RESERVE BANK
OF AUSTRALIA

RESERVE BANK OF AUSTRALIA ANNUAL REPORT

Reserve Bank

2013

RESERVE BANK OF AUSTRALIA

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G.R. Stevens
GOVERNOR

2 October 2013

The Hon Joe Hockey MP
Treasurer
Parliament House
CANBERRA ACT 2600

Dear Treasurer

RESERVE BANK ANNUAL REPORT 2013

In accordance with section 9 of the *Commonwealth Authorities and Companies Act 1997* (CAC Act), I am pleased to submit the Reserve Bank's Annual Report for the year ended 30 June 2013 for presentation to the Parliament. The annual report has been prepared in accordance with Part 1 of Schedule 1 of the CAC Act.

Yours sincerely

Reserve Bank of Australia

ANNUAL REPORT 2013

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Governor’s Foreword

The global economy expanded at a pace somewhat below average in 2012/13, but some of the downside risks that had been such a concern a year earlier did not materialise. The actions of the European Central Bank, in particular, were key in stabilising the situation in Europe. China’s economy settled to a more moderate but more sustainable pace of expansion, while Japan embarked on a new and aggressive round of expansionary economic policies. The US economy continued to recover gradually, which has seen the Federal Reserve set out the conditions for a change of course on policy.

The Australian economy recorded below-average growth over the year, as the impetus from the extraordinary run-up in investment spending by the resources sector began to abate and as some other sectors remained somewhat subdued. The unemployment rate rose gradually, while inflation remained consistent with the medium-term target. The Board lowered the cash rate three times during 2012/13 and again in August 2013, bringing the total reduction in this cycle to 225 basis points, and the cash rate to 2.50 per cent, the lowest in more than 50 years. These changes were guided, as in past years, by the longstanding framework for monetary policy of flexible inflation targeting.

There was a notable decline in the exchange rate of the Australian dollar late in the year under review. For about two years up to early 2013, the currency had traded mostly at a level above parity with the US dollar and in the high 70s in terms of the trade-weighted index. But as prospects for the US and Australian economies have been reassessed over recent months, it has depreciated somewhat.

These trends also affected the Reserve Bank’s balance sheet and earnings. Valuation effects, mostly from the lower exchange rate, raised assets by $3.6 billion. Underlying earnings, which are essentially driven by the running yield on the portfolio of foreign and domestic assets, were $0.7 billion, about the same as the previous year and very low by historical standards. This mainly reflects the very low level of interest rates, especially those in the major advanced countries where the Bank holds its foreign assets.

Measured on the basis of accounting standards, which bring to profit and loss both realised and unrealised valuation changes, the Bank recorded a profit of $4.3 billion, the highest for four years. The *Reserve Bank Act 1959* allows only underlying earnings and net realised valuation gains to be paid to the Commonwealth. Earnings available for distribution amounted to $588 million, down from $1 096 million the previous year, mainly because the outcome the previous year included some valuation gains on foreign securities that were realised as yields fell.

The Board’s view is that the earnings should be devoted in their entirety to rebuilding the Reserve Bank Reserve Fund (RBRF), the Bank’s main permanent capital reserve, which had been depleted by the large accounting losses in 2009/10 and 2010/11. The Treasurer has agreed with this course of action and accordingly no dividend will be paid to the Commonwealth from net profits of the Bank in 2012/13. The RBRF therefore stands at $2.5 billion and remains well below its target level. Further such transfers will be required in future years.

The Reserve Bank's cost of operations rose by a little over 8 per cent in 2012/13. Some cost increases in the business areas were matched by revenue gains. Stripping those out, operating costs rose by about 6½ per cent. As always, a large share of costs is staff costs. Staff salary increases averaged 4 per cent, the same as the previous year, while staff numbers rose by 64, or 6 per cent, the highest for some years. The transition of some projects into the more intense phase of development accounted for about half of the staffing increase. Costs are again anticipated to rise at an above-average pace in 2013/14, reflecting the further build-up of expenses for major projects; 'business-as-usual' costs should rise at a similar pace as in the year under review.

There are a number of projects underway, including three large and noteworthy ones. The Next Generation Banknote project, announced in September 2012, seeks to keep Australia's banknotes ahead of the efforts of counterfeiters. At about 10 counterfeits detected per million banknotes in circulation, counterfeiting rates remain low at present. But with the current series of banknotes approaching 20 years in circulation, and given the lead times involved in designing, testing and introducing new security features, it is time now to be investing in upgrading the security of the existing designs. The Reserve Bank will be providing more information on the new banknote series in the coming year. The project will also involve the construction of more efficient facilities for the secure storage and distribution of banknotes.

The second project, the New Payments Platform, had its genesis in the *Strategic Review of Innovation in the Payments System* by the Payments System Board in 2012, which saw a need to set some goals for faster and more efficient payments, together with strengthened industry governance arrangements. The private sector has responded to these high-level goals with proposals to build the necessary payments infrastructure. The Reserve Bank will play its own part by building certain key elements of infrastructure that will facilitate the use of the Reserve Bank Information and Transfer System to enable faster payments for the community.

The third major project is an upgrade of the Reserve Bank's banking systems that provide services to its government customers. The current systems have been operating for nearly two decades and, while still reliable, are nearing the end of their useful life. Use of more modern technology will better meet customer needs, improve efficiency and reduce operational risks in the Bank.

Each of these is a complex, multi-year project that will entail considerable expense, but they are in the public interest and are necessary if the Reserve Bank is to fulfil its responsibilities to provide a secure currency, foster a world-class payments infrastructure and provide efficient banking services to the Commonwealth. The Bank is appropriately strengthening its project management and oversight capabilities.

Jillian Broadbent AO finished a 15-year stint on the Board on 6 May 2013, having served with great distinction over three terms. The Board thanks her for her outstanding service and wishes her well. Kathryn Fagg joined the Board on 7 May 2013, bringing the benefit of many years of commercial experience to the Board's deliberations.

Once again the Reserve Bank management and staff performed their roles with their customary quiet dedication and high levels of competence. The Board joins me in thanking them for their efforts.

Glenn Stevens
Chairman, Reserve Bank Board
2 September 2013

Functions and Objectives of the Reserve Bank

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

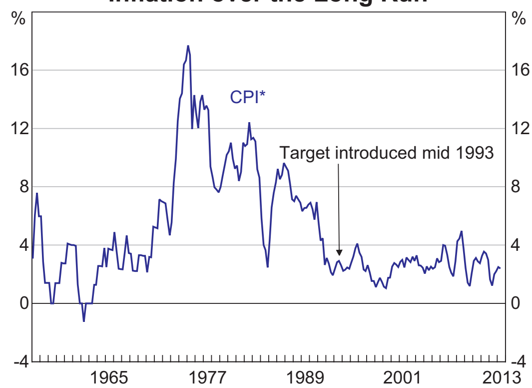
Under its enabling legislation, the *Reserve Bank Act 1959*, the Bank has broad powers, including to take deposits, borrow and lend money, give guarantees, effect transfers of money and deal in Commonwealth and other securities, foreign currency and gold.

The Reserve Bank's responsibility for monetary policy is set out in the Reserve Bank Act. Section 10(2) 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.

Since 1993, policies in pursuit of these objectives have found practical expression in a target for consumer price inflation of 2 to 3 per cent, on average, over the cycle. Monetary policy aims to achieve this over the medium term so as to encourage strong and sustainable growth in the economy. The fifth *Statement on the Conduct of Monetary Policy*, signed by the Treasurer and the Governor in September 2010, records the common understanding of the Government and the Reserve Bank on key aspects of the monetary policy framework.

Inflation over the Long Run



* Excludes interest charges prior to September quarter 1998 and adjusted for the tax changes of 1999–2000

Sources: ABS; RBA

The Reserve Bank also works to promote the overall stability of the financial system, seeking to mitigate the risk of financial disturbances that may have systemic consequences, and responding to a financial system disturbance should it occur. The Bank works on these matters with other relevant agencies, including through the Council of Financial Regulators (CFR). The CFR, which is chaired by the Reserve Bank Governor, brings together the Bank, the Australian Prudential Regulation Authority, the Australian Securities and Investments Commission (ASIC) and the Australian Treasury, with a mandate to contribute to the efficiency and effectiveness of regulation and the stability of the financial system.

The Reserve Bank designs, produces and issues Australia's banknotes, with the ultimate objective of ensuring public confidence in banknotes as an effective payment mechanism and a secure store of wealth.

The Reserve Bank provides specialised banking services to government and foreign official institutions. The services include payments and collections as well as general account maintenance and reporting. The Bank also operates Australia's main high-value payments system.

The Reserve Bank holds and manages Australia's foreign currency reserves, operating in the foreign exchange market on a regular basis to meet the foreign exchange needs of its clients and to assist with domestic liquidity management.

Since 1998 the Reserve Bank has not had responsibility for the prudential supervision of banks, but has responsibility for ensuring the stability, efficiency and competitiveness of the payments system through the Payments System Board, which was established at that time. The Bank's powers in relation to the payments system are set out in a number of other statutes, including the *Payment Systems (Regulation) Act 1998* and the *Corporations Act 2001*. Under the Corporations Act, the Bank, overseen by the Payments System Board, has responsibility for determining financial stability standards for licensed clearing and settlement facilities and assessing facilities' compliance with those standards. Amendments to the Corporations Act in January 2013 in relation to the regulation of over-the-counter (OTC) derivative transactions gave the Bank an additional role, complementary to its financial stability mandate. The amendments include a formal structure for the Minister and ASIC to consult with or seek advice from the Bank in relation to some of their responsibilities under the new regime. The amendments also provide for regulation of trade repositories by ASIC and give the Bank access to valuable data with which to assess the risks associated with OTC derivatives.

Governance

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

Reserve Bank Board

The Reserve Bank Board has responsibility for monetary and banking policy and the Reserve Bank's policy on all other matters except payments system policy, as well as a range of other statutory obligations. The Board comprises nine members: the Governor (Chairman), Deputy Governor (Deputy Chairman), Secretary to the Treasury and six other non-executive members appointed by the Treasurer. Members of the Board during 2012/13 are shown opposite and details of their qualifications and experience are provided on pages 9–13. Jillian Broadbent AO completed her third term on the Board in May 2013; a resolution of the Board on 2 April 2013 is shown on page 14.

The Reserve Bank Board meets 11 times a year, on the first Tuesday of each month except in January. Five members form a quorum at a meeting of the Board. Most Board meetings are held at the Head Office in Sydney. Meetings are held in Reserve Bank offices in other Australian cities twice in most calendar years, once in Melbourne and once in another location.

Board Meetings in 2012/13 – Attendance by Members

	No of meetings attended	No of meetings eligible to attend
Glenn Stevens (Governor)	11	11
Philip Lowe (Deputy Governor)	11	11
John Akehurst	11	11
Jillian Broadbent[(a)]	8	9
Roger Corbett	11	11
John Edwards	11	11
Kathryn Fagg[(b)]	2	2
Martin Parkinson (Treasury Secretary)[(c)]	10	11
Heather Ridout	11	11
Catherine Tanna	11	11

(a) Jillian Broadbent's term on the Board ended on 6 May 2013
(b) Kathryn Fagg's term on the Board commenced on 7 May 2013
(c) David Gruen (Executive Director (Domestic), Macroeconomic Group, Australian Treasury) attended one meeting in place of Martin Parkinson, in terms of section 22 of the *Reserve Bank Act 1959*

Following a review of governance arrangements for the Reserve Bank's wholly owned subsidiary, Note Printing Australia Limited (NPA), the Board decided to appoint one of its non-executive members, Heather Ridout AO, to the Board of NPA. Mrs Ridout's term on the NPA Board commenced on 15 November 2012 and is concurrent with her term on the Reserve Bank Board.

The Board has an Audit Committee (see page 6) and a Remuneration Committee (see page 7).

Payments System Board

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

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

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

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

Conduct of Reserve Bank Board Members

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

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

Over and above these statutory requirements, members recognise their responsibility for maintaining a reputation for integrity and propriety on the part of the Board and the Reserve Bank in all respects. Members have 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, which was revised in 2012, is on the Bank's website.

Reserve Bank Board Audit Committee

The primary objective of the Audit Committee of the Reserve Bank Board is to report to the Board on matters relevant to the fulfilment of the Bank's statutory financial reporting and other obligations in terms of the Reserve Bank Act and the CAC Act. The Committee assists the Governor and the Board in fulfilling their obligations relating to financial reporting, risk management, fraud control and regulatory compliance. Its particular responsibilities are to ensure the effectiveness of the Bank's internal control environment.

Following the retirement of Jillian Broadbent AO from the Board, John Akehurst assumed the role of Chairman of the Audit Committee from May 2013. Other members of the Committee are Roger Corbett AO, a member of the Reserve Bank Board, and Michael Coleman and Terry Williamson, both of whom are company directors and former senior audit partners of major accounting firms and have extensive

Audit Committee Meetings in 2012/13 – Attendance by Members

	No of meetings attended	No of meetings eligible to attend
John Akehurst[a]	1	1
Jillian Broadbent[b]	5	5
Michael Coleman	6	6
Roger Corbett	5	6
Terry Williamson	6	6

(a) John Akehurst's term on the Audit Committee commenced on 1 May 2013

(b) Jillian Broadbent's term on the Audit Committee ended on 30 April 2013 experience in the finance sector. Consistent with contemporary governance standards, no executive is a member of the Audit Committee, although the Deputy Governor attends all meetings of the Committee as the chief management representative. During 2012/13, the Audit Committee met on six occasions.

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

Reserve Bank Board Remuneration Committee

The Remuneration Committee of the Reserve Bank Board was established in terms of section 24A of the Reserve Bank Act to recommend to the Board 'terms and conditions relating to the remuneration and allowances' for the Governor and Deputy Governor. Membership of the Committee is drawn from the non-executive members of the Board and at present comprises Roger Corbett AO (Chairman), John Edwards and Catherine Tanna. John Edwards succeeded Jillian Broadbent AO as a member of the Committee following her retirement from the Board in May 2013. During 2012/13 the Committee met on six occasions.

Remuneration Committee Meetings in 2012/13 – Attendance by Members

	No of meetings attended	No of meetings eligible to attend
Jillian Broadbent[(a)]	4	5
Roger Corbett	6	6
John Edwards[(b)]	2	2
Catherine Tanna	6	6

(a) Jillian Broadbent's term on the Remuneration Committee ended on 6 May 2013
(b) John Edwards' term on the Remuneration Committee commenced on 2 April 2013

The offices of Governor and Deputy Governor are Principal Executive Offices in terms of the *Remuneration Tribunal Act 1973*, which provides for the Remuneration Tribunal to determine the applicable remuneration reference rate for these offices. The Remuneration Committee reviews the terms and conditions (including remuneration and allowances) applying to the Governor and Deputy Governor annually and recommends adjustments to the Board for approval, providing that such terms and conditions are consistent with the framework for Principal Executive Offices determined by the Remuneration Tribunal.

The Remuneration Committee is also kept informed of the remuneration arrangements for Reserve Bank staff. The Governor attends meetings of the Committee at the invitation of the Chairman to discuss remuneration matters in the Bank, but not those relating to his own remuneration. The Committee communicates with the Remuneration Tribunal as required.

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

Remuneration and Allowances

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

Induction of Board Members

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

Executive Committee

The Executive Committee is the key decision-making committee of the Reserve Bank for matters of an administrative and managerial nature. It is a management committee, comprised of the Bank's most senior executives, whose role is to assist and support the Governor in fulfilling his responsibilities under the Reserve Bank Act to manage the Bank. The Committee is chaired by the Governor and meets weekly.

Risk Management Committee

The Risk Management Committee has responsibility for ensuring that operational and financial risks are identified, assessed and properly managed across the Reserve Bank in accordance with its Risk Management Policy. It is a management committee chaired by the Deputy Governor and comprises senior executives drawn mainly from the operational areas of the Bank. During 2012/13 the Committee met on four occasions and kept the Executive Committee and Reserve Bank Board Audit Committee informed of its activities.

Values and Ethics

A key governance initiative undertaken during the year in review was the development and launch of a new Code of Conduct articulating the Reserve Bank's core values of promotion of the public interest, integrity, excellence, intelligent enquiry and respect. Building on those values, the Code outlines the conduct the Bank expects of its staff. The new Code of Conduct was developed by a steering committee chaired by the Deputy Governor and assisted by a legal firm. The Governor launched the new Code to staff in November 2012 via an email that included a video interview of him discussing the Bank's values with the Executive Director of the St James Ethics Centre, Dr Simon Longstaff AO. All departments subsequently held discussions led by their senior management to discuss the Bank's values and the new Code. Staff are required to read the Code on an annual basis.

To further develop an understanding of the culture and systems required for an organisation to operate ethically, the Reserve Bank's executive team participated in an Ethical Awareness and Decision-Making workshop facilitated by the St James Ethics Centre. All other staff will be invited to attend an Ethical Awareness workshop during the current financial year.

Indemnities for Members of Boards and Senior Staff

Members of the Reserve Bank Board and the Payments System Board have been indemnified in accordance with section 27M of the CAC Act against liabilities incurred by reason of their appointment to the relevant Board or by virtue of holding and discharging such office.

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

As the Reserve Bank does not take out directors and officers liability insurance in relation to its Board members or other officers, no premiums were paid for any such insurance during 2012/13.

Other Policy Matters

Over the course of the past year, the Reserve Bank Board reviewed its responsibilities for the Reserve Bank's policy on all matters other than monetary, banking and payments system policy. The Governor subsequently reported to the Board on the process of review and implementation of the relevant policies, including compliance arrangements and any material breaches.

Reserve Bank Board

September 2013

Glenn Stevens

BEc (Hons) (Sydney), MA (Western)

Governor and Chairman

Governor since 18 September 2006

Reappointed from 18 September 2013 until 17 September 2016

Glenn Stevens has held various senior positions in the Reserve Bank, including Head of Economic Analysis and International Departments and Assistant Governor (Economic), where he was responsible for overseeing economic and policy advice to the then Governor and Reserve Bank Board. He was Deputy Governor from 2001 to 2006.

Other Roles

Chairman – Payments System Board

Chairman – Council of Financial Regulators

Chairman – Financial Markets Foundation for Children

Member – Financial Stability Board

Director – The Anika Foundation

Philip Lowe

BCom (Hons) (UNSW), PhD (MIT)

Deputy Governor and Deputy Chairman

Member since 14 February 2012

Present term ends 13 February 2019

Philip Lowe has held various senior positions in the Reserve Bank, including Assistant Governor (Economic) and Assistant Governor (Financial System). He spent two years with the Bank for International Settlements working on financial stability issues (2000–2002). Dr Lowe has authored numerous papers, including on the linkages between monetary policy and financial stability.

John Akehurst

MA (Oxon)

Non-Executive Member

Member since 31 August 2007

Present term ends 30 August 2017

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

Directorships

Chairman – National Centre for Asbestos Related Diseases

Chairman – Transform Exploration Pty Ltd

Director – CSL Limited

Director – Origin Energy Limited

Reserve Bank Board Committee membership

Chairman – Audit Committee

Roger Corbett AO

BCom (UNSW)

Non-Executive Member

Member since 2 December 2005

Present term ends 1 December 2015

Roger Corbett has had extensive experience in the retailing industry, both in Australia and overseas. He served as the CEO of Woolworths Limited (1999–2006) and has held numerous board positions. Mr Corbett is a Fellow of the Australian Institute of Management and the Risk Management Institution of Australasia.

Directorships

Chairman – Fairfax Media Limited

Chairman – Mayne Pharma Group Limited

Chairman – PrimeAg Australia Limited

Director – Wal-Mart Stores, Inc.

Reserve Bank Board Committee membership

Chairman – Remuneration Committee

Member – Audit Committee

John Edwards

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

Non-Executive Member

Member since 31 July 2011

Present term ends 30 July 2016

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

Other Roles

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

Adjunct Professor – University of Sydney School of Business

Visiting Fellow – Lowy Institute for International Policy

Member – Australian Workforce and Productivity Agency

Reserve Bank Board Committee membership

Member – Remuneration Committee

Kathryn Fagg

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

Non-Executive Member

Member since 7 May 2013

Present term ends 6 May 2018

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

Directorships

Chair – Melbourne Recital Centre

Martin Parkinson PSM

BEc (Hons) (Adelaide), MEc (ANU), MA, PhD (Princeton)

Ex Officio Member

Secretary to the Treasury

Member since 27 April 2011

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

Other Roles

Chair – Advisory Board of the Australian Office of Financial Management

Member – Australia in the Asian Century Strategic Advisory Board

Member – Council of Financial Regulators

Member – Board of Taxation

Member – Infrastructure Australia

Heather Ridout AO

BEc (Hons) (Sydney)

Non-Executive Member

Member since 14 February 2012

Present term ends 13 February 2017

Heather Ridout has a strong understanding of public policy and of the manufacturing sector. Mrs Ridout was Chief Executive of the Australian Industry Group (2004–2012). Her previous appointments include key national policy-setting and consultative groups, including member of the Henry Tax Review panel, board member of Infrastructure Australia, member of the Prime Minister's Taskforce on Manufacturing and member of the Australian Workforce and Productivity Agency.

Directorships

Chair – AustralianSuper Trustee Board

Director – Australian Securities Exchange Limited

Director – Note Printing Australia Limited

Director – Sims Metal Management Limited

Catherine Tanna

LLB (Queensland)

Non-Executive Member

Member since 30 March 2011

Present term ends 29 March 2016

Catherine Tanna has extensive experience in the resources sector with BG Group, Royal Dutch Shell and BHP Billiton. She held senior executive roles with responsibility for LNG, gas transmission and power-generation businesses across Africa, North Asia, Russia, North America, Latin America and Australia.

Directorships

Chairman – BG Australia

Chair – Queensland 20 (Q20)

Member – Australian G20 Business Body (B20)

Member – Gold Coast 2018 Commonwealth Games Corporation Board

Reserve Bank Board Committee membership

Member – Remuneration Committee

Retirement from the Board

Jillian Broadbent AO retired from the Board on 6 May 2013.

Jillian Broadbent AO

BA (Sydney)

Non-Executive Member

Appointed 7 May 1998

Retired 6 May 2013

Jillian Broadbent has extensive experience in corporate banking and finance both in Australia and internationally, primarily with Bankers Trust Australia. Her previous directorships include ASX Limited, Special Broadcasting Service Corporation, Westfield Management Limited, Qantas Airways Limited, Woodside Petroleum Limited and Coca-Cola Amatil Limited.

Directorships

Director – Woolworths Limited

Chair – Clean Energy Finance Corporation

Chancellor – University of Wollongong

Reserve Bank Board Committee membership until retirement from the Board

Chairman – Audit Committee

Member – Remuneration Committee

Resolution Passed by the Board – 2 April 2013

Members noted that this was the final meeting for Jillian Broadbent, who had served three terms on the Board, covering a period of 15 years, with great professionalism and distinction. The Governor paid tribute to Ms Broadbent's active and inquiring role as a Board member, which had drawn on her extensive knowledge of financial markets. He also acknowledged her roles on the Audit and Remuneration Committees, including as Chair of the Audit Committee for the past four and a half years, and the significant part she played in strengthening the role of the Audit Committee in the Bank's broader governance framework. Members recorded their appreciation for Ms Broadbent's contribution to the sound and pragmatic conduct of monetary policy, as well as the good governance of the Bank. They wished her well in the future.

Accountability and Communication

Relationship with Government

Section 11 of the *Reserve Bank Act 1959* provides for substantial independence of the Reserve Bank in terms of its monetary and banking policy. The Reserve Bank's independence is accompanied by an obligation to inform the Government of its policies 'from time to time'. The Reserve Bank Act sets out a clear and transparent process for resolving differences of opinion between the Board and the Government on policy matters. Regular discussions between the Governor and the Treasurer (at the date of signing The Hon Chris Bowen MP and formerly The Hon Wayne Swan MP) served to keep the Government informed during the year in review.

Reporting Obligations

The Reserve Bank is a Commonwealth authority. The members of the Reserve Bank Board are the directors of the Bank responsible under the *Commonwealth Authorities and Companies Act 1997* (CAC Act) for the preparation and contents of the annual report. At its meeting on 6 August 2013 the Board resolved that the Chairman sign the annual report and financial statements as at 30 June 2013, and provide 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 public hearings, at which the Bank presents its views on the economy and financial markets and other matters pertaining to the Bank's operations, and responds to questions from Committee members. In 2012/13, the Governor and senior Bank officers attended hearings of this Committee for this purpose in August 2012 and February 2013, on both occasions in Canberra. An additional hearing, also in Canberra, was held in October 2012 in relation to matters concerning Note Printing Australia Limited and Innovia Security Pty Ltd (formerly Securency International Pty Ltd). The Committee issued its reports on these hearings on 1 November 2012, *Review of the Reserve Bank Annual Report 2011 (Second Report)*, which covered the August 2012 and October 2012 hearings, and on 18 March 2013, *Review of the Reserve Bank Annual Report 2012 (First Report)*, which covered the February 2013 hearing.

The regular twice-yearly appearances before the House of Representatives Standing Committee on Economics, and the quarterly *Statement on Monetary Policy* (see below), are important elements of the arrangements embodied in the understandings between the Governor and the Treasurer (outlined in the fifth *Statement on the Conduct of Monetary Policy*, which was issued in September 2010).

The Reserve Bank made two public written submissions to parliamentary inquiries during the year: a submission in October 2012 to the inquiry into family business in Australia and a submission in April 2013 to the inquiry into the Corporations and Financial Sector Legislation Amendment Bill 2013, both of which were conducted by the Parliamentary Joint Committee on Corporations and Financial Services. The Parliamentary Joint Committee issued its report on family businesses, *Family Businesses in Australia – Different and Significant: Why They Shouldn't be Overlooked*, on 20 March 2013, and its report on the Corporations and Financial Sector

Legislation Amendment Bill 2013 was issued on 15 May 2013. In August 2012, senior officers appeared before the Senate Economics References Committee in Sydney as part of its inquiry into the post-global financial crisis banking sector, which followed lodgement of a submission to the inquiry in May 2012. The Committee issued its report, *The post-GFC Banking Sector*, on 28 November 2012. In November 2012, the Governor gave testimony before a hearing in Canberra of the Parliamentary Joint Committee on the Australian Commission for Law Enforcement Integrity as part of its inquiry into the integrity of overseas Commonwealth law enforcement operations. This followed answers to questions on notice provided by the Bank to the Parliamentary Joint Committee on 1 June 2012. The Bank also made a confidential written submission to this Committee in November 2012. The Committee issued its report on 24 June 2013.

Communication

The Reserve Bank seeks to ensure a high degree of transparency about its activities, goals, decision-making processes and the basis of its policy decisions. Transparency facilitates the accountability of the central bank, in keeping with its operational independence. Importantly, it also increases the effectiveness of policy decisions by promoting more informed decision-making by the wider community.

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

Reserve Bank publications

The quarterly *Statement on Monetary Policy* informs the financial markets, media and general public about the Reserve Bank's views about monetary policy and developments in financial markets. It also provides a basis for the House of Representatives Economics Committee's questioning of the Bank at its regular hearings. The *Statement* contains analysis of conditions in the economy and financial markets, describes the outlook for inflation and economic growth and offers further explanation of recent decisions about the cash rate.

The *Financial Stability Review*, published each March and September, provides a detailed assessment of the condition of Australia's financial system, along with analysis of financial system issues of specific interest. In the past year, these issues included households' mortgage prepayment buffers, the funding composition of Australian banks, Australian banking activity in Asia and the financial conditions of companies servicing the mining sector. The *Review* reports on international regulatory reforms, the Reserve Bank's involvement in these reforms and their potential effects. Additionally, it reports on domestic regulatory issues, including through the Bank's work with the Council of Financial Regulators (CFR), which is the coordinating body for Australia's main financial regulatory agencies. The CFR is a non-statutory body whose role is to contribute to the efficiency and effectiveness of financial regulation and to promote stability of the Australian financial system. Its members share information, discuss regulatory issues and, if the need arises, coordinate responses to potential threats to financial stability. The CFR also advises the Australian Government on Australia's financial regulatory arrangements.

Australia's financial stability policy framework involves clear mandates for financial stability distributed across several of the CFR agencies. The prudential elements of that framework rest with the Australian Prudential Regulation Authority (APRA). The Reserve Bank and APRA published a paper, *Macroprudential Analysis and Policy in the Australian Financial Stability Framework*, during the reporting year, setting out the tools and practices of these two agencies that are designed to support financial stability from a system-wide perspective.

The Reserve Bank's quarterly *Bulletin* contains analysis of a broad range of economic and financial developments as well as aspects of the Bank's operations. *Bulletin* articles over the past year covered topics ranging from regular articles on bank fees and margins to developments in the markets for foreign exchange and domestic securities. There were articles on the increasingly important economies of China and India, along with developments in mobile payments in developing and advanced economies. Other articles explored the resources boom and structural change in the Australian economy. There were also articles that complemented the *Statement on Monetary Policy* by providing more detail about specific economic developments and measurement issues.

Speeches

During 2012/13 the Governor, Deputy Governor and senior officers gave 42 speeches on various topics and participated in a number of public panel discussions. In addition to explaining current economic and financial conditions, many speeches addressed the longer-term forces shaping the economy, and the challenges associated with adapting to structural change and efforts to raise productivity. There were also speeches devoted to innovation and reform in the payments system along with reflections on financial system stability in the post-crisis environment. Audio files of these speeches, the associated Q&A and panel discussions were published on the Reserve Bank's website to enhance accountability and communication.

1. Governor Glenn Stevens addresses participants at the 2012 RBA/BIS Research Conference, August 2012 **2.** Deputy Governor Philip Lowe speaking at the Australian Business Economists Annual Dinner, December 2012 **3.** Assistant Governor (Economic) Christopher Kent addresses the Structural Change and the Rise of Asia Conference, September 2012 **4.** Assistant Governor (Financial Markets) Guy Debelle speaking at the KangaNews Summit, March 2013 **5.** Assistant Governor (Financial System) Malcolm Edey speaking at the Thomson Reuters Australian Regulatory Summit, May 2013

Research

The Reserve Bank disseminates research conducted by staff in the form of Research Discussion Papers (RDPs) as well as through articles in the quarterly *Bulletin*.

The views expressed in RDPs are those of the authors and do not necessarily represent those of the Reserve Bank. RDPs are published to further the understanding of issues that affect policy and to encourage debate among a broad range of researchers. During 2012/13, 15 RDPs were published on a range of topics including RBA forecasts, the Australian corporate bond market, the demand for cash during the financial crisis and house prices.

In addition, Reserve Bank staff published papers in various journals, including the *Journal of Banking and Finance, JASSA: The Finsia Journal of Applied Finance* and the *Economic Record*.

Research undertaken at the Reserve Bank is also frequently presented at external conferences and seminars. Presentations at domestic conferences in 2012/13 included: the CAMA conference on Commodity Price Volatility Past and Present, the 18th Australasian Macroeconomics Workshop and a conference on Implications for the Australian Economy of Strong Growth in Asia, all held in Canberra; the Housing Markets Workshop at the University of Tasmania; the 7th and 8th Workshops on Macroeconomic Dynamics at the University of Sydney and ANU House in Melbourne, respectively; the Melbourne Money and Finance Conference hosted by the Australian Centre for Financial Research; and the Econometric Society Australasian Meeting at Melbourne University.

Papers were also presented by staff at a number of international conferences and workshops, including: the Bank of England Workshop for Heads of Financial Stability; the Southern Workshop in Economics at the University of Victoria, Wellington; the BIS Asian Research Network Conference in Manila; the Chinese Economics Society Annual Conference in Chengdu; the American Real Estate and Urban Economics Association Conference in Jerusalem; and the Bank of Papua New Guinea Seminar in Port Moresby.

The Reserve Bank hosts regular conferences, which foster interaction between academics, central bankers and other economic practitioners. The Bank's annual conference for 2013 was held in August in Sydney, with a focus on liquidity and funding markets. The conference covered a range of issues, including the ways in which private sector institutions are responding to changes in funding markets and their liquidity, the interaction between central banks and funding markets, the macroeconomic and financial stability consequences of these changes and the impact of regulatory change. A volume containing the conference papers and discussions will be published in late 2013.

In December 2012 the Reserve Bank hosted the annual Quantitative Macroeconomics workshop, which featured 10 papers by international and Australian academics and central bankers. Another macroeconomic workshop will be held in December 2013.

The Reserve Bank also hosted a number of academics and central bankers from the Bank of Canada and the Deutsche Bundesbank through the year, who presented seminars and participated in research activities at the Bank during their visits.

Online communication

The Reserve Bank publishes information in both electronic and hard copy formats, though most access to information is online. The website is heavily visited, with over 62 million page views and downloads made during 2012/13, and large spikes in visitation following the release of market-sensitive information. It is now more than two years since the Bank commenced using Twitter, and the number of subscribers to the website's conventional email alert service has continued to fall (to around 11 500 at the end of June 2013, down from 15 500 two years ago), while the number of followers on Twitter has grown (to 15 200 by the end of June 2013). Visitors to the website also made greater use of the RSS feeds, which allow them to receive alerts about updates to selected data, media releases, speeches, research papers and other documents.

In 2012/13 content relating to banknotes was separated from the main website and developed to form a new Banknotes microsite (www.banknotes.rba.gov.au). This new site focuses on explaining the design, production and security features of Australia's banknotes; more information is provided in the chapter on 'Currency'.

Michael Andersen, Note Issue Department, receives an award for the Banknotes microsite from Richard Haycock, Chairman, Currency Research, at the 2013 Currency Conference in Athens, June 2013

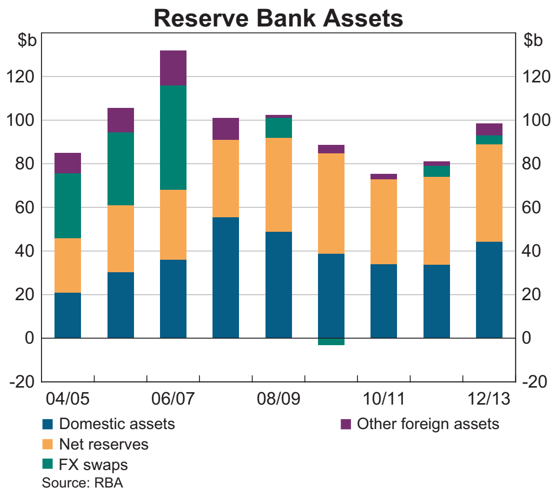
In addition, a dedicated website (www.cfr.gov.au) for the CFR was launched during the year to improve public understanding of its work. It includes information on how the CFR operates and highlights some of the key policy initiatives of the CFR in recent years. The website is also intended to serve as a central platform for information during any period of financial distress, complementing that provided by the individual member agencies.

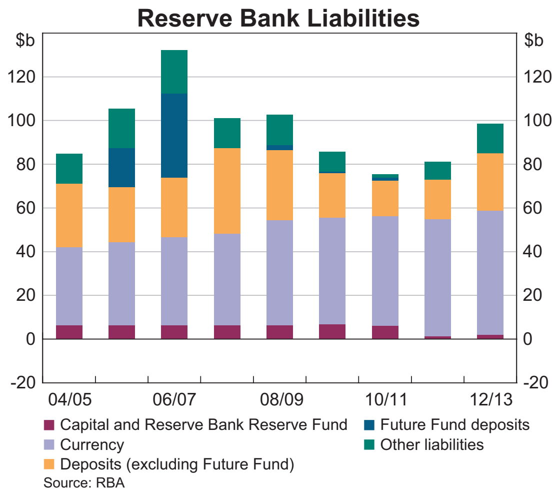
Operations in Financial Markets

The Balance Sheet

The Reserve Bank undertakes daily transactions in both domestic and international financial markets in order to implement the Board's monetary policy decisions, manage the nation's foreign reserve assets and provide banking services to its clients (mainly the Australian Government and foreign central banks). The structure of the Bank's balance sheet is influenced by these transactions and by the Bank's role in issuing Australia's banknotes.

The Bank's balance sheet grew by around $18 billion over 2012/13, to $99 billion. The increase in liabilities was mainly due to increased deposits and issuance of banknotes. Deposits held by the Australian Government increased by around $5 billion. These deposits are used by the Government to manage the timing of its receipts and outlays, and can vary considerably over the course of a year. Over 2012/13, banknotes on issue grew broadly in line with the size of the economy.





The rise in liabilities was matched on the balance sheet by increased holdings of domestic securities under reverse repurchase agreements (repos), as well as an increase in foreign currency-denominated assets. The Australian dollar value of net foreign exchange reserves held on the balance sheet increased by $5 billion over the year to $45 billion. This primarily reflected valuation gains of $3.6 billion resulting from the recent depreciation of the exchange rate. The Australian dollar depreciated by 12 per cent against the euro and 9 per cent against the US dollar, the main currencies in which the Bank holds its portfolio of foreign exchange reserves. At the end of June, the Reserve Bank also held $4 billion of foreign currency assets sourced via foreign exchange swaps against Australian dollars; these swaps were undertaken to assist with domestic liquidity management (see below). In total, the gross level of foreign exchange reserves held by the Bank stood at $49 billion at the end of June. Taking into account Australia's reserve position at the International

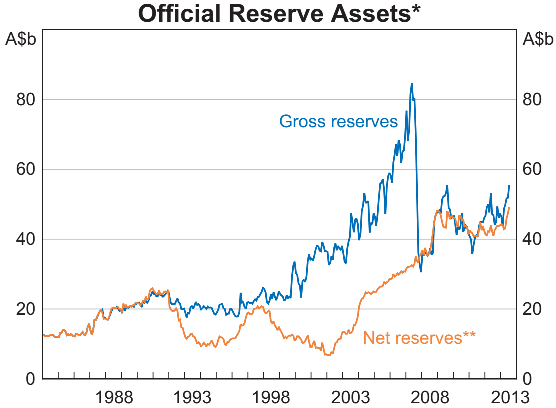
Reserve Bank Balance Sheet
$ billion

	June 2011	June 2012	June 2013
Assets	*75*	*81*	*99*
Foreign	41	47	54
– Net reserves[(a)]	39	40	45
– Foreign exchange swaps	0	5	4
– Other[(b)]	2	2	5
Domestic	34	34	44
Liabilities	*75*	*81*	*99*
Deposits	18	18	26
Currency	50	54	57
Capital and Reserve Bank Reserve Fund	6	1	2
Other (including capital)	2	8	13

(a) Excludes Australia's reserve position at the International Monetary Fund
(b) On a contractual basis; official reserve assets include foreign exchange swaps on a market basis (refer Note 15)
Source: RBA

Monetary Fund (which is an asset of the Australian Government not captured on the Bank's balance sheet), Australia's overall official reserve assets were $52 billion.

Official Reserve Assets*

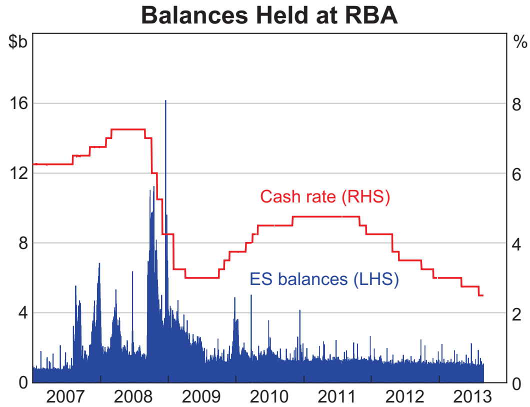


* Includes Australia's reserve position at the International Monetary Fund
** Net reserves exclude FX swaps
Source: RBA

Domestic Market Operations

The Reserve Bank Board's operational target for monetary policy is the cash rate – the rate at which banks borrow and lend to each other on an overnight, unsecured basis. The Board lowered its target for the cash rate four times during the past year – at the October, December, May and August Board meetings – from 3.5 per cent to 2.5 per cent. To meet the Board's target, the Reserve Bank operates in financial markets to maintain an appropriate level of exchange settlement (ES) balances. ES balances are liabilities of the Bank and are used by financial institutions to settle their payment obligations with each other and with the Bank. Of the 130 or so financial institutions that are members of the Reserve Bank Information and Transfer System (RITS), almost half operate ES accounts. The Bank pays interest on ES balances at a rate 25 basis points below the Board's cash rate target. ES account holders are not permitted to overdraw their accounts, although the Bank is willing to advance overnight funds, against appropriate securities, to account holders at an interest rate 25 basis points above the cash rate target. These funds are provided via reverse repos, whereby the Bank buys securities that the ES account holder agrees to repurchase on the following business day. In general, such overnight repos are undertaken only when banks have to meet unforeseen payments late in the day and are not able to source funds elsewhere. During 2012/13, the overnight repo facility was accessed only twice.

These arrangements create the incentive for account holders to recycle their settlement balances in the interbank market. With the rate for overnight repos and the rate paid on ES balances set at a constant margin to the cash rate target, the Reserve Bank does not need to alter the supply of ES balances to guide the cash rate towards a new target level. Over the past year, aggregate ES balances were generally around $1 billion, slightly below their average of the previous year.



Source: RBA

To monitor where the cash rate has traded, each business day the Reserve Bank collects data from ES account holders on their cash market activity. Prior to March 2013 around 25 banks had participated in the survey and, as these banks were the major participants within the market, the survey captured over 95 per cent of activity. Since March, all banks that operate ES accounts have been required to submit details of their unsecured borrowing and lending in the overnight interbank market. Each business day, the Bank publishes data on the total volume of transactions in the cash market and the weighted-average rate at which those transactions were executed. Aggregate activity within the cash market has averaged around $5 billion each day over the past year. The weighted-average cash rate was equal to the Board's target on all days.

Payments between ES account holders and the Reserve Bank's customers (principally, the Australian Government) alter the supply of ES balances. In order to offset the impact of its clients' transactions and ensure the aggregate ES balance remains at an appropriate level, the Bank generally needs to transact in the market on a daily basis. The Bank announces its dealing intentions in the domestic securities market each morning at 9.30 am. (Separate to these operations, the Bank occasionally uses FX swaps to supply or withdraw ES balances; see below.) Those RITS members wishing to participate in the Bank's open market operations have a 15 minute window in which to approach the Bank. Currently, these approaches are made by telephone, although the Bank intends to move its open market operations onto an electronic platform in the coming year.

Most of the Reserve Bank's transactions in the domestic market are contracted as repos. Under reverse repo, the Bank is willing to purchase both government-related debt securities ('general collateral') and private debt securities. To protect against a decline in the value of these securities should the Bank's counterparty not be able to meet its repurchase obligation, the Bank requires the value of the security to exceed the cash lent by a certain margin. These margins are higher for private securities than for government-related securities and are listed on the Bank's website (http://www.rba.gov.au/mkt-operations/resources/tech-notes/eligible-securities.html).

Domestic securities purchased by the Reserve Bank are held in an account that the Bank maintains in Austraclear, the ASX's securities depository. In April, the Bank agreed to become a Foundation Customer of ASX Collateral, a collateral management service that will allow the ASX to act as tri-party agent to the Bank's repos. As agent, the ASX will be responsible for ensuring that securities delivered to the Bank's Austraclear account are appropriately valued and meet the Bank's eligibility requirements. Tri-party arrangements can make it easier for those with large numbers of small-denomination holdings to fund their securities via repo. As agent, the ASX will also offer optimisation tools that can determine the most efficient allocation of securities against each exposure that a user is managing. While the Bank expects to settle its first tri-party repo by early 2014, counterparties will have the option of continuing with existing arrangements – confirming each individual security and its value bilaterally with the Bank prior to settlement.

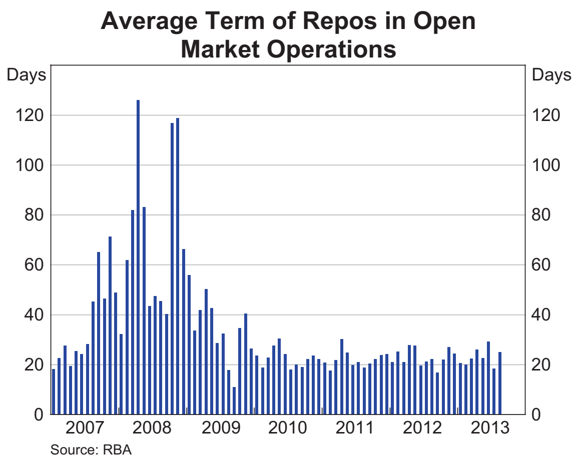
Over the past year, as the Reserve Bank's balance sheet has fluctuated with movements in government deposits, the value of securities held under reverse repo has ranged between $17 billion and $37 billion. With the stock of repos outstanding in the domestic market generally around $100 billion, the Bank's operations comprise a significant share of this market. The most active users of repo tend to be the fixed-income trading desks of banks and securities firms seeking to finance their inventories of Commonwealth Government Securities (CGS) and semi-government securities (semis). Reflecting this, around three-quarters of the securities held by the Bank are government related. The average term of reverse repos contracted via open market operations over the past year was around three weeks, similar to recent years.

Australian Dollar Securities Held under Repurchase Agreements

	June 2011		June 2012		June 2013	
	$ billion	Per cent of total	$ billion	Per cent of total	$ billion	Per cent of total
General collateral						
– CGS	3.9	18	8.5	35	15.5	42
– Semis	8.7	41	8.6	35	9.4	30
– Supras	2.0	10	0.6	2	1.4	4
– Government guaranteed	4.0	19	0.3	1	0.2	1
Private Securities						
– ADI issued	1.2	5	5.6	23	8.0	19
– RMBS	1.5	7	0.8	3	0.6	4
– Other	0.0	0	0.0	0	0.0	0
Total	21.4		24.4		35.2	

Source: RBA

As payments across the Government's account with the Reserve Bank cannot always be known with certainty in advance, on some days the Bank is required to conduct a further round of dealing after its 9.30 am operations. Since June 2012, unexpected liquidity flows resulted in the Bank conducting a second round of dealing on six occasions, generally late in the day.



The forthcoming shift to settling certain low-value transactions on a same-day basis (discussed in the chapter on 'Banking and Payments') will make the task of forecasting payment flows more difficult for both the Reserve Bank and ES account holders, especially as some of these payments will settle after the interbank cash market has closed. To ensure that these changes to the payments system do not impair the Bank's ability to implement monetary policy, certain aspects of its operational framework will be modified.

Under current arrangements, ES account holders can obtain term funding against securities via the Reserve Bank's open market operations. They are also able to access intraday funds from the Bank via a type of repurchase transaction known as an 'RBA Repo'. These repos are available without an interest charge and provide a means by which participants in a real-time gross settlement (RTGS) system can meet payments across the day in advance of funds being received. Failure to unwind an RBA Repo on the same day it is contracted results in an interest charge set at 25 basis points above the cash rate target (the overnight repo facility discussed above).

From November 2013, ES account holders will be able to contract RBA Repos on an 'open' basis, i.e. without a maturity date. Up to a limit specified for each account holder, these open repos will accrue interest at the cash rate target. The compensation of ES balances will also be altered. To the extent that account holders retain matching funds against their open repo position, those ES balances will be compensated at the cash rate target. In net terms then, there need be no cost to holding an open repo position. However, as is the case currently, surplus ES funds will earn a rate 25 basis points below the cash rate target, while any shortfall in funds below the account holder's open repo position will incur a 25 basis point penalty, although an allowance will be made for variations in ES balances arising from certain low-value payments that settle during the evening.

These arrangements will preserve the incentive for ES account holders to participate in the interbank cash market while it is open, lending surplus balances or borrowing against a shortfall. At the same time, they will allow those account holders participating in low-value payment streams to hold sufficient liquidity to meet payment obligations arising after the close of the cash market. Similarly, recipients of late payments will not be penalised for their inability to recycle these funds in the interbank market immediately.

In aggregate, it is anticipated that ES account holders will establish open positions in RBA Repos between $20 and $30 billion, expanding the Reserve Bank's balance sheet by a corresponding amount. Securities that are eligible for term repos contracted in the Bank's open market operations may also be used for RBA Repos, with the same margins imposed. However, while it is only in extraordinary circumstances that the Bank is willing to purchase self-securitised assets in its open market operations (the last occasion being at the height of the global financial crisis in late 2008 and 2009), from November 2013 ES account holders will be able to use such related-party assets for RBA Repos.

When the Basel III liquidity standards are introduced in January 2015, an ES account holder will only be able to contract RBA Repos at the cash rate target using securities that are consistent with the Australian Prudential Regulation Authority's (APRA's) liquidity policy for that institution. Specifically, banks will be required to hold a quantity of 'high-quality liquid assets' (HQLA) sufficient to withstand a 30-day period of stress. In the domestic securities market, only CGS and semis have been recognised as HQLA by APRA. As discussed in the 2012 Annual Report, owing to a shortage of CGS and semis relative to banks' liquidity needs, the Reserve Bank will introduce a committed liquidity facility (CLF) from January 2015. Under this facility, ES account holders will be able to obtain a commitment from the Bank to provide a certain amount of funding via RBA Repo, with a per annum fee of 15 basis points payable on the size of the Bank's commitment. This will mean that securities eligible for RBA Repo (including self-securitisations) may fulfil APRA's liquidity requirements where an institution has subscribed to the CLF. (Further details on the CLF are available from the Bank's website at: http://www.rba.gov.au/mkt-operations/resources/tech-notes/liquidity-facilities.html.)

In January 2015, the Reserve Bank will also introduce new eligibility requirements for residential mortgage-backed securities (RMBS) used in repurchase agreements with the Bank. Issuers of RMBS will need to complete and make publicly available detailed reporting templates that cover both transaction-related data as well as information on the underlying assets. These templates were made available for public consultation in late 2012 and have now been finalised. The information contained in these templates will assist the Bank in managing its potential exposure to these assets should a counterparty default on its repurchase obligation. Reporting templates for certain other asset-backed securities eligible for repo with the Bank will be introduced at a later stage.

Maturities of CGS are generally the largest transactions undertaken by a client of the Reserve Bank. To manage their impact on system liquidity, the Bank needs to reduce or otherwise offset the large volume of funds that are paid out of the Australian Government's account into banks' ES accounts (for the credit of the security holder) on the maturity date. The Bank generally uses three instruments to do this: reverse repos and FX swaps (both contracted to unwind on the same day as the CGS maturity) as well as outright purchases of the CGS just ahead of its maturity date. To offset the liquidity impact of the $17 billion maturity of the May 2013 CGS (the largest government bond maturity to date), the Bank purchased almost $7 billion of the bond in the 12 months preceding its maturity. The Bank also transacted a large volume of reverse repos and FX swaps that matured on the same date as the bond, thereby fully sterilising the impact of the CGS maturity.

In addition to CGS, the Reserve Bank is willing to hold semis on an outright basis in its domestic portfolio. At present, the Bank holds around $2 billion of long-term securities on an outright basis, almost all of which have been issued by the semi-government authorities. This is slightly below the level of earlier years.

On behalf of the Australian Office of Financial Management (AOFM), the Reserve Bank operates a lending facility for CGS. This facility allows market participants to borrow specific lines of CGS via a repo with the Reserve Bank. The cash received by the Bank in the repo accrues interest at a rate 300 basis points below the cash rate target, or 25 basis points, whichever is the greater. An offsetting repo in other CGS or government-related securities is transacted at the same time to ensure there is no impact on ES balances. The rate earned by the Bank on cash invested in that repo is set at the cash rate target. The expense of the facility means that it is used only as a last resort by dealers to avoid failing on securities settlements with their counterparties. Less than $400 million of CGS was lent through the facility in 2012/13, as dealers were almost always able to source the required securities in the market.

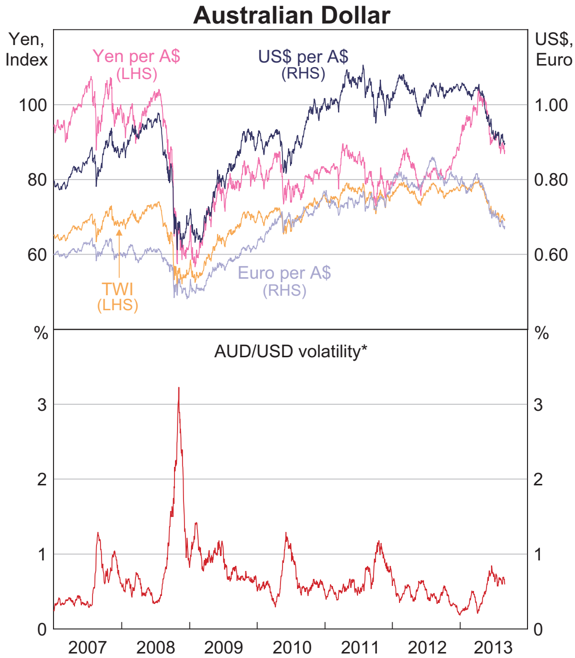
Foreign Exchange Operations

The Reserve Bank is an active participant in the foreign exchange market. The majority of its transactions (by number) reflect the management of positions arising from client business. The Bank's largest client, by far, is the Australian Government. In 2012/13, the Bank sold $6.1 billion of foreign currency to the Australian Government. These sales were funded, as they normally are, by the Bank purchasing foreign currency in the spot market. At times of extreme stress in the foreign exchange market, the Bank can elect to fund these flows temporarily from foreign currency reserves. These reserves are replenished at a later time when market conditions have normalised. The last time this occurred was in late 2008.

Foreign exchange swaps are undertaken for several reasons, but the majority (by value) reflect transactions undertaken to assist with domestic liquidity management. They can be used in the same way as repos in securities to manage system liquidity (see above). The Reserve Bank's foreign exchange swap transactions have an important role in managing the liquidity impact of large flows, such as bond maturities, because the swap market is larger and more liquid than the domestic repo market. In 2012/13, turnover in swaps undertaken for liquidity management purposes totalled $58.7 billion.

The Reserve Bank also operates in the foreign exchange market to manage its foreign currency reserves. As discussed below, the foreign currency assets on the Bank's balance sheet are managed to a benchmark. The currency, asset allocation and interest rate risk on these investments are rebalanced to benchmark targets.

Currency risk in particular is rebalanced on a daily basis. To manage the associated currency flows, the Bank executes foreign currency transactions in both the foreign exchange spot and swap markets. The Bank also uses foreign exchange swaps from time to time to assist with the management of the cash holdings of the Bank's foreign currency reserves portfolios. Finally, the Bank can transact in foreign exchange markets to manage the composition of its foreign currency holdings. During 2012/13 these operations included transactions in the spot market to effect a change to the weights of the US dollar and the euro in the currency benchmark (for more details see below).



* Daily absolute percentage change, 22-day rolling average
Sources: RBA; Thomson Reuters; WM/Reuters

Although Australia operates a floating exchange rate regime, the Reserve Bank retains discretion to undertake transactions in the foreign exchange market to address market dislocation and severe misalignments of the exchange rate. These types of transactions are usually referred to as foreign exchange intervention. Such activity has become less frequent over the years as the market has developed and hedging activity has become more widespread and efficient. Further information on the evolution of the Bank's approach to foreign exchange intervention can be found on the Bank's website at: http://www.rba.gov.au/publications/bulletin/2011/dec/7.html.

The Reserve Bank did not undertake any transactions in the market in 2012/13 to affect the level of the exchange rate directly or market conditions more generally. Volatility in the foreign exchange market was very low through much of the financial year. This changed in the June quarter with the depreciation of the Australian dollar. This adjustment was accommodated without significant deterioration in conditions in the foreign exchange market. Volatility rose but remained at a moderate level overall.

Although the Reserve Bank did not intervene directly in the foreign exchange market in 2012/13, it did accumulate foreign currency assets. In this case, the Bank was approached by a client looking to acquire Australian dollars and sell US dollars as part of its portfolio diversification program. With the Australian dollar trading above the Bank's assessment of fair value for the currency at the time, the Bank decided to retain the foreign currency acquired in the transactions in its foreign currency reserves portfolio. This decision avoided the purchase placing additional upward pressure on the exchange rate.

During the year, the Reserve Bank strengthened the risk mitigation offered by the use of ISDA Master Agreements on its foreign exchange forward and swap transactions by entering into two-way Credit Support Annexes (CSAs). A CSA defines the rules under which previously agreed collateral is exchanged between counterparties. The collateral exchange is designed to offset the daily change in the value of outstanding foreign exchange forward and swap transactions, reducing the potential cost involved in replacing the contract in the event of a counterparty default. Further detail can be found in the chapter on 'Risk Management'.

Reserves Management

With one exception, all of Australia's official reserve assets are held on the balance sheet of the Reserve Bank. These include Australia's holdings of foreign currency assets, gold and Special Drawing Rights (SDRs), a liability of the International Monetary Fund (IMF). The exception is Australia's reserve position at the IMF, which is an asset of the Australian Government.

The Reserve Bank holds foreign currency assets primarily to facilitate policy operations in the foreign exchange market (see above) and has responsibility for managing the level and composition of those assets. These assets expose the Bank's balance sheet to foreign currency risk as well as interest rate and credit risk. Hence, the Bank holds the minimum level of reserves that it assesses will allow it to meet expected policy requirements.

For a given level of reserves, the Reserve Bank attempts to mitigate the risks to the balance sheet where possible, chiefly through maintaining a diversified currency composition and investing in assets of high credit quality. The policy objectives of the foreign currency portfolio also require that a large proportion of investments are highly liquid. The investment process itself is guided by a benchmark, which represents the Bank's assessment of the combination of foreign currencies and foreign currency assets that maximise return over the long run, subject to an acceptable level of currency, interest rate, credit and liquidity risk. This benchmark is reviewed from time to time to take account of changes in the Bank's investment universe and risk tolerance. A number of adjustments to the benchmark were implemented early in the June quarter 2013:

- The currency and asset allocation to the euro was reduced from 45 per cent to 35 per cent and the allocation to the US dollar was increased from 45 per cent to 55 per cent. This change was undertaken to improve the liquidity and replicability of the benchmark portfolio.
- The duration targets of the US dollar and Canadian dollar benchmark portfolios were reduced from 18 months to 6 months and the duration target of the Japanese yen benchmark portfolio was reduced from 12 months to 6 months. These reductions in interest rate risk took account of the extremely low level of yields, and the associated risk of capital losses on bond holdings in the event of a return to more normal levels. The duration target of the European benchmark portfolio was unchanged at 18 months.

Benchmark Portfolio

	US	Europe	Japan	Canada
Asset allocation (per cent of total)	55	35	5	5
Currency allocation (per cent of total)	55	35	5	5
Duration (months)	6	18	6	6

Source: RBA

As previously announced in April, the Reserve Bank also plans to invest directly in Chinese government securities denominated in renminbi (RMB).[1] In December 2012, the Bank received a quota of CNY6 billion from the People's Bank of China for investment in the Chinese interbank bond market. The allocation to RMB is further recognition of the increasing financial and economic relationship between Australia and China. At a portfolio level, the allocation is expected to provide increased diversification and enhanced returns over the long run.

Investments in the benchmark currencies are limited to sovereign, quasi sovereign and supranational debt instruments as well as cash investments secured by high-quality debt under repurchase agreements. At the

1 Lowe P (2013), 'The Journey of Financial Reform', Address to the Australian Chamber of Commerce in Shanghai, 24 April.

end of June 2013, virtually all outright holdings of securities were in the form of sovereign debt. Sovereign credit exposures are currently limited to the United States, Germany, France, the Netherlands, Canada and Japan.

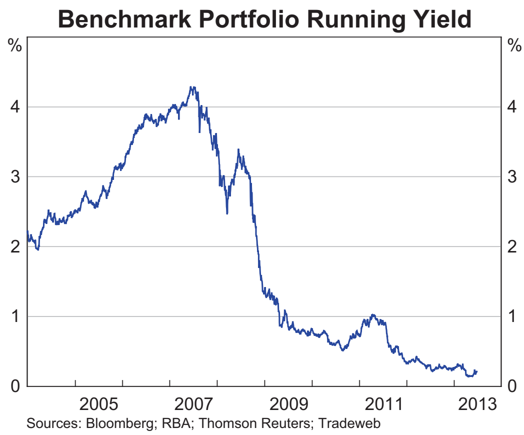
Over 2012/13 the return on foreign currency assets measured in SDR was just 1.5 per cent, well below the historical average. This reflected the low interest rate environment in the major economies, which depressed interest earnings, and mark-to-market capital losses on bond holdings owing to the increase in bond yields towards the end of the financial year. At the end of June 2013, the running yield on the portfolio was only 0.2 per cent, compared with over 4 per cent prior to the 2008/09 financial crisis.

RBA Security Holdings
A$ million, June 2013

Issuing government	Securities held outright[(a)]	Securities held under repurchase agreements[(b)]	Funds held at central banks[(c)]
United States	15 066	2 821	596
Germany	8 557	1 367	
France	1 785	846	
Netherlands	1 135	423	32
Canada	1 828		5
Japan	5 423	16	4
Supranational	253		541
Total	34 047	5 473	1 179

(a) Includes holdings of $4.4 billion funded by foreign exchange swaps
(b) Includes securities issued by US government-sponsored enterprises
(c) Includes the Bank for International Settlements
Source: RBA

Generating positive returns in the prevailing low interest rate environment has been a challenge for the Reserve Bank given its low risk tolerance. In Europe in particular, interest rates on eligible short-term investments have been negative for much of the past year. In response, the Bank has enhanced the return on the portfolio by periodically shifting some euro and US dollar reserves into Japanese yen on a fully hedged basis via the foreign exchange swap market. A positive cross-currency swap basis in favour of the yen has delivered a higher overall return on these investments.



The Reserve Bank also has investments in a number of non-Japan Asian debt markets through participation in the EMEAP Asian Bond Fund (ABF) Initiative. This initiative was established in the wake of the Asian currency crisis in the late 1990s to assist in the development of bond markets in the region. The Bank has modest holdings in the US dollar-denominated fund, ABF1, and the local currency-denominated fund, ABF2. The two funds are managed by external managers and sit outside the Bank's internal reserves benchmark framework.

Rates of Return in Local Currency by Portfolio
Per cent

	US	Europe	Japan	Canada
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	–
2010/11	1.1	0.4	0.2	1.0
2011/12	2.1	2.9	0.4	1.1
2012/13	0.4	0.4	0.2	1.0

Source: RBA

At the end of June 2013 the total allocation of reserves to these funds was $467 million. The return on these investments over 2012/13 was 1.1 per cent measured in US dollar terms.

Gold holdings at the end of June 2013 were around 80 tonnes, unchanged from the previous year. Gold prices fell by 18.1 per cent in Australian dollar terms in 2012/13, reducing the value of the Reserve Bank's holdings of gold by around $0.7 billion to $3.3 billion. Activity in the gold lending market remained subdued over the year. Income earned on secured gold loans was little changed from the previous year at $0.2 million. At the end of June 2013 there was only 1 tonne of gold on loan.

Banking and Payments

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

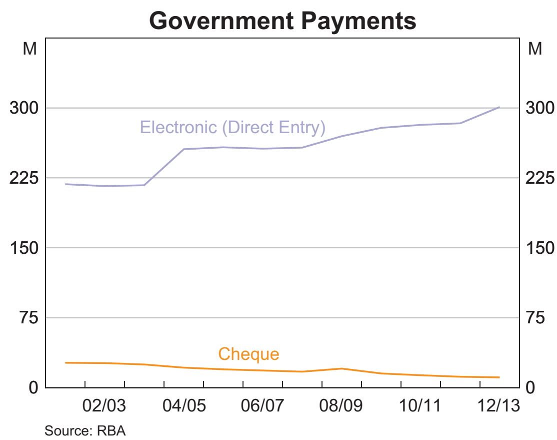
Banking

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

Core banking services are provided to the Department of Finance and Deregulation (DoFD) on behalf of the Australian Government and the Australian Office of Financial Management (AOFM). These services derive directly from the Reserve Bank's role as Australia's central bank. They require the Bank to manage the consolidation of Australian Government agency account balances – irrespective of which financial institution each agency banks with – into the Government's Official Public Accounts (OPA) at the Bank on a daily basis. This involves 'sweeping' balances from agency accounts at transactional banks to the OPA at the end of each business day and transferring balances required to meet their day-to-day functions back the following morning. The average daily sweep to and from the OPA was $4 billion and $2 billion, respectively, in 2012/13. 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 when there is unexpected demand on Commonwealth cash balances. The overdraft facility is used infrequently and was not drawn upon in the reporting period.

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

The Reserve Bank's transactional banking services are associated with more traditional banking activities. Principal among these are services for making payments from government agencies to recipients' accounts. The Bank processed some 315 million payments, totalling $455 billion, for government agencies in 2012/13. Most of these were made via



direct entry. The Australian Government also makes payments by eftpos, the RTGS system and cheque, though its use of cheques has fallen significantly in recent years relative to electronic payment methods. Cheques now make up less than 4 per cent of agency payments, compared with around 10 per cent a decade ago. In addition to payments, the Bank provides its government agency customers with access to a number of services through which they can collect funds, including Electronic Funds Transfer, BPAY, eftpos, and card-based services via phone and internet. The Bank processed 25 million collections-related transactions for the Australian Government in 2012/13, amounting to around $430 billion.

The provision of transactional banking services is consistent with the Reserve Bank's responsibilities under the *Reserve Bank Act 1959*. The principal difference between core and transactional banking services is that the latter are offered on a commercial basis in line with the Australian Government's competitive neutrality guidelines. To deliver these services, the Bank must compete with other commercial financial institutions, in many instances bidding for business at tenders conducted by the agencies themselves. It must also cost and price the services separately from the Bank's other activities, including its core banking services, and meet a prescribed minimum rate of return. Some 90 government agencies are transactional banking customers of the Bank. Pro forma business accounts for transactional banking are provided with the Financial Statements in this Report (see page 125).

After-tax earnings from the Reserve Bank's transactional banking services were $2.5 million in 2012/13. This is lower than in the previous year owing to higher costs in the provision of online transaction services and expenditure arising from improvements to banking systems.

The Reserve Bank typically works closely with its agency customers and with the Government more generally to ensure that they have access to services that are consistent with their needs and those of the public. In 2012/13 the Bank assisted the Department of Health and Ageing and the Australian Treasury in establishing a system of accounts for the National Health Funding Pool, under which hospital funding is coordinated between the Federal, state and territory governments, and worked with the Australian Prudential Regulation Authority to establish arrangements for paying depositors in the event of a failed authorised deposit-taking institution under the Government's Financial Claims Scheme. For some services, the Bank combines its specialist knowledge of the government sector with specific payment services and products from commercial providers to meet the Government's banking needs. Many of the collection services mentioned above – including eftpos and card-based phone and internet services – are examples of this. The Bank expects to make greater use of combined service arrangements as the Government's banking needs continue to evolve.

In common with other financial institutions, the Reserve Bank relies heavily on information technology and systems to deliver banking services to its customers. These systems require changes and improvements over time to ensure that they provide the highest levels of service, reliability and efficiency. Following a 15-month assessment of requirements, the Bank began a major program of work in July 2012 to upgrade its banking systems, a number of which have been in place for around 20 years and are, consequently, becoming costly to maintain. The program of work – which is occurring in stages over several years – will see the migration of existing systems to a contemporary programming language and architecture and result in more cost-effective banking processes. The first stage, involving the processing of RTGS payments for government agencies, is scheduled for completion in mid 2014. A dedicated team of business analysts, application developers and project managers is undertaking this work. A number of staff have been recruited externally to complement the Bank's existing resources. Further recruiting will take place over the next few years as the project progresses. Oversight is being provided by a steering committee comprising senior Bank staff.

Registry

The 2012 Annual Report noted that the Australian Government had decided to transfer the provision of registry services for Commonwealth Government Securities (CGS) from the Reserve Bank to a commercial service provider from the end of 2012. The decision followed an announcement by the Government in 2010 that it was looking to improve access to the bond market for retail investors. These services have been provided by the Bank under agreement with the AOFM, and typically include registration of new issues, ongoing maintenance of ownership records, distribution of interest payments and redemption of securities at maturity. Reflecting the complexities involved in resourcing these services, the AOFM now expects the transfer to occur at the end of 2013.

The Reserve Bank has also for many years provided a facility that enables retail investors to buy and sell CGS over the counter. In May, the AOFM announced that, as part of arrangements to improve access to bond markets, retail investors can now buy and sell entitlements to CGS through an electronic platform provided by the Australian Securities Exchange (ASX). The new arrangements mean that a separate, over-the-counter service provided by the Bank is no longer required. As a result, the Bank closed its facility for selling CGS to retail investors in May at the time of the AOFM's announcement. Arrangements by which the Bank will purchase CGS from investors through the facility will cease around the end of the year when the CGS registry is expected to move to an external provider.

Registry services are provided by the Reserve Bank to a number of foreign official institutions that have Australian dollar debt programs. These are not affected by the move in the CGS registry.

Earnings after tax for the registry business were $0.2 million in 2012/13, similar to earnings in the previous year.

Settlement Services

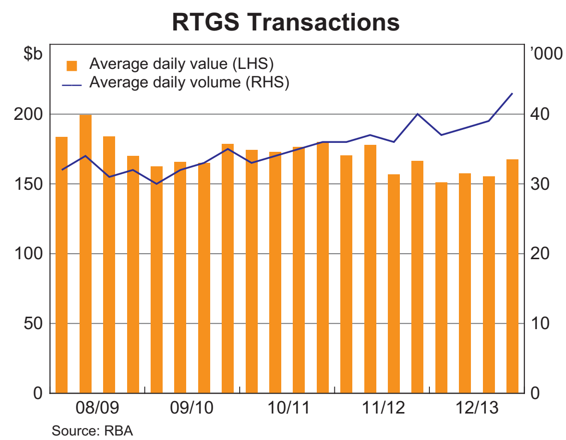
The Reserve Bank owns and operates the Reserve Bank Information and Transfer System (RITS), which provides for the settlement of payment obligations across Exchange Settlement Accounts (ESAs) held with the Bank. Payments settled individually on an RTGS basis include time-critical customer payments, all 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 International each day. Around 90 per cent of electronic payments in Australia by value are settled in RITS on an RTGS basis.

RITS also settles some payments on a net basis. One such arrangement – the daily CHESS batch – is for settlement of payments arising from stock market transactions and is managed by the ASX as Batch Administrator. Another batch arrangement is for settlement of obligations arising from cheque, direct entry and retail card transactions that are cleared through low-value systems prior to settlement across RITS. Settlement of these obligations currently occurs at 9.00 am on the next business morning. The Reserve Bank has been working with the payments industry over recent years to allow these transactions to settle on a more timely basis.

The RITS Low Value Settlement Service (LVSS), described in previous Annual Reports, enables RITS Members to provide settlement instructions to RITS at around the same time as file-based clearing activity takes place between the institutions. During 2012, the LVSS replaced legacy arrangements whereby only aggregated settlement instructions were sent to the Reserve Bank during overnight processing, prior to settlement across RITS at 9.00 am on the next business day. Settlement instructions relating to low-value clearing obligations are now sent directly to RITS multiple times during the day and are able to be settled on the same day as clearing files are exchanged. Accordingly, the Bank is working closely with APCA and RITS Members to introduce same-day settlement for the direct entry system. The implementation of this industry project is scheduled for November 2013. This outcome is in line with the conclusions of the Payments System Board's *Strategic Review of Innovation in the Payments System* published in June 2012.

At the end of June 2013, there were 62 institutions approved to operate an ESA. A further 23 institutions hold ESAs but have appointed another ESA holder to settle their RTGS transactions on their behalf in RITS. Another 45 institutions were Non-Transaction Members of RITS in order to participate in the Reserve Bank's domestic open market operations.

Close to 39 000 RTGS transactions worth $157 billion were settled in RITS, on average, each day during 2012/13. While RTGS volumes have grown steadily since the global financial crisis in 2008, values are yet to return to the levels that prevailed before the crisis.



In addition to RTGS payments, the daily value of obligations settled on a net deferred basis at 9.00 am each day using the LVSS averaged $3.8 billion in 2012/13. These settlements covered 12 million underlying transactions worth around $20 billion on average each day. CHESS batch settlements averaged around $767 million each day in 2012/13.

The liquidity used to settle transactions in RITS during the day comes from overnight balances held in ESAs and intraday repurchase transactions undertaken with the Reserve Bank (see the chapter on 'Operations in Financial Markets'). Intraday liquidity in RITS was close to all-time peak levels in 2012/13; combined with subdued payment values, this contributed to faster throughput of transactions in RITS.

Reflecting the critical importance of RITS to the Australian financial system, the Reserve Bank invests significantly in its technical and business infrastructure and in operational resourcing. This ensures that RITS operates to appropriately high standards of availability and resilience and that its settlement services evolve to meet the changing needs of the payments system. In addition to the work involved in migrating to LVSS, major infrastructure work undertaken in 2012/13 included:

- upgrading the RITS certificate authority, which provides security credentials for accessing and operating the RITS user interface
- undertaking proof of concept testing ahead of a required replacement of RITS servers, operating systems and databases scheduled for completion in 2014
- providing additional functionality in RITS for new liquidity arrangements that will support extended settlement hours for direct entry payments
- introducing enhanced transaction management functionality in RITS to assist Members with management of small-value payments.

Over the coming year, the Reserve Bank will be considering further enhancements to RITS and related payment services. One important development will be the RITS Fast Settlement Service, which will provide high-speed settlement services to support the New Payments Platform being developed by the payments industry. This is an initiative proposed in response to the objectives outlined in the Payments System Board's *Strategic Review of Innovation in the Payments System*. The New Payments Platform is expected to provide real-time bank account to bank account transfers on a 24/7 basis, immediate funds availability to recipients, richer remittance information, ease of addressing payments, and settlement of each payment in ES funds via a new RITS Fast Settlement Service. This new infrastructure is expected to be the basis for future payments innovation.

In managing RITS, the Reserve Bank aims to recover its operating costs from RITS Members. Capital and development costs of major upgrades and functional enhancements are absorbed by the Bank as a policy-related expense. In July 2012, the Bank revised the RITS fee structure to provide a more representative distribution of costs among Members. Key changes to the fee structure were a reduced RTGS settlement fee, abolition of separate fees for cash transfers, the introduction of a fee based on values settled and the introduction of annual fees for membership and for the use of the Automated Information Facility.

More than 50 overseas central banks hold accounts at the Reserve Bank for settlement of their Australian dollar transactions and safe custody services. Reflecting increased overseas demand for Australian dollar investments, the amount held in custody by the Bank for these institutions increased by \$6.5 billion to \$68.7 billion over the reporting period.

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

Currency

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

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

Banknotes on Issue

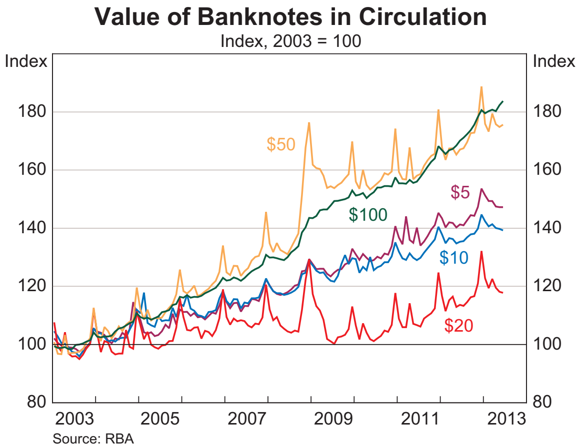
At the end of June 2013 there were 1.2 billion banknotes worth $56.9 billion in circulation. Although $5, $10 and $20 banknotes accounted for 35 per cent of the number of banknotes in circulation, they represented only 9 per cent of the value of banknotes in circulation.

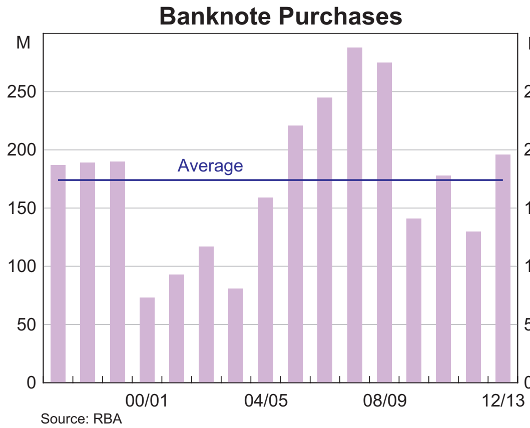
Banknotes on Issue
$ million

At end June	$5	$10	$20	$50	$100	Total
2004	533	791	2 533	15 941	14 224	34 022
2005	539	837	2 584	16 740	14 924	35 624
2006	572	857	2 690	18 044	15 903	38 066
2007	591	894	2 846	19 228	16 730	40 289
2008	614	917	2 732	20 111	17 690	42 064
2009	644	954	2 651	23 721	20 117	48 087
2010	673	983	2 653	23 711	20 740	48 760
2011	731	1 010	2 796	24 287	21 234	50 059
2012	737	1 059	2 980	25 663	23 156	53 595
2013	768	1 090	3 089	26 987	25 009	56 943

Source: RBA

The value of banknotes in circulation increased by 6.2 per cent over 2012/13. This is broadly in line with the long-term trend growth rate. By denomination, demand for $100 and $50 banknotes has been growing strongly in recent years, with growth of 8.0 and 5.2 per cent, respectively, over 2012/13, while growth in demand for lower-denomination banknotes was between 3 and 4 per cent.





New Banknote Purchases

The Reserve Bank purchased 197 million banknotes from Note Printing Australia Limited (NPA) in 2012/13, an increase of 68 million from 2011/12. The Bank purchased new banknotes for all denominations: 20.1 million $5 banknotes, 26.6 million $10 banknotes, 30.1 million $20 banknotes, 80.1 million $50 banknotes and 40.1 million $100 banknotes.

Distribution

Cash-in-transit companies manage banknote holdings on behalf of commercial banks in approved cash centres across Australia, to ensure that there is sufficient stock to meet public demand. Banknotes are also held by the Reserve Bank to meet seasonal fluctuations in demand and mitigate the risks associated with systemic shocks and production disruptions. The Bank has established agreements with the commercial banks that ensure their access to these banknotes.

In 2012/13 the Reserve Bank issued banknotes worth $8.9 billion, $3.6 billion of which had previously been in circulation and were deemed to be fit for purpose. Banknotes worth $5.6 billion were returned to the Bank, of which banknotes worth $3.6 billion were deemed to be suitable for reissue and banknotes worth $2.0 billion were deemed unfit for recirculation.

The Reserve Bank aims to maintain a high quality of banknotes in circulation to ensure public confidence in Australia's banknotes. High-quality banknotes reduce problems in banknote acceptance equipment and make it more difficult for counterfeits to be passed.

A major contribution to the Reserve Bank achieving this objective comes from the Note Quality Reward Scheme (NQRS). Under the NQRS, the Bank provides incentives for commercial banks and cash-in-transit companies to remove unfit banknotes from circulation and return them to the National Note Processing and Distribution Centre (NNPDC). At the NNPDC the authenticity and quality of these banknotes is confirmed. Banknotes that are categorised as being unfit are destroyed while fit banknotes are reissued. Of the banknotes returned to the NNPDC and processed during 2012/13, 74.5 million (96 per cent) were identified as being unfit and were destroyed.

The Reserve Bank also removes unfit banknotes from circulation through its Damaged Banknote Facility. Under this facility, the public can request that the Bank examine and verify their damaged and contaminated banknotes. Payment is then made, based on the assessed value of each banknote claim. In 2012/13, the

Bank processed 14 765 damaged banknote claims and made $10.4 million in payments. This represented a $4.3 million increase on 2011/12, largely as a result of $2.6 million of claims arising from floods in Queensland and New South Wales.

Counterfeiting in Australia

In 2012/13 a total of 12 125 counterfeits were detected in circulation, with a nominal value of $730 700. This corresponds to around 10 counterfeits detected per million genuine banknotes in circulation. While this represents an increase from the previous year, this level remains low by international standards and is similar to levels experienced in Australia in recent years.

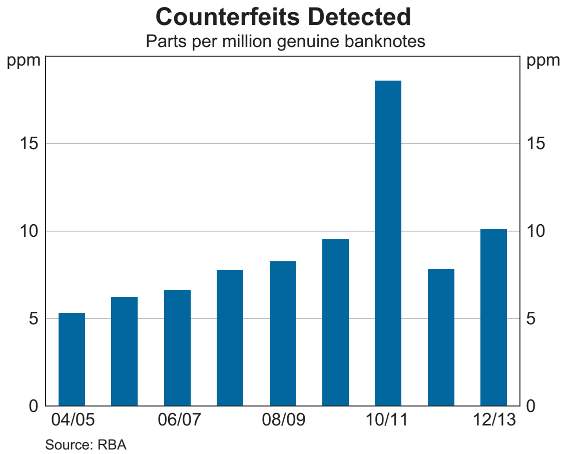
Counterfeit Banknotes in Australia
2012/13

	$5	$10	$20	$50	$100	Total
Number	32	25	187	9 231	2 650	12 125
Nominal value ($)	160	250	3 740	461 550	265 000	730 700
Parts per million	0.2	0.2	1.2	17.2	10.9	10.1

Source: RBA

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

During 2012/13 the Bank conducted a Counterfeit Deterrence Workshop, which was attended by representatives from the Australian Federal Police, New South Wales Police, Victoria Police, large retailers



Participants at the Counterfeit Deterrence Workshop examine banknote security features and financial institutions. The workshop provided participants with an opportunity to discuss counterfeit deterrence initiatives as well as develop a broader understanding of banknote security features.

Next Generation Banknote Project

In September 2012 the Reserve Bank announced plans to upgrade the security of Australia's banknotes as part of the Next Generation Banknote (NGB) project.

The upgraded banknotes will incorporate a number of new features so that Australia's banknotes remain secure. While Australia has experienced relatively low levels of counterfeiting – both in absolute terms and compared with other countries – the Reserve Bank's assessment is that a security upgrade is necessary to ensure that Australia's counterfeiting level remains low into the future. The new banknotes will retain many of the key design elements of the current banknote series, such as their colour, their size and the portraits, but some design changes will be necessary to accommodate the new security features.

Considerable work has already been undertaken on this project since it was established in 2007, including the development and review of banknote designs and production trials of new security features. It is anticipated that it will be several years before the first of the upgraded banknotes will be issued and, as was the case for the current series of banknotes, the issuance of the denominations will be staged across a number of years. The time required to complete the project reflects the complexity of the process of designing and producing a new banknote and the need to make sure that the design produces a secure, functional and durable banknote. An important element of this process is the consultation with relevant stakeholders to ensure that Australia's banknotes continue to meet community needs.

To ensure the ongoing security of Australia's banknotes, it is essential that appropriate levels of investment in the NGB series occurs. As at the end of June 2013, $11.3 million has been spent on design, development and testing and it is expected that the total cost of this work will be around $44 million.

Banknote Research and Development

The Reserve Bank's research and development program seeks to ensure Australian banknotes remain secure against counterfeiting by identifying innovative technologies and developing new security features for

Michele Bullock, Assistant Governor (Currency), speaking at an NGB Steering Committee meeting with Keith Hall, Assistant Governor (Banking and Payments), left, and Frank Campbell, Assistant Governor (Corporate Services), right polymer banknotes. To achieve this objective, the Bank collaborates with a range of third parties, including universities, public and private companies, research institutes and other central banks. It also contributes to several international forums related to banknote security, including the Central Bank Counterfeit Deterrence Group, which assesses threats posed by emerging counterfeiting technologies, and the Reproduction Research Centre, which provides facilities to test anti-counterfeiting technologies.

The Banknote Research and Development team is based in the NPA building in Craigieburn, Victoria, although the staff remain part of, and report directly to, the Bank's Note Issue Department in Head Office. In 2012/13, the research program focused on the development of the NGB series. While extensive trials have been conducted over previous years, significant amounts of testing and development are still underway to ensure the new features are secure, durable and can be implemented in the banknote production process.

Community Liaison

The Reserve Bank is actively involved in a number of banknote awareness initiatives involving law enforcement agencies, retail associations and the community. The Bank works with these stakeholders to assist with their training and education requirements and delivers presentations on relevant topics. More than 70 presentations were made during 2012/13 to business, school and community groups with the aim of increasing knowledge about banknotes in the community.

A banknotes internet microsite was launched in August 2012, providing the public with information about Australia's banknotes, including through a range of interactive tools that allow users to explore the security and design features found on the current banknote series. The site incorporates games and other educational material to cater to a wide range of age groups, along with production and security information. In May 2013, the site was named 'Best New Currency Website' at the Excellence in Currency Awards established by the International Association of Currency Affairs.

Numismatic Banknote Sales

The Reserve Bank conducted numismatic banknote sales in July and August 2013 for all denominations of banknotes produced in 2012. New banknotes were also offered for other denominations from the most recent year of print. These banknotes were sold to the public at fixed prices during a six-week sale period.

Note Printing Australia Limited (NPA)

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

NPA is governed by a Board of Directors appointed by the Reserve Bank. As at 30 June 2013, the Board comprised four Bank executives and a member of the Reserve Bank Board: Michele Bullock, Assistant Governor (Currency) as Chair; Keith Hall, Assistant Governor (Banking and Payments); Lindsay Boulton, Head of Banking Department; Michelle McPhee, Head of Risk Management; and Heather Ridout AO. The Board has an Audit

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

NPA is headed by its Chief Executive Officer, Bernhard Imbach. There are six business units: Financial Services (headed by the Chief Financial Officer), Manufacturing Operations, Passports Business, Quality Management, Risk and Security, and Human Resources. The CEO and the heads of these business areas constitute NPA's Executive Committee. In addition, NPA has a Risk and Compliance Committee, whose membership comprises the CEO, heads of the business areas and the Business Resilience Manager. As at the end of June 2013, NPA employed 234 permanent staff.

In 2012/13, NPA delivered 196.9 million Australian banknotes to the Reserve Bank. Those banknotes were delivered under a contract entered into in 2011. NPA also provided banknote distribution and banknote processing services to the Bank during the year, under a contract entered into in 2001. The aggregate amount paid by the Bank to NPA in 2012/13 for the supply of banknotes and related services under the above contracts was $50.8 million. No decisions were undertaken by the Reserve Bank Board in 2012/13 in relation to those supply contracts.

In addition, NPA delivered 330.1 million banknotes to other countries in 2012/13, including Singapore, Brunei, New Zealand and Papua New Guinea. NPA also produced 1.4 million passports for DFAT over the past year.

NPA recorded a loss after tax of $865 000 in 2012/13, compared with a loss of $1.9 million in 2011/12. The financial accounts of NPA are consolidated with those of the Reserve Bank.

Securency

In February 2013, the Reserve Bank sold its 50 per cent shareholding in Innovia Security Pty Ltd (formerly Securency International Pty Ltd – 'Securency') to Innovia Films, a UK-based film manufacturer that held the other 50 per cent in Securency. Securency manufactures polymer substrate for banknotes used in Australia and many other countries.

The sale was in accordance with the Reserve Bank's longstanding intention to sell its shareholding once Securency had established itself as a viable long-term supplier in the international market for banknote substrate. A sale process was commenced in late 2010, with the Reserve Bank and Innovia Films both announcing their intention to undertake a joint sale of Securency. Subsequently, Innovia Films advised the Bank that it no longer wished to sell its 50 per cent shareholding and made an offer to purchase the Bank's shares.

Under the terms of the sale, the Reserve Bank had, at the end of June 2013, received payments of approximately $75 million for its shares, which exceeds the value of the Bank's investment of $54 million in Securency in its 2011/12 financial accounts. Additional payments may be made to the Bank over following years, including if Securency exceeds certain earnings benchmarks. As part of the sale, NPA and the Reserve Bank entered into a long-term supply contract with Securency for the provision of polymer substrate, including for Australia's next generation of banknotes.

International Financial Cooperation

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

Group of Twenty (G20)

The G20 facilitates international cooperation on economic and financial policy issues. In December 2013, Australia will become the G20 chair for a 12-month period. Accordingly, in December 2012 Australia joined the G20 'troika', comprising the chair countries for the previous, current and future year. The aim of the troika system is to ensure continuity from one chair to another.

At the St Petersburg Summit in September 2013, G20 Leaders will release an 'Action Plan' for the 'Framework for Strong, Sustainable and Balanced Growth'. The Framework is a mechanism under which G20 members collectively assess whether their policies are consistent with these three aims, and endorse further policy actions as necessary. Also to be released is the second accountability assessment, which monitors G20 members' progress on past commitments contained in action plans. The Reserve Bank and Australian Treasury are members of a working group that is supporting this exercise.

G20 Finance Ministers and Central Bank Governors' Meeting, July 2013

Reform of the international monetary system continues to be a priority for the G20. Work on this issue is led by the working group on the International Financial Architecture, co-chaired by Australia and Turkey, with the Australian Treasury taking the leadership role for Australia. The Reserve Bank also made regular contributions to this work over the past year. Key areas of focus for the G20 in this area include facilitating completion of the 2010 International Monetary Fund (IMF) quota and governance reforms and progress on the 15th General Review of Quotas, which the IMF is scheduled to complete by January 2014. The agenda of this group also includes work on other items such as public debt management practices, local currency bond markets and global liquidity indicators.

The Reserve Bank has actively contributed to a new area of work in the G20 on financing for investment, including infrastructure. The G20 has established a study group to carry out work on this topic, and the Bank and Australian Treasury are members. This group will examine policies and practices that foster the necessary conditions for mobilising long-term financing for investment and promoting a sound investment climate. This will also involve an assessment of how to improve intermediation of global savings into long-term investments and improving the transparency, planning and prioritisation of infrastructure projects.

Reform of financial regulation remains an ongoing priority for the G20. In recent years the focus has begun to shift from developing new policy proposals to implementing agreed reforms at the national level and monitoring the consistency of implementation internationally.

Financial Stability Board (FSB)

Over the past year, the FSB has continued to play an important role in overseeing the international financial regulatory reform agenda. FSB members include representatives from 24 economies (including all of the G20 economies), as well as the main international financial institutions (including the IMF and the Bank for International Settlements (BIS)) and the standard-setting bodies, such as the Basel Committee on Banking Supervision (BCBS). As part of an ongoing process of strengthening its capacity, resources and governance, the FSB underwent changes in January to constitute itself as a separate legal entity (specifically, an association under Swiss law). As was required of all FSB members, the Reserve Bank confirmed its continuing membership by formally joining the association.

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

In addition to regularly assessing vulnerabilities in the global financial system, the FSB coordinates international financial regulatory reform in several areas. In recent years, a high priority for the FSB has been to develop, in cooperation with key international standard-setting bodies, a policy framework for systemically important financial institutions (SIFIs). Another priority area has been addressing the risks posed by 'shadow banks', i.e. non-bank financial institutions that engage in bank-like activities but do not face the same prudential regulation as banks. The FSB will present recommendations in this area to the G20 Leaders' Summit in September 2013.

The FSB's Regional Consultative Group (RCG) for Asia is one of six regional groups established to expand the FSB's outreach activities with non-member economies. In early 2013, the RCG for Asia launched two working groups, one on the impact of the SIFI framework on Asia and the second on the structure of shadow banking in Asia. Along with the Australian Treasury, the Reserve Bank is a member of both working groups.

Other key areas of the FSB's work over the past year in which Reserve Bank staff have been involved include:[1]

- Monitoring the implementation of the G20 commitments to reform over-the-counter (OTC) derivatives markets and highlighting areas where further international work is needed to achieve the objective of reducing the scope for contagion in these markets. In a related area, the Bank participates in the OTC Derivatives Regulators' Forum, an international group that facilitates cooperation and information sharing between regulators of OTC derivatives markets and infrastructure. To better understand the potential effects of OTC derivatives regulatory reforms, an international macroeconomic impact assessment of these reforms was undertaken by the BIS with the findings released in August; the Head of Economic Research Department was a member of the team that produced the report.
- Reforming the setting of interbank and other financial benchmark rates. In particular, the FSB is coordinating and guiding work on reforms to short-term interest rate benchmarks, as well as identifying suitable alternatives to existing benchmarks. An Official Sector Steering Group has been established, which will be responsible for coordinating and maintaining the consistency of reviews of existing interest rate benchmarks and for guiding the work of a Market Participants Group, which will examine the feasibility and viability of adopting additional reference rates. The Assistant Governor (Financial Markets) is a member of the Steering Group.
- Continuing its program of peer reviews, with thematic reviews on risk governance and resolution regimes released in the first half of 2013. The FSB also conducts country peer reviews, which focus on the implementation and effectiveness of regulatory, supervisory or other financial sector standards and policies within individual FSB member jurisdictions. The Head of Financial Stability Department is participating in a team conducting a peer review of the United Kingdom.
- In the area of credit rating agencies (CRAs), developing a 'road map' to accelerate the implementation of the FSB's 2010 'Principles for Reducing Reliance on CRA Ratings', including a peer review on how countries have implemented the Principles. An interim peer review report was released in August.
- Contributing to G20 work on long-term investment finance, through continued monitoring of the possible effects of financial regulatory reforms on the provision of long-term finance.

In late 2012, a senior officer from Payments Policy Department commenced a two-year secondment to the FSB, to work in the area of OTC derivatives reforms. This follows an earlier secondment by another senior officer from Financial Stability Department. One aim of these secondments is to build closer links between the two organisations.

Bank for International Settlements (BIS)

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

1 For further detail, see RBA (2013), *Financial Stability Review*, March.

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. In June 2013, he was appointed chair of the Markets Committee for a three-year term.

The CGFS monitors developments in financial markets, focusing on potential vulnerabilities in the global financial system. In the past year, the CGFS has considered issues such as increased demand for collateral assets, regional banking system integration, trade finance, and the use of credit ratings by central banks. The Head of Domestic Markets Department participated in a CGFS working group that assessed the implications for central banks and markets of greater demand for collateral. A senior officer from International Department participated in a CGFS study group that considered recent structural changes in the provision of trade finance, and a senior officer from Financial Stability Department participated in a CGFS working group that investigated ways to operationalise the selection and application of macroprudential instruments. Another senior officer from Financial Stability Department is currently participating in a CGFS working group analysing the implications of international expansion by regionally focused banking groups in emerging market economies.

The Markets Committee considers how current events may affect central bank operations and broader financial markets. In the past year, the Assistant Governor (Financial Markets) chaired a Markets Committee working group, which in March produced the report, *Central Bank Collateral Frameworks and Practices*.

Basel Committee on Banking Supervision (BCBS)

The new Basel III capital standards, which aim to improve the resilience of banks to financial and economic shocks, came into effect on 1 January 2013 in Australia and a number of other countries, in keeping with the Basel Committee's timetable. Implementation by countries of Basel III is the subject of ongoing comprehensive monitoring by the BCBS, which regularly reports its findings to both the FSB and the G20. The Assistant Governor (Financial System) and the Chairman of the Australian Prudential Regulation Authority (APRA) represent Australia on the BCBS, while the Governor and Chairman of APRA represent Australia on the oversight body of the BCBS, the Group of Governors and Heads of Supervision.

The Assistant Governor (Financial System) is co-chair of a BCBS taskforce on liquidity that is examining the interaction between the Basel III liquidity coverage ratio and the provision of central bank facilities, given that these facilities are the most reliable form of liquidity. The taskforce is also examining whether the option of using a central bank facility (such as the committed liquidity facility in Australia) as part of the regulatory framework should be available to all jurisdictions or continue to be limited to those with insufficient high-quality liquid assets.

A senior officer from Financial Stability Department has continued to be part of the Macroprudential Supervision Group of the BCBS. Over the past year, this group has mainly worked on technical aspects of the methodology of the BCBS for global systemically important banks (G-SIBs), such as reviewing the results of the annual G-SIB data collection exercise and assessment, and outstanding G-SIB data and methodological issues. It also continued its work on developing a set of principles on the assessment methodology and the higher loss absorbency requirement for domestic systemically important banks (D-SIBs), the final framework of which was released by the BCBS in October 2012.

In February 2013, the BCBS published *Supervisory Guidance for Managing Risks Associated with the Settlement of Foreign Exchange Transactions*. A senior officer from Payments Policy Department was a member of a joint BCBS-Committee on Payment and Settlement Systems (CPSS) working group that developed this guidance.

The Australian Securities and Investments Commission (ASIC) continues to represent Australia in a joint BCBS-International Organization of Securities Commission (IOSCO) working group that is developing margin requirements for non-centrally cleared OTC derivatives. ASIC has consulted closely with the Reserve Bank as this work has progressed. Further to an initial consultation in July 2012, this group sought further feedback on near-final principles in February 2013 and is now in the process of finalising its proposals.

Committee on Payment and Settlement Systems (CPSS)

The Reserve Bank is a member of the CPSS, which serves as a forum for central banks to monitor and analyse developments in payment and settlement infrastructures and set standards for them. Over the year to the end of June the CPSS met three times, with either the Head or Deputy Head of Payments Policy Department representing the Bank.

The Reserve Bank is also a member of the CPSS-IOSCO Steering Group, which brings together members of both the CPSS and the IOSCO to advance policy work on the regulation and oversight of financial market infrastructures (FMIs). In recent years, the CPSS-IOSCO Steering Group has overseen work on the development of the *Principles for Financial Market Infrastructures* (PFMIs), which were released in April 2012. These Principles set internationally agreed standards for the design and operations of FMIs, as well as responsibilities for regulators. To complement the PFMIs, in December 2012 the CPSS and IOSCO published an assessment methodology and a framework for public disclosures by FMIs. Bank staff contributed to the finalisation of these materials and a senior officer from Payments Policy Department continues to participate in a related working group that is finalising proposals for quantitative metrics to support FMI's disclosures.

Members of CPSS and IOSCO are expected to implement the PFMIs in their jurisdictions. To oversee this process, the CPSS-IOSCO Steering Group has established a joint task force on implementation monitoring. As a first step, the task force has carried out an initial review of the measures taken by each jurisdiction formally to adopt the PFMIs within their respective regulatory frameworks. The results of this initial work are due to be published in the third quarter of 2013. A senior officer from Payments Policy Department is contributing to this work.

While the PFMIs are intended to establish a comprehensive framework for day-to-day risk management, it is increasingly recognised that more work needs to be done to ensure that the official sector and FMIs have in place appropriate arrangements to deal with extraordinary events should they occur. This involves recovery planning by FMIs themselves, which is now required under the PFMIs, and the establishment of FMI-specific resolution regimes by the relevant authorities. Further to an initial consultation by CPSS-IOSCO in July 2012, a CPSS-IOSCO group overseen by the CPSS-IOSCO Steering Group is finalising proposals on FMI recovery and resolution. A senior officer from Payments Policy Department is a member of this group. In August 2013, two pieces of work were released for public consultation. The first will provide guidance to FMIs on recovery planning, setting out the potential recovery tools available to an FMI and the steps an FMI should take to make it likely that, following an extreme shock, it could continue to provide critical services or facilitate an orderly wind-down of operations. The second contributes to existing FSB work, by providing an FMI-specific annex to the *Key Attributes of Effective Resolution Regimes for Financial Institutions*. Resolution is action that a resolution authority might take.

A senior officer from Payments Policy Department is also participating in a CPSS working group on retail payments. Following on from a report on innovations in retail payments released in May 2012, this group has commenced a report on the increasing importance of non-banks in the payments process and the implications for competition and innovation.

International Monetary Fund (IMF)

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

The Reserve Bank works with the Australian Treasury to provide regular briefings to the Constituency Office at the IMF on issues that are to be discussed by the IMF's Executive Board. The Bank supports the Constituency Office directly by providing an adviser with expertise in financial markets and financial sector issues.

The IMF continued to support its member countries through financial assistance programs over the year in review, although the size of *new* lending arrangements was much smaller in the past year than the preceding few years, when large lending arrangements were provided to Greece, Ireland and Portugal. Among the larger arrangements approved over the past year were a SDR 1.36 billion stand-by arrangement provided to Jordan and a SDR 0.89 billion extended facility provided to Cyprus. The IMF facility provided to Cyprus was part of a broader package of €10 billion provided with euro area member states (via the European Stability Mechanism). The IMF has provided ongoing support to members with existing lending arrangements by making scheduled loan disbursements. As at the end of August 2013, the IMF's outstanding credit was around SDR 91 billion. Lending to Greece, Ireland and Portugal accounted for the bulk of this, with outstanding credit of SDR 62.1 billion provided to these countries.

Four countries also renewed their precautionary facilities. Mexico, Poland and Colombia rolled over their Flexible Credit Line facilities of SDR 47.3 billion, SDR 22 billion and SDR 3.9 billion, while Morocco rolled over its Precautionary and Liquidity Line of SDR 4.1 billion.

The IMF published the results of its second Financial Sector Assessment Program (FSAP) review of Australia in November 2012. Overall, the FSAP contained a positive assessment of the stability of Australia's financial system and the quality of domestic financial supervisory and crisis management arrangements. The IMF provided a number of recommendations that the Australian authorities are currently considering. Among these was a recommendation that the Reserve Bank develop a 'top-down' (macro model-based) stress-testing framework to complement the stress testing already performed by APRA. A program of work to investigate the feasibility of developing such a framework for Australia has now been initiated.

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

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

At the Governors' and Deputies' meetings over the past year, members discussed a range of topics, including economic and financial developments and the implications of international regulatory developments for the EMEAP region. EMEAP Deputy Governors held a roundtable discussion with private sector experts in April 2013, focusing on developments in Asian finance, particularly for infrastructure.

At the Deputy Governor level, the Monetary and Financial Stability Committee (MFSC) focused on strengthening regional cooperation and monitoring economic and systemic risks. The Reserve Bank also continued to participate in the three working groups that report to the Deputies and support the surveillance work of the MFSC: the Working Group on Financial Markets, the Working Group on Banking Supervision and the Working Group on Payment and Settlement Systems.

The Assistant Governor (Financial Markets) currently chairs the Working Group on Financial Markets, which has responsibility for the analysis and development of foreign exchange, money and bond markets in the region. Over the past year, the group focused on the impact of regulatory reform measures on regional financial markets, an assessment of repo markets in the region and the compilation of financial market stress indicators. This group is also closely involved at a working level with the operation and development of the Asian Bond Funds (ABF1 and ABF2).

EMEAP Deputy Governors are responsible for the ongoing oversight of Asian Bond Fund 1, a US dollar-denominated Asian bond fund, and also Asian Bond Fund 2, comprising eight local currency-indexed bond funds and a Pan Asia Index Bond Fund (PAIF) (see the chapter on 'Operations in Financial Markets' for further information). In May 2013, the Reserve Bank stepped down from chairing the PAIF Supervisory Committee, a position held since 2007.

Organisation for Economic Co-operation and Development (OECD)

The OECD comprises the governments of 34 countries and is committed to promoting policies that improve economic and social development globally. The OECD's most recent economic survey of Australia, based in part on discussions with domestic authorities, including the Reserve Bank, was released in December 2012. In March, an officer from Economic Group started a three-year secondment to the OECD, to work in the area of macroeconomic policy.

The Assistant Governor (Financial System) has continued to chair the OECD's Committee on Financial Markets, which is the main OECD body dealing with issues in financial markets, such as banking, securities and derivatives. The Reserve Bank's Chief Representative in Europe is also a member of the Committee. Recent topics of discussion at the Committee included financing for small and medium-sized enterprises and long-term investment financing.

Government Partnership Fund (GPF)

The Reserve Bank continued its involvement with Bank Indonesia (BI) under the auspices of the GPF. This program has supported an exchange of skills and knowledge between Australian public sector institutions and their Indonesian counterparts through a series of attachments and workshops. In 2012/13 a total of 18 BI officers were attached to the Bank, bringing the total number of attachments to 163 since the start of the program in 2005/06. The attachments cover policy and operational areas of the Bank, including economic research, financial markets and financial stability, as well as auditing and human resources. The Bank's involvement in the GFP program is scheduled to conclude in 2013/14.

Following a BI request for technical assistance, the Assistant Governor (Financial System) and another Reserve Bank officer visited BI in November 2012. The purpose of the visit was to discuss the conduct of financial stability policy in the Reserve Bank, as well as the coordination arrangements between the regulatory agencies in Australia, in order to help inform changes to Indonesia's financial regulatory arrangements that are currently underway. Bank staff also participated in two workshops held at BI – one on risk management and business continuity and another on measuring potential output and strengthening external sector analysis.

South Pacific Central Bank Cooperation

In December 2012 the Reserve Bank hosted the annual meeting of the South Pacific Central Bank Governors in Sydney. This meeting brings together the central bank governors of those countries in the Pacific region that have their own currencies – Australia, Fiji, New Zealand, Papua New Guinea, Samoa, Solomon Islands, Tonga, and Vanuatu – to discuss economic issues of particular interest. Representatives from the IMF's Pacific Financial Technical Assistance Centre also contributed to the meeting. The main issues discussed were recent economic developments, mobile payment systems in the Pacific and the transmission mechanism of monetary policy. The Governors also met with the major regional commercial banks to discuss banking issues.

The Reserve Bank continued to foster closer ties with the South Pacific countries through an exchange of staff. A Bank officer is currently on secondment to the National Reserve Bank of Tonga. Another officer, based in Sydney, provided support to the Reserve Bank of Fiji (RBF) on a range of economic research projects, while several RBF officers participated in a Reserve Bank training course.

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

Cooperative Oversight Arrangements

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

Bilateral Relations and Cooperation

As in previous years, the Reserve Bank received a number of visitors from overseas. Predominantly from foreign central banks, the visits covered the full range of the Bank's activities and included delegations from Cambodia, China, Korea, Tanzania, Timor Leste and Vietnam.

The Reserve Bank co-hosted the inaugural Australia-Hong Kong Renminbi Trade and Investment Dialogue, with the Australian Treasury and Hong Kong Monetary Authority. The Dialogue, which was held in Sydney on 12 April 2013, brought together senior banking and business leaders to raise awareness in the Australian private sector of renminbi (RMB) business opportunities, and to build closer collaboration between the Hong Kong and Australian banking sectors on development of the offshore RMB market. Representatives from a number of banks, firms and official sector organisations participated in the Dialogue, including the Bank's Deputy Governor. A key outcome of the event was the establishment of an industry-led working group, which will continue to examine issues associated with RMB trade settlement and investment and aim to take practical steps to address them. The next Dialogue meeting will be held in Hong Kong in 2014.

The Reserve Bank in the Community

Activities of the State Offices

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

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

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

Liaison with Small Businesses

The Reserve Bank continues to convene its Small Business Finance Advisory Panel. The 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 provides a valuable source of information on the financial and economic conditions faced by small businesses. The Bank's liaison program also involves Bank staff meeting with a number of small businesses and small business groups.

Museum of Australian Currency Notes

The Reserve Bank's Museum houses a permanent collection of artefacts, hosts periodic exhibitions and offers regular talks and tours. The permanent collection portrays the story of Australia's banknotes against the backdrop of the nation's broader social and economic history. Following a timeline, it first displays the types of money used before Federation – from an early colonial rum bottle through to Australia's first gold coins. Visitors can then view various banknotes produced since the first Australian note series in 1913–1915. Finally, the Museum focuses on Australia's polymer banknotes, describing their design, security features and potential for recycling. When viewing the collection, visitors can observe the evolution of the nation's identity as expressed through its currency, learn about the influential men and women depicted on the banknotes and the intricate artwork used in banknote design. During 2013 the Museum gave prominence to two significant anniversaries that relate to items in the permanent collection: the bicentenary of the manufacturing of the first distinctive coin of New South Wales, known as the 'holey dollar', and the centenary of the first banknote issued by the Australian nation. It also supported the centenary of the naming of Canberra as the nation's capital by lending significant items from its permanent collection relating to the event to the National Museum of Australia and Parliament House.

A temporary exhibition was introduced in 2012 entitled 'Pocket Money'. It captures the relationship between children, money and banking and depicts changing social attitudes to saving. Among the items on display are rare and unusual moneyboxes dating from the early 20th century, including the only known example of the first series of the Commonwealth Bank moneyboxes and illustrated literature from the 1950s and 1960s that encouraged children's interest in saving. This exhibition has continued to be a focus of tours in the Museum, particularly to school groups. During NAIDOC Week 2013, which marked the 50th anniversary of the Yirrkala Bark Petitions (the first traditional documents recognised by the Commonwealth Parliament), the Museum exhibited Aboriginal barks collected by the Reserve Bank's first Governor, Dr HC Coombs, and his successors.

Over 13 500 people visited the Museum over the year to the end of June 2013, higher than in the previous two years. There were around 1 500 visitors on Australia Day 2013, with overall attendance also boosted by the Reserve Bank's participation in the NSW Office of Communities' 'Go Play', NAIDOC Week and History Week as

1. Nina Jackman, Information Department, takes a group of children through the Museum, April 2013 **2.** Year five students from Balmain Public School on a visit to the Museum, June 2013 **3.** Amanda Martz, Note Issue Department, with some of the children from Willowra in the Northern Territory who visited the Museum in November 2012 **4.** Some of the children listen to Bank staff talk about banknote security features and the production process, November 2012 well as its collaboration with other museums in the precinct through 'The History Trail' program. A wide cross-section of the public visited the Museum, with educational groups increasing to account for around 30 per cent of total visitors. Presentations and tours have been prepared to cater for more stages of learning. As a result, in addition to talks to senior high school students on the economy and the role of the Bank, there has been a doubling of talks to students in primary and junior high school on the role of money and the features of Australian banknotes. A school holiday program has also been introduced. Furthermore, the Museum is increasingly receiving organised visits by groups of new migrants, those with English as a second language and those from remote communities, all of whom are learning about the nation's currency. Most of the information in the Museum is depicted on the Museum's website.

Assistance for Research and Education

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

In 2012/13, the Reserve Bank continued its longstanding contribution towards the cost of a monthly survey of inflation expectations undertaken by the Melbourne Institute of Applied Economic and Social Research at the University of Melbourne, and a quarterly survey of union inflation and wage expectations undertaken by the Workplace Research Centre at the University of Sydney.

The Reserve Bank continued to provide financial support for the *International Journal of Central Banking*, the primary objectives of which are to disseminate first-class, policy-relevant and applied research on central banking and to promote communication among researchers both inside and outside central banks. The Bank continued its support of the International Accounting Standards Board and also its longstanding practice of 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 conferences on economics and closely related fields. In 2012/13 these conferences included: the 25th Conference for PhD Students in Economics and Business, held at the University of Western Australia; the Economic Society of Australia's 42nd Conference of Economists, held at Murdoch University; the 18th Melbourne Money and Finance Conference; the Australasian Meeting of the Econometric Society, held at the University of Sydney; the University of New South Wales 25th Australasian Finance and Banking Conference; the Paul Woolley Centre's Study of Capital Market Dysfunctionality Conference 2012, held at the University of Technology, Sydney; the 8th Annual Workshop on Macroeconomic Dynamics, held at the University of Sydney; the Australian Economic Forum 2012, hosted by the Economic Society (NSW); the second Conference on Global Financial Stability and Prosperity, held in Sydney; and the 18th Australasian Macroeconomic Workshop, held at the Australian National University.

The total value of support for research and education in 2012/13 was $262 000.

The Reserve Bank sponsors an annual essay competition designed to engage and support undergraduate students of economics across Australia. The competition is organised jointly with the University of New South Wales Economics Society and the Economic Society of Australia. In 2012 students were required to discuss the sources of growth in the Chinese economy and the implications for Australia. Sidney Powell (University of Adelaide) wrote the winning essay, the runner-up was Andrew O'Connor (University of New South Wales) and the best essay from a first-year student was by Minna Featherstone (Australian National University). These students were presented with prizes by the Governor at a ceremony at the Bank in October 2012. For the 2013 competition, students have been invited to submit an essay on 'Australian Household Saving'.

The Reserve Bank also supports the discussion of economic issues in the community by providing a venue for the Economic Society of Australia's Lunch Time Seminar Series and the Emerging Economist Series. In 2012/13 the Emerging Economist Series featured interviews with prominent Australian policymakers, including former Prime Minister The Hon John Howard OM AC.

In conjunction with the Australian Prudential Regulation Authority (APRA), the Reserve Bank has continued to sponsor the Brian Gray Scholarship Program, initiated in 2002 in memory of a former senior officer of the Bank and APRA. Four scholarships were awarded under this program in 2013: one for a PhD in Finance at Monash University, two for honours studies in economics, at the University of New South Wales and the University of Wollongong, and the fourth was for honours studies in finance at Flinders University in South Australia. The cost to the Bank of these scholarships in 2013 was $30 000.

Over the past year, the Reserve Bank hosted visits by numerous researchers (including academics, postgraduate students, authors, journalists, numismatists, heritage architects and designers) interested in accessing the Bank's archives. The archives contain a rich collection of records about the Bank's own activities as well as those of financial institutions in Australia that predate the creation of the central bank. Because the central bank was formerly the government printer for materials other than banknotes, the Bank's archives also include a historical collection of Australian stamps, posters and vouchers (including wartime ration tickets). The Bank responded to many requests from researchers that required staff to research and retrieve archival records, and it has provided access to the archives by allowing members of the public to make specific enquiries and view material in a dedicated research room. Following amendments to the *Archives Act 1983* in 2010, in which the open-access period was reduced from 30 years to 20 years, there has been a substantial increase in the number of requests to view records from the 1980s and early 1990s, along with an increased appetite for earlier records relating to episodes of financial crisis. A program to digitise the Bank's most significant historical records is underway, with thousands of records scanned and made available electronically to researchers over the past two years. The Bank's Historian, Professor Selwyn Cornish of the Australian National University, is at an advanced stage of his research for the next volume of the official history of the Reserve Bank, which covers the period 1975–2000.

Charitable Activities

During the year, the Reserve Bank made its 11th annual contribution of $50 000 to the Financial Markets Foundation for Children, of which the Governor is Chairman. In July 2013, in its eighth public event to raise funds, the Governor addressed the Anika Foundation, which was established in 2005 to support research into adolescent depression and suicide.

The Reserve Bank's corporate philanthropy program involves several initiatives, with the primary one being dollar-matching staff payroll deductions to the Reserve Bank Benevolent Fund. In late 2012, the Bank also matched donations of $2 341 to the MS Society, which were raised by Bank staff participating in the 'Sydney to the Gong' charity bike ride. Reserve Bank staff also participated in a number of volunteer activities in the past year, including the Cancer Council's Biggest Morning Tea fundraiser, Pink Ribbon and Daffodil Days, Oxfam Trailwalker and Foodbank.

The Reserve Bank's contributions under all these initiatives in 2012/13 totalled $117 002. In addition, the Bank facilitates staff salary sacrificing under a Workplace Giving Program.

1. Information Department staff in the Reserve Bank's Museum of Australian Currency Notes (from left) Raigen Carleton, Nina Jackman, Jeff Connors, Bronwyn Nicholas and Christopher Collins **2, 3, 4.** Over 1 500 people visited the Museum on Australia Day in 2013 **5.** The Bank's Foodbank team (from left) Christos Fragias, Cathy Russell, Laurel Mason, Natasha Spowart, Alona Dave, Jonathan Lees, Jenny Lee, Adam Morris, Ryan Legaspi and Maria Gonzales, December 2012 **6.** Former Prime Minister The Hon John Howard OM AC with Ellis Connolly, Economic Analysis Department, at the final talk in the 2012/13 Emerging Economist Series, February 2013

Management of the Reserve Bank

Operating Costs

A high proportion of the Reserve Bank's call on resources comes from activities associated with its key policy and operational responsibilities in financial markets, settlements and banking. As a central bank, its active presence in financial markets incurs significant costs for the systems that support these activities, which are, in large part, provided in pursuit of the public interest as they are systemically critical, particularly at times of financial stress when the Bank must provide liquidity and ensure the continuity of key components of financial infrastructure. Systems and assets that support these operational activities are constantly evolving and typically subject to gradual and incremental change. The Bank, however, currently anticipates change in its systems on a larger scale across a wider range of activities than has occurred in the past. This work is justified, in the Bank's view, by the public interest and will help the Bank to continue to meet its responsibilities in a changing financial environment. Some, though not all, of this new work can be expected to result in increased revenue, which will partly or fully offset the costs incurred.

A critical piece of financial infrastructure is the platform the Reserve Bank provides for real-time interbank settlements. This platform has evolved over the years, and continues to do so, in response to technological innovation and rising policy expectations. One major initiative is the new work that has begun, in response to the Payments System Board's *Strategic Review of Innovation in the Payments System*, to deliver the capability for fast payments for transactions of low value. Advances in technology have also fundamentally changed how services are delivered in the banking industry, leading the Bank to adopt new technology for its own systems, so that it will continue to provide contemporary and cost-effective services to its banking customers, the largest of which is the Australian Government. Parallel pressures are evident on systems to implement monetary policy, with, for example, innovation in dealing practices and instruments, partly in response to the financial crisis. New platforms are necessary to support operations in these instruments, for the Bank to better manage the associated credit risk and to accommodate Australia's response to change in the global regulatory regime for banks. As they advance, each of these systems must achieve higher levels of performance, stronger control – for the Bank and the financial system – and remain resilient to stress. The same-day settlement and banking projects are discussed in the chapter on 'Banking and Payments'.

There was also further progress in the project to introduce a new series of banknotes to deal with the potential threat to the security of the note issue from the age of the current series (discussed in the chapter on 'Currency'). Aside from tasks associated with designing and printing new banknotes, the program of distributing the new note issue, and withdrawing existing notes, presents a major storage and distribution challenge in its own right. The Reserve Bank will modernise its storage facilities and adopt modern logistics arrangements at the Note Printing Australia facility at Craigieburn, Victoria, so that control will be strengthened and storage and distribution of banknotes will become more efficient. The construction aspects of the banknote project will be subject to scrutiny by the Parliamentary Standing Committee on Public Works.

The range of projects, and interactions among them, gives rise to significant management challenges and a high level of risk that must be controlled as investment in new systems and assets progresses. The Reserve Bank is, accordingly, adding resources to risk management, compliance, and project management and governance, particularly around IT activities, to ensure that new project work is delivered efficiently, in a coordinated way and with minimum risk.

The range of initiatives outlined has begun to add significantly to the Reserve Bank's costs, both operating and capital, and will continue to do so for several years. Some projects have been underway for some time, including the upgrade of banking systems and development of the new banknotes, and these have already had an impact on costs. Other projects are planned to begin in the year ahead, including in markets and payments settlements.

In total, operating costs rose by about 8.2 per cent in 2012/13, to $267.3 million. Taking account of cost increases in business areas that were matched by revenue gains, costs from ongoing activities rose by about 6½ per cent, whereas operating costs from projects rose by 28.2 per cent. Project costs are expected to double in 2013/14, while business-as-usual costs are expected to grow at a similar pace as in 2012/13. As has historically been the case, staff costs represent the single largest operating expense for the Reserve Bank (this includes remuneration, on-costs and other staff-related costs, such as recruitment and training), accounting for over 60 per cent of operating costs.

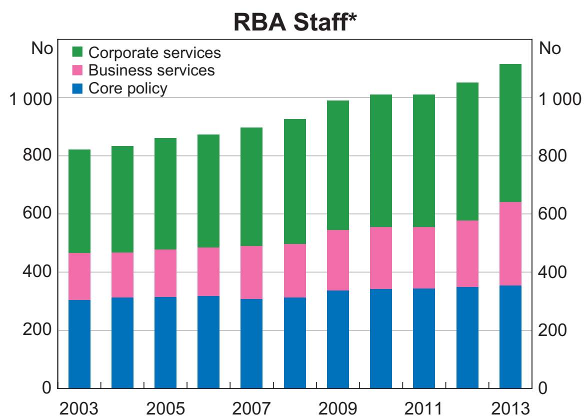
Operating Costs[(a)]
$ million

	2008/09	2009/10	2010/11	2011/12	2012/13
Staff costs	132.6	141.6	148.1	156.7	169.0
Other costs	82.8	83.3	86.0	90.4	98.3
Underlying operating costs	**215.4**	**224.9**	**234.1**	**247.1**	**267.3**
Cost of redundancies	2.0	0.5	1.3	1.9	2.5

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

Our People

Over the year to June 2013, the total number of employees at the Reserve Bank increased by 64 to 1 115, a rise of around 6 per cent. The increase in staff numbers was concentrated in the business and support areas of the Bank and around half reflected additional resources for major projects.

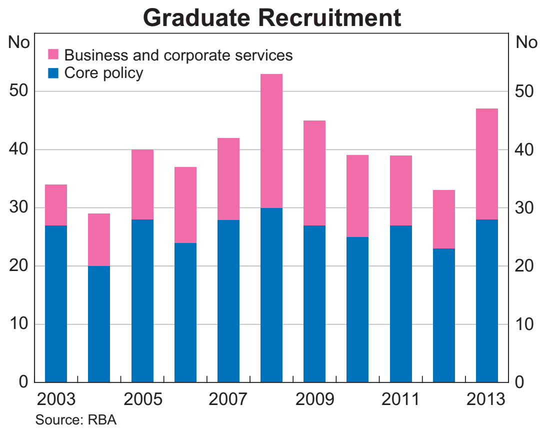


* As at end June, excludes NPA
Source: RBA

The Reserve Bank recruited 150 people over the past financial year. Forty-seven recent graduates, representing around one-third of all new employees, began the Graduate Development Program this year. Forty per cent of graduate recruits are working in the Bank's business and corporate services areas. While the majority of graduates hold economics or finance degrees, the business and corporate services areas also

The 2013 graduate recruits at the HC Coombs Centre during their first week at the Reserve Bank, February 2013

recruited graduates with degrees in science, engineering, accounting and information technology. During the year, the Bank was awarded the inaugural 'Best Employer' award by the Australian Association of Graduate Employers for the employer providing its graduates with the best overall experience during their first 12 months on the job.



Meeting the Reserve Bank's responsibilities requires high-calibre employees. Around half of the Bank's employees have degree qualifications and around a fifth have postgraduate qualifications. A number of programs support the Bank's aim of recruiting professional employees of suitable quality. Honours graduates are sought through the Cadetship Program, which provides students of high potential in relevant disciplines with work experience at the start of their honours year. Financial support during that year is available if cadets are offered, and accept, a place on the next Graduate Development Program.

Financial support is also provided to current staff for part-time study in disciplines related to their work, with around 80 employees studying part-time. In addition, the Reserve Bank provides support for full-time postgraduate study at universities in Australia and overseas, and in the past year four employees were awarded such assistance. Employees who are supported for full-time study are required to reimburse these costs if they resign either while studying or before completing an agreed period of work after returning from study.

Other training is provided on the job, through formal courses and, for a limited number of staff, through attachments to other organisations. Over the past year, for example, the Reserve Bank has had staff on secondment with the Departments of the Treasury and the Prime Minister and Cabinet, the International Monetary Fund, the Bank for International Settlements, the Organisation for Economic Co-operation and Development, the Bank of England, the Bank of Canada and the Federal Reserve Bank of New York. At the same time, the Bank has hosted secondees from the Departments of the Treasury and the Prime Minister and Cabinet, the Australian Prudential Regulation Authority and the Bank of Canada.

Training was also provided to staff on work health and safety (WHS) obligations and contemporary WHS matters such as mental health at work. Those staff who have a greater level of WHS responsibility, or require a greater level of training because of the nature of their role, also attended specialist training or conferences during the year. The Reserve Bank regards the safety and wellbeing of employees to be of paramount importance. The Bank's WHS activities are covered in the chapter on 'Statutory Reporting Obligations'.

A Staff Discussion Series was launched during the year to raise employees' awareness about the roles, activities and range of work undertaken across the Reserve Bank. The series offers an opportunity for staff to participate in discussions about new Bank projects, policies and other activities. It is envisaged that there will be six to eight presentations in the series each year. Topics covered during the past year included the Next Generation Banknote project, the renovation of banking systems project, managing the cash rate and the Bank's payments system responsibilities.

The Reserve Bank strives to offer a total remuneration package that attracts and engages high-calibre employees. Independent consultants are engaged to ensure that remuneration policies are consistent with market practice. The Bank's Workplace Agreement provided for a 4 per cent salary increase in 2012/13 for the staff it covers, with scope for a modest additional payment in recognition of good performance. Staff on individual contracts received, on average, a salary increase comparable to that provided by the Workplace Agreement.

Facilities

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

The value of the Reserve Bank's property assets increased by $12.6 million to $329.0 million in 2012/13, primarily because of an increase in the value of the facility at Craigieburn. Surplus accommodation in the Bank's properties is leased to external tenants. Gross income from these leases amounted to $9.0 million in 2012/13.

During the year, the Reserve Bank continued to strengthen the resilience of facilities supporting critical operations. In Sydney, infrastructure associated with the auxiliary power system was upgraded to provide greater reliability in the event of interruptions to the mains supply; this included new cooling, fuel delivery and control systems. The program to upgrade Head Office's hydraulic systems also continued during the year with the installation of a flood control drainage system. At Craigieburn, work commenced to replace and upgrade the remaining mechanical infrastructure supporting the facility's air-conditioning and heating systems.

A number of other capital improvements were undertaken over 2012/13 to address life-cycle replacements or the refurbishment of accommodation in response to changing business needs. At Head Office, a basement improvement project commenced to rationalise storage areas, extend lift services and update amenities, and some office accommodation was refurbished. At Craigieburn, office and laboratory areas were consolidated and upgraded. Planning is well underway for the Currency Storage Project, which involves the development of a new storage and processing facility as part of the Next Generation Banknote project.

Environmental Management

The Reserve Bank is committed to improving the environmental performance of its operations. The Environmental Management Committee (EMC) in the facilities management function of the Bank has

1. Claude Pelosi, Facilities Management Department, with one of the gas-fired boilers in Head Office, April 2013
2. David Stanton (left) and Jamie Moorby, Facilities Management Department, on the roof of the Canberra building with the new air-conditioning chiller

developed policies that are in accordance with the principles of ecologically sustainable development as set out in the *Environment Protection and Biodiversity Conservation Act 1999*. These policies reduce the impact of the Bank's operations on the environment and include the following initiatives:

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

Electricity consumption decreased by 1 per cent during 2012/13 compared with the average of the past five years. Further improvements in electricity consumption were realised during the year at most of the Reserve Bank's sites, with the biggest reduction in the Canberra building, where the air-conditioning and heating system was recently upgraded. Head Office maintained the lower levels of consumption attained the previous year.

Gas consumption during 2012/13 was similar to the previous year and 4 per cent lower than the average for the previous five years. Water consumption increased by 3.5 per cent in 2012/13, as a result of higher ambient temperatures, but was 5 per cent lower than the average of the previous five years.

The amount of waste produced by the Reserve Bank during 2012/13 rose by 3 per cent compared with the five-year average. The waste recycled across all facilities increased by 29 per cent. Landfill waste from the Bank's New South Wales sites is now sent to bioreactors that capture methane to produce 'green' electricity.

The Reserve Bank's EMC will continue to set targets and pursue lower energy and water consumption. Some of the initiatives being investigated include extending sub-metering systems and improvements in information technology operations at the Bank's sites.

Consultancies

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

Spending on Consultancies[(a)]
$

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

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

As in previous years, consultancies during 2012/13 covered a range of activities, including corporate governance, security arrangements and risk management. Spending on consultants was also significantly boosted by ongoing work on several major projects, most notably the development of the new series of banknotes. These projects are expected to boost expenditure on consultancies for a number of years.

Risk Management

Objectives and Governance Structure

In the process of carrying out its responsibilities as a central bank, the Reserve Bank faces a broad range of risks. From a financial perspective, the most significant of these are derived from the financial assets held to support the Bank's operations in financial markets. However the Bank also manages material risks arising from its banking and settlement operations, the implementation of large and complex projects and from the administration of the Bank itself. The Bank seeks to manage its risk profile carefully. This reflects the view that satisfactory fulfilment of its important public policy responsibilities could be seriously undermined if poorly managed risks were to result in significant financial losses or damage to the Bank's reputation. That said, the Bank recognises that it cannot eliminate the risks involved in its activities completely.

Risk management is an integral part of the management function in the organisation and, as such, is the clear responsibility of management. Line managers have the responsibility to evaluate their risk environment, to put in place appropriate controls and to monitor the effectiveness of these controls. Management is supported in this role through the development and maintenance of an active risk management culture that acknowledges the need for careful analysis and management of risk in all business processes.

The Reserve Bank identifies, assesses and manages risk at both an enterprise ('top-down') and business ('bottom-up') level, a process that is subject to ongoing review. Controls put in place to manage the Bank's risk environment are carefully assessed to ensure they are well developed and implemented effectively. During the past year the Bank's senior executives participated in a facilitated workshop to discuss the key risks that could potentially affect the Bank at an enterprise-wide level. These key enterprise risks were analysed to ensure the primary drivers are fully understood and the corresponding control environment is as robust as possible. This exercise was a valuable addition to the existing risk assessment process undertaken by individual departments on an annual basis.

Oversight of the risk management framework sits with the Risk Management Committee, which is chaired by the Deputy Governor and comprises the Assistant Governors for Banking and Payments, Corporate Services, Currency and Financial Markets; the Chief Financial Officer; the Chief Information Officer; the Heads of Audit, Human Resources and Risk Management; and the General Counsel and Deputy Secretary. The Risk Management Committee is responsible for ensuring that all the risks the organisation faces, with the exception of those arising directly from the Bank's monetary policy, financial stability and payments policy functions, are properly assessed and managed. Over the course of the past year, the Committee met quarterly and informed the Executive Committee and Reserve Bank Board Audit Committee of its activities. The Committee recently decided to move to six meetings a year, and will meet more frequently if needed.

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

The Audit Department also supports the framework for managing risk, complementing but remaining separate from the work of RM. In addition to providing assurance that the 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 Reserve Bank. RM itself is subject to audit review. The Audit Department reports to the Deputy Governor and the Reserve Bank Board Audit Committee, which meets every three months or more frequently if required.

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

Portfolio Risks

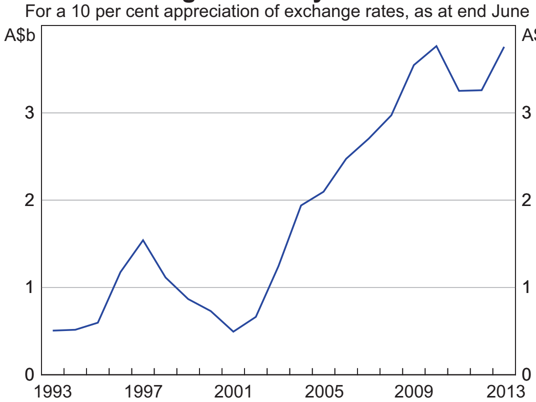
The Reserve Bank holds domestic and foreign currency-denominated financial instruments to support its operations in financial markets in pursuit of its policy objectives. These instruments account for the majority of the Bank's assets and expose the balance sheet to a number of financial risks, of which the largest are exchange rate risk, interest rate risk and credit risk. The Bank does not aim to eliminate these portfolio risks entirely as this would interfere with its ability to implement its policy objectives. Instead, the risks are managed to an acceptable level and minimised where appropriate through a number of controls, which are discussed below. The primary responsibility for managing these risks rests with the Financial Markets Group. The role of RM is to monitor these risks and report on adherence with approved authorities and limits. In that regard, the Assistant Governor (Financial Markets), the Head of Risk Management and other senior staff are provided with real-time and daily reports on limits compliance, portfolio risks and performance.

Exchange rate risk

The Reserve Bank invests in foreign currency-denominated assets as holder of Australia's official foreign currency reserves. These holdings expose the Bank's balance sheet to fluctuations in exchange rates. Given its policy role, the Bank does not seek to eliminate this exposure but rather mitigates the risk by diversifying its foreign currency assets across four currencies. The weights of these four currencies are specified in terms of a benchmark that reflects the Bank's long-term risk and return preferences given its need for high liquidity and security. The portfolio is rebalanced daily taking into account changes in market rates or transactions.

Exchange Rate Risk on RBA Foreign Currency Portfolio

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



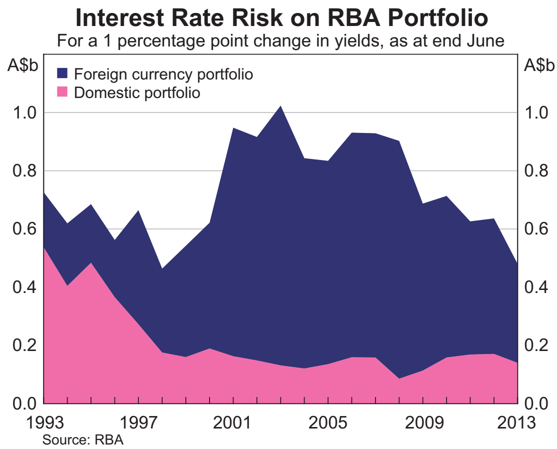
Source: RBA

The allocation of the portfolio across the four currencies was changed over the course of 2012/13, with the US dollar allocation increased from 45 to 55 per cent, while the euro allocation was reduced from 45 to 35 per cent; the 5 per cent allocation to the Japanese yen and the 5 per cent allocation to the Canadian dollar remained unchanged (see chapter on 'Operations in Financial Markets'). The changes in allocation were effected gradually to avoid disrupting markets.

The Australian dollar value of the Reserve Bank's portfolio rose over the year, mainly owing to valuation gains due to the depreciation of the Australian dollar exchange rate. As exchange rate risk is primarily a function of portfolio size, the yardstick measure of exchange rate risk increased over the year. At the current level of reserves, a yardstick measure of exchange rate risk (a 10 per cent appreciation of the Australian dollar) would result in losses of around $3.8 billion.

Interest rate risk

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



The Reserve Bank holds domestic securities for policy-related purposes. At the end of June 2013, total holdings of domestic securities were $43 billion, around $11 billion higher than a year earlier owing to an increase in holdings of securities under reverse repurchase agreements (repos). The average term of the Bank's domestic repo book at the end of June was almost four weeks, slightly higher than a year earlier. For domestic securities held outright, the sensitivity to movements in market yields fell marginally over the year as the value of the outright holdings in the portfolio declined.

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

In contrast to the domestic portfolio, the Reserve Bank's foreign currency assets are managed relative to a benchmark that reflects the Bank's long-term appetite for risk and return and is specified in terms of a target portfolio duration. The benchmark duration was reduced to six months for the US, Canadian and Japanese portfolios over the past year, but remains at 18 months for the European portfolio.

The overall level of interest rate risk on the Reserve Bank's domestic and foreign financial assets decreased over the past year, driven by the changes to the benchmark duration targets and asset allocation of the foreign portfolio. The Bank would incur a valuation loss of about $480 million if interest rates in Australia and overseas rose uniformly by 1 percentage point across the yield curve.

Credit risk

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

The Reserve Bank is exposed to very little credit risk on its outright holdings in the domestic portfolio as it invests only in securities issued by the Australian Government or by state and territory government borrowing authorities. Given that a large portion of the Bank's domestic assets are held under repo, the Bank is exposed to some counterparty credit risk. However, the credit risk on repos is inherently limited and ultimately reflects the quality and market value of the securities provided as collateral. The Bank faces a loss only if the counterparty fails to repurchase securities sold under repo and the market value of the securities falls to be less than the agreed repurchase amount. Furthermore, the Bank manages this exposure by applying an appropriate margin ('haircut') to the securities and requiring that these securities meet certain eligibility criteria. The degree of over-collateralisation ranges from 1 to 23 per cent, and increases with the risk profile of the security. As a result, the residual exposure to the Bank is very low.

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

The Reserve Bank's investments in the foreign portfolio are also typically confined to highly rated securities. The majority of the Bank's outright holdings are highly liquid securities issued by the national governments of the United States, Germany, France, the Netherlands, Japan and Canada, with modest holdings of securities issued by select highly rated supranational institutions. The Bank also holds a portion of its foreign portfolio in short-term repos. This exposes the Bank to the small amount of residual credit risk that is inherent in repos, as noted above. The Bank manages this risk by requiring 2 per cent over-collateralisation and accepting only high-quality and liquid securities as collateral. Credit exposure on foreign repurchase agreements is further managed by imposing limits on individual counterparty exposures. The credit risk framework applies credit ratings and market-based credit measures to manage risk exposures.

The Reserve Bank uses foreign exchange swaps as part of its policy operations. Credit risk on these instruments is managed to a low level by executing foreign exchange transactions under internationally recognised legal agreements only with counterparties that meet strict eligibility criteria and have been approved by a group of senior Bank officials. These counterparties are generally highly rated; however, factors other than credit ratings are also considered. The Bank has sought to reduce risk associated with foreign exchange swaps further through margining under two-way credit support annexes. This involves the Bank receiving and sending collateral to cover exposures on foreign exchange swaps generated by movements in exchange rates away from the contracted rate.

Operational Risk

The Reserve Bank faces risks to the operation of its systems and the effective functioning of its internal processes on a day-to-day basis. These risks are similar to those faced by other financial institutions and range from the possibility that access to key financial infrastructure might be lost to the possibility that services might not be delivered to the required standard.

The risks associated with financial transactions remain among the most significant faced by the Reserve Bank. These transactions are carried out both to support the Bank's activities and on behalf of clients. During 2012/13, Financial Markets Group executed around 82 000 transactions, generating an average daily settlement value of around $29 billion.

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

The provision of the Reserve Bank's policy and business operations are highly dependent on complex information technology (IT) systems. As such, the Bank's risk management framework supports a continuing focus on controlling the main operational risks associated with these systems, including extensive monitoring, reconciliation and reporting functions, to ensure that a control failure does not lead to an unacceptable outage. In addition to this, IT staff regularly evaluate industry developments to ensure the Bank's systems reflect current technology and remain robust. Assessments of appropriate staff resourcing, the adequacy of controls over IT processes and the level of security over information management are all incorporated into the Bank's ongoing risk management processes.

As well as maintaining existing IT systems, the Reserve Bank is currently engaged in a number of large and complex technology projects, including the renovation of its banking applications and systems, the development of infrastructure to facilitate real-time retail payments and the upgrade of Australia's banknotes. These initiatives will ensure high-quality services are maintained for the Bank's clients and the Australian public. To address any potential risk that infrastructure changes to the systems and databases used in these projects could result in a failure or deterioration of service, the Bank has put in place comprehensive change management procedures and project management systems. This includes a comprehensive testing regime before any change is upgraded to a production environment, with staff on-call to ensure any system problems are quickly assessed and remedial action is put in place where required.

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

A significant operational risk facing any institution is that staff may engage in fraud or undertake unauthorised transactions exposing the institution to reputational damage or significant financial loss. Over the year to the end of June 2013, the Reserve Bank has seen this risk materialise in two instances. The first incident concerned the theft and unauthorised disclosure of Bank data in September 2012. The second instance occurred from December 2011 to November 2012 in the procurement area of the Melbourne Office and involved a former manager of the facilities management function. In both cases the Deputy Governor notified the Australian Federal Police and requested its assistance in the investigation.

The Reserve Bank has a number of controls in place to mitigate the risk of fraud. These include having a clear decision-making hierarchy, separation of duties, and controls over computer access at both the user and administrator levels. However, when a control failure is detected a reassessment of the risk environment is undertaken. Following the two fraud incidents, the relevant circumstances were reviewed extensively by the Risk Management Committee and remedial work was commissioned by management to strengthen the Bank's processes and controls.

With regard to financial transactions, all staff involved in financial dealing have well-defined limits to their authority to take risk or otherwise commit the Reserve Bank. These arrangements are further enhanced by independent front-, back- and middle-office functions where staff who initiate trades, those who settle them and those who monitor and report on exposures and compliance with trading and investment guidelines are physically separate and have separate reporting lines.

The Reserve Bank is strongly committed to establishing and maintaining a culture that encourages and supports the highest standards of behaviour. As noted in the chapter on 'Governance', the Code of Conduct for employees was rewritten over the course of the past year to articulate more explicitly the values that the Bank expects its staff to demonstrate when pursuing its objectives, including promotion of the public interest, integrity, excellence, intelligent inquiry and respect. The Fraud Control Policy and arrangements by which fraud and unethical behaviour can be reported anonymously are part of the framework. These initiatives are supported by regular fraud awareness training, which endeavours to keep staff aware of their responsibilities in this area.

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.

Anti-Money Laundering and Counter-Terrorism Financing Program

As a provider of designated services under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act), the Reserve Bank is required to have an anti-money laundering and counter-terrorism financing program. The AML/CTF Act mandates that an AML/CTF program be divided into Part A and Part B, with the primary purpose of Part A being to identify, manage and mitigate the money laundering or terrorism financing risks faced by the Bank, while Part B sets out its customer identification procedures under the AML/CTF Act. One of the requirements of the rules made under the AML/CTF Act is that Part A must be approved by an organisation's governing board and senior management.

Over the past year, the Reserve Bank reviewed and updated its AML/CTF program to ensure that it accurately reflected the Bank's AML/CTF-related activities and met the requirements of the AML/CTF Act. Part A of the Bank's revised AML/CTF program was endorsed by the Bank's Executive Committee in June 2013 and by the Reserve Bank Board the following month. The Board also receives an annual report on the Bank's AML/CTF program.

Government Guarantee Scheme

The Reserve Bank manages on behalf of the Australian Government the Guarantee Schemes for Large Deposits and Wholesale Funding and for State and Territory Borrowing. Applications for new guaranteed liabilities under both schemes closed in 2010, but the Bank will continue to have responsibility for collecting fees on existing liabilities for some years. Around $600 million in fees was collected on behalf of the Government in 2012/13.

Earnings and Distribution

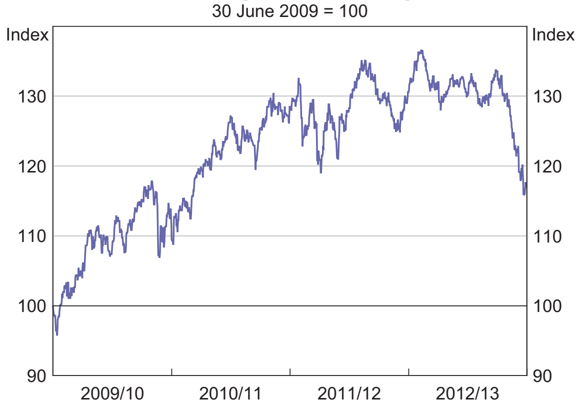
The Reserve Bank manages a balance sheet of financial assets to conduct operations in financial markets to pursue its monetary policy objectives. The balance sheet fluctuates in size according to these operations; total assets averaged around $89 billion in 2012/13. These assets include Australia's foreign exchange reserves as well as domestic securities used to manage liquidity in Australia. Management of the Bank's assets is discussed in the chapter on 'Operations in Financial Markets'; a discussion of the associated risks appears in the chapter on 'Risk Management'. Liabilities on the balance sheet are composed of banknotes on issue, deposits of the Australian Government and other customers, and capital and reserves.

The Reserve Bank's earnings come from two sources of income. The first, underlying earnings, arises because the Bank earns interest on almost all of its assets while it pays no interest on a large portion of its liabilities, including banknotes in circulation and capital and reserves. With interest rates around the world at exceptionally low levels, underlying earnings have also been very low in recent years. The second source of income arises from valuation gains or losses resulting from fluctuations in the value of the Bank's assets that reflect changes in exchange rates or security yields. An appreciation of the Australian dollar or a rise in interest rates reduces the value of the Bank's securities, resulting in valuation losses. Conversely, a depreciation of the Australian dollar or a decline in market yields has the opposite effect and results in valuation gains. These valuation gains and losses are realised only when the Bank sells the underlying asset.

Valuation gains and losses are volatile as market interest rates and the exchange rate can fluctuate across wide ranges over time. The Reserve Bank has limited discretion to manage these foreign exchange and interest rate risks since, as noted, its financial assets are mainly held for policy purposes and are managed accordingly. If the exchange rate depreciates, as it did this year, valuation gains are recorded. In some recent years, by contrast, large valuation losses occurred as the exchange rate appreciated.

Reserves-weighted Exchange Rate*

30 June 2009 = 100

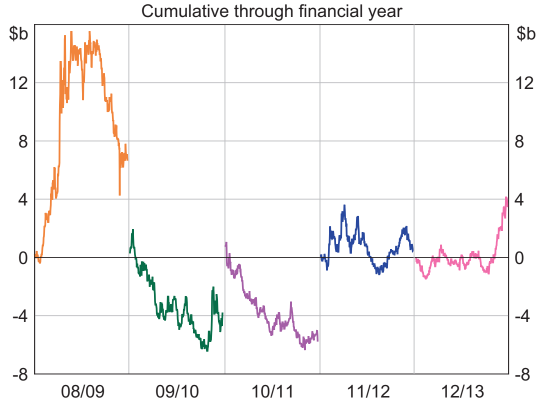


* Australian dollar exchange rate weighted by composition of the RBA's foreign reserves

Source: RBA

Valuation Gains and Losses

Cumulative through financial year



Source: RBA

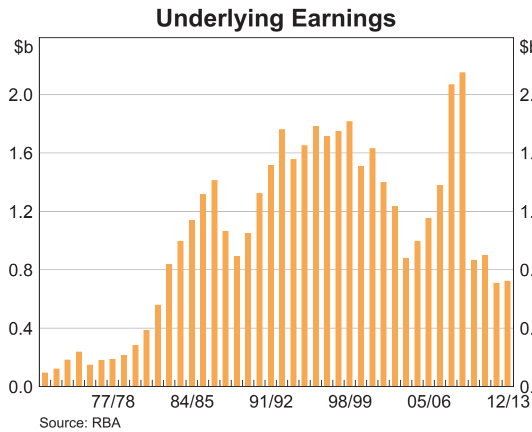
The distribution of the Reserve Bank's net profits is determined by section 30 of the *Reserve Bank Act 1959*. In terms of the Act, underlying earnings and realised gains and losses are available for distribution. Unrealised gains are not available for distribution, but are transferred to an unrealised profits reserve where they are retained to absorb future valuation losses or until the relevant assets are sold and the gains realised. The legislative provision to retain unrealised gains reflects sound central banking practice, as the distribution of the unrealised gains would reduce the Bank's capacity to absorb any future valuation losses. Unrealised losses are, in the first instance, also transferred to this unrealised profits reserve, and are offset against unrealised gains accumulated from previous years. For purposes of calculating distributable earnings, any unrealised losses that exceed retained unrealised gains are initially offset against other sources of income, namely underlying earnings and realised gains, with any remaining losses charged against the Reserve Bank Reserve Fund, the Bank's permanent reserve. Such a charge has occurred in some recent years.

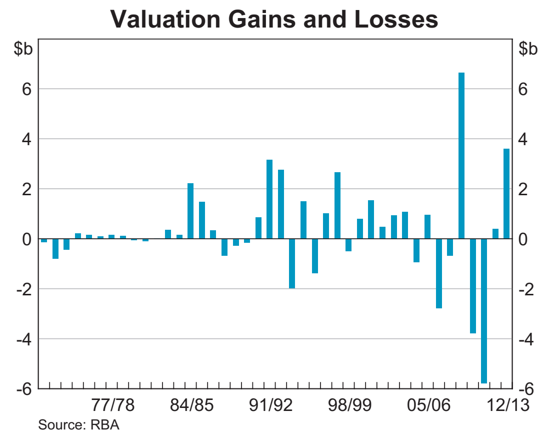
The Reserve Bank's Earnings

In accordance with Australian Accounting Standards (AAS), the Reserve Bank reports accounting profit as earnings from all sources, including realised and unrealised valuation gains and losses. In the 12 months to 30 June 2013, the Bank recorded an accounting profit of $4 313 million, compared with a profit of $1 076 million in the previous financial year. The accounting profit in 2012/13 comprised:

- Underlying earnings of $723 million, which were slightly higher than in the previous financial year, but still exceptionally low in historical terms, reflecting the continuing low level of interest rates in Australia and in the countries in which Australia's international reserves are held.
- Realised valuation losses of $135 million, primarily from maturing domestic securities purchased during the year at a premium that reflected the high coupon at which they were issued. The Bank purchased these securities to help manage the impact on liquidity as the large line of stock matured. Taking account of coupon payments while the stock was held, the relevant bond holding was profitable for the Bank. Gains were realised on foreign exchange transactions associated with managing the portfolio of foreign reserves.
- Unrealised valuation gains of $3 725 million, mainly from holdings of foreign exchange as the Australian dollar depreciated later in the year against currencies in which international reserves are held.

Earnings available for distribution amounted to $588 million in 2012/13, comprising underlying earnings less realised valuation losses.





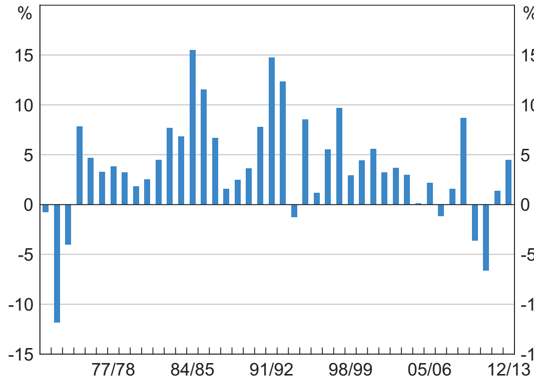
The composition and distribution of the accounting profit in 2012/13, and of historical profits and losses, are summarised in the table on page 72.

Reserves and Distribution

The Reserve Bank Reserve Fund (RBRF), the Bank's permanent general reserve, is established by the Reserve Bank Act. In terms of this Act, sums are credited to the RBRF from earnings available for distribution, as determined by the Treasurer after consulting the Reserve Bank Board. The balance of distributable earnings after any such transfer is payable as a dividend to the Commonwealth.

RBA Profits*

Per cent of balance sheet



* Accounting profit is estimated prior to 1998

Source: RBA

The RBRF is essentially the Reserve Bank's capital. Its primary purpose is to provide a capacity to absorb losses when it is necessary to do so. The RBRF served this purpose when it was substantially depleted in 2009/10 and 2010/11 by large accounting losses as the exchange rate appreciated. Following these losses, the Reserve Bank Board considered the balance of the RBRF to be below a level appropriate to the market risks on the Bank's balance sheet. The Treasurer determined, after consulting the Board, that $596 million from earnings available for distribution in 2011/12 be transferred to the RBRF with $500 million paid as a dividend to the Commonwealth. In 2012/13, the Treasurer determined that all earnings available for distribution be credited to the RBRF. With this transfer of $588 million, the balance of the RBRF at 30 June 2013 stood at $2 501 million. The Board considers that further transfers to this reserve will be needed in future years to restore its balance to a level that adequately reflects the Bank's risks.

In addition to the RBRF, the Reserve Bank maintains a number of other financial reserves. As noted, unrealised gains are transferred to an unrealised profits reserve where they are retained to absorb future valuation losses or are realised, and become available for distribution, when the relevant assets are sold. Unrealised gains of $3 725 million were transferred in 2012/13 to this reserve, the first time such a transfer has been possible since 2008/09. By contrast with the RBRF, which is a permanent reserve, the balance of the unrealised profits reserve fluctuates in response to movements in the exchange rate or bond yields. This balance is nevertheless available as a buffer to absorb unrealised losses that would occur if the exchange rate appreciated or bond yields rose.

Asset revaluation reserves are held for non-traded assets such as gold holdings, property, plant and equipment. Balances in these reserves represent the difference between the market value of these assets and the cost at which they were acquired. The total balance in these reserves stood at $3 705 million at 30 June 2013, $670 million lower than a year earlier, mainly reflecting the fall in the Australian dollar value of the Bank's holdings of gold.

The balance of the RBRF plus asset revaluation reserves and unrealised profits reserves stood at 10.1 per cent of total assets at 30 June 2013.

The Reserve Bank's financial statements (and accompanying Notes to the Financial Statements) for the 2012/13 financial year were prepared in accordance with AAS, consistent with the Finance Minister's Orders issued under the *Commonwealth Authorities and Companies Act 1997*.

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(–)[a]	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	897	–1 135	–4 651	– 4 889	–23	–	–4 866	–	–	750	750
2011/12	710	405	–39	1 076	–20	–	596	500	–	–	–
2012/13	723	–135	3 725	4 313	3 725	–	588	–	500	–	500
2013/14									–	–	–

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

Statutory Reporting Obligations

Equal Employment Opportunity

The Reserve Bank is required under the *Equal Employment Opportunity (Commonwealth Authorities) Act 1987* to report to the Australian Parliament each year on its equity and diversity program. *The Equity and Diversity Annual Report 2012*, which reviews the Bank's diversity profile, employee engagement with existing policies and progress with the program, was tabled on 10 September 2012.

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

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

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

The major focus in 2012/13 was to enhance the Reserve Bank's culture of inclusiveness and better understand the equity and diversity issues associated with employee participation and work-life balance.

Full details and outcomes of the Diversity Program are included in the Reserve Bank's *Equity & Diversity Annual Report 2013*.

Work Health and Safety, Compensation and Rehabilitation

The Reserve Bank continued to foster a safety culture that is preventative, proactive and based on due diligence, by demonstrating the visible commitment to safety of the Bank's senior and executive management. To ensure a coordinated approach to work health and safety (WHS) management across the Bank, the WHS Coordination Committee was formed in August 2012. The Committee meets quarterly and comprises the executive management from a number of departments as well as the Chairperson of the WHS Committee. The output of the WHS Coordination Committee flows through to the Risk Management Committee, Executive Committee and the Reserve Bank Board.

In terms of the *Work Health and Safety Act 2011 (Cth)* (WHS Act) and the conditions of its licence as a Licensed Authority under the *Safety, Rehabilitation and Compensation Act 1988*, the Reserve Bank is required to report each year on WHS and workers compensation and rehabilitation matters as they affect the Bank.

The Reserve Bank is committed to the safety, health and wellbeing of its workers, including contractors and other persons involved in the Bank's operations. The Bank has a strong track record in all aspects of WHS. Compliance with the relevant legislation and the Bank's Conditions of Licence was confirmed in 2013 by external audits of the Bank's safety, compensation and rehabilitation arrangements. The Safety, Rehabilitation and Compensation Commission subsequently confirmed that the Bank retained the highest possible rating for its prevention, claims management and rehabilitation practices for 2013/14 by maintaining Tier 3 status in each area.

A key focus of the Reserve Bank's activities during the year was to continue robust implementation of the WHS Act across the Bank's worksites. A new WHS strategic plan was developed, setting key priorities for the Bank over the medium term. The Bank continued to provide ongoing training to workers, health and safety representatives and management on contemporary WHS matters, including mental health. The Bank's Health & Wellbeing Program also provided education and promoted physical and psychological health through the implementation of evidence-based initiatives, which are targeted at WHS risks, attitudinal and behavioural change, and the provision of a supportive and safe workplace environment.

From 1 July 2012 to 30 June 2013, there were 51 reported WHS incidents, a decline of 15 per cent from the previous year. Around half of the incidents were sporting injuries sustained during recess breaks and two incidents were notified to Comcare – one a sporting injury that occurred during recess and the other a 'near miss' involving a contractor undertaking building works for the Reserve Bank. Two incidents resulted in workers compensation claims, down from six the previous year, with both involving sporting injuries sustained during recess breaks. The remaining incidents were relatively minor in nature. The Bank's Lost Time Injury Frequency Rate (number of lost time injuries per million hours worked) for the year was 1.2, down from 2 in the previous year, and a little lower than the industry average.

The Reserve Bank's policies and framework documents covering WHS were endorsed by the Reserve Bank Board in March 2013. The Board receives regular reports on WHS matters in the Bank, including an annual review covering the Bank's WHS indicators and main activities.

Freedom of Information (FOI)

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

Seventeen requests for access to documents under the FOI Act were received in 2012/13. Access was granted in part in response to 10 requests. No relevant documents were found in response to one request. Access to documents was denied in response to one request and four requests were withdrawn. One request remained outstanding at the end of the financial year. The Reserve Bank continued to publish on its website information that has been released in response to FOI access requests, as required by the FOI Act, with RSS feeds to these releases available from the Bank's website.

One application was received for the internal review of a decision in 2012/13.

The estimated number of staff hours spent dealing with all aspects of FOI requests in 2012/13 was around 395 hours, up from an estimated 294 hours in 2011/12. The total cost to the Reserve Bank of administering the FOI Act in 2012/13 is estimated to be about $123 000, compared with $88 000 the previous year. Charges levied and received amounted to $2 265. In terms of staff hours and costs, the increase in both is attributable to the overall complexity of requests being higher than those received in 2011/12.

Amendments to Enabling and Other Relevant Legislation

In January 2013, in accordance with commitments made by G20 leaders, a new regime for the regulation of derivative transactions and derivative trade repositories was introduced into the *Corporations Act 2001*. The *Corporations Legislation Amendment (Derivative Transactions) Act 2012* introduced a new Part 7.5A, under which the responsible Minister may issue a determination that mandatory obligations with respect to trade reporting, central clearing or platform trading should apply to a specified class or classes of over-the-counter (OTC) derivatives. Once the Minister has made a determination, the Australian Securities and Investments Commission (ASIC) may make derivative transaction rules that apply to the relevant products. Such rules set out the details of any requirements, including the institutional scope, product scope, transitional arrangements and the manner and form in which persons must comply with the requirements. In making determinations under Part 7.5A, the Minister must consult with ASIC, the Australian Prudential Regulation Authority (APRA) and the Reserve Bank. ASIC must also consult with APRA and the Bank in making derivative transaction rules. In order to inform their advice to the Minister, ASIC, APRA and the Bank actively monitor developments in the Australian and overseas OTC derivatives markets. As part of this process, the regulators carry out periodic surveys of the Australian OTC markets and produce assessment reports based on the results of these surveys. Over the past year the regulators have produced two such reports: in October 2012 and July 2013. In accordance with a recommendation in the October 2012 report, the Minister issued a determination in respect of trade reporting. ASIC finalised derivative transaction rules in relation to this determination in July 2013.

Part 7.5A also establishes a licensing regime for trade repositories. This regime imposes obligations on licensed trade repositories, including that they comply with requests for derivative trade data from ASIC, APRA and the Reserve Bank, and that they give such assistance to these regulators as might reasonably be requested in the performance of the regulators' functions.

In conjunction with these changes, section 79A of the *Reserve Bank Act 1959* was amended to extend the information protection provisions in that section to data provided under the new regime. Section 79A was also amended to clarify the ability of the Reserve Bank to share protected information with financial sector supervisory agencies and other central banks for the purpose of performance or exercise of their functions and powers. This clarification was important to ensure that effective sharing of protected information can occur for the purpose of ensuring financial system stability, including as it relates to derivative transactions.

In June 2013 the *Corporations and Financial Sector Legislation Amendment Act 2013* made a number of changes relevant to the Reserve Bank's powers and functions, in particular its role in the regulation of clearing and settlement facilities, which is overseen by the Payments System Board. This legislation:

- amended the *Payment Systems and Netting Act 1998* to support the capacity for central counterparties to transfer client positions from a potentially insolvent clearing participant to another clearing participant, in line with requirements in the new Financial Stability Standards set by the Reserve Bank
- amended the Corporations Act to remove the requirement for the Reserve Bank and ASIC to conduct annual assessments of licensed clearing and settlement facilities, except as determined by regulation

- further amended the information protection provisions in section 79A of the Reserve Bank Act to assist the Reserve Bank to collaborate with other regulators, both domestically and internationally. Among other things, the changes allow for regulations to prescribe persons and bodies with which the Bank may share protected information, for the Governor or a prescribed delegate to permit information sharing that would otherwise be prohibited and for the Bank to impose confidentiality restrictions on persons to whom protected information is provided. These changes brought the information sharing powers of the Bank into line with those of APRA.

In light of the removal of the requirement for annual assessments of licensed clearing and settlement facilities, the Reserve Bank has issued a statement setting out criteria to be considered in determining which clearing and settlement facilities, in addition to any for which annual assessment has been prescribed by regulation, should continue to be subject to annual assessments.

Ministerial Directions

The Reserve Bank received no new directions from its responsible Minister, the Treasurer, or from any other Minister during 2012/13.

No General Policy Orders under section 48A of the *Commonwealth Authorities and Companies Act 1997* (CAC Act) apply to the Reserve Bank. No general policies of the Australian Government were first applied, or continued to apply, to the Bank under section 28 of the CAC Act during 2012/13.

Since 1 July 2012 the Reserve Bank has been bound by the Finance Minister's (CAC Act Procurement) Directions 2012, which require the Bank to apply the Commonwealth Procurement Rules (CPRs) when undertaking a procurement where the expected value of the property or service being procured exceeds $400 000 for non-construction services or $9 million for construction services. For purchases of lower value, the Bank follows its own guidelines based on the principles contained in the CPRs. The broad objective is to ensure that all goods and services procured by the Bank support its policy and operational responsibilities in an efficient and cost-effective manner.

The Reserve Bank's policy covering procurement was endorsed by the Reserve Bank Board in March 2013, and in July 2013 the Board received an annual review covering the Bank's procurement activities in 2012/13.

Other Statutory Reporting Obligations

Other statutory reporting obligations applying to the Reserve Bank are covered elsewhere in this report and are identified in the Statutory Reporting Requirements Index on pages 77 and 78.

Statutory Reporting Requirements Index

The Reserve Bank Annual Report complies with the reporting requirements of the *Commonwealth Authorities and Companies Act 1997* (CAC Act), related Orders and other applicable legislation. To assist readers to locate relevant information, this index of annual report statutory reporting requirements identifies where the information can be found in this Annual Report.

***Work Health and Safety Act 2011* – reporting requirements**	
Health, safety and welfare initiatives	74
Health and safety outcomes	74
Statistics of notifiable incidents	74
Investigations conducted	Nil
***Environment Protection and Biodiversity Conservation Act 1999* – reporting requirements**	
Report on implementation of Ecologically Sustainable Development principles	60–61
Contribution of outcomes specified in Appropriations Act	No such outcomes specified for the RBA
Effect of the RBA's activities on the environment	60–61
Measures to minimise the impact of the RBA's activities	60–61
Mechanisms for reviewing/increasing effectiveness of measures	60–61

Financial Statements

For the year ended 30 June 2013

Directors' Statement

In the opinion of the directors, the financial statements for the year ended 30 June 2013 give a true and fair view of the matters required by the Finance Minister's Orders for Financial Reporting made under the *Commonwealth Authorities and Companies Act 1997*. These statements have been prepared from properly maintained financial records and are signed in accordance with a resolution of the directors.

Glenn Stevens
Chairman, Reserve Bank Board
2 September 2013

Frank Campbell
Assistant Governor (Corporate Services)

Statement of Financial Position – as at 30 June 2013

Reserve Bank of Australia and Controlled Entities

	Note	2013 $M	2012 $M
Assets			
Cash and cash equivalents	6	137	164
Australian dollar securities	1(b), 15	43 249	32 648
Foreign exchange	1(b), 15	50 930	43 296
Gold	1(c), 15	3 299	4 027
Property, plant and equipment	1(d), 8	491	448
Loans, advances and other assets	7	421	496
Total Assets		98 527	81 079
Liabilities			
Deposits	1(b), 9	26 183	18 000
Distribution payable to the Commonwealth	1(f), 3	–	500
Other liabilities	10	5 389	2 615
Australian notes on issue	1(b), 15	56 943	53 595
Total Liabilities		88 515	74 710
Net Assets		10 012	6 369
Capital and Reserves			
Reserves:			
Unrealised profits reserve	1(e), 5	3 766	41
Asset revaluation reserves	1(e), 5	3 705	4 375
Reserve Bank Reserve Fund	1(e), 5	2 501	1 913
Capital	1(e), 5	40	40
Total Capital and Reserves		10 012	6 369

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

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

Reserve Bank of Australia and Controlled Entities

	Note	2013 $M	2012 $M
Revenue			
Interest revenue	2	1 642	1 875
Net gains on securities and foreign exchange	2	3 662	386
Dividend revenue	2	5	4
Fees and commissions	2	28	24
Other income	2	138	97
Total Revenue		5 475	2 386
Expenses			
Interest expense	2	708	889
General administrative expenses	2	410	377
Other expenses	2	44	44
Total Expenses		1 162	1 310
Net Profit		4 313	1 076
Other Comprehensive Income			
Items that may be reclassified to profit or loss			
Gains/(losses) on:			
Gold	5	(727)	427
Shares in international and other institutions	5	42	23
		(685)	450
Items that will not be reclassified to profit or loss			
Gains/(losses) on:			
Property, plant and equipment	5	15	4
Total Other Comprehensive Income		(670)	454
Total Comprehensive Income		3 643	1 530

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

Statement of Distribution – for the year ended 30 June 2013

Reserve Bank of Australia and Controlled Entities

	Note	2013 $M	2012 $M
Net Profit		4 313	1 076
Transfer (to)/from unrealised profits reserve	5	(3 725)	20
Earnings available for distribution		588	1 096
Distributed as follows:			
Transfer to Reserve Bank Reserve Fund	5	588	596
Payable to the Commonwealth	3	–	500
		588	1 096

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

Statement of Changes in Capital and Reserves – for the year ended 30 June 2013

Reserve Bank of Australia and Controlled Entities

	Note	Asset revaluation reserves $M	Unrealised profits reserve $M	Reserve Bank Reserve Fund $M	Capital $M	Earnings available for distribution $M	Total capital and reserves $M
Balance as at 30 June 2011		3 921	61	1 317	40	–	5 339
Plus:							
Net Profit/(Loss)	2	–	(20)	–	–	1 096	1 076
Gains/(losses) on:							
Gold	5	427					427
Shares in international and other institutions	5	23					23
Property, plant and equipment	5	4					4
Other comprehensive income		454					454
Total comprehensive income for 2011/12							1 530
Less:							
Transfer to Reserve Bank Reserve Fund	3	–	–	596	–	(596)	–
Transfer to distribution payable to the Commonwealth	3	–	–	–	–	(500)	(500)
Balance as at 30 June 2012		4 375	41	1 913	40	–	6 369
Plus:							
Net Profit/(Loss)	2	–	3 725	–	–	588	4 313
Gains/(losses) on:							
Gold	5	(727)					(727)
Shares in international and other institutions	5	42					42
Property, plant and equipment	5	15					15
Other comprehensive income		(670)					(670)
Total comprehensive income for 2012/13							3 643
Less:							
Transfer to Reserve Bank Reserve Fund	3	–	–	588	–	(588)	–
Transfer to distribution payable to the Commonwealth	3	–	–	–	–	–	–
Balance as at 30 June 2013		3 705	3 766	2 501	40	–	10 012

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

Cash Flow Statement – for the year ended 30 June 2013

Reserve Bank of Australia and Controlled Entities

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

	Note	2013 Inflow/ (outflow) $M	2012 Inflow/ (outflow) $M
Cash flows from operating activities			
Interest received on investments		1 655	1 961
Interest received on loans, advances and on net overnight settlements balances		30	41
Loan management reimbursement		1	1
Banking service fees received		28	23
Dividends received		5	9
Rents received		9	9
Net payments for investments		(11 592)	(5 957)
Cash collateral received/(pledged)		(253)	–
Interest paid on deposit liabilities		(611)	(778)
Interest paid on currency note holdings of banks		(89)	(123)
Staff costs (including redundancy)		(198)	(184)
Premises and equipment		(41)	(38)
Other		(28)	(24)
Net cash used in operating activities	6	(11 084)	(5 060)
Cash flows from investment activities			
Proceeds from the sale of Securency		75	–
Net expenditure on property, plant and equipment		(50)	(17)
Net cash provided by investment activities		25	(17)
Cash flows from financing activities			
Distribution to the Commonwealth		(500)	–
Net movement in deposit liabilities		8 183	496
Net movement in loans and advances		1	–
Net movement in notes on issue		3 348	3 536
Net cash provided by financing activities		11 032	4 032
Net increase/(decrease) in cash		(27)	(1 045)
Cash at beginning of financial year		164	1 209
Cash at end of financial year	6	137	164

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

Notes to and Forming Part of the Financial Statements – 30 June 2013

Reserve Bank of Australia and Controlled Entities

Note 1 – Accounting Policies

The Reserve Bank of Australia (RBA) reports its consolidated financial statements in accordance with the *Reserve Bank Act 1959* and the *Commonwealth Authorities and Companies Act 1997* (CAC Act). These financial statements for the year ended 30 June 2013 have been prepared under Australian Accounting Standards (AAS), other accounting standards and accounting interpretations issued by the Australian Accounting Standards Board, in accordance with the Finance Minister's Orders for Financial Reporting (FMOs), which are issued pursuant to the CAC Act. These financial statements comply fully with International Financial Reporting Standards. The RBA has not sought any exemptions from the requirements of the FMOs in 2012/13. 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 2013.

These financial statements and attached notes are a general purpose financial report prepared in accordance with relevant AAS. Elections as to the accounting treatment under AAS made by the Bank are noted appropriately. All amounts are expressed in Australian dollars, the functional and presentational currency of the RBA, unless another currency is indicated. The RBA is classified as a for-profit public sector entity for purposes of financial disclosure. Fair values are used to measure the RBA's major assets, including domestic and foreign marketable securities, gold and foreign currency, and 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 Reserve Bank Board on 6 August 2013.

(a) Consolidation and joint venture

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

Note Printing Australia Limited

NPA was incorporated as a wholly owned subsidiary of the RBA on 1 July 1998, with an initial capital of $20.0 million. The RBA provided NPA with additional capital of $15.0 million in July 2008 and a further $25.0 million of capital in July 2009. NPA's total assets, liabilities and equity as at 30 June 2013 were $135.7 million, $23.4 million and $112.3 million, respectively ($151.2 million, $37.8 million and $113.4 million as at 30 June 2012).

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.

Innovia Security Pty Ltd (formerly Securency International Pty Ltd)

The RBA formerly held 50 per cent of the shares in Securency International Pty Ltd (Securency). The other 50 per cent was owned by Innovia Films, a UK-based film manufacturer. In November 2010, the RBA announced it was pursuing with Innovia Films a joint sale of Securency. This process was terminated late in 2011, after Innovia advised the Bank that it no longer intended to sell its share. Subsequently, the Bank pursued the sale of its interest in Securency. On 28 February 2013, the RBA completed the sale of this interest to a related entity of Innovia Films (refer Note 7). The RBA's investment in Securency was classified in its financial statements as at 30 June 2012 as held for sale, in accordance with AASB 5 – *Non-current Assets Held for Sale and Discontinued Operations*. This was based on the expectation that the carrying amount of the asset would be recovered through a sale transaction within one year.

Legal issues

During 2011 charges were laid against several former employees of NPA and Securency, and against the companies, alleging that they had conspired to provide, or offer to provide, benefits to foreign public officials that were not legitimately due. Further charges were laid against several former NPA employees in March 2013. The RBA has accounted for these matters in accordance with the relevant accounting standards. Specific information relating to the charges and associated costs has not been disclosed in the notes to the accounts as legal matters remain before the courts.

(b) Financial instruments

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

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 Financial Position and Statement of Comprehensive Income 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 eligible 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 the purpose of conducting monetary policy and may be sold or lent, typically for short terms, under repurchase agreements. In accordance with this standard, the securities are valued at market bid prices on balance date; realised and unrealised gains or losses are taken to profit. Only realised gains and losses are available for distribution in accordance with the Reserve Bank Act (Note 1(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 the securities are held. The face value is received at maturity.

Foreign exchange

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

Foreign exchange translation

Assets and liabilities denominated in foreign currency are converted to Australian dollar equivalents at the relevant market bid or offer exchange rate ruling on balance date in accordance with AASB 121 – *The Effects of Changes in Foreign Exchange Rates*. Realised and unrealised gains or losses on foreign currency are taken to profit, but only realised gains and losses are available for distribution in accordance with the Reserve Bank Act (Note 1(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 the securities are held. 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 (Note 1(f)). Interest earned on securities is accrued over the term of the security as revenue in the Statement of Comprehensive Income.

Foreign deposits

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

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. If the Bank enters into a buy repurchase agreement, the Bank records a receivable equal to the consideration paid; this is the equivalent of fair value. The difference between the purchase and sale price is accrued over the term of the agreement and recognised as interest revenue (see page 91 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. 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.

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 (Note 1(f)).

Bank for International Settlements

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

Financial liabilities

Deposit liabilities

Deposits 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 2012/13, notes with a face value of $208 491, which had previously been written down, were presented to the RBA and expensed ($254 636 in 2011/12).

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

Costs related to the production of currency notes are included in General Administrative Expenses in Note 2.

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

(d) Property, plant and equipment

The RBA accounts for its property, plant and equipment at fair value in accordance with AASB 116 – *Property, Plant and Equipment*. Valuation gains (losses) are generally transferred to (from) the relevant revaluation reserve. Valuation losses which exceed the balance in the relevant asset revaluation reserve are expensed. Subsequent valuation gains are included in income, 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 2013. 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. The value of the RBA's property at Craigieburn reflects fair value based on the renegotiation in 2012/13 of leases with NPA and Innovia Security, the tenants of this property. These leases are on commercial terms. The fair value of the Craigieburn property had previously been determined on the basis of vacant possession.

Reflecting its specialised nature, the RBA's Business Resumption Site in outer metropolitan Sydney continues to be valued on a depreciated replacement cost basis. 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 at 30 June 2011. 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
Fit-out 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.

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

The Reserve Bank Board assesses the adequacy of the balance of the RBRF each year. In line with section 30 of the Reserve Bank Act, the Treasurer, after consultation with the Board, determines any amounts to be credited to the RBRF from earnings available for distribution (refer Note 1(f)). As accounting losses in 2009/10 and 2010/11 reduced this reserve, the Board will, over time, seek to restore its balance from future profits to a level that it regards as satisfactory.

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. Such gains or losses are not available for distribution to the Australian Government and are transferred to the Unrealised Profits Reserve where they remain available to absorb future unrealised losses or become available for distribution when gains are realised as assets are sold.

When calculating distributable earnings, unrealised losses that exceed the balance held in the Unrealised Profits Reserve are initially charged against other components of income, consistent with the Reserve Bank Act.

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 Unrealised Profits Reserve (refer Note 1(h)). A sum of $70.7 million, representing an unrealised loss on the RBA's superannuation asset, was transferred to this reserve in 2012/13.

Balances of asset revaluation reserves reflect differences between the fair value of relevant assets, mainly non-traded assets, and their cost. These assets are gold; property, plant and equipment; and shares in international and other institutions. These unrealised gains are transferred directly to the relevant reserves and are included in Other Comprehensive Income. The unrealised gains on these assets are not distributable until the gains are realised through the sale of the relevant asset.

(f) Profits

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

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

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

(a) such amount as the Treasurer, after consultation with the Reserve Bank Board, determines shall be placed to the credit of the Reserve Bank Reserve Fund; and

(b) the remainder shall be paid to the Commonwealth.

(2) If the net profit of the Bank for a year is calculated on a basis that requires the inclusion of unrealised gains on assets during the year, the amount to which subsection (1) applies is to be worked out as follows:

(a) deduct from the net profit an amount equal to the total of all amounts of unrealised gains included in the net profit; and

(b) if an asset in respect of which unrealised gains were included in the net profit for a previous year or years is realised during the year – add to the amount remaining after applying paragraph (a) the total amount of those unrealised gains.

(g) Provisions

The RBA maintains provisions for accrued annual leave in accordance with AASB 119, based on expected salaries when leave is expected 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 as an asset or liability the position of its defined benefit superannuation funds. Actuarial gains and losses are included in the asset or liability in accordance with the 'corridor' approach under AASB 119. Movements in the superannuation asset or liability are reflected in the Unrealised Profits Reserve. 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 and revised accounting standards

A number of new and revised accounting standards will be applied from 1 July 2013. The RBA's assessment of the main effects of these standards on its financial statements is set out below.

AASB 119 – Employee Benefits and AASB 2011-10 – Amendments to Australian Accounting Standards

Revisions to AASB 119 and AASB 2011-10 will amend the basis for recognising and measuring employee benefits, in particular post-employment benefits. As a result of the change, the 'corridor' approach is no longer available to account for the remeasurement of defined benefit superannuation obligations. Accordingly, service costs and net interest amounts will be recognised in net profit. The calculation of net interest has also been amended and is to be calculated by applying the discount rate to the net defined benefit liability. Actuarial gains and losses will be recognised as part of other comprehensive income in the reporting period in which they occur.

Based on current estimates, application of the revised standard would have resulted in the recognition of a superannuation liability of $370.9 million as at 30 June 2013 (compared with a liability of $668.5 million had the standard been applied as at 30 June 2012) as well as a corresponding adjustment to the RBA's total comprehensive income. Additional narrative disclosures will also be required to be made in the notes to the financial statements around the RBA's defined benefit obligations.

The revised standard also amends the recognition and measurement of short-term and long-term employee benefits. These changes are not expected to have a material effect on the RBA's financial statements.

The revised AASB 119 will be applied in the RBA's financial statements for the year ending 30 June 2014.

AASB 13 – Fair Value Measurement

AASB 13 provides a framework for measuring fair value. The standard is not expected to have a material effect on the RBA's financial statements but will require additional disclosures to be made around fair value measurements contained in the notes to the financial statements. AASB 13 will be first applied in the RBA's financial statements for the year ending 30 June 2014.

AASB 9 – Financial Instruments

AASB 9 contains new requirements for the classification, measurement and de-recognition of financial assets and liabilities. It will replace the corresponding requirements in AASB 139. The Bank is assessing the impact of the new standard, which will first become applicable for annual reporting periods beginning on or after 1 January 2015.

Note 2 – Net Profits

	Note	2013 $M	2012 $M
Interest revenue			
Foreign investments	1(b), 4	213	325
Australian dollar securities	1(b), 4	1 398	1 508
Overnight settlements	4	30	41
Loans, advances and other	4	1	1
		1 642	1 875
Net gains/(losses) on securities and foreign exchange			
Foreign investments	1(b)	(70)	426
Australian dollar securities	1(b)	(244)	188
Foreign currency	1(b)	3 976	(228)
		3 662	386
Dividend revenue			
Investment in Bank for International Settlements	1(b)	5	4
Fees and commissions			
Banking services fees received		28	24
Other income			
Reimbursement by Australian Government for loan management and registry expenses		1	1
Rental of Bank premises		9	9
Sales of note and security products		79	66
Gain on the sale of Securency		21	–
Other		28	21
		138	97
Total		5 475	2 386
Less:			
Interest expense			
Deposit liabilities	1(b), 4	614	753
Currency note holdings of banks	1(b), 4	89	123
Cash collateral received	1(b), 4	2	–
Repurchase agreements	1(b), 4	3	13
		708	889
General administrative expenses			
Staff costs		153	199
Superannuation costs	1(h), 14	97	45
Special redundancy/retirement payments		6	2
Depreciation of property	1(d), 8	8	7
Depreciation of plant and equipment	1(d), 8	19	18
Premises and equipment	1(d)	41	38
Materials used in note and security products	1(b)	70	48
Travel		3	3
Consultants' fees, legal fees and payments to contractors		6	8
Other		7	9
		410	377

Note 2 – Net Profits (continued)

	Note	2013 $M	2012 $M
Other expenses			
Agency business reimbursement		12	7
Subsidiary income tax		–	3
Cash distribution expenses		5	5
Other		27	29
		44	44
Total		1 162	1 310
Net Profit		4 313	1 076

Staff costs in 2012/13 include a credit of $20.6 million associated with the decrease in the balance of the provision for post-employment benefits, mostly from post-employment health insurance (in 2011/12 there was an expense of $34.4 million) (refer Note 10). The large decrease in these provisions mainly reflected the increase in the discount rate, as measured by the yield on Commonwealth Government bonds.

The RBA's aggregate research and development expenditure recognised as an expense in 2012/13 was $0.7 million ($0.6 million in 2011/12); this is included in Other Expenses.

Comparative figures for staff costs and other expenses have been reclassified. Staff costs and other expenses in 2011/12 were previously shown as $192 million and $36 million, respectively.

Note 3 – Distribution Payable to the Commonwealth

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

In 2012/13, the Bank recorded an accounting profit of $4 313 million. Earnings available for distribution were $588 million, comprising underlying earnings of $723 million minus realised losses of $135 million. Unrealised gains of $3 725 million were transferred to the Unrealised Profits Reserve.

After consulting the Reserve Bank Board, the Treasurer has determined that all earnings available for distribution in 2012/13, a sum of $588 million, are to be placed to the credit of the RBRF, consistent with the Board's aim of restoring the reserve. As a result, no dividend will be paid to the Commonwealth from earnings in 2012/13. A dividend of $500 million was distributed from 2011/12 earnings to the Commonwealth in September 2012.

Note 3 – Distribution Payable to the Commonwealth (continued)

	2013 $M	2012 $M
Opening balance	500	–
Distribution to the Commonwealth	(500)	–
Transfer from Statement of Distribution	–	500
As at 30 June	–	500

Note 4 – Interest Revenue and Interest Expense

Analysis for the year ended 30 June 2013

	Average balance $M	Interest $M	Average annual interest rate %
Interest revenue			
Foreign investments	41 439	213	0.5
Australian dollar securities	36 738	1 398	3.8
Overnight settlements	1 029	30	2.9
Loans, advances and other	20	1	2.9
	79 226	1 642	2.1
Interest expense			
Exchange Settlement balances	1 120	32	2.9
Deposits from governments	17 891	552	3.1
Deposits from overseas institutions	1 223	29	2.3
Currency note holdings of banks	3 112	89	2.9
Foreign repurchase agreements	1 884	1	0.0
Australian dollar repurchase agreements	73	2	3.1
Cash collateral received	156	2	3.0
Other deposits	29	1	1.9
	25 488	708	2.8
Analysis for the year ended 30 June 2012			
Interest revenue total	75 837	1 875	2.5
Interest expense total	22 890	889	3.9

Interest revenue for 2012/13 includes $857 million calculated using the effective interest method for financial assets not at fair value through profit and loss ($1 138 million in 2011/12). Interest expense for 2012/13 includes $708 million calculated using the effective interest method for financial liabilities not at fair value through profit and loss ($889 million in 2011/12).

Note 5 – Capital and Reserves

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

	Note	2013 $M	2012 $M
Asset revaluation reserves			
Gold	1(c)		
Opening balance		3 900	3 473
Net revaluation adjustments		(727)	427
As at 30 June		3 173	3 900
Shares in international financial institutions	1(b), 7		
Opening balance		282	259
Net revaluation adjustments		42	23
As at 30 June		324	282
Property, plant and equipment	1(d), 8		
Opening balance		193	189
Net revaluation adjustments		15	4
As at 30 June		208	193
Total asset revaluation reserves	1(e)		
Opening balance		4 375	3 921
Net revaluation adjustments		(670)	454
As at 30 June		3 705	4 375
Unrealised profits reserve	1(e)		
Opening balance		41	61
Net transfers (to)/from Statement of Distribution		3 725	(20)
As at 30 June		3 766	41
Reserve Bank Reserve Fund	1(e)		
Opening balance		1 913	1 317
Transfers (to)/from Statement of Distribution		588	596
As at 30 June		2 501	1 913
Capital			
Opening and closing balance		40	40

Note 6 – Cash and Cash Equivalents

This includes net amounts of $115 million owed to the RBA for overnight clearances of financial transactions through the clearing houses; an amount of $135 million was owed to the RBA at 30 June 2012. Other cash and cash equivalents includes NPA's bank deposits.

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

	2013 $M	2012 $M
Cash	22	29
Overnight settlements	115	135
	137	164

Reconciliation of net cash used in operating activities to Net Profits	**Note**	**2013 $M**	**2012 $M**
Net Profit		4 313	1 076
Increase/(decrease) in interest payable		5	(25)
Net loss/(gain) on overseas investments	2	70	(426)
Net loss/(gain) on Australian dollar securities	2	244	(188)
Net loss/(gain) on foreign currency	2	(3 976)	228
Decrease/(increase) in income accrued on investments		47	140
Cash collateral received/(pledged)		(253)	–
Depreciation of property	8	8	7
Depreciation of plant and equipment	8	19	18
Net payments for investments		(11 592)	(5 957)
Other		31	67
Net cash used in operating activities		(11 084)	(5 060)

Note 7 – Loans, Advances and Other Assets

	Note	**2013 $M**	**2012 $M**
Shareholding in Bank for International Settlements	1(b)	367	325
Superannuation asset	1(h), 14	–	41
Officers' Home Advances		4	5
Investment in Securency	1(a)	–	54
Computer software and other intangibles	1(d)	21	16
Other		29	55
As at 30 June		421	496

In February 2013, the RBA completed the sale of its 50 per cent shareholding in Securency (now Innovia Security Pty Ltd) to a related entity of Innovia Films, a UK-based film manufacturer and the owner of the remaining 50 per cent shareholding in Securency.

The sale of the RBA's interest in Securency is in accordance with its longstanding intention to exit from its shareholding once Securency had established itself as a viable long-term supplier in the international market for banknote substrate. The sale brings to a conclusion the process that had commenced in late 2010 with the RBA and Innovia Films announcing their intention to undertake a joint sale of Securency. Subsequent to this announcement, Innovia Films advised that it no longer wished to sell its 50 per cent shareholding and made an offer to purchase the RBA's shareholding.

Under the terms of the sale, the RBA has to date received payments of $75.4 million for its shareholding. This amount exceeds the value of the RBA's investment in Securency of $53.9 million recorded in its 2011/12 financial statements. The gain on sale is included as part of Other Income. Additional payments may be made to the Bank over the following years, including if Innovia Security exceeds certain earnings benchmarks. Because the possibility of such additional payments is uncertain, they are not recognised in the Statement of Financial Position.

The RBA may also recover certain funds currently held in escrow to satisfy potential liabilities of Innovia Security relating to events prior to the sale if such liabilities do not materialise. The RBA has provided the purchaser with a number of indemnities for the period during which Securency was jointly owned (refer Note 11).

In conjunction with the sale of Securency, NPA has entered into a long-term supply contract with Innovia Security to supply polymer substrate, including for Australia's next generation of banknotes.

During 2012/13, the RBA acquired $1.8 million of computer software and intangibles ($3.0 million in 2011/12) and amortised $2.8 million ($2.3 million in 2011/12). At 30 June 2013, the gross book value of the RBA's computer software and intangibles amounted to $33.7 million and accumulated amortisation on these assets was $12.6 million ($27.1 million and $10.9 million, respectively, at 30 June 2012). The RBA had contractual commitments of $0.4 million as at 30 June 2013 for the acquisition of computer software and other intangibles (nil at 30 June 2012).

As at 30 June 2013, other assets included receivables of $20.8 million, none of which are impaired (at 30 June 2012 other assets included receivables of $32.2 million).

Note 8 – Property, Plant and Equipment

	Land $M	Buildings $M	Plant and Equipment $M	Total $M
Gross Book Value as at 30 June 2012	132	199	150	481
Accumulated depreciation	–	–	(33)	(33)
Net Book Value	132	199	117	448
Additions	–	5	45	50
Depreciation expense	–	(8)	(19)	(27)
Net revaluation increment/(decrement)	(2)	23	–	21
Disposals	–	–	(1)	(1)
Net additions to net book value	(2)	20	25	43
Gross Book Value as at 30 June 2013	130	219	190	539
Accumulated depreciation	–	–	(48)	(48)
Net Book Value	130	219	142	491

The net book value of buildings as at 30 June 2013 includes expenditure of $3.9 million on work in progress which has been capitalised in the carrying amount of these assets ($4.0 million as at 30 June 2012). Additions include expenditure of $40.0 million on work in progress during 2012/13 ($6.8 million in 2011/12).

As at 30 June 2013, the RBA had contractual commitments of $12.0 million to acquire plant and equipment ($6.7 million at 30 June 2012); contractual commitments of $7.6 million are due within one year ($6.7 million in 2011/12).

Note 9 – Deposits

	2013 $M	2012 $M
Banks' Exchange Settlement balances	2 235	1 567
Australian Government	21 100	15 861
State governments	10	2
Foreign governments, foreign institutions and international organisations	2 815	542
Other depositors	23	28
As at 30 June	26 183	18 000

Note 10 – Other Liabilities

	Note	2013 $M	2012 $M
Provisions	1(g)		
Provision for accrued annual leave		17	16
Provision for long service leave		40	37
Provision for post-employment benefits		96	117
		153	170
Other			
Amounts purchased under repurchase agreements (contract price)	1(b)	2 379	1 535
Purchases not yet settled		2 484	825
Interest accrued on deposits		17	12
Other		356	73
		5 236	2 445
Total Other Liabilities as at 30 June		5 389	2 615

The provision for workers compensation at 30 June 2013 was $290 000 ($340 000 at 30 June 2012).

During 2012/13, annual leave of $10.6 million was accrued by staff, while $9.6 million of accrued leave was used. Staff accrued and used long service leave of $5.0 million and $2.0 million, respectively, in 2012/13.

The RBA reduced its provision for post-employment benefits by $20.6 million in 2012/13. This is largely due to an increase in the discount rate, and the payment of $4.2 million in benefits. 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 2013, $9.3 million of the provision for accrued annual leave was due within 12 months ($7.3 million at 30 June 2012); $3.5 million of the provision for long service leave was due within 12 months ($3.6 million at 30 June 2012); and $4.4 million of the provision for post-employment benefits was due within 12 months ($3.9 million at 30 June 2012).

Note 11 – Contingent Assets and Liabilities

The RBA has a contingent liability, amounting to $58.4 million at 30 June 2013 ($53.4 million at 30 June 2012), in respect of the uncalled portion of its shares held in the BIS.

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

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

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

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

In addition, an amount covering 50 per cent of certain potential liabilities of Innovia Security relating to events prior to the sale has been placed in escrow. The RBA will receive the balance of the escrow funds after any relevant claims have been paid, settled or lapse. It is not possible to estimate the likelihood of the RBA receiving any payments from the amount held in escrow and they are disclosed as contingent assets.

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 the Governor and Deputy Governor, up to seven non-executive members of the Reserve Bank Board, up to six non-executive members of the Payments System Board and six Assistant Governors. No new positions were added to this group in 2012/13. A total of 21 individuals occupied these positions over the course of 2012/13, compared with 23 in 2011/12.

Remuneration of the Governor and Deputy Governor, and fees of non-executive members of the Reserve Bank Board and the Payments System Board, are governed by the Remuneration Tribunal. The positions of Governor and Deputy Governor are Principal Executive Offices (PEOs) within the jurisdiction of the Remuneration Tribunal. As the employing body of the Governor and Deputy Governor, the Reserve Bank Board sets their remuneration following a recommendation of the Remuneration Committee (comprising three non-executive directors). No adjustment was made to the remuneration of the Governor or Deputy Governor in 2012/13. Total remuneration (and salary) for these positions in 2012/13 was $986 773 (including salary of $842 285) and $700 000 (including salary of $593 782). These rates are consistent with those declared by the Remuneration Tribunal.

The Governor, in consultation with the Board Remuneration Committee, determines the remuneration of Assistant Governors. For staff generally, remuneration is market competitive and designed to attract and retain appropriately skilled people. Remuneration levels for employees are externally benchmarked.

The RBA discloses remuneration of directors, executives and management in terms of both AAS and the FMOs.

Disclosures under AAS

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

Table A: Remuneration of Key Management Personnel

	2013 $	2012 $
Short-term employee benefits	5 046 255	5 103 308
Post-employment benefits	966 809	959 306
Other long-term benefits	90 074	502 594
Share based payments	–	–
Termination benefits	–	–
Total compensation	6 103 138	6 565 208

Under AASB 124, short-term benefits include cash salary and, where relevant for executives, lump sum payments, annual leave, motor vehicle benefits, car parking and health benefits and the fringe benefits tax paid or payable on these benefits. Post-employment benefits include superannuation benefits and, in the case of staff, health benefits. Other long-term benefits include long service leave. The reduction in short-term employee benefits reflects the effect of turnover in key management personnel in 2011/12. The reduction in other long-term benefits reflects leave taken and the revaluation of the provision for long service leave. In 2011/12, the high level of other long-term benefits reflected adjustments to the provision for long service leave arising from the appointments of the Deputy Governor and an Assistant Governor in that year.

There were no loans during 2012/13 and 2011/12 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.

Disclosure under FMOs

The disclosures on remuneration required in terms of Division 23 of the FMOs are shown in Tables B to E below. Table B shows similar aggregates to those in Table A above which are based on AASB 124. The corresponding figures are lower in Table B because the FMOs require that non-executive directors be excluded from this Table (shown separately in Table E).

Table B: Executive Remuneration[(a)]

	2013 $	2012 $
Short-term employee benefits		
Salary	3 776 765	3 864 664
Annual leave accrued	319 568	316 354
Performance-related payments	57 858	60 482
Other[(b)]	234 490	239 044
Total short-term employee benefits	4 388 681	4 480 544
Post-employment benefits		
Superannuation	884 968	880 234
Other[(c)]	27 466	26 283
Total post-employment benefits	912 434	906 517
Other long-term benefits		
Long service leave	126 978	123 184
Total other long-term benefits	126 978	123 184
Termination benefits	–	–
Total employment benefits	5 428 093	5 510 245

(a) This table is based on remuneration for the group of executives, including the Governor and Deputy Governor, included for reporting purposes under AASB 124 and is prepared on an accruals basis. These figures exclude staff acting in executive positions and part-year service where total remuneration expensed was less than $180 000. Figures for annual and long service leave include the accrual of leave in the relevant year but not the cost of revaluing leave entitlements previously accrued (as in Table A above).
(b) Other short-term employee benefits include car parking and health benefits and, for relevant executives, motor vehicle benefits.
(c) Other post-employment benefits include health benefits.

As required by the FMOs, the figures in Tables C and D below are on a cash basis. Any differences between figures in Table C for remuneration of the Governor and Deputy Governor and remuneration determined by the Remuneration Tribunal reflect that the FMOs require measurement of remuneration on a different basis from the Remuneration Tribunal. There was no increase to the gross salary paid to the Governor and Deputy Governor in 2012/13. The average adjustment to gross salary for other senior staff included in Table C was 3.8 per cent in 2012/13; these staff were eligible for lump sum performance-related payments in 2012/13 and 2011/12. The positions of Governor and Deputy Governor were not eligible for performance-related payments in 2012/13 and 2011/12. The figures for reportable salary in 2012/13 and 2011/12 include all salary sacrificed amounts.

Table C: Executive Remuneration[(a)]

30 June 2013

Remuneration band	Number of staff	Reportable salary[(b)]	Contributed superannuation[(c)]	Reportable allowances[(d)]	Lump sum payment[(e)]	Total
Total remuneration:						
$540 000 to $569 999	3	447 751	90 822	–	8 319	546 892
$570 000 to $599 999	1	478 091	96 623	–	8 841	583 555
$600 000 to $629 999	2	502 769	104 957	–	12 030	619 756
$720 000 to $749 000	1	605 866	126 476	–	–	732 342
$1 020 000 to $1 049 999	1	845 805	179 407	–	–	1 025 212
	8					

30 June 2012

Remuneration band	Number of staff	Reportable salary[(b)]	Contributed superannuation[(c)]	Reportable allowances[(d)]	Lump sum payment[(e)]	Total
Total remuneration:						
$180 000 to $209 999	1	160 521	32 925	–	–	193 446
$480 000 to $509 999	1	400 099	84 417	–	–	484 516
$510 000 to $539 999	2	431 259	88 043	–	7 050	526 352
$540 000 to $569 999	1	460 104	92 906	–	7 438	560 448
$570 000 to $599 999	1	484 380	101 479	–	13 973	599 832
$600 000 to $629 999	1	486 053	100 894	–	13 848	600 795
$630 000 to $659 999	1	528 883	107 909	–	11 124[(f)]	647 916
$1 020 000 to $1 049 999	1	846 306	179 407	–	–	1 025 713
	9					

(a) This table is based on remuneration for the group of executives, including the Governor and Deputy Governor, included for reporting purposes under AASB 124 who received remuneration of more than $180 000 during the reporting period, including from part-time arrangements. Each row is an average figure based on the number of individuals in each band. As the components of this table are measured on a cash basis and fully in accordance with the provisions of the FMOs, these figures are on a different measurement basis from those determined by the Remuneration Tribunal for the positions of Governor and Deputy Governor and are not directly comparable with those figures.
(b) 'Reportable salary' includes gross payments (including salary less any lump sum amounts paid), the net amount of reportable fringe benefits and any amounts salary sacrificed.
(c) The 'contributed superannuation' amount is the average actual superannuation contributions paid.
(d) 'Reportable allowances' are the average actual allowances paid as per the 'total allowances' line on individuals' payment summaries.
(e) 'Lump sum payment' represents average actual lump sum amounts paid during the reporting period to staff in the remuneration band.
(f) Lump sum payment awarded in position of Assistant Governor.

Table D includes disclosures for RBA and NPA staff. The increase in the number of staff in 2013 in the remuneration bands '$180 000 to $209 999', mainly reflects that normal salary increases resulted in more RBA staff being remunerated at a level above the reportable threshold; it does not reflect the creation of new management positions. The average salary increase for the group of RBA staff shown in Table D was 3.9 per cent in 2012/13. Lump sum performance-based payments and modest career increments were also paid to some individuals within this group. NPA staff are not employees of the RBA and are employed on terms and conditions determined by NPA. Lump sum performance-based payments are available to NPA staff.

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

30 June 2013

Remuneration band	Number of staff	Reportable salary[(b)]	Contributed superannuation[(c)]	Reportable allowances[(d)]	Lump sum payment[(e)]	Total
Total remuneration:						
$180 000 to $209 999	69	158 834	30 534	14	4 413	193 795
$210 000 to $239 999	36	180 941	35 679	25	5 838	222 483
$240 000 to $269 999	15	211 453	41 936	–	3 643	257 032
$270 000 to $299 999	17	229 749	44 553	49	9 064	283 415
$300 000 to $329 999	8	255 239	49 192	–	9 956	314 387
$330 000 to $359 999	5	284 462	44 072	–	13 609	342 143
$360 000 to $389 999	4	304 838	59 987	–	5 317	370 142
$420 000 to $449 999	7	357 887	71 168	–	6 753	435 808
$450 000 to $479 999	1	398 609	46 787	–	7 502	452 898
$480 000 to $509 999	2	405 082	81 084	–	7 431	493 597
$570 000 to $599 999	1	425 918	47 113	–	106 070	579 101
	165					

30 June 2012

Remuneration band	Number of staff	Reportable salary[(b)]	Contributed superannuation[(c)]	Reportable allowances[(d)]	Lump sum payment[(e)]	Total
Total remuneration:						
$180 000 to $209 999	55	159 112	31 027	49	4 256	194 444
$210 000 to $239 999	30	182 455	35 194	7	3 597	221 253
$240 000 to $269 999	22	207 772	40 299	8	10 109	258 188
$270 000 to $299 999	12	231 116	49 081	62	7 705	287 964
$300 000 to $329 999	3	254 485	42 899	–	19 977	317 361
$330 000 to $359 999	8	287 901	52 021	–	4 357	344 279
$390 000 to $419 999	3	333 190	66 286	–	6 071	405 547
$420 000 to $449 999	3	349 334	69 713	–	6 384	425 431
$450 000 to $479 999	2	388 381	78 217	–	7 180	473 778
$480 000 to $509 999	1	400 815	78 963	–	7 248	487 026
$540 000 to $569 999	1	414 992	45 230	–	101 207	561 429
	140					

(a) This table shows remuneration for staff of the RBA and NPA whose reportable remuneration was $180 000 or more in the year, and whose remuneration was not required to be disclosed in Table C. Each row shows an average figure based on the number of staff in each band. These figures are disclosed on a cash basis.
(b) 'Reportable salary' includes gross payments (including salary less any lump-sum amounts paid), the net amount of reportable fringe benefits and any amounts salary sacrificed.
(c) The 'contributed superannuation' amount is the average actual superannuation contributions paid.
(d) 'Reportable allowances' are the average actual allowances paid as per the 'total allowances' line on individuals' payments summaries.
(e) 'Lump-sum payment' represents the average actual lump-sum amounts paid during the reporting period for staff in the remuneration band.

Table E includes total remuneration received (or due and receivable) by non-executive directors who are members of the Reserve Bank Board, the Payments System Board and the NPA Board. Executives of the Reserve Bank who are non-executive directors of NPA are paid no fees as directors.

Table E: Remuneration of Non-executive Directors

	Number of directors	
	2013	**2012**
$0 to $29 999	3	4
$30 000 to $59 999	4	5
$60 000 to $89 999	5	5
$90 000 to $119 999	1	–
Total	13	14
Total remuneration received	683 459	639 334

Note 13 – Auditor's Remuneration

	2013 $	2012 $
Fees paid or payable to the statutory auditor (Australian National Audit Office) for audit services	416 500	364 500
	416 500	364 500

PricewaterhouseCoopers has been contracted by the Australian National Audit Office to provide audit services in relation to the audit of the RBA. This includes audit services for the RBA's subsidiary, Note Printing Australia Limited, and the Reserve Bank of Australia Officers' Superannuation Fund.

During 2012/13, PricewaterhouseCoopers earned additional fees of $609 680 ($986 402 in 2011/12) for non-audit services that were separately contracted by the RBA.

These fees are included in Consultants' Fees, Legal Fees and Payments to Contractors in Note 2.

Note 14 – Superannuation Funds

The Reserve Bank administers two superannuation funds: 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 (e.g. 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 2012/13.

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. The UK Pension Scheme is a defined benefit scheme.

Two disclosure standards are relevant for superannuation funds: AAS 25 – *Financial Reporting by Superannuation Plans* and AASB 119. Superannuation funds themselves report their financial position on the basis of AAS 25, which is also the basis for making assessments about the adequacy of funding arrangements to meet future obligations. Entities which sponsor superannuation funds, typically the employer entity, report for their purposes on the basis of AASB 119. Differences of approach between AAS 25 and AASB 119 result in different measures of the financial position of the same superannuation fund. Disclosures on these standards are discussed further below.

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 2011 and for the UK Pension Scheme at 30 June 2010. 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 OSF for 30 June 2014 will be undertaken early in 2014/15 and that for the UK Pension Scheme for 30 June 2013 will be undertaken during 2013/14.

The OSF triennial funding valuation as at 30 June 2011 was based on the Attained Age Funding method, consistent with the accounting standard for superannuation funds, AAS 25. 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 $57.8 million, as the assets of the OSF of $915.5 million exceeded the accrued benefits of $857.7 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 2013 amounted to $59.6 million (assets of $1 033.8 million less accrued benefits of $974.2 million).

Consistent with the actuaries' funding recommendation, the RBA maintained its contribution rate to the OSF defined benefit at 18.3 per cent of salaries in 2012/13.

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 2013, measured in accordance with AAS 25, was $1.4 million (assets of $19.6 million compared with accrued benefits of $18.2 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 these superannuation schemes to fund future benefits have over time 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 4.7 per cent (3.9 per cent in 2011/12), future salary increases of 3.25 per cent (3.5 per cent in 2011/12), future pension increases of 3.25 per cent (3.5 per cent in 2011/12) and an assumed return on plan assets of 7.1 per cent (8.5 per cent in 2011/12). The discount rate increased over 2012/13 reflecting the movement in yields on Australian Government bonds. The actual return on plan assets of the OSF for 2012/13 was 12.7 per cent (2.4 per cent in 2011/12). The assumptions used for the UK Pension Scheme were a discount rate of 4.3 per cent (4.25 per cent in 2011/12), future salary increases of 5.4 per cent (4.95 per cent in 2011/12), future pension increases of 3.4 per cent (2.95 per cent in 2011/12) and an assumed return on plan assets of 3.14 per cent (2.42 per cent in 2011/12). The actual return on plan assets of the UK Pension Scheme for 2012/13 was 4.3 per cent (21.2 per cent in 2011/12). The expected overall rates of return 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 financial position of the OSF. At 30 June 2013, accumulation balances in the OSF totalled $206.7 million ($176.0 million as at 30 June 2012).

Asset Distribution as at 30 June

	Per cent of fund assets			
	OSF		UK Pension Scheme	
	2013	2012	2013	2012
Cash and short-term securities	5.7	4.4	0.1	–
Fixed interest and indexed securities	11.9	13.9	93.0	94.0
Domestic shares	42.4	39.3	6.9	6.0
Foreign shares	6.7	6.0	–	–
Property				
Direct	1.6	5.0	–	–
Indirect	12.6	12.0	–	–
Private equity and alternative investments	19.1	19.4	–	–
Total	100.0	100.0	100.0	100.0

Note 14 – Superannuation Funds (continued)

	OSF		UK Scheme		Total	
	2013 $M	2012 $M	2013 $M	2012 $M	2013 $M	2012 $M
Opening balances:						
Net market value of assets	744	730	18	17	762	747
Accrued benefits	(1 412)	(976)	(14)	(13)	(1 426)	(989)
Surplus/(deficit)	(668)	(246)	4	4	(664)	(242)
Effect of asset cap	–	–	(3)	(2)	(3)	(2)
Actuarial (gains)/losses not included in balance sheet under Corridor	709	307	(1)	(1)	708	306
Opening superannuation asset	41	61	–	–	41	61
Change in net market value of assets	86	13	1	2	87	15
Change in accrued benefits	211	(436)	(1)	(1)	210	(437)
Change in asset cap	–	–	–	(1)	–	(1)
Change in actuarial (gains)/losses not included in balance sheet under Corridor	(368)	402	–	–	(368)	402
Total change in superannuation asset	(71)	(21)	–	–	(71)	(21)
Closing balances:						
Net market value of assets	830	744	20	18	850	762
Accrued benefits	(1 201)	(1 412)	(15)	(14)	(1 216)	(1 426)
Surplus/(deficit)	(371)	(668)	4	4	(367)	(664)
Effect of asset cap	–	–	(3)	(3)	(3)	(3)
Actuarial (gains)/losses not included in balance sheet under Corridor	341	709	(2)	(1)	339	708
Closing superannuation asset/(liability)	(30)	41	–	–	(30)	41
Actuarially assumed return on plan assets	49	58	–	1	49	58
Benefit payments	(36)	(36)	(1)	(1)	(37)	(36)
Actuarial gains/(losses) on assets	55	(26)	–	1	55	(25)
Contributions from RBA to defined benefit schemes	22	21	–	–	22	21
Contributions tax	(3)	(3)	–	–	(3)	(3)
Exchange rate gains/(losses)	–	–	1	–	1	–
Change in net market value of assets	86	13	1	2	87	15

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

Note 14 – Superannuation Funds (continued)

	OSF		UK Scheme		Total	
	2013 $M	2012 $M	2013 $M	2012 $M	2013 $M	2012 $M
Current service cost	(51)	(34)	-	-	(51)	(34)
Interest cost	(48)	(47)	(1)	(1)	(49)	(48)
Benefit payments	36	36	1	1	37	36
Contributions tax	3	3	–	–	3	3
Experience adjustments on benefits	(18)	(31)	–	–	(18)	(31)
Effects of changes in benefit actuarial assumptions	289	(363)	–	(1)	289	(363)
Exchange rate gains/(losses)	–	–	(1)	–	(1)	–
Change in accrued benefits	211	(436)	(1)	(1)	210	(437)
Actuarial (gains)/losses on assets	(55)	26	–	(1)	(55)	25
Experience adjustments on benefits	18	31	–	–	18	31
Effects of changes in benefit actuarial assumptions	(289)	363	–	1	(289)	363
Amortisation of actuarial gains/(losses)	(43)	(18)	–	1	(43)	(17)
Exchange rate gains/(losses)	–	–	–	–	–	–
Change in actuarial losses not included in balance sheet under Corridor	(368)	402	–	–	(368)	402
Superannuation expense/(income) included in Statement of Comprehensive Income						
Current service cost	51	34	–	–	51	34
Interest cost	48	47	1	1	48	48
Assumed return on plan assets	(49)	(58)	–	(1)	(49)	(58)
Amortisation of actuarial (gains)/losses under Corridor	43	18	–	(1)	43	17
Effect of asset cap	–	–	–	–	–	–
Productivity and superannuation guarantee contributions	5	4	–	–	5	4
Total superannuation expense/(income)	97	45	–	–	97	45

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:

Note 14 – Superannuation Funds (continued)

	2013 $M	2012 $M	2011 $M	2010 $M	2009 $M
OSF					
Closing balances:					
Net market value of assets	830	744	730	691	652
Accrued benefits	(1 201)	(1 412)	(976)	(928)	(829)
Surplus/(deficit)	(371)	(668)	(246)	(236)	(177)
Experience adjustments on assets	55	(26)	1	2	(150)
Experience adjustments on benefits	(18)	(31)	(31)	(3)	(54)
UK Scheme					
Closing balances:					
Net market value of assets	20	18	17	18	20
Accrued benefits	(15)	(14)	(13)	(14)	(14)
Surplus	4	4	4	4	7
Experience adjustments on assets	–	1	1	1	(1)
Experience adjustments on benefits	–	–	–	–	–

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

The funding valuations of the OSF and UK Pension Scheme as at 30 June for the current reporting period and previous four reporting periods are:

	2013 $M	2012 $M	2011 $M	2010 $M	2009 $M
OSF					
Surplus	60	33	39	51	34
UK Scheme					
Surplus	1	1	1	1	1

Note 15 – Financial Instruments and Risk

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

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

Financial Risk

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

Market risk

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

Foreign exchange risk

Foreign exchange risk is the risk that the fair value or cash flows of 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 the Bank does not seek to reduce foreign exchange risk. The RBA's net foreign currency exposure as at 30 June 2013 was $42.0 billion ($35.9 billion as at 30 June 2012). Within the overall exposure and to a limited extent, foreign currency risk can be mitigated by holding assets across a diversified portfolio of currencies. The RBA holds foreign reserves in four currencies – the US dollar, the euro, the Canadian dollar and the yen – because the markets for these currencies are typically liquid and suitable for investing foreign exchange reserves. The RBA has announced its intention to hold assets in renminbi but has not as yet purchased such assets.

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

Concentration of foreign exchange

During 2012/13 the Reserve Bank adjusted the proportions of its holdings in the currencies in which it invests, increasing the proportion of US dollars and reducing the proportion of euros. The RBA's net holdings of foreign exchange (excluding its holding of Special Drawing Rights) were distributed as follows as at 30 June:

	Per cent of foreign exchange	
	2013	**2012**
US dollar	55	45
Euro	35	45
Canadian dollar	5	5
Japanese yen	5	5
Total foreign exchange	100	100

Sensitivity to foreign exchange risk

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

	2013 $M	2012 $M
Change in profit/equity due to a 10 per cent appreciation in the reserves-weighted value of the A$	–3 764	–3 267
Change in profit/equity due to a 10 per cent depreciation in the reserves-weighted value of the A$	4 601	3 993

Interest rate risk

Interest rate risk is the risk that the fair value or cash flows of financial instruments will fluctuate because of movements in market interest rates. The RBA's balance sheet is exposed to interest rate risk because most of its assets are financial assets, such as domestic and foreign securities, which have a fixed income stream. The price of such securities increases when market interest rates decline, while the price of a security will fall if market rates rise. Interest rate risk increases with the maturity of a security because the associated income stream is fixed for a longer period. Interest rate risk on foreign assets is controlled through limits on the duration, or interest rate sensitivity, of the portfolio. Interest rate risk on domestic assets is small as the bulk of the portfolio is held under short-term repurchase agreements. The RBA reduced the duration targets for some of its portfolios of foreign securities during 2012/13.

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.

	2013 $M	2012 $M
Change in profit/equity due to movements of +/–1 percentage point across yield curves:		
Foreign currency securities	–/+339	–/+467
Australian dollar securities	–/+140	–/+171

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 in the BIS. The RBA's membership of the BIS is mainly to maintain and develop strong relationships, which are to Australia's advantage, with other central banks. Shares in the BIS are owned exclusively by its member central banks and monetary authorities. For accounting purposes, the RBA treats the BIS shares as 'available for sale' and the fair value of these shares is estimated on the basis of the BIS' net asset value, less a discount of 30 per cent. Accordingly, these shares are revalued to reflect movements in the net asset value of the BIS and in the Australian dollar. The price risk faced on the BIS shares is incidental to the policy reasons for holding them and is immaterial compared with other market risks faced by the RBA. For this reason, this 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 to: repay principal; make interest payments due on an asset; or settle a transaction. For the RBA, credit risk arises from exposure to: the issuers of securities that it holds; and counterparties which are yet to settle transactions. The RBA's credit exposure is 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; and holding high-quality collateral against buy repurchase agreements.

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, banks and various corporate and asset-backed securities (see Note 1(b)). The RBA holds collateral to a value of between 101 and 123 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 repurchase transaction falls by more than a predetermined amount, the counterparty is required to provide additional collateral to restore this margin; the thresholds are specified in the legal agreements which govern these transactions.

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, is the carrying amount of those assets as indicated in the balance sheet.

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

1. ***Foreign exchange swaps*** – As at 30 June 2013, the RBA was under contract to purchase $1.5 billion of foreign currency ($4.4 billion at 30 June 2012) and sell $5.7 billion of foreign currency ($9.5 billion at 30 June 2012). As of that date there was a net unrealised loss of $275 million on these swap positions included in net profit ($110 million unrealised gain at 30 June 2012). To manage credit risk associated with foreign exchange swaps, the Bank in 2012/13 began to give or receive collateral under credit support annexes (CSAs) to cover the potential cost of replacing in the market the Bank's exposure to a swap if a counterparty fails to deliver the second leg of such a transaction and the exchange rate has moved from the rate at which the swap was contracted. Net cash collateral received was nil at 30 June 2013.
2. ***Interest rate futures*** – As at 30 June 2013, the amount of credit risk on interest rate futures contracts was approximately $0.6 million ($0.7 million at 30 June 2012). As at 30 June 2013, there was an unrealised loss brought to account on those contracts of $0.15 million ($0.03 million unrealised loss at 30 June 2012).

Concentration of credit risk

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

The RBA held no past due or impaired assets at 30 June 2013 or 30 June 2012.

	Risk rating of security/issuer[a]	Risk rating of counterparties[a]	Per cent of investments 2013	2012
Australian dollar securities				
Holdings – Commonwealth Government Securities	AAA	na	1.5	1.9
Holdings – semi-government securities	AAA	na	5.4	4.0
	AA	na	1.2	4.0
Securities sold under repurchase agreements	AAA	A	–	0.1
Securities purchased under repurchase agreements	AAA	AA	14.7	9.1
	AAA	A	8.3	8.6
	AAA	BBB	–	0.1
	AAA	Other[b]	0.6	0.7
	AA	AA	6.6	7.1
	AA	A	3.1	2.6
	AA	BBB	–	0.1
	AA	Other[b]	0.2	0.2
	A	AA	0.8	0.5
	A	A	1.4	1.3
	BBB	AA	0.1	–
Foreign investments				
Holdings of securities	AAA	na	16.3	17.2
	AA	na	23.2	18.1
	A	na	0.5	0.5
Securities sold under repurchase agreements	AAA	A	0.6	–
	AA	A	–	1.8
	AA	BBB	1.7	–
Securities purchased under repurchase agreements	AAA	AA	0.7	0.5
	AAA	A	1.8	1.2
	AA	AA	0.9	1.8
	AA	A	5.1	11.9
	AA	BBB	–	0.2
Deposits	na	AAA	0.6	–
Cash collateral	na	AA	0.2	–
	na	A	0.1	–
Other	na	AA	–	0.1
	na	A	–	0.1
Gold loans	na	AAA	–	0.1
Other			4.4	6.2
			100.0	100.0

(a) Standard & Poor's or equivalent rating.
(b) This category includes counterparties which are not rated.

Collateral pledged

At 30 June 2013, the carrying amount of securities sold and contracted for purchase under sell repurchase agreements was $2 371 million ($1 172 million at 30 June 2012). Terms and conditions of sell repurchase agreements are consistent with those for buy repurchase agreements disclosed above.

Cash collateral of $253 million was provided to cover credit risk on foreign exchange swaps under terms and conditions established by CSAs. As noted above, CSAs were introduced with swap counterparties during the course of 2012/13. The collateral exchanged under a CSA is designed to cover the cost of replacing the swap position in the market if a counterparty fails to deliver on the second leg of a swap. The RBA's CSAs specify that only Australian dollar cash is eligible as collateral. Under CSAs, either party to the agreement may be obliged to deliver collateral with interest paid or received on a monthly basis.

Liquidity risk

Liquidity risk is the risk that the RBA will not have the resources required at a particular time to meet its obligations to settle its financial liabilities. As the ultimate source of liquidity in Australian dollars, the RBA has the power 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 (on page 118) 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 2013

	Balance sheet total $M	Contracted maturity $M On demand	0 to 3 months	3 to 12 months	1 to 5 years	Over 5 years	No specified maturity $M	Weighted average coupon rate %	Weighted average effective rate %
Assets									
Cash and cash equivalents	137	–	115	–	–	–	22	2.75	2.75
Australian dollar securities									
Securities sold under repurchase agreements	77	–	–	38	17	22	–	5.92	2.72
Securities purchased under repurchase agreements	35 130	–	33 870	1 260	–	–	–	2.73	2.73
Other securities	7 968	–	3 496	1 998	966	1 508	–	4.12	3.04
Accrued interest	74	–	60	14	–	–	–	na	na
	43 249								
Foreign exchange									
Balances with central banks	1 175	10	1 165	–	–	–	–	0.09	0.09
Securities sold under repurchase agreements	2 294	–	1 155	516	421	202	–	0.39	0.21
Securities purchased under repurchase agreements	7 777	–	7 777	–	–	–	–	0.09	0.09
Other securities	39 339	–	16 686	10 377	6 271	793	5 212	0.50	0.27
Deposits with BIS	3	2	–	–	–	–	1	0.02	0.02
Collateral exchanged	253	–	253	–	–	–	–	2.75	2.75
Accrued interest	89	–	61	28	–	–	–	na	na
	50 930								
Gold									
Gold loans	42	–	–	42	–	–	–	0.40	0.40
Gold holdings	3 257	–	–	–	–	–	3 257	na	na
	3 299								
Property, plant & equipment	491	–	–	–	–	–	491	na	na
Loans and advances	4	–	–	–	–	4	–	3.04	3.04
Other assets	417	–	21	–	–	–	396	na	na
Total assets	98 527	12	64 659	14 273	7 675	2 529	9 379	1.54	1.35
Liabilities									
Deposits	26 183	6 033	20 150	–	–	–	–	2.52	2.52
Distribution payable to Australian Government	–	–	–	–	–	–	–	na	na
Other liabilities	5 389	–	5 201	–	–	–	188	0.03	0.03
Australian notes on issue	56 943	–	–	–	–	–	56 943	0.13	0.13
Total liabilities	88 515	6 033	25 351	–	–	–	57 131	0.83	0.83
Capital and reserves	10 012								
Total balance sheet	98 527								
Local Currency									
Swaps									
Contractual outflow	(46)	–	(46)	–	–	–	–	na	na
Contractual inflow	4 266	–	4 266	–	–	–	–	na	na
	4 220	–	4 220	–	–	–	–		
Foreign Currency									
Swaps									
Contractual outflow	(5 700)	–	(5 700)	–	–	–	–	na	na
Contractual inflow	1 480	–	1 480	–	–	–	–	na	na
	(4 220)	–	(4 220)	–	–	–	–		

Maturity Analysis – as at 30 June 2012

	Balance sheet total $M	Contracted maturity $M On demand	0 to 3 months	3 to 12 months	1 to 5 years	Over 5 years	No specified maturity $M	Weighted average coupon rate %	Weighted average effective rate %
Assets									
Cash and cash equivalents	164	–	135	–	–	–	29	3.25	3.25
Australian dollar securities									
Securities sold under repurchase agreements	17	–	–	–	17	–	–	5.50	2.47
Securities purchased under repurchase agreements	24 484	–	23 983	501	–	–	–	3.57	3.57
Other securities	8 028	–	2 269	2 225	2 007	1 527	–	5.09	3.39
Accrued interest	119	–	117	2	–	–	–	na	na
	32 648								
Foreign exchange									
Balances with central banks	572	10	562	–	–	–	–	0.15	0.15
Securities sold under repurchase agreements	1 155	–	245	–	330	580	–	1.01	1.01
Securities purchased under repurchase agreements	12 129	–	12 129	–	–	–	–	0.14	0.14
Other securities	29 344	–	7 413	6 850	8 707	1 595	4 779	0.95	0.37
Deposits with BIS	5	3	1	–	–	–	1	0.01	0.01
Accrued interest	91	–	91	–	–	–	–	na	na
	43 296								
Gold									
Gold loans	48	–	–	48	–	–	–	0.40	0.40
Gold holdings	3 979	–	–	–	–	–	3 979	na	na
	4 027								
Property, plant & equipment	448	–	–	–	–	–	448	na	na
Loans and advances	5	–	–	–	–	5	–	3.40	3.40
Other assets	491	–	33	–	–	–	458	na	na
Total assets	81 079	13	46 978	9 626	11 061	3 707	9 694	1.97	1.59
Liabilities									
Deposits	18 000	3 500	14 500	–	–	–	–	3.45	3.45
Distribution payable to Australian Government	500	–	500	–	–	–	–	na	na
Other liabilities	2 615	–	2 447	–	–	–	168	0.19	0.19
Australian notes on issue	53 595	–	–	–	–	–	53 595	0.19	0.19
Total liabilities	74 710	3 500	17 447	–	–	–	53 763	0.98	0.98
Capital and reserves	6 369								
Total balance sheet	81 079								
Local Currency									
Swaps									
Contractual outflow	(83)	–	(83)	–	–	–	–	na	na
Contractual inflow	5 191	–	5 191	–	–	–	–	na	na
	5 108	–	5 108	–	–	–	–		
Foreign Currency									
Swaps									
Contractual outflow	(9 539)	–	(9 539)	–	–	–	–	na	na
Contractual inflow	4 431	–	4 431	–	–	–	–	na	na
	(5 108)	–	(5 108)	–	–	–	–		

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 arm's 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 BIS are carried in the balance sheet (and shown in this note) at fair value. The RBA's repurchase agreements, the BIS 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.

	2013 $M	2012 $M
Assets accounted for under AASB 139		
At fair value through Profit or Loss	47 960	38 283
Loans and receivables	46 421	37 912
Available for sale	367	325
Assets accounted for under other standards	3 779	4 559
Total assets as at 30 June	98 527	81 079
Liabilities accounted for under AASB 139		
At fair value through Profit or Loss	287	15
Not at fair value through Profit or Loss	88 038	74 020
Liabilities accounted for under other standards	190	175
Total liabilities as at 30 June	88 515	74 210

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 1 $M	Level 2 $M	Level 3 $M	Total $M
As at 30 June 2013				
Assets at fair value through Profit or Loss				
Domestic government securities	4 083	3 958	–	8 041
Foreign government securities	38 809	1 098	–	39 907
Foreign currency swap gains	–	12	–	12
Available for sale				
Shares in international and other institutions	–	–	367	367
	42 892	5 068	367	48 327
Liabilities at fair value through Profit or Loss				
Foreign currency swap losses	15	272	–	287
	15	272	–	287

Level 3 assets are comprised of shares in the BIS. In accordance with the accounting policy, the gain on BIS shares of $42 million has been included in Other Comprehensive Income.

	Level 1 $M	Level 2 $M	Level 3 $M	Total $M
As at 30 June 2012				
Assets at fair value through Profit or Loss				
Domestic government securities	5 364	2 720	–	8 084
Foreign government securities	28 389	1 684	–	30 073
Foreign currency swap gains	8	118	–	126
Available for sale				
Shares in international and other institutions	–	–	325	325
	33 761	4 522	325	38 608
Liabilities at fair value through Profit or Loss				
Foreign currency swap losses	–	15	–	15
	–	15	–	15

Note 16 – Subsequent Events

There have been no events subsequent to 30 June 2013 to be disclosed.

Auditor-General for Australia

Australian National
Audit Office

INDEPENDENT AUDITOR'S REPORT

To the Treasurer

I have audited the accompanying financial statements of the Reserve Bank of Australia and the controlled entities for the year ended 30 June 2013, which comprise: a Directors' Statement; Statement of Financial Position; Statement of Comprehensive Income; Statement of Distribution; Statement of Changes in Capital and Reserves; Cash Flow Statement; and Notes to and Forming Part of the Financial Statements, including a summary of accounting policies. The consolidated entity comprises the Reserve Bank of Australia and the entity it controlled during the financial year.

Directors' Responsibility for the Financial Statements

The directors of the Reserve Bank of Australia are responsible for the preparation of the financial statements that give a true and fair view in accordance with the Finance Minister's Orders made under the *Commonwealth Authorities and Companies Act 1997*, including the Australian Accounting Standards, and for such internal control as is necessary to enable the preparation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error. 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 Australian Auditing Standards. These auditing standards require that I comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Independence

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

Opinion

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

(a) have been prepared in accordance with the Finance Minister's Orders made under the *Commonwealth Authorities and Companies Act 1997*, including the Australian Accounting Standards;

(b) give a true and fair view of the matters required by the Finance Minister's Orders including the consolidated entity's financial position as at 30 June 2013 and of its financial performance and cash flows for the year then ended; and

(c) comply with *International Financial Reporting Standards* as disclosed in Note 1.

Australian National Audit Office

Ian McPhee
Auditor-General

Canberra
2 September 2013

Pro Forma Business Accounts

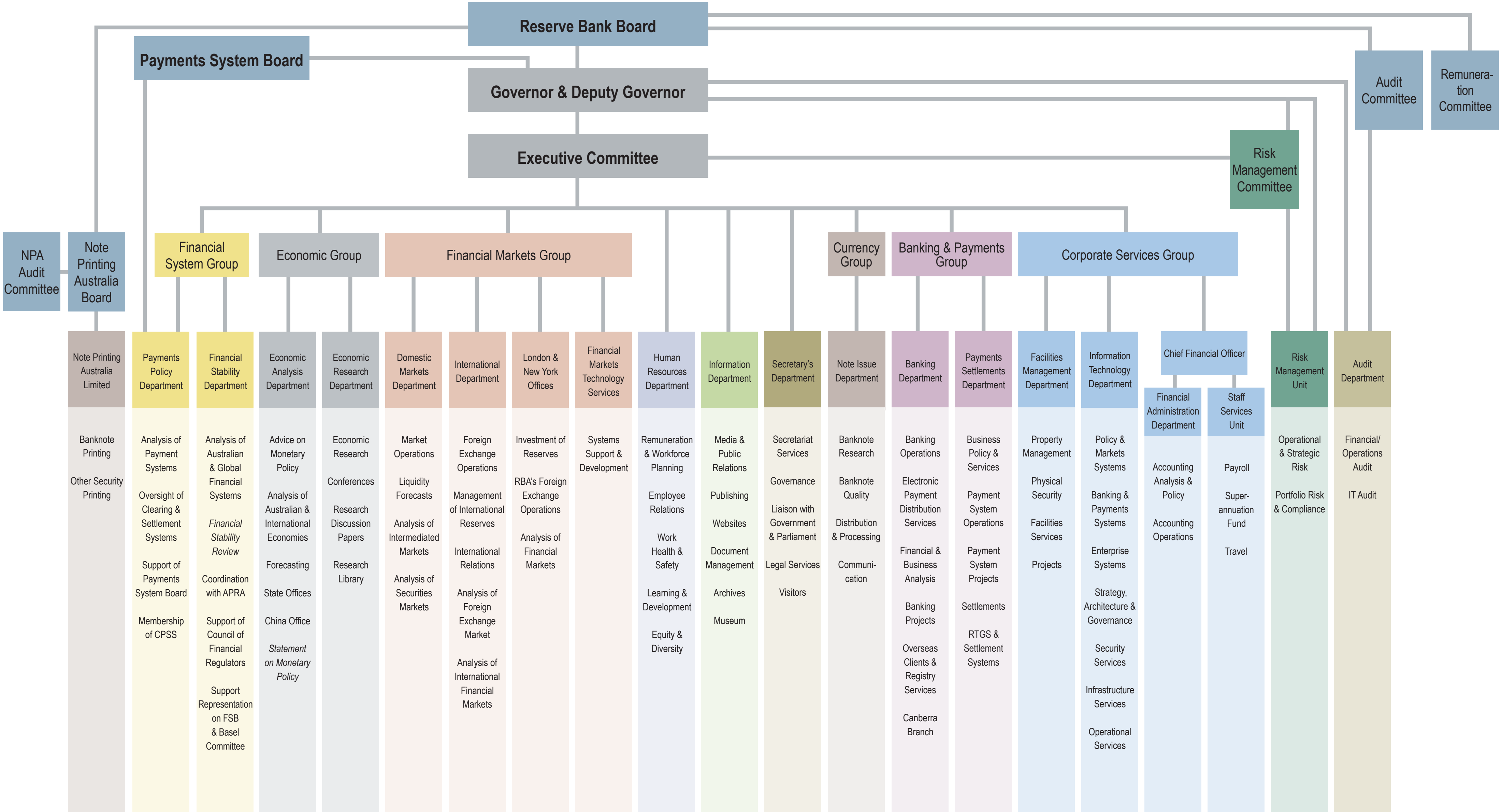
The following sets of accounts for each of the Reserve Bank's contestable businesses have been prepared in accordance with competitive neutrality guidelines. These accounts do not form part of the audited financial statements.

	Transactional Banking		Registry	
	2011/12 $ million	2012/13 $ million	2011/12 $ million	2012/13 $ million
Revenue				
– Service fees	21.7	26.0	0.6	0.6
– Other revenue	6.8	5.7	–	0.1
Total	28.5	31.7	0.6	0.7
Expenditure				
– Direct costs	19.1	27.7	0.3	0.4
– Indirect costs	2.6	0.3	0.1	–
Total	21.7	28.0	0.4	0.4
Net profit/(loss)	6.8	3.7	0.2	0.3
Net profit/(loss) after taxes[(a)]	4.8	2.5	0.1	0.2
Assets[(b)]				
– Domestic markets investments	648.4	527.7	1.3	1.3
– Other assets	14.7	17.4	–	–
Total	633.1	545.1	1.3	1.3
Liabilities[(b)]				
– Capital and reserves	25.0	25.0	1.0	1.0
– Deposits	623.8	505.8		
– Other liabilities	14.3	14.3	0.3	0.3
Total	663.1	545.1	1.3	1.3

(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
Source: RBA

Organisational Chart

September 2013



Organisation Overview and Executives

September 2013

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

Banking and Payments Group

Assistant Governor: Keith Hall[*†]

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

Banking Department

Head: Lindsay Boulton

Deputy Heads: Stephanie Connors, Paul Phibbs

Banking Department provides a range of banking services to Australian Government departments and agencies as well as a number of overseas central banks and official institutions.

Payments Settlements Department

Head: Greg Johnston

Deputy Heads: David Brown, Peter Gallagher

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

Corporate Services Group

Assistant Governor: Frank Campbell[*†]

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

Facilities Management Department

Head: Grant Baldwin[1]

Chief Manager: Matthew Nolan

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

1 Richard Mayes retired as Head of Facilities Management Department in July 2013 after 20 years' service in that position.

Financial Administration Department

Chief Financial Officer: Robert Middleton-Jones†

Chief Manager: Colleen Andersen

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

Information Technology Department

Chief Information Officer: Sarv Girn†

Chief Manager: Peter Speranza

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

Staff Services Unit

Chief Manager: Michael Davies

Staff Services Unit is responsible for a range of staff services, such as payroll, superannuation and travel, reporting to the Chief Financial Officer.

Currency Group

Assistant Governor: Michele Bullock*†

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

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

Note Issue Department

Head: Michael Andersen

Deputy Head: Keith Drayton

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

Economic Group

Assistant Governor: Christopher Kent*

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

Economic Analysis Department

Head: Jonathan Kearns

Deputy Heads: Ellis Connolly, Marion Kohler, David Orsmond

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

The Reserve Bank maintains four State Offices, covering Queensland, South Australia and the Northern Territory, Victoria and Tasmania, and Western Australia. The State Offices analyse economic conditions in regions throughout Australia and conduct liaison with individual firms and agencies in both the private and public sectors. New South Wales and the Australian Capital Territory are covered by Head Office. State Offices also provide a vehicle for communicating the workings of monetary policy to the wider community and for improving access to the Bank.

The Reserve Bank has an office in Beijing, China, which is responsible for monitoring local economic and financial developments as well as maintaining relationships with government and private entities.

Economic Research Department

Head: Alexandra Heath

Deputy Head: Michael Plumb

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

Financial Markets Group

Assistant Governor: Guy Debelle*†

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

Domestic Markets Department

Head: Chris Aylmer

Deputy Head: Matthew Boge

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

International Department

Head: Chris Ryan

Deputy Heads: James Holloway, James Whitelaw

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

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

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

Financial System Group

Assistant Governor: Malcolm Edey*

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

Financial Stability Department

Head: Luci Ellis

Deputy Heads: Merylin Coombs, Carl Schwartz

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

Payments Policy Department

Head: Tony Richards

Deputy Heads: Darren Flood, Mark Manning

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

Audit Department

Head: Darryl Ross†‡

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

Human Resources Department

Head: Melissa Hope[*†]

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

Information Department

Head: Jacqui Dwyer[‡]

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

Risk Management Unit

Head: Michelle McPhee[†‡]

Risk Management Unit ensures there are clear responsibilities and a consistent framework for the definition, assessment, monitoring and control of risk throughout the Reserve Bank. The Unit also monitors the Bank's operations in financial markets, adherence with investment and trading authorities and limits, and measures portfolio risks and performance. The Head of Risk Management reports to the Risk Management Committee and to the Deputy Governor.

Secretary's Department

Secretary: Anthony Dickman[*]

Deputy Secretary: Peter Stebbing[†]

General Counsel: Catherine Parr[†‡]

Deputy General Counsel: Peter Jones

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

* Member of Executive Committee

† Member of Risk Management Committee

‡ Adviser to Executive Committee

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Abbreviations

AAS	Australian Accounting Standards
ABF	Asian Bond Fund
ABF1	Asian Bond Fund 1
ABF2	Asian Bond Fund 2
ACC	Asian Consultative Council (of the BIS)
ADI	Authorised deposit-taking institution
AML/CTF	Anti-Money Laundering/Counter-Terrorism Financing
AOFM	Australian Office of Financial Management
APCA	Australian Payments Clearing Association Limited
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
BCBS	Basel Committee on Banking Supervision
BI	Bank Indonesia
BIS	Bank for International Settlements
BPNG	Bank of Papua New Guinea
BRS	Business Resumption Site (of the RBA)
CAC Act	*Commonwealth Authorities and Companies Act 1997*
CFR	Council of Financial Regulators
CGFS	Committee on the Global Financial System (of the BIS)
CGS	Commonwealth Government Securities
CHESS	Clearing House Electronic Sub-register System
CLF	Committed liquidity facility
CLS	Continuous linked settlement
CPR	Commonwealth Procurement Rules
CPSS	Committee on Payment and Settlement Systems (of the BIS)
CRA	Credit rating agency
CSA	Credit Support Annex
DFAT	Department of Foreign Affairs and Trade
DoFD	Department of Finance and Deregulation
D-SIB	Domestic systemically important bank
ECB	European Central Bank
EFT	Electronic Funds Transfer
EMC	Environmental Management Committee
EMEAP	Executives' Meeting of East Asia-Pacific Central Banks
ES	Exchange settlement
ESA	Exchange Settlement Account
ESD	Ecologically sustainable development
FCL	Flexible Credit Line
FMI	Financial market infrastructure
FOI	Freedom of Information
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
GHOS	Group of Governors and Heads of Supervision
GPF	Government Partnership Fund (with Indonesia)
G-SIB	Global systemically important bank
G-SIFI	Global SIFI
G20	Group of Twenty
HQLA	High-quality liquid assets
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IPS	Information Publication Scheme
ISDA	International Swaps and Derivatives Association
IT	Information Technology
LVCS	Low Value Clearing Service
LVSS	Low Value Settlement Service
MFSC	Monetary and Financial Stability Committee
NAIDOC	National Aborigines and Islanders Day Observance Committee
NGB	Next Generation Banknote
NNPDC	National Note Processing and Distribution Centre
NPA	Note Printing Australia Limited
NQRS	Note Quality Reward Scheme
OECD	Organisation for Economic Co-operation and Development
OPA	Official Public Account
OTC	Over-the-counter (derivatives)

PAIF	Pan Asian Index Bond Fund
PBC	People's Bank of China
PFMI	Principles for Financial Market Infrastructures
PFTAC	Pacific Financial Technical Assistance Centre
PLL	Precautionary and Liquidity Line
RBA	Reserve Bank of Australia
RBF	Reserve Bank of Fiji
RBRF	Reserve Bank Reserve Fund
RCG	Regional Consultative Group
RDP	Research Discussion Paper
Repo	Repurchase agreement
RITS	Reserve Bank Information and Transfer System
RM	Risk Management Unit
RMB	Renminbi
RMBS	Residential mortgage-backed securities
RTGS	Real-time gross settlement
SAR	Special Administrative Region
SDR	Special Drawing Right
Semis	Semi-government securities (Australian state and territory government securities)
SIFI	Systemically important financial institution
SWIFT	Society for Worldwide Interbank Financial Telecommunication
WHS	Work health and safety

RESERVE BANK OF AUSTRALIA