RESERVE BANK
OF AUSTRALIA

RESERVE BANK OF AUSTRALIA ANNUAL REPORT

2010

Reserve Bank

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ANNUAL REPORT 2010

Contents

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Governor's Foreword

After a period of extreme international financial instability and global economic weakness, conditions improved materially in 2009/10. The international financial system stabilised and began the long journey back to health. The global economy stopped contracting and began to grow, at a pace that surprised many observers. The Australian dollar, having fallen very sharply in the closing months of 2008, recovered during 2009 and the first half of 2010 as prospects improved.

Under these circumstances, the exceptional measures taken in 2008 to assist the local economy to weather the international downturn could be gradually withdrawn. The provision of additional liquidity, which had seen the Reserve Bank's balance sheet nearly double in size, had largely been unwound by the end of June 2009. The size of the balance sheet has remained within normal variations since then. The Government's guarantee of wholesale debt issued by authorised deposit-taking institutions was closed to new issuance from March 2010 without disruption. The stock outstanding of these guaranteed liabilities is now declining. A similar guarantee for State and Territory governments is no longer used for new issuance and access will close for new raisings in December. The guarantee on deposits of up to $1 million is scheduled to continue until October 2011. As it emerged that the Australian economy had not entered a deep downturn, but in fact had experienced one of its mildest post-war downturns, exceptional monetary policy stimulus was progressively removed starting in late 2009. By mid 2010, interest rates to borrowers had returned to about their average levels over the past decade.

The past two years have seen more frequent, and on some occasions much larger, changes to interest rates than had been the norm in the earlier period of stability. That reflects the nature and frequency of events that, as they occurred, were judged to have a major bearing on the economic outlook for Australia. Throughout, the Board has remained focused on the need to secure the medium-term stability both of the financial system and of the economy, especially in relation to price stability.

But while the past year was much better than the preceding year, it was far from plain sailing for the global economy. As noted last year, one of the lasting effects of the financial crisis is a significant run-up in public-sector debt around the world. It is not surprising that attention turned to questions of sovereign credit and the complex interplay between sovereign and bank creditworthiness in Europe. Those concerns led to periodic bouts of instability in financial markets. After the results of the stress test on European banks were announced in late July 2010, concerns eased. But the global financial system still has work to do to regain full strength and constraints on public finances will persist for many years to come.

The large rise in the exchange rate of the Australian dollar in 2009/10 had a major effect on the Reserve Bank's earnings. As has been explained in previous annual reports, the Reserve Bank, as the custodian of Australia's official foreign reserves, has a very large open foreign currency position. It cannot hedge that position. In years when the Australian dollar changes against the currencies of countries in which the reserves are held – the United States, Japan and the euro area – the value of those assets measured in Australian dollar terms changes. In 2008/09, as the Australian dollar fell, these valuation effects were strongly positive, and the Bank's earnings were consequently the highest in its history. As last year's annual report made clear, however, a large rise in the exchange rate would see the Bank record a loss. That is precisely what occurred in 2009/10, just as it had in 2006/07. The valuation loss arising mainly from the rise in the exchange rate amounted to $3.8 billion, which was the largest loss, in absolute terms, the Bank has ever experienced. Underlying earnings – at $866 million in 2009/10 – were also lower than normal because of the low level of global interest rates. The total loss, measured in terms of the accounting standards, came to $2.9 billion.

The *Reserve Bank Act 1959* is clear about how such losses are to be treated. In the first instance, valuation losses are absorbed by any unrealised valuation gains from earlier years, which are retained in a reserve. Any remaining loss beyond the capacity of this reserve is charged against the Reserve Bank Reserve Fund (RBRF), a capital reserve maintained for exactly such circumstances. For 2009/10, the accounting loss reduced the RBRF by $680 million. As it turned out, the drawdown was only a little larger than the transfer *into* the RBRF (of $577 million) approved by the Treasurer last year.

Two implications follow from this outcome. The first is that because the valuation losses have exhausted the underlying earnings that would otherwise have been available, no dividend from 2009/10 is payable to the Commonwealth. Second, it will be prudent to seek to rebuild the RBRF over coming years by making transfers from future earnings. The Board has informed the Treasurer of this need and the Government's budget estimates have been compiled accordingly. A component of the dividend earned in 2008/09 but deferred was paid to the Commonwealth as scheduled in August 2010.

A highlight of the year was the 50th anniversary of the commencement of central banking operations by the Reserve Bank of Australia on 14 January 1960. A number of events were held to mark the occasion. These included an international conference and associated international official meetings, the exhibition of items of historical interest from the Bank's archives and art collection, and the publication of a monograph on the evolution of central banking in Australia, authored by Professor Selwyn Cornish of the Australian National University.

The Reserve Bank's staff complement increased by 21 over the year, in response to several demands. In the policy areas, the more intensive engagement on financial regulatory matters and increased research effort on Asian economies added to the required numbers. On the services front, the Bank is continuing a program of upgrading the quality and resilience of the payments services it provides to the private sector and its banking services to government agencies. Overall, the Bank's running costs rose by 4.4 per cent.

The Bank's staff served with their customary calm professionalism and high standards. The Board joins me in thanking them for their efforts.

Glenn Stevens

Chairman, Reserve Bank Board

16 August 2010

Functions and Objectives of the Reserve Bank

The Reserve Bank of Australia was established as Australia's central bank by the *Reserve Bank Act 1959*. This act sets out the powers of the Bank and the objectives of the Bank's policies. Section 10(2) of the Reserve Bank Act 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.'

For more than 15 years now, this general mandate has found concrete expression in the form of a medium-term inflation target. Monetary policy aims to keep the rate of consumer price inflation at 2–3 per cent, on average, over the cycle. The fourth *Statement on the Conduct of Monetary Policy*, signed by the Treasurer and the Governor in December 2007, records the common understanding of the Government and the Reserve Bank on key aspects of the monetary policy framework.

In addition to conducting monetary policy, the Reserve Bank also:

- conducts market operations in Australian dollar assets on its balance sheet;
- holds and manages Australia's foreign currency reserves;
- operates Australia's main high-value payments system;
- provides banking services to government; and
- designs, produces and issues Australia's banknotes.

The Reserve Bank has not, since 1998, been responsible for prudential supervision of banks. It has, however, a general responsibility, within the limits of its powers, to foster stability in the overall financial system.

Amendments to the Reserve Bank Act in 1998 gave the Bank responsibility for ensuring the stability, efficiency and competitiveness of the payments system. These amendments also established the Payments System Board, which is separate from the Reserve Bank Board and issues its own annual report. The Reserve Bank's main powers in relation to the payments system are set out in the *Payment Systems (Regulation) Act 1998*.

Governance

Reserve Bank Board

The Reserve Bank Board comprises the Governor (Chairman), Deputy Governor (Deputy Chairman), Secretary to the Treasury and six non-executive members appointed by the Treasurer, a total of nine members. There was no change in the composition of the Board during the year; current members are shown here and on pages 7 and 8. The Board has an Audit Committee and a Remuneration Committee.

The Board meets 11 times a year, on the first Tuesday of each month except January. Five members form a quorum.

Most meetings are held at the Reserve Bank's Head Office in Sydney. From time to time, Board meetings are held in other Australian capitals. During the year, the May 2010 meeting was held in Melbourne.

Board Meetings in 2009/10 – Attendance by Members[(a)]

Glenn Stevens	11	(11)
Ric Battellino	11	(11)
Ken Henry[(b)]	8	(11)
John Akehurst	11	(11)
Jillian Broadbent	11	(11)
Roger Corbett	11	(11)
Graham Kraehe	10	(11)
Donald McGauchie	9	(11)
Warwick McKibbin	10	(11)

(a) Figures in brackets show the number of meetings each member was eligible to attend
(b) David Gruen (Executive Director, Macroeconomic Group, Australian Treasury) attended three meetings in place of Ken Henry, as provided for in section 22 of the Reserve Bank Act

Conduct of Reserve Bank Board Members

On appointment to the Reserve Bank Board, each member is required under the *Reserve Bank Act 1959* to sign a declaration to maintain confidentiality in relation to the affairs of the Board and the Reserve Bank. Further, by law, members must meet the general obligations of directors of statutory authorities, as set out in the *Commonwealth Authorities and Companies Act 1997* (CAC Act). The CAC Act sets standards of conduct for directors and officers of Commonwealth authorities. Directors must:

- discharge their duties with care and diligence;
- act in good faith, and in the best interests of the Reserve Bank;
- not use their position to benefit themselves or any other person, or to cause detriment to the Reserve Bank or any 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 person; and
- declare any material personal interest where a conflict arises with the interests of the Reserve Bank.

Over and above these legislated 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 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 objectives of the Audit Committee of the Reserve Bank Board are to:

- ensure that both the internal and external audit processes are independent and effective, and carried out to a very high standard; and
- assist the Governor and the Board in fulfilling their obligations relating to financial reporting, compliance with laws and regulations, internal control and risk assessment, employee conflicts of interest, business ethics and fraud prevention.

Jillian Broadbent, a non-executive member of the Reserve Bank Board, is Chairman of the Audit Committee. Other members of the Committee are Ric Battellino, Deputy Governor; George Bennett, a company director and former National Executive Chairman of KPMG Peat Marwick; and Roger Corbett, a non-executive member of the Reserve Bank Board.

During 2009/10, the Committee met on five occasions. The external members of the Audit Committee also meet, at least annually, with the external auditors in the absence of management. At its July 2010 meeting, the Committee endorsed the consolidated financial statements for the Reserve Bank for the year ended 30 June 2010 and agreed that they be presented to the Reserve Bank Board for its consideration.

Remuneration Committee

The Remuneration Committee of the Reserve Bank Board was established in terms of section 24A of the Reserve Bank Act to determine 'terms and conditions relating to the remuneration and allowances' for the Governor and Deputy Governor. It recommends to the Board remuneration and allowances for each Governor and Deputy Governor at the time of their appointment, following consultation with the Treasurer. The Committee then reviews the remuneration packages of the Governor and Deputy Governor annually, and recommends adjustments to the Board for approval. The Committee is kept informed of the general remuneration arrangements for Reserve Bank staff.

Donald McGauchie, a non-executive member of the Board, is Chairman of the Remuneration Committee. Other members of the Committee are Jillian Broadbent and Roger Corbett. The Committee meets as often as necessary, but at least twice each year. In terms of section 21A of the Reserve Bank Act, the Governor and Deputy Governor are not present during deliberations, and do not take part in decisions, of the Remuneration Committee or the Board relating to the determination or application of any terms or conditions on which they hold office.

Remuneration and allowances for the non-executive members of the Reserve Bank Board are determined by the Remuneration Tribunal.

Indemnities

Under the provisions of section 27 of the CAC Act and pursuant to a Board resolution on 3 November 1998, members of the Reserve Bank Board have been indemnified against liabilities incurred arising out of the proper discharge of their responsibilities, provided that any such liability does not arise from conduct involving a lack of good faith. This indemnity does not extend to claims by the Reserve Bank itself or any subsidiary of the Bank. A similar indemnity was extended to members of the Payments System Board, pursuant to a resolution by the Reserve Bank Board on 3 November 1998.

Reserve Bank Board

August 2010

Glenn Stevens (Chairman)

Governor since 18 September 2006
Present term ends 17 September 2013

Chairman – Payments System Board
Chairman – Council of Financial Regulators

Ric Battellino

Deputy Governor since 14 February 2007
Present term ends 13 February 2012

Member – Reserve Bank Board Audit Committee

Ken Henry AC

Secretary to the Treasury
Member since 27 April 2001

Member – Council of Financial Regulators

John Akehurst

Member since 31 August 2007
Present term ends 30 August 2012

Chairman – National Centre for Asbestos Related Diseases
Director – CSL Limited
Director – Origin Energy Limited
Director – Securency International Pty Ltd

Jillian Broadbent AO

Member since 7 May 1998
Present term ends 6 May 2013

Chairman – Reserve Bank Board Audit Committee
Member – Reserve Bank Board Remuneration Committee

Director – Australian Securities Exchange
Director – Coca-Cola Amatil Limited
Director – Special Broadcasting Service
Chancellor – University of Wollongong

Roger Corbett AO

Member since 2 December 2005

Present term ends 1 December 2010

Member – Reserve Bank Board Audit Committee

Member – Reserve Bank Board Remuneration Committee

Chairman – Fairfax Holdings Limited

Chairman – Salvation Army Advisory Board

Deputy Chairman – PrimeAg Australia Limited

Director – Wal-Mart Stores Inc

Graham Kraehe AO

Member since 14 February 2007

Present term ends 13 February 2012

Chairman – BlueScope Steel Limited

Chairman – Brambles Limited

Director – Djerriwarrh Investments Limited

Donald McGauchie AO

Member since 30 March 2001

Present term ends 29 March 2011

Chairman – Reserve Bank Board Remuneration Committee

Chairman – Australian Agricultural Company Ltd

Chairman – Nufarm Limited

Deputy Chairman – James Hardie Industries SE

Director – GrainCorp Limited

Warwick McKibbin

Member since 31 July 2001

Present term ends 30 July 2011

Director – Research School of Economics, Australian National University

Professorial Fellow – Lowy Institute for International Policy

Non-resident Senior Fellow – The Brookings Institution

Director of Research – McKibbin Software Group Pty Ltd

Accountability and Communication

Relationship with Government

Section 11 of the *Reserve Bank Act 1959* sets out the relationship between the Government and the Reserve Bank Board. It confers substantial independence on the Board, but balances this with an obligation to inform the Government of its policies 'from time to time' and a requirement for Parliamentary accountability. Regular discussions between the Governor and the Treasurer serve to keep the Government informed.

Reporting Obligations

For the purposes of the *Commonwealth Authorities and Companies Act 1997* (CAC Act), the Reserve Bank is a Commonwealth authority and the members of the Reserve Bank Board are the directors of the Reserve Bank. The directors are responsible for the preparation of the annual report. At its meeting on 3 August 2010, the Board resolved that the Chairman sign the annual report and financial statements as at 30 June 2010, and give them to the Treasurer for presentation to the Parliament, in accordance with the CAC 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 hearings, at which the Bank presents its views on the economy and responds publicly to questions from Committee members. In 2009/10, the Governor and senior officers attended hearings in Sydney in August 2009 and in Canberra in February 2010. These appearances, 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 fourth *Statement on the Conduct of Monetary Policy*, which was issued in December 2007).

During the year, senior staff of the Reserve Bank provided evidence before an inquiry by the Senate Economics References Committee into access to finance by small businesses, to which the Bank had made a written submission. A submission by the Bank was also made to an inquiry by the same committee into the bank funding guarantees.

Communication

The Reserve Bank seeks to ensure a high degree of transparency about its goals, decision-making processes and the reasons for its policy decisions. Transparency facilitates the accountability of an independent central bank in a democracy. Importantly, it also increases the effectiveness of policy decisions by promoting more informed decision-making by the community.

The Reserve Bank publishes its *Statement on Monetary Policy* each quarter to inform the financial markets, media and wider community about the Bank's thinking on monetary policy and provide a basis for the Parliamentary Committee's questioning of the Bank. These statements provide an analysis of the state of the economy and financial markets, the outlook for inflation and economic growth, and further explanation of recent decisions on interest rates. The Governor also issues a statement immediately after each meeting of the Reserve Bank Board, announcing and explaining the Board's monetary policy decision, and minutes of each meeting are issued two weeks later providing background to the Board's deliberations.

The *Financial Stability Review*, published in March and September each year, gives a detailed assessment of the overall condition of Australia's financial system. It also contains analysis and views on issues of specific interest; in the past year such issues included wholesale funding, global recovery rates on corporate defaults, and foreign currency exposure and hedging.

In addition to these regular communications, the senior management of the Reserve Bank also give frequent speeches. During 2009/10, the Governor, Deputy Governor and senior officers gave 36 on-the-record speeches on various topics. Audio files of these speeches, including the associated 'question and answer' sessions, were made available on the Bank's website, further enhancing transparency and accountability.

Speeches 1. Assistant Governor Guy Debelle addresses the Westpac Research and Strategy Forum in December 2009
2. Assistant Governor Malcolm Edey on his way to address the Cards & Payments Australasia 2010 conference
3. Some 420 people attended the speech by Governor Glenn Stevens at the Regional Business Leaders Forum in Toowoomba, Queensland

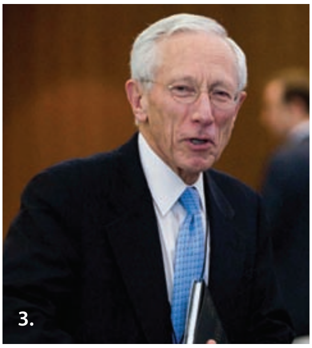
The Reserve Bank *Bulletin* contains articles about economic and financial developments, along with major speeches. Until December 2009 it was published monthly and also included statistics, media releases and minutes of the monetary policy meetings of the Board; it became a quarterly publication in March 2010 with a greater focus on the analytical work of the Bank. Statistics have since been published only on the website, updated in near real time and with additional data series made available to the public. Articles in the *Bulletin* over the past year have covered numerous topics, including bank fees and margins, ATM reform, deposit guarantee arrangements, developments in commercial and residential property, price-setting behaviour, the labour market and demographic trends.

The Reserve Bank disseminates research conducted by the staff in the form of *Research Discussion Papers* (RDPs). While the views expressed in these papers are those of the authors and do not necessarily represent those of the Bank, their publication encourages discussion and comment on economic issues among a broad range of researchers. During 2009/10, 10 RDPs were released on a wide range of topics, such as economic modelling and forecasting (including of inflation), the macroeconomic consequences of volatility in relative prices and capital flows, the transmission of shocks internationally in the presence of leverage constraints, and papers using household-level data related to consumption and labour market status. Staff have had their work accepted for publication in various jounals, such as the *Australian Economic Review, Economic Analysis and Policy, Economic Papers,* the *Economic Record*, the *Journal of the History of Economic Thought*, the *Journal of Economic Dynamics and Control* and the *North American Journal of Economics and Finance*.

Reserve Bank staff frequently present their research at external conferences. In 2009/10, papers were presented at such gatherings as the Bank of Israel's Macroeconomic Modelling Workshop, held in Jerusalem; the Workshop of the Asian Research Network on Monetary Policy and Exchange Rates, held in Tokyo; a workshop jointly sponsored by the Bank of England and the European Central Bank on Central Counterparty Risk Controls, held in Frankfurt; a meeting of the Society for Computational Economics, in Sydney; the 21st Annual East Asia Seminar on Economics, also in Sydney; a gathering of the Econometrics Society, in Canberra; and the Chinese Economists Society Annual Conference, in Xiamen.

The Reserve Bank hosts regular conferences, bringing together academics, central bankers and other economics practitioners. In early 2010, the Bank held a symposium to mark its 50th anniversary. The Symposium provided a forum to discuss what policymakers have learned over recent decades and what needed to be reconsidered in the areas of monetary and regulatory policies, as well as supply-side policies. It was attended by a large number of distinguished guests, including heads of various central banks and prominent academics. A volume containing the Symposium papers and discussions was published in July 2010. The Bank has issued a call for papers for a Research Workshop to be held later in 2010 focusing on issues relating to the growing importance of China and east Asia in the global economy. This follows a Research Workshop at the end of 2009 on monetary policy in open economies, which was organised in conjunction with the Bank for International Settlements and featured nine papers by academics and central bankers from Australia and overseas. The Bank was also host to a number of prominent academics through the year, who presented seminars during their visits and conducted research on issues relevant to monetary policy, with one paper being released as part of the Bank's RDP series.

The Reserve Bank publishes information in both electronic and hardcopy formats. Demand for hardcopy publications has been declining as use of the Bank's website continues to grow strongly. In keeping with the public's expectation for effective online access to information, the Bank's website was rebuilt and launched in December 2009, with improved functionality and search tools. In 2009/10, the number of page views/downloads of information on the website averaged about 90 000 per day, though there were nearly 300 000 on some days when interest rate decisions were announced.



The Reserve Bank's 50th Anniversary Symposium **1.** Deputy Governor Ric Battellino opened the Symposium **2.** Janet Yellen (President, Federal Reserve Bank of San Francisco) **3.** Stanley Fischer (Governor, Bank of Israel) **4.** (From left) Andrew Crockett (President, JPMorgan Chase International) and Jaime Caruana (General Manager, BIS) **5.** (From left) Stanley Fischer, Jean-Claude Trichet (President, European Central Bank) and Joseph Yam (former Chief Executive, Hong Kong Monetary Authority) **6.** (From left) Stephen Cecchetti (Economic Adviser, BIS), Governor Glenn Stevens and former Governor Ian Macfarlane **7.** (From left) Ian Macfarlane, Jaime Caruana, Bill Dudley (President, Federal Reserve Bank of New York), Mohamed El-Erian (CEO, PIMCO) and Charles Goodhart (Professor Emeritus, London School of Economics) **8.** Tarisa Watanagase (Governor, Bank of Thailand)

Operations in Financial Markets

Financial markets functioned considerably better over 2009/10 than in the previous year. As a result, the Reserve Bank was able to undertake its operations in financial markets without needing to employ the policy measures used to address the distressed financial conditions in 2008/09.

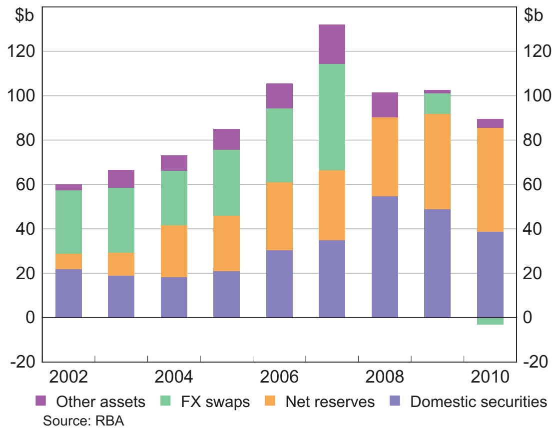
The Balance Sheet

Over the past year, there has been some contraction in the size of the Reserve Bank's balance sheet, though its broad composition has remained relatively steady. This is in contrast to the previous year when measures undertaken to support financial market conditions, in particular the term deposit facility with authorised deposit-taking institutions (ADIs) and the US dollar swap facility with the Federal Reserve, led to a large expansion and subsequent contraction in the balance sheet.

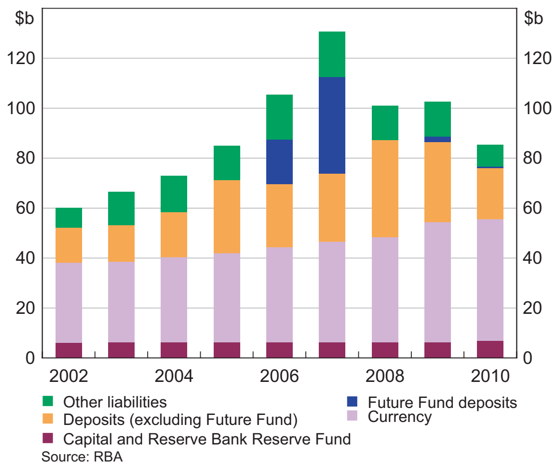
With financial conditions in Australia recovering faster than in most other developed economies, the Reserve Bank was able to unwind some of the extraordinary liquidity measures it had undertaken. As a result, over 2009/10 the size of the Bank's balance sheet declined by around $17 billion, to $86 billion. Currency on issue was broadly unchanged, following a large rise in the previous year when the turbulence in financial markets resulted in higher demand for banknotes. Australian Government deposits fell by around $13 billion. Other liabilities also declined, as revaluation losses from the appreciation of the Australian dollar exchange rate reduced the Bank's Unrealised Profits Reserve (see the chapter on 'Earnings and Distribution').

There was a corresponding rundown of the Reserve Bank's asset holdings, with the level of repurchase agreements (repos) using domestic assets and foreign assets (in the form of foreign exchange swaps) both declining. Net foreign exchange reserves rose slightly.

Reserve Bank Assets



Reserve Bank Liabilities



Reserve Bank Balance Sheet
$ billion

	June 2008	June 2009	June 2010
Assets	*101*	*103*	*86*
Foreign	45	54	47
– Net reserves	36	43	47
– FX swaps	0	9	-3
– Other	9	1	3
Domestic	56	48	39
Liabilities	*101*	*103*	*86*
Deposits	39	34	21
Currency	42	48	49
Other (including capital)	20	20	16

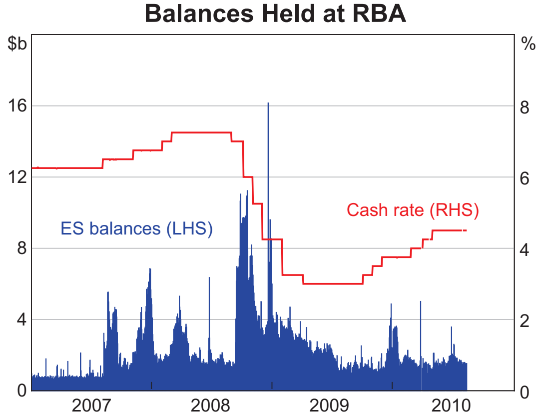
Source: RBA

Domestic Market Operations

To implement monetary policy, the Reserve Bank Board sets a target for the cash rate – the rate at which banks borrow and lend to each other on an overnight unsecured basis. This rate affects interest rates in other wholesale and retail markets, which in turn affect economic activity and inflation. Over the past year, the Board increased the cash rate target on six occasions, in increments of 25 basis points, lifting the rate from 3 per cent to 4.5 per cent. This followed the very large reduction in the cash rate in the preceding year.

To ensure that the Board's target is met, the Reserve Bank operates in the cash market to maintain a level of exchange settlement (ES) balances consistent with the cash rate trading at target. ES balances are liabilities of the Reserve Bank held by financial institutions to settle their payment obligations with each other and the Bank. The Reserve Bank pays interest on ES balances at a rate 25 basis points below the cash rate target. This creates an incentive for institutions to recycle ES balances within the market. Over the past year, the cash rate has traded at the target on all but two business days (when it traded one basis point lower).

Balances Held at RBA



Source: RBA

Over the past year, ES balances have averaged around $1.7 billion. This is well below the previous couple of years, during which the Reserve Bank increased the supply of ES balances to meet increased demand as market participants became more cautious in their cash management. Given the improvement in market conditions over 2009/10, it has usually only been around balancing dates at the end of a calendar quarter that banks have sought to hold higher ES balances. In these instances, the Bank has accommodated the additional demand by allowing the level of ES balances to rise temporarily.

Payment flows between ES account holders and the Reserve Bank or its customers (principally, the Australian Government) alter the aggregate supply of ES funds. The Bank will generally offset the liquidity impact of these flows by purchasing (or more rarely, selling) securities in its open market operations. Most of the Bank's transactions within the domestic market are contracted as repos. Under a repo, one party agrees to sell a security to another with an agreement to repurchase the security at a future date at a pre-agreed price. In its market operations, the Reserve Bank is willing to purchase both government debt securities ('general collateral') and private debt securities under repo. To guard against a possible loss if the counterparty to the transaction is not able to repurchase its security at the agreed time, leaving the Bank holding the security, the Bank imposes a margin (or 'haircut') on the security's initial price. These margins range from 2 to 10 per cent, depending on the price and credit risk characteristics of the security, and protect the Bank against adverse moves in the security's price (see the chapter on 'Risk Management').

During 2009/10, as the Reserve Bank's balance sheet contracted, there was a fall in the level of the domestic repo book as well as a significant shift in its composition. During the height of the market turmoil the Bank shifted towards holding private securities in the repo portfolio, in a way that was designed to be helpful to the markets for private debt securities. ADIs were also able to put together securities backed by mortgages on their books – 'internal securitisations' – and use them as collateral in the Bank's market operations. At various stages throughout the financial crisis, as much as 90 per cent of the Bank's repo portfolio was in private securities (including internal securitisations).

With market conditions improving throughout the year, the Reserve Bank has increased the share of general collateral in its repo operations relative to private-sector securities back towards pre-crisis levels. The Bank has also stated that generally it would not expect to see internal securitisations offered as collateral in market operations on a regular basis, though they remain eligible collateral.

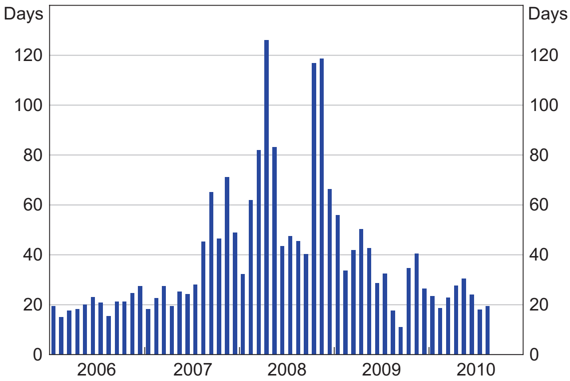
These developments have seen the share of general collateral rise to around 60 per cent in June 2010, compared with 10 per cent a year earlier. Internal securitisations now comprise less than 10 per cent of the Reserve Bank's repo portfolio, compared with around half in June 2009.

Australian Dollar Securities Held under Repurchase Agreements

	June 2008		June 2009		June 2010	
	$ billion	Per cent of total	$ billion	Per cent of total	$ billion	Per cent of total[(a)]
General collateral						
– CGS	0.9	2	2.5	6	3.3	9
– Semis	4.0	7	1.2	3	10.8	31
– Supras	1.5	3	0.4	1	2.2	6
– Government guaranteed	..	..	0.3	1	5.6	16
Private Securities						
– ADIs	45.3	82	11.8	28	8.8	25
– RMBS (internal securitisations)	..	..	21.2	50	3.1	9
– RMBS (other)	2.9	5	4.9	11	0.5	1
– ABCP	0.3	1	0	0	0.4	1
– Other	0	0	0.2	0	0.1	0
Total	55.1		42.5		34.8	

(a) Does not sum to 100 owing to rounding
Source: RBA

Average Term of RBA Repos Dealt



Source: RBA

For much of the past year, the average term of the repos contracted by the Reserve Bank has generally been less than a month. Again, this represents a normalisation of the Bank's operations, as shorter terms provide the most flexibility for conducting market operations. Nevertheless, the Bank remains willing to deal for longer terms if the demand is there and if it suits the Bank's liquidity management needs. In this regard, over the past year the Bank has occasionally contracted repos with terms as long as 12 months.

In addition to its regular morning operations, the Reserve Bank is willing to conduct a second round of dealing with the market on the same day should liquidity conditions require it. In 2009/10, only two second-round operations were conducted.

ES account holders may also occasionally face unexpected funding shortfalls late in the settlement session. Although these shortfalls are generally met by participants borrowing funds from another bank, ES account holders are able to access a standing overnight facility with the Reserve Bank. Under this facility, banks can borrow funds on a secured basis at a rate 25 basis points above the cash rate. During 2009/10, the facility was used on five occasions for aggregate borrowings totalling $1.0 billion. The lower usage of the facility over the past year in part reflects an increase in the willingness of ES counterparties to lend late in the settlement session.

Usage of Overnight Standing Facility

	Number of times used	Value ($m)
2005/06	10	436
2006/07	24	3 589
2007/08	18	4 220
2008/09	15	3 257
2009/10	5	1 035

Source: RBA

In addition to repurchase transactions, the Reserve Bank is willing to purchase CGS and State government securities (semis) on an outright basis in its daily operations, provided these securities have a term to maturity not exceeding 18 months. Outright purchases of longer-dated government securities are transacted through separate, less regular, operations. During 2009/10, the Bank conducted seven 'long-dated' operations, purchasing securities totalling $750 million. At present, the Bank holds around $3 billion of longer-dated securities on an outright basis, almost all of these being State government securities not guaranteed by the Australian Government. These holdings of government securities assist with the Bank's liquidity management; in circumstances where the Bank needs to drain ES balances from the market, the Bank is able to sell its securities under repo.

On occasion, the Reserve Bank may also sell its securities under repo to satisfy market demand for the specific securities that the Bank owns. The effect of these transactions on ES balances is generally offset by a purchase of other securities under repo from the same counterparty. During 2009/10, the Bank's income from securities lending was negligible, amounting to less than $0.1 million.

In addition to lending securities from its own portfolio, the Reserve Bank operates a lending facility for CGS on behalf of the Australian Office of Financial Management (AOFM). This facility allows market participants to borrow specific lines of CGS via a repo with the Reserve Bank. An offsetting repo in other CGS or government-related securities is transacted at the same time. During 2009/10, $2.9 billion of CGS was lent under this facility, significantly less than in the previous year. The increase in CGS on issue has meant that there have been fewer occasions when dealers have had difficulty finding these securities in the market in order to settle their transactions.

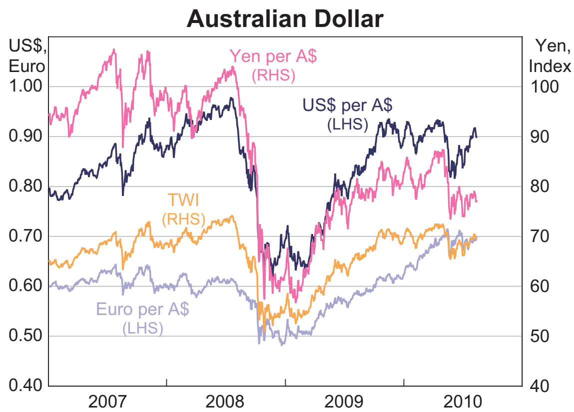
Foreign Exchange Operations

The Reserve Bank carries out transactions in the foreign exchange market on a daily basis. The Bank operates in both the spot market and the market for foreign exchange swaps. Most of these transactions are undertaken on behalf of the Bank's clients and are typically small by value. Some result from the day-to-day management of the Bank's portfolio of foreign currency assets. Other larger but less frequent transactions arise from policy operations. These are mostly transactions undertaken to assist with the Bank's management of domestic liquidity, and complement the Bank's open market operations. On rare occasions, the Bank intervenes in the foreign exchange market. Intervention is only carried out to address disorderly market conditions or when the exchange rate is judged to be significantly mispriced.

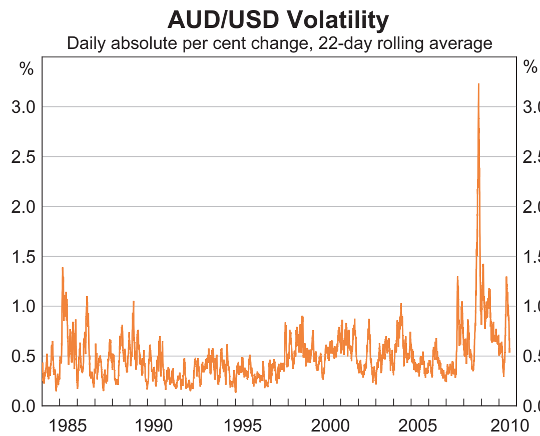
The Australian dollar appreciated from its trough in March 2009, supported by the improving outlook for global growth, related increases in commodity prices and the broad improvement in global risk appetite. The relatively positive outlook for the domestic economy and associated widening in interest rate differentials also supported the appreciation. The Australian dollar reached a high of around US$0.94 in November 2009, 5 per cent below its 2008 peak, but around 40 per cent higher than its 2008 lows on a trade-weighted basis.

Through the early months of 2010, the Australian dollar traded within a reasonably wide band. Over this period, sentiment toward the currency remained positive even as concerns about developments in Europe were building. Volatility in the exchange rate trended lower. This combination of a relatively favourable fundamental outlook and declining volatility encouraged a build-up of positions in the Australian dollar against a range of currencies, particularly the yen and the euro.

In May, an escalation of concerns about sovereign risk in Europe led to a sharp depreciation in the Australian dollar as some of these positions were unwound. The exchange rate depreciated particularly sharply against the yen and the US dollar, which enjoyed safe haven status as in late 2008. The Australian dollar depreciated by around 10 per cent on a trade-weighted basis over the first three weeks



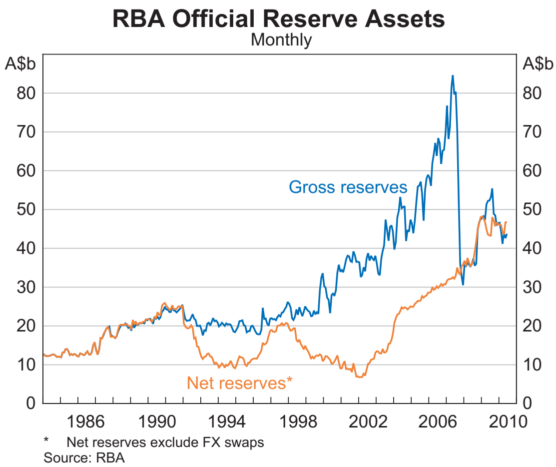
Sources: RBA; Thomson Reuters; WM/Reuters



Source: RBA

of May. Volatility increased noticeably. While the speed and size of the adjustment in the currency placed some strains on the foreign exchange market, these were modest and short-lived compared with developments after the collapse of Lehman Brothers in 2008. Accordingly, the Reserve Bank did not judge it necessary to intervene.

Over the financial year, transactions in foreign currency and earnings on foreign currency assets added $6.8 billion to net foreign currency reserves. Net transactions in 2009/10 included the purchase from the Australian Government of $4.8 billion of Special Drawing Rights (SDRs) at the IMF. The Australian Government had received additional SDRs as part of the General SDR Allocation in August and the Special SDR Allocation in September (see the chapter on 'International Financial Co-operation'). Valuation losses arising from the net appreciation of the Australian dollar reduced the value of net reserves (in Australian dollar terms) by $3.4 billion. As a result, the Australian dollar value of net foreign currency reserves rose by $3.4 billion over the financial year to $46.7 billion.



As it has done for some years, the Reserve Bank continued to utilise foreign exchange swaps as part of its domestic liquidity operations. At the end of June 2010, the Bank had a net obligation to receive foreign currency of $3.0 billion. Gross reserves, namely foreign exchange held outright (net reserves) adjusted for foreign exchange held or lent under foreign exchange swaps, ended the financial year at $43.7 billion.

As noted above, the Reserve Bank provides foreign exchange services to its clients. While these include a number of foreign official institutions, the Bank's largest client is the Australian Government. The Government purchases foreign currency from the Bank to meet a range of obligations, including defence expenditure, foreign aid and the costs of maintaining its diplomatic presence around the world. The Bank typically covers sales of foreign exchange to its clients directly from the market but can fund them temporarily from reserves if market conditions warrant this. In 2009/10, the Bank sold $7.3 billion of foreign currency to the Australian Government, which was covered in the market.

Reserves Management

The Reserve Bank also regularly undertakes transactions in foreign money and bond markets as part of the management of the portfolio of foreign currency assets that it holds on its balance sheet. These assets along with gold, which is also held on the Bank's balance sheet, comprise the major part of Australia's official reserve assets. The Reserve Bank draws on the foreign currency portfolio to implement policy operations in the foreign exchange market and assist with the management of domestic liquidity.

The investment mandate under which these assets are managed places a high priority on investing only in assets of the highest credit quality and ensuring that the portfolio has sufficient liquidity to meet its policy objectives in all market conditions. These requirements have implications for the selection of investment currencies and individual asset classes, as well as the risk management framework. They are embodied in an internal benchmark that is used to guide the investment process.

The benchmark is a hypothetical portfolio that represents the Reserve Bank's best estimate of the long-run optimal investment allocation given the policy objectives of the portfolio and the various constraints under which it is managed. The Bank has managed its portfolio to an internal benchmark for almost 20 years, over which time there have been few adjustments to the benchmark. Since inception, this has restricted currency exposure to the US dollar, the euro (the Deutschemark prior to 1999) and the Japanese yen. Since 2001, the allocation across these three currencies has been 45 per cent each to the US dollar and euro and 10 per cent to the yen. Benchmark investments are limited to sovereign debt issued by the governments of the United States, Germany, France and Japan; investments secured by sovereign or quasi-sovereign debt under repos; and commercial bank deposits. Exposure to interest rate risk is limited by the prescription of a benchmark duration target within each currency. This target was reduced to 18 months for all three portfolios in 2008/09 and no changes were made in 2009/10.

The Benchmark Portfolio

	US	Europe	Japan
Asset allocation (% of total)	45	45	10
Currency allocation (% of total)	45	45	10
Duration (months)	18	18	18

Source: RBA

Over 2009/10, the return on foreign currency assets, measured in SDRs, was 2 per cent, considerably below returns recorded in recent years. The Australian dollar value of the return on reserves was $0.3 billion, also considerably lower than in the previous financial year. This outcome largely reflected the very low level of global bond yields over the year, which limited interest earnings across all three portfolios, and the higher average Australian dollar exchange rate, which reduced the Australian dollar value of foreign earnings by 17 per cent. Modest mark-to-market capital gains on holdings of bonds contributed to returns.

Rates of Return in Local Currency by Portfolio

Per cent

	US	Europe	Japan
2003/04	0	1.9	0
2004/05	4.1	5.8	1.1
2005/06	1.2	0.1	–0.9
2006/07	5.6	2.2	1.1
2007/08	8.1	4.0	1.7
2008/09	5.2	8.1	1.8
2009/10	2.3	2.7	0.8

Source: RBA

For some years, the Reserve Bank has maintained investments in two regional bond funds established by EMEAP central banks to support the development of local bond markets. These funds comprise the Asian Bond Fund initiative. The Bank has investments in both the US dollar denominated fund, ABF1, and the local currency denominated fund, ABF2. At the end of June 2010, the total allocation of reserves to these funds was $443 million. The return on these investments over 2009/10 was 9.5 per cent, measured in US dollar terms. These investments are managed externally and outside the benchmark framework.

As noted, the Reserve Bank holds the gold tranche of Australia's official reserve assets on its balance sheet. Gold holdings are around 80 tonnes, unchanged from the previous year. Over 2009/10, the price of gold rose by 34 per cent in US dollar terms and by 28 per cent in Australian dollar terms. As a result, the value of the Bank's holdings of gold increased by around $0.8 billion to $3.7 billion.

The Reserve Bank is prepared to lend gold from its holdings to participants in the gold market provided such loans are secured by high-quality collateral. In recent years, gold leasing rates have been low and there has been little demand from the market for gold loans. As a result, the amount of gold on loan has progressively declined as maturing loans have not been renewed. In 2009/10, income from gold loans declined further to $0.4 million. In June 2010, there were 3 tonnes of gold on loan.

Banking and Payments

The Reserve Bank provides a range of banking, registry and payment settlement services to Australian financial system participants, the Australian Government, and other central banks and international bodies. These include the provision of central banking services to the Australian Government for the public accounts operated by the Department of Finance and Deregulation (DoFD); transactional banking services to government agencies; custodial, registry and associated services; and the operation of a real-time gross settlement (RTGS) system for Australian dollar high-value payments.

While the majority of these services fall within the scope of central banks' core activities, some, such as the transactional banking and registry services provided to Australian Government agencies, do not. Accordingly, these services are provided on a commercial basis in line with the Australian Government's competitive neutrality guidelines.

Banking

The Reserve Bank provides central banking and related services to DoFD on behalf of the Australian Government, the Australian Office of Financial Management (AOFM), the Australian Reinsurance Pool Corporation and 46 overseas central banks and other official institutions. It also provides contestable transactional banking services to around 90 government agencies on a commercial basis.

One aspect of the Reserve Bank's central banking activities is the role it plays as core banker to the Australian Government. Among other things, this requires the Bank to manage the consolidation of all Australian Government agency account balances, irrespective of the financial institution that provides transactional services to an Australian Government agency. These balances are transferred at the end of the operational day into a group of accounts at the Reserve Bank, known as the Official Public Accounts (OPA) Group. This is where the Commonwealth's overnight at-call cash balances are held. The 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 where there is an unexpected demand on Commonwealth cash balances. These broad arrangements have been established under an agreement with DoFD.

The AOFM has day-to-day responsibility for ensuring there are sufficient cash balances in the OPA Group and for investing excess Commonwealth funds in approved investments, including term deposits at the Reserve Bank. The Bank also offers term deposit investment facilities to other government entities, including the Australian Reinsurance Pool Corporation.

The Reserve Bank's transactional banking activities involve the delivery of payment and related banking services. The provision of these services is contestable, and the Bank competes against other commercial financial institutions to deliver these services to government agencies. These agencies can require service features that are common to government but not routinely requested by other users of payment and collection services. Because of its particular focus on the government sector, the Bank is able to provide facilities tailored to their specific requirements. These include features such as extremely high standards of system reliability and availability, purpose-built overnight reporting and the flexibility to react quickly when changes in government policy require consequent changes to systems and processes.

The delivery of direct entry payments from government agencies to recipients' accounts is a significant part of the Reserve Bank's transactional banking activities. In 2009/10, approximately 277 million payments totalling $276 billion were delivered through this payment stream by the Bank.

During the course of the year, the Reserve Bank continued to work closely with industry on replacing the outdated bilateral communication links that support the exchange of direct entry and other low-value payments between payment service providers in Australia. In February 2010, the industry formally established a new communication 'network cloud', called the Community of Interest Network (COIN), to facilitate the exchange of these low-value payments. An industry management committee has been established under the auspices of the Australian Payments Clearing Association to oversee the operation of this network. The Bank is represented on this committee.

By end June 2010, the Reserve Bank's Banking Department had migrated its cheque and direct entry payment exchanges with four financial institutions – including two of the four major banks – to the COIN infrastructure. It anticipates migrating all of its low-value payment exchanges by end September 2010.

In addition, one major bank has chosen to exchange its direct entry and cheque payments via SWIFT. Banking Department has also migrated its payments exchanges with this institution, using the Low Value Clearing Service (LVCS) established by the Reserve Bank's Payments Settlements Department. Additional detail on the LVCS is set out in the 'Settlement Services' section of this chapter.

Over the past year, the Reserve Bank has also been working actively with its larger government agency customers to upgrade their legacy bilateral communication links with the Bank, which had been based on similar technology to that used by payments service providers. These links are used by agencies to send payment request files to the Bank and receive end of day reports and other data from the Bank. By end June 2010, the Bank and its government agency customers had replaced all bilateral links reaching the end of their technology life cycle.

The Reserve Bank also provides its government agency customers with access to a number of bill collection services, including BPAY©, over-the-counter, phone and internet-based collection services. The range of services provided in this area has continued to expand over the past year and the Bank has worked closely with government agencies to make sure that they have the payments options most suited to their business needs. As part of this process, the Bank worked with an external service provider to introduce a purpose built internet and phone-based card collection facility for the Australian Taxation Office. Since its introduction, other agencies have also begun to use this enhanced service.

The Reserve Bank has also introduced a new service that allows frequent within-day submission of RTGS payment files to the Bank on an automated basis. Agencies are able to submit RTGS payments promptly using their own business systems once they have identified a need to send an urgent, or time critical, payment. In October 2009, the Bank also responded to an industry discussion paper released by the Minister for Human Services on *Better Dealings with Government: Innovation in Payments and Information Services*. The response outlined various ways in which the Department of Human Services could enhance its customer service options and processing efficiency, including by making greater use of internet and phone-based payment collection services to reduce manual processing.

Earnings after tax in 2009/10 for the Reserve Bank's transactional banking services were $3.8 million, compared with $3.5 million in the previous year.

Registry

The Reserve Bank provides registry services to the Australian Government, under an agreement with the AOFM, and a number of official foreign institutions that have Australian dollar debt programs. In common with other registry operators, the services provided to clients include registration of new issuance, ongoing maintenance of ownership records, distribution of interest payments and redemption of securities at maturity.

The Reserve Bank also provides a small-investor facility that enables retail investors to buy or sell CGS. The number of small-parcel transactions has dropped noticeably over the past 12 months as a result of the more stable economic environment. Information relating to the small-investor facility, including indicative buying/selling prices, is available on the Bank's website.

As in past years, the level of transactional activity in the Reserve Bank's registry remained quite low because wholesale financial market participants settle their CGS trades electronically in Austraclear. Earnings after tax for the CGS registry business in 2009/10 were $0.1 million, the same as in the previous year.

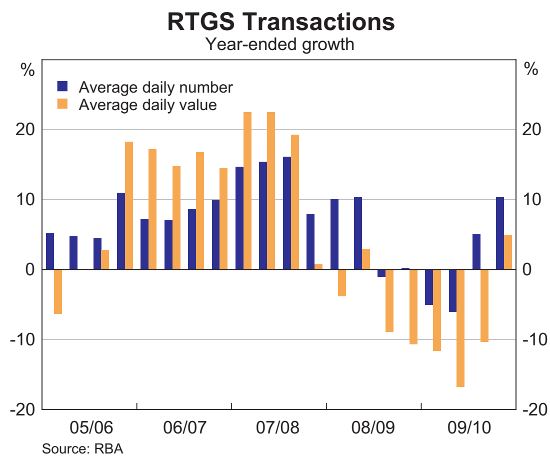
Settlement Services

The Reserve Bank owns and operates the Reserve Bank Information and Transfer System (RITS), which is a critical piece of infrastructure of the Australian financial system. It is used for real-time payments and settlements by 58 institutions – mainly APRA-licensed ADIs – that have been approved by the Bank to operate an Exchange Settlement Account (ESA). A further 10 institutions that hold ESAs have appointed another ESA holder to act as a settlement agent in RITS.

Payments between institutions are settled in RITS across their respective ESAs. By value, about 90 per cent of all payments settled in RITS are settled individually on an RTGS basis. These include time-critical customer payments, all wholesale debt and money market transactions and the Australian dollar legs of foreign exchange transactions. The latter includes Australian dollar trades involved in continuous linked settlement (CLS), for which net amounts are paid to and received from CLS Bank each day.

In addition to RTGS payments, RITS settles batches of netted payments. One batch is a dedicated multilateral settlement at 9.00 am each day for payments arising from cheque, direct entry and retail card transactions that are cleared through low-value systems prior to settlement the next business morning across RITS. A batch settlement facility in RITS also allows approved parties to submit batches of netted payments to RITS at any time during the business day. This facility is used once each day by the Australian Securities Exchange for settlement of payments arising from equity transactions. It has also been used to settle some property-related transactions to prove the capability for electronic conveyancing and settlement.

The average daily value and number of RTGS transactions in 2009/10 were $168 billion and 32 400, respectively. The value of transactions was well below annual averages recorded prior to the onset of the global financial crisis. RTGS transaction figures continued to be relatively low through 2009/10, particularly in the first half of the year. Some recovery was experienced in the June quarter, with transaction values and numbers both higher than in the June quarter 2009. In 2009/10, the highest daily value of transactions settled in RITS was $254 billion, on 15 June 2010, a decrease from the previous year's peak day of $289 billion, which in turn was down from the peak day of $312 billion recorded in 2007/08.



The Reserve Bank continues to invest significant resources in maintaining and enhancing RITS to ensure it operates to the highest standards of availability and resilience and keeps pace with international best practice for RTGS systems.

One new piece of functionality implemented in RITS in July 2009 is a targeted bilateral offset facility. This functionality allows any two RITS members to offset selected transactions against each other to improve the efficient use of system liquidity and to assist in client credit management.

As foreshadowed in last year's Annual Report, the Reserve Bank is making use of its significant public policy investment in RITS to assist the industry to make improvements in the infrastructure for low-value clearing systems. This major RITS initiative – the Low Value Feeder (LVF) project – comprises three main parts:

- Establishment of RITS network connectivity with members utilising the COIN infrastructure. This work has been completed.
- Provision of the LVCS, which facilitates interconnectivity between the COIN and SWIFT so that RITS members can exchange clearing files across their preferred network rather than having to use both SWIFT and the COIN industry infrastructure. The LVCS became operational in June.
- Provision of a Low Value Settlement Service, which facilitates more timely settlement of low-value clearings. RITS members will be able to provide settlement instructions to RITS for these low-value clearings by either SWIFT or the COIN. This service is expected to be available in the first half of 2011.

Together, the three components represent a new settlement infrastructure for low-value payments that will improve timeliness and efficiency. This infrastructure modernisation aims to provide a platform to support product innovation and customer service, as well as reducing the risk associated with the current net deferred settlement arrangements.

The Reserve Bank also provides settlement services for banknote lodgements and withdrawals by commercial banks and for high-value transactions undertaken by the Bank and its customers, including the Australian Government, overseas central banks and official institutions. At the end of June 2010, 41 central banks and official institutions overseas were using the settlement and safe custody services provided by the Bank to settle their Australian dollar transactions.

Currency

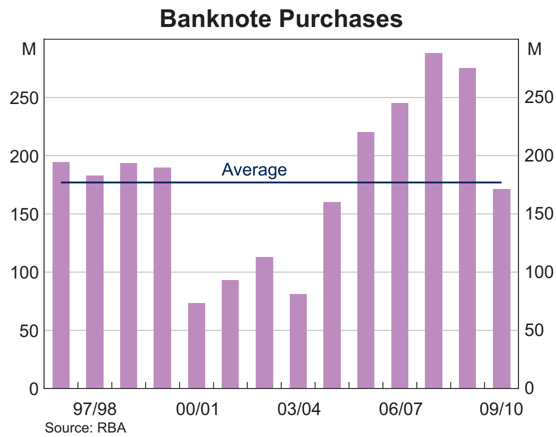
The Reserve Bank is responsible for the production and issuance of new banknotes and the destruction of unfit banknotes. The ultimate goal is to preserve public confidence in the currency, such that banknotes continue to be an effective payment mechanism and a secure store of wealth. This confidence is maintained by:

- ensuring there are sufficient banknotes available to meet public demand;
- keeping a high quality of banknotes in circulation; and
- conducting research to ensure that the currency remains secure against counterfeiting.

Note Issue Department is responsible for ensuring the supply of quality banknotes and researching security features to be incorporated on banknotes. The Assistant Governor (Currency) also chairs the boards of Note Printing Australia Limited (NPA), the Reserve Bank's wholly owned subsidiary that prints Australia's banknotes, and Securency International Pty Ltd, the joint venture company that produces the polymer substrate used for Australia's banknotes.

New Banknote Purchases

The Reserve Bank purchased 170 million banknotes from NPA in 2009/10, 104 million fewer banknotes than were purchased in the previous year. The order consisted of 31 million $20 banknotes, 111 million $50 banknotes and 29 million $100 banknotes. No $5 or $10 banknotes were printed as the Reserve Bank had sufficient stock of these denominations to meet public demand. The lower number of banknotes purchased in 2009/10 than in recent years reflected a slowing in the growth of demand for new banknotes since the start of 2009, but was around the average number of banknotes purchased each year since the polymer series was introduced in the mid 1990s.



Banknotes on Issue

At the end of June 2010 there were around 1 billion banknotes on issue, worth approximately $48.8 billion. This represents an increase of 1.4 per cent over the year, following a rise of 14.3 per cent over the previous year.

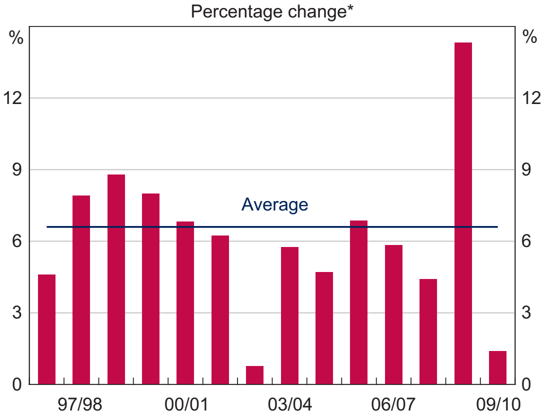
Towards the end of 2008 there was a sharp increase in the demand for banknotes in line with the public's concerns associated with the global financial crisis. Demand abated considerably as those concerns diminished over the course of 2009. Considering these two periods together, the average annual growth in the value of banknotes on issue during this episode was around 8 per cent, broadly comparable to the average over the past 15 years of 7 per cent.

Banknotes on Issue
$ million

At end June	$5	$10	$20	$50	$100	Total	Increase (percentage change)
2004	533	791	2 533	15 941	14 224	34 022	5.7
2005	539	837	2 584	16 740	14 924	35 624	4.7
2006	572	857	2 690	18 044	15 903	38 066	6.9
2007	591	894	2 846	19 228	16 730	40 289	5.8
2008	614	917	2 732	20 111	17 690	42 064	4.4
2009	644	954	2 651	23 721	20 117	48 087	14.3
2010	673	983	2 653	23 711	20 740	48 760	1.4

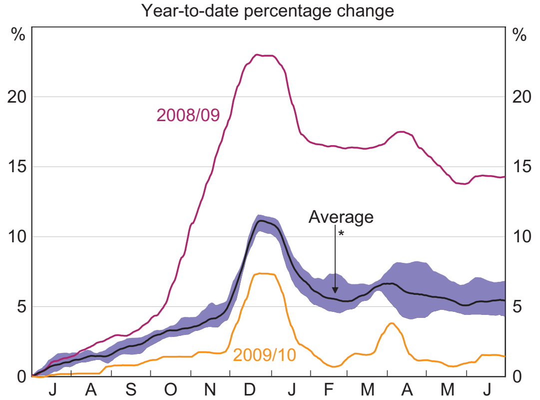
Source: RBA

Banknotes on Issue
Percentage change*



* Adjusted for 2001/02 change in distribution arrangements
Source: RBA

Banknotes on Issue
Year-to-date percentage change



* Shaded area represents the range for the four years ended June 2008
Source: RBA

The stock of banknotes on issue is equivalent to 47 banknotes worth $2 180 for every Australian, a marginal decline from the previous year. The $50 banknote accounted for half the value of banknotes on issue and 45 per cent of the number of banknotes on issue, while the $100 banknote accounted for around 43 per cent of the value and 20 per cent of the number.

Distribution

In addition to banknotes on issue, the Reserve Bank maintains a contingency holding of banknotes. The purpose of this holding is to meet normal seasonal fluctuations in demand as well as to mitigate the risks associated with financial shocks and production disruptions.

Commercial banks also maintain surplus banknote stocks in approved cash centres located throughout Australia. These stocks ensure there are sufficient banknotes to meet customers' daily currency requirements. Commercial banks are encouraged to replenish these stocks by dealing directly with each other, but have the option of sourcing new banknotes from the Reserve Bank when required. For the past decade, new banknotes have been issued by the Bank from the National Note Processing and Distribution Centre (NNPDC), located within NPA at Craigieburn, Victoria. Following the increase in demand in 2008, a second distribution point was opened at the Bank's Head Office in Sydney in late 2009. This has provided commercial banks with more flexible access to the Reserve Bank's contingency holdings, and has significantly enhanced the Bank's ability to respond to changes in the demand for banknotes.

Banknote Quality

In order to maintain a high quality of banknotes in circulation, the Reserve Bank regularly issues new banknotes and withdraws unfit banknotes. These activities ensure the efficient handling of banknotes by the public and processing through the banknote evaluation machines (for example, ticketing machines) that are increasingly present in the community. High-quality banknotes also enable the public to detect counterfeits more easily.

The commercial banks and armoured car companies play an important role in achieving the Reserve Bank's quality objective. The Bank provides incentives for commercial banks and armoured car companies to sort unfit banknotes from their holdings and to invest in banknote examination technologies. Banknotes deemed to be unfit by the commercial banks and armoured car companies are returned to the NNPDC, where they are processed to confirm their quality and authenticity. Returned banknotes that are verified as being fit by the NNPDC are reissued, while those determined to be unfit are destroyed. Of the 104 million banknotes returned to the NNPDC during 2009/10, 92 million were destroyed.

Some banknotes are damaged in circulation beyond the normal levels of wear and tear, becoming unsuitable for processing through high-speed sorting equipment. The Reserve Bank has a policy of paying value for severely damaged banknotes that can be authenticated as genuine Australian banknotes. This includes banknotes significantly damaged or contaminated as a result of natural disasters.

Although commercial banks can assess damaged banknotes and pay the assessed value for them, all damaged banknotes are returned to the Reserve Bank for final assessment and destruction. Under this arrangement, most damaged banknotes receive full value. Where a large piece of a banknote is missing, however, only the appropriate partial value is paid. During 2009/10, the Bank assessed around 19 400 damaged banknote claims, and paid out around $6.7 million.

Counterfeiting in Australia

Australia's level of counterfeiting continues to remain low in comparison with most other countries. In 2009/10, a total of 7 836 counterfeits were detected, with a nominal value of $413 995. This corresponds to around seven counterfeits passed per million genuine banknotes in circulation, a small decline from 2008/09 and around the average over recent years. As in previous years, the $50 note was the most commonly counterfeited denomination, accounting for 88 per cent of the counterfeits passed in 2009/10.

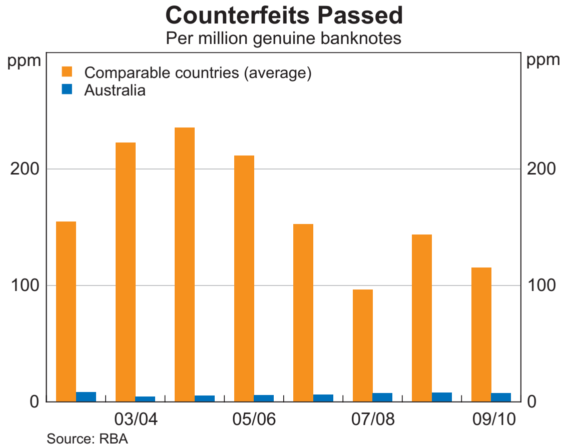
Counterfeit Banknotes in Australia
2009/10

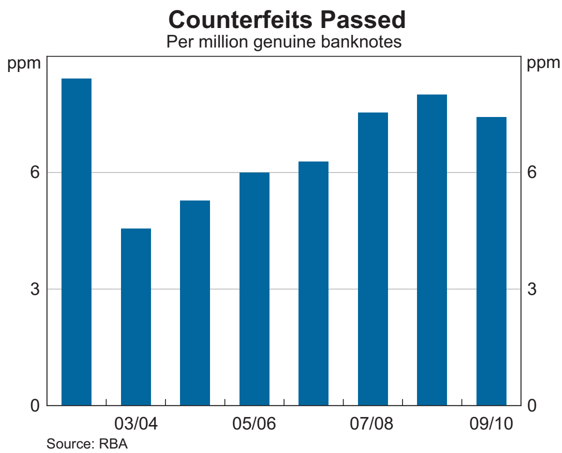
	$5	$10	$20	$50	$100	Total
Number	35	107	170	6 861	663	7 836
Nominal value ($)	175	1 070	3 400	343 050	66 300	413 995
Parts per million	0.3	1.1	1.2	14.3	3.2	7.4

Source: RBA

Consistent with the objective of maintaining confidence in Australia's banknotes, the Reserve Bank is committed to ensuring counterfeiting activity in Australia remains as low as possible. Reflecting this objective, the Bank is actively involved in a number of initiatives, including:

- working with law enforcement agencies in Australia and overseas, as well as other central banks, to monitor trends in counterfeiting;
- maintaining a dedicated Counterfeit Examination Laboratory to assist the Australian Federal Police with counterfeit handling by providing law enforcement with expert witness statements and court testimonies as required; and





- educating the public and domestic law enforcement agencies about how to identify counterfeits and what actions should be taken when counterfeits are identified. In addition to improving the accessibility of this information on the Reserve Bank's website, a number of counterfeit information sessions were conducted with State Police in New South Wales, South Australia and Queensland during the year.

Banknote Research and Development

The Reserve Bank maintains an active research and development program in order to develop security features that are more difficult to counterfeit but which are functional for a wide variety of users. As part of this program, the Bank works co-operatively with a range of third parties, including private companies, research institutions and universities. The Bank also shares information with other central banks on counterfeit deterrence issues and solutions.

In 2009/10, the Reserve Bank continued its involvement in two major international initiatives related to the combat of counterfeiting: the Central Bank Counterfeit Deterrence Group, a working group of central banks and banknote printing authorities that monitors threats posed by emerging counterfeiting technologies and proposes solutions for implementation by issuing authorities; and the Reproduction Research Centre, an anti-counterfeiting testing facility operated by a small number of central banks.

Numismatic Banknote Sales

The Reserve Bank conducted two auctions of banknotes of numismatic interest in 2007 and 2008. Notwithstanding the success of these auctions, the Bank considered a number of alternative models. As a result of this review, it was decided that numismatic banknotes that were produced in the previous year would be sold to the public at fixed prices during a pre-defined sales period.

The sale of these numismatic banknotes, of all the denominations produced in 2008, was conducted over a six-week period from September 2009. In May 2010, a similar sale was conducted for banknotes produced in 2009. In both cases, public participation in the process was high.

Note Printing Australia

Note Printing Australia (NPA) is a wholly owned subsidiary of the Reserve Bank, which produces Australia's banknotes and operates the NNPDC on behalf of the Bank. NPA's charter states that its prime focus is on the efficient production of Australia's banknotes to a high quality, consistent with specifications determined by the Bank's Note Issue Department. In addition to these core activities, NPA also produces Australia's passports for the Department of Foreign Affairs and Trade, banknotes for some other countries in the Asia-Pacific region, and banknote security materials for a number of countries.

NPA is governed by a board of four directors appointed by the Reserve Bank. The Board at present comprises four serving Bank executives: Bob Rankin, Assistant Governor (Business Services) as Chairman; Keith Hall, Assistant Governor (Banking & Payments); Darryl Ross, Chief Financial Officer; and Lindsay Boulton, Head of Risk Management. The Chief Executive is Bernhard Imbach, who was appointed to this position in 2008.

In 2009/10, NPA delivered 170 million banknotes for Australia and 275 million banknotes for other countries, specifically Chile, Malaysia, New Zealand, Papua New Guinea and Singapore. NPA also produced 2.0 million Australian passports during the year.

NPA earned a profit after tax of $4.3 million in 2009/10, compared with a profit of $6.1 million in the previous year. The financial accounts for NPA are consolidated with those of the Reserve Bank.

Securency

Securency is a joint venture between the Reserve Bank and Innovia Films, a leading manufacturer of polypropylene films based in the United Kingdom. Securency produces Guardian® banknote substrate for Australia and a number of other countries; this substrate is based on a specialised film manufactured by Innovia.

Securency is governed by a board comprising eight voting directors, of which the Reserve Bank and Innovia each appoint four. The directors appointed by the Bank are Bob Rankin (Chairman), John Akehurst (a non-executive member of the Reserve Bank Board), Darryl Ross and Les Austin. Securency is based in Craigieburn, Victoria.

Securency manufactures substrate at factories in Craigieburn and in Queretaro, Mexico. The latter is operated by Securency Mexico, S.A. DE C.V., a joint venture between Securency and the Banco de Mexico. During 2009/10, Securency manufactured substrate for 12 countries: Australia, Chile, Costa Rica, Guatemala, Honduras, Mexico, Nigeria, Papua New Guinea, Paraguay, Romania, Singapore and Vietnam. In May 2010, Securency launched a new optically variable feature, Latitude™, the first of a range of banknote security features based on a newly developed proprietary manufacturing platform.

Securency earned a profit after tax of $24.1 million in 2009, sharply higher than the profit of $7.9 million in the previous year. The rise reflected an increase in demand for substrate by customers in Africa and Latin America. Sales in 2009 were $172 million, up from $119 million the year before. The Reserve Bank equity accounts for its investment in Securency.

In mid 2009, following media allegations of possible corruption involving Securency's agents in overseas territories, the Board of Securency referred the allegations to the Australian Federal Police for independent investigation. The Board also commissioned a review by KPMG of the company's policies and procedures relating to the use of agents. KPMG's report was completed, and released by Securency, in March 2010. The review found that the Board of Securency had established policies that should have been adequate in managing or mitigating risks associated with the use of agents, but that these policies had not been fully implemented. KPMG made 12 recommendations to strengthen policies and procedures, which the Board accepted and committed to implement. The investigation by the Australian Federal Police is continuing. The Board of Securency has kept the Reserve Bank and Innovia fully informed of its actions and decisions.

International Financial Co-operation

International co-operation increased through the global financial crisis and has remained high over the past year as conditions in financial markets have improved. Various groups are currently addressing shortcomings in the global financial architecture that were revealed by the crisis. The Reserve Bank is an active participant in these efforts through its membership of global and regional fora and its close bilateral relationships with other central banks.

Group of Twenty (G-20)

The G-20 has taken a lead role in co-ordinating the global efforts to address issues arising from the crisis. In the past 12 months, G-20 leaders met in Pittsburgh in September 2009 and in Toronto in June 2010. The ongoing work of the G-20 has been overseen by G-20 finance ministers and central bank governors and their deputies.

At their Pittsburgh Summit, G-20 leaders committed to policies to secure a durable economic recovery, while also discussing strategies to return policy to more normal settings as the recovery took hold. The leaders launched a 'Framework for Strong, Sustainable and Balanced Growth', under which countries collectively assess the consistency of their policies with these three aims. At the Toronto Summit in June, G-20 leaders agreed that this mutual assessment process would proceed at the individual country and European level. Advanced G-20 economies also committed to develop plans to reduce fiscal deficits and stabilise debt to GDP ratios.

The Reserve Bank and Australian Treasury are contributing to the Framework initiative through membership of a G-20 working group established to guide the process. The Reserve Bank is also represented on an experts' group that is considering potential enhancements to global financial safety nets.

In both Pittsburgh and Toronto, leaders reiterated their commitment to strengthen international financial regulatory arrangements, including measures to improve the quality and quantity of bank capital and discourage excessive leverage in the financial sector. Leaders have called on national authorities to establish crisis management groups for major cross-border financial firms.

Another priority for the G-20 has been to ensure that international financial institutions, including the IMF, have appropriate resources and governance arrangements. To support this, G-20 leaders committed to enlarge the IMF's New Arrangements to Borrow. They also committed to shift IMF quota shares by at least 5 per cent to under-represented countries. The Australian Treasury is co-chairing a working group on IMF reform.

Financial Stability Board (FSB)

The FSB is playing a key role in assessing vulnerabilities in the global financial system, as well as co-ordinating the reform of the financial system architecture to minimise the probability and severity of future financial crises. The FSB has a broad membership, with representatives from the national financial authorities of 24 economies (including all of the G-20 countries), the main international financial institutions, including the Bank for International Settlements (BIS) and the IMF, and standard-setting bodies, including the Basel Committee on Banking Supervision (BCBS) and the Committee on Payment and Settlement Systems (CPSS).

The Reserve Bank is an inaugural member of the FSB (and its predecessor, the Financial Stability Forum). The Governor represents the Reserve Bank on the FSB, and the Head of Financial Stability Department is a member of a group that provides analytical support on assessing vulnerabilities. With the transformation and enlargement of the Financial Stability Forum to the FSB in April 2009 (discussed in the 2009 Annual Report), the Australian Treasury joined the Bank in representing Australia on the FSB.

Key areas of the FSB's work over the past year include:[1]

- commissioning, jointly with the BCBS, an assessment of the macroeconomic impact of the proposed major reforms to banks' capital and liquidity requirements, which the BCBS had released in December 2009 and are discussed further below;
- developing, jointly with the IMF, early warning indicators of financial vulnerabilities;
- assessing the usefulness of macroprudential measures to reduce excess build-up of system-wide risk in the financial system, for example, by reducing procyclicality in bank capital;
- working jointly with the IMF and BCBS on the issue of capital and liquidity surcharges on systemic institutions, and systemic levies and taxes;
- analysing options to reduce the moral hazard posed by systemically important financial institutions, often described as 'too big to fail' institutions (to this end, the FSB provided a list of policy options in this area to the G-20 leaders at the Toronto Summit);
- developing firm-specific contingency and resolution plans (or 'living wills'), particularly for the large cross-border banks;
- examining options for reform of over-the-counter (OTC) derivatives and market infrastructure, to reduce the scope for contagion between (systemic) entities (discussed further below); and
- strengthening accounting standards, including improved converged standards for financial instruments and their valuation.

Another important area of the FSB's work has been to improve international adherence to standards, such as in the banking and insurance sectors. In this context, the FSB has commenced periodic 'thematic' reviews across countries as well as more wide-ranging reviews of individual countries. The initial thematic review on compensation concluded in early 2010; a senior official from the Australian Treasury participated in the review team. Australia has volunteered to undergo a country peer review in 2011.

Bank for International Settlements (BIS)

The BIS and its associated committees have continued to play an important role in the response to the challenges posed by the global crisis, by bringing together high-level officials from central banks and other financial regulatory bodies to exchange information and consider lessons from the crisis.

The Governor or Deputy Governor attended the regular bi-monthly meetings of governors at the BIS and participated in meetings of the Asian Consultative Council (ACC), which focuses on financial and monetary developments in Asia and provides direction for the work of the BIS in Asia. In February 2010, the ACC met in Sydney as part of the series of high-level meetings that coincided with the Reserve Bank's 50th anniversary.

The Assistant Governor (Financial Markets) represents the Reserve Bank on two BIS committees: the Committee on the Global Financial System (CGFS) and the Markets Committee. The CGFS discusses vulnerabilities in the global financial system and structural developments in financial markets, while the Markets Committee focuses

1 For details on these measures, see RBA *Financial Stability Review*, March 2010.

on the implications of current events for the functioning of financial markets. Over 2009/10, the CGFS published reports on the functioning and resilience of cross-border funding markets; funding patterns and liquidity management of internationally active banks; long-term issues in international banking; the role of margin requirements and haircuts in procyclicality; macroprudential instruments and frameworks; and credit risk transfer statistics.

The Assistant Governor (Financial Markets) chaired the working group that reported on the impact of the crisis on cross-border funding patterns and liquidity management of international banks. The Head of the Reserve Bank's International Department participated in the working group on long-term issues in international banking. A senior manager from the Financial Markets Group participated in a CGFS Workshop on Macroprudential Instruments. Another senior manager from the Financial Markets Group was involved in the CGFS working group that reported on credit risk transfer statistics and in the Review Group for the BIS/ECB/IMF Handbook on Securities Statistics.

Basel Committee on Banking Supervision (BCBS)

As with the FSB, the BCBS also underwent an expansion in membership in 2009, to include Australia and all the remaining G-20 countries, as well as Hong Kong SAR and Singapore. The BCBS is the international standard-setter in the area of bank regulation and supervision. As such, it has played a central role in the international response to the inadequacies in the capital and liquidity management of a number of banks that became apparent during the financial crisis. In December 2009, the BCBS released consultation papers that outlined major reform proposals for capital and liquidity requirements for banks, including:

- raising the quality, consistency and transparency of the capital base;
- strengthening the risk coverage of the capital framework;
- introducing a leverage ratio as a supplementary measure to the Basel II risk-based framework;
- considering measures to promote the build-up of capital buffers in good times that can be drawn upon in periods of stress; and
- introducing two new measures of liquidity risk exposure developed for internationally active banking organisations.

The Assistant Governor (Financial System) and the Chairman of APRA represent Australia on the BCBS. The Reserve Bank and APRA are both actively involved in the reform of the Basel standards. The potential effects of these changes on banks have been assessed via a cross-country quantitative impact study (QIS); APRA co-ordinated the participation of Australian banks in this study. APRA is also involved in a 'top-down calibration group', which will determine the overall calibration of the new regulatory standards for capital and liquidity, factoring in broader macroeconomic considerations. A senior Reserve Bank officer from the Financial Markets Group is participating in the related joint FSB-BCBS group assessing the macroeconomic impact of the proposals. The BCBS and its oversight body considered the output from this work and the public consultation process at meetings in July 2010 and announced a broad agreement of the main design elements of the proposed reforms. A package of finalised measures is to be released by the end of 2010.

Committee on Payment and Settlement Systems (CPSS)

Since November 2009, the Head of Payments Policy Department has represented the Reserve Bank on the CPSS. The CPSS serves as a forum for central banks to monitor and analyse developments in payment and settlement infrastructures and set standards for them. Over the past year, the primary focus of the CPSS has been on the international standards for financial market infrastructures. With the Technical Committee of the

International Organization of Securities Commissions (IOSCO), the CPSS is undertaking a comprehensive review of three sets of international standards: core principles for systemically important payment systems; recommendations for central counterparties; and recommendations for securities settlement systems. While financial market infrastructures generally performed well during the financial crisis, it had been some time since the standards were established. The CPSS and IOSCO therefore agreed to review the standards, with a view to strengthening them where appropriate. The Head of the Reserve Bank's Payments Policy Department is on the Steering Group undertaking this review and two managers in the Financial System Group are contributing to specific work streams. A draft of the work for public consultation is expected in early 2011.

During 2010, the CPSS and IOSCO also drafted guidance for central counterparties and trade repositories in the OTC derivatives market. This guidance is currently under consultation, the results of which will ultimately be folded into the comprehensive review of the standards discussed above.

In addition to contributing to the CPSS and IOSCO work on OTC derivatives, a senior manager from the Financial System Group represents Australian financial regulators at an OTC Derivatives Regulators Forum established in September 2009. The Forum provides regulators of OTC derivatives markets around the world with a means to co-operate, exchange views and share information related to OTC derivatives, central counterparties and trade repositories.

International Monetary Fund (IMF)

The IMF has also been involved in responding to the financial crisis and in the host of international work that is seeking to reduce the likelihood of, and better prepare for, any future financial crisis. There has been ongoing reform of the IMF over the past year, including to its resourcing, governance, lending facilities and surveillance mandate.

In late 2009, the IMF undertook around US$285 billion of allocations of Special Drawing Rights (SDRs), to supplement member countries' foreign currency reserves and thereby help to address the shortage of liquidity.[2] Australia supported this initiative by establishing an arrangement by which it stands ready to exchange SDRs for foreign currency, especially from countries that wish to reduce their SDR holdings.

The IMF has continued to provide financial assistance to member countries, with the assistance for Greece a recent high-profile example. As noted above, G-20 leaders agreed to increase the IMF's funding through an expansion of the New Arrangements to Borrow, and there are ongoing discussions about increasing quota resources. In late 2009, G-20 countries also agreed to a shift in quota shares that would give emerging market and developing countries greater voting power in the IMF. More generally, the IMF has been actively involved in several aspects of the G-20 work agenda, such as the G-20 Framework for Strong, Sustainable and Balanced Growth and examining options for financial sector burden sharing.

The Reserve Bank works with the Australian Treasury to provide regular briefings to Australia's Constituency Office at the IMF on issues being considered by the IMF Executive Board. During the year, some of the main issues discussed by the Executive Board have related to the ongoing review of the IMF's mandate, the instruments that the IMF has to respond to periods of financial distress, and the Fund's governance arrangements. The Bank supports the Constituency Office directly by providing an advisor with expertise in financial system and markets issues. The Bank also provides assistance to other IMF activities – for example, the Assistant Governor (Banking & Payments) has participated in the IMF's Financial Sector Assessment Program in both Indonesia and China over the past 12 months.

An IMF team visited Australia in July 2010 for the regular annual consultation on the economy and policy, known as the Article IV Consultation. As is customary, the team spoke with the Governor, Deputy Governor and

2 For further information, see Doherty E (2009), 'IMF Initiatives to Bolster Funding and Liquidity', RBA *Bulletin*, November.

Assistant Governors of the Reserve Bank. Another team from the IMF visited Australia in March to assess observance of the IMF and World Bank standards and codes relating to the dissemination and quality of statistics. The team spent time with several agencies involved in the production and dissemination of data, including the Reserve Bank, and a range of users of macroeconomic and financial statistics.

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

EMEAP is an important regional forum, in which the Reserve Bank is extensively involved. It brings together representatives from 11 economies in the East Asia-Pacific region – Australia, China, Hong Kong SAR, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore, Thailand – to discuss monetary and financial stability, and exchange information and expertise on issues of common interest. The Governor of the Reserve Bank is the Chair of the EMEAP Governors in 2010.

The focus of discussion at EMEAP meetings in the past year has been on economic conditions and policies in the aftermath of the financial crisis. Most EMEAP economies experienced milder downturns than the large advanced economies at the centre of the crisis, and economic activity has recovered relatively quickly. Reflecting these outcomes, attention has focused on issues such as the appropriate timing of exit from the stimulatory policies that were introduced to mitigate the effects of the crisis, and the potential risks associated with strong capital inflows to the region. At the deputy governor level, the Monetary and Financial Stability Committee (MFSC) focused on the implications for EMEAP members of the proposed changes to international regulatory standards.

The Reserve Bank participates in the three working groups that report to the deputies and support the surveillance work of the MFSC: the Working Group on Financial Markets, the Working Group on Banking Supervision, and the Working Group on Payment and Settlement Systems. EMEAP is also responsible for the ongoing oversight of Asian Bond Fund 1, a US dollar-denominated Asian bond fund, and Asian Bond Fund 2, comprising eight local currency indexed bond funds and a Pan Asia Index Bond Fund (PAIF).

In addition to the regular EMEAP meetings, the Reserve Bank hosted the 5th EMEAP-Eurosystem High-level Seminar in February 2010. This event brought together governors from EMEAP and euro area central banks to discuss issues of mutual interest and to develop closer ties between the two regions. Governors and their representatives discussed economic policies in the aftermath of the financial crisis, the challenges posed by cross-border banking and the prospect of strengthening macroprudential supervision. The Reserve Bank also hosted the EMEAP Governors annual meeting in Sydney in July 2010.

EMEAP Governors in session, Utzon Room, Sydney Opera House, July 2010

Government Partnership Fund (GPF)

The Reserve Bank has continued its program with Bank Indonesia (BI), under the auspices of the Australian Government's GPF. This program supports an exchange of skills and knowledge between Australian public-sector institutions and their Indonesian counterparts; the first phase of the five-year program concluded in 2009/10 and the second phase is now under way.

The Reserve Bank's program with BI has expanded over time to encompass all aspects of central banking. In 2009/10, there were 40 staff exchanges between the Reserve Bank and BI, bringing the total number of exchanges to 145 officers since the start of the program in 2005/06. In the past year, attachments of BI officers to the Bank ranged from one week to four weeks and covered both policy and operational aspects of the Bank's activities. In May 2010, staff from the Economic Group participated in a workshop on inflation and potential output, which represented the culmination of research work by BI over the previous year. Several officers from the Financial Markets Group participated in a workshop on monetary operations, while other Reserve Bank officers visited BI to discuss risk management, human resources, auditing and payments issues.

South Pacific Central Bank Co-operation

The Reserve Bank maintains close relationships with the central banks of the South Pacific region through participation in high-level meetings, exchanges of staff, participation in workshops, and regular sharing of information on technical issues.

In December 2009, South Pacific Central Bank Governors met in the Solomon Islands. This group comprises the central banks of those countries in the region with their own currencies – that is, Australia, Fiji, New Zealand, Papua New Guinea, Samoa, Solomon Islands, Tonga and Vanuatu. Representatives from the IMF's Pacific Financial Technical Assistance Centre also participated in the meeting. The main issues discussed were the effects of global developments on the Pacific islands, economic prospects for the region and financial literacy. The South Pacific Governors met again in April 2010 in New Zealand, to discuss economic and financial sector developments.

Among the staff exchanges, a Reserve Bank officer returned from a 12-month secondment to the Reserve Bank of Vanuatu and was replaced by another officer for a further nine months. Reserve Bank staff also presented at a workshop of South East Asian Central Banks in July 2009 and at the annual meeting of the Association of Financial Supervisors of Pacific Countries in November 2009. Several officers from the Central Bank of Samoa participated in a Reserve Bank training course, and the Bank's Economic Group hosted officers from the Bank of Papua New Guinea to discuss economic analysis and monetary policy.

Bilateral Relations and Co-operation

As in previous years, the Reserve Bank continued to receive 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 Argentina, China, Ghana, Malaysia, South Korea, Sweden, Thailand and Vietnam. In addition, the Bank welcomed two delegations from Iraq. The first delegation included academics, trainers and officials from the Centre for Accounting and Finance Training (which operates from within Iraq's Ministry of Finance), and the second delegation included representatives from the Iraqi Ministry of Finance and the Central Bank of Iraq, among others.

The Reserve Bank in the Community

The Reserve Bank's 50th Anniversary

The Reserve Bank opened for business as Australia's central bank on 14 January 1960 (with the *Reserve Bank Act 1959* having separated the central banking and commercial functions of the Commonwealth Bank). The 50th anniversary of the Reserve Bank provided a special opportunity for greater engagement with the community. The Bank hosted a sequence of international meetings in Sydney to mark the anniversary, including a symposium that addressed central banking lessons learned over the past 50 years and the challenges ahead. The papers and proceedings were published online and a commemorative volume has also been published. A special anniversary monograph by Professor Selwyn Cornish of the Australian National University, *The Evolution of Central Banking in Australia*, was published in January and is available to interested readers. There were several exhibitions at the Bank's Head Office designed to share the Bank's cultural holdings with the public and provide insights into the place of financial institutions and events in the nation's history. Later this year, in recognition of the anniversary, the Research Library will re-open in a refurbished condition as the A.S. Holmes Library, in memory of one of the most influential officers to serve in the Reserve Bank in its 50-year history, Austin Stewart Holmes, OBE. It is a modest but fitting tribute to Holmes' pursuit of intellectual excellence and public service.

Activities of the State Offices

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

Since 2001, the Reserve Bank has devoted significant resources systematically to building relationships across a broad cross-section of the business community, with a view to gaining first-hand insights into conditions in different industries and regions within the national economy. The staff involved in the business liaison program have built up a pool of over 1 500 regular contacts around the country, with information from liaison meetings reported in detail to Head Office and incorporated in the material prepared for monthly Board meetings and in the quarterly *Statement on Monetary Policy*. In this way, information obtained from liaison is used as a complement to standard sources, such as data from the Australian Bureau of Statistics and business surveys, in forming the Bank's assessments of the economy.

Assistant Governor Philip Lowe (right) at Cape Lambert, Western Australia

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The Reserve Bank's 50th Anniversary Gala Dinner 1. Bob Hawke (former Prime Minister and Reserve Bank Board member, on left) and John Howard (former Prime Minister and Treasurer) **2.** Bill Hayden (former Governor-General and Treasurer, on left) and Paul Keating (former Prime Minister and Treasurer) **3.** (From left) Former Deputy Governor Don Sanders, Governor Glenn Stevens and former Governor Bob Johnston **4.** Wayne Swan (Treasurer) **5.** Anne Krueger (Johns Hopkins University) and Peter Costello (former Treasurer) **6.** Jean-Claude Trichet (President, European Central Bank, on left) and Athanasios Orphanides (Governor, Central Bank of Cyprus)

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 both state capitals and regional centres. They also 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.

Liaison with Small Businesses

The Reserve Bank continues to convene its Small Business Advisory Panel. This panel 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 represents a useful source of information on the financial and economic conditions faced by small businesses.

Museum of Australian Currency Notes

The Reserve Bank's Museum contains a permanent collection as well as periodic displays, and held several exhibitions in the past year associated with the Bank's 50th anniversary. The permanent collection exhibits the story of Australia's banknotes against the background of the nation's broader history. It displays the types of money used before Federation, ranging from a rum bottle used in early colonial days to Australia's first gold coins. Visitors then view the various banknotes produced since the first Australian note series in 1913–1915. The final stage of the Museum focuses on Australia's polymer banknotes, including information on their design, security features and potential for recycling. When viewing the collection, visitors can observe the evolution of Australian identity as expressed through Australia's currency, learn about the men and women represented on the banknotes and the artwork used in their design. The banknotes are presented alongside displays of key episodes in Australian history captured in archival film, photographs and documents.

The Reserve Bank's 50th anniversary was marked by exhibitions that explored aspects of the progress of the nation through the records held in the Reserve Bank's archives. One exhibition, 'Hidden History of Banking', displayed convict banking records and was used to show the progress of convicts to citizens who made significant contributions to society so that they became represented on the nation's banknotes. Another exhibition, 'Reflections of Martin Place', included historic photographs from the Bank's collection covering landmark financial events in Martin Place; these photographs were displayed on the façade of the Head Office building during the year. And finally, there was a display of the early artworks and interior design commissioned by Governor HC ('Nugget') Coombs, who was committed to modernism and progress.

Nearly 13 000 people visited the Museum in 2009/10, including around 1 500 visitors on Australia Day 2010, which was a record daily attendance with many visitors attracted by the anniversary displays. Attendance was also boosted by the Reserve Bank's participation in History Week. The Museum remains popular with school groups, with many of these groups receiving a short presentation on the role of the Bank or, in the case of senior economics students, a talk on the Australian economy. Most of the information in the Museum is on the Bank's website, which was redesigned in 2010; there were around 570 000 page views/downloads of information from the Museum site in the past year, with around one-third of users of the site being from other countries.

Images of Martin Place 1. As part of the Reserve Bank's 50th anniversary celebrations, photographs were displayed on the façade of the Head Office building depicting the formation of the Commonwealth Bank and the Reserve Bank, as well as some significant financial events **Australia Day 2.** Crowds of people came to the city **3, 4.** Some 1 500 visitors went through the Currency Museum

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 research activities of the Sydney Institute and the Centre for Independent Studies.

In 2009/10, 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 Committee Foundation, with the last of three pledges following completion in 2005 of the initial five-year support plan, and also its longstanding practice of contributing to the Group of Thirty's program of research and publications in the area of international finance.

Financial assistance to Australian universities each year includes contributions towards the costs of their organising conferences in economics and closely related fields. In 2009/10, these conferences included the 22nd Conference for PhD Students in Economics and Business, held at the University of Western Australia; the Economic Society of Australia's 38th Conference of Economists, held at the University of Adelaide; the 21st Annual East Asian Seminar on Economics – 'A Pacific Rim Perspective on the Financial Crisis'; the 15th Melbourne Money and Finance Conference; the Australasian Meeting of the Econometric Society, held at the Australian National University; the University of New South Wales 22nd Australasian Finance and Banking Conference; the Financial Integrity Research Network PhD Tutorial and the Paul Woolley Conference, both held at the University of Technology, Sydney; the National Honours Colloquium and the 5th Annual Workshop on Macroeconomic Dynamics, both at the University of New South Wales; a conference focusing on econometrics and applied time series in honour of Professor Adrian Pagan; and the Asia Pacific Group's Money Laundering Conference. The Reserve Bank is also continuing to support a research project on real-time forecasting, convened by Professor Shaun Vahey of the Australian National University.

The total value of support offered for research and education in 2009/10 was $250 000.

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. In 2009, the theme of the competition was 'Policy Responses to the Global Financial Crisis'. Madeline Ehler (University of Queensland) wrote the winning essay, the runner-up was Richard Swain (University of Sydney) and the best essay from a first-year student was written by Varun Chhabra (University of New South Wales). These students were presented with their prizes by the Governor at a ceremony in October. For the 2010 competition, students have been invited to submit an essay on the theme of 'Australia's Real Exchange Rate'.

In conjunction with APRA, the Reserve Bank has continued sponsorship of the Brian Gray Scholarship Program, initiated in 2002 in memory of a former senior officer of the Bank and APRA. Two scholarships were awarded under this program in 2010, one for PhD studies at the Australian Centre for Economic Research on Health at the University of Queensland, and the other for Honours studies for Bachelor of Commerce and Finance and Bachelor of Laws and Legal Practice at Flinders University. The cost to the Bank of these scholarships in 2009/10 was $12 500.

The Reserve Bank has a rich archive of records that relate not only to the Reserve Bank, but to banking activities in Australia. Archival records have been inherited from other financial institutions, with some dating back to colonial settlement. Furthermore, as part of the Commonwealth Bank and then as Australia's central bank, the Reserve Bank was for some time the government printer for materials other than banknotes. Consequently, in addition to documents, the Bank's archives contain an historical collection of Australian stamps, vouchers and posters that are of interest to researchers.

Over the past year, the Bank hosted visits by numerous researchers interested in its archives (including academics, heritage architects, curators and postgraduate students). It also dealt with many written requests from researchers that required Bank staff to access archival records, and it has provided access to its archives by members of the public making specific enquiries. Research was conducted by Professor Selwyn Cornish, the Reserve Bank's Historian since 2007, for the monograph to mark the Bank's 50th anniversary, *The Evolution of Central Banking in Australia*. Professor Cornish also continued research on a further volume of the official history of the Bank covering the period 1975–2000.

Professor Selwyn Cornish of the Australian National University was commisioned to write *The Evolution of Central Banking in Australia*

Charitable Activities

During the year the Reserve Bank made its eighth annual contribution of $50 000 to the Financial Markets Foundation for Children, of which the Governor is Chairman. In July 2010, in its fifth 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 two major initiatives: dollar-matching staff payroll deductions to the Reserve Bank Benevolent Fund; and donating the value of leave days given up by staff to work for charitable organisations under a Volunteer Day Program. In addition, in late 2009 the Bank matched the donations raised by Reserve Bank staff who participated in the 'Sydney to the Gong' charity bike ride. The Bank's contributions under these initiatives in 2009/10 totalled $60 550. The Bank also facilitates staff salary sacrificing under a Workplace Giving Program.

Reserve Bank staff interacted with the community in a number of volunteering capacities in the past year, including the Cancer Council's Biggest Morning Tea fundraiser, Oxfam's Trailwalker, the Starlight Children's Foundation Starlight Day and Foodbank's corporate volunteer program.

Management of the Reserve Bank

Operating Costs

Business initiatives in 2009/10 were mainly geared towards enhancing the Reserve Bank's banking and settlement systems and improving the quality and distribution of banknotes. The former involved building new network connections for the Community of Interest Network, including to RITS, upgrading SWIFT links and work on replacing the mainframe banking system. The latter contribution involved an additional program to improve the quality of banknotes in circulation and an extension of the distribution infrastructure in Sydney. The Bank also undertook work to enhance the general security of its IT systems and to modernise several human resources systems, making more staff-related services available electronically with the aim of increasing overall efficiency. New exhibition spaces were developed in the Currency Museum to display material of historical interest from the Bank's archives.

Some of the activities undertaken in 2008/09 in response to the global financial crisis were wound back as market conditions returned to normal. Guarantees under the Government Guarantee Scheme for Large Deposits and Wholesale Funding, which is administered by the Reserve Bank on behalf of Treasury, ceased to be issued for new borrowings in March 2010. Staff resources involved in these activities declined and leave taken returned to more usual levels. Nonetheless, the increased demands on the Reserve Bank from the crisis have led to a small permanent increase in staff numbers, mainly in areas associated with financial stability, but also in some support areas. More resources were also applied to monitoring and researching the economies of China and India.

In total, operating costs in 2009/10 rose by about 4.4 per cent over the prior year, to $224.9 million. More than half of these costs relate to the implementation of monetary and payments system policies, including financial market operations; about a quarter are associated with providing banking and settlement services, including the real-time interbank settlement system and transactional banking services for the Australian Government; and about 17 per cent of operating costs arise from issuing banknotes. A decade ago, policy functions accounted for around 40 per cent of the Bank's costs.

Staff costs continue to represent the single largest operating expense, accounting for about 60 per cent of costs in 2009/10. This year's increase in staff costs – which include remuneration, on-costs and other staff related costs – reflects a rise in base salaries of 4 per cent in November 2009 as well as an increase in staffing for core policy areas and project-related short-term contractors. Redundancies related to restructures to meet changing business requirements and to improve the efficiency of operations resulted in redundancy payments of $0.5 million.

Operating Costs[a]
$ million

	2005/06	2006/07	2007/08	2008/09	2009/10
Staff costs	101.0	110.2	119.1	132.6	141.6
Other costs	73.1	74.7	77.2	82.8	83.3
Underlying operating costs	174.1	184.9	196.3	215.4	224.9
Cost of redundancies	0.2	0.2	0.2	2.0	0.5

(a) Costs associated with the ongoing operation of the Reserve Bank, excluding NPA

Our People

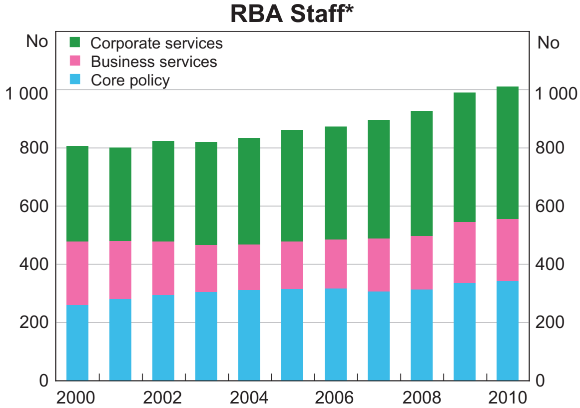
The Reserve Bank relies on talented people to meet its objectives, with employees undertaking research, analysing complex issues, managing the Bank's various operations and providing services. Given its reliance on people, the Bank aims to provide a superior and stimulating work environment.

Most of the Reserve Bank's 1 010 employees work at its Head Office and the Business Resumption Site in Sydney, while 5 per cent are located elsewhere in Australia – at the Bank's Canberra Branch, at Note Printing Australia in Craigieburn and in the State Offices in Adelaide, Brisbane, Melbourne and Perth. Staff in the State Offices assist in the Bank's monitoring of economic and financial developments across the country, liaise with individual firms and agencies in both the public and private sectors, and provide a vehicle for communicating the operation of monetary policy to the wider community. The Bank also maintains a presence in London and New York as part of its foreign exchange reserves management and financial market analysis.

Staff numbers rose by 21 people, or 2.1 per cent, over the year to 30 June. The increase was spread between core policy and support functions. In the core policy area, increased demands for participation in international efforts to deal with the global financial crisis and the associated participation of the Reserve Bank in bodies such as the Financial Stability Board, the Basel Committee on Banking Supervision and the Committee on Payment and Settlements Systems resulted in a small rise in staff numbers in the Bank's Financial System Group. The Bank also established a special Asian economies research unit to carry out more extensive and focused analysis of the Chinese and Indian economies. Staff numbers were boosted in the finance area of the Bank to better support the Bank's finance, risk and budget frameworks.

The Reserve Bank's single largest recruitment exercise continues to be the Graduate Development Program. The Program, which accounts for about one-third of new recruits to the Bank each year, is an important means of ensuring that the Bank can meet its objectives. Conducted over two years, the Program seeks to equip new graduates with the appropriate knowledge and skill set to contribute effectively to the output of the Bank. Thirty-nine graduates joined the Program this year, compared with 45 last year. The trend to a wider mix of disciplines continued, with one-third of the graduate recruits coming from fields other than economics and finance, such as law, accounting, information technology and science/engineering.

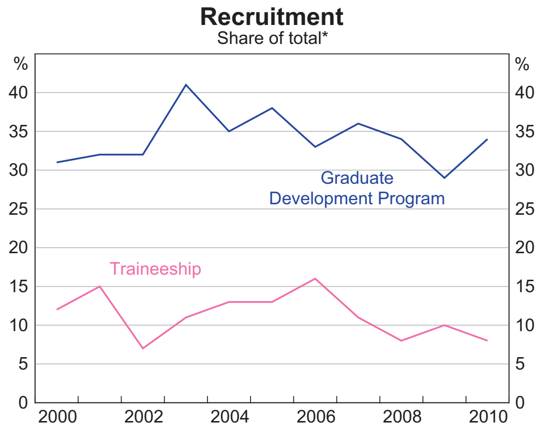
RBA Staff*



* As at 30 June, excludes NPA
Source: RBA

The Reserve Bank employed nine staff under the Federal Government's traineeship scheme, which assists people without post-secondary qualifications to enter the workforce and gain certification. An important aspect of the program is ensuring that the applicant pool includes individuals with disabilities and those from Aboriginal and Torres Strait Islander (ATSI) backgrounds. Since the commencement of the Bank's participation in the scheme in 1991, 28 ATSI recruits have participated in this training.

The Reserve Bank also recruits on a regular basis from the market. This tends to be for the support areas of the Bank to work on specific projects that require specialist knowledge or where a position cannot be filled internally. These people tend to have significant work experience and are mainly hired on fixed-term contracts, owing to the largely temporary nature of the work involved.



* As at 30 June, excludes NPA
Source: RBA

Reflecting its recruitment programs, the Reserve Bank is a relatively young organisation, with 70 per cent of staff currently younger than 45 years, compared with just under 60 per cent for other industries. Median tenure of staff has been steady for the past few years at around six years, though this is well down on the median tenure of 11 years at the beginning of the decade. Staff turnover this year was 10 per cent, a little higher than the previous year, which was affected by the global financial crisis, but in line with earlier years.

The Reserve Bank's remuneration package needs to be attractive to high-calibre and increasingly mobile employees. Individual contracts continue to provide flexibility in remuneration based on performance and market relativities and, for those who prefer, there is the option of remaining on the Bank's Workplace Agreement. The Agreement provided for a 4 per cent salary increase in 2009/10, with scope for a modest additional payment in recognition of good performance.

Consistent with its aim of providing a stimulating work environment, the Reserve Bank supports continuous professional development to ensure that new staff are adequately prepared for the work of the Bank, and that longer-tenured employees continue to improve their skills and knowledge. The support takes many forms, including on-the-job training, formal courses and further study. Forty-seven staff received financial support for further study during the year, including four who commenced full-time post-graduate study at overseas universities.

For a small number of staff, there is also the opportunity to work on attachment in other organisations. Within Australia, staff have been seconded in the past year to APRA, the Australian Securities Exchange, the Australian Treasury, the Productivity Commission and the Department of the Prime Minister and Cabinet. International attachments assist in directly exposing staff to the increasingly global context of the Reserve Bank's work and this year have involved secondments to the BIS, the IMF, the OECD and the Reserve Bank of Vanuatu. At the same time, the Bank has hosted secondees from the Australian Treasury and the Bank of England. The increasing need for competency in international arenas has led to increased demand within the Bank for cultural-awareness and language training for staff in relevant areas.

Facilities

The Reserve Bank owns premises in locations where there is a business need to do so, including its Head Office building in Sydney, a conference/training centre in Kirribilli, Sydney, office buildings in Melbourne and Canberra, the Note Printing Australia 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 demands for space are quite small.

The value of premises assets, which is appraised annually by external valuers, decreased by $24 million to $312 million in 2009/10, reflecting the widespread softening of the commercial property market in Australia. Surplus accommodation in premises owned by the Bank is leased to external tenants; gross income from these leases amounted to $7.8 million in 2009/10.

During the year, the Reserve Bank continued to strengthen the resilience of facilities supporting critical operations. At Head Office, this involved upgrading electrical and communications infrastructure and workspace to improve resilience and crisis response for the payments settlements function. In Victoria, electrical infrastructure upgrade works continued at the Craigieburn facility to enhance system resilience further and to meet the operational needs of Note Printing Australia.

Environmental Management

The Reserve Bank continues to develop initiatives to reduce costs and promote sustainable practices in its operations. During the year, building services were upgraded, leading to significant improvements in energy and water efficiency. At Head Office, this involved replacing the three original chillers with three multi-staged energy efficient chillers, and at the Melbourne Office replacing and upgrading the building management system to improve the control and efficiency of the air conditioning system. The Bank also continues to measure the impact of environmental initiatives, with the following results in 2009/10:

- a reduction in consumption of electricity of 4 per cent;
- a reduction in consumption of gas of 11 per cent;
- a reduction in consumption of water of 22 per cent, arising from the full-year effect of water recycling in the note-printing process combined with higher stormwater recovery at the Business Resumption Site;
- a reduction in consumption of paper per employee of 3 per cent, with 85 per cent of paper now 50/50 recycled, up from 75 per cent the previous year;
- fuel efficiency that remains well within the Australian Government's green guidelines for vehicle fleets; and
- 52 per cent of waste from the Bank's mainstream activities being recycled.

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. In 2009/10, the following consultancies were undertaken.

Consultancies[a]
2009/10

Consultant	Project	Cost ($)[b]	Purpose
Arup Pty Ltd	Handling of MEK at Securency	28 555	Make recommendations on safe handling of MEK at the Securency facility, Craigieburn, Victoria
Clayton Utz	Payments system reforms	20 805	Advice on possible undertakings by card schemes
Allens Arthur Robinson	Advice for the Council of Financial Regulators	11 330	RBA share of review of aspects of financial crisis management framework

(a) Costing $10 000 or more
(b) Excluding GST

Risk Management

Objectives and Governance Structure

The Reserve Bank manages a broad range of risks in carrying out its responsibilities as a central bank. The major risks flow from the financial assets held to underpin the Bank's operations in financial markets. The Bank also faces significant operational risks arising from banking and settlement transactions, and from the administration of the Bank itself. It is not possible to eliminate these risks; rather, the Bank's key risk management objective is to contain risk to a level that does not constrain the Bank from meeting its policy or business objectives.

The Reserve Bank's framework for managing risk involves identifying and assessing risks as well as implementing and reviewing the effectiveness of controls. Underpinning this framework is the principle that risk management is an integral part of each line manager's job. As such, the prime responsibility for controlling and mitigating risks on a day-to-day basis rests with managers of the various business areas within the organisation. Management also promotes an active risk management culture that emphasises the careful analysis and control of risk as a vital part of all business processes in the Bank.

Oversight of the Reserve Bank's arrangements for risk management rests with the Risk Management Committee. This is a committee of senior staff responsible for ensuring that all the risks facing the organisation, with the exception of those arising directly from decisions about monetary policy, are properly assessed and managed. It is chaired by the Deputy Governor and comprises the Assistant Governors for Banking & Payments, Corporate Services, Currency and Financial Markets; the Chief Financial Officer; the Heads of Audit and Risk Management; and the General Counsel and Deputy Secretary. It meets once every three months, or more frequently if needed, and informs the Reserve Bank Board's Audit Committee of its activities. The Risk Management Committee is assisted in its responsibilities by the Risk Management Unit (RMU), whose main role is to assist individual business areas to manage their risk environment within a broadly consistent framework across the organisation. The RMU also monitors risk and performance associated with the Bank's activities in financial markets, known as the middle office function.

Arrangements for managing risk are also supported by the Reserve Bank's Audit Department, which complements – but remains separate from – the work of the RMU. In addition to providing assurance that the 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. The RMU itself is subject to audit review. The Audit Department reports to the Board's Audit Committee.

As noted above, the Reserve Bank's risk management framework covers a broad spectrum of financial and operational risks, but not those inherent to the Bank's core monetary policy functions, which remain the responsibility of the Governor and the Board. The risks associated with the Bank's ownership of Note Printing Australia and Securency International are also covered by the framework, though the day-to-day activities of these entities are the responsibility of their management and respective Boards.

The sections below describe the various risks faced and associated management practices in more detail.

Portfolio Risks

The Reserve Bank holds domestic and foreign currency-denominated financial assets to support its operations in financial markets in pursuit of its policy objectives. The risks flowing from these holdings – of which the most significant are exchange rate, interest rate and credit risks – are managed by the Financial Markets Group. Responsibility for monitoring the risks, as well as the day-to-day compliance with the control framework surrounding the management of the assets, rests with the RMU, which provides compliance reports, and reports on portfolio performance and risks, to the Assistant Governor (Financial Markets), the Head of Risk Management and other senior staff on a daily basis.

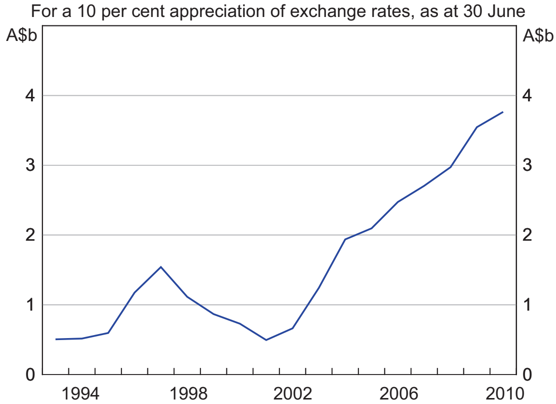
Exchange Rate Risk

The Reserve Bank's foreign currency-denominated assets – which form Australia's official foreign currency reserves – are exposed to exchange rate risk, i.e. a change in the value of the portfolio in response to movements in the Australian dollar. Unlike commercial banks, because of its policy role the Reserve Bank cannot hedge its exposure.

The level of the Reserve Bank's foreign currency risk is also determined by the size of the portfolio. Over the course of 2009/10, the size of the Bank's foreign portfolio rose in foreign currency terms because of a general allocation of Special Drawing Rights (SDRs) by the IMF to all its member countries in August 2009. SDRs are regarded by the IMF as a reserve asset, which can be sold to other member countries in exchange for foreign currency if needed. The allocation to member countries was one of a number of measures introduced by the IMF to boost global market liquidity. Australia's allocation is held on the Bank's balance sheet.

Exchange Rate Risk on RBA Foreign Currency Portfolio

For a 10 per cent appreciation of exchange rates, as at 30 June



Source: RBA

The exchange rate risk to which the Reserve Bank is exposed is mitigated to a degree by the diversification of foreign currency reserves across three highly liquid currencies – 45 per cent is held in US dollars, 45 per cent in euros and 10 per cent in Japanese yen. The portfolio is typically rebalanced to these shares each day in response to changes in market rates or transactions that the Bank undertakes for other purposes.

Overall, the exchange rate risk on the portfolio rose over the past year; at the current level of reserves, the potential valuation loss from a 10 per cent appreciation of the Australian dollar (on the basis of a weighted average of the currencies in the portfolio) would be around $3.8 billion.

Interest Rate Risk

The value of the Reserve Bank's financial assets is also subject to movements in market yields. Most of these assets are held as fixed-income securities, i.e. the stream of income is fixed over the term of the security. Consequently, a rise in market yields generates a fall in the value of these securities and a fall in yields results in an increase in their value. Securities held outright that have a longer maturity (or duration) face a higher potential loss from a given rise in market interest rates because the associated cashflows are fixed further into the future.

Domestic securities comprise around half of the Reserve Bank's portfolio of financial assets. These securities, which are highly rated, are held for policy-related purposes – specifically, to manage the demand for and supply of settlement balances in the banking system to ensure that the overnight cash rate remains close to its target level. During the course of 2009/10, the Bank's holdings of domestic securities varied primarily with movements in the Bank's liabilities. At the end of June 2010, total holdings of domestic securities were $37 billion, around $10 billion lower than a year earlier.

The interest rate risk associated with the domestic portfolio is small because the vast bulk of these securities is held under repurchase agreements (repos) with short terms to maturity. Although already fairly short, the average term to maturity of the Bank's domestic repos declined over 2009/10 as conditions in funding markets continued to recover from the effects of the global financial crisis. The average maturity of the Bank's repo holdings was 24 days at the end of June 2010, compared with around 90 days a year earlier.

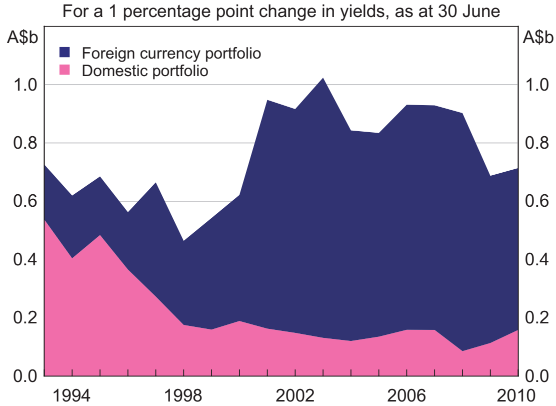
The Reserve Bank has little exposure to interest rate movements on its balance sheet obligations because of the unique nature of its liabilities. The largest liability is notes on issue, which carry no interest cost to the Bank. The most significant of the other liabilities are deposits held by the Australian Government and government agencies, and settlement balances held by authorised deposit-taking institutions (ADIs). These deposits have short maturities that broadly match those of the domestic assets, particularly those held as repos, and the interest paid on these deposits reflects domestic short-term rates. In short, the interest rate exposure on the Bank's liabilities is low and largely offset by the exposure of its domestic assets.

In contrast to the domestic asset portfolio, the interest rate risk on the foreign portfolio is managed against a benchmark specified in terms of portfolio duration and which reflects the Reserve Bank's appetite for risk and return. The different approaches to the two portfolios reflect different portfolio objectives – the domestic portfolio is held for domestic policy purposes while the Bank's foreign currency assets are held to provide capacity for intervention in the foreign exchange market. The Bank seeks a market-based return on its foreign holdings subject to high degrees of security and liquidity. The benchmark duration is 18 months for each of the three foreign portfolios (US dollar, euro and Japanese yen).

Taking the domestic and foreign assets together, the interest rate risk on the Reserve Bank's assets rose only slightly over the year. The Bank would record a valuation loss of around $700 million if interest rates in Australia and overseas rose uniformly by 1 percentage point across the yield curve.

Interest Rate Risk on RBA Portfolio

For a 1 percentage point change in yields, as at 30 June



Source: RBA

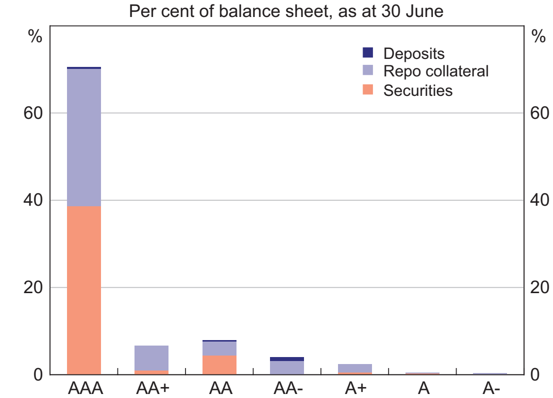
Credit risk

The Reserve Bank minimises its credit exposure by applying a set of strict criteria to its investments. These primarily involve dealing in highly rated assets and with highly rated counterparties. Also, where appropriate, the Bank's transactions are executed in terms of internationally recognised legal agreements.

In the domestic portfolio, securities held outright are limited to those issued by the Australian Government or by State and Territory government borrowing authorities. As mentioned above, a significant proportion of the Bank's domestic portfolio consists of securities held under repo.

Credit Exposure

Per cent of balance sheet, as at 30 June



Source: RBA

Foreign Currency Credit Exposures

Total risk-weighted exposures

Source: RBA

The Reserve Bank is exposed to some credit risk on its repos, which comprise the bulk of the domestic portfolio. However, the credit risk on repos is inherently limited and ultimately reflects the quality and market value of the collateral provided – the Bank would face a potential loss if a counterparty failed to repurchase securities sold under repo and the market value of the securities was less than the value of the initial cash consideration. The Bank manages this risk by requiring that repo collateral is of high quality and by applying a margin (or 'haircut') to the securities it is willing to accept. The haircut is generally set at 2 per cent for government-backed securities and other securities regarded as 'general collateral', but up to 10 per cent for some long-dated privately issued securities. The degree of collateralisation is monitored daily by the RMU and advice is given to the Bank's front-office dealers when a margin call is required to maintain the degree of over-cover.

The composition of the domestic securities that the Bank holds under repo changed during 2009/10 (see the chapter on 'Operations in Financial Markets' for more details). Holdings of residential mortgage-backed securities, for example, fell from around 60 per cent of the Bank's collateral pool at the start of the financial year to around 10 per cent in June 2010. For the most part, these were replaced by government securities.

The Reserve Bank's counterparties for domestic operations include a broad range of bank and non-bank financial institutions. Since these operations are conducted for policy purposes, the Bank does not explicitly assign a minimum credit rating to counterparties with which it is prepared to deal. Nevertheless, counterparties must be co-signatories with the Reserve Bank to the legal documentation underpinning repos and be able to settle transactions in a timely and efficient manner within the Austraclear system. Maintaining a high credit quality for collateral and imposing a suitable haircut on transactions are other measures used to manage counterparty credit risk in the domestic portfolio.

As with the domestic portfolio, the Reserve Bank's investments in the foreign portfolio are mostly limited to highly rated securities. Outright holdings are concentrated in liquid securities issued by the national governments of the United States, Germany, France, the Netherlands and Japan. The foreign asset portfolio also contains modest holdings of securities issued by select AAA-rated supranational institutions, US agencies and foreign government-guaranteed securities.

The Reserve Bank also invests a small portion of its foreign portfolio in short-term cash, primarily as repos and commercial bank deposits. These instruments expose the Bank to a degree of credit risk, which is managed through a combination of measures that restrict investments to highly rated counterparties. Specifically: deposits are placed only with commercial banks with a credit rating of no lower than AA-; repos are undertaken only with counterparties rated at least BBB+; and foreign exchange transactions are executed only with counterparties rated at least A-. The lower minimum credit ratings for repos and foreign exchange transactions reflect the lower risk profiles inherent in dealing in these instruments. Overlaying this framework is a limit that restricts the total value of commercial bank deposits to no more than 10 per cent of the foreign currency portfolio and a limit on the overall exposure to individual counterparties based on their capital base.

With no major changes to the credit management framework during 2009/10, there was little material change in the Reserve Bank's credit exposure on the foreign portfolio and little change in the overall credit quality of the Bank's assets. The majority are rated AA- or higher.

Operational Risk

The operational risks faced by the Reserve Bank in carrying out its day-to-day responsibilities range from the possibility that access to key financial infrastructure is lost, to the possibility that work in any of its activities is not completed properly owing to insufficient or poorly trained staff. The Bank also faces security risks, both IT and physical, because of the sensitive nature and strategic importance of the information with which it deals, and because of the value of the assets it holds.

A significant operational risk facing any financial institution is that its staff may engage in fraud or undertake unauthorised transactions, exposing the institution to significant financial loss or reputational damage. The Reserve Bank has a number of measures in place to manage this risk. These include having a clear decision-making hierarchy, with all staff involved in financial dealing having well-defined limits to their authority to take risks or otherwise commit the Bank, and controls over computer access at both the user and administrator levels. These arrangements are further enhanced by independent front, middle and back-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 within the organisation.

The Reserve Bank's employee Code of Conduct is a key document that sets out the standard of integrity and propriety expected of staff in carrying out their duties. Also important is the Bank's Fraud Control Policy and arrangements by which suspected suspicious behaviour can be reported anonymously. This policy is regularly reviewed to ensure that it remains up to date and staff are periodically reminded of the arrangements for reporting suspicious behaviour. In addition, all Bank staff have access to fraud-awareness training, with those in key dealing and procurement-related positions given regular face-to-face training by forensic professionals from a major auditing firm.

Operational risks also arise in the Reserve Bank's Financial Markets Group from the large number of transactions undertaken each day and because dealing arrangements change from time to time to reflect changes in market conditions. Some 62 000 transactions were undertaken in 2009/10, generating average daily settlement flows of around $31 billion. These figures are a little lower than the corresponding numbers for the previous financial year, with much of the decrease reflecting lower volumes of repos in the foreign portfolio. The risks associated with such a large volume of transactions are managed by ensuring that systems and processes are efficient and robust. Consistent with this, the Bank has an on-going program of development work for systems used in monitoring and managing its financial market transactions; the Bank is currently upgrading the system for managing its foreign currency benchmark portfolios. This work is typically carried out under standard guidelines for project management, with all new hardware and newly developed software, and their links to existing management systems, thoroughly tested before entering production.

The pivotal position of the Reserve Bank in the financial system means that operational risks associated with providing services to clients or market participants are especially significant because any failure could have widespread consequences. The Reserve Bank is the main banker for a number of government agencies – including the Australian Taxation Office, Medicare Australia and Centrelink. It also provides real-time interbank payment and settlement services through RITS. The Bank invests significant resources to ensure that its banking and settlement systems are robust and have sufficient capacity to perform their critical roles. Recent improvements and system upgrades are discussed in the chapter on 'Banking and Payments'.

The Reserve Bank has extensive back-up plans and capacity to ensure that its critical business services can continue efficiently and reliably if access to Head Office facilities and IT systems is lost. The centrepiece of these arrangements is the Bank's Business Resumption Site located north-west of the Sydney metropolitan area. Some staff are based permanently at the site to ensure that a number of critical services can be maintained if Head Office is unexpectedly inaccessible. Business areas within the Bank regularly test their back-up arrangements at the site – some 30 tests were undertaken over the course of 2009/10. In addition, a large-scale test of systems, involving staff from all the Bank's departments, is conducted at the site twice a year. The results of the tests are monitored by the Risk Management Committee.

Despite strong controls and a good risk management culture, operational failures occur from time to time, which can adversely affect the Reserve Bank's reputation or lead to other costs. These failures are reported in a timely way to the Risk Management Committee and monitored to identify areas where new controls may be needed or where existing controls should be strengthened.

Government Guarantee Scheme

The Reserve Bank has administered the Guarantee Scheme for Large Deposits and Wholesale Funding since it was introduced in late 2008 as part of the Australian Government's response to the global financial crisis. The Bank's primary responsibilities have been to process applications for guarantees from ADIs, issue guarantee certificates to successful applicants and process monthly fee payments.

As conditions in global financial markets improved during the first half of 2009/10, interest by ADIs in accessing the Scheme tapered off and by early 2010 the number of applications for guarantees had largely dried up. In response, the Government closed the Scheme to new liabilities in March 2010. Given the term of the guarantees, the Reserve Bank will continue to have an administrative role in collecting guarantee fees for a few more years. Fees paid to the Government since the Scheme commenced amounted to $1.7 billion by June 2010, of which a little under $1.3 billion was processed in the 2009/10 financial year. In the absence of new applications, however, the work involved in the Scheme's administration declined and, as a result, staff resources in the area were scaled back. Total liabilities guaranteed under the Scheme also began to fall. In June 2010, they amounted to $160 billion, around $10 billion below their peak in January 2010.

Earnings and Distribution

The Reserve Bank holds assets to carry out its policy and operational responsibilities. Over the past year, these assets amounted to about $88 billion, on average. The portfolio of domestic securities, primarily repurchase agreements, is used to conduct market operations and manage domestic liquidity. The portfolio of foreign securities represents Australia's foreign reserves, which are invested mainly in highly rated securities. The Bank operates in the foreign exchange market on behalf of its customers and to manage these foreign reserves. The main counterparts to these assets are capital, liabilities from issuing banknotes in Australia and deposits of the Australian Government.

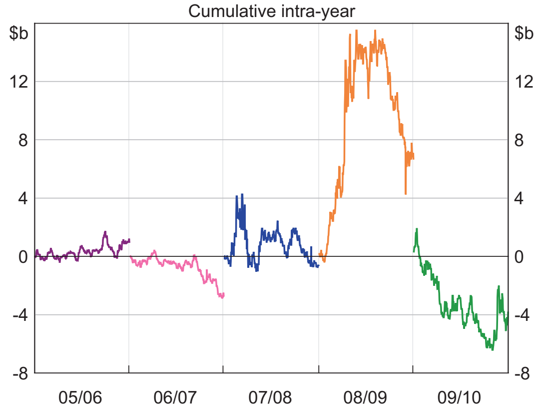
Reflecting the structure of its balance sheet, the Reserve Bank has two general sources of earnings: underlying earnings and valuation gains and losses. Underlying earnings are composed of the Bank's net interest earnings plus small sums of other revenue, less its operating costs. Underlying earnings are usually substantial because the Bank earns market rates of interest on most of its assets but pays no interest on banknotes or capital (which together account for about 70 per cent of the balance sheet). The second component of earnings, namely valuation gains and losses, arises because the value of the Bank's financial assets changes according to movements in the exchange rate and market interest rates. An appreciation of the exchange rate results in valuation losses, as foreign assets are worth less in Australian dollars; an exchange rate depreciation leads to valuation gains. In the case of securities, a decline in market yields increases security prices, producing valuation gains; a rise in yields results in losses. Gains and losses are realised only when the Bank sells the relevant asset; until then they remain unrealised.

The variability in gains and losses associated with fluctuations in exchange rates and security yields is a reflection of the market risk faced by the Reserve Bank. As the Bank's assets are held essentially for policy purposes, however, it has no scope to manage foreign exchange risk and only limited discretion to manage interest rate risk. As discussed elsewhere in this Annual Report, these market risks are large and can produce marked swings in earnings through the year and from year to year.

Since the Reserve Bank is constrained in managing market risk, it inevitably records valuation losses when the exchange rate appreciates or bond yields rise. This has important consequences for the Bank's earnings, measured either by the yardstick of accounting profits, as determined by the accounting standards, or in terms of earnings that are available for distribution under section 30 of the *Reserve Bank Act 1959*. Under the relevant accounting standards – Australian equivalents to International Financial Reporting Standards (AIFRS) – disclosed profits include earnings from all sources, namely underlying earnings and all valuation gains or losses, whether realised or unrealised. On the distribution of net profit, the Reserve Bank Act determines that

Valuation Gains and Losses

Cumulative intra-year



Source: RBA

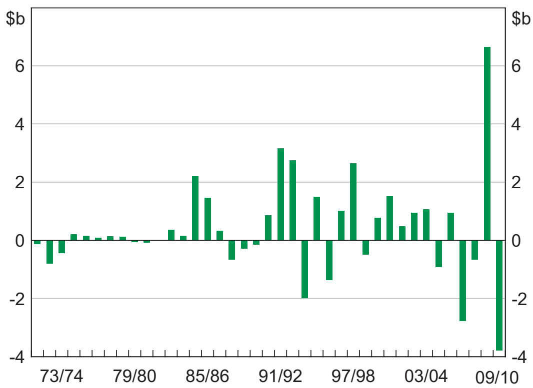
Reserves-weighted Exchange Rate*

30 June 2008 = 100

* Australian dollar exchange rate weighted by composition of the RBA's foreign reserves

Source: RBA

Valuation Gains and Losses



Source: RBA

unrealised gains are not distributed, but 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, also taken to the Unrealised Profits Reserve and charged against the unrealised gains retained from previous years. This distribution framework accords with sound central banking practice, as it ensures that the Bank's capacity to absorb valuation losses, when they occur, is not compromised by the previous distribution of unrealised gains.

If unrealised losses exceed the balance of the Unrealised Profits Reserve, the amount by which they do so is initially charged against other sources of income – underlying earnings and realised gains. Any such charge would reduce the earnings available to be paid as a dividend by a corresponding amount. If such a charge exhausted these resources, it would be necessary to absorb the remaining loss in the Reserve Bank Reserve Fund (RBRF), the Bank's permanent general reserve. In this case, no dividend would be payable.

Following the very large gains in the previous year, when the exchange rate fell, the Reserve Bank incurred valuation losses in 2009/10 as the exchange rate recovered. These losses were partly absorbed by underlying earnings and earlier unrealised gains, and partly by a reduction in the RBRF.

The Reserve Bank's Earnings

The Reserve Bank recorded an accounting loss of $2 928 million, following the unusually large profit of $8 806 million in the previous year. The components of the loss in 2009/10 were:

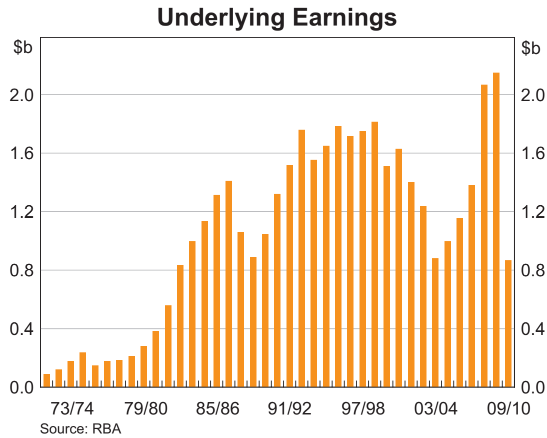
- Underlying earnings of $866 million, $1 284 million less than in 2008/09 as interest rates around the world were, on average, lower than in the previous year and the appreciation of the exchange rate meant that foreign interest earnings were worth less in Australian dollar terms. At this level, underlying earnings were lower than had been the case since 1982/83.
- Realised valuation losses of $128 million, comprising losses on foreign exchange of $358 million, partially offset by gains of $190 million realised on the sale of foreign securities and of $40 million on domestic securities.
- Unrealised valuation losses of $3 666 million, reflecting an appreciation of 12 per cent in a measure of the exchange rate weighted by the composition of Australia's international reserves.

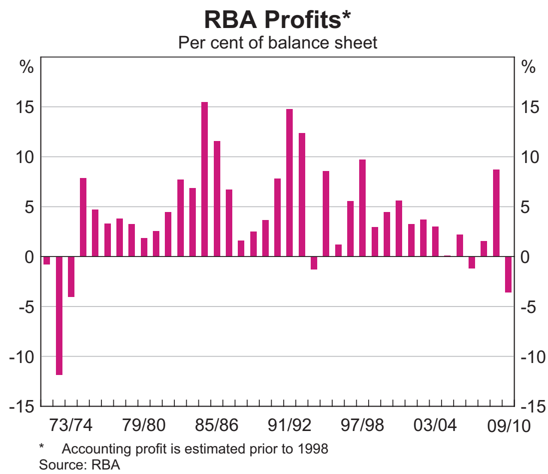
The net accounting loss was absorbed by:

- a transfer of \$2 248 million from the Unrealised Profits Reserve, which exhausted the balance of this reserve; and
- a transfer of \$680 million from the RBRF.

Reflecting these results, no dividend is payable to the Australian Government from the Reserve Bank's profits in 2009/10. However, the sum of \$750 million, deferred from the dividend payable in 2009/10 and as such a liability of the Bank, was paid to the Government in August 2010.

The composition and distribution of the loss in 2009/10, and of the profit or loss in earlier years, is summarised in the table on page 58.





The Reserve Bank Reserve Fund and Other Reserves

The transfer from the RBRF in 2009/10 is consistent with the purpose of this reserve and the policy of the Reserve Bank Board towards it. In making the transfer from the RBRF, the Board took account of a number of considerations. In particular, the RBRF is a permanent reserve, established by section 29 of the Reserve Bank Act as a 'reserve fund', built up by transfers from earnings over the years to provide for exceptionally large losses in the value of the Bank's assets that cannot be absorbed by the Bank's other available resources. The other available resources – namely, the balance in the Unrealised Profits Reserve and underlying earnings – were exhausted in absorbing the valuation loss in 2009/10. Further, while the Board's policy is to hold a balance in the RBRF at a benchmark ratio to the risk held on the balance sheet, this ratio is regarded as a target, not a minimum requirement, consistent with the RBRF remaining available to absorb losses when necessary. The Board has pursued its policy towards the RBRF for a number of years in anticipation that a large valuation loss was likely to occur at some point, given the constraints faced by the Bank in managing market risk on its assets in a floating exchange rate environment.

Since the transfer of \$680 million from the RBRF in 2009/10 has reduced the balance of this reserve to \$6 183 million, a level modestly below that which the Board regards as desirable in the long term, the Board will seek to replenish the reserve from earnings in future years. Consistent with the Reserve Bank Act, such transfers to the RBRF are determined by the Treasurer in consultation with the Board. The loss taken to the RBRF in the latest year is slightly larger than the transfer of \$577 million to this reserve from earnings in 2008/09.

Composition and Distribution of Reserve Bank Profits

$ million

	Composition of Profits				Distribution of Profits				Payments to Government		
					Transfer to/from(–)						
	Underlying earnings	Realised gains and losses(–)*	Unrealised gains and losses(–)	Accounting profit or loss(–)	Unrealised Profits Reserve	Asset revaluation reserves	Reserve Bank Reserve Fund	Dividend payable	Payment from previous year's profit	Payment delayed from previous year	Total payment
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	..	..	..	..	..	..	..	..	–	750	750

* Excludes gains or losses realised from the sale of fixed assets that had been held in asset revaluation reserves

Source: RBA

As noted above, a component of the unrealised loss in 2009/10, amounting to $2 248 million, was absorbed in the Unrealised Profits Reserve, so that the balance of this reserve was nil at 30 June. As with the transfer from the RBRF, this transfer is consistent with the Reserve Bank Act and in line with the purpose of this reserve.

In addition to these reserves, the Reserve Bank holds balances in asset revaluation reserves, which, although not available to absorb losses, do count towards its net worth. These reserves reflect valuation gains on non-traded assets. The balance in these reserves at 30 June 2010 totalled $4 087 million, $779 million higher than a year earlier. The main factor was the increase in the Australian dollar value of the Bank's holdings of gold.

The balance of the RBRF plus asset revaluation reserves stood at 12 per cent of total assets on 30 June 2010.

The Reserve Bank's financial statements (and accompanying Notes to the Accounts) are prepared in accordance with AIFRS, consistent with the Finance Minister's Orders issued under the *Commonwealth Authorities and Companies Act 1997*.

Statutory 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 and Diversity Annual Report 2009, which reviews the Bank's diversity profile, the take-up of existing policies and progress with the program, was tabled on 21 October 2009.

The Reserve Bank aims to ensure that all staff are treated with dignity and respect in the workplace, and experience equal opportunity throughout their careers with the Bank. This commitment is underpinned by a Diversity Program comprising two elements: the Bank's existing policies and processes, which aim to embed equity and diversity principles in work practices; and new diversity initiatives that the Bank supports over the near term, as outlined in the Bank's Diversity Plan 2009–2011. The Program is governed by the Bank's Equity & Diversity Policy Committee, a consultative body responsible for monitoring the development and implementation of equity and diversity initiatives, policies and practices.

During the year, the Reserve Bank continued to work on initiatives outlined in the Diversity Plan 2009–2011. A major focus this year was on gender-based employment trends at the Bank. A number of initiatives were introduced that are designed to ensure that the Bank provides a superior work environment and that women are not disadvantaged. The Bank continued to support an employer-sponsored childcare facility for its staff. During the period the Bank also developed a number of new online training modules on workplace behaviour and accessibility, which are being made available to all staff. Full details of the equity and diversity program will be included in the Bank's Equity & Diversity Annual Report 2010, which is scheduled to be tabled in Parliament later this year.

Health and Safety, Compensation and Rehabilitation

The Reserve Bank is required, in terms of the *Occupational Health and Safety Act 1991* and the conditions of its licence as a Licensed Authority under the *Safety, Rehabilitation and Compensation Act 1988*, to report each year on matters of health and safety, workers' compensation and rehabilitation as they affect the Bank.

The Reserve Bank is committed to the safety, health and well being of its employees, contractors and visitors. The focus of the Bank's activities this year was on educating management on contemporary occupational health and safety issues, the prevention of injuries and continuous improvement in the Bank's work practices. A new online training module on occupational health and safety was introduced and made available to all staff. The Bank also continued to promote its Health & Well Being Program, which is designed to promote the physical and psychological health of employees. This is achieved through the implementation of evidence-based initiatives targeted at occupational health and safety risks, attitudinal and behavioural change, and the provision of a supportive and safe workplace environment.

The Reserve Bank's Health & Safety Management Arrangements were updated following consultation with staff, the Reserve Bank Health & Safety Committee, Comcare and the Finance Sector Union. Two additional Health & Safety Representatives were appointed to the Health & Safety Committee to ensure a wider coverage of designated workgroups.

During the year there were 45 work-related incidents, which resulted in eight claims for workers' compensation, predominantly related to lunch-time sporting injuries, compared with 47 incidents and 10 claims in the previous financial year. There were no dangerous occurrences requiring notification to Comcare.

The Reserve Bank's strong track record in all aspects of occupational health and safety, and compliance with the relevant legislation and the Bank's Conditions of Licence, was confirmed by external audits of the Bank and strong performance against Commission benchmarks. The Safety, Rehabilitation and Compensation Commission confirmed the Bank's highest possible rating for its prevention, claims management and rehabilitation practices during the year.

Freedom of Information

Section 8 Statement

Organisation and functions: The Reserve Bank of Australia is Australia's central bank. In 1911, legislation established the Commonwealth Bank of Australia, which undertook central banking functions. In 1959 this original body corporate was preserved as the Reserve Bank of Australia in legislation, specifically to carry on the central banking functions; at that time, the commercial and savings banking functions were transferred to a new institution, which carried on the old name of Commonwealth Bank of Australia. The Reserve Bank's functions, powers and responsibilities are specified in the *Reserve Bank Act 1959*, the *Banking Act 1959*, the *Commonwealth Authorities and Companies Act 1997*, the *Payment Systems (Regulation) Act 1998*, the *Payment Systems and Netting Act 1998*, the *Corporations Act 2001* and the *Financial Services Reform Act 2001*, and in Regulations made under those Acts. An overview of the structure of the Bank is provided in the organisational chart, which appears on pages 110 and 111.

Categories of documents: The Reserve Bank publishes speeches, reports, articles, conference volumes, information booklets, minutes of the monetary policy meetings of the Reserve Bank Board, media releases, statistical data and various other documents. These are available on the Bank's website (www.rba.gov.au), which also provides other information about the Bank. Until December 2009, the Bank published a monthly statistical bulletin that included speeches, reports, media releases, articles of interest and updated series of statistical data maintained by the Bank. As the Bank's website evolved to become the principal means by which users access these statistical data, it was decided that production of these series in hardcopy form was a duplication of more up-to-date data readily available on the website. As a result, since the start of 2010 the *Bulletin* has been published quarterly and no longer contains statistical data. Other documents are held in the form of working notes and files covering policy and operational matters, statistical data, personnel, premises and general administration.

The right of access to documents in the possession of Australian Government agencies in terms of the *Freedom of Information Act 1982* (FOI Act) applies to the Reserve Bank. However, the Bank is an exempt agency under the FOI Act in respect of documents concerning banking operations (including individual open market operations and foreign exchange dealings) and exchange control matters.

Facilities for access and Freedom of Information procedures: Enquiries under the FOI Act, including requests for access to documents, should be directed to the Secretary of the Reserve Bank. Applications should be accompanied by the application fee (currently $30). Facilities to inspect documents to which access has been granted are available.

Section 93 Statement

Four requests for access to documents under the FOI Act were received in 2009/10. Access was granted in part in response to one request and no relevant documents were found in response to one request. One request was in relation to a document that was deemed not to be a document of the agency in terms of the Act. The applicant on that occasion requested an internal review of the decision, whereby the original decision was reaffirmed. One request, which was received towards the end of the financial year, had not been finalised at the end of June 2010. A request that was outstanding at the end of the 2008/09 financial year was finalised, with several documents released in full and others withheld in accordance with provisions of the Act.

The estimated number of staff hours spent dealing with all aspects of FOI requests in 2009/10 was around 77.5 hours. The total cost to the Reserve Bank of administering the FOI Act in 2009/10, including legal fees, is estimated to have been about $35 600, compared with $70 300 in 2008/09. Application fees of $160 were collected; no additional charges were levied.

Financial Statements

For the year ended 30 June 2010

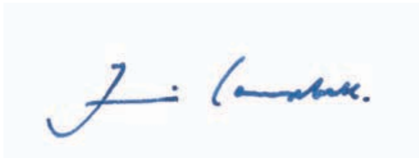
Directors' Statement

In the opinion of the directors, the financial statements for the year ended 30 June 2010 give a true and fair view of the matters required by the Finance Minister's Orders 2009-2010 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

Chairman, Reserve Bank Board

16 August 2010



Frank Campbell

Assistant Governor (Corporate Services)

Balance Sheet – As at 30 June 2010

Reserve Bank of Australia and Controlled Entities

	Note	2010 $M	2009 $M
Assets			
Cash and cash equivalents	6	852	772
Australian dollar securities	1(b), 15	36 972	47 125
Foreign exchange	1(b), 15	43 096	51 156
Gold	1(c), 15	3 747	2 957
Property, plant and equipment	1(d), 8	449	443
Loans, advances and other	7	536	513
Total Assets		85 652	102 966
Liabilities			
Deposits	1(b), 9	20 987	34 266
Distribution payable to Australian Government	1(f), 3	750	5 977
Other	10	4 762	2 093
Australian notes on issue	1(b), 15	48 759	48 087
Total Liabilities		75 258	90 423
Net Assets		10 394	12 543
Capital and Reserves			
Reserves:			
Unrealised profits reserves	1(e), 5	84	2 332
Asset revaluation reserves	1(e), 5	4 087	3 308
Reserve Bank Reserve Fund	1(e), 5	6 183	6 863
Capital	1(e)	40	40
Total Capital and Reserves		10 394	12 543

These Financial Statements should be read in conjunction with the accompanying notes.

Statement of Comprehensive Income – For the year ended 30 June 2010

Reserve Bank of Australia and Controlled Entities

	Note	2010 $M	2009 $M
Income			
Interest revenue	2	1 994	4 401
Net gains on securities and foreign exchange	2	–	6 640
Dividend revenue	2	11	5
Fees and commissions	2	20	21
Other revenue	2	69	70
Total Income		2 094	11 137
Expenses			
Interest expense	2	918	2 040
Net losses on securities and foreign exchange	2	3 782	–
General administrative expenses	2	282	250
Other expenses	2	40	41
Total Expenses		5 022	2 331
Net Profit		(2 928)	8 806
Other Comprehensive Income			
Gains/(losses) on:			
Gold	5	790	475
Shares in international and other institutions	5	10	49
Properties	5	(21)	(23)
Total Other Comprehensive Income		779	501
Total Comprehensive Income		(2 149)	9 307

These Financial Statements should be read in conjunction with the accompanying notes.

Statement of Distribution – For the year ended 30 June 2010

Reserve Bank of Australia and Controlled Entities

	Note	2010 $M	2009 $M
Net Profit		(2 928)	8 806
Distributed as follows:			
Unrealised gains transferred to/ (from) Unrealised profits reserves	5	(2 248)	2 252
Transfer to/(from) Reserve Bank Reserve Fund	5	(680)	577
Payable to the Australian Government	3	–	5 977
		(2 928)	8 806

These Financial Statements should be read in conjunction with the accompanying notes.

Statement of Changes in Capital and Reserves – For the year ended 30 June 2010

Reserve Bank of Australia and Controlled Entities

	Note	Asset Revaluation Reserves $M	Unrealised Profits Reserves $M	Reserve Bank Reserve Fund $M	Capital $M	Earnings Available for Distribution $M	Total Capital and Reserves $M
Balance as at 30 June 2008		2 807	80	6 286	40	–	9 213
Plus:							
Net Profit	2	–	2 252	577		5 977	8 806
Gains/(losses) on:							
Gold	5	475					475
Shares in international and other institutions	5	49					49
Properties	5	(23)					(23)
Other comprehensive income		501					501
Total comprehensive income for 2008/09							9 307
Less:							
Transfer to the distribution payable to Australian Government	3	–	–	–		(5 977)	(5 977)
Balance as at 30 June 2009		3 308	2 332	6 863	40	–	12 543
Plus:							
Net Profit	2	–	(2 248)	(680)		–	(2 928)
Gains/(losses) on:							
Gold	5	790					790
Shares in international and other institutions	5	10					10
Properties	5	(21)					(21)
Other comprehensive income		779					779
Total comprehensive income for 2009/10							(2 149)
Less:							
Transfer to the distribution payable to Australian Government	3	–	–	–		–	–
Balance as at 30 June 2010		4 087	84	6 183	40	–	10 394

These Financial Statements should be read in conjunction with the accompanying notes.

Cash Flow Statement – For the year ended 30 June 2010

Reserve Bank of Australia and Controlled Entities

This statement meets the requirements of AASB 107 – *Cash Flow Statements* and the Finance Minister's Orders 2009-2010. In the RBA's view, due to the nature of central banking activities, this statement does not shed additional light on the RBA's financial results. For the purpose of this statement, cash includes the notes and coins held at the Reserve Bank and overnight settlements balances due from other banks.

	2010 Inflow/ (outflow) $M	2009 Inflow/ (outflow) $M
Cash flows from operating activities		
Interest received on investments	2 498	4 040
Interest received on loans, advances, and on net overnight settlements balances	27	38
Loan management reimbursement	1	1
Banking service fees received	20	20
Dividends received	11	5
Rents received	9	9
Net payments for and proceeds from investments	16 559	(1 824)
Interest paid on deposit liabilities	(808)	(1 784)
Interest paid on currency note holdings of banks	(104)	(167)
Staff costs (including redundancy)	(167)	(142)
Property, plant and equipment	(37)	(37)
Other	(25)	(32)
Net cash provided by operating activities	17 984	127
Cash flows from investment activities		
Net expenditure on property, plant and equipment	(56)	(34)
Net cash used in investment activities	(56)	(34)
Cash flows from financing activities		
Profit payment to Australian Government	(5 227)	(1 403)
Net movement in deposit liabilities	(13 279)	(4 740)
Net movement in loans and advances	1	2
Net movement in notes on issue	672	6 023
Other	(15)	(65)
Net cash used in financing activities	(17 848)	(183)
Net increase/(decrease) in cash	80	(90)
Cash at beginning of financial year	772	862
Cash at end of financial year	852	772

These Financial Statements should be read in conjunction with the accompanying notes.

Cash Flow Statement (continued) – For the year ended 30 June 2010

Reserve Bank of Australia and Controlled Entities

Reconciliation of Cash	Note	2010 $M	2009 $M
Cash		8	29
Overnight settlements systems	6	844	743
		852	772

Reconciliation of net cash provided by operating activities to Net Profits in terms of the *Reserve Bank Act 1959*	Note	2010 $M	2009 $M
Net Profit		(2 928)	8 806
Increase/(decrease) in interest payable		(7)	(39)
Net loss/(gain) on overseas investments	2	(416)	(1 469)
Net loss/(gain) on Australian dollar securities	2	(75)	(142)
Net loss/(gain) on foreign currency	2	4 273	(5 029)
Decrease/(increase) in income accrued on investments		544	(190)
Depreciation of property	8	9	9
Depreciation of plant and equipment	8	17	14
Net payments for and proceeds from investments		16 559	(1 824)
Other		8	(9)
Net cash provided by operating activities		17 984	127

These Financial Statements should be read in conjunction with the accompanying notes.

Notes to and Forming Part of the Financial Statements – 30 June 2010

Reserve Bank of Australia and Controlled Entities

Note 1 – Accounting Policies

The Reserve Bank of Australia (RBA) reports its financial statements in accordance with the *Reserve Bank Act 1959* and the *Commonwealth Authorities and Companies (CAC) Act 1997*. These financial statements for the year ended 30 June 2010 have been prepared under Australian equivalents to International Financial Reporting Standards (AIFRS), other accounting standards and accounting interpretations issued by the Australian Accounting Standards Board, in accordance with the Finance Minister's Orders (FMOs) 2009–2010, which are issued pursuant to the *CAC Act 1997*. These financial statements comply fully with International Financial Reporting Standards. The RBA has not sought any exemptions from the requirements of the FMOs in 2009/10. 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 2010.

These financial statements and attached notes are a general purpose financial report prepared in accordance with relevant AIFRS. Elections as to the accounting treatment under AIFRS made by the Bank are noted appropriately. All amounts are expressed in Australian dollars 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 for the RBA's major assets, including domestic and foreign marketable securities, gold and foreign currency, as well as for properties, 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 Board of the Reserve Bank of Australia on 3 August 2010.

(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

Note Printing Australia Limited was incorporated as a wholly-owned subsidiary of the RBA on 1 July 1998, with an initial capital of $20 000 000. 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 capital as at 30 June 2010 were $129.9 million, $20.2 million and $109.7 million respectively ($103.0 million, $22.6 million and $80.4 million as at 30 June 2009).

The assets, liabilities and results of NPA have been consolidated with the parent entity accounts in accordance with AASB 127 – *Consolidated and Separate Financial Statements*. All internal transactions and balances have been eliminated on consolidation.

Securency

The RBA equity accounts for its investment in Securency International Pty Ltd in accordance with AASB 131 – *Interests in Joint Ventures* as the Bank and its partner have joint control of the company. The RBA's investment in Securency International Pty Ltd is included in Note 7.

(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, bank deposits, interest rate futures, foreign currency swap contracts, gold loans, cash and cash equivalents, notes on issue, deposit liabilities and its shareholding in the Bank for International Settlements. 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.*

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 these securities in the Statement of Comprehensive Income and the Balance Sheet on the date these transactions are arranged (not when the transactions 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 selected Australian dollar domestic residential and commercial mortgage-backed securities, asset-backed commercial paper and corporate securities.

Domestic securities, except those held under buy repurchase agreements, are classified under AASB 139 as 'at fair value through profit or loss', as they are held for purposes 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 1959* (Note 1 (f)). Interest earned on the 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 of the securities. 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 and Japan) and bank deposits (with highly-rated international banks, central banks and international agencies). The RBA engages in interest rate futures and foreign currency swaps.

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 1959* (Note 1 (f)). 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 comprise coupon and discount securities. Coupon securities have biannual or annual interest payments depending on the currency and type of security; the principal of these securities 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 of the securities. The face value is received at maturity. Foreign securities, except those held under buy repurchase agreements, are classified under AASB 139 as 'at fair value through profit or loss', as they are held for trading in the course of 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 1959* (Note 1 (f)). Interest earned on securities is accrued over the term of the security as revenue in the Statement of Comprehensive Income.

Foreign bank deposits

The RBA invests part of its foreign currency reserves in deposits with highly-rated international banks; it also maintains working accounts in foreign currencies. 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).

Buy repurchase agreements

In the course of its financial market operations, the RBA engages in repurchase agreements involving foreign and Australian dollar marketable securities. Securities purchased and contracted for sale under buy repurchase agreements are classified under AASB 139 as 'loans and receivables' and valued at amortised cost. The difference between the purchase and sale price is accrued over the term of the agreement and recognised as interest revenue (see page 78 for the treatment of sell repurchase agreements).

Foreign currency swaps

The RBA uses foreign currency swaps with market counterparties to assist daily domestic liquidity management and to manage balance sheet holdings. 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 must therefore reflect 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.

Foreign exchange holdings contracted for sale beyond 30 June 2010 (including those under swap contracts) have been valued at market exchange rates (Note 15).

The temporary foreign exchange swap facility established with the US Federal Reserve in September 2008, to address pressures in US dollar short-term funding in the Asian time zone, expired in February 2010. The facility had not been accessed since April 2009, with the final swap unwinding in July 2009. Under this facility, the Fed provided US dollar liquidity to the RBA in exchange for Australian dollars. The US dollars were, in turn, made available by the RBA to market participants under repurchase agreements, in exchange for Australian dollar collateral. The Australian dollars provided to the Fed under the swap were held on deposit with the RBA. On maturity, these swaps were unwound at the same exchange rate as the currencies were exchanged in the first leg. This facility increased the RBA's balance sheet, but had no effect on its net profits (see Note 15). Further detail on the establishment and use of this facility was discussed in the chapter on 'Operations in Financial Markets' in the 2009 Annual Report.

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'. In accordance with this standard, 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 1959* (Note 1 (f)).

Bank for International Settlements

Under AASB 139 the RBA's shareholding in the Bank for International Settlements (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 and other institutions (Note 5). The fair value is estimated on the basis of BIS' net asset value, less a discount of 30 per cent. When declared, dividends are recognised as revenue in the Statement of Comprehensive Income.

Financial Liabilities

Deposit liabilities

Deposits include deposits at call and term deposits. Deposits are classified as financial liabilities under AASB 139. 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 adjusted 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 2009/10, notes with a face value of $234 211 which had previously been written down were presented to the RBA and expensed ($280 000 in 2008/09).

The RBA pays interest on working balances of currency notes held by banks under cash distribution arrangements. Interest is paid on balances up to certain limits.

Sell repurchase agreements

Securities sold and contracted for purchase under sell repurchase agreements are classified under AASB 139 as 'at fair value through profit or loss', as they 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 3pm 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 these loans under AASB 7.

(d) Property, plant and equipment

The RBA accounts for its property, plant and equipment in accordance with AASB 116 – *Property, Plant and Equipment*. Valuation gains (and 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, to the extent that the gains offset prior losses 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 2010. In accordance with AASB 116, properties are recognised at fair value, which reflects observable prices and is based on the assumption that assets would be exchanged between knowledgeable, willing parties at arm's length. Reflecting the specialised nature of the respective assets, the value of the Craigieburn property has been determined on the basis of vacant possession, while the RBA's Business Resumption Site in outer metropolitan Sydney is valued at depreciated replacement cost. The latest valuations have been incorporated in the accounts. Annual depreciation is based on fair values and assessments of the useful remaining life of the relevant asset, 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 on 30 June 2008. 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 assessments of the useful remaining life of individual assets. Computer software and other intangible assets are accounted for in accordance with AASB 138 – *Intangible Assets*. Intangibles are recognised at cost less accumulated amortisation, which is calculated on the basis of the estimated useful life of the relevant assets. Amortisation expense for intangibles is included in Other Expenses in Note 2.

The range of useful lives used for each class of newly-purchased assets is:

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

Details of annual net expenditure, revaluation adjustments and depreciation of buildings, and plant and equipment are included in Note 8; details of computer software and other intangibles are included in Note 7.

(e) Capital and Reserves

The capital of the Reserve Bank is established by the *Reserve Bank Act 1959*.

The Reserve Bank Reserve Fund (RBRF) is also established by the *Reserve Bank Act 1959* and is, in all respects, essentially capital. It is a general reserve maintained by the RBA to provide for events which are contingent and non-foreseeable, including to cover losses from exceptionally large falls in the market value of its holdings of domestic and foreign securities that cannot be absorbed by its other resources. The RBRF also provides for other risks to which the RBA is exposed, including fraud and operational risk. This reserve has been funded over the years 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 1959*, the Treasurer, after consultation with the Board, determines any amounts to be credited to the RBRF from earnings available for distribution (refer Note 1(f)). As the accounting loss in 2009/10 has reduced this reserve, the Board will seek to restore its balance to a level that it regards as satisfactory over time.

The Bank 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. However, until such gains or losses are realised, they are not available for distribution to the Australian Government; such unrealised gains are reflected in the Reserve for Unrealised Profits on Investments. Unrealised losses that exceed the balance held in the Unrealised Profits Reserve are initially charged against other sources of income, consistent with the *Reserve Bank Act 1959* and accounting practice. In 2009/10, unrealised losses exceeded both the balance of the Unrealised Profits Reserve plus income from other sources. Accordingly, the balance of the Unrealised Profits Reserve at 30 June 2010 was nil. At the same time, consistent with the purpose of the RBRF, the Board has transferred an amount of $680 million from this reserve to absorb the component of the accounting loss in 2009/10 that exceeds the balance of the Unrealised Profits Reserve.

Unrealised gains and losses on the asset which represents the staff superannuation funds are also recognised in the Statement of Comprehensive Income in accordance with the 'corridor' approach under AASB 119 – *Employee Benefits*. These amounts are reflected in the Reserve for Unrealised Profits on Superannuation (refer Note 1(h)).

Balances of asset revaluation reserves reflect differences between the fair value of a number of the RBA's assets, mainly non-traded assets (gold; property, plant and equipment; and shares in international and other institutions), and their cost. These unrealised gains are transferred directly to the relevant reserve and are not included in accounting profits. The unrealised gains on these assets are not distributable until the gains are realised through the sale of the relevant asset.

The *Earnings and Distribution* chapter in this Annual Report provides additional information on the RBA's capital and reserves.

(f) Profits

Profits of the RBA are dealt with in the following terms by section 30 of the *Reserve Bank Act 1959:*

(1) Subject to subsection (2), the net profits of the Bank in each year shall be dealt with as follows:

(a) such amount as the Treasurer, after consultation with the Reserve Bank Board, determines is to be set aside for contingencies; and

(b) 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

(c) 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.

In 2009/10, the RBA's net profit was negative. The part of the accounting loss that exceeds unrealised gains retained from previous years and held in the unrealised profits reserves has been absorbed by the RBRF. Accordingly, the RBRF will be reduced by an amount of $680 million. No dividend will be payable to the Commonwealth in 2010/11 from earnings in 2009/10.

(g) Provisions

The RBA maintains provisions for accrued annual leave in accordance with AASB 119 – *Employee Benefits,* calculated on salaries expected to prevail when leave is anticipated to be taken and including associated payroll tax. The RBA also maintains provisions for long service leave and post-employment benefits, in the form of health insurance and housing assistance, and associated fringe benefits tax; these provisions are made on a present value basis consistent with AASB 119. In addition, the RBA makes provision for future workers' compensation claims in respect of incidents which have occurred before balance date.

(h) Superannuation funds

The RBA includes in its balance sheet an asset representing the position of its defined benefit superannuation funds. Actuarial gains and losses are included in the asset in accordance with the 'corridor' approach under AASB 119 – *Employee Benefits*. The counterpart to the superannuation asset is the Reserve for Unrealised Profits on Superannuation. Actuarial gains and losses in excess of 10 per cent of the greater of the funds' assets or its defined benefit obligations are charged or credited to income in subsequent years over the expected average remaining working life of members. Details of the superannuation funds and superannuation expenses are included in Note 14.

(i) Rounding

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

(j) New Accounting Standards

A number of new accounting standards and amendments to current standards may be applied from 1 July 2010. The main changes relevant to the RBA relate to: AASB 2009-5 *Further Amendments to Australian Accounting Standards arising from the Annual Improvement Project;* AASB 9 – *Financial Instruments*; and Revised AASB 124 –*Related Party Disclosures*. These changes are not expected to have a material effect on the RBA's financial statements or the notes to the accounts.

Note 2 – Net Profits

	Note	2010 $M	2009 $M
Interest revenue			
Overseas investments	1(b), 4	452	1 266
Australian dollar securities	1(b), 4	1 515	3 093
Overnight settlements	4	26	37
Gold loans	1(c), 4	–	4
Loans, advances and other	4	1	1
		1 994	4 401
Net gains on securities and foreign exchange			
Overseas investments	1(b)	–	1 469
Australian dollar securities	1(b)	–	142
Foreign currency	1(b)	–	5 029
		–	6 640
Dividend revenue			
Earnings on shares in Bank for International Settlements	1(b)	11	5
Fees and commissions			
Banking services fees received		20	21
Other revenue			
Reimbursementb yA ustralianG overnmentf or loan management and registry expenses		1	1
Rental of Bank premises		9	9
Sales of note and security products		35	34
Other		24	26
		69	70
Total		2 094	11 137
Less:			
Interest expense			
Deposit liabilities	1(b), 4	801	1 744
Currency note holdings of banks	1(b), 4	104	167
Repurchase agreements	1(b), 4	13	129
		918	2 040
Net losses on securities and foreign exchange			
Overseas investments	1(b)	(416)	–
Australian dollar securities	1(b)	(75)	–
Foreign currency	1(b)	4 273	–
		3 782	–
General administrative expenses			
Staff costs		148	149
Superannuation costs	1(h), 14	33	4
Special redundancy/retirement payments		2	3
Depreciation of property	1(d), 8	9	9
Depreciation of plant and equipment	1(d), 8	17	14
Premises and equipment	1(d)	37	37
Materials used in note and security products		23	20

Note 2 – (Continued)

	Note	2010 $M	2009 $M
Travel		3	4
Consultants' fees, legal fees and payments to contractors		2	2
Other		8	8
		282	250
Other expenses			
Agency business reimbursement		3	3
Subsidiary income tax		2	3
Cash distribution expenses		6	4
Other		29	31
		40	41
Total		5 022	2 331
Net Profit		(2 928)	8 806

Staff costs in 2009/10 include an expense of $10.5 million associated with the increase in the balance of the provision for post-employment benefits (in 2008/09 there was an expense of $9.0 million) (refer Note 10). Post-employment health care costs of $10.3 million are included in Staff costs ($9.6 million in 2008/09).

The RBA's aggregate research and development expenditure recognised as an expense in 2009/10 was $0.7 million ($0.5 million in 2008/09); this is included in Other expenses.

Note 3 – Distribution Payable to Australian Government

Section 30 of the *Reserve Bank Act 1959* requires that the net profits of the Reserve Bank of Australia, less amounts set aside for contingencies or placed in the RBRF as determined by the Treasurer after consultation with the Board, shall be paid to the Australian Government (see Note 1(f)). Also under section 30, unrealised profits are not available for distribution and 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; if such losses exceed the balance in this reserve, the amount by which the losses exceed this balance is initially charged against other sources of income and then taken to the RBRF.

In 2009/10, the Bank's accounting loss exceeded the sum available to absorb losses in the Unrealised Profits Reserve. As a result, the Board transferred an amount of $680 million from the RBRF to offset the loss as measured on this basis. No dividend will be payable from 2009/10 earnings.

An amount of $5 227 million from earnings in 2008/09 was paid to the Australian Government in August 2009. The balance of $750 million from 2008/09 earnings was deferred and will be distributed to the Australian Government in August 2010.

Note 3 – (Continued)

	2010 $M	2009 $M
Opening balance	5 977	1 403
Distribution to Australian Government	(5 227)	(1 403)
Transfer from Statement of Distribution	–	5 977
As at 30 June	750	5 977

Note 4 – Interest Revenue and Interest Expense

Analysis for the year ended 30 June 2010

	Average balance $M	Interest $M	Average annual interest rate %
Interest revenue			
Overseas investments	46 207	452	1.0
Australian dollar securities	36 441	1 515	4.2
Overnight settlements	773	26	3.4
Gold loans	127	–	0.3
Loans, advances and other	28	1	3.3
	83 576	1 994	2.4
Interest expense			
Banks' Exchange Settlement balances	1 713	59	3.4
Deposits from governments	20 400	730	3.6
Deposits from overseas institutions	860	11	1.3
Currency note holdings of banks	2 827	104	3.7
Overseas repurchase agreements	3 295	3	0.1
Domestic repurchase agreements	288	10	3.5
Other deposits	24	1	2.4
	29 407	918	3.1
Analysis for the year ended 30 June 2009			
Interest revenue total	118 785	4 401	3.7
Interest expense total	56 783	2 040	3.6

Interest revenue for 2009/10 includes $1 317 million calculated using the effective interest method for financial assets not at fair value through profit and loss ($3 353 million in 2008/09). Interest expense for 2009/10 includes $918 million calculated using the effective interest method for financial liabilities not at fair value through profit and loss ($2 040 million in 2008/09).

Note 5 – Capital and Reserves

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

	2010 $M	2009 $M
Asset revaluation reserves		
Gold (Note 1(c))		
Opening balance	2 830	2 355
Net revaluation adjustments	790	475
As at 30 June	3 620	2 830
Shares in international and other institutions (Notes 1(b), 7)		
Opening balance	275	226
Net revaluation adjustments	10	49
As at 30 June	285	275
Bank properties, plant and equipment (Notes 1(d), 8)		
Opening balance	203	226
Net revaluation adjustments	(21)	(23)
As at 30 June	182	203
Total asset revaluation reserves (Note 1(e))		
Opening balance	3 308	2 807
Net revaluation adjustments	779	501
As at 30 June	4 087	3 308
Unrealised profits reserves		
Reserve for unrealised profits on investments (Note 1(e))		
Opening balance	2 237	–
Net transfers (to)/from Statement of Distribution	(2 237)	2 237
As at 30 June	–	2 237
Reserve for unrealised profits on superannuation (Note 1(h))		
Opening balance	95	80
Net transfers (to)/from Statement of Distribution	(11)	15
As at 30 June	84	95
Total unrealised profits reserves		
Opening balance	2 332	80
Net transfers (to)/from Statement of Distribution	(2 248)	2 252
As at 30 June	84	2 332
Reserve Bank Reserve Fund (Note 1(e))		
Opening balance	6 863	6 286
Transfers (to)/from Statement of Distribution	(680)	577
As at 30 June	6 183	6 863
Capital		
Opening and closing balance	40	40

Note 6 – Cash and Cash Equivalents

This includes net amounts of $844 million owed to the RBA for overnight clearances of financial transactions through the clearing houses; an amount of $743 million was owed to the RBA at 30 June 2009. Other cash and cash equivalents includes NPA's bank deposits.

Note 7 – Loans, Advances and Other Assets

	Note	2010 $M	2009 $M
Shareholding in Bank for International Settlements	1(b)	328	318
Superannuation asset	1(h),14	84	95
Officers' Home Advances		7	8
Investment in Securency	1(a)	49	44
Computer software and intangibles	1(d)	12	7
Other		56	41
As at 30 June		536	513

The Reserve Bank of Australia has a 50 per cent share in Securency International Pty Ltd (formerly Securency Pty Ltd), which is incorporated in Victoria, Australia, and whose principal activity is the marketing and manufacture of polymer substrate. The Bank jointly controls Securency with a joint-venture partner. The capital of Securency International (Securency) as at 30 June 2010 was $36.5 million. The carrying value of the RBA's investment in Securency as at 30 June 2010 was $49.4 million ($43.5 million at 30 June 2009). Securency has a 31 December balance date.

The RBA's share of Securency's profit before income tax in 2009/10 was $9.5 million ($11.9 million in 2008/09); its share of Securency's income tax expense in 2009/10 was $2.7 million ($3.5 million in 2008/09); and its share of the movement in Securency's reserves was -$0.5 million. Securency's current and non-current assets as at 30 June 2010 were $69.4 million and $95.2 million respectively ($74.4 million and $90.0 million as at 30 June 2009). Current and non-current liabilities on 30 June 2010 were $39.3 million and $24.0 million ($50.7 million and $25.8 million on 30 June 2009). Securency's revenue and expenses for 2009/10 were $137.5 million and $118.4 million ($132.9 million and $109.2 million in 2008/09). The RBA provides facilities to Securency under operating leases.

In 2005/06, the RBA provided a finance lease to Securency for $5.6 million in relation to the construction of a new building on the Bank's land at Craigieburn. The finance lease was fully drawn down during 2006/07. The lease was provided on commercial terms and at arm's length; it has a term of 10 years. The balance of the lease receivable as at 30 June 2010 was $3.4 million ($3.9 million as at 30 June 2009).

During 2009/10, the RBA acquired $1.0 million of computer software and intangibles ($0.7 million in 2008/09) and amortised $1.8 million ($1.7 million in 2008/09). At 30 June 2010 the gross book value of the RBA's computer software and intangibles amounted to $20.4 million and accumulated amortisation on these assets was $8.6 million ($14.1 million and $6.9 million respectively at 30 June 2009). The RBA had no contractual commitments as at 30 June 2010 for the acquisition of computer software and intangibles ($1.4 million at 30 June 2009).

As at 30 June 2010, other assets included receivables of $29.5 million, all of which are current (at 30 June 2009 other assets included receivables of $20.3 million, all of which were current).

Note 8 – Property, Plant and Equipment

	Land $M	Buildings $M	Plant and Equipment $M	Total $M
Gross Book Value as at 30 June 2009	121	229	114	464
Accumulated depreciation	–	(1)	(20)	(21)
Net Book Value	121	228	94	443
Additions	–	8	46	54
Depreciation expense	–	(9)	(17)	(26)
Net revaluation increment/ (decrement)	(4)	(17)	–	(21)
Disposals	–	–	(1)	(1)
Net additions to net book value	(4)	(18)	28	6
Gross Book Value as at 30 June 2010	117	210	158	485
Accumulated depreciation	–	–	(36)	(36)
Net Book Value	117	210	122	449

The net book value of buildings as at 30 June 2010 includes expenditure of $3.5 million on work in progress which has been capitalised in the carrying amount of these assets ($1.6 million as at 30 June 2009). Additions include expenditure of $11.4 million on work in progress that was capitalised during 2009/10 ($19.2 million in 2008/09).

As at 30 June 2010, the RBA had contractual commitments of $2.5 million to acquire buildings, plant and equipment ($30.3 million at 30 June 2009); contractual commitments of $2.5 million are due within 1 year ($2.5 million in 2008/09).

Note 9 – Deposits

	2010 $M	2009 $M
Banks' Exchange Settlement balances	3 584	2 582
Australian Government	16 663	30 160
State Governments	2	8
Foreign Governments, foreign institutions and international organisations	724	1 502
Other depositors	14	14
As at 30 June	20 987	34 266

Note 10 – Other Liabilities

	2010 $M	2009 $M
Provisions (Note 1(g))		
Provision for accrued annual leave	14	13
Provision for long service leave	30	27
Provision for post-employment benefits	89	78
Provision for workers' compensation	–	–
	133	118
Other		
Amounts outstanding under repurchase agreements (contract price) (Note 1(b))	4 167	1 501
Interest accrued on deposits	23	30
Other	439	444
	4 629	1 975
As at 30 June	4 762	2 093

The provision for workers' compensation at 30 June 2010 was $375 000 ($441 000 at 30 June 2009).

During 2009/10, annual leave of $7.5 million was accrued by staff, while $6.4 million of accrued leave was used. Staff accrued and used long service leave of $3.7 million and $1.7 million respectively in 2009/10; the provision for long service leave also increased by $0.5 million due to the decrease in the interest rate used to discount future cash flows.

The RBA provided an additional $2.5 million for post-retirement benefits in 2009/10; a decrease in the discount rate increased the provision by $7.6 million, while benefits of $3.7 million were paid out of the provision. The balance of the provision for post-employment benefits will change if assumptions regarding the length of staff service, the longevity of retired staff, future movements in medical costs or the discount rate vary.

At 30 June 2010, $6.7 million of the provision for accrued annual leave was due within 12 months ($6.1 million at 30 June 2009); $2.9 million of the provision for long service was due within 12 months ($2.7 million at 30 June 2009); and $1.9 million of the provision for post-employment benefits was due within 12 months ($2.6 million at 30 June 2009).

Note 11 – Contingent Liabilities and Other Items Not Included in the Balance Sheet

The RBA has a contingent liability, amounting to $62.3 million at 30 June 2010 ($68.8 million at 30 June 2009), in respect of the uncalled portion of its shares held in the Bank for International Settlements.

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.

Note 12 – Key Management Personnel

The key management personnel of the Reserve Bank are members of the Reserve Bank Board, members of the Payments System Board, and senior staff who have responsibility for planning, directing and controlling the activities of the Bank. This Group comprises 20 in total, including the Governor and Deputy Governor, seven non-executive members of the Reserve Bank Board, five non-executive members of the Payments System Board and six Assistant Governors.

Fees of non-executive members of the Reserve Bank Board and the Payments System Board are determined by the Remuneration Tribunal. Responsibility for the terms and conditions on which the Governor and Deputy Governor hold office rests with the Reserve Bank Board, in accordance with section 24A of the *Reserve Bank Act 1959*. The Board's Remuneration Committee (comprising three non-executive directors) reviews annually these terms and conditions and, consistent with the Act, makes recommendations to the Board. The Governor and Deputy Governor do not participate in these deliberations.

Under long-standing arrangements, the remuneration of the Governor, Deputy Governor and senior executives of the Reserve Bank takes account of market levels of remuneration. This arrangement was established to allow the Bank the flexibility to attract and retain staff of the necessary quality. This arrangement is strongly supported by the Reserve Bank Board which sees it as being critical to supporting the Bank in achieving its objectives to the required standard.

In drawing relevant comparisons about the remuneration of the Governor and Deputy Governor as part of the annual review, the Board takes account of the high level of policy and operational responsibility carried by these positions. Their responsibilities for monetary policy and financial system stability are set out in the *Reserve Bank Act 1959* and the fourth *Statement on the Conduct of Monetary Policy* issued in December 2007. The Governor and Deputy Governor exercise both governance and executive responsibilities for monetary policy as, respectively, the Chief Executive and Deputy Chief Executive of the Bank, and Chairman and Deputy Chairman of the Reserve Bank Board. They direct the professional work of the Bank's staff concerning monetary policy, bring recommendations to the Board, and speak on behalf of the Board on policy and other matters. The Governor takes the leading role in publicly articulating Australia's monetary policy framework, objectives and decisions. There are parallel responsibilities in relation to the Bank's policies and actions to foster overall financial stability.

The Governor and Deputy Governor are also responsible for overseeing the operations of the Bank. As the nation's central bank, the Reserve Bank is a substantial financial institution, with a balance sheet that averaged about $90 billion in 2009/10. It manages a large portfolio of domestic and foreign assets and transacts in large volumes in markets on a daily basis. It provides core payment and interbank settlement facilities to Australian financial institutions and a number of international financial institutions. As banker to the Australian Government, it undertakes banking transactions that account for some 20 per cent of outward direct entry payments in Australia, and provides other banking services. It is responsible for issuing currency notes which remain secure against counterfeiting and retain public confidence. As the Bank's monetary policy and other operations are pivotal to the safe and effective functioning of the financial system, the associated financial, operational and other risks must be controlled to the highest possible standard.

In addition to the responsibilities for monetary policy and overall financial system stability, the Governor is Chairman of the Payments System Board, which has been given specific regulatory and other powers under the *Payments System (Regulation) Act 1998* for safety, efficiency and competition in the payments system. In this capacity, the Governor directs the work of the Bank's professional staff in relation to payments system policies and regulation.

The 2009 review of remuneration took account of the recent subdued outcomes in market pay. This followed a detailed review of the remuneration of these positions which began in 2007 and resulted in a substantial restructuring of this remuneration in 2008. The aim was to make the remuneration of these positions more transparent by removing long-standing non-cash benefits, which the Board regarded as no longer appropriate, and replacing them with salary. Accordingly, the only non-salary components of the remuneration of these positions is parking in Head Office, leave provisions and access to superannuation and health insurance on the same terms as are available to Reserve Bank staff. The Governor and the Deputy Governor are not eligible for performance bonuses. The Board also decided to increase total remuneration at the time of this review after reviewing developments in remuneration of executives in the private and public sectors, taking into account the significance and diversity of responsibility of the positions of Governor and Deputy Governor. The Board advises the Treasurer and the President of the Remuneration Tribunal of details of the remuneration of these positions.

The Governor, in consultation with the Remuneration Committee, determines the remuneration of Assistant Governors. Remuneration of staff, including Assistant Governors, is designed to ensure that the Bank attracts and retains the level of expertise necessary to carry out the work associated with its specialised policy, operating and regulatory objectives. Remuneration of staff is externally benchmarked against positions at a comparable level in the financial sector and in government business enterprises. Periodically, advice is sought from independent, specialised remuneration advisers on the structure of remuneration packages and the level of compensation in positions of comparable expertise and responsibility in relevant other organisations. The latest such review for Assistant Governors was carried out in 2007 and concluded that remuneration of these positions appeared toward the middle of the range of fixed remuneration for positions at a comparable level in a group of smaller financial institutions. Assistant Governors are employed under contract with a fixed term of five years. Continuation of employment, and renewal of contracts, is subject to ongoing satisfactory performance. Assistant Governors are not eligible for performance bonuses.

The RBA discloses remuneration of key management personnel on the basis of AASB 124 – *Related Party Disclosures*. The aggregate remuneration of the RBA's key management personnel on this basis was:

	2010 **$**	**2009** **$**
Short-term employee benefits	4 757 156	4 513 477
Post-employment benefits	899 960	861 621
Other long-term benefits	240 286	332 707
Share based payments	–	–
Termination benefits	–	–
Total Compensation	5 897 402	5 707 805

Short-term benefits include cash salary and, where relevant for executives, annual leave, motor vehicle benefits, car parking, 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. The components of remuneration are reported on an accruals basis. Members of the RBA's staff may salary sacrifice in exchange for certain benefits.

As at 30 June 2010 and 30 June 2009 there were no loans by the RBA to 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 conducted on terms no more favourable than similar transactions with other employees or customers; such transactions were incidental and for small amounts. As the Board of NPA comprised executives of the RBA in 2009/10 no directors fees were paid that year. An amount of $36 976 in 2008/09 was paid for non-executive members of the Board of NPA Limited who were not employees of the RBA or members of the Reserve Bank Board.

The information contained in the following table shows details of the remuneration of directors and management. The figures on which the table is based comply with AASB 124 – *Related Party Disclosures*, the usual commercial standard.

	2010			2009		
Remuneration Band $	**Number**	**Salary $**	**Total Remuneration $**	**Number**	**Salary $**	**Total Remuneration $**
0	2	0	0	2	0	0
40 000 – 54 999	4	44 969	49 016	4	45 130	49 192
55 000 – 69 999	5	57 732	62 928	5	55 591	60 594
70 000 – 84 999	1	69 613	75 887	1	67 443	73 513
505 000 – 519 999				2	365 542	507 705
520 000 – 534 999	1	398 272	532 667			
535 000 – 549 999	1	386 134	535 167			
565 000 – 579 999				2	401 390	573 539
580 000 – 594 999	2	416 972	585 834	2	397 557	585 452
595 000 – 609 999	1	439 258	605 063			
610 000 – 624 999	1	433 910	614 747			
790 000 – 804 999	1	607 663	802 202	1	593 800	790 995
1 000 000 – 1 014 999				1	786 300	1 010 169
1 045 000 – 1 059 999	1	804 657	1 049 297			
	20			20		

Average figures are shown for salary and total remuneration in remuneration bands in which there is more than one individual.

Note 13 – Remuneration of Auditor

Fees paid or payable to the statutory auditor (Auditor-General of the Commonwealth of Australia) for audit services (excluding GST) totalled $435 000 in 2009/10 ($326 000 in 2008/09); this includes audit services in relation to the RBA's subsidiary Note Printing Australia. These fees are included in Consultants' Fees, Legal Fees and Payments to Contractors in Note 2.

Note 14 – Superannuation Funds

Two superannuation funds are operated pursuant to the *Reserve Bank Act 1959*: the Reserve Bank of Australia Officers' Superannuation Fund (OSF) and the Reserve Bank of Australia UK Pension Scheme. A small part of the assets of the OSF is held by the RBA as nominee for the trustees of the OSF; such assets are not included in the RBA's financial statements. Payment of these superannuation funds' current and future benefits is funded by member and RBA contributions and the funds' existing asset bases. The RBA's superannuation expenses in relation to the OSF and the UK Pension Scheme are included in accounting profits and shown in Note 2. Administration and other operational costs (eg salaries, overheads, legal costs and valuation fees) incurred by the RBA for superannuation arrangements are also included in Note 2. There were no other related-party transactions between the RBA and the funds during 2009/10.

The OSF is a hybrid fund. Most members receive a Bank-funded 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 for the purposes of AASB 119 – *Employee Benefits*. The UK Pension Scheme is a defined benefit scheme.

Funding valuation

Full independent actuarial valuations of the OSF and UK Pension Scheme are conducted every three years to determine funding for these schemes. The most recent funding valuation of the OSF was at 30 June 2008 and for the UK Pension Scheme at 30 June 2007. At the most recent valuations, the actuaries indicated that, on the basis of accrued benefits, both funds were in surplus and that the funds were in a satisfactory financial position. The next triennial funding valuation for the UK Pension Scheme for 30 June 2010 will be undertaken in 2010/11.

The OSF triennial funding valuation as at 30 June 2008 was based on the Attained Age Funding method, consistent with the accounting standard for superannuation funds, AAS 25 – *Financial Reporting by Superannuation Plans*. Under this standard, the accrued benefits of the OSF were determined as the value of the future benefits payable to members (allowing for future salary increases), discounted using the expected rate of return on the assets held to fund these benefits. At the time of the triennial review, the surplus of the OSF on this measure was $175 million, as the assets of the OSF of $897 million exceeded the accrued benefits of $722 million. The main financial assumptions in the triennial valuation were that the annual post-tax rate of return on assets for benefits of active members was 7.0 per cent, that for assets for current pensions was 7.5 per cent (pre-tax), with annual salary increases of 4.0 per cent and annual pension increases of 3.5 per cent. Subsequent to the triennial review, the OSF surplus measured on the basis of AAS 25 as at 30 June 2010 amounted to $51 million (assets of $690 million less accrued benefits of $639 million).

Consistent with the Actuary's funding recommendation, the RBA maintained its contribution rate to the OSF at 18.3 per cent of salaries in 2008/09. The main financial assumptions in the triennial valuation were that the annual post-tax rate of return on assets for benefits of active members was 7.0 per cent, that for assets for current pensions was 7.5 per cent (pre-tax), with annual salary increases of 4.0 per cent and annual pension increases of 3.5 per cent.

The triennial funding valuation for the UK Pension Scheme was based on the Attained Age method. The surplus of the UK Pension Scheme as at 30 June 2010, measured in accordance with AAS 25, was $1.1 million (assets of $18.2 million compared with accrued benefits of $17.1 million).

Accounting valuation

For financial statement purposes, the financial positions of the superannuation schemes are valued in accordance with AASB 119. Under AASB 119, accrued benefits are determined by discounting future benefits payable to current fund members at the yield on government bonds of similar maturity on the reporting date. The approach under AASB 119, in contrast with the results of the actuaries' triennial valuations noted above, does not take into account that the assets held by the superannuation schemes to fund future benefits have generally earned a higher rate of return on average than government bonds.

The principal actuarial assumptions for the AASB 119 valuation used in the case of the OSF were a discount rate of 5.27 per cent (5.70 per cent in 2008/09), future salary increases of 3.5 per cent (3.5 per cent in 2008/09), future pension increases of 3.5 per cent (3.5 per cent in 2008/09) and an assumed return on plan assets of 8.5 per cent (8.6 per cent in 2008/09). The actual return on plan assets of the OSF for 2009/10 was 10.6 per cent (-13.7 per cent in 2008/09). The assumptions used for the UK Pension Scheme were a discount rate of 5.3 per cent (6.4 per cent in 2008/09), future salary increases of 5.25 per cent (5.25 per cent in 2008/09), future pension increases of 3.25 per cent (3.25 per cent in 2008/09) and an assumed return on plan assets of 4.4 per cent (4.25 per cent in 2008/09). The actual return on plan assets of the UK Pension Scheme for 2009/10 was 6.1 per cent (–0.5 per cent in 2008/09). The expected overall rates of returns are based on the actuaries' models of returns for major asset classes and reflect the historic rates of return and volatility for each class and correlations across asset classes.

Details of the funds are as shown on the following pages. In the case of the OSF, these details relate only to the defined benefit component of the fund; defined contribution accumulation balances, on which the Bank has no actuarial risk, are excluded. This has no effect on the measurement of the surpluses in the OSF. At 30 June 2010 accumulation balances in the OSF totalled $150.5 million ($125.8 million as at 30 June 2009).

The distribution of the funds' assets at 30 June is shown below:

	% of fund assets			
	OSF		UK Pension Scheme	
	2010	2009	2010	2009
Cash and short-term securities	4.5	6.2	–	–
Fixed interest securities	7.0	6.0	–	–
Indexed securities	2.2	2.5	94.3	95.1
Domestic shares	40.2	37.0	5.7	4.9
Foreign shares	4.1	4.1	–	–
Property				
Direct	4.6	5.3	–	–
Indirect	16.6	18.7	–	–
Private equity and alternative investments	20.8	20.2	–	–
	100	100	100	100

Note 14 – (Continued)

	OSF		UK Scheme		Total	
	2010 $M	**2009 $M**	**2010 $M**	**2009 $M**	**2010 $M**	**2009 $M**
Opening balances:						
Net market value of assets	652	755	20	22	672	777
Accrued benefits	(829)	(679)	(14)	(16)	(843)	(695)
Surplus/(deficit)	(177)	76	7	6	(170)	82
Effect of asset cap	–	–	(3)	–	(3)	–
Actuarial (gains)/losses not included in balance sheet under Corridor	272	–	(4)	(3)	268	(3)
Exchange rate (gains)/losses	–	–	–	1	–	1
Opening superannuation asset	95	76	–	4	95	80
Change in net market value of assets	39	(103)	(2)	(1)	37	(104)
Change in accrued benefits	(99)	(149)	–	2	(99)	(148)
Change in asset cap	–	–	–	(3)	–	(3)
Change in actuarial (gains)/losses not included in balance sheet under Corridor	48	272	1	(1)	49	271
Exchange rate (gains)/losses	–	–	1	(1)	1	(1)
Total change in superannuation asset	(12)	20	–	(4)	(12)	16
Closing balances:						
Net market value of assets	691	652	18	20	710	672
Accrued benefits	(928)	(829)	(14)	(14)	(942)	(843)
Surplus/(deficit)	(236)	(177)	4	7	(232)	(170)
Effect of asset cap	–	–	(3)	(3)	(3)	(3)
Actuarial (gains)/losses not included in balance sheet under Corridor	320	272	(3)	(4)	317	268
Exchange rate (gains)/losses	–	–	1	–	1	–
Closing superannuation asset	84	95	–	–	83	95
Actuarially assumed return on plan assets	52	63	1	1	53	64
Benefit payments	(31)	(30)	(1)	(1)	(32)	(31)
Actuarial gains/(losses) on assets	2	(150)	1	(1)	3	(151)
Contributions from RBA to defined benefit schemes	19	17	–	–	19	17
Contributions tax	(3)	(2)	–	–	(3)	(2)
Exchange rate gains/(losses)	–	–	(3)	–	(3)	–
Change in net market value of assets	39	(103)	(2)	(1)	37	(104)

Note 14 – (Continued)

	OSF		UK Scheme		Total	
	2010 $M	**2009 $M**	**2010 $M**	**2009 $M**	**2010 $M**	**2009 $M**
Current service cost	(27)	(21)	–	–	(27)	(21)
Interest cost	(39)	(39)	(1)	(1)	(40)	(40)
Benefit payments	31	30	1	1	31	31
Contributions tax	3	2	–	–	3	2
Experience adjustments on benefits	3	(54)	–	–	3	(54)
Effects of changes in benefit actuarial assumptions	(69)	(68)	(2)	2	(71)	(66)
Exchange rate gains/(losses)		–	2	-	2	–
Change in accrued benefits	(99)	(149)	–	2	(99)	(148)
Actuarial (gains)/losses on assets	(2)	150	(1)	1	(3)	151
Experience adjustments on benefits	(3)	54	–	–	(3)	54
Effects of changes in benefit actuarial assumptions	69	68	2	(2)	71	66
Amortisation of actuarial gains/(losses)	(16)	–	–	–	(16)	–
Change in actuarial losses not included in balance sheet under Corridor	48	272	1	(1)	49	271
Superannuation expense/(income) included in Statement of Comprehensive Income						
Current service cost	27	21	–	–	27	21
Interest cost	39	39	1	1	40	40
Assumed return on plan assets	(52)	(63)	(1)	(1)	(53)	(64)
Amortisation of actuarial (gains)/losses under Corridor	16	–	–	–	16	–
Effect of asset cap	–	–	–	3	–	3
Productivity and superannuation guarantee contributions	4	3	–	–	4	3
Total superannuation expense/(income)	35	–	–	3	35	3

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

The position of the funds and experience adjustments on plan assets and accrued benefits (under AASB 119) as at 30 June for the current reporting period and previous four reporting periods are:

	2010 $M	2009 $M	2008 $M	2007 $M	2006 $M
OSF					
Closing balances:					
Net market value of assets	691	652	755	796	672
Accrued benefits	(928)	(829)	(679)	(631)	(650)
Surplus/(deficit)	(236)	(177)	76	165	22
Experience adjustments on assets	2	(150)	(90)	95	40
Experience adjustments on benefits	(3)	(54)	(20)	7	(11)
UK Scheme					
Closing balances:					
Net market value of assets	18	20	22	23	24
Accrued benefits	(14)	(14)	(16)	(17)	(20)
Surplus	4	7	6	5	4
Experience adjustments on assets	1	(1)	2	–	–
Experience adjustments on benefits	–	–	–	–	–

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. As a consequence, the RBA holds a range of financial assets, including Australian dollar securities, foreign government securities, repurchase agreements, bank deposits, interest rate futures contracts, foreign currency swaps, gold loans, cash and cash equivalents. The RBA also holds a shareholding in the Bank for International Settlements. 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. Accordingly, the main financial claims on the RBA are banknotes on issue as well as deposit liabilities. The RBA also provides banking services to its customers, and operates Australia's high-value payments and inter-bank settlement systems. These payments and settlements occur through accounts held on the RBA's balance sheet.

AASB 7 – *Financial Instruments*: *Disclosures* 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 reflecting its policy and operational responsibilities. These risks include market risk, credit risk and liquidity risk. The chapters in the Annual Report on the Reserve Bank's *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 foreign currency assets and liabilities will fluctuate because of movements in exchange rates. Foreign exchange risk arises from the RBA's foreign currency assets, which are held to support its operations in the foreign exchange market. The value of these assets, measured in Australian dollars, varies with movements in the value of the Australian dollar exchange rate against the currencies in which the assets are invested. 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 and cannot otherwise be managed to reduce foreign exchange risk. The RBA's net foreign currency exposure as at 30 June 2010 was $41.8 billion ($39.3 billion as at 30 June 2009). Within the overall exposure and to a limited extent, foreign currency risk can be reduced by holding assets across a diversified portfolio of currencies. The RBA holds foreign reserves in three currencies – the US dollar, the Euro and the Yen – because the markets for these currencies are typically liquid and suitable for investing foreign exchange reserves (*see Concentration of foreign exchange below*).

The RBA also undertakes foreign currency swaps to assist its daily domestic market operations. 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

The RBA's net holdings of foreign exchange (excluding its holding of Special Drawing Rights) were distributed as follows as at 30 June:

	% of foreign exchange	
	2010	**2009**
US dollar	45	45
Euro	45	45
Japanese yen	10	10
	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.

	2010 $M	2009 $M
Change in profit/equity due to a 10 per cent appreciation in the reserves-weighted value of the A$	–3 804	–3 577
Change in profit/equity due to a 10 per cent depreciation in the reserves-weighted value of the A$	4 650	4 372

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 considerable 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.

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. The valuation effects shown are generally reflective of the RBA's exposure over the financial year.

	2010 $M	2009 $M
Change in profit/equity due to movements of +/-1 percentage point across yield curves:		
Foreign currency securities	–/+568	–/+591
Australian dollar securities	–/+158	–/+113

A rise in interest rates would be associated with a valuation loss; a fall in interest rates would be associated with a valuation gain.

Other price risk

The RBA holds shares as a member of the Bank for International Settlements. This membership is mainly to maintain and develop strong relationships with other central banks which are to Australia's advantage. Shares in the BIS are owned exclusively by its member central banks and monetary authorities. For accounting purposes, the RBA treats 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 BIS shares is incidental to the general reasons for holding them and is immaterial compared with other market risks faced by the RBA. For this reason, this exposure 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 either to repay the principal, make interest payments due on an asset, or to settle a transaction. For the RBA, credit risk arises from exposure to: the issuers of securities that it holds; banks with which it deposits funds; and counterparties which are yet to settle transactions. The RBA's credit exposure is low compared with that of most commercial financial institutions, as it manages such risks within a highly risk-averse framework. In particular, credit risk is managed by: holding securities issued by a limited number of highly-rated governments, government-guaranteed agencies and supranational organisations; holding government guaranteed issues of certain highly-rated commercial banks and deposits with highly-rated banks, in amounts consistent with the credit ratings and capital positions of these financial institutions; and holding collateral only of low credit risk against buy repurchase agreements and gold loans.

Cash invested under 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 buy repurchase agreements is secured by securities issued by Australian governments, Australian banks and various corporate and asset-backed securities (see Note 1(b)). The RBA holds collateral to a value of between 102 and 110 per cent of the amount invested according to the risk profile of the collateral held. If the current value of collateral offered by a counterparty to a repo transaction falls by more than 1 percentage point below the initial margin, the counterparty is required to provide additional collateral to restore this margin. Gold loans are secured by Australian dollar securities to 110 per cent of the market value of the gold loaned.

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

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

The RBA's maximum credit risk exposure in relation to off-balance sheet items is:

1. Foreign exchange swaps – As at 30 June 2010 the RBA was under contract to purchase $4.9 billion of foreign currency ($2.5 billion at 30 June 2009) and sell $1.9 billion of foreign currency ($12.6 billion at 30 June 2009). As of that date there was a net unrealised gain of $26 million on these swap positions included in net profit ($773 million unrealised gain at 30 June 2009). The exposure of these contracts to credit risk is the cost of reestablishing the contract in the market if a counterparty fails to fulfill its obligations.

2. Interest rate futures – As at 30 June 2010 the amount of credit risk on interest rate futures contracts was approximately $1.4 million ($11.3 million at 30 June 2009). As at 30 June 2010 there was an unrealised loss brought to account on those contracts of $0.5 million ($9.2 million unrealised loss at 30 June 2009).

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.

The RBA held no past due or impaired assets at 30 June 2010 or 30 June 2009.

	Risk rating of security/issuer[1]	Risk rating of counterparties[1]	% of total assets 2010	% of total assets 2009
Australian Dollar Securities				
Holdings – Commonwealth Government securities	AAA	n/a	0.9	0.2
Holdings – Semi Government securities	AAA	n/a	3.8	2.1
	AA	n/a	1.0	1.7
Securities sold under repurchase agreements	AAA	AA	0.1	0.1
	AAA	A	0.2	–
Securities held under repurchase agreements	AAA	AA	9.8	21.4
	AAA	A	10.0	6.5
	AAA	BBB	1.2	0.6
	AAA	Other[3]	0.8	1.1
	AA	AA	9.7	9.3
	AA	A	2.0	1.4
	AA	BBB	0.1	0.1
	AA	Other[3]	0.1	–
	A	AA	2.3	1.0
	A	A	0.1	0.3
	Other[2]	AA	0.9	–
Foreign Investments				
Holdings of securities	AAA	n/a	29.2	22.1
	AA	n/a	4.7	11.6
	A	n/a	0.5	0.4
Securities sold under repurchase agreements	AAA	AA	3.6	0.3
	AAA	A	0.9	1.0
	AA	A	0.1	–
Securities held under repurchase agreements	AAA	AAA	–	0.4
	AAA	AA	6.8	6.2
	AAA	A	2.8	4.9
	AA	AA	0.1	–
	AA	A	0.1	–
Deposits	n/a	AAA	0.4	1.2
	n/a	AA	1.2	0.7
	n/a	A	–	0.2
Other	n/a	AA	–	0.6
	n/a	A	–	0.1
Gold Loans	n/a	AAA	0.2	0.1
Other			6.4	4.4
			100	100

1 Standard & Poor's equivalent ratings.
2 This category includes Asset Backed Commercial Paper (ABCP), which does not have a long-term credit rating.
3 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 associated with its financial liabilities. As the ultimate source of liquidity in Australian dollars, the RBA has the powers and operational wherewithal to 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 sale 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 which is 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 (over page) is based on the RBA's contracted portfolio as reported in the RBA's balance sheet. All financial instruments are shown at their remaining term to maturity, which is equivalent to the repricing period. Other liabilities include amounts outstanding under sale 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 2010

	Balance sheet total $M	Contracted maturity $M					No Specified Maturity $M	Weighted average coupon rate %	Weighted average effective rate %
		On Demand	0 to 3 months	3 to 12 months	1 to 5 years	Over 5 years			
Assets									
Gold									
Gold loans	141	–	47	47	47	–	–	0.27	0.28
Gold holdings	3 606	–	–	–	–	–	3 606	n/a	n/a
	3 747								
Foreign exchange									
Balances with central banks	376	2	374	–	–	–	–	0.03	0.03
Securities sold under repurchase agreements	3 142	–	409	1 026	678	1 029	–	1.57	1.33
Securities purchased under repurchase agreements	8 348	–	8 348	–	–	–	–	0.19	0.19
Other securities	30 092	–	6 320	7 548	7 867	2 551	5 806	1.32	0.73
Deposits	997	3	993	–	–	–	1	0.31	0.31
Accrued interest	141	–	79	62	–	–	–	n/a	n/a
	43 096								
Australian dollar securities									
Securities sold under repurchase agreements	248	–	–	–	130	118	–	6.52	5.27
Securities purchased under repurchase agreements	31 634	–	29 252	2 382	–	–	–	4.63	4.63
Other securities	4 889	–	1 245	866	1 198	1 580	–	5.57	4.96
Accrued interest	201	–	116	85	–	–	–	n/a	n/a
	36 972								
Property, plant & equipment	449	–	–	–	–	–	449	n/a	n/a
Cash and cash equivalents	852	–	845	–	–	–	7	4.25	4.25
Loans and advances	7	–	–	–	–	7	–	3.68	3.68
Other	529	–	30	–	–	–	499	n/a	n/a
Total assets	85 652	5	48 058	12 016	9 920	5 285	10 368	2.63	2.38
Liabilities									
Australian notes on issue	48 759	–	–	–	–	–	48 759	0.23	0.23
Deposits	20 987	5 967	15 020	–	–	–	–	4.44	4.44
Distribution payable to Australian Government	750	–	750	–	–	–	–	n/a	n/a
Other	4 762	–	4 615	–	–	–	147	0.53	0.53
Total liabilities	75 258	5 967	20 385	–	–	–	48 906	1.42	1.42
Capital and reserves	10 394								
Total balance sheet	85 652								
Local Currency									
Swaps									
Contractual outflow	(4 172)	–	(4 172)	–	–	–	–	n/a	n/a
Contractual inflow	1 231	–	1 231	–	–	–	–	n/a	n/a
	(2 941)	–	(2 941)	–	–	–	–		
Foreign Currency									
Swaps									
Contractual outflow	(1 916)	–	(1 916)	–	–	–	–	n/a	n/a
Contractual inflow	4 857	–	4 857	–	–	–	–	n/a	n/a
	2 941	–	2 941	–	–	–	–		

Maturity Analysis – As at 30 June 2009

	Balance sheet total $M	Contracted maturity $M					No Specified Maturity $M	Weighted average coupon rate %	Weighted average effective rate %
		On Demand	0 to 3 months	3 to 12 months	1 to 5 years	Over 5 years			
Assets									
Gold									
Gold loans	149	–	38	74	37	–	–	0.45	0.48
Gold holdings	2 808	–	–	–	–	–	2 808	n/a	n/a
	2 957								
Foreign exchange									
Balances with central banks	372	2	370	–	–	–	–	0.01	0.01
Securities sold under repurchase agreements	1 393	–	–	–	733	660	–	2.24	2.60
Securities purchased under repurchase agreements	11 374	–	11 374	–	–	–	–	0.29	0.29
Other securities	35 671	–	15 283	7 640	8 375	3 735	638	1.45	1.00
Deposits	2 125	–	2 125	–	–	–	–	0.40	0.40
Accrued interest	221	–	144	77	–	–	–	n/a	n/a
	51 156								
Australian dollar securities									
Securities sold under repurchase agreements	104	–	–	–	104	–	–	7.13	5.43
Securities purchased under repurchase agreements	42 286	–	21 366	20 920	–	–	–	3.74	3.74
Other securities	4 069	–	1 261	457	909	1 442	–	5.27	4.56
Accrued interest	666	–	165	501	–	–	–	n/a	n/a
	47 125								
Property, plant & equipment	443	–	–	–	–	–	443	n/a	n/a
Cash and cash equivalents	772	–	767	–	–	–	5	2.76	2.76
Loans and advances	8	–	–	–	–	8	–	2.82	2.82
Other	505	–	20	–	–	–	485	n/a	n/a
Total assets	102 966	2	52 913	29 669	10 158	5 845	4 379	2.34	2.16
Liabilities									
Australian notes on issue	48 087	–	–	–	–	–	48 087	0.17	0.17
Deposits	34 266	6 914	27 352	–	–	–	–	2.96	2.96
Distribution payable to Australian Government	5 977	–	5 227	–	750	–	–	n/a	n/a
Other	2 093	–	1 969	–	–	–	124	(0.61)	(0.61)
Total liabilities	90 423	6 914	34 548	–	750	–	48 211	1.20	1.20
Capital and reserves	12 543								
Total balance sheet	102 966								
Local Currency									
Swaps									
Contractual outflow	(851)	–	(851)	–	–	–	–	n/a	n/a
Contractual inflow	10 913	–	10 913	–	–	–	–	n/a	n/a
	10 062	–	10 062	–	–	–	–		
Foreign Currency									
Swaps									
Contractual outflow	(12 584)	–	(12 584)	–	–	–	–	n/a	n/a
Contractual inflow	2 522	–	2 522	–	–	–	–	n/a	n/a
	(10 062)	–	(10 062)	–	–	–	–		

Fair Value of Financial Instruments

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms' length transaction, and is usually determined by the quoted market price. The RBA's Australian dollar securities, foreign government securities, interest rate futures, foreign currency swap contracts and its shareholding in the Bank for International Settlements are carried in the balance sheet (and shown in this note) at fair value. The RBA's repurchase agreements, bank deposits, cash and cash equivalents, notes on issue and deposit liabilities are carried in the balance sheet (and shown in this note) 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.

	2010 $M	2009 $M
Assets accounted for under AASB 139		
At fair value through Profit or Loss	38 071	41 261
Loans and receivables	43 025	57 968
Available-for-sale	328	318
Assets accounted for under other standards	4 228	3 419
As at 30 June	85 652	102 966
Liabilities accounted for under AASB 139		
At fair value through Profit or Loss	7	23
Not at fair value through Profit or Loss	75 104	90 276
Liabilities accounted for under other standards	147	124
As at 30 June	75 258	90 423

AASB 7 also requires that financial assets and liabilities measured at fair value be disclosed according to their position in the fair value hierarchy. This hierarchy has three levels for financial instruments valued at fair value: 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; while Level 3 valuations are based on inputs other than observable market data.

	Level One $M	Level Two $M	Level Three $M	Total $M
As at 30 June 2010				
Assets at fair value through Profit or Loss				
Australian dollar securities	4 077	1 091	–	5 168
Foreign government securities	28 966	3 903	–	32 869
Foreign currency swap gains	–	34	–	34
Available-for-sale				
Shares in international and other institutions	–	–	328	328
	33 043	5 028	328	38 399
Liabilities at fair value through Profit or Loss				
Foreign currency swap losses	–	7	–	7
	–	7	–	7
As at 30 June 2009				
Assets at fair value through Profit or Loss				
Australian dollar securities	3 160	1 059	–	4 219
Foreign government securities	31 537	4 709	–	36 246
Foreign currency swap gains	–	796	–	796
Available-for-sale				
Shares in international and other institutions	–	–	318	318
	34 697	6 564	318	41 579
Liabilities at fair value through Profit or Loss				
Foreign currency swap losses	–	23	–	23
	–	23	–	23

Note 16 – Subsequent Events

There have been no events since 30 June 2010 relevant to the financial statements.

Auditor-General for Australia

Australian National Audit Office

INDEPENDENT AUDITOR'S REPORT

To the Treasurer

Scope

I have audited the accompanying financial statements of Reserve Bank of Australia (the Bank) and the controlled entities for the year ended 30 June 2010, which comprise: a Directors' Statement, Balance Sheet; Statement of Comprehensive Income; Statement of Distributions; Statement of Changes in Capital and Reserves; Cash Flow Statement; and Notes to and forming part of the Financial Statements, including a Summary of Significant Accounting Policies.

The Directors' Responsibility for the Financial Statements

The members of the Board are responsible for the preparation and fair presentation of the financial statements in accordance with the Finance Minister's Orders made under the *Commonwealth Authorities and Companies Act 1997,* including the Australian Accounting Standards (which include the Australian Accounting Interpretations). This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 1, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements comply with *International Financial Reporting Standards.*

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 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 Bank's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting

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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.

Independence

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

Auditor's Opinion

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

(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 Bank's and the consolidated entity's financial position as at 30 June 2010 and their financial performance and cash flows for the year then ended.

Ian McPhee
Auditor-General

Sydney
16 August 2010

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.

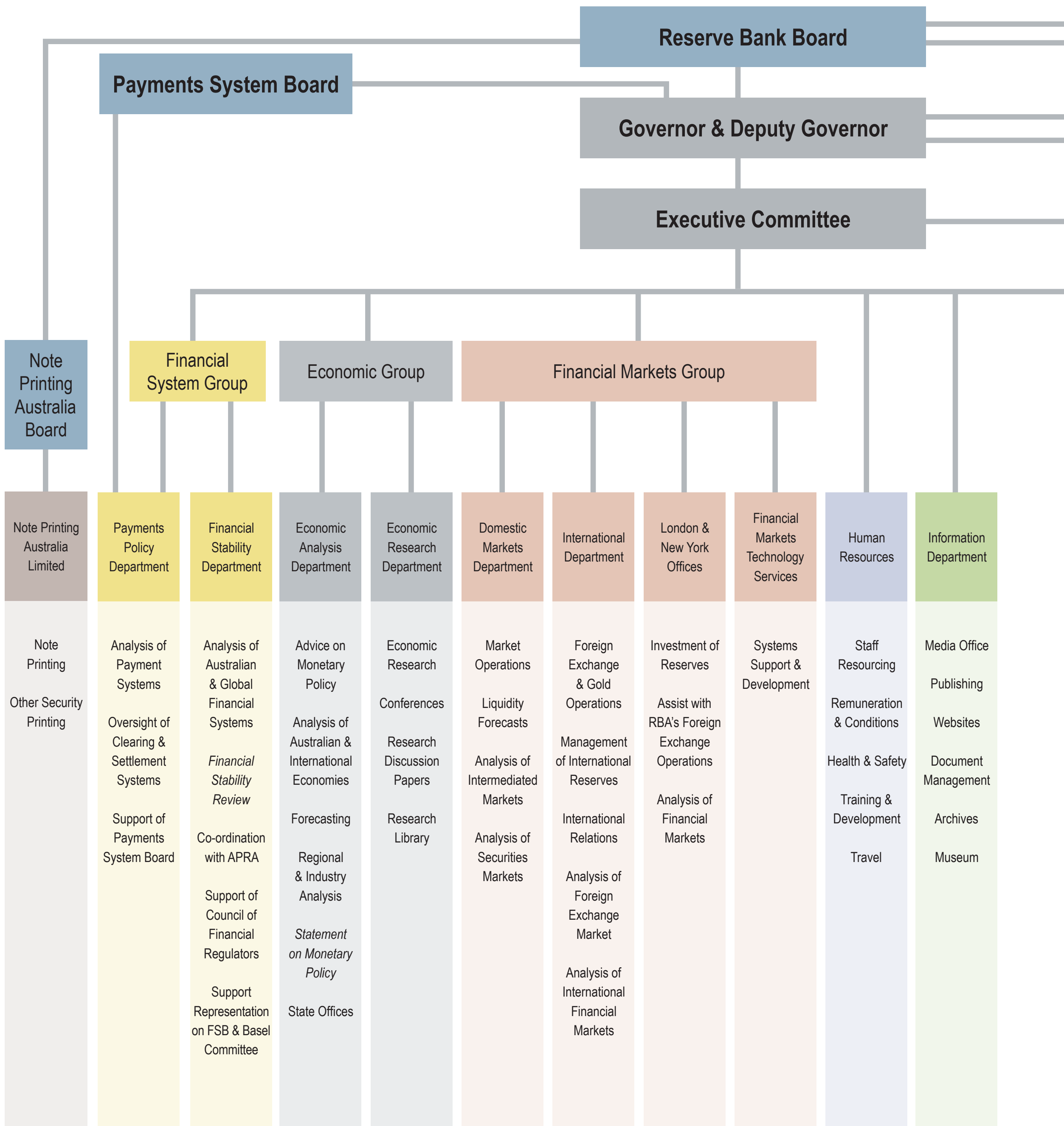
	Transactional Banking		Registry	
	2008/09 $ million	2009/10 $ million	2008/09 $ million	2009/10 $ million
Revenue				
– Service fees	18.3	17.8	0.5	0.5
– Other revenue	5.0	4.2	0.1	0.1
Total	23.3	22.0	0.6	0.6
Expenditure				
– Direct costs	14.3	14.1	0.3	0.3
– Indirect costs	4.0	2.4	0.1	0.1
Total	18.3	16.5	0.4	0.4
Net profit/(loss)	5.0	5.5	0.2	0.2
Net profit/(loss) after taxes[(a)]	3.5	3.8	0.1	0.1
Assets[(b)]				
– Domestic markets investments	418.0	508.8	1.5	1.3
– Other assets	8.8	8.9		0.1
Total	426.8	517.7	1.5	1.4
Liabilities[(b)]				
– Capital & reserves	25.0	25.0	1.0	1.0
– Deposits	395.5	485.4		
– Other liabilities	6.3	7.3	0.5	0.4
Total	426.8	517.7	1.5	1.4

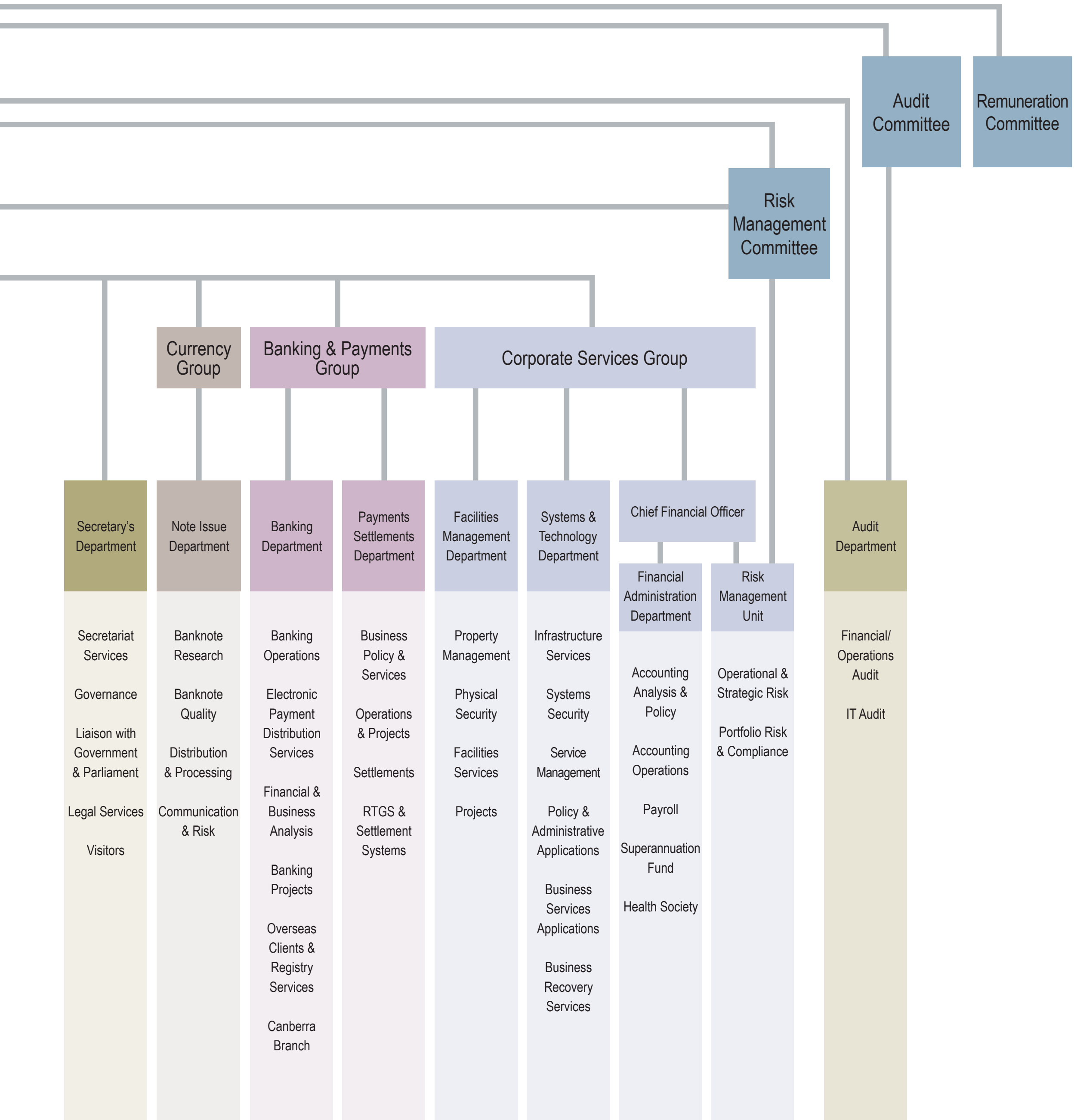
(a) In accordance with competitive neutrality guidelines, income tax expense has been calculated and transferred to the Commonwealth as a notional part of the Reserve Bank's annual profit distribution

(b) As at 30 June

Organisational Chart

August 2010




Audit Committee
Remuneration Committee
Risk Management Committee
Currency Group
Banking & Payments Group
Corporate Services Group
Secretary's Department
Secretariat Services
Governance
Liaison with Government & Parliament
Legal Services
Visitors
Note Issue Department
Banknote Research
Banknote Quality
Distribution & Processing
Communication & Risk
Banking Department
Banking Operations
Electronic Payment Distribution Services
Financial & Business Analysis
Banking Projects
Overseas Clients & Registry Services
Canberra Branch
Payments Settlements Department
Business Policy & Services
Operations & Projects
Settlements
RTGS & Settlement Systems
Facilities Management Department
Property Management
Physical Security
Facilities Services
Projects
Systems & Technology Department
Infrastructure Services
Systems Security
Service Management
Policy & Administrative Applications
Business Services Applications
Business Recovery Services
Chief Financial Officer
Financial Administration Department
Accounting Analysis & Policy
Accounting Operations
Payroll
Superannuation Fund
Health Society
Risk Management Unit
Operational & Strategic Risk
Portfolio Risk & Compliance
Audit Department
Financial/ Operations Audit
IT Audit

Executives of the Reserve Bank

August 2010

Governor:	Glenn Stevens
Deputy Governor:	Ric Battellino

Economic Group

Assistant Governor:	Philip Lowe

Economic Analysis Department

Head:	Tony Richards
Deputy Heads:	Ellis Connolly
	James Holloway
Head of Regional and Industry Analysis:	David Orsmond

Economic Research Department

Head:	Christopher Kent

Financial Markets Group

Assistant Governor:	Guy Debelle

Domestic Markets Department

Head:	John Broadbent
Deputy Head:	Jonathan Kearns

International Department

Head:	Chris Ryan
Deputy Heads:	Alexandra Heath
	James Whitelaw

Financial System Group

Assistant Governor:	Malcolm Edey

Financial Stability Department

Head:	Luci Ellis
Deputy Head:	Carl Schwartz

Payments Policy Department

Head:	Michele Bullock
Deputy Head:	John Simon

Banking and Payments Group

Assistant Governor: Keith Hall

Banking Department

Head: Greg Johnston

Payments Settlements Department

Head: Nola McMillan

Currency Group

Assistant Governor: Bob Rankin

Note Issue Department

Head: Michael Andersen

Corporate Services Group

Assistant Governor: Frank Campbell

Financial Administration Department

Chief Financial Officer: Darryl Ross

Facilities Management Department

Head: Richard Mayes

Systems & Technology Department

Head: Michael Hogan

Risk Management Unit

Head: Lindsay Boulton

Secretary's Department

Acting Secretary: Anthony Dickman
General Counsel: Catherine Parr

Audit Department

Head: Peter Russell

Information Department

Head: Jacqui Dwyer

Human Resources

Head: Chris Aylmer

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Deputy Chief Representative: Andrew Sewell
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Craigieburn VIC 3064
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Fax: (03) 9303 0491

Glossary

ABCP	Asset-backed commercial paper
ADI	Authorised deposit-taking institution
AIFRS	Australian equivalents to International Financial Reporting Standards
AOFM	Australian Office of Financial Management
APRA	Australian Prudential Regulation Authority
ATM	Automated teller machine
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
CAC Act	*Commonwealth Authorities and Companies Act 1997*
CGFS	Committee on the Global Financial System (of the BIS)
CGS	Commonwealth Government securities
CLS	Continuous linked settlement
COIN	Community of Interest Network
CPSS	Committee on Payment and Settlement Systems (of the BIS)
DoFD	Department of Finance and Deregulation
ECB	European Central Bank
EMEAP	Executives' Meeting of East Asia-Pacific Central Banks
ES	Exchange settlement
ESA	Exchange Settlement Account
FOI	Freedom of Information
FSB	Financial Stability Board
G-20	Group of Twenty
GPF	Government Partnership Fund (with Indonesia)
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
LVCS	Low Value Clearing Service
LVF	Low Value Feeder
NNPDC	National Note Processing and Distribution Centre
NPA	Note Printing Australia Limited
OECD	Organisation for Economic Co-operation and Development
OPA	Official Public Accounts
OTC	Over the counter (derivatives)
RBA	Reserve Bank of Australia
RBRF	Reserve Bank Reserve Fund
RDP	Research Discussion Paper
repo	Repurchase agreement
RITS	Reserve Bank Information and Transfer System
RMBS	Residential mortgage-backed securities
RMU	Risk Management Unit
RTGS	Real-time gross settlement
SDR	Special Drawing Right
SWIFT	Society for Worldwide Interbank Financial Telecommunication

RESERVE BANK OF AUSTRALIA