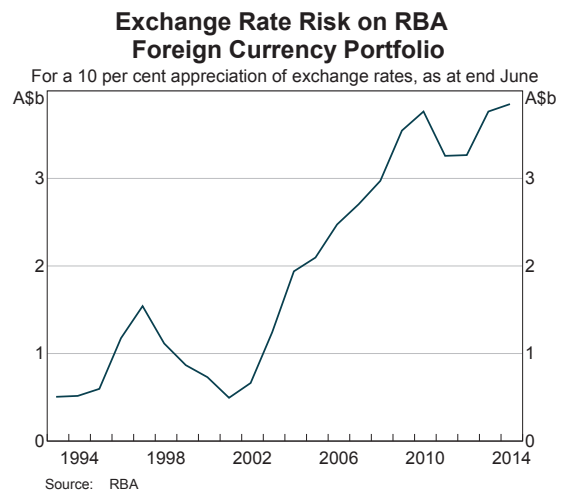
Exchange rate risk

The Reserve Bank invests in foreign currency-denominated assets as the holder of Australia's official foreign currency reserves. These holdings expose the Bank's balance sheet to fluctuations in exchange rates as the Bank's financial statements are reported in Australian dollars. Given its policy role, the Bank mitigates this risk by diversifying its foreign currency assets across five currencies. The diversification of the Bank's foreign currency investments was increased in 2013/14 to include assets denominated in Chinese renminbi, taking the portfolio composition to 52 per cent in US dollars, 35 per cent in euros, 5 per cent in Japanese yen, 5 per cent in Canadian dollars and 3 per cent in Chinese renminbi (see the chapter on 'Operations in Financial Markets'). The weights of currencies are specified in terms of a benchmark that reflects the Bank's long-term risk and return preferences given its need for high liquidity and security. The portfolio is rebalanced daily taking into account changes in market rates and transactions. The Bank's holdings of gold, Special Drawing Rights and the Asian Bond Funds are not managed relative to a benchmark.

The Australian dollar value of the Reserve Bank's portfolio rose slightly over the year. As exchange rate risk is primarily a function of portfolio size, the yardstick measure of exchange rate risk increased over the year. At the current level of reserves, a 10 per cent appreciation of the Australian dollar would result in mark-to-market losses of around \$3.8 billion.

Interest rate risk

The value of the Reserve Bank's financial assets is also exposed to movements in market interest rates as the bulk of the portfolio is made up of domestic and foreign fixed-income securities. For securities with fixed cashflows, changes in market yields affect the present value of this income stream. In general, the value of these securities will decline as market yields rise while a fall in market yields will increase their value. Other things being equal, securities that have a longer maturity carry a greater degree of interest rate risk as their cashflows extend further into the future. In present value terms, these securities will be more sensitive to discounting than those with near-term cashflows. In contrast, securities with floating cashflows carry very little interest rate risk.

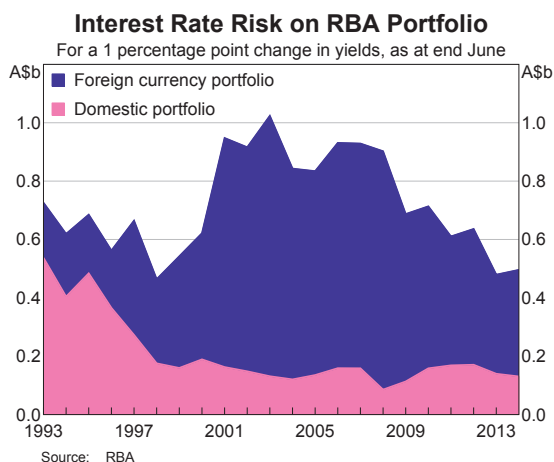


The Reserve Bank holds domestic securities for policy-related purposes. Total holdings of domestic securities rose in response to an increase in the Bank's liabilities (see chapter on 'Operations in Financial Markets'). Part of the increase was reflected in holdings of securities held under reverse repurchase agreements (repos) following the commencement of RBA repos on an 'open' basis in November 2013. Because these open repo positions reference the overnight cash rate and have a short maturity (they can be closed by either party at any time), they carry little interest rate risk. The average term of the Bank's domestic repo book at the end of June was around three weeks, slightly lower than a year earlier. For domestic securities held outright, the sensitivity to movements in market yields fell marginally over the course of 2013/14 owing to a decrease in the average duration.

The Reserve Bank is exposed to little interest rate risk on its balance sheet liabilities. Banknotes on issue account for about 40 per cent of total liabilities and carry no interest cost to the Bank. The other sizeable obligations include deposits held by the Australian Government and its agencies, and exchange settlement account balances held by authorised deposit-taking institutions. These deposits have short maturities that broadly match the Bank's domestic assets held under repo. Interest paid on these deposits reflects domestic short-term interest rates, effectively hedging part of the interest rate exposure of the domestic asset portfolio.

In contrast to the domestic portfolio, the Reserve Bank's foreign currency assets are managed relative to a benchmark that reflects the Bank's long-term appetite for risk and return and is specified in terms of a target portfolio duration (some foreign currency assets, such as gold, are excluded from the benchmark). The benchmark duration remained at six months for the US, Canadian and Japanese portfolios, and at 18 months for the European portfolio. The benchmark duration of the Chinese portfolio is 18 months.

The overall level of interest rate risk on the Reserve Bank's domestic and foreign financial assets was little changed over 2013/14. The Bank would incur a valuation loss of about \$500 million if interest rates in Australia and overseas rose uniformly by 1 percentage point across the yield curve.



Credit risk

Credit risk is the potential for financial loss arising from the default of a debtor or issuer, as well as declines in asset values arising from deterioration in credit quality. The Reserve Bank manages its credit exposure by applying a strict set of criteria to its investments, confining its dealings to highly creditworthy counterparties and holding only highly rated securities. The Bank's transactions are also executed under internationally recognised legal agreements.

The Reserve Bank is exposed to very little credit risk on its outright holdings in the domestic portfolio as it invests only in securities issued by the Australian Government or by state and territory government borrowing authorities. The Bank is exposed to a small amount of counterparty credit risk as a large portion of the Bank's domestic assets are held under repo. However, the credit risk on repos is inherently limited and ultimately reflects the quality and market value of the securities provided as collateral. The Bank would face a loss only if the counterparty fails to repurchase securities sold under repo and the market value of the securities falls to be less than the agreed repurchase amount. The Bank manages this exposure by applying an appropriate margin

(‘haircut’) to the securities and requiring that these securities meet certain eligibility criteria. The degree of over-collateralisation increases with the risk profile of the security and currently ranges from 1 to 27 per cent.

The Bank also mitigates credit risk by not purchasing securities from counterparties deemed to be materially related to the credit quality of the security in its market operations. However, for repos contracted under its liquidity facilities, the Bank may agree to relax its restriction on purchasing asset-backed securities from parties that sponsor the issuing trust, have originated assets held by the trust and/or service assets held by the trust. These arrangements help facilitate the same-day settlement of direct entry transactions (see the chapter on ‘Operations in Financial Markets’). To date, a small number of institutions have been granted related-party exemptions, enabling them to post specific self-securitised residential mortgage-backed securities (RMBS) as collateral. The credit risk is inherently limited as the securities are issued by bankruptcy-remote vehicles. Any residual risk is managed to a low level by discounting the value of the securities by a margin of 19 to 27 per cent, depending on the degree of credit support provided to the transaction by the sponsor.

Given its policy role, the Reserve Bank does not apply specific credit criteria to the counterparties with which it is willing to deal in its domestic market operations. Rather, to be eligible to participate in the Bank’s open market operations, counterparties must be subject to an appropriate level of regulation and be able to ensure efficient and timely settlement of transactions within the Austraclear system.

The Reserve Bank’s investments in the foreign portfolio are also confined to highly rated and liquid securities. The bulk of the Bank’s outright holdings are securities issued by the national governments of the United States, Germany, France, the Netherlands, Japan, Canada and China. The Bank also holds a portion of its foreign portfolio under short-term repos. This exposes the Bank to the small amount of residual credit risk that is inherent in repos, as noted above. The Bank manages this risk by requiring 2 per cent over-collateralisation and accepting only high-quality and liquid securities as collateral. Credit exposure on foreign repurchase agreements is further managed by imposing limits on individual counterparty exposures. The credit risk framework is overseen by a credit committee, chaired by the Assistant Governor (Financial Markets), which takes into account a number of factors to manage risk exposures, including market-based credit measures.

The Reserve Bank uses foreign exchange swaps and spot transactions as part of its policy operations. Credit risk on these instruments is managed to a low level by executing foreign exchange transactions under internationally recognised legal agreements only with counterparties that meet strict eligibility criteria and have been approved by the credit committee. These counterparties are generally highly rated; however, factors other than credit ratings are also considered. The Bank has sought to reduce credit risk associated with foreign exchange swaps through margining under two-way credit support annexes. This involves the Bank receiving and sending collateral to cover exposures on foreign exchange swaps generated by movements in exchange rates away from the contracted rate. Because the exchange of one currency for another is not simultaneous, foreign exchange transactions expose the Reserve Bank to settlement risk.

Operational Risk

As part of its day-to-day activities, the Reserve Bank faces risks to the operation of its systems and the effective functioning of its internal processes. These operational risks are similar to those faced by other financial institutions. They range from the possibility that access to key financial infrastructure might be lost through to the possibility that services might not be delivered to the required standard. The Bank generally has a low appetite for operational risk. This reflects the Bank’s view that satisfactory fulfilment of its important public policy responsibilities could be seriously undermined if its risk profile is poorly managed. That said, the Bank recognises it cannot eliminate risk from its operations completely.

While all parts of the Reserve Bank are exposed to operational risk of varying degrees, the most significant risks are those associated with financial transactions undertaken by the Bank for its own activities and that of its clients. During 2013/14, Financial Markets Group executed around 89 000 transactions, generating an average daily settlement value of around \$34 billion.

In addition to these activities, the Reserve Bank is the primary banker for a number of government entities – including the Australian Taxation Office and the Department of Human Services – and maintains the infrastructure to facilitate real-time interbank payment and settlement services through the Reserve Bank Information and Transfer System. Given the pivotal nature of these activities, any operational failure could have widespread consequences for the financial system. To ensure the control environment remains suitably robust, ongoing assessments of the operating risks associated with these functions are undertaken.

The provision of the Reserve Bank's policy and business operations is highly dependent on complex information technology (IT) systems and the associated control framework is under continual review. A Technology Committee has been established to strengthen this framework further. This Committee is chaired by the Assistant Governor (Corporate Services) and includes the Chief Information Officer and the Heads of the Banking, Domestic Markets and Note Issue Departments. In collaboration with the Risk Management Committee and the relevant business areas, the Technology Committee facilitates the assessment, monitoring and management of IT risks, and ensures any IT-related initiatives are consistent with the Bank's overall technology strategy. This work is supported by the ongoing evaluation of industry developments to ensure the Bank's systems reflect current technology and remain robust. Assessments of appropriate staff resourcing, the adequacy of controls over IT processes and the level of security over information management are all incorporated in the Bank's ongoing risk management practices.

In addition to maintaining existing IT systems, the Reserve Bank is currently engaged in a number of large and complex projects, including the renovation of its banking applications and systems, the development of infrastructure to facilitate real-time retail payments and the upgrade of Australia's banknotes, as described elsewhere in this annual report. The successful delivery of these initiatives will ensure high-quality services are maintained for the Bank's clients and the Australian public. To further support the processes required to undertake this work, an Enterprise Portfolio Management Office (EPMO) was established early in 2014. The objective of the EPMO is to enhance the management of risk across the Bank's portfolio of projects by supporting the implementation of a consistent project management framework with controls and checks throughout the project lifecycle, including the change management and testing phases.

A key risk to the Reserve Bank is the loss of facilities, IT systems and/or staff as a result of a natural disaster or other disruptive event. In order to ensure the continuity of critical business services in such an event, the Bank has put in place extensive backup plans and operates a Business Resumption Site (BRS) in north-west Sydney. Permanent staff from some of the Bank's most critical operational areas are located at the BRS to enable virtual continuity of operations if a disruption to Head Office were to occur. All departments regularly test backup arrangements to cover a range of contingency scenarios, including working from the BRS or an alternative location. The Risk Management Committee monitors the results of these tests.

The effective management of compliance risk is central to the Reserve Bank's activities. The facilitation of compliance with relevant legislation, regulations, industry codes, standards and selected internal policies has been advanced over recent months with the creation of a small central compliance unit within RM. The compliance unit collaborates with all business areas to develop a broadly consistent approach to managing this risk and provides ongoing assurance to the Executive Committee regarding the level of compliance within the organisation. This work has included coordinating the Bank-wide implementation of recent amendments to the *Privacy Act 1988* and the appointment of the head of RM's compliance unit as the Bank's Privacy Officer.

In common with other organisations, the Reserve Bank faces the risk that its staff may engage in fraud or undertake unauthorised transactions, exposing the organisation to significant financial loss and/or reputational damage. To mitigate this risk, the Bank has several layers of controls in place. These include having a clear decision-making hierarchy, separation of duties, and controls over computer access at both the user and administrator levels. All staff involved in financial dealings have well-defined limits to their authority to take risks or otherwise commit the Bank. These arrangements are further enhanced by independent front-, back- and middle-office functions, where staff who initiate trades, those who settle them and those who monitor and report on exposures and compliance with trading and investment guidelines are physically separate and have separate reporting lines.

The Reserve Bank is strongly committed to establishing and maintaining a culture that encourages and supports the highest standards of behaviour. The Code of Conduct for employees articulates the values that the Bank expects its staff to demonstrate when pursuing its objectives, including promotion of the public interest, integrity, excellence, intelligent inquiry and respect (see the chapter on 'Management of the Reserve Bank'). Arrangements by which fraud and unethical behaviour can be reported anonymously, an important part of this framework, were modified during the year to reflect the requirements of the *Public Interest Disclosure Act 2013*. These changes supplemented the Bank's existing processes for dealing with reports of illegal or unethical behaviour by giving legislative effect to protections that the Bank was providing to its staff voluntarily. A number of further initiatives aimed at enhancing the existing fraud control framework were undertaken during 2013/14, including face-to-face fraud awareness training for all Bank staff and the enhancement of employee screening processes.

Operational failures can occur notwithstanding a strong risk management framework. These failures can adversely affect the Reserve Bank's reputation or lead to other costs. The Risk Management Committee receives timely reports on any disruptions. The reports document and review the relevant circumstances and identify areas where new controls may be needed or where existing controls should be strengthened.

Anti-Money Laundering and Counter-Terrorism Financing Program

As a provider of designated services, the Reserve Bank is a 'reporting entity' under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act) and, as such, is required to have and comply with an anti-money laundering and counter-terrorism financing program (AML/CTF program). The AML/CTF Act mandates that an AML/CTF program be divided into Part A and Part B. The primary purpose of Part A is to identify and mitigate the money laundering or terrorism financing risks faced by the Bank, while Part B sets out its customer identification procedures. In accordance with the AML/CTF Rules, Part A was approved by the Executive Committee and the Reserve Bank Board in mid 2013. At its August 2014 meeting, the Reserve Bank Board received a report, prepared by RM, on the operation of the Bank's AML/CTF program during 2013/14.

Government Guarantee Scheme

On behalf of the Australian Government, the Reserve Bank manages the Guarantee Scheme for Large Deposits and Wholesale Funding (the Guarantee Scheme) and the Guarantee of State and Territory Borrowing. Applications for new guaranteed liabilities under both schemes closed in 2010 and the final outstanding liabilities under the Guarantee Scheme will expire in October 2015. The Bank will continue to have responsibility for collecting fees on existing liabilities under the state and territory borrowing guarantee for some years. Around \$280 million in fees was collected on behalf of the Australian Government in 2013/14.

Earnings and Distribution

Balance Sheet

The Reserve Bank holds a portfolio of financial assets to conduct operations in financial markets in order to pursue its monetary policy objectives and support an efficient and orderly payments system in Australia. In particular, these assets are the basis for transactions to manage liquidity in the cash market in Australia, and thereby implement monetary policy. They include Australia's foreign exchange reserves and domestic securities. The Bank's financial liabilities mainly comprise banknotes on issue, deposits of the Australian Government and other customers, and capital and reserves.

The Reserve Bank's balance sheet expanded significantly in 2013/14, to about \$141 billion at the end of the financial year, compared with \$99 billion a year earlier. This expansion was largely due to the start of same-day settlement of direct entry payments in November 2013. Under these arrangements, banks have higher demand for liquidity and balances held in Exchange Settlement (ES) accounts rose accordingly to assist banks meet their interbank payment obligations after the cash market closes each day. Banks funded the higher ES balances by contracting RBA open repurchase agreements available to holders of ES accounts; 'open repos' are a domestic asset on the Bank's balance sheet. Deposits of the Australian

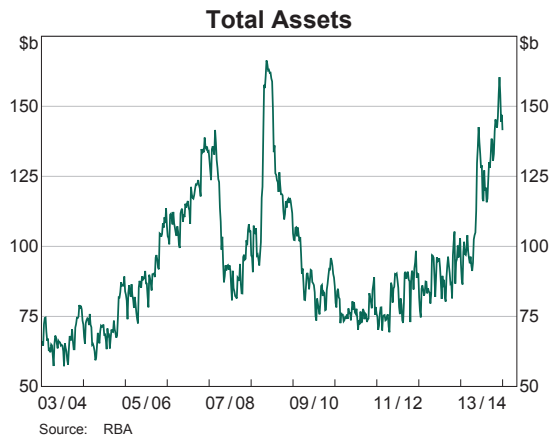
Government also increased in 2013/14, while capital and reserves rose with the receipt of the proceeds of the Commonwealth grant of \$8.8 billion. Banknotes in circulation, the Bank's largest liability, rose by about 7 per cent.

These movements in liabilities were reflected in the Reserve Bank's investments, with both domestic and foreign exchange assets increasing. Management of the Bank's assets is discussed in the chapter on 'Operations in Financial Markets'; the associated risks are considered in the chapter on 'Risk Management'.

Earnings

The Reserve Bank's earnings in most years come from two sources – underlying earnings and valuation gains or losses. As noted above, in 2013/14 the Bank received a grant from the Commonwealth, which, as revenue, passes through the Profit and Loss account in accordance with Australian Accounting Standards (AAS).

Underlying earnings arise because the Reserve Bank earns interest on almost all of its assets, while it pays no interest on a large portion of its liabilities, including banknotes in circulation and capital and reserves. Valuation gains and losses result from fluctuations in the value of the Bank's assets, because of movements in exchange rates or in the yields on the securities it holds. An appreciation of the Australian dollar or a rise in interest rates



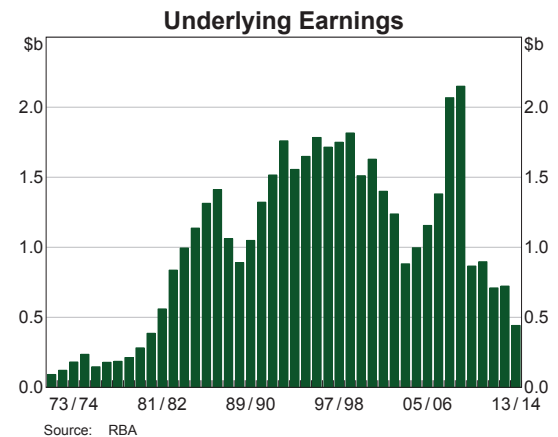
reduces the value of assets and leads to valuation losses. Conversely, a depreciation of the Australian dollar or a decline in interest rates results in valuation gains. Valuation gains and losses are realised only when the underlying asset is sold. Valuation gains and losses are volatile, as both exchange rates and market interest rates can fluctuate in wide ranges over time. The Bank manages these market risks within strict parameters determined by its responsibility for monetary policy.

In accordance with AAS, the Reserve Bank reports net profit as income from all sources, while the distribution of profits is determined by section 30 of the *Reserve Bank Act 1959*. In terms of the Reserve Bank Act, the distribution of net profit is determined in the following way:

- Unrealised gains (or losses) are not available for distribution and are transferred to (or absorbed by) the unrealised profits reserve. The balance of this reserve is available to absorb future valuation losses or it tends to be distributed gradually over time as these gains are realised when relevant assets are sold.
- Net profit that remains after the transfer of unrealised gains or losses is available for distribution. The Treasurer determines, after consulting the Reserve Bank Board, any amounts to be placed from distributable earnings to the credit of the Reserve Bank Reserve Fund (RBRF), the Bank's permanent reserve.
- The remainder of earnings is payable as a dividend to the Commonwealth.

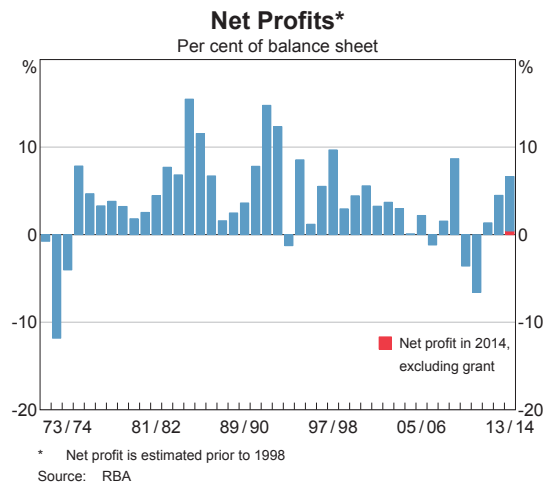
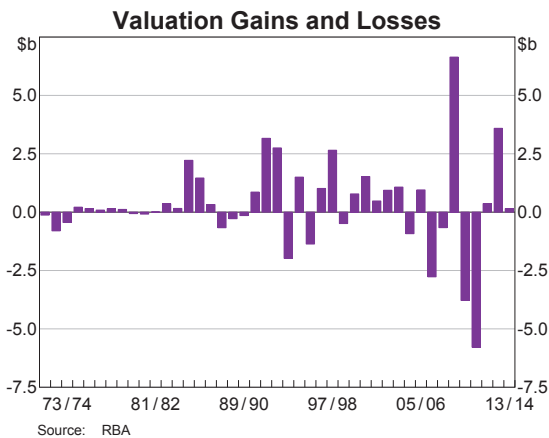
The Reserve Bank recorded a net profit of \$9 392 million in 2013/14, comprising:

- underlying earnings of \$442 million, an exceptionally low level in historical terms, which reflects the protracted period of low interest rates globally
- net total valuation gains of \$150 million. Gains of \$790 million were realised mainly as some unrealised gains accumulated the previous year were realised in 2013/14 as foreign currency was sold in the course of managing the portfolio of foreign reserves
- the Commonwealth grant of \$8 800 million.



Excluding the unrealised losses of \$640 million from net profit, distributable earnings, including proceeds from the Commonwealth grant, amount to \$10 035 million in 2013/14. Excluding the grant, these earnings were \$1 235 million.

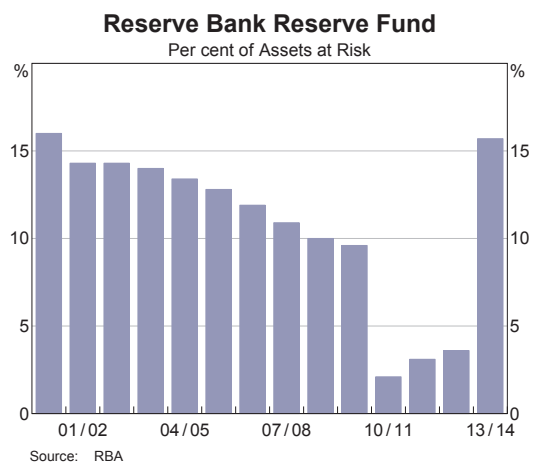
The pattern of net profit over the longer term, and the pattern for valuation gains and losses, are shown in the graphs below.



Capital, Reserves and Distribution

The RBRF is the Reserve Bank's general reserve and is essentially its capital. As noted above, the RBRF is funded from transfers from earnings available for distribution. Its purpose is to provide the capacity to absorb losses when it is necessary to do so. Large valuation losses as the exchange rate rose in 2009/10 and 2010/11 substantially depleted the RBRF. As a result, the balance of this reserve fell to a level that was significantly lower than the Board judged to be prudent. While the process of rebuilding this reserve had begun in recent years, it seemed likely that this would take an unacceptably long time if the Bank were to rely exclusively on replenishing the RBRF out of its profits, particularly if interest rates remained around current low levels. The decision of the Australian Government to make a grant to the Bank and boost its net profits provided the potential for a large transfer to the RBRF so that the balance of this reserve could be lifted immediately to an appropriate level. This approach was adopted to add to the Bank's capital because no other mechanism is available in terms of the Reserve Bank Act for the government to add directly to these resources.

In the event, the Treasurer, after consulting the Board, determined that a sum of \$8 800 million, the equivalent of the proceeds of the grant, be placed to the credit of the RBRF. Following this transfer, the balance of the RBRF stood at \$11 159 million as at 30 June 2014, a level the Board regards as providing the Bank with strong resources against the risks it faces at present. The remainder of net profit, a sum of \$1 235 million, was payable as a dividend to the Commonwealth. The Treasurer decided that an amount of \$618 million of this dividend would be paid in August 2014 and the remainder would be paid in 2015/16. This decision is at the Treasurer's discretion and such an approach to receiving the dividend has occurred in a number of previous years.



Unrealised losses of \$640 million were absorbed by the unrealised profits reserve in 2013/14, resulting in the balance of this reserve falling to \$3 156 million at the end of the financial year.

In terms of AAS, asset revaluation reserves are held for non-traded assets, such as gold holdings and property, plant and equipment. Balances in these reserves represent the difference between the market value of these assets and the cost at which they were acquired. The total balance for these reserves stood at \$3 978 million at 30 June 2014, \$273 million higher than in the previous financial year, largely reflecting the increase in the Australian dollar value of the Reserve Bank's holdings of gold.

A superannuation reserve was established in the accounts for 2013/14, as the counterpart to movements in other comprehensive income from remeasurement gains and losses on the Reserve Bank's defined benefit superannuation obligation. The balance of this reserve was a debit of \$23 million as at 30 June 2014, compared with a debit of \$178 million a year earlier.

Details on the composition and distribution of the Reserve Bank's profits are contained in the table on page 79.

The Financial Statements (and accompanying Notes to the Financial Statements) for the 2013/14 financial year were prepared in accordance with AAS, consistent with the Finance Minister's Orders for Financial Reporting issued under the *Commonwealth Authorities and Companies Act 1997*.



Signing of the Reserve Bank's accounts for 2014 (from left) Frank Campbell, Assistant Governor (Corporate Services), Governor Glenn Stevens, John Akehurst, Chair of the Audit Committee, Ian McPhee PSM, Auditor General of Australia, and Michael Watson, Group Executive Director, Australian National Audit Office

Composition and Distribution of Reserve Bank Profits

\$ million

	Composition of profits				Distribution of profits				Payments to government		
	Underlying earnings	Realised gains and losses(-) ^(a)	Unrealised gains and losses(-)	Net profit or loss(-)	Transfer to/from(-)				Payment from previous year's profit	Payment delayed from previous year	Total payment
					Unrealised profits reserve	Asset revaluation reserves	Reserve Bank Reserve Fund	Dividend payable			
1997/98	1 750	966	1 687	4 403	1 687	-558	548	2 726	1 700	-	1 700
1998/99	1 816	2 283	-2 773	1 326	-2 349	-1	-	3 676	2 726	-	2 726
1999/00	1 511	-708	1 489	2 292	1 489	-	-	803	3 000	-	3 000
2000/01	1 629	1 200	320	3 149	320	-5	-	2 834	803	676	1 479
2001/02	1 400	479	-11	1 868	-11	-10	-	1 889	2 834	-	2 834
2002/03	1 238	1 157	-222	2 173	-222	-2	133	2 264	1 889	-	1 889
2003/04	882	-188	1 261	1 955	1 261	-	-	694	1 300	-	1 300
2004/05	997	366	-1 289	74	-1 289	-	-	1 363	374	964	1 338
2005/06	1 156	4	933	2 093	933	-17	-	1 177	1 063	320	1 383
2006/07	1 381	72	-2 846	-1 393	-2 475	-3	-	1 085	1 177	300	1 477
2007/08	2 068	614	-1 252	1 430	27	-	-	1 403	1 085	-	1 085
2008/09	2 150	4 404	2 252	8 806	2 252	-	577	5 977	1 403	-	1 403
2009/10	866	-128	-3 666	-2 928	-2 248	-	-680	-	5 227	-	5 227
2010/11	897	-1 135	-4 651	-4 889	-23	-	-4 866	-	-	750	750
2011/12	710	405	-39	1 076	-20	-	596	500	-	-	-
2012/13	723	-135	3 725	4 313	3 725	-	588	-	500	-	500
2013/14	9 242 ^(b)	790	-640	9 392	-640	-3	8 800	1 235	-	-	-
2014/15									618	-	618
2015/16										618	

(a) Excludes gains or losses realised from the sale of fixed assets that had been held in Asset Revaluation Reserves

(b) Includes the Commonwealth grant of \$8 800 million

Source: RBA

Pro Forma Business Accounts

The following sets of accounts for each of the Reserve Bank's contestable businesses have been prepared in accordance with competitive neutrality guidelines. These accounts do not form part of the audited financial statements.

	Transactional Banking		Registry	
	2012/13 \$ million	2013/14 \$ million	2012/13 \$ million	2013/14 \$ million
Revenue				
– Service fees ^(a)	63.7	83.1	0.6	0.4
– Other revenue	5.7	5.4	0.1	0.0
Total	69.4	88.5	0.7	0.4
Expenditure				
– Direct costs ^(a)	65.4	81.1	0.4	0.3
– Indirect costs	0.3	0.2	0.0	0.0
Total	65.7	81.3	0.4	0.3
Net profit/(loss)	3.7	7.2	0.3	0.1
Net profit/(loss) after taxes ^(b)	2.5	5.1	0.2	0.1
Assets^(a)				
– Domestic markets investments	527.7	524.8	1.3	1.3
– Other assets	17.4	25.4	0.0	0.0
Total	545.1	550.2	1.3	1.4
Liabilities^(c)				
– Capital and reserves	25.0	25.0	1.0	1.0
– Deposits	505.8	509.8	0.0	0.0
– Other liabilities	14.3	15.4	0.3	0.4
Total	545.1	550.2	1.3	1.4

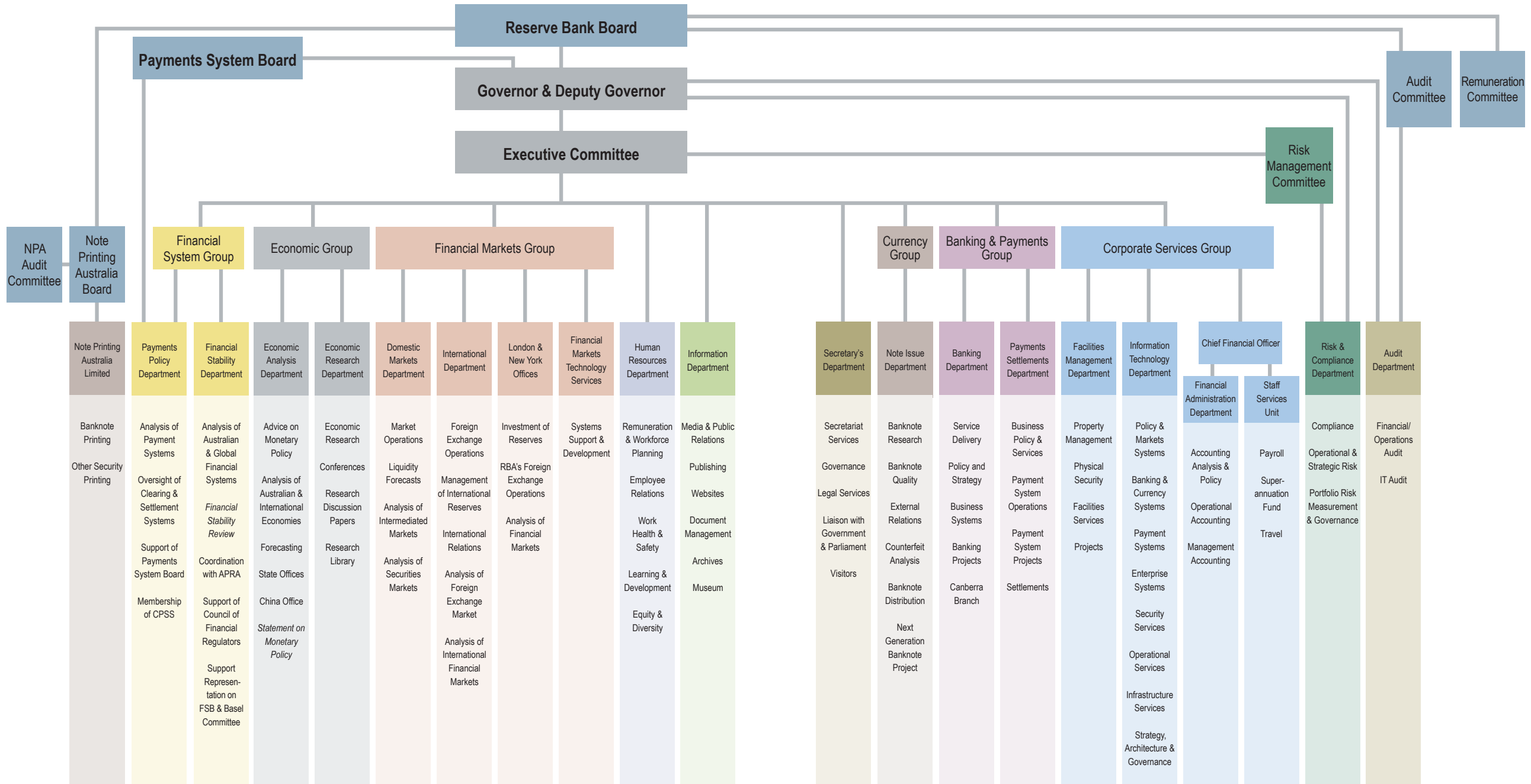
(a) Comparative figures for service fee revenue and direct expenses have been restated. Banking service fees received were previously presented net of the associated expenses. However, as the Reserve Bank acts as principal in these transactions, revenue from banking service fees and the associated expenses are now shown in gross terms. This restatement has no effect on Net Profits.

(b) In accordance with competitive neutrality guidelines, income tax expense has been calculated and transferred to the Commonwealth as a notional part of the Reserve Bank's annual profit distribution.

(c) As at 30 June.

Organisational Chart

August 2014



Organisation Overview including Executives

August 2014

The Reserve Bank is organised along the following operational lines, under the leadership of the Governor, Glenn Stevens,* and Deputy Governor, Philip Lowe.**†

Banking and Payments Group

Assistant Governor: Keith Hall**†

Banking and Payments Group comprises Banking Department and Payments Settlements Department.

Banking Department

Head: Lindsay Boulton

Deputy Heads: Stephanie Connors, Paul Phibbs

Banking Department provides a range of banking services to Australian Government departments and agencies as well as a number of overseas central banks and official institutions. The services are broadly divided into two activities – management of the government’s core accounts and transactional banking. Sydney-based staff are responsible for the direction, administration and development of the Department’s work, while the day-to-day interaction with customers is largely managed by staff in the Canberra Branch.

Payments Settlements Department

Head: Greg Johnston

Deputy Heads: David Brown, Peter Gallagher

Payments Settlements Department is responsible for the settlement of high-value payments and interbank obligations arising from the conduct of Exchange Settlement accounts and the Reserve Bank’s own trading activities, as well as the operations of RITS (Reserve Bank Information and Transfer System), Australia’s real-time gross settlement system. Services are also provided for the clearing and settlement of low-value payments, such as those arising from cheque and direct entry transactions.

Corporate Services Group

Assistant Governor: Frank Campbell**

Corporate Services Group comprises three departments and one unit, which provide services to other parts of the Reserve Bank.

Facilities Management Department

Head: Grant Baldwin

Chief Manager: Matt Nolan

Facilities Management Department is responsible for the Reserve Bank's properties, security management and a range of facilities services.

Financial Administration Department

Chief Financial Officer: Robert Middleton-Jones†

Chief Manager: Colleen Andersen

Financial Administration Department prepares the Reserve Bank's financial and management accounts.

Staff Services Unit

Chief Manager: Michael Davies

Staff Services Unit is responsible for a range of staff services, such as payroll, superannuation and travel.

Information Technology Department

Chief Information Officer: Sarv Girm†

Deputy Head, Infrastructure and Operations: Peter Speranza

Deputy Head, Technology Services: Gayan Benedict

Information Technology Department is responsible for maintaining and developing the IT functions that support the Reserve Bank's policy, operational and corporate objectives.

Currency Group

Assistant Governor: Michele Bullock**

Currency Group is responsible for all aspects of the banknote life cycle, including the design, production and distribution of banknotes.

The Assistant Governor (Currency) is Chair of Note Printing Australia Limited (NPA), a separately incorporated, wholly owned subsidiary of the Reserve Bank of Australia. It is responsible for printing banknotes, passports and other security documents for Australia and for export. More detail on NPA's governance and structure is provided in the chapter on 'Banknotes'.

Note Issue Department

Head: Michael Andersen

Deputy Head: Keith Drayton

Note Issue Department is responsible for research into and development of new banknote designs and security features, and the supply of high-quality banknotes to meet the community's demand. The Department manages laboratories that assess new and used banknotes, develop new security features on banknotes and assess counterfeits detected in circulation. It has an extensive public engagement program with commercial banks, retailers, cash-in-transit companies, law enforcement agencies and banknote equipment manufacturers. Staff actively participate in a number of international groups with the objective of minimising the threat posed by counterfeiters internationally.

Economic Group

Assistant Governor: Christopher Kent*

Economic Group is responsible for analysis of economic trends, both domestic and overseas, forecasting and research relevant to the framing of monetary policy. It consists of Economic Analysis Department and Economic Research Department.

Economic Analysis Department

Head: Alexandra Heath

Deputy Heads: Marion Kohler, David Orsmond, Michael Plumb

Economic Analysis Department monitors and forecasts trends in the international and domestic economies, provides regular advice on these developments and monetary policy to the Governors and the Reserve Bank Board, contributes to various external bodies, maintains contacts with relevant external analysts, undertakes applied research and prepares reports for publication.

The Reserve Bank maintains four State Offices, covering: Queensland; South Australia and the Northern Territory; Victoria and Tasmania; and Western Australia. New South Wales and the Australian Capital Territory are covered by Head Office. These offices analyse economic conditions in regions throughout Australia and conduct liaison with individual firms and agencies in both the private and public sectors. They also provide a vehicle for communicating the operations of monetary policy to the wider community and for improving access to the Reserve Bank. The Bank also has an office in Beijing, China, which is responsible for monitoring local economic and financial developments as well as maintaining relationships with government and private entities.

Economic Research Department

Head: John Simon

Deputy Head: Vacant

Economic Research Department undertakes longer-term research into issues relevant to monetary policy formulation and the operation of financial markets. Results are published in the Research Discussion Paper series. The Department organises a major annual conference, as well as an annual Research Workshop. In addition, it organises a program of internal seminars, regularly hosts invited academic visitors and is responsible for administering a comprehensive library service for the Reserve Bank.

Financial Markets Group

Assistant Governor: Guy Debelle**

Financial Markets Group is responsible for implementing the Reserve Bank's operations in domestic and foreign exchange markets, monitoring developments in financial markets and coordinating the Bank's relationships with international institutions. The Group is divided into Domestic Markets Department and International Department.

Domestic Markets Department

Head: Chris Aylmer

Deputy Head: Ellis Connolly

Domestic Markets Department is responsible for the Reserve Bank's operations in the domestic money and bond markets. The Department analyses developments in domestic financial markets, including the cost and availability of finance through financial intermediaries and capital markets, and provides regular advice to the Governors and the Reserve Bank Board on these issues.

International Department

Head: Chris Ryan

Deputy Heads: Matthew Boge, James Holloway

International Department is responsible for the Reserve Bank's foreign exchange operations, the investment of international reserve holdings of gold and foreign exchange, and the provision of regular advice on developments in international financial markets to the Governors and the Reserve Bank Board. The Department is also responsible for maintaining the Bank's relations with major international institutions.

The Reserve Bank's Representative Offices in London and New York come under the umbrella of the Financial Markets Group. The European Representative Office in London maintains liaison with central banks and other institutions and authorities in Europe, including the Bank for International Settlements and the Organisation for Economic Co-operation and Development. The New York Representative Office performs similar functions in North America. Both of these offices monitor economic and financial developments in the local markets, and are responsible for foreign exchange operations and investment of international reserves.

The Reserve Bank's investment and trading operations are supported by the Financial Markets Technology Services area.

Financial System Group

Assistant Governor: Malcolm Edey*

Financial System Group supports the Reserve Bank's role in payments system regulation and its broad responsibilities for financial system stability. The Group is divided into Financial Stability Department and Payments Policy Department.

Financial Stability Department

Head: Luci Ellis

Deputy Heads: Merylin Coombs, Carl Schwartz

Financial Stability Department analyses the implications for financial system stability of developments in the macroeconomy, financial markets and the financial sector more generally, including areas such as patterns of financial intermediation, financial products and risk management techniques. The Department provides advice on these issues to the Governors and the Reserve Bank Board and supports the Reserve Bank's representation on bodies such as the Council of Financial Regulators, the Financial Stability Board and the Basel Committee on Banking Supervision. It is responsible for producing the *Financial Stability Review*.

Payments Policy Department

Head: Tony Richards

Deputy Heads: Darren Flood, Mark Manning

Payments Policy Department is responsible for developing and implementing the Reserve Bank's payments system policy. It provides analysis and advice to the Payments System Board on improving the safety and efficiency of the payments system. The Department is also responsible for oversight of Australia's clearing and settlement facilities and represents the Bank on the Committee on Payment and Settlement Systems of the Bank for International Settlements.

Audit Department

Head: Darryl Ross^{††}

Audit Department is responsible for conducting independent appraisals of the Reserve Bank's activities, functions and operations to ensure that an adequate framework of internal controls has been established and is operating effectively. The Head of Audit Department reports to the Chair of the Audit Committee.

Human Resources Department

Head: Melissa Hope*†

Deputy Head: Bruce Harries

Human Resources Department provides a range of centralised human resource functions primarily focused on ensuring the Reserve Bank's human resources policies and practices are tailored to attract and retain high-quality staff. These include policies covering employment conditions, remuneration, staff training and development, equity and diversity, and occupational health and safety.

Information Department

Head: Jacqui Dwyer†

Information Department is responsible for preparing and publishing Reserve Bank information and maintaining the Bank's websites. It handles enquiries from the public and media. In addition, the Department is responsible for the Bank's records management systems, archives and the Museum of Australian Currency Notes.

Risk and Compliance Department

Head: Michelle McPhee*‡

Risk and Compliance Department supports the consistent and effective application of the Reserve Bank's framework for managing risk, both at the enterprise level and for individual business units across the Bank. It assists departments to identify, understand and manage their compliance obligations. It also monitors and reports on portfolio risks and compliance with respect to the Bank's operations in financial markets. The Head of Risk and Compliance Department reports to the Risk Management Committee and the Deputy Governor.

Secretary's Department

Secretary: Anthony Dickman*

Deputy Secretary: Peter Stebbing†

General Counsel: Catherine Parr*‡

Deputy General Counsel: Peter Jones

Secretary's Department provides governance, secretariat and coordination services for the Governors, the Reserve Bank Board and its Audit and Remuneration Committees, the Payments System Board and the Bank's Executive Committee and Risk Management Committee. In addition, it provides legal services to the Reserve Bank through the General Counsel, and coordinates a range of contacts with government, the Parliament, other central banks and international organisations, including arranging programs for visitors.

* Member of Executive Committee

† Member of Risk Management Committee

‡ Advisor to Executive Committee

Statutory Reporting Obligations

Equal Employment Opportunity

The Reserve Bank is required under the *Equal Employment Opportunity (Commonwealth Authorities) Act 1987* to report to the Australian Parliament each year on its equity and diversity program. The *Equity & Diversity Annual Report 2013*, which reported on the Bank's diversity profile, employee engagement with existing policies and progress with the program in 2012/13, was tabled on 24 October 2013.

The Reserve Bank aims to ensure that all employees are treated with dignity and respect and experience equal opportunity throughout their careers with the Bank. This commitment is underpinned by the two key elements of the equity and diversity program, namely existing policies and procedures, and the current Diversity Plan (covering 2012–2015). Existing policies and procedures seek to embed equity, diversity and inclusion principles in work practices and the current Diversity Plan provides specific initiatives to highlight priorities, raise awareness and aim for continuous improvement. The program is governed by the Bank's Executive Committee, in consultation with the Diversity & Inclusion Policy Committee, a consultative body responsible for monitoring the development and implementation of equity and diversity initiatives, policies and practices.

During the year in review, the Reserve Bank developed new initiatives outlined in the current Diversity Plan. The four priorities are to:

- undertake training and awareness on unconscious bias in the workplace to promote the quality of employment-related decision-making
- develop and promote flexible work arrangements
- better understand the factors influencing the career experience of women
- understand the needs of a maturing workforce and use that information to assist in workforce planning and corporate knowledge transfer.

The major focus in 2013/14 was to enhance the Reserve Bank's culture of inclusiveness and flexible work practices, to encourage diversity of people, ideas and approaches to work such that no employee is disadvantaged on the basis of their individual differences.

Full details and outcomes of the equity and diversity program are provided in the Reserve Bank's *Equity & Diversity Annual Report 2014*.

Work Health and Safety (WHS)

The Reserve Bank continued to foster a safety culture that is preventative, proactive and based on due diligence, by demonstrating the visible commitment to safety of the Bank's senior and executive management. During the year in review, the Bank continued to implement and monitor initiatives associated with its WHS strategic plan. The Bank continued to provide ongoing training to workers, health and safety representatives and management on contemporary WHS matters, including mental health. The Bank's Health & Wellbeing Program continued to provide education and promote physical and psychological health through the implementation

of initiatives targeted at WHS risks, attitudinal and behavioural change and the provision of a supportive and safe work environment.

The Reserve Bank's policies and framework documents covering WHS have been endorsed by the Reserve Bank Board. The Board and the Bank's executive management receive regular reports on WHS matters in the Bank, including an annual review covering the Bank's WHS indicators and key activities.

There were 54 reported WHS incidents between 1 July 2013 to 30 June 2014, about the same as in the previous year. Around a quarter of the incidents were sporting injuries sustained during breaks; only one incident required notification to Comcare, which involved the collapse of a structural prop in a building works area of the Bank's Craigieburn site, although there were no injuries. Incidents resulting in accepted workers compensation claims rose from two in 2012/13 to five in 2013/14, with two involving sporting injuries sustained during breaks and three occurring at the usual place of work. Overall, the Bank's Lost Time Injury Frequency Rate (number of lost time injuries per million hours worked) for 2013/14 was 1.2, the same as in 2012/13, and a little lower than the industry average.

In terms of the *Work Health and Safety Act 2011* (WHS Act) and the conditions of its licence as a Licensed Authority under the *Safety, Rehabilitation and Compensation Act 1988*, the Reserve Bank is required to report to the Safety, Rehabilitation and Compensation Commission each year on WHS and workers compensation and rehabilitation matters as they affect the Bank. Compliance with the relevant legislation – and the conditions of its licence as a Licensed Authority – were validated in 2014 by external audits of the Bank's safety, compensation and rehabilitation arrangements. The Commission subsequently confirmed that the Bank retained the highest rating (Tier 3) for its prevention, claims management and rehabilitation practices in each area for 2014/15.

Freedom of Information (FOI)

The Reserve Bank is an Australian Government agency subject to the *Freedom of Information Act 1982* (FOI Act). As required by Part II of the FOI Act, the Bank publishes information to the public as part of the Information Publication Scheme (IPS). Details of the Bank's obligations under the FOI Act and the IPS can be found on the Bank's website at www.rba.gov.au/foi.

In 2013/14, 23 requests for access to documents under the FOI Act were received. Access was granted in part in response to six requests. No relevant documents were found in response to four requests. Access to documents was denied in response to two requests, and ten requests were withdrawn. One request was refused in terms of section 24 of the FOI Act (practical refusal). No requests were outstanding at the end of the financial year. All requests received in 2013/14 were finalised within statutory time frames as determined by relevant provisions of the FOI Act. The Reserve Bank continued to publish on its website information that has been released in response to FOI access requests, as required by the FOI Act, with RSS feeds to these releases available from the Bank's website.

One application was received for the internal review of a decision in 2013/14. As required by the FOI Act, a fresh decision was taken, with the original decision being affirmed in this instance.

The estimated number of staff hours spent dealing with all aspects of FOI requests in 2013/14 was around 250 hours, compared with around 395 hours in 2012/13. The total cost to the Reserve Bank of administering the FOI Act in 2013/14 is estimated to have been about \$76 300, compared with \$123 400 in the previous year. Charges levied and received amounted to \$2 440.

Amendments to Enabling and Other Relevant Legislation

The *Public Governance, Performance and Accountability Act 2013* (PGPA Act) replaced the *Commonwealth Authorities and Companies Act 1997* (CAC Act) on 1 July 2014, subject to various transitional arrangements. On the same date, consequential changes were made to the *Reserve Bank Act 1959*.

The combined effect of these changes is that, from 1 July 2014, the Governor is the accountable authority of the Bank and in that capacity has a number of specific responsibilities in relation to the governance of, and reporting by, the Bank. Some of these responsibilities are newly created under the PGPA Act and some rested with the Board under the CAC Act. Notwithstanding the broader responsibilities of the Governor following the changes, the Board will continue to be responsible for approving the Bank's annual financial statements and the Audit Committee's charter.

Ministerial Directions

The Reserve Bank received no new directions from its responsible Minister, the Treasurer, or from any other Minister during 2013/14.

No General Policy Orders under section 48A of the CAC Act were first applied, or continued to apply, to the Reserve Bank during 2013/14. No general policies of the Australian Government were first applied, or continued to apply, to the Bank under section 28 of the CAC Act during 2013/14.

Since 1 July 2012, the Reserve Bank has been bound by the Finance Minister's (CAC Act Procurement) Directions 2012, which require the Bank to apply the Commonwealth Procurement Rules (CPRs) when undertaking a procurement where the expected value of the property or service being procured exceeds \$400 000 for non-construction services or \$7.5 million for construction services. For purchases below these thresholds, the Bank follows its own guidelines based on the principles contained in the CPRs. The broad objective is to ensure that all goods and services procured by the Bank support its policy and operational responsibilities in an efficient and cost-effective manner.

The Reserve Bank's policy covering procurement was endorsed by the Reserve Bank Board in March 2013, and in August 2014 the Board received an annual review covering the Bank's procurement activities in 2013/14.

Effective from 1 July 2014, the CPRs were amended and reissued under section 105B(1) of the PGPA Act.

Other Statutory Obligations

Other statutory reporting obligations applying to the Reserve Bank that are covered elsewhere in this report are identified in the Statutory Reporting Requirements Index on page 95.

Statutory Reporting Requirements Index

The Reserve Bank Annual Report complies with the reporting requirements of the *Commonwealth Authorities and Companies Act 1997* (CAC Act), related Orders and other applicable legislation. The relevant provisions of the CAC Act and related Orders continue to apply to this Annual Report notwithstanding the repeal of the CAC Act on 1 July 2014.

To assist readers to locate this information, this index of annual report statutory reporting requirements identifies where relevant information can be found in the Bank's Annual Report for 2014.

CAC Act Schedule 1 – Annual Report for Commonwealth Authority	Page numbers
Report of operations	1–93
Financial statements	97–145
Auditor-General's report	146–147
Directors' statement	99
Commonwealth Authorities (Annual Reporting) Orders 2011	
Approval by directors	17
Exemptions	Nil
Parliamentary standards of presentation	17, Letter of transmittal to Treasurer
Enabling legislation	5
Responsible Minister	17, 93, Letter of transmittal to Treasurer
Ministerial directions under legislation	93
General policies notified before 1 July 2008	93
General Policy Orders under section 48A of CAC Act	93
Information about directors	7, 11–15
Organisational structure	45, 55, 82–90
Location of offices and facilities	45, 55, 66, 73, 87, 88, 149
Statement on governance	7–10, 66, 69–74
Related entity transactions	46
Key activities and changes affecting the Reserve Bank	1, 2, 93
Judicial decisions	There were no judicial decisions or decisions of administrative tribunals that have had, or may have, a significant effect on the operations of the RBA

Reviews by outside bodies	17–18
Information on subsidiaries	There is no information from NPA that is missing from the Report of Operations
Indemnities and insurance premiums for officers	10

Work Health and Safety Act 2011 – reporting requirements

Health, safety and welfare initiatives	91–92
Health and safety outcomes	92
Statistics of notifiable incidents	92
Investigations conducted	Nil

Environment Protection and Biodiversity Conservation Act 1999 – reporting requirements

Report on implementation of Ecologically Sustainable Development principles	67
Contribution of outcomes specified in Appropriations Act	No such outcomes specified for the RBA
Effect of the Reserve Bank’s activities on the environment	67
Measures to minimise the impact of the Reserve Bank’s activities	67
Mechanisms for reviewing/increasing effectiveness of measures	67

Financial Statements

For the year ended 30 June 2014

Directors' Statement

In the opinion of the directors, the financial statements for the year ended 30 June 2014 give a true and fair view of the matters required by the Finance Minister's Orders for Financial Reporting made under the *Commonwealth Authorities and Companies Act 1997*. These statements have been prepared from properly maintained financial records and are signed in accordance with a resolution of the directors.



Glenn Stevens

Governor and Chair, Reserve Bank Board



Frank Campbell

Assistant Governor (Corporate Services)

21 August 2014

Statement of Financial Position – as at 30 June 2014

Reserve Bank of Australia and Controlled Entity

	Note	2014 \$M	2013 \$M
Assets			
Cash and cash equivalents	6	273	137
Australian dollar securities	1(b), 15	72,886	43,249
Foreign exchange	1(b), 15	63,807	50,930
Gold	1(c), 15	3,584	3,299
Property, plant and equipment	1(d), 8, 16	523	491
Loans, advances and other assets	7	412	421
Total Assets		141,485	98,527
Liabilities			
Deposits	1(b), 9	53,574	26,183
Distribution payable to the Commonwealth	1(g), 3	1,235	–
Australian notes on issue	1(b), 15	60,778	56,943
Other liabilities	10	7,588	5,679
Total Liabilities		123,175	88,805
Net Assets			
		18,310	9,722
Capital and Reserves			
Reserves:			
Unrealised profits reserve	1(f), 5	3,156	3,796
Asset revaluation reserves	1(f), 5	3,978	3,705
Superannuation reserve	1(f), 5	(23)	(178)
Reserve Bank Reserve Fund	1(f), 5	11,159	2,359
Capital	1(f), 5	40	40
Total Capital and Reserves		18,310	9,722

The above statement should be read in conjunction with the accompanying notes.

Comparative figures for the financial reporting period ended 30 June 2013 have been restated for the revised accounting standard AASB 119 – Employee Benefits (refer Note 1(l)).

Statement of Comprehensive Income – for the year ended 30 June 2014

Reserve Bank of Australia and Controlled Entity

	Note	2014 \$M	2013 \$M
Revenue			
Interest revenue	2	1,834	1,642
Net gains on securities and foreign exchange	2	150	3,662
Dividend revenue	2	3	5
Fees and commissions	2	86	66
Commonwealth grant	2	8,800	–
Other income	2	118	138
Total Revenue		10,991	5,513
Expenses			
Interest expense	2	1,086	708
General administrative expenses	2	405	393
Other expenses	2	108	79
Total Expenses		1,599	1,180
Net Profit		9,392	4,333
Other Comprehensive Income			
<i>Items that may be reclassified to profit or loss</i>			
Gains/(losses) on:			
Gold	5	284	(727)
Shares in international and other institutions	5	(20)	42
		264	(685)
<i>Items that will not be reclassified to profit or loss</i>			
Gains/(losses) on:			
Property, plant and equipment	5	12	15
Superannuation	5	155	345
		167	360
Total Other Comprehensive Income		431	(325)
Total Comprehensive Income		9,823	4,008

The above statement should be read in conjunction with the accompanying notes.

Comparative figures for the financial reporting period ended 30 June 2013 have been restated for the revised accounting standard AASB 119 – Employee Benefits (refer Note 1(l)).

Statement of Distribution – for the year ended 30 June 2014

Reserve Bank of Australia and Controlled Entity

	Note	2014 \$M	2013 \$M
Net Profit		9,392	4,333
Transfer from/(to) unrealised profits reserve	5	640	(3,796)
Transfer from asset revaluation reserves	5	3	–
Earnings available for distribution		10,035	537
<i>Distributed as follows:</i>			
Transfer to Reserve Bank Reserve Fund	5	8,800	537
Payable to the Commonwealth	3	1,235	–
		10,035	537

The above statement should be read in conjunction with the accompanying notes.

Comparative figures for the financial reporting period ended 30 June 2013 have been restated for the revised accounting standard AASB 119 – Employee Benefits (refer Note 1(l)).

Statement of Changes in Capital and Reserves – for the year ended 30 June 2014

Reserve Bank of Australia and Controlled Entity

	Note	Unrealised profits reserve \$M	Asset revaluation reserves \$M	Superannuation reserve \$M	Earnings available for distribution \$M	Reserve Bank Reserve Fund \$M	Capital \$M	Total capital and reserves \$M
Balance as at 30 June 2012		–	4,375	(523)	–	1,822	40	5,714
Net Profit/(Loss)	1(g), 2	3,796			537			4,333
Gains/(losses) on:								
Gold	1(c), 5		(727)					(727)
Shares in international and other institutions	1(b), 5		42					42
Property, plant and equipment	1(d), 5		15					15
Superannuation	1(i), 5		–	345				345
Other comprehensive income			(670)	345				(325)
Total comprehensive income for 2012/13								4,008
Transfer to Reserve Bank Reserve Fund	1(f), 3		–		(537)	537		–
Transfer to distribution payable to the Commonwealth	1(g), 3		–		–			–
Balance as at 30 June 2013		3,796	3,705	(178)	–	2,359	40	9,722
Net Profit/(Loss)	1(g), 2	(640)			10,032			9,392
Gains/(losses) on:								
Gold	1(c), 5		284					284
Shares in international and other institutions	1(b), 5		(20)					(20)
Property, plant and equipment	1(d), 5		12					12
Superannuation	1(i), 5		–	155				155
Other comprehensive income			276	155				431
Total comprehensive income for 2013/14								9,823
Transfer from asset revaluation reserve	1(f), 3		(3)		3			–
Transfer to Reserve Bank Reserve Fund	1(f), 3		–		(8,800)	8,800		–
Transfer to distribution payable to the Commonwealth	1(g), 3		–		(1,235)			(1,235)
Balance as at 30 June 2014		3,156	3,978	(23)	–	11,159	40	18,310

Comparative figures for the financial reporting period ended 30 June 2013 have been restated for the revised AASB 119 – Employee Benefits (refer Note 1(i)).

Cash Flow Statement – for the year ended 30 June 2014

Reserve Bank of Australia and Controlled Entity

This statement meets the requirements of AASB 107 – *Cash Flow Statements* and the Finance Minister’s Orders for Financial Reporting. For the purposes of this statement, cash includes the notes and coin held at the RBA and overnight settlement balances due from other banks.

	Note	2014 Inflow/ (outflow) \$M	2013 Inflow/ (outflow) \$M
Cash flows from operating activities			
Interest received on investments		1,719	1,655
Interest received on loans, advances, and on net overnight settlements balances		13	30
Banking service fees received		81	66
Banking service fees paid		(61)	(64)
Dividends received		–	5
Rents received		10	9
Commonwealth grant received	1(j)	8,800	–
Net payments for investments		(40,686)	(11,592)
Cash collateral received/(pledged)		382	(253)
Interest paid on deposit liabilities		(964)	(611)
Interest paid on banknote holdings of banks		(62)	(89)
Staff costs (including redundancy)		(215)	(198)
Premises and equipment		(45)	(41)
Other		(19)	(1)
Net cash used in operating activities	6	(31,047)	(11,084)
Cash flows from investment activities			
Proceeds from the sale of Securrency		7	75
Net expenditure on property, plant and equipment		(50)	(50)
Net cash provided by investment activities		(43)	25
Cash flows from financing activities			
Distribution to the Commonwealth		–	(500)
Net movement in deposit liabilities		27,391	8,183
Net movement in loans and advances		–	1
Net movement in notes on issue		3,835	3,348
Net cash provided by financing activities		31,226	11,032
Net increase/(decrease) in cash		136	(27)
Cash at beginning of financial year		137	164
Cash at end of financial year	6	273	137

The above statement should be read in conjunction with the accompanying notes.

Notes to and Forming Part of the Financial Statements – 30 June 2014

Reserve Bank of Australia and Controlled Entity

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Note 1 – Accounting Policies

The Reserve Bank of Australia (RBA) reports its consolidated financial statements in accordance with the *Reserve Bank Act 1959* and the *Commonwealth Authorities and Companies Act 1997* (CAC Act). These financial statements for the year ended 30 June 2014 have been prepared under Australian Accounting Standards (AAS), other accounting standards and accounting interpretations issued by the Australian Accounting Standards Board, in accordance with the Finance Minister's Orders for Financial Reporting (FMOs), which are issued pursuant to the CAC Act. In preparing these financial statements, the RBA has not 'early adopted' new accounting standards or amendments to current standards that will apply from 1 July 2014.

These financial statements and accompanying notes are a general purpose financial report prepared in accordance with relevant AAS. Elections of accounting treatment under AAS are noted appropriately. All amounts are expressed in Australian dollars, the functional and presentational currency of the RBA, unless another currency is indicated. The RBA is classified as a for-profit public sector entity for purposes of financial disclosure. Fair values are used to measure the RBA's major assets, including domestic and foreign marketable securities, gold and foreign currency, and property, plant and equipment. Revenue and expenses are brought to account on an accruals basis. All revenues, expenses and profits of the RBA are from ordinary activities.

These financial statements were approved and authorised for issue by a resolution of the Reserve Bank Board on 5 August 2014.

From 1 July 2014, the *Public Governance, Performance and Accountability Act 2013* (PGPA Act) replaced the CAC Act. As a result, the RBA's consolidated financial statements will be prepared in accordance with the PGPA Act from the 2014/15 financial reporting period. The requirements of the PGPA Act are not expected to have a material impact on these financial disclosures.

(a) Consolidation and joint venture

The financial statements show information for the economic entity only; this reflects the consolidated results for the parent entity, the Reserve Bank of Australia, and its wholly owned subsidiary, Note Printing Australia Limited (NPA). The results of the parent entity do not differ materially from the economic entity and have therefore not been separately disclosed.

Note Printing Australia Limited

NPA was incorporated as a wholly owned subsidiary of the RBA on 1 July 1998, with an initial capital of \$20.0 million. The RBA provided NPA with additional capital of \$15.0 million in July 2008 and a further \$25.0 million of capital in July 2009. NPA's total assets, liabilities and equity as at 30 June 2014 were \$143.4 million, \$22.0 million and \$121.4 million respectively (\$135.7 million, \$23.4 million and \$112.3 million as at 30 June 2013).

The assets, liabilities and results of NPA have been consolidated with the accounts of the parent entity in accordance with AASB 10 – *Consolidated Financial Statements*. All internal transactions and balances have been eliminated on consolidation. These transactions include items relating to the purchase of Australian banknotes, lease of premises and the provision of general administrative services.

Innovia Security Pty Ltd (formerly Securrency International Pty Ltd)

In February 2013, the RBA completed the sale of its 50 per cent interest in Securrency International Pty Ltd (Securrency). The sale of the RBA's shares was made to a related entity of Innovia Films, a UK-based film manufacturer, which prior to the sale owned the other half share of Securrency.

Under the terms of the sale agreement, additional payments arising from the sale may be made to the RBA in future periods, including if Innovia Security exceeds certain earnings benchmarks. In 2013/14, an amount of \$7.3 million was received under these arrangements and recognised in the Statement of Comprehensive Income. The receipt is shown within the Gain on sale of Securency in Note 2. As the possibility of further additional payments is uncertain at the reporting date, they are not recognised in the financial statements.

Legal issues

Charges were laid against NPA and Securency and against former employees of these companies in the period between 2011 and 2013. These charges related to allegations that these employees and the companies had conspired to provide, or offered to provide, benefits to foreign public officials that were not legitimately due. The RBA has accounted for these matters in accordance with the relevant accounting standards. Specific information about these charges and the associated costs has not been disclosed in the notes to the accounts as these legal matters remain before the courts.

(b) Financial instruments

A financial instrument is defined as any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity. The RBA's financial instruments are its Australian dollar securities, foreign government securities, repurchase agreements, deposits with the Bank for International Settlements (BIS) and other central banks, interest rate futures, foreign currency swap contracts, holdings in the Asian Bond Fund (ABF), gold loans, cash and cash equivalents, notes on issue, deposit liabilities and a shareholding in the BIS. The RBA accounts for its financial instruments in accordance with AASB 139 – *Financial Instruments: Recognition and Measurement* and reports these instruments under AASB 7 – *Financial Instruments: Disclosures* and AASB 13 – *Fair Value Measurement*.

The RBA brings its securities transactions and foreign exchange transactions to account on a trade date basis; that is, it recognises the effects of purchases and sales of securities in the financial statements on the date these transactions are arranged (not when they are settled). Bank deposits and repurchase agreements are brought to account on settlement date.

Financial assets

Australian dollar securities

The RBA holds Commonwealth Government Securities and securities issued by the central borrowing authorities of state and territory governments. These holdings include fixed coupon, inflation indexed and discount securities. It also holds under repurchase agreements: bank bills, certificates of deposit and debt securities of authorised deposit-taking institutions licensed in Australia; Australian dollar-denominated securities issued by foreign governments, foreign government agencies that have an explicit government guarantee (or equivalent support) and by certain highly rated supranational organisations; and eligible Australian dollar domestic residential and commercial mortgage backed securities, asset-backed commercial paper and corporate securities.

Domestic securities, except those held under repurchase agreements, are classified under AASB 139 as 'at fair value through profit or loss', as they are held for the purpose of conducting monetary policy and may be sold or lent, typically for short terms, under repurchase agreements. In accordance with this standard, the securities are valued at market bid prices on balance date; realised and unrealised gains or losses are taken to profit. Only realised gains and losses are available for distribution in accordance with the Reserve Bank Act (Note 1(g)). Interest earned on these securities is accrued over the term of the security and included as revenue in the Statement of Comprehensive Income.

Interest on fixed coupon securities is received biannually at the coupon rate and the principal is received at maturity. Inflation indexed bonds are coupon securities with the nominal value of the security indexed in line with movements in the Consumer Price Index each quarter until maturity; interest is paid quarterly. Interest earned on discount securities is the difference between the purchase cost and the face value of the security; this is accrued over the term the securities are held. The face value is received at maturity.

Foreign exchange

Foreign exchange holdings are invested mainly in securities issued by the governments of the United States, Germany, France, the Netherlands, Canada, Japan and China and deposits with the BIS and other central banks. The RBA transacts in interest rate futures and foreign currency swaps.

Foreign exchange translation

Assets and liabilities denominated in foreign currency are converted to Australian dollar equivalents at the relevant market bid or offer exchange rate ruling on balance date in accordance with AASB 121 – *The Effects of Changes in Foreign Exchange Rates*. Realised and unrealised gains or losses on foreign currency are taken to profit, but only realised gains and losses are available for distribution in accordance with the Reserve Bank Act (Note 1(g)). Interest revenue and expenses and revaluation gains and losses on foreign currency assets and liabilities are converted to Australian dollars using the relevant market exchange rate on the date they are accrued or recognised, in accordance with AASB 121.

Foreign government securities

Foreign government securities include coupon and discount securities. Coupon securities have biannual or annual interest payments depending on the currency and type of security; the principal is received at maturity. Interest earned on discount securities is the difference between the purchase cost and the face value of the security; this is accrued over the term the securities are held. The face value is received at maturity. Foreign securities, except those held under reverse repurchase agreements, are classified under AASB 139 as 'at fair value through profit or loss', as they are traded in managing the portfolio of foreign exchange reserves. In accordance with this standard, the securities are valued at market bid prices on balance date. Realised and unrealised gains or losses are taken to profit; only realised gains and losses are available for distribution in accordance with the Reserve Bank Act (Note 1(g)). Interest earned on securities is accrued as revenue in the Statement of Comprehensive Income.

Foreign deposits

Some foreign currency reserves are invested in deposits with the BIS and other central banks. Deposits are classified as 'loans and receivables' under AASB 139 and recorded at their face value, which is equivalent to their amortised cost using the effective interest method. Interest is accrued over the term of deposits and is received periodically or at maturity. Interest accrued but not received is included in Accrued interest (Note 15).

Repurchase agreements and reverse repurchase agreements

In carrying out operations to manage domestic liquidity and international reserves, the RBA enters into repurchase agreements and reverse repurchase agreements in domestic and foreign securities. A repurchase agreement involves the sale of securities with an undertaking to repurchase them on an agreed future date at an agreed price. A reverse repurchase agreement initially involves the purchase of securities with this transaction being reversed in the second leg. A reverse repurchase agreement provides the RBA's counterparties with cash for the term of the agreement and is an asset as the RBA records a cash receivable. Repurchase agreements

result in cash being paid to the RBA and are treated as a liability reflecting the obligation to repay cash. The accounting treatment of this financial liability is discussed further below.

Securities purchased and contracted for sale under reverse repurchase agreements are classified under AASB 139 as 'loans and receivables', and valued at amortised cost, equivalent to fair value. The difference between the purchase and sale price is accrued over the term of the agreement and recognised as interest revenue.

RBA open repurchase agreements were introduced after the introduction of same-day settlement of Direct Entry payments in November 2013 to assist eligible financial institutions manage their liquidity. An RBA open repurchase agreement is an Australian dollar reverse repurchase agreement contracted without an agreed maturity date. The RBA accrues interest revenue daily on open repurchase agreements at the target cash rate.

Foreign currency swaps

The RBA uses foreign currency swaps with market counterparties to assist daily domestic liquidity management. A foreign currency swap is the simultaneous purchase and sale of one currency against another currency for specified maturities. The cash flows are the same as borrowing one currency for a certain period and lending another currency for the same period. The pricing of the swap therefore reflects the interest rates applicable to these money market transactions. Interest rates are implicit in the swap contract but interest itself is not paid or received.

Interest rate futures

The RBA uses interest rate futures contracts on overseas exchanges to manage interest rate risk on its portfolio of foreign securities. An interest rate futures contract is a contract to buy or sell a specific amount of securities for a specific price on a specific future date.

Interest rate futures positions are classified under AASB 139 as 'at fair value through profit or loss'. Futures positions are marked to market on balance date at the relevant bid or offer price and valuation gains and losses taken to profit. Only realised gains and losses are available for distribution in accordance with the Reserve Bank Act (Note 1(g)).

Asian Bond Fund

The RBA invests in a number of non-Japan Asian debt markets through participation in the EMEAP Asian Bond Fund Initiative. The RBA has modest holdings in the US dollar-denominated fund, ABF1, and the local currency-denominated fund, ABF2. The two funds are classified under AASB 139 as 'at fair value through profit or loss'. The funds are marked to market on balance date at the relevant unit price of the fund and valuation gains and losses taken to profit. Only realised gains and losses are available for distribution in accordance with the Reserve Bank Act (Note 1(g)).

Bank for International Settlements

Under AASB 139, the RBA's shareholding in the BIS is classified as 'available for sale' for accounting purposes. The shareholding is valued at fair value and revaluation gains and losses are transferred directly to the revaluation reserve for Shares in international financial institutions (Note 5). The fair value is estimated on the basis of BIS' net asset value, less a discount of 30 per cent. This discount is consistent with the decision of the Hague Arbitral Tribunal, and has been applied by the BIS to new central bank subscriptions of shares. When declared, dividends are recognised as revenue in the Statement of Comprehensive Income.

Financial liabilities

Deposit liabilities

Deposits are classified as financial liabilities under AASB 139. Deposits include deposits at call and term deposits. Deposit balances are shown at their amortised cost, which is equivalent to their face value. Interest is accrued over the term of deposits and is paid periodically or at maturity. Interest accrued but not paid is included in Other Liabilities (Note 10). Details of deposits are included in Note 9.

Australian notes on issue

Notes on issue are recorded at face value. Prior to 2005/06, the RBA periodically reduced its liability for note series that had ceased to be issued – to reflect the likelihood that the remaining notes on issue from these series would not be presented for redemption – and the gains were included in accounting profits. If the written down notes are subsequently presented, the RBA charges an expense against profits. In 2013/14, notes with a face value of \$214,034 which had previously been written down were presented to the RBA and expensed (\$208,491 in 2012/13).

The RBA pays interest on working balances of banknotes held by banks under cash distribution arrangements. Details of the interest expense are included in Note 4.

Costs related to the production of banknotes are included in General administrative expenses in Note 2.

Repurchase agreements

Securities sold and contracted for repurchase under repurchase agreements are classified under AASB 139 as 'at fair value through profit or loss', as these securities are held for trading, and reported on the balance sheet within the relevant investment portfolio. The counterpart obligation to repurchase the securities is reported in Other Liabilities (Note 10) at amortised cost; the difference between the sale and purchase price is accrued over the term of the agreement and recognised as interest expense.

(c) Gold

Gold holdings (including gold on loan to other institutions) are valued at the Australian dollar equivalent of the 3 pm fix in the London gold market on balance date. Revaluation gains and losses on gold are transferred to the gold revaluation reserve. The RBA lends gold to financial institutions participating in the gold market. As outlined in Note 1(b), gold loans are a financial instrument and the RBA accounts for them in accordance with AASB 139 and reports them under AASB 7.

(d) Property, plant and equipment

The RBA accounts for its property, plant and equipment at fair value in accordance with AASB 116 – *Property, Plant and Equipment* and AASB 13. Valuation gains (losses) are generally transferred to (from) the relevant revaluation reserve. Valuation losses which exceed the balance in the relevant asset revaluation reserve are expensed. Subsequent valuation gains are included in income if they offset prior losses that were treated as an expense.

Property

Formal valuations of all the RBA's Australian properties are conducted annually; overseas properties are formally valued on a triennial basis. Australian properties are valued by an independent valuer; overseas properties are valued by local independent valuers. The most recent independent valuation of overseas properties was at 30 June 2013. The RBA's properties are recognised in accordance with AASB 116 at fair value, which reflects the

price that would be received from an orderly sale between market participants at the reporting date, having regard also to the highest and best use of an asset as required by AASB 13. Reflecting its specialised nature, the RBA's Business Resumption Site is valued at depreciated replacement cost. Annual depreciation is based on fair values and assessments of the remaining useful life of the relevant asset, as determined by the independent valuer.

Plant and equipment

Plant and equipment is valued by independent valuers on a triennial basis. The most recent independent valuation was at 30 June 2014. Between revaluations, plant and equipment is carried at the most recent valuation less any subsequent depreciation. Annual depreciation is based on fair values and the RBA's assessment of the remaining useful life of individual assets.

Depreciation rates for each class of depreciable assets are based on the following range of useful lives:

	Years
Buildings	20–50
Fit-out and furniture	5–13
Computer hardware	3–5
Office equipment	4–5
Motor vehicles	5
Plant	4–20

The RBA's assets are assessed for impairment at the end of each financial year. Where indications of impairment exist, the asset's recoverable amount is estimated and an impairment adjustment is made if the asset's recoverable amount is less than its carrying amount.

Details of annual net expenditure, revaluation adjustments and depreciation of buildings and plant and equipment are included in Note 8.

(e) Computer software

Computer software that is internally developed or purchased is accounted for in accordance with AASB 138 – *Intangible Assets*. Intangibles are recognised at cost less accumulated amortisation and impairment adjustments (if any), details of which are included in Note 7.

Amortisation of computer software is calculated on the basis of the estimated useful life of the relevant asset, which is usually for a period between three and five years. The useful life of core banking software may be up to 15 years reflecting the period over which future economic benefits are expected to be realised. Amortisation of computer software is disclosed in Note 2.

(f) Capital and Reserves

The capital of the Reserve Bank is established by the Reserve Bank Act.

The Reserve Bank Reserve Fund (RBRF) is also established by the Reserve Bank Act and is regarded essentially as capital. The RBRF is a permanent reserve maintained by the RBA to provide for events which are contingent and not foreseeable, including to cover losses from exceptionally large falls in the market value of the RBA's holdings of domestic and foreign securities that cannot be absorbed by its other resources. The RBRF also provides for other risks such as fraud and operational risk. In terms of the Reserve Bank Act, this reserve can be funded only by transfers from earnings available for distribution.

The Reserve Bank Board assesses the adequacy of the balance of the RBRF each year. In line with section 30 of the Reserve Bank Act, the Treasurer, after consultation with the Board, determines any amounts to be placed to the credit of the RBRF from earnings available for distribution (refer Note 1(g)). The Treasurer, after consulting the Board, has determined that in 2013/14 a sum of \$8,800 million is to be transferred from net profit to the RBRF. The balance of the RBRF has now been restored to a level that the Board regards as appropriate given the risk the Bank holds on its balance sheet.

The RBA also holds a number of other reserves which form part of its equity.

Unrealised gains and losses on foreign exchange, foreign securities and Australian dollar securities are recognised in profit from ordinary activities. Such gains or losses are not available for distribution and are transferred to the Unrealised profits reserve where they remain available to absorb future unrealised losses or become available for distribution if gains are realised when assets are sold.

The balance of the Superannuation reserve represents accumulated re-measurement gains and losses on the RBA's defined benefit superannuation obligations (refer Note 1 (i)). These unrealised gains and losses are included in Other Comprehensive Income in accordance with AASB 119 – *Employee Benefits*.

Balances of asset revaluation reserves reflect differences between the fair value of relevant assets, mainly non-traded assets, and their cost. These assets are: gold; property, plant and equipment; and shares in international and other institutions. These unrealised gains are transferred directly to the relevant reserves and are included in Other Comprehensive Income. The unrealised gains on these assets are not distributable unless they are realised if an asset is sold. The RBA sold a residential property in 2013/14 and recognised a gain of \$4.0 million, of which \$2.6 million represented gains from earlier periods held in the Asset revaluation reserve; the balance of this gain, a sum of \$1.4 million, was recognised in net profit in 2013/14.

(g) Profits

Profits of the RBA are dealt with in the following terms by section 30 of the Reserve Bank Act:

- (1) Subject to subsection (2), the net profits of the Bank in each year shall be dealt with as follows:
 - (aa) such amount as the Treasurer, after consultation with the Reserve Bank Board, determines is to be set aside for contingencies; and
 - (a) such amount as the Treasurer, after consultation with the Reserve Bank Board, determines shall be placed to the credit of the Reserve Bank Reserve Fund; and
 - (b) the remainder shall be paid to the Commonwealth.
- (2) If the net profit of the Bank for a year is calculated on a basis that requires the inclusion of unrealised gains on assets during the year, the amount to which subsection (1) applies is to be worked out as follows:
 - (a) deduct from the net profit an amount equal to the total of all amounts of unrealised gains included in the net profit; and
 - (b) if an asset in respect of which unrealised gains were included in the net profit for a previous year or years is realised during the year – add to the amount remaining after applying paragraph (a) the total amount of those unrealised gains.

(h) Provisions

The RBA maintains provisions for accrued annual leave and long service leave, including associated payroll tax, and post-employment benefits in the form of health insurance and housing assistance, and the associated fringe benefits tax; these provisions are made on a present value basis consistent with AASB 119. The RBA also makes provision for future workers compensation claims for incidents which have occurred before balance date.

(i) Superannuation funds

The RBA includes in its Statement of Financial Position an asset or liability representing the position of its defined benefit superannuation funds measured in accordance with AASB 119. Movements in the superannuation asset or liability are reflected in the Statement of Comprehensive Income. Re-measurement gains and losses are transferred to the Superannuation Reserve. Details of the superannuation funds and superannuation expenses are included in Note 14.

(j) Commonwealth grant

On 23 October 2013, the Australian Government announced it would make a grant of \$8,800 million to strengthen the financial position of the RBA, and enhance its capacity to conduct its monetary policy and foreign exchange operations. The grant was paid to the RBA on 7 May 2014.

The grant has been recognised as revenue in the Statement of Comprehensive Income.

(k) Rounding

Amounts in the financial statements are rounded to the nearest million dollars unless otherwise stated.

(l) Application of new or revised Australian accounting standards

A number of new and revised Australian accounting standards apply to the RBA's financial statements. The RBA's assessment of the main effects of these standards on its financial statements is set out below.

AASB 13 – Fair Value Measurement

AASB 13 has been applied in the RBA's financial statements for the year ending 30 June 2014. AASB 13 provides a framework for measuring fair value. The standard has not had a material effect on the RBA's financial statements but has required additional disclosures to be made around fair value measurements, contained in Note 16.

AASB 10 – Consolidated Financial Statements

AASB 10 introduces a broader concept of control for the preparation of consolidated financial statements. Control is established, and consolidated financial statements are to be prepared, based on whether an entity is exposed, or has the rights, to the variable returns from its involvement with an investee and has the ability to affect those returns through its power over the investee. This standard replaces AASB 127 – *Consolidated and Separate Financial Statements* and has been applied in preparing the RBA's consolidated financial statements for the year ended 30 June 2014. The application of AASB 10 has not had a material effect on the RBA's financial statements.

AASB 9 – Financial Instruments

AASB 9 contains new requirements for the classification, measurement and de-recognition of financial assets and liabilities. It will replace the corresponding requirements in AASB 139. The RBA is assessing the impact of the new standard, which will now be applicable for annual reporting periods beginning on or after 1 January 2018.

AASB 119 – Employee Benefits

The revised accounting standard AASB 119 – *Employee Benefits* affects retrospectively the RBA's accounting policy on employee benefits, in particular post-employment benefits. Under the revised standard, actuarial gains and losses on defined benefit superannuation obligations are now fully recognised on the balance sheet, and included in Other Comprehensive Income, in the reporting period in which they occur. Current service and net interest costs are now recognised in net profit. Net interest is now calculated by applying the discount rate to the net defined benefit liability; previously the return on the assets of a superannuation scheme was incorporated in this calculation.

These amendments result in the RBA showing a Superannuation liability of \$321 million being retrospectively recognised at 30 June 2013 (\$614 million at 30 June 2012), with corresponding adjustments to the historical figures for the RBA's reported Total Comprehensive Income. The impact of these amendments in 2012/13 is shown in the restated financial statements set out in the following tables. Additional narrative disclosures are provided in Note 14.

The historical revision to the RBA's profit and loss from the revised AASB 119 has resulted in a cumulative reduction of \$142 million in the balance of the RBRF as at 30 June 2013 from previous disclosures.

In addition, the revised standard amends disclosures for short-term and other long-term employee benefits, in particular annual leave. This does not materially affect the RBA's financial disclosures.

The effect of these changes on the consolidated financial statements if the revised accounting standard had been applied retrospectively, is outlined in the following tables.

Opening Statement of Financial Position – as at 1 July 2012

Reserve Bank of Australia and Controlled Entity

	Previous Accounting Standard \$M	Revised Accounting Standard \$M	Difference \$M
Assets			
Cash and cash equivalents	164	164	–
Australian dollar securities	32,648	32,648	–
Foreign exchange	43,296	43,296	–
Gold	4,027	4,027	–
Property, plant and equipment	448	448	–
Loans, advances and other assets	496	455	(41)
Total Assets	81,079	81,038	(41)
Liabilities			
Deposits	18,000	18,000	–
Distribution payable to the Commonwealth	500	500	–
Australian notes on issue	53,595	53,595	–
Other liabilities	2,615	3,229	614
Total Liabilities	74,710	75,324	614
Net Assets	6,369	5,714	(655)
Capital and Reserves			
Reserves:			
Unrealised profits reserve	41	–	(41)
Asset revaluation reserves	4,375	4,375	–
Superannuation reserve	–	(523)	(523)
Reserve Bank Reserve Fund	1,913	1,822	(91)
Capital	40	40	–
Total Capital and Reserves	6,369	5,714	(655)

Statement of Financial Position – as at 30 June 2013

Reserve Bank of Australia and Controlled Entity

	Previous Accounting Standard \$M	Revised Accounting Standard \$M	Difference \$M
Assets			
Cash and cash equivalents	137	137	–
Australian dollar securities	43,249	43,249	–
Foreign exchange	50,930	50,930	–
Gold	3,299	3,299	–
Property, plant and equipment	491	491	–
Loans, advances and other assets	421	421	–
Total Assets	98,527	98,527	–
Liabilities			
Deposits	26,183	26,183	–
Distribution payable to the Commonwealth	–	–	–
Australian notes on issue	56,943	56,943	–
Other liabilities	5,389	5,679	290
Total Liabilities	88,515	88,805	290
Net Assets	10,012	9,722	(290)
Capital and Reserves			
Reserves:			
Unrealised profits reserve	3,766	3,796	30
Asset revaluation reserves	3,705	3,705	–
Superannuation reserve	–	(178)	(178)
Reserve Bank Reserve Fund	2,501	2,359	(142)
Capital	40	40	–
Total Capital and Reserves	10,012	9,722	(290)

Statement of Comprehensive Income – for the year ended 30 June 2013

Reserve Bank of Australia and Controlled Entity

	Previous Accounting Standard \$M	Revised Accounting Standard \$M	Difference \$M
Revenue			
Interest revenue	1,642	1,642	–
Net gains on securities and foreign exchange	3,662	3,662	–
Dividend revenue	5	5	–
Fees and commissions	66	66	–
Other income	138	138	–
Total Revenue	5,513	5,513	–
Expenses			
Interest expense	708	708	–
General administrative expenses	413	393	(20)
Other expenses	79	79	–
Total Expenses	1,200	1,180	(20)
Net Profit	4,313	4,333	20
Other Comprehensive Income			
<i>Items that may be reclassified to profit or loss</i>			
Gains/(losses) on:			
Gold	(727)	(727)	–
Shares in international and other institutions	42	42	–
	(685)	(685)	–
<i>Items that will not be reclassified to profit or loss</i>			
Gains/(losses) on:			
Property, plant and equipment	15	15	–
Superannuation	–	345	345
	15	360	345
Total Other Comprehensive Income	(670)	(325)	345
Total Comprehensive Income	3,643	4,008	365

Figures as at 30 June 2013 under the previous accounting standard relating to fees and commissions, general administrative expenses and other expenses have been restated (refer to Note 2).

Note 2 – Net Profits

	Note	2014 \$M	2013 \$M
Interest revenue			
Foreign investments	1(b), 4	153	213
Australian dollar securities	1(b), 4	1,667	1,398
Overnight settlements	4	13	30
Cash collateral provided	4	1	–
Loans, advances and other	4	–	1
		1,834	1,642
Net gains/(losses) on securities and foreign exchange			
Foreign investments	1(b)	94	(70)
Australian dollar securities	1(b)	(90)	(244)
Foreign currency	1(b)	146	3,976
		150	3,662
Dividend revenue			
Investment in Bank for International Settlements	1(b)	3	5
Fees and commissions			
Banking services fee income		86	66
Commonwealth grant revenue			
	1(j)	8,800	–
Other income			
Rental of Bank premises		10	9
Sales of note and security products		78	79
Gain on sale of Securrency		7	21
Other		23	29
		118	138
Total			
		10,991	5,513
<i>Less:</i>			
Interest expense			
Deposit liabilities	1(b), 4	1,010	614
Banknote holdings of banks	1(b), 4	72	89
Cash collateral received	4	2	2
Repurchase agreements	1(b), 4	2	3
		1,086	708
General administrative expenses			
Staff costs		189	153
Superannuation costs	1(i), 14	60	77
Special redundancy/retirement payments		1	6
Depreciation of property	1(d), 8	9	8
Depreciation of plant and equipment	1(d), 8	21	19
Amortisation of computer software	1(e), 7	3	3
Premises and equipment	1(d)	45	41
Materials used in note and security products		61	70
Travel		3	3
Consultants' fees, legal fees and payments to contractors		4	6
Other		9	7
		405	393

Note 2 – Net Profits (continued)

	Note	2014 \$M	2013 \$M
Other expenses			
Banking service fee expenses		67	50
Subsidiary income tax		2	–
Banknote distribution expenses		4	5
Other		35	24
		108	79
Total		1,599	1,180
Net Profit		9,392	4,333

Staff costs in 2013/14 include an expense of \$4.4 million associated with the increase in the balance of the provision for post-employment benefits, mostly from post-employment health insurance (in 2012/13 there was a credit of \$20.6 million) (refer Note 10). This benefit ceased to be available for new staff appointed after 30 June 2013. The increase in this provision reflects a reduction in the discount rate, as measured by the yield on Commonwealth government bonds.

The RBA incurred aggregate research and development expenditure of \$1.1 million in 2013/14 (\$0.7 million in 2012/13); this is included in Other expenses.

Comparative figures for Banking service fee income and Other expenses have been restated. Banking service fees received were previously presented net of the associated expenses. However, as the RBA acts as principal in these transactions, revenue from banking service fees and the associated expenses are now shown in gross terms. This restatement has no effect on Net Profits.

Additional presentational amendments have also been made to improve readability. Amortisation of computer software is now separately disclosed and amounts relating to the reimbursement by the Australian Government for loan management and registry expenses have been included in 'Other' within reported Other income.

Note 3 – Distribution Payable to the Commonwealth

Section 30 of the Reserve Bank Act requires that the net profits of the RBA, less amounts set aside for contingencies or placed to the credit of the RBRF as determined by the Treasurer after consulting the Board, shall be paid to the Commonwealth (see Note 1(g)). Also under section 30, unrealised profits from foreign exchange, foreign securities and Australian dollar securities are not available for distribution. Instead they are transferred to the Unrealised profits reserve, where they remain available to absorb future valuation losses or are realised when relevant assets are sold. Unrealised losses are, in the first instance, absorbed within the Unrealised profits reserve and are offset against unrealised profits accumulated from previous years. For purposes of distribution, if such losses exceed the balance in this reserve, the amount by which they do so is initially charged against other components of income, with any remaining loss absorbed by the RBRF.

In 2013/14, the Reserve Bank recorded an accounting profit of \$9,392 million, including revenue from the Commonwealth grant of \$8,800 million. Unrealised losses of \$640 million were absorbed within the Unrealised profits reserve, while \$3 million was transferred from the Asset revaluation reserve to the Statement of Distribution, from the sale of a property at Kirribilli. Earnings available for distribution amounted to \$10,035 million in 2013/14.

After consulting the Reserve Bank Board, the Treasurer determined that a sum of \$8,800 million was to be placed from distributable earnings to the credit of the RBRF in 2013/14. This transfer is the equivalent of the proceeds from the Commonwealth grant. Accordingly, a sum of \$1,235 million is payable as a dividend to the Commonwealth from earnings available for distribution in 2013/14. The Treasurer has determined that an amount of \$618 million be paid in early 2014/15, with the balance to be paid in 2015/16. No dividend was distributed from earnings in 2012/13.

	2014 \$M	2013 \$M
Opening balance	–	500
Distribution to the Commonwealth	–	(500)
Transfer from Statement of Distribution	1,235	–
As at 30 June	1,235	–

Note 4 – Interest Revenue and Interest Expense

Analysis for the year ended 30 June 2014

	Average balance \$M	Interest \$M	Average annual interest rate %
Interest revenue			
Foreign investments	52,404	153	0.3
Australian dollar securities	58,397	1,667	2.9
Overnight settlements	549	13	2.3
Cash collateral provided	50	1	2.6
Gold loans	49	–	0.4
Loans, advances and other	20	–	2.3
	111,469	1,834	1.6
Interest expense			
Exchange Settlement balances	13,752	342	2.5
Deposits from governments	25,988	653	2.5
Deposits from overseas institutions	1,073	15	1.4
Banknote holdings of banks	3,175	72	2.3
Foreign repurchase agreements	2,548	(1)	–
Australian dollar repurchase agreements	124	3	2.5
Cash collateral received	101	2	2.5
Other deposits	19	–	1.0
	46,780	1,086	2.3
Analysis for the year ended 30 June 2013			
Interest revenue total	79,226	1,642	2.1
Interest expense total	25,488	708	2.8

Interest revenue for 2013/14 includes \$1,259 million calculated using the effective interest method for financial assets not at fair value through profit and loss (\$857 million in 2012/13). Interest expense for 2013/14 includes \$1,086 million calculated using the effective interest method for financial liabilities not at fair value through profit and loss (\$708 million in 2012/13).

Note 5 – Capital and Reserves

Changes in the RBA's Capital and Reserves (Note 1(f)) are shown below.

	Note	2014 \$M	2013 \$M
Asset revaluation reserves			
Gold			
	1(c)		
Opening balance		3,173	3,900
Net revaluation adjustments		284	(727)
As at 30 June		3,457	3,173
Shares in international financial institutions			
	1(b), 7		
Opening balance		324	282
Net revaluation adjustments		(20)	42
As at 30 June		304	324
Property, plant and equipment			
	1(d), 8		
Opening balance		208	193
Net revaluation adjustments		12	15
Transfers (to)/from Statement of Distribution		(3)	–
As at 30 June		217	208
Total asset revaluation reserves			
	1(f)		
Opening balance		3,705	4,375
Net revaluation adjustments		276	(670)
Transfers (to)/from Statement of Distribution		(3)	–
As at 30 June		3,978	3,705
Superannuation reserve			
	1(f)		
Opening balance		(178)	(523)
Net revaluation adjustments		155	345
As at 30 June		(23)	(178)
Unrealised profits reserve			
	1(f)		
Opening balance		3,796	–
Net transfers (to)/from Statement of Distribution		(640)	3,796
As at 30 June		3,156	3,796
Reserve Bank Reserve Fund			
	1(f)		
Opening balance		2,359	1,822
Transfers (to)/from Statement of Distribution		8,800	537
As at 30 June		11,159	2,359
Capital			
	1(f)		
Opening and closing balance		40	40

Note 6 – Cash and Cash Equivalents

This includes net amounts of \$256 million owed to the RBA for overnight clearances of financial transactions through the payments system; an amount of \$115 million was owed to the RBA at 30 June 2013. Other cash and cash equivalents include NPA's bank deposits.

Cash and cash equivalents exclude Australian and foreign short-term investments held to implement monetary policy or as part of Australia's foreign reserve assets. These investments are disclosed as Australian dollar securities and foreign exchange, respectively; detail is disclosed in Note 15.

	2014 \$M	2013 \$M
Cash	17	22
Overnight settlements	256	115
As at 30 June	273	137

Reconciliation of net cash used in operating activities to Net Profits	Note	2014 \$M	2013 \$M
Net Profit		9,392	4,333
Increase/(decrease) in interest payable		48	5
Net loss/(gain) on overseas investments	2	(94)	70
Net loss/(gain) on Australian dollar securities	2	90	244
Net loss/(gain) on foreign currency	2	(146)	(3,976)
Decrease/(increase) in income accrued on investments		(100)	47
Cash collateral received/(pledged)		382	(253)
Depreciation of property	8	9	8
Depreciation of plant and equipment	8	21	19
Amortisation of computer software	7	3	3
Net payments for investments		(40,686)	(11,592)
Other		34	8
Net cash used in operating activities		(31,047)	(11,084)

Note 7 – Loans, Advances and Other Assets

	Note	2014 \$M	2013 \$M
Shareholding in Bank for International Settlements	1(b)	348	367
Computer software	1(e)	18	11
Officers' Home Advances		4	4
Other		42	39
As at 30 June		412	421

At 30 June 2014, the gross book value of the RBA's computer software amounted to \$33.2 million and the accumulated amortisation on these assets was \$15.1 million (\$23.3 million and \$12.6 million, respectively, at 30 June 2013). During 2013/14, there were \$10.8 million in net additions to computer software (\$5.9 million in 2012/13) and \$3.5 million in amortisation expense (\$2.8 million in 2012/13). The RBA had contractual commitments of \$1.9 million as at 30 June 2014 for the acquisition of computer software (\$0.4 million at 30 June 2013).

Computer software has been separately disclosed to improve the presentation and readability of the financial statements. Other intangibles, previously reported with computer software, have been included within reported Other assets. As at 30 June 2014, Other assets included receivables of \$30.1 million, none of which are impaired (\$20.8 million at 30 June 2013).

Note 8 – Property, Plant and Equipment

	Land	Buildings	Plant and Equipment	Total
	\$M	\$M	\$M	\$M
Gross Book Value as at 30 June 2013	130	219	190	539
Accumulated depreciation	–	–	(48)	(48)
Net Book Value	130	219	142	491
Additions	–	13	41	54
Depreciation expense	–	(9)	(21)	(30)
Net revaluation increment/(decrement)	2	9	1	12
Disposals	(3)	–	(1)	(4)
Net additions to net book value	(1)	13	20	32
Gross Book Value as at 30 June 2014	129	232	182	543
Accumulated depreciation	–	–	(20)	(20)
Net Book Value	129	232	162	523

The net book value of the RBA's property, plant and equipment includes \$27.5 million of work in progress (\$45.4 million at 30 June 2013).

As at 30 June 2014, the RBA had contractual commitments of \$8.4 million to acquire plant and equipment (\$12.0 million at 30 June 2013); contractual commitments of \$6.5 million are due within one year (\$7.6 million in 2012/13).

Note 9 – Deposits

	2014	2013
	\$M	\$M
Exchange Settlement balances	22,379	2,235
Australian Government	30,304	21,100
State governments	–	10
Foreign governments, foreign institutions and international organisations	872	2,815
Other depositors	19	23
As at 30 June	53,574	26,183

Note 10 – Other Liabilities

	Note	2014 \$M	2013 \$M
Provisions	1(h)		
Provision for accrued annual leave		17	17
Provision for long service leave		40	40
Provision for post-employment benefits		101	96
		158	153
Other			
Securities sold under agreements to repurchase	1(b)	5,244	2,379
Payable for unsettled purchases of securities		1,693	2,484
Interest accrued on deposits		65	17
Superannuation liability	1(i), 14	197	321
Other		231	325
		7,430	5,526
Total Other Liabilities as at 30 June		7,588	5,679

The provision for workers compensation at 30 June 2014 was \$237,000 (\$290,000 at 30 June 2013).

During 2013/14, annual leave of \$11.3 million was accrued by staff, while \$11.0 million of accrued leave was used. Staff accrued and used long service leave of \$5.3 million and \$3.8 million respectively in 2013/14.

The RBA provided an additional \$4.4 million for its post-retirement benefits in 2013/14, partially due to a decrease in the discount rate. Benefits of \$4.1 million were paid out of the provision for post-employment benefits in 2013/14. The balance of the provision for post-employment benefits will change if assumptions about the length of staff service, the longevity of retired staff, future movements in medical costs or the discount rate vary.

At 30 June 2014, \$11.4 million of the provision for accrued annual leave was due within 12 months (\$9.3 million at 30 June 2013); \$4.2 million of the provision for long service leave was due within 12 months (\$3.5 million at 30 June 2013); and \$4.5 million of the provision for post-employment benefits was due within 12 months (\$4.4 million at 30 June 2013).

Note 11 – Contingent Assets and Liabilities

The RBA has a contingent liability, amounting to \$59.0 million at 30 June 2014 (\$58.4 million at 30 June 2013), for the uncalled portion of its shares held in the BIS.

In the course of providing services to its customers, the RBA provides performance guarantees to third parties in relation to customer activities. Such exposure is not material and has not given rise to losses in the past.

The RBA carries its own insurance risks except where external insurance cover is considered to be more cost-effective or required by legislation.

As outlined in Note 1, the RBA has accounted for the costs, and potential costs, to the consolidated entity associated with the charges laid against NPA, Securrency and several former employees of these companies during 2011 and the charges against former employees in 2013. In light of the uncertainties, it is not possible to make reliable estimates of all of the potential costs associated with the charges, or potential claims in connection with them, at the date of preparing these accounts.

Regarding the sale of Securrency in 2013, the RBA provided the owner of Innovia Security with a number of indemnities for the period during which the company had been jointly owned by the RBA and Innovia Films. It is not possible to reliably estimate the potential financial effect of these indemnities. The RBA, however, does not consider it probable at this time that it will have to make payments in terms of these indemnities. Accordingly, they are treated as contingent liabilities in accordance with AASB 137 – *Provisions, Contingent Liabilities and Contingent Assets*.

In addition, an amount covering 50 per cent of certain potential liabilities of Innovia Security relating to events prior to the sale has been placed in escrow. The RBA will receive the balance, if any, after relevant claims have been paid, settled or lapse. At this time it is not possible to estimate the likelihood of the RBA receiving any payments from the amounts that remain in escrow and they are treated as a contingent asset, in accordance with AASB 137.

Note 12 – Key Management Personnel

The key management personnel of the Reserve Bank are the Governor and Deputy Governor, non-executive members of the Reserve Bank Board, non-executive members of the Payments System Board and the Assistant Governors, who are the senior staff responsible for planning, directing and controlling the activities of the Bank. No new positions were added to this group in 2013/14. As a vacancy was filled on the Payments System Board, 22 individuals occupied these positions in 2013/14, one more than in the previous year.

The Reserve Bank Board determines the remuneration for the position of the Governor and Deputy Governor on a recommendation of the Board's Remuneration Committee, comprising three non-executive directors, and in terms of arrangements governed by the Remuneration Tribunal. Fees for non-executive members of the Reserve Bank Board and the Payments System Board are governed by the Remuneration Tribunal. The Governor, in consultation with the Board Remuneration Committee, determines the remuneration of Assistant Governors and other staff. For staff generally, remuneration aims to be market competitive and designed to attract and retain appropriately skilled people. Remuneration levels for employees are externally benchmarked.

The Remuneration Tribunal advised an increase in the remuneration rate for the position of Governor of 2.4 per cent, effective from 1 July 2013. The Board determined remuneration for this position accordingly. Consequently, total remuneration for the position of the Governor was \$1,010,456 in 2013/14 (including salary of \$862,256), compared with \$986,773 (salary of \$842,285) in 2012/13.

Further detail on remuneration of staff is set out below. The RBA discloses remuneration of directors, executives and management in terms of both AAS and the FMOs.

Disclosures under AAS

Under AAS, disclosure of remuneration of key management personnel is based on AASB 124 – *Related Party Disclosures*, as shown in Table A below. The figures are on an accruals basis and show the full cost to the consolidated entity; they include all leave and all fringe benefits tax charges.

Table A: Remuneration of Key Management Personnel^(a)

	2014	2013
	\$	\$
Short-term employee benefits	5,375,433	5,076,213
Post-employment benefits	1,010,678	968,976
Other long-term benefits	52,929	85,030
Share-based payments	–	–
Termination benefits	–	–
Total compensation	6,439,040	6,130,219

(a) Comparative figures for the financial reporting period ended 30 June 2013 have been restated in terms of the revised AASB 119 – *Employee Benefits* (refer Note 1(l)).

Short-term benefits include cash salary and, where relevant for executives, lump sum payments, motor vehicle benefits, car parking and health benefits and the fringe benefits tax paid or payable on these benefits. Post-employment benefits include superannuation benefits and, in the case of staff, health benefits. Other long-term benefits include long service leave and annual leave.

There were no loans during 2013/14 and 2012/13 by the RBA to any key management personnel.

There were no related party transactions with Board members or executives. Transactions with director-related entities which occurred in the normal course of the RBA's operations were incidental and conducted on terms no more favourable than similar transactions with other employees or customers; any vendor relationships with such entities were at arm's length and were compliant with the Bank's requirements for procurement.

Disclosure under FMOs

The disclosures on remuneration required in terms of Division 23 of the FMOs are shown in Tables B to E below. Aggregates in Table B are similar to those in Table A but exclude information for non-executive directors, which is shown separately in Table E.

Table B: Executive Remuneration^(a)

	2014 \$	2013 \$
Short-term employee benefits		
Salary	3,975,575	3,776,765
Performance-related payments	62,015	57,858
Other ^(b)	234,374	234,490
Total short-term employee benefits	4,271,964	4,069,113
Post-employment benefits		
Superannuation	914,407	884,968
Other ^(c)	28,702	27,466
Total post-employment benefits	943,109	912,434
Other long-term benefits		
Annual leave accrued	333,183	319,568
Long service leave	132,456	126,978
Total other long-term benefits	465,639	446,546
Termination benefits	–	–
Total employment benefits	5,680,712	5,428,093

(a) This table is based on remuneration for the executives, including the Governor and Deputy Governor, who are included in key management personnel. It is prepared on an accruals basis. Figures for annual and long service leave in 'Other long-term benefits' include the accrual of leave in the relevant year but not the cost of revaluing leave entitlements previously accrued (as in Table A above).

(b) Other short-term employee benefits include car parking and health benefits and, for relevant executives, motor vehicle and related benefits.

(c) Other post-employment benefits include health benefits.

The figures in Tables C and D are prepared in accordance with the FMOs and are on a cash basis derived from information on the payment summaries for individual employees. Differences between figures in Table C and those determined by the Remuneration Tribunal are due to measurement differences. The average adjustment to gross salary for Assistant Governors was 3.7 per cent in 2013/14; these staff were eligible for lump sum performance-related payments in 2013/14 and 2012/13.

Table C: Executive Remuneration^(a)

30 June 2014

Remuneration band	Number of staff	Reportable salary ^(b)	Contributed superannuation ^(c)	Reportable allowances ^(d)	Lump sum payment ^(e)	Total
Total remuneration:						
\$555,000 to \$584,999	3	463,781	94,252	–	9,356	567,389
\$585,000 to \$614,999	1	498,304	100,488	–	11,494	610,286
\$615,000 to \$644,999	2	518,415	108,706	–	11,227	638,348
\$735,000 to \$764,999	1	636,507	126,476	–	–	762,983
\$1,035,000 to \$1,064,999	1	863,161	183,644	–	–	1,046,805
	<u>8</u>					

30 June 2013

Remuneration band	Number of staff	Reportable salary ^(b)	Contributed superannuation ^(c)	Reportable allowances ^(d)	Lump sum payment ^(e)	Total
Total remuneration:						
\$525,000 to \$554,999	2	442,902	90,069	–	8,242	541,213
\$555,000 to \$584,999	2	467,220	94,476	–	8,658	570,354
\$585,000 to \$614,999	1	473,884	105,031	–	13,257	592,172
\$615,000 to \$644,999	1	503,282	104,883	–	10,802	618,967
\$705,000 to \$734,999	1	580,808	126,476	–	–	707,284
\$975,000 to \$1,004,999	1	815,234	179,407	–	–	994,641
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(a) This table is based on remuneration for the executives included in the RBA's key management personnel. Figures are averages for the individuals contained in each remuneration band. The figures are disclosed in terms of the FMOs and are on a different measurement basis from AASB 124 and as determined by the Remuneration Tribunal.

(b) In terms of the FMOs, 'Reportable salary' includes gross payments (including salary less any lump sum amounts paid), net reportable fringe benefits and reportable employer superannuation contributions. Reportable salary as prescribed by the FMOs differs from superannuable salary. It excludes salary sacrificed amounts (other than superannuation). The exclusion of salary sacrificed amounts means that increases in 'Reportable salary' and 'Total' remuneration, as measured, will differ from the increase in actual salary and total remuneration of these positions if salary sacrificed amounts (other than superannuation) change from year to year. In 2012/13, the Governor salary sacrificed the lease on a motor vehicle and for the associated fringe benefits tax; in 2013/14, the conclusion of that arrangement meant that the 'Reportable salary' and 'Total' remuneration amounts shown in Table C rose by more than the actual increase in salary and total remuneration for this position. The adjustment made to the remuneration of the position of Governor was 2.4 per cent, as advised by the Remuneration Tribunal.

(c) 'Contributed superannuation' amount is the average amount of actual superannuation contributions paid.

(d) 'Reportable allowances' are the average actual allowances paid as per the 'total allowances' line on individuals' payment summaries.

(e) 'Lump sum payment' represents the average actual lump sum amounts paid during the reporting period for staff in the remuneration band.

Table D includes disclosures for RBA and NPA staff. The increase in the number of staff in 2013/14 in the initial remuneration bands mainly reflects salary increases received during the financial year that resulted in more RBA staff being remunerated at levels above the reportable threshold; it does not primarily reflect the creation of new management positions. The average salary increase for RBA staff shown in Table D was 3.8 per cent in 2013/14; lump sum performance-based payments and modest career increments were also paid to some individuals. NPA staff are not employees of the Bank and their terms and conditions are determined by NPA. Lump sum performance-based payments are available to NPA staff.

Table D: Remuneration of Other Staff above the Reportable Threshold^(a)

30 June 2014

Remuneration band	Number of staff	Reportable salary ^(b)	Contributed superannuation ^(c)	Reportable allowances ^(d)	Lump sum payment ^(e)	Total
Total remuneration:						
\$195,000 to \$224,999	54	174,187	34,568	15	4,501	213,271
\$225,000 to \$254,999	29	193,469	38,512	2	4,331	236,314
\$255,000 to \$284,999	16	223,185	41,536	–	7,459	272,180
\$285,000 to \$314,999	21	244,152	45,283	3	7,893	297,331
\$315,000 to \$344,999	9	270,501	46,805	–	9,862	327,168
\$345,000 to \$374,999	2	290,923	57,168	–	5,240	353,331
\$375,000 to \$404,999	5	336,859	53,315	–	5,186	395,360
\$405,000 to \$434,999	2	366,998	60,197	–	5,517	432,712
\$435,000 to \$464,999	7	377,665	69,670	–	7,148	454,483
\$495,000 to \$524,999	2	420,530	84,254	–	7,520	512,304
\$555,000 to \$584,999	1	415,978	49,940	–	105,788	571,706

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30 June 2013

Remuneration band	Number of staff	Reportable salary ^(b)	Contributed superannuation ^(c)	Reportable allowances ^(d)	Lump sum payment ^(e)	Total
Total remuneration:						
\$195,000 to \$224,999	49	170,894	33,171	34	4,719	208,818
\$225,000 to \$254,999	19	193,065	39,209	–	5,353	237,627
\$255,000 to \$284,999	21	218,829	43,483	39	7,721	270,072
\$285,000 to \$314,999	9	244,171	47,675	–	9,427	301,273
\$315,000 to \$344,999	7	267,601	48,793	–	11,664	328,058
\$345,000 to \$374,999	3	304,878	48,638	–	3,364	356,880
\$375,000 to \$404,999	2	309,365	60,975	–	5,589	375,929
\$405,000 to \$434,999	5	352,013	70,336	–	6,433	428,782
\$435,000 to \$464,999	3	375,390	64,426	–	7,537	447,353
\$465,000 to \$494,999	1	394,151	80,310	–	7,360	481,821
\$495,000 to \$524,999	1	413,425	81,857	–	7,502	502,784
\$555,000 to \$584,999	1	402,886	47,113	–	106,070	556,069

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(a) This table shows remuneration for staff of the RBA and NPA whose reportable remuneration was \$195,000 or more in the year, and whose remuneration was not required to be disclosed in Table C. Each row shows an average figure based on the number of staff in each remuneration band. These figures are disclosed on a cash basis.

(b) 'Reportable salary' includes gross payments (including salary less any lump sum amounts paid), reportable fringe benefits (net amount) and reportable employer superannuation contributions.

(c) 'Contributed superannuation' amount is the average amount of actual superannuation contributions paid.

(d) 'Reportable allowances' are the average actual allowances paid as per the 'total allowances' line on individuals' payment summaries.

(e) 'Lump sum payment' represents the average actual lump sum amounts paid during the reporting period for staff in the remuneration band.

Table E reports total remuneration earned by non-executive directors who are members of the Reserve Bank Board, the Payments System Board and the NPA Board. Non-executive directors of NPA who are RBA executives are not paid directors' fees.

Table E: Remuneration of Non-executive Directors

	Number of directors	
	2014	2013
\$0 to \$29,999	3	3
\$30,000 to \$59,999	5	4
\$60,000 to \$89,999	5	5
\$90,000 to \$119,999	1	1
Total	14	13
Total remuneration received (\$)	798,045	685,626

Note 13 – Auditor's Remuneration

	2014 \$	2013 \$
Fees paid or payable to the statutory auditor (Australian National Audit Office) for audit services	412,272	416,500

In 2013/14, KPMG was contracted by the Australian National Audit Office (ANAO) to provide audit services in relation to the audit of the RBA. This includes audit services for NPA and the Reserve Bank of Australia Officers' Superannuation Fund. PricewaterhouseCoopers provided these services to the ANAO in 2012/13.

During 2013/14, KPMG earned additional fees of \$538,827 for non-audit services that were separately contracted by the RBA. A significant proportion of these fees was for services commissioned before the ANAO appointed KPMG to the RBA's audit. In 2012/13, PricewaterhouseCoopers earned additional fees of \$609,680 for non-audit services that were also separately contracted by the RBA.

These fees are included in Consultants' fees, legal fees and payments to contractors in Note 2.

Note 14 – Superannuation Funds

Overview

Based on independent actuarial estimates, the defined benefit superannuation fund administered by the RBA was in surplus at 30 June 2014. This actuarial analysis is based on an update of the full actuarial valuation prepared as at 30 June 2011, and is consistent with AAS 25 – *Financial Reporting by Superannuation Plans*. As required by relevant legislation, a new actuarial review of the fund as at 30 June 2014 is currently being prepared.

The presentation of the RBA's financial statements follows disclosures for superannuation required by AASB 119 – *Employee Benefits*. Disclosures under this standard are based on the assumption of future liabilities being discounted at the government bond yield, which places a higher present value on those liabilities than the independent actuarial assessment which discounts them at the assumed return on fund assets. In other words, AASB 119 does not take into account that the assets held to fund future defined benefits have in the

past earned a higher average rate of return than government bonds or that this tendency might continue over time.

Disclosures under AASB 119 in 2013/14 incorporate revisions that apply for the first time. The key revision is that the 'corridor approach', which the RBA previously applied to value actuarial gains and losses on defined benefit funds, is no longer available. The 'corridor approach' had the effect of smoothing out and delaying the impact of actuarial gains and losses on both the Statement of Financial Position and the Statement of Comprehensive Income. The result of the revised approach, which applies retrospectively, is that actuarial gains and losses are now immediately brought to account. In terms of this standard, the RBA currently carries a liability for defined benefit superannuation.

Structure of funds

The RBA has two superannuation funds: the Reserve Bank of Australia Officers' Superannuation Fund (OSF) and the Reserve Bank of Australia UK Pension Scheme. Current and future benefits of these schemes are funded by member and RBA contributions and the existing assets of these schemes. The RBA's superannuation expenses for these schemes are included in accounting profits and shown in Note 2. Administration and other operational costs are also included in Note 2. There were no other related party transactions between the RBA and the funds during 2013/14.

The OSF is a hybrid fund licensed by the Australian Prudential Regulation Authority. Most members receive a defined benefit in accordance with the rules of the fund; other member benefits include unitised defined contribution accumulation balances, which comprise the RBA's productivity and superannuation guarantee contributions and members' personal contributions, plus earnings on these contributions. The OSF is classified as a single-employer plan in terms of AASB 119. The UK Pension Scheme is a closed defined benefit scheme subject to relevant UK regulation.

Defined benefit membership in the OSF was closed to new RBA staff from 1 August 2014. From that date, new staff have been offered defined contribution superannuation.

Funding valuation

Full independent actuarial valuations of the OSF and UK Pension Scheme are conducted every three years. The most recent funding valuation of the OSF was at 30 June 2011. The latest valuation of the UK Pension Scheme was at 30 June 2013. At these valuations, the actuaries concluded that, on the basis of accrued benefits, both funds were in surplus and in a satisfactory financial position.

The funding valuation of the OSF in 2011 was based on the Attained Age Funding method, consistent with AAS 25. Accrued benefits were determined as the value of the future benefits payable to members (allowing for future salary increases), discounted by the expected rate of return on assets held to fund these benefits. At the time of this review, the surplus of the OSF was \$57.8 million, as the assets of the OSF of \$915.5 million exceeded the accrued benefits of \$857.7 million. The OSF surplus measured on this basis as at 30 June 2014 amounted to \$119.4 million (assets of \$1,135.4 million less accrued benefits of \$1,016.0 million).

Consistent with the actuary's recommendation at the 2011 triennial review, the RBA maintained its contribution rate to the OSF defined benefit at 18.3 per cent of salaries in 2013/14. This contribution rate will be maintained for the time being, but will be subject to review on the basis of the triennial valuation for 30 June 2014.

The latest triennial funding valuation for the UK Pension Scheme was also based on the Attained Age Funding method. The UK Pension Scheme recorded a surplus of \$0.1 million at 30 June 2014 (assets of \$21.5 million compared with accrued benefits of \$21.4 million).

Accounting valuation

For financial statement purposes, the financial positions of the OSF and UK Pension Scheme are valued in accordance with AASB 119. Information on these valuations and their impact on the financial statements are provided in a detailed reconciliation at the end of this Note.

AASB 119 requires disclosures of significant actuarial assumptions, a maturity analysis of the defined benefit obligation and key risk exposures. Unless otherwise stated, information is provided only for the OSF, as the UK Pension Scheme is not material.

Actuarial assumptions

The principal actuarial assumptions for the AASB 119 valuation of the OSF are:

	2014 Per cent	2013 Per cent
Discount rate (gross of tax)	4.60	4.70
Future salary growth	3.00	3.25
Future pension growth	3.00	3.25

Maturity Analysis

The weighted-average duration of the defined benefit obligation for the OSF is 18 years (18 years in 2013). The expected maturity profile for defined benefit obligations of the OSF is as follows:

	Maturity profile (per cent)					Total
	Less than 5 years	Between 5–10 years	Between 10–20 years	Between 20–30 years	Over 30 years	
Defined benefit obligation – 30 June 2013	18	16	26	19	21	100
Defined benefit obligation – 30 June 2014	19	16	26	18	21	100

Risk exposures

The RBA is exposed to risk from its sponsorship of the OSF defined benefit plan. Key risks include investment, interest rate, longevity, salary and pension risks.

Investment risk is the risk that plan assets will not generate returns at the expected level.

Interest rate risk is the exposure of the defined benefit obligations to adverse movements in interest rates. A decrease in interest rate will increase the present value of these obligations. This may, however, be partially offset by an increase in value of the interest-bearing securities held by the fund.

Longevity risk is the risk that OSF members live longer than actuarial estimates of life expectancy.

Salary risk is the risk that higher than expected salary rises increase the cost of providing a salary-related pension.

Pension risk is the risk that pensions increase at a faster rate than assumed and increases the cost of providing pensions.

The table below shows the estimated increase in the defined benefit obligation resulting from a movement of +/- 0.25 percentage point in key actuarial assumptions. These estimates change each assumption individually, holding other factors constant; they do not incorporate any correlations among factors. Comparative information is not required for these disclosures by the transitional provisions of AASB 119.

	2014 \$M
Change in the defined benefit obligation from an increase of 0.25 percentage point in:	
Discount rate (gross of tax)	(53)
Future salary growth	13
Future pension growth	40
Change in the defined benefit obligation from a decrease of 0.25 percentage point in:	
Discount rate (gross of tax)	57
Future salary growth	(13)
Future pension growth	(38)

The RBA outsourced the provision of most of the OSF's member and accounting services during 2013/14. Appropriate practices and procedures have been adopted to manage the associated risks.

Asset Distribution

The distribution of the OSF's assets at 30 June is provided in the table below. This distribution relates to the option used by the OSF to fund members' defined benefits.

	Per cent of fund assets	
	2014	2013
Cash and short-term securities	7.0	5.7
Fixed interest and indexed securities	14.0	11.9
Domestic shares	40.2	42.4
Foreign shares	11.6	6.7
Property	10.5	14.2
Private equity and infrastructure	16.7	19.1
Total	100.0	100.0

AASB 119 Reconciliation

A detailed reconciliation of the AASB 119 valuation of the funds is shown in the table below. In the case of the OSF, these details relate only to the defined benefit component of the fund as the RBA faces no actuarial risk on defined contribution accumulation balances. This has no effect on the measurement of the financial position of the OSF. At 30 June 2014 accumulation balances in the OSF totaled \$236.8 million (\$206.7 million as at 30 June 2013).

	OSF		UK Scheme		Total	
	2014 \$M	2013 \$M	2014 \$M	2013 \$M	2014 \$M	2013 \$M
<i>Opening balances:</i>						
Net market value of assets	830	744	20	18	850	762
Accrued benefits	(1,151)	(1,358)	(15)	(14)	(1,166)	(1,372)
Surplus/(deficit)	(321)	(615)	4	4	(317)	(610)
Effect of asset cap	–	–	(4)	(4)	(4)	(4)
Opening superannuation asset/(liability)	(321)	(615)	–	–	(321)	(615)
Change in net market value of assets	76	86	2	1	78	88
Change in accrued benefits	48	207	(4)	(1)	44	206
Change in asset cap	–	–	2	–	2	–
Change in superannuation asset/(liability)	124	294	–	–	124	294
<i>Closing balances:</i>						
Net market value of assets	906	830	22	20	927	850
Accrued benefits	(1,103)	(1,151)	(19)	(15)	(1,123)	(1,166)
Surplus/(deficit)	(197)	(321)	2	4	(195)	(317)
Effect of asset cap	–	–	(2)	(4)	(2)	(5)
Closing superannuation asset/(liability)	(197)	(321)	–	–	(197)	(321)
Interest income	39	29	1	1	39	29
Benefit payments	(37)	(40)	(1)	(1)	(38)	(40)
Return on plan assets	51	75	–	–	51	75
Contributions from RBA to defined benefit schemes	23	22	–	–	24	22
Exchange rate gains/(losses)	–	–	2	1	2	1
Change in net market value of assets	76	86	2	1	78	88

The components of this table may not add due to rounding.

Note 14 – Superannuation Funds (continued)

	OSF		UK Scheme		Total	
	2014 \$M	2013 \$M	2014 \$M	2013 \$M	2014 \$M	2013 \$M
Current service cost	(41)	(51)	–	–	(41)	(51)
Interest cost	(52)	(50)	(1)	(1)	(53)	(51)
Benefit payments	37	40	1	1	38	40
Gains/(losses) from change in demographic assumptions	–	–	–	–	–	–
Gains/(losses) from change in financial assumptions	59	332	(1)	(1)	58	331
Gains/(losses) from change in other assumptions	46	(63)	(1)	–	45	(62)
Exchange rate gains/(losses)	–	–	(2)	(1)	(2)	(1)
Change in accrued benefits	48	207	(4)	(1)	44	206
Current service cost	41	51	–	–	41	51
Net Interest expense/(income)	14	22	–	–	14	22
Productivity and superannuation guarantee contributions	5	5	–	–	5	5
Superannuation expense/(income) included in profit or loss	60	77	–	–	60	77
Actuarial re-measurement loss/(gain)	(155)	(344)	–	–	(156)	(344)
Superannuation expense/(income) included in Statement of Comprehensive Income	(96)	(267)	–	–	(95)	(267)

The components of this table may not add due to rounding.

Note 15 – Financial Instruments and Risk

As the central bank of Australia, the RBA is responsible for implementing monetary policy and managing Australia's foreign reserve assets. Consequently, the RBA holds a range of financial assets, including Australian dollar securities, foreign government securities, repurchase agreements, deposits with the BIS and other central banks, interest rate futures contracts, foreign currency swaps, gold loans, cash and cash equivalents. The RBA also holds shares in the BIS. As to financial liabilities, the RBA issues Australia's banknotes and offers deposit facilities to its customers, mainly the Australian Government, and eligible financial institutions, including other central banks. Accordingly, the main financial claims on the RBA are banknotes on issue and deposit liabilities. The RBA also provides banking services to its customers, and operates Australia's high-value payments and interbank settlement systems. These payments and settlements occur through accounts held on the RBA's balance sheet.

AASB 7 requires disclosure of information relating to financial instruments; their significance and performance; terms and conditions; fair values; risk exposures and risk management.

Financial Risk

The RBA is exposed to a range of financial risks that reflect its policy and operational responsibilities. These risks include market risk, credit risk and liquidity risk. The chapters in the Annual Report on 'Operations in Financial Markets' and 'Risk Management' provide additional information on the RBA's management of these financial risks.

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises: foreign exchange risk; interest rate risk; and other price risk.

Foreign exchange risk

Foreign exchange risk is the risk that the fair value or cash flows of the RBA's foreign currency assets and liabilities will fluctuate because of movements in exchange rates. An appreciation in the exchange rate results in valuation losses, while a depreciation leads to valuation gains. The overall level of foreign currency exposure is determined by policy considerations. The RBA's net foreign currency exposure as at 30 June 2014 was \$42.3 billion (\$41.4 billion as at 30 June 2013). Within the overall exposure and to a limited extent, foreign currency risk can be mitigated by holding assets across a diversified portfolio of currencies. The RBA holds foreign reserves in five currencies – the US dollar, the euro, the Canadian dollar, the Japanese yen and the Chinese renminbi – because the markets for most of these currencies are liquid and suitable for investing foreign exchange reserves.

The RBA also undertakes foreign currency swaps to assist its daily domestic liquidity management. These instruments carry no foreign exchange risk since the exchange rates at which both legs of the transaction are settled are agreed at the time the swap is undertaken.

Concentration of foreign exchange

During 2013/14, the RBA began purchasing assets denominated in renminbi by reducing the proportion of US dollars held in its reserves. The RBA's net holdings of foreign exchange (excluding its holding of Special Drawing Rights) were distributed as follows as at 30 June:

	Per cent of foreign exchange	
	2014	2013
US dollar	52	55
Euro	35	35
Canadian dollar	5	5
Japanese yen	5	5
Chinese renminbi	3	–
Total foreign exchange	100	100

Sensitivity to foreign exchange risk

The sensitivity of the RBA's profit and equity to a movement of +/-10 per cent in the value of the Australian dollar exchange rate as at 30 June is shown below. These figures are generally reflective of the RBA's exposure over the financial year.

	2014 \$M	2013 \$M
Change in profit/equity due to a 10 per cent appreciation in the reserves-weighted value of the A\$	-3,849	-3,764
Change in profit/equity due to a 10 per cent depreciation in the reserves-weighted value of the A\$	4,704	4,601

Interest rate risk

Interest rate risk is the risk that the fair value or cash flows of financial instruments will fluctuate because of movements in market interest rates. The RBA's balance sheet is exposed to interest rate risk because most of its assets are financial assets, such as domestic and foreign securities, which have a fixed income stream. The price of such securities increases when market interest rates decline, while the price of a security will fall if market rates rise. Interest rate risk increases with the maturity of a security because the associated income stream is fixed for a longer period. Interest rate risk on foreign assets is controlled through limits on the duration, or interest rate sensitivity, of the portfolio. Interest rate risk on domestic assets is small as the bulk of the portfolio is held under short-term reverse repurchase agreements.

Sensitivity to interest rate risk

The figures below show the effect on the RBA's profit and equity of a movement of +/-1 percentage point in interest rates, given the level, composition and modified duration of the RBA's foreign currency and Australian dollar securities as at 30 June.

	2014 \$M	2013 \$M
Change in profit/equity due to movements of +/-1 percentage point across yield curves:		
Foreign currency securities	-/+365	-/+339
Australian dollar securities	-/+131	-/+140

Other price risk

The RBA holds shares in the BIS. The RBA's membership of the BIS is mainly to maintain and develop strong relationships, which are to Australia's advantage, with other central banks. Shares in the BIS are owned exclusively by its member central banks and monetary authorities. For accounting purposes, the RBA treats the BIS shares as 'available for sale' and the fair value of these shares is estimated on the basis of the BIS' net asset value, less a discount of 30 per cent. Accordingly, these shares are revalued to reflect movements in the net asset value of the BIS and in the Australian dollar. The price risk faced on the BIS shares is incidental to the policy reasons for holding them and is immaterial compared with other market risks faced by the RBA. For this reason, this asset is not included as part of the RBA's net foreign currency exposure outlined above.

Credit risk

Credit risk is the potential for financial loss arising from an issuer or counterparty defaulting on its obligations to: repay principal; make interest payments due on an asset; or settle a transaction. For the RBA, credit risk arises from exposure to: the issuers of securities that it holds; and counterparties which are yet to settle transactions. The RBA's credit exposure is managed within a highly risk-averse framework. In particular, credit risk is controlled by: holding securities issued by a limited number of highly rated governments, government-guaranteed agencies and supranational organisations; and holding high quality collateral against reverse repurchase agreements.

Cash invested under reverse repurchase agreements in overseas markets is secured by collateral in the form of government securities or securities issued by US agencies; the RBA takes and maintains collateral to the value of 102 per cent of the cash invested. Cash invested under domestic reverse repurchase agreements is secured by securities issued by Australian governments, banks and various corporate and asset-backed

securities (see Note 1(b)). The RBA holds collateral to a value of between 101 and 127 per cent of the amount invested according to the risk profile of the collateral held. If the current value of collateral falls by more than a predetermined amount, the counterparty is required to provide additional collateral to restore this margin; the thresholds are specified in the legal agreements which govern these transactions. During 2013/14, the RBA began contracting reverse repurchase agreements on a tri-party basis, though these still represent a small component of the RBA's total repurchase agreements. The management of collateral and cash associated with tri-party repurchase agreements is conducted through a third party, in this case the Australian Securities Exchange. The terms and requirements of tri-party repurchase agreements are broadly consistent with bilateral agreements and the RBA manages the risk of holding them in a similar way.

The RBA does not sell or re-pledge securities held as collateral under reverse repurchase agreements.

The RBA's maximum exposure to credit risk for each class of recognised financial assets, other than derivatives, is the carrying amount of those assets as indicated in the balance sheet.

The RBA's maximum credit risk exposure in relation to derivative financial instruments is:

1. Foreign exchange swaps – As at 30 June 2014, the RBA was under contract to purchase \$5.5 billion of foreign currency (\$1.5 billion at 30 June 2013) and sell \$20.0 billion of foreign currency (\$5.7 billion at 30 June 2013). As of that date there was a net unrealised gain of \$42 million on these swap positions included in net profit (\$275 million unrealised loss at 30 June 2013).

The RBA has a credit exposure from foreign exchange swaps because of the risk that a counterparty might fail to deliver the second leg of a swap which would have to be replaced, potentially at a loss if the exchange rate had moved from the level at which the second leg of the swap was to be completed. To manage credit risk on swaps, the RBA exchanges collateral with counterparties under credit support annexes (CSAs), which cover the potential cost of replacing the swap position in the market if a counterparty fails to deliver. The RBA's CSAs specify that only Australian dollar cash is eligible as collateral. Under CSAs, either party to the agreement may be obliged to deliver collateral with interest paid or received on a monthly basis. At 30 June 2014, net cash collateral received was \$129 million (nil at 30 June 2013), while cash collateral provided was nil (\$253 million at 30 June 2013).

2. Interest rate futures – As at 30 June 2014, the amount of credit risk on interest rate futures contracts was approximately \$0.6 million (\$0.6 million at 30 June 2013). As at 30 June 2014 there was an unrealised loss brought to account on those contracts of \$0.2 million (\$0.2 million unrealised gain at 30 June 2013).

The RBA held no past due or impaired assets at 30 June 2014 or 30 June 2013.

Collateral pledged

At 30 June 2014, the carrying amount of securities sold and contracted for purchase under repurchase agreements was \$5,243 million (\$2,371 million at 30 June 2013). Terms and conditions of repurchase agreements are consistent with those for reverse repurchase agreements disclosed above.

Concentration of credit risk

As noted, the RBA operates to minimise its credit risk exposure through comprehensive risk management policy guidelines. The following table indicates the concentration of credit risk in the RBA's investment portfolio.

	Risk rating of security/issuer ^(a)	Risk rating of counterparties ^(a)	Per cent of investments	
			2014	2013
Australian dollar securities				
Holdings – Commonwealth Government Securities	AAA	na	3.3	1.5
Holdings – semi-government securities	AAA	na	0.8	4.7
	AA	na	1.8	1.9
Securities sold under repurchase agreements	AAA	AA	–	0.0
	AAA	A	–	0.0
	AA	AA	–	0.0
Securities purchased under repurchase agreements	AAA	AA	24.0	14.8
	AAA	A	9.1	8.6
	AAA	BBB	0.0	–
	AA	AA	7.3	7.1
	AA	A	3.9	2.9
	AA	Other ^(b)	0.1	0.1
	A	AA	0.8	0.7
	A	A	0.4	1.4
	A	Other ^(b)	0.0	0.0
	BBB	AA	0.1	0.1
	BBB	A	–	0.0
Foreign investments				
Holdings of securities	AAA	na	9.8	16.0
	AA	na	24.9	22.2
Securities sold under repurchase agreements	AAA	AA	0.0	–
	AAA	A	0.2	0.6
	AA	A	3.5	1.7
Securities purchased under repurchase agreements	AAA	AA	0.0	0.7
	AAA	A	0.2	1.8
	AA	AA	0.1	0.4
	AA	A	4.9	5.1
	AA	BBB	–	0.0
Deposits	na	AAA	0.8	0.6
	na	AA	0.4	0.6
	na	A	0.0	0.0
Cash collateral pledged	na	AA	–	0.2
	na	A	–	0.1
Other	na	AAA	0.1	0.2
	na	AA	0.1	1.6
	na	A	0.0	0.0
Gold loans	na	AAA	0.0	0.0
Other			3.4	4.4
			100.0	100.0

(a) Standard & Poor's or equivalent rating.

(b) This category includes counterparties which are not rated.

Liquidity risk

Liquidity risk is the risk that the RBA will not have the resources required at a particular time to meet its obligations to settle its financial liabilities. As the ultimate source of liquidity in Australian dollars, the RBA can create liquidity in unlimited amounts in Australian dollars at any time. A small component of the RBA's liabilities is in foreign currencies, namely foreign repurchase agreements.

Liquidity risk is also associated with financial assets to the extent that the RBA may, in extraordinary circumstances, be forced to sell a financial asset at a price less than its fair value. The RBA manages this risk by holding a diversified portfolio of highly liquid domestic and foreign assets.

The maturity analysis table that follows is based on the RBA's contracted portfolio as reported in the RBA's Statement of Financial Position. All financial instruments are shown at their remaining term to maturity, which is equivalent to the repricing period. Other liabilities include amounts outstanding under repurchase agreements. Foreign currency swaps reflect the gross settlement amount of the RBA's outstanding foreign currency swap positions.

Maturity Analysis – as at 30 June 2014

	Balance sheet total \$M	Contracted maturity \$M					No specified maturity \$M	Weighted average effective rate %
		On demand	0 to 3 months	3 to 12 months	1 to 5 years	Over 5 years		
Assets								
Cash and cash equivalents	273	–	256	–	–	–	17	2.25
Australian dollar securities								
Securities sold under repurchase agreements	–	–	–	–	–	–	–	na
Securities purchased under repurchase agreements	64,394	–	42,587	1,206	–	–	20,601	2.50
Other securities	8,298	–	1,030	5,118	903	1,247	–	2.69
Accrued interest	194	–	131	63	–	–	–	na
	72,886							
Foreign exchange								
Balances with central banks	622	32	590	–	–	–	–	0.07
Securities sold under repurchase agreements	5,241	–	2,820	1,532	776	113	–	0.15
Securities purchased under repurchase agreements	7,421	–	7,421	–	–	–	–	0.12
Other securities	49,388	–	26,483	10,536	6,248	955	5,166	0.22
Deposits	1,067	2	1,064	–	–	–	1	0.02
Cash collateral pledged	–	–	–	–	–	–	–	na
Accrued interest	68	–	36	32	–	–	–	na
	63,807							
Gold								
Gold loans	45	–	–	45	–	–	–	0.40
Gold holdings	3,539	–	–	–	–	–	3,539	na
	3,584							
Property, plant & equipment	523	–	–	–	–	–	523	na
Loans and advances	4	–	–	–	–	4	–	2.92
Other assets	408	–	32	–	–	–	376	na
Total assets	141,485	34	82,450	18,532	7,927	2,319	30,223	1.39
Liabilities								
Deposits	53,574	26,474	27,100	–	–	–	–	2.43
Distribution payable to Australian Government	1,235	–	618	–	617	–	–	na
Cash collateral received	129	–	129	–	–	–	–	2.50
Other liabilities	7,459	–	7,101	–	–	–	358	–0.09
Australian notes on issue	60,778	–	–	–	–	–	60,778	0.13
Total liabilities	123,175	26,474	34,948	–	617	–	61,136	1.12
Capital and reserves	18,310							
Total balance sheet	141,485							
Domestic currency								
Swaps								
Contractual outflow	(14)	–	(14)	–	–	–	–	na
Contractual inflow	14,556	–	14,556	–	–	–	–	na
	14,542	–	14,542	–	–	–	–	
Foreign currency								
Swaps								
Contractual outflow	(20,026)	–	(20,026)	–	–	–	–	na
Contractual inflow	5,484	–	5,484	–	–	–	–	na
	(14,542)	–	(14,542)	–	–	–	–	

Maturity Analysis – as at 30 June 2013

	Balance sheet total \$M	Contracted maturity \$M					No specified maturity \$M	Weighted average effective rate %
		On demand	0 to 3 months	3 to 12 months	1 to 5 years	Over 5 years		
Assets								
Cash and cash equivalents	137	–	115	–	–	–	22	2.50
Australian dollar securities								
Securities sold under repurchase agreements	77	–	–	38	17	22	–	2.72
Securities purchased under repurchase agreements	35,130	–	33,870	1,260	–	–	–	2.73
Other securities	7,968	–	3,496	1,998	966	1,508	–	3.04
Accrued interest	74	–	60	14	–	–	–	na
	43,249							
Foreign exchange								
Balances with central banks	636	10	626	–	–	–	–	0.10
Securities sold under repurchase agreements	2,294	–	1,155	516	421	202	–	0.21
Securities purchased under repurchase agreements	7,777	–	7,777	–	–	–	–	0.09
Other securities	39,339	–	16,686	10,377	6,271	793	5,212	0.27
Deposits	542	2	539	–	–	–	1	0.07
Cash collateral pledged	253	–	253	–	–	–	–	2.75
Accrued interest	89	–	61	28	–	–	–	na
	50,930							
Gold								
Gold loans	42	–	–	42	–	–	–	0.40
Gold holdings	3,257	–	–	–	–	–	3,257	na
	3,299							
Property, plant & equipment	491	–	–	–	–	–	491	na
Loans and advances	4	–	–	–	–	4	–	3.04
Other assets	417	–	21	–	–	–	396	na
Total assets	98,527	12	64,659	14,273	7,675	2,529	9,379	1.35
Liabilities								
Deposits	26,183	6,033	20,150	–	–	–	–	2.52
Distribution payable to Australian Government	–	–	–	–	–	–	–	na
Cash collateral received	–	–	–	–	–	–	–	na
Other liabilities	5,679	–	5,201	–	–	–	478	0.03
Australian notes on issue	56,943	–	–	–	–	–	56,943	0.13
Total liabilities	88,805	6,033	25,351	–	–	–	57,421	0.83
Capital and reserves	9,722							
Total balance sheet	98,527							
Domestic currency								
Swaps								
Contractual outflow	(46)	–	(46)	–	–	–	–	na
Contractual inflow	4,266	–	4,266	–	–	–	–	na
	4,220	–	4,220	–	–	–	–	
Foreign currency								
Swaps								
Contractual outflow	(5,700)	–	(5,700)	–	–	–	–	na
Contractual inflow	1,480	–	1,480	–	–	–	–	na
	(4,220)	–	(4,220)	–	–	–	–	

Note 16 – Fair Value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at measurement date. This is determined by the quoted market price, if one is available. The RBA's financial assets measured at fair value include its holdings of Australian dollar securities, foreign government securities, interest rate futures, foreign currency swap contracts and its shareholding in the BIS. Non-financial assets carried on the balance sheet at fair value include the RBA's property, plant and equipment. There are no financial liabilities, other than derivatives, measured at fair value. The RBA's repurchase agreements, BIS deposits, cash and cash equivalents, payables, receivables, notes on issue and deposit liabilities are carried on the balance sheet at face value, which is equivalent to their amortised cost using the effective interest method; this approximates fair value.

AASB 7 requires that the fair value of financial assets and liabilities be disclosed according to their accounting classification under AASB 139.

	2014	2013
	\$M	\$M
Financial assets accounted for under AASB 139		
At fair value through profit or loss	62,855	47,960
Loans and receivables	74,189	46,421
Available for sale	348	367
Assets accounted for under other standards	4,093	3,779
Total assets as at 30 June	141,485	98,527
Financial liabilities accounted for under AASB 139		
At fair value through profit or loss	45	287
Not at fair value through profit or loss	122,771	88,038
Liabilities accounted for under other standards	359	480
Total liabilities as at 30 June	123,175	88,805

AASB 13 – *Fair Value Measurement* requires financial and non-financial assets and liabilities measured at fair value to be disclosed according to their position in the fair value hierarchy. This hierarchy has three levels: Level 1 is based on quoted prices in active markets for identical assets; Level 2 is based on quoted prices or other observable market data not included in Level 1; Level 3 valuations include inputs other than observable market data. The following table presents the RBA's assets and liabilities measured and recognised at fair value and their classification within the fair value hierarchy at 30 June 2014. There were no transfers between levels within the fair value hierarchy during the financial year.

	Level 1 \$M	Level 2 \$M	Level 3 \$M	Total \$M
As at 30 June 2014				
Financial assets				
At fair value through profit or loss				
Australian dollar securities	7,284	1,097	–	8,381
Foreign government securities	52,823	1,564	–	54,387
Foreign currency swaps	7	80	–	87
Available for sale				
Shares in international financial institutions	–	–	348	348
	60,114	2,741	348	63,203
Non-financial assets				
Land and buildings	–	–	361	361
Plant and equipment	–	–	162	162
	–	–	523	523
Financial liabilities				
At fair value through profit or loss				
Foreign currency swaps	1	44	–	45
	1	44	–	45
As at 30 June 2013				
Financial assets				
At fair value through profit or loss				
Australian dollar securities	4,083	3,958	–	8,041
Foreign government securities	38,809	1,098	–	39,907
Foreign currency swaps	–	12	–	12
Available for sale				
Shares in international financial institutions	–	–	367	367
	42,892	5,068	367	48,327
Non-financial assets				
Land and buildings	–	–	349	349
Plant and equipment	–	–	142	142
	–	–	491	491
Financial liabilities				
At fair value through profit or loss				
Foreign currency swaps	15	272	–	287
	15	272	–	287

The fair value of Level 2 financial instruments is determined by reference to observable inputs from active markets or prices from markets not considered active. Australian dollar-denominated discount securities and some foreign currency swaps are priced with reference to an active market yield or rate, but with an adjustment applied to reflect maturity dates. Prices for some Australian dollar and foreign currency-denominated securities are derived from markets that are not considered active.

The RBA's shareholding in the BIS is valued using the net asset value, as published in annual financial statements of the BIS, less a discount of 30 per cent. The discount applied is based on the 2001 Hague Arbitral Tribunal decision on compensation to be paid to former private shareholders, and subsequent transactions involving the re-allocation of BIS shares. This financial asset is classified as a Level 3 financial instrument.

Level 3 non-financial assets include the RBA's property, plant and equipment reflecting the use of unobservable market inputs in their valuation.

The following table presents the changes in Level 3 assets during 2013/14 for recurring fair value measurements of financial and non-financial assets.

	Financial Assets		Non-financial Assets	
	Shareholding in the BIS	Land and Buildings	Plant and Equipment	
	\$M	\$M	\$M	\$M
Opening Balance as at 1 July 2013	367	349	142	
Transfers	–	–	–	
Additions	–	13	41	
Disposals	–	(4)	(1)	
Depreciation	–	(9)	(21)	
Gains or losses recognised in Net Profit	–	1	–	
Gains or losses recognised in Other Comprehensive Income	(19)	11	1	
Closing Balance as at 30 June 2014	348	361	162	

The following table provides information about the significant unobservable inputs used in Level 3 fair value measurements, including the sensitivity of fair value measurements to changes in the noted unobservable inputs.

	Valuation Technique	Unobservable Inputs	Range of Inputs	Fair Value Movement Due to +/- Change in Unobservable Input:	
				Increase	Decrease
BIS Shares	Net asset value	Discount rate	30.0%	Decrease	Increase
Land and Buildings	Income capitalisation and Discounted Cash Flow methods	Net market income	\$86/m ² to \$546/m ²	Increase	Decrease
		Discount rate	8.3% to 10.0%	Decrease	Increase
	Depreciated replacement cost	Terminal yield	6.9% to 13.0%	Decrease	Increase
		Capitalisation rate	6.8% to 12.0%	Decrease	Increase
Plant and Equipment	Depreciated replacement cost	Depreciation rate	2.0%	Decrease	Increase
		Indexation rate	0.2% to 5.3%	Increase	Decrease
		Depreciation rate	4.8% to 25.0%	Decrease	Increase

Note 17 – Subsequent Events

There have been no events subsequent to 30 June 2014 to be disclosed.



Auditor-General for Australia



INDEPENDENT AUDITOR'S REPORT

To the Treasurer

I have audited the accompanying financial statements of the Reserve Bank of Australia and the controlled entity for the year ended 30 June 2014, which comprise: a Directors' Statement; Statement of Financial Position; Statement of Comprehensive Income; Statement of Distribution; Statement of Changes in Capital and Reserves; Cash Flow Statement; and Notes to and Forming Part of the Financial Statements, including a summary of accounting policies. The consolidated entity comprises the Reserve Bank of Australia and the entity it controlled during the financial year.

Directors' Responsibility for the Financial Statements

The directors of the Reserve Bank of Australia are responsible for the preparation of the financial statements that give a true and fair view in accordance with the Finance Minister's Orders made under the *Commonwealth Authorities and Companies Act 1997*, including the Australian Accounting Standards, and for such internal control as is necessary to enable the preparation of financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on the financial statements based on my audit. I have conducted my audit in accordance with the Australian National Audit Office Auditing Standards, which incorporate the Australian Auditing Standards. These auditing standards require that I comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Reserve Bank of Australia's preparation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Reserve Bank of Australia's internal control. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

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Independence

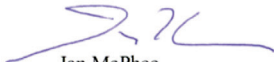
In conducting my audit, I have followed the independence requirements of the Australian National Audit Office, which incorporate the requirements of the Australian accounting profession.

Opinion

In my opinion, the financial statements of the Reserve Bank of Australia:

- (a) have been prepared in accordance with the Finance Minister's Orders made under the *Commonwealth Authorities and Companies Act 1997*, including the Australian Accounting Standards; and
- (b) give a true and fair view of the matters required by the Finance Minister's Orders including the consolidated entity's financial position as at 30 June 2014 and its financial performance and cash flows for the year then ended.

Australian National Audit Office



Ian McPhee
Auditor-General

Canberra
21 August 2014

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Abbreviations

AAS	Australian Accounting Standards	EPMO	Enterprise Portfolio Management Office
ABF	Asian Bond Fund	ES	Exchange Settlement
ABF1	Asian Bond Fund 1	ESD	Ecologically Sustainable Development
ABF2	Asian Bond Fund 2	FMI	financial market infrastructure
ADI	authorised deposit-taking institution	FMO	Finance Minister's Orders
AML/CTF	Anti-Money Laundering/Counter-Terrorism Financing	FOI	Freedom of Information
AOFM	Australian Office of Financial Management	FSB	Financial Stability Board
APCA	Australian Payments Clearing Association	FSS	Fast Settlement Service
APRA	Australian Prudential Regulation Authority	FX	foreign exchange
ASIC	Australian Securities and Investments Commission	G20	Group of Twenty
ASX	Australian Securities Exchange	GPF	Government Partnership Fund
BCBS	Basel Committee on Banking Supervision	G-SIB	global systemically important bank
BI	Bank Indonesia	HQLA	high-quality liquid assets
BIS	Bank for International Settlements	IJCB	<i>International Journal of Central Banking</i>
BPNG	Bank of Papua New Guinea	IMF	International Monetary Fund
BRS	Business Resumption Site	IOSCO	International Organization of Securities Commissions
CAC Act	<i>Commonwealth Authorities and Companies Act 1997</i>	IPS	Information Publication Scheme
CFR	Council of Financial Regulators	ISDA	International Swaps and Derivatives Association
CGFS	Committee on the Global Financial System	IT	information technology
CGS	Commonwealth Government Securities	LCR	liquidity coverage ratio
CHESS	Clearing House Electronic Sub-register System	MFSC	Monetary and Financial Stability Committee
CLF	Committed Liquidity Facility	NAIDOC	National Aborigines and Islanders Day Observance Committee
COAG	Council of Australian Governments	NBS	National Banknote Site
CPRs	Commonwealth Procurement Rules	NGB	Next Generation Banknote
CPSS	Committee on Payment and Settlement Systems	NNPDC	National Note Processing and Distribution Centre
DE	direct entry	NPA	Note Printing Australia Limited
DFAT	Department of Foreign Affairs and Trade	NPP	National Payments Platform
eftpos	electronic funds transfer at point of sale	OECD	Organisation for Economic Co-operation and Development
EMEAP	Executives' Meeting of East Asia-Pacific Central Banks	OPA	Official Public Accounts
EMC	Environmental Management Committee	OSF	Officers' Superannuation Fund
		OSSG	Official Sector Steering Group
		OTC	over-the-counter
		PEXA	Property Exchange Australia Limited

PFMIs	<i>Principles for Financial Market Infrastructures</i>	RTGS	real-time gross settlement
PGPA Act	<i>Public Governance, Performance and Accountability Act 2013</i>	SAR	Special Administrative Region
RBA	Reserve Bank of Australia	SDR	Special Drawing Right
RBRF	Reserve Bank Reserve Fund	semis	semi-government securities (Australian state and territory government securities)
RCG	Regional Consultative Group	SIFI	systemically important financial institution
RDP	Research Discussion Paper	SWIFT	Society for Worldwide Interbank Financial Telecommunication
repo	repurchase agreement	WGBS	Working Group on Banking Supervision
RITS	Reserve Bank Information and Transfer System	WGFM	Working Group on Financial Markets
RM	Risk and Compliance Department	WGPSS	Working Group on Payment and Settlement Systems
RMB	renminbi	WHS	work health and safety
RMBS	residential mortgage-backed securities		



RESERVE BANK OF AUSTRALIA