RESERVE BANK
OF AUSTRALIA

RESERVE BANK OF AUSTRALIA ANNUAL REPORT

Reserve Bank

2012

RESERVE BANK OF AUSTRALIA

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G.R. Stevens
GOVERNOR

10 September 2012

The Hon Wayne Swan MP
Deputy Prime Minister and Treasurer
Parliament House
CANBERRA ACT 2600

Dear Deputy Prime Minister

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 ending 30 June 2012, 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 2012

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Governor's Foreword

The global economy experienced rather more difficult conditions in 2011/12 than in the preceding year. Although fears a year ago of a 'double dip' in the United States were not borne out, the long-running crisis in Europe worsened. Financial market sentiment swung repeatedly, from extreme risk aversion as some critical moment approached, to relief as the hurdle was cleared, soon followed by fretting about the next one. Through it all, though, the mood darkened as the sheer magnitude of the problems facing a number of European countries, and the euro area as a whole, became ever more apparent. The process of strengthening public and private finances in Europe, and building genuinely European structures for fiscal and banking policies to accompany the common monetary policy, will take some time. Hence, periodic bouts of anxiety are likely to be a recurring feature of the period ahead.

Risk aversion saw changes to financial pricing that affected Australia in important ways. The very large rise in the exchange rate that had been a feature of the preceding years – and which saw the Reserve Bank recording large valuation losses – abated. Whether that is a precursor to a significant fall, a pause before a further rise, or whether in fact the currency has reached a new, higher, mean value, cannot be known. In any event, the large valuation losses sustained on the Reserve Bank's own balance sheet in the preceding year were not repeated, and the Bank returned to profit, amounting to about $1.1 billion, as measured by the accounting standards. Underlying earnings remained low, however – in fact, they were lower in nominal terms than at any time in the past three decades, due to the very low level of yields on the Bank's assets.

This exceptionally low level of yields on highly rated debt is a major global phenomenon. The Commonwealth of Australia has been borrowing at the lowest cost it has faced since Federation. Yields on long-term securities issued by the United States – a nation not without serious fiscal challenges – are well below 2 per cent, while German government bond yields are negative out to about two years, such is the 'flight to safety' that has been occurring. Central bank policy rates of course remain extremely low in major countries.

These sorts of yields have, as noted, reduced the Reserve Bank's earnings considerably. But the implications extend far more widely: around the world, pension funds, insurance companies, small savers and official investors with very large portfolios have sought to avoid private credit risk, sovereign credit risk of 'peripheral' European countries and, increasingly, re-denomination risk in Europe. The purchases of government debt by major central banks, as part of their 'unconventional' response to very weak economic conditions, have also played a role. In the process, however, investors in these securities are having to accept very low earnings. Many retirees around the world may find their income streams disappointing over the years ahead.

On the Reserve Bank's own balance sheet, the effects of the large valuation losses incurred in earlier years will be in evidence for some time yet. Although the Bank's net worth remains strongly positive, it is the Board's view that the capital buffers run down to absorb the losses of the preceding two years need to be replenished. To that end, the Deputy Prime Minister and Treasurer determined that a substantial proportion of the earnings in 2011/12 should be transferred to the Reserve Bank Reserve Fund. The process of rebuilding capital will need to continue for several more years.

Monetary policy in Australia has responded to the changing dynamics of the international and domestic economy. Although in early 2011 it was widely expected that monetary policy would probably need to be tightened, as the expansionary effects of the resource investment boom worked through the economy, the cash rate was in fact lowered four times during the past year as the global economy softened, the non-mining sector grew more slowly than anticipated and evidence emerged that inflation was easing. The cash rate ended the financial year at 3.5 per cent, which by historical standards is unusually low, and which helped to produce lending rates in the economy a little below their medium-term averages. These changes were made according to the medium-term, flexible inflation target that has guided monetary policy for nearly 20 years now. As of this writing, the available data show an economy recording growth close to trend, unemployment at just over 5 per cent (little changed from a year earlier) and inflation at about 2 per cent in underlying terms.

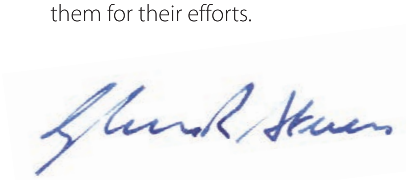
The work of maintaining and upgrading key aspects of the Reserve Bank's capability to deliver financial services to the private sector and government continued. Over the next several years the need to replace or upgrade key elements of critical financial infrastructure in the banking and settlements areas is likely to see substantial investment, and an associated increase in staffing. On the other hand, some other services that had long been provided by the Reserve Bank, such as registry services for government securities, will migrate to private providers, on efficiency grounds.

International engagement continues to grow in importance, with the Reserve Bank active in numerous international bodies and committees. Two highlights were the establishment of representation in China for the first time and the conclusion of a foreign currency swap agreement with the People's Bank of China, aimed at facilitating the growing flows of goods, services and capital between the two countries.

Graeme Kraehe completed his term on the Board during the past year, having made a very strong contribution to its work over five years. Heather Ridout joined the Board, bringing many years of experience to the role.

Ric Battellino retired as Deputy Governor in February, after 39 years in the Reserve Bank. He made an enduring contribution to the institution, with great integrity, and I thank him for his counsel and support particularly over the past five years. In his successor, Philip Lowe, the Deputy Prime Minister and Treasurer has made an outstanding choice.

The management and staff of the Reserve Bank have once again gone about their work with calm professionalism and high standards in the face of not inconsiderable challenges. The Board joins me in thanking them for their efforts.



Glenn Stevens

Chairman, Reserve Bank Board

5 September 2012

Functions and Objectives of the Reserve Bank

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

> It is the duty of the Reserve Bank Board, within the limits of its powers, to ensure that the monetary and banking policy of the Bank is directed to the greatest advantage of the people of Australia and that the powers of the Bank … are exercised in such a manner as, in the opinion of the Reserve Bank Board, will best contribute to:
>
> (a) the stability of the currency of Australia;
>
> (b) the maintenance of full employment in Australia; and
>
> (c) the economic prosperity and welfare of the people of Australia.

For almost 20 years now, this general mandate has found concrete expression in the form of a medium-term inflation target. Monetary policy aims to keep the rate of consumer price inflation at 2–3 per cent, on average, over the cycle. The 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.

In addition to conducting monetary policy, the Reserve Bank:

- promotes the overall stability of the financial system
- holds and manages Australia's foreign currency reserves
- operates Australia's main high-value payments system
- provides banking services to government and overseas official institutions
- designs, produces and issues Australia's banknotes.

Amendments to the Reserve Bank Act in 1998 removed from the Bank responsibility for the prudential supervision of banks but gave it responsibility for ensuring the stability, efficiency and competitiveness of the payments system. These amendments also established the Payments System Board. The Reserve Bank's main powers in relation to the payments system are set out in the *Payment Systems (Regulation) Act 1998*.

Governance

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

Reserve Bank Board

The Reserve Bank Board has responsibility for monetary policy and financial stability, as well as a range of other statutory obligations. The Board comprises the Governor (Chairman), Deputy Governor (Deputy Chairman), Secretary to the Treasury and six external members appointed by the Treasurer, a total of nine. Two members completed terms on the Board during the past year; the resolution passed by the Board on the occasion of the departure of Ric Battellino and Graham Kraehe from the Board is shown on page 11. Members of the Board during 2011/12 are shown below and on pages 9–10.

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

Most meetings are held at the Head Office in Sydney. From time to time, Board meetings are held in Reserve Bank offices in other Australian capitals. During the year in review, the September 2011 meeting was held in Perth and the April 2012 meeting was held in Melbourne.

Board Meetings in 2011/12 – Attendance by Members[(a)]

Glenn Stevens	11	(11)
Ric Battellino[(b)]	7	(7)
Philip Lowe[(c)]	4	(4)
Martin Parkinson[(d)]	10	(11)
John Akehurst	10	(11)
Jillian Broadbent	10	(11)
Roger Corbett	10	(11)
John Edwards[(e)]	10	(10)
Graham Kraehe[(f)]	7	(7)
Warwick McKibbin[(g)]	1	(1)
Heather Ridout[(h)]	4	(4)
Catherine Tanna	11	(11)

(a) Figures in brackets show the number of meetings each member was eligible to attend during the year in review
(b) Ric Battellino's term as a member ended on 13 February 2012
(c) Philip Lowe's term on the Board commenced on 14 February 2012, following his appointment as Deputy Governor
(d) 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*
(e) John Edwards' term on the Board commenced on 31 July 2011
(f) Graham Kraehe's term as a member ended on 13 February 2012
(g) Warwick McKibbin's term as a member ended on 30 July 2011, as noted in the 2011 Annual Report
(h) Heather Ridout's term on the Board commenced on 14 February 2012

The Board has an Audit Committee and a Remuneration Committee.

Payments System Board

The responsibilities of the Payments System Board are set out in the *Reserve Bank Act 1959*. In particular, the Act requires the Board to determine the Reserve Bank's payments system policy so as to 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 is separate 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, by law, members must meet the general obligations of directors of statutory authorities, as set out in the *Commonwealth Authorities and Companies Act 1997* (CAC Act). The CAC Act sets standards of conduct for directors and officers of Commonwealth authorities. Directors must:

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

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

Members of the Payments System Board have adopted a Code of Conduct in substantially the same terms, which is also on the Bank's website.

Audit Committee

The objectives of the Audit Committee of the Reserve Bank Board are to:

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

Jillian Broadbent has been Chairman of the Audit Committee since August 2008. Other members of the Committee are Roger Corbett, a member of the Reserve Bank Board, and Michael Coleman and Terry Williamson, both of whom are company directors and former senior audit partners of major accounting firms who have extensive control experience in the financial sector. Mr Coleman succeeded Mr Battellino, who retired from the position of Deputy Governor and from the Audit Committee in February 2012.

During 2011/12, the Audit Committee met on four occasions. The Committee also meets, at least annually, with the external auditors in the absence of management. At its meetings in July and August 2012, the Committee considered the draft consolidated financial statements for the Reserve Bank for the year ended 30 June 2012 and agreed that the statements be presented to the Reserve Bank Board with its endorsement.

Remuneration Committee

The Reserve Bank Board also has a Remuneration Committee, which 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 (Chairman), Jillian Broadbent and Catherine Tanna. Ms Tanna succeeded Graham Kraehe as a member of the Remuneration Committee following Mr Kraehe's retirement from the Board in February 2012. The Committee meets as often as necessary, but at least twice each year.

Early in the year in review, the offices of Governor and Deputy Governor were declared 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 Committee communicates with the Remuneration Tribunal as required.

In accordance with section 21A of the Reserve Bank Act, the Governor and Deputy Governor are not present during deliberations and do not take part in decisions of the Remuneration Committee or the Board relating to the determination or application of any terms or conditions on which they hold office. The Remuneration Committee is also kept informed of the remuneration arrangements for Reserve Bank staff.

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

Executive Committee

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

Risk Management Committee

The Risk Management Committee of the Reserve Bank has responsibility for ensuring that non-policy risks are properly identified and managed across the Bank in accordance with its Risk Management Policy. The Committee, which is chaired by the Deputy Governor and comprises senior executives drawn mainly from the operational areas of the Bank, meets quarterly.

Indemnities for Members of Boards

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.

Reserve Bank Board

August 2012

Glenn Stevens (Chairman)

Governor since 18 September 2006
Present term ends 17 September 2013

Chairman – Payments System Board
Chairman – Council of Financial Regulators
Member – Financial Stability Board

Philip Lowe (Deputy Chairman)

Deputy Governor since 14 February 2012
Present term ends 13 February 2019

Martin Parkinson PSM

Secretary to the Treasury
Member since 27 April 2011

Member – Council of Financial Regulators

John Akehurst

Member since 31 August 2007
Present term ends 30 August 2017

Director – CSL Limited
Director – Origin Energy Limited
Director – Securency International Pty Ltd
Director – University of Western Australia Business School

Jillian Broadbent AO

Member since 7 May 1998
Present term ends 6 May 2013

Chairman – Reserve Bank Board Audit Committee
Member – Reserve Bank Board Remuneration Committee
Chair – Clean Energy Finance Corporation
Director – ASX Limited
Director – Woolworths Limited
Chancellor – University of Wollongong

Roger Corbett AO

Member since 2 December 2005

Present term ends 1 December 2015

Chairman – Reserve Bank Board Remuneration Committee

Member – Reserve Bank Board Audit Committee

Chairman – Fairfax Media Limited

Chairman – Mayne Pharma Group Limited

Chairman – PrimeAg Australia Limited

Director – Wal-Mart Stores Inc

John Edwards

Member since 31 July 2011

Present term ends 30 July 2016

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 – National Workforce and Productivity Agency

Heather Ridout

Member since 14 February 2012

Present term ends 13 February 2017

Employer Director – AustralianSuper Trustee Board

Director – Sims Metal Management

Member – Climate Change Authority

Member – National Workforce and Productivity Agency

Catherine Tanna

Member since 30 March 2011

Present term ends 29 March 2016

Member – Reserve Bank Board Remuneration Committee

Chairman – BG Australia

Member – Gold Coast 2018 Commonwealth Games Corporation Board

Ric Battellino retired from the Board on 13 February 2012

Graham Kraehe AO retired from the Board on 13 February 2012

Resolution Passed by the Board

7 February 2012 Meeting

Ric Battellino

Graham Kraehe AO

Members noted that this was the final meeting for Messrs Battellino and Kraehe, both of whom had served five years on the Board with dedication and professionalism. Their skills, extensive knowledge and experience had contributed enormously to the deliberations of the Board on monetary policy and a range of other matters.

As Deputy Governor and Deputy Chairman of the Board, Mr Battellino had used his outstanding intellect, deep understanding of financial markets and strong grasp of central banking to bring rigorous analysis and astute judgement to the Board's deliberations. As a member of the Reserve Bank Board Audit Committee, including as Chairman for a time, Mr Battellino had also made an important contribution to fulfilling the Board's wider obligations in corporate governance. Mr Kraehe had contributed to the Board's deliberations using his broad commercial experience, specialist knowledge across several industries and thoughtful judgement. These attributes had also been valuable during his period as a member of the Reserve Bank Board Remuneration Committee over the past year or so. Members recorded their appreciation of the contributions of Messrs Battellino and Kraehe to the sound conduct of monetary policy and good governance of the Bank, and wished them well in the future.

Accountability and Communication

Relationship with Government

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

Reporting Obligations

The Reserve Bank is a Commonwealth authority and the members of the Reserve Bank Board are the directors of the Bank. Those directors are responsible for the preparation of the annual report. At its meetings on 7 August and 4 September 2012, the Board resolved that the Chairman sign the annual report and financial statements as at 30 June 2012, and provide them to the Deputy Prime Minister and Treasurer for presentation to the Parliament, in accordance with the *Commonwealth Authorities and Companies Act 1997* (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 responds to questions from Committee members. In 2011/12, the Governor and senior officers attended hearings of this Committee in Melbourne in November 2011 and in Sydney in February 2012. These appearances, and the quarterly *Statement on Monetary Policy* (see below), are important elements of the arrangements embodied in the understandings between the Governor and the Treasurer (outlined in the fifth *Statement on the Conduct of Monetary Policy*, an update of which was issued in September 2010 following the re-election of the Labor Government).

The Reserve Bank made two written submissions to Parliamentary inquiries during the year: a submission to the inquiry into the post-global financial crisis held by the Senate Economics References Committee, and responses to questions on notice to an inquiry into the integrity of overseas Commonwealth law enforcement operations by the Parliamentary Joint Committee on the Australian Commission for Law Enforcement Integrity. Both these submissions were lodged in May 2012.

Communication

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

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

The quarterly *Statement on Monetary Policy* informs the financial markets, media and general public about the Reserve Bank's thinking about monetary policy and developments in financial markets. It also provides a basis for the Parliamentary Economics Committee's questioning of the Bank. The *Statement* provides an analysis of conditions in the economy and financial markets, the outlook for inflation and economic growth and a further explanation of recent decisions on interest rates.

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. Another explained aspects of banknote quality, while there were also articles on the increasingly important economies of China and India, along with a feature on Indonesia. Some articles explored structural change in the Australian economy and the regional dimensions of economic growth. Others complemented the *Statement on Monetary Policy* by providing more detail about specific economic developments.

The *Financial Stability Review*, published in March and September each year, gives a detailed assessment of the condition of Australia's financial system, along with analysis of issues of specific interest. In the past year, such issues included foreign-owned banking activity in Australia, aspects of home mortgage debt and arrears, the shadow banking system, global systemically important banks and the stress tests conducted on European banks. The *Review* also reports on the Reserve Bank's involvement in financial regulatory policy, including through its work with the Council of Financial Regulators.

During 2011/12, the Governor, Deputy Governor and senior officers gave 40 on-the-record speeches on various topics and participated in several public panel discussions. In addition to explaining current economic conditions, many speeches addressed the longer-term forces shaping the economy and the challenges associated with structural change. There were also speeches devoted to innovation and reform in the payments system, bank funding, financial system stability and developments in financial markets. Audio files of these speeches and the associated Q&A sessions and panel discussions were published on the Reserve Bank's website to further enhance accountability and communication.

The Reserve Bank disseminates research conducted by the staff in the form of Research Discussion Papers (RDPs). While the views expressed in these papers are those of the authors and do not necessarily represent those of the Bank, their publication encourages discussion and comment on economic issues among a broad range of researchers. During 2011/12, RDPs were released on a range of topics, including the terms of trade, the effects of conditions in financial markets on the real economy and co-movements in inflation across countries.

In addition, Reserve Bank staff published papers in various external journals, such as: the *Journal of International Economics*; the *Journal of Monetary Economics*; the *International Journal of Central Banking*; the *Journal of International Money and Finance*; the *Journal of Economic Dynamics and Control*; *Applied Economics Letters*; the *China Economic Review*; the *Economic Record*; and the *Australian Economic Review*.

Research undertaken at the Reserve Bank is frequently presented at external conferences and seminars. Presentations to domestic conferences and workshops in 2011/12 included the 17th Australasian Macroeconomics Workshop at Monash University; the 23rd Annual Meeting of the Association for Chinese Economic Studies (Australia), at the University of Western Australia; the Econometric Society Australasian Meeting, at the University of Adelaide; and the Economic Forum 2011, hosted by the Economic Society of Australia. Bank staff also presented seminars at a number of universities, including the Australian National University, the University of Melbourne, the University of Tasmania and the University of Technology, Sydney.

1. Governor Glenn Stevens speaking at the Inaugural Warren Hogan Memorial Lecture, at Sydney University, December 2011 **2.** Philip Lowe's first speech as Deputy Governor was to the Committee for Economic Development of Australia, February 2012 **3.** Assistant Governor Guy Debelle speaking at a Bloomberg Financial Markets seminar, February 2012 **4.** Deputy Governor Ric Battellino speaking at *The Economist's* Bellwether Series, August 2011 **5.** Luci Ellis, Head of Financial Stability Department, speaking at the Australian Mortgage Conference, February 2012

Papers were prepared for a number of international conferences and workshops, including the Macro Workshop at the Victoria University of Wellington, New Zealand; the Reserve Bank of New Zealand's conference on Macro Policies after the Crisis; the SEACEN Research Workshop and High-level Seminar on Policy Responses and Adjustments in the Course of Exchange Rate Appreciation, in Indonesia; and the Labour Market Dynamics Workshop at the Centre for Central Banking Studies in London.

The Reserve Bank hosts regular conferences to foster interaction between academics, central bankers and other economic practitioners. The Bank's annual conference for 2012 was held jointly with the Bank for International Settlements in August in Sydney on the theme of Property Markets and Financial Stability. The conference focused on several important topics, including issues in measuring property prices, housing finance, the effects of macroprudential policies, the management of banks' risks and securitisation. A volume containing the conference papers and discussions will be published in late 2012.

The Reserve Bank held a workshop in December 2011 on Quantitative Macroeconomics. The workshop featured 10 papers by international and Australian academics and central bankers. Another macroeconomic workshop, to be organised jointly with Australian academics, will be held in December 2012.

A number of academic researchers were hosted by the Reserve Bank through the year. They presented seminars and participated in research activities at the Bank during their visits.

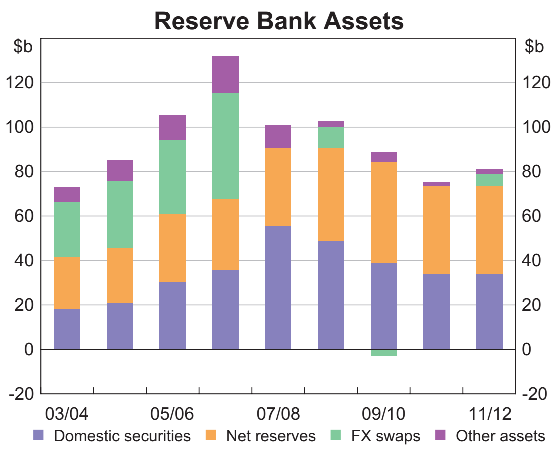
The Reserve Bank publishes information in both electronic and hardcopy formats, though most access to information is online. In 2011/12, the number of page views/downloads of information on the website averaged about 192 000 per day, up from 90 000 per day only two years earlier, with visitation boosted by heightened interest in monetary policy decisions in late 2011. The number of subscribers to the conventional email service for information published on the website fell to around 13 500 at the end of June 2012, from around 15 500 in recent years. In contrast, having commenced using Twitter in early 2011, the number of followers grew to 9 200 by the end of June 2012. Furthermore, visitors to the website 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.

Operations in Financial Markets

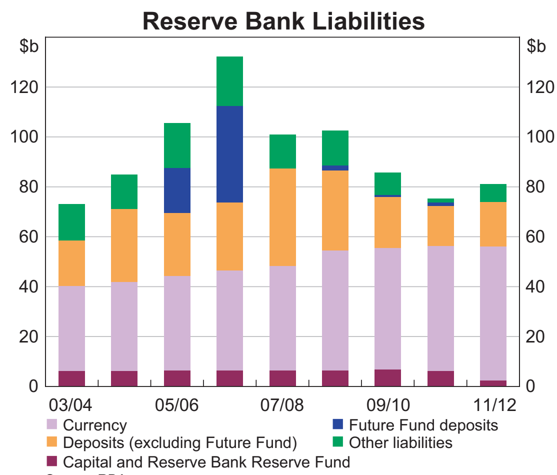
The Balance Sheet

The Reserve Bank undertakes transactions in 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). The structure of the Bank's balance sheet is influenced by the execution of these functions as well as the Bank's role in issuing the nation's banknotes.

The Reserve Bank's balance sheet grew by around $6 billion over 2011/12. There was an increase in banknotes on issue, broadly in line with the growth in the size of the economy over the year. The Australian Government's balances on deposit with the Bank were little changed; such balances are used to manage the liquidity position of the Government and usually fluctuate over the course of the year. The higher liabilities were matched on the asset side of the balance sheet by increased holdings of domestic securities under repurchase agreements (repos) and foreign assets purchased under foreign exchange swaps.



Source: RBA



Source: RBA

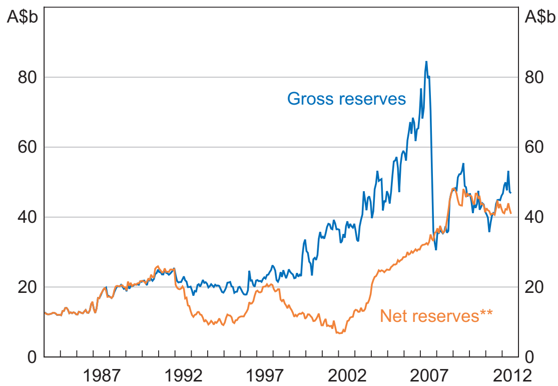
The Australian dollar value of net reserves held on the balance sheet increased by $0.5 billion over the year to $40.0 billion. This mainly reflected earnings on the portfolio and valuation gains. Transactions with the International Monetary Fund (IMF) linked to funding assistance programs for Ireland, Portugal and Greece resulted in a drawdown in the Bank's holdings of foreign currency reserves of around $0.7 billion. This was matched by an increase in Australia's reserve position at the IMF, which is an asset of the Australian Government and not on the Reserve Bank's balance sheet. Foreign exchange swaps outstanding at the end of June stood at $5.0 billion. These are undertaken for domestic liquidity management (see below). As a result, the level of gross reserves held on the Bank's balance sheet, which is the level of net reserves adjusted for foreign exchange held or lent under foreign exchange swaps, stood at $45.0 billion at the end of June. Taking into account Australia's reserve position at the IMF, Australia's official reserve assets were $47.2 billion.

Reserve Bank Balance Sheet
$ billion

	June 2010	June 2011	June 2012
Assets	*86*	*75*	*81*
Foreign	47	41	47
– Net reserves[(a)]	46	39	40
– FX swaps	–3	0	5
– Other[(b)]	4	2	2
Domestic	39	34	34
Liabilities	*86*	*75*	*81*
Deposits	21	18	18
Currency	49	50	54
Other (including capital)	16	8	9

(a) Excludes Australia's reserve position at the IMF
(b) Includes foreign currency securities sold under repurchase agreements
Source: RBA

Official Reserve Assets*



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

Committed Liquidity Facility

As discussed in the 2011 Annual Report, the implementation of the Basel Committee on Banking Supervision's (BCBS) new global liquidity standard will affect the Reserve Bank's earnings and, potentially, its balance sheet in future years. The standard, which will take effect from 1 January 2015, imposes a greater requirement for financial institutions to hold high-quality liquid assets (HQLA). In Australia, the supply of assets that qualify as HQLA (Commonwealth and state government debt) will not be sufficient for authorised deposit-taking institutions (ADIs) to meet the standard. For this reason, the Bank has undertaken to provide a 'committed liquidity facility' (CLF), thereby ensuring that ADIs will have sufficient access to liquidity in an acute stress scenario, as specified under the standard.

In November 2011, the Reserve Bank released details of the CLF, concurrently with the Australian Prudential Regulation Authority (APRA) publishing details of the proposed implementation of the BCBS liquidity reforms in Australia. The CLF will enable participating ADIs to access a pre-specified amount of liquidity by selling securities to the Bank under repo. These repos will be contracted outside of the Bank's normal market operations and at a rate that is 25 basis points above the cash rate target. The range of eligible securities will be broader than that used for normal market operations. In particular, ADIs will be able to use certain related-party assets issued by bankruptcy remote vehicles, such as 'self-securitisations' of their residential mortgages. To secure the Bank's commitment, an ADI will be required to pay a fee of 15 basis points per annum, with the fee assessed on the size of the Bank's commitment. The fee will apply to both drawn and undrawn commitments and must be paid monthly in advance. Fees collected for the facility will be reported as revenue by the Bank. The Bank's commitment under the CLF is contingent upon an ADI having positive net worth in the opinion of the Bank, having consulted with APRA. Further details on the facility can be found in a November 2011 speech by the Assistant Governor (Financial Markets), 'The Committed Liquidity Facility'.

In the normal course of events, the standing arrangements with ADIs will not affect the size or composition of the Reserve Bank's balance sheet. However, in the event that an ADI draws on the liquidity facility, the Bank's balance sheet would expand as the ADI would deliver securities against the funds provided. The facility has been designed so as to not impair the Bank's ability to manage system liquidity or implement the Board's monetary policy decisions.

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. In order to meet the Board's target, the Bank operates within financial markets to maintain an appropriate level of exchange settlement (ES) balances. Approximately 60 financial institutions operate ES accounts at the Reserve Bank. Balances held within these accounts are liabilities of the Reserve Bank and are used by financial institutions to settle their payment obligations with each other and with the Bank. The Reserve Bank pays interest on ES balances at a rate 25 basis points below the cash rate target. ES account holders are not permitted to overdraw their accounts, although the Bank stands ready to advance funds overnight to ES account holders, against securities, at an interest rate 25 basis points above the cash rate target. This provision of funds is done via repo, whereby the Bank purchases securities that the ES account holder agrees to repurchase on the following business day. In general, these transactions are undertaken only when banks have experienced unforeseen payments flows late in the day and are unable readily to source covering funds. During 2011/12, the overnight repo facility was accessed on just five occasions, similar to its usage in the preceding two years.

Usage of Overnight Standing Facility

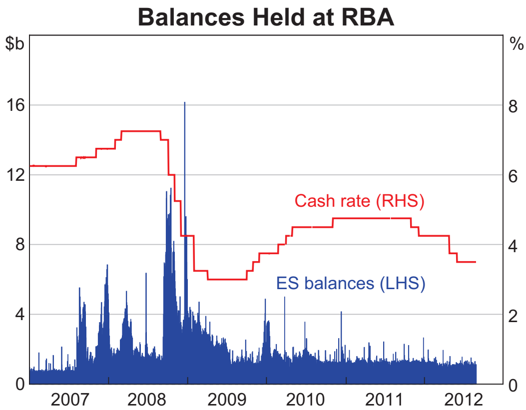
	Number of times used	Value ($m)
2006/07	24	3 589
2007/08	18	4 220
2008/09	15	3 257
2009/10	5	1 035
2010/11	2	363
2011/12	5	1 103

Source: RBA

The Board lowered its target for the cash rate four times during the past year – at the November, December, May and June Board meetings – from 4.75 per cent to 3.5 per cent. By setting the rate for overnight repos and the rate paid on ES balances at constant spreads to the cash rate target, the Reserve Bank is not required to alter the supply of ES balances as the target rate changes. Over the past year, aggregate ES balances were generally around $1¼ billion, a similar level to the previous year. Only on isolated occasions, such as over the end of the year, did the Bank need to accommodate an increase in demand for ES balances by allowing the supply to rise. Notwithstanding various periods of market turbulence, the Bank did not observe any precautionary increase in demand for ES balances. During 2011/12, the cash rate traded at the Board's target on all business days.

Although the level of ES balances is reasonably constant, the Reserve Bank needs to transact in the market on almost every business day in order to achieve this outcome. As payment flows between ES account holders and the Bank's customers, principally the Australian Government, alter the aggregate level of ES balances, the

Bank needs to offset the impact of this activity (see 'Domestic Market Operations and Liquidity Forecasting' in the December 2010 *Bulletin*). As part of this, the Bank undertakes repos in domestic securities, makes outright purchases of domestic securities and executes foreign exchange swaps. As the size of the payments across the Government's account is not always known with certainty, the Bank is sometimes required to conduct a second round of dealing on the same business day. In the past year, unexpected liquidity flows resulted in the Bank conducting a second round of dealing on four occasions.



Source: RBA

Most of the Reserve Bank's transactions within the domestic market are contracted as repos. In its market operations, the Bank is willing to purchase both government-related debt securities ('general collateral') and private debt securities under repo. To protect against a fall in the value of the security in the event that the counterparty to the transaction is not able to repurchase its security at the agreed time, the Bank requires the value of the security to be higher than the cash lent by a percentage of the security's initial price. These percentages (or 'haircuts') were reviewed during 2011/12, with a revised schedule introduced in February 2012. The haircuts used now range from 1 to 23 per cent, increasing with the risk profile of the security used.

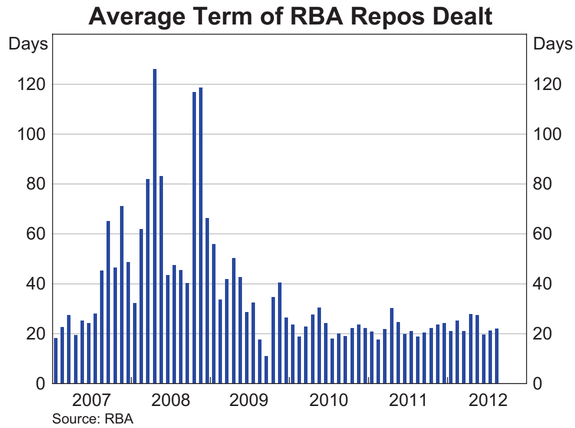
Over the past year, the value of securities held under repo has ranged between $15 billion and $36 billion as the Reserve Bank's balance sheet has fluctuated with movements in government deposits. Although government-related securities continue to account for the larger share of the securities held under repo, certain classes of these securities have diminished in relative importance. In particular, with a significant amount of the government-guaranteed debt issued by the ADIs during the financial crisis having matured, the Bank is now purchasing less of this debt under repo.

Australian Dollar Securities Held under Repurchase Agreements

	June 2010		June 2011		June 2012	
	$ billion	Per cent of total	$ billion	Per cent of total	$ billion	Per cent of total
General collateral						
– CGS	3.3	9	3.9	18	8.5	35
– Semis	10.8	31	8.7	41	8.6	35
– Supras	2.2	6	2.0	10	0.6	2
– Government guaranteed	5.6	16	4.0	19	0.3	1
Private Securities						
– ADI issued	8.8	25	1.2	5	5.6	23
– RMBS	3.6	10	1.5	7	0.8	3
– Other	0.5	1	0.0	0	0.0	0
Total	34.8		21.4		24.4	

Source: RBA

The average term of the repos contracted by the Reserve Bank in its market operations has been stable during the past year at around three to four weeks. During the financial crisis, the Bank extended the term of its dealing to accommodate a heightened demand for longer-term funding within the domestic money market. In the past year, although global financial markets were at times quite unsettled, the domestic money market continued to function smoothly and the Bank did not need to modify its operations, either in terms of the maturity of its repo operations or the size of its liquidity provision. While the Bank remains willing occasionally to deal for longer terms, short-term repos generally provide the Bank with the appropriate degree of flexibility to manage its balance sheet.



To better gauge the structure of the domestic repo market, and the Reserve Bank's role within it, the Bank has instituted a quarterly survey of repo and bond dealers, the results of which are shared with survey respondents. The survey collects data on the size of dealer positions in government-related securities including, for repo dealers, information on the type of counterparty. The most recent survey suggests that the size of the repo market in government-related securities is around $80 billion. For details of the inaugural survey, see 'The Repo Market in Australia' in the Bank's December 2010 *Bulletin*.

In addition to repurchase transactions, the Reserve Bank is willing to purchase short-term Commonwealth Government securities (CGS) and semi-government securities on an outright basis as part of its management of system liquidity. Large CGS maturities potentially have a significant impact on system liquidity as funds are paid out of the Australian Government's account to the holders of the bonds. During 2011/12, to offset the liquidity impact of the $14 billion maturity of the April 2012 CGS, the Bank purchased a large quantity of the bond ahead of its maturity date, some of which was on-sold to the Australian Office of Financial Management (AOFM) at the prevailing market price. The Bank also structured a large volume of its repos and foreign exchange swaps to mature on the same date as the bond. Consequently, any addition to ES funds brought about by the bond's maturity was offset by the Bank receiving ES funds in exchange for the return of securities or foreign exchange that it had previously purchased.

Outright purchases of longer-term semi-government securities are transacted through separate, less regular, operations. During 2011/12, the Bank conducted four 'long-dated' operations, purchasing $100 million on each occasion. At present, the Bank holds around $3 billion of longer-dated securities on an outright basis, almost all of which has been issued by the semi-government authorities. The size of this portfolio has remained relatively constant over recent years.

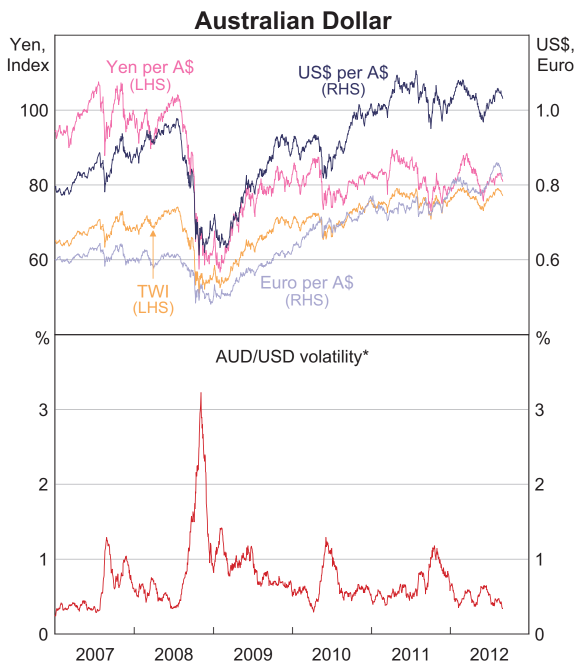
On behalf of the AOFM, the Reserve Bank operates a lending facility for CGS. This facility allows market participants to borrow specific lines of CGS via a repo with the Reserve Bank. An offsetting repo in other CGS or government-related securities is transacted at the same time to offset the impact on system liquidity. As the spread between the two repo rates is significant for the Bank's counterparty (300 basis points), the facility is used only as a last resort by dealers to avoid settlement fails. Only $2.5 billion of CGS was lent through the facility in 2011/12, as dealers were almost always able to source the required securities within the market.

Foreign Exchange Operations

The Reserve Bank undertakes transactions in the foreign exchange markets as a result of foreign exchange services it provides to its clients, management of its portfolio of foreign currency assets and policy operations. Client transactions account for the bulk of this activity by number of transactions (but not by value). The vast majority of client transactions arise from the provision of foreign exchange services to the Australian Government. In the normal course of events, the Bank covers its sales of foreign currency to the Government by purchasing foreign currency in the market. At times of market stress, the Bank can draw on its foreign currency holdings to meet demand from the Government, delaying the impact of these flows on the market. In 2011/12, the Reserve Bank sold $7.3 billion of foreign currency to the Australian Government. All of these transactions were covered in the market. The last time such transactions were funded temporarily from foreign currency reserves was in late 2008.

Management of the currency risk on its portfolio of foreign currency assets also requires the Reserve Bank to transact in the foreign exchange market. As discussed below, the foreign currency assets on the Bank's balance sheet are managed to a benchmark. The foreign currency risk of these assets is managed to fixed targets, with actual positions rebalanced to these targets daily. These rebalancing transactions involve the Bank operating in both the foreign exchange spot and swap markets.

The Reserve Bank is also active in the foreign exchange swap market as a result of its domestic liquidity management responsibilities. For many years, the Bank has supplemented its daily market operations in repos with foreign exchange swaps. These transactions can be used in the same way as repos to reshape the profile of domestic liquidity flows into and out of the system. The market for foreign exchange swaps is larger and more liquid than the market for domestic repos and provides the Bank with a valuable additional tool for managing liquidity in its domestic operations. The Bank's use of foreign exchange swaps has no implications for the value of the Australian dollar.



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

Some transactions undertaken by the Reserve Bank are intended to influence the exchange rate or conditions in the market for foreign exchange. Such transactions, commonly described as foreign exchange intervention, are typically undertaken in the spot market. Intervention by the Reserve Bank has become less frequent as the market has developed, hedging foreign currency risk has become more efficient, and as awareness of the benefits of a floating exchange rate regime has grown. Nevertheless, the Bank retains discretion to intervene to address dislocated markets and gross misalignments of the exchange rate. The Bank did not undertake any such transactions in 2011/12. Despite periodic spikes in volatility in response primarily to offshore developments, particularly in late 2011, the Australian foreign exchange market functioned effectively through the year. The last time the Bank intervened was in late 2008. The Bank now provides daily data (with a lag) on foreign exchange intervention on its website.

Finally, the Reserve Bank also operates in the foreign exchange market from time to time to manage the level of its foreign currency holdings. Traditionally, this has involved the Bank offsetting changes in its holdings as a result of intervention. To the extent that these transactions involve a change in the net foreign currency position of the Bank, they qualify technically as intervention. In practice, however, they differ from intervention transactions in that they are executed in a way that minimises their impact on the exchange rate and on market conditions more generally. They are typically executed in small amounts over long periods.

Reserves Management

With the exception of its reserve position at the IMF (see above), Australia's holdings of foreign currency official reserve assets and gold are held on the balance sheet of the Reserve Bank. The Bank holds foreign currency assets mainly to facilitate policy operations in the foreign exchange market, although they are also used to augment operations in domestic cash markets (see above). Assets denominated in foreign currencies expose the Bank's balance sheet to foreign currency risk in addition to the interest rate, credit and liquidity risks faced on the Bank's portfolio of domestic securities (see the Chapter on 'Risk Management'). The optimal level of reserves represents a trade-off between these risk exposures and what is considered necessary to meet policy objectives.

The mandate under which reserves are managed requires investment in assets of the highest credit quality and that the portfolio has sufficient liquidity to meets its policy objectives. The major risks to the balance sheet are mitigated where possible, chiefly through maintaining a diversified currency composition. The investment process is guided by an internal benchmark, which represents the Reserve Bank's best estimate of the combination of foreign currencies and foreign currency assets that maximises return over the long run, subject to an acceptable level of risk and the overarching requirements for security and liquidity.

The current benchmark has a currency and asset allocation of 45 per cent to the United States, 45 per cent to Europe, 5 per cent to Japan and 5 per cent to Canada. The most recent change to the benchmark currency composition was the addition of the Canadian dollar in 2010 alongside a comparable reduction in the share of the Japanese yen. The Canadian benchmark portfolio has a target duration of 18 months but this is yet to be implemented owing to the low level of yields. Canadian investments currently have a duration of around six months.

Benchmark Portfolio

	US	Europe	Japan	Canada
Asset allocation (per cent of total)	45	45	5	5
Currency allocation (per cent of total)	45	45	5	5
Duration (months)	18	18	12	18

Source: RBA

Investments within the benchmark currencies are limited to sovereign, quasi-sovereign and supranational debt instruments, and cash investments secured by high-quality debt under repos. Sovereign credit exposures are limited to the United States, Germany, France, the Netherlands, Canada and Japan.

Over 2011/12, the return on foreign currency assets measured in Special Drawing Rights was 1.5 per cent, considerably below the average return over the past decade. This outcome was primarily due to the very low level of global bond yields, which depressed interest earnings. In some markets, yields reached their lowest levels in the post-war period and at the end of June 2012 the running yield on the portfolio was just 0.3 per cent. Mark-to-market capital gains on bonds made the largest contribution to returns.

RBA Security Holdings
A$ million, June 2012

Issuing government	Securities held outright	Securities held under repurchase agreements[(a),(b)]	Funds held at central banks
US	7 935	6 243	543
Germany	6 686	834	–
France	1 818	1 609	–
Netherlands	321	509	23
Canada	1 625	–	4
Japan[(c)]	5 580	1 480	9
Supra-national	921	–	–
Total	24 886	10 674	579

(a) Includes securities issued by US government sponsored agencies
(b) Includes $4.46 billion of securities held under repo for domestic liquidity management purposes
(c) Japanese securities held outright include Treasury bill holdings of A$3.99 billion to hedge FX swaps
Source: RBA

Benchmark Portfolio Running Yield

Sources: Bloomberg; RBA; Thomson Reuters; Tradeweb

The Reserve Bank also has investments in a number of Asian debt markets through participation in the EMEAP Asian Bond Fund (ABF) Initiative. This was established to assist in the development of bond markets in the region in the wake of the Asian currency crisis in the late 1990s. The Bank has modest holdings in both the US dollar-denominated fund, ABF1, and the local currency-denominated fund, ABF2. At the end of June 2012, the total allocation of reserves to these funds was $423 million. The return on these investments over 2011/12 was 4.2 per cent when measured in US dollar terms. The two funds are managed by external managers and sit outside the Bank's internal reserves benchmark framework.

Gold holdings at the end of June 2012 were around 80 tonnes, unchanged from the previous year. Gold prices rose by 12 per cent in Australian dollar terms in 2011/12, lifting the value of the Bank's holdings of gold by around $0.4 billion to $4.0 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 2012, there was just 1 tonne of gold on loan.

Rates of Return in Local Currency by Portfolio
Per cent

	US	Europe	Japan	Canada
2005/06	1.2	0.1	–0.9	–
2006/07	5.6	2.2	1.1	–
2007/08	8.1	4.0	1.7	–
2008/09	5.2	8.1	1.8	–
2009/10	2.3	2.7	0.8	–
2010/11	1.1	0.4	0.2	1.0
2011/12	2.1	2.9	0.4	1.1

Source: RBA

Bilateral Currency Swap

In March 2012, the Reserve Bank signed a bilateral local currency swap agreement with the People's Bank of China (PBC). The agreement allows for the exchange of local currencies between the two central banks of up to A$30 billion or CNY200 billion. It is for an initial period of three years and can be activated by either party. The main purposes of the swap agreement are to support trade and investment between Australia and China, by providing a backup source of local currency liquidity, and to strengthen bilateral financial cooperation. The agreement reflects the increasing opportunities available to settle trade between the two countries in Chinese renminbi (RMB) and to make RMB-denominated investments. This arrangement should offer increased confidence to both Australian firms wishing to contract their trade in RMB terms and their banks in arranging settlement. The signing of this agreement by Governor Glenn Stevens and PBC Governor Zhou Xiaochuan took place at a ceremony in Beijing.

Governor Glenn Stevens and PBC Governor Zhou Xiaochuan signing the swap agreement at a ceremony in Beijing, in the presence of the RBA's representative in China, Ivan Roberts (far left) and the PBC's Lü Tingting (far right); behind them are the RBA's Mark Hack, Frances Adamson (Australia's Ambassador to China), Song Xiangyan, PBC Deputy Director-General, International Department, and Li Bo, PBC Director-General, Monetary Policy Department II

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 are provided by Banking Department, with the common objective of delivering secure and efficient arrangements to meet the banking and payments needs of the Australian Government and its various agencies. In addition, the Bank provides banking and related services to a number of overseas central banks and official institutions. Services are of two broad types.

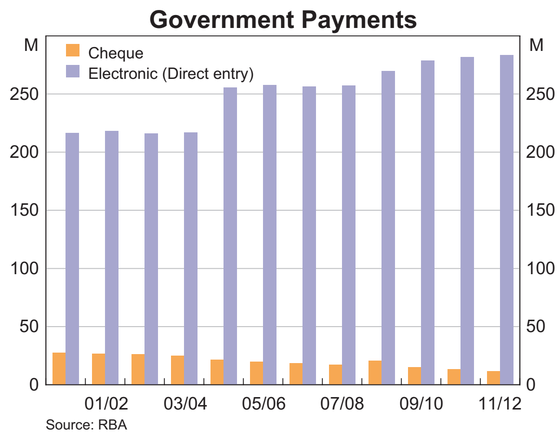
Core banking services are provided to the Department of Finance and Deregulation on behalf of the Australian Government and the Australian Office of Financial Management (AOFM). These services derive directly from the Reserve Bank's role as Australia's central bank. They require the Bank to manage the consolidation of all Australian Government agency account balances – irrespective of which financial institution each agency banks with – into the Government's Official Public Accounts (OPA) at the Reserve Bank on a daily basis. This involves 'sweeping' each agency's balances from accounts with their transactional bank to the OPA at the end of each business day and back again the following morning. 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 has been used only infrequently for many years; it was used last in August 2010.

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 Reserve Bank.

The Reserve Bank's transactional banking services involve the provision of services that are associated with more traditional banking and payments-related activities. Principal among these is the delivery of direct entry payments from government agencies to recipients' accounts – some 285 million direct entry payments, totalling $215 billion, were delivered by the Reserve Bank in 2011/12. The Government also makes payments by cheque, though its use of cheques has fallen in recent years relative to electronic payment methods. Cheques now make up less than 4 per cent of agency payments. 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 BPAY, over-the-counter, phone, internet and card-based payment facilities.

In common with the core banking services, 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. Pro Forma business accounts for transactional banking are provided with the Financial Statements in this Report, on page 115.

Some 90 government agencies are transactional banking customers of the Reserve Bank. The Bank typically works closely with these agencies to ensure that they have access to services that are consistent with their needs and those of the public. In recent years, as the banking requirements of the government and its agencies have broadened, the Bank has done this by combining its specialist knowledge of the government sector with specific payments services and products from commercial providers. During 2011/12, for example, the Reserve Bank assisted one customer, the Department of Human Services, to reduce its reliance on cash in favour of electronic transactions through a debit card network as a way of making real-time over-the-counter payments. The new arrangements are expected to reduce the Department's processing costs without its customers losing the convenience typically associated with receiving payments in cash. The Bank expects to make greater use of combined service arrangements as the Government's banking needs continue to evolve.



The Reserve Bank also continued to work closely with other payments industry participants to improve important elements of the payments system infrastructure that will benefit all users, including the Bank's government clients. The 2011 Annual Report noted that the Bank was working with industry participants to develop a service, known as the Low Value Settlement Service (LVSS), to facilitate improved arrangements for settling low-value payments. The first phase of this project, which allows industry participants to provide settlement instructions for low-value clearings around the same time that clearing activity takes place, was completed in May 2012. Additional information is provided in the 'Settlement Services' section of this chapter.

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. During 2011/12, the Bank completed a significant upgrade of its online banking systems – RBAnet and ReserveLink – combining them into one platform that allows customers to access a broad range of banking services. The Bank also completed scoping the requirements for a major program of work to upgrade its remaining banking systems. The redevelopment work – which formally commenced in July 2012 and will occur in stages over a number of years – will use a combination of in-house development staff and external providers to migrate the existing systems to a more contemporary programming language and architecture. A Steering Committee, comprising senior Reserve Bank staff, is overseeing the program.

After-tax earnings from the Reserve Bank's transactional banking services were $4.8 million in 2011/12, similar to the previous year.

Registry

The Reserve Bank has for many years provided registry services to the Australian Government. The services are undertaken under agreement with the AOFM and include registration of new issues of Commonwealth Government securities (CGS), ongoing maintenance of ownership records, distribution of interest payments and redemption of securities at maturity. After a review of arrangements last year, the AOFM announced that it will commence purchasing its registry services for CGS from a commercial provider during the course of 2012/13.

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

Earnings after tax for the registry business were $0.1 million in 2011/12, similar to earnings in the previous year.

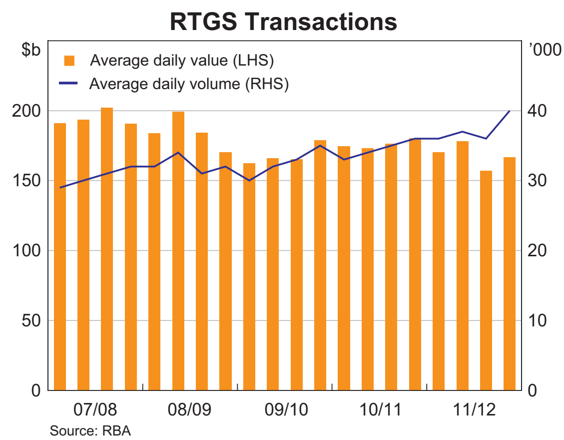
Settlement Services

The Reserve Bank owns and operates the Reserve Bank Information and Transfer System (RITS), which provides a real-time settlement service for institutions approved to operate an Exchange Settlement Account (ESA) with the Bank. At end June 2012, there were 59 such approved institutions; 23 other institutions hold an ESA but have appointed another ESA holder to act as a settlement agent in RITS. A further 32 institutions were Non Transaction Members of RITS in order to participate in the Bank's domestic open market operations.

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

In addition to RTGS payments, RITS settles batches of payments where many underlying transactions are either netted or settled simultaneously. One batch settlement is for payments arising from cheque, direct entry and retail card transactions that are cleared through low-value systems prior to settlement across RITS, currently at 9.00 am on the next business morning. Another daily batch is for settlement of payments arising from equity transactions, and is managed by the Australian Securities Exchange as Batch Administrator.

The average daily value of RTGS transactions settled across RITS fell by 4.5 per cent in 2011/12, to $168 billion. This compares with an average of $194 billion in 2007/08 before the global financial crisis. RTGS transaction values have fallen in three of the past four financial years. By contrast, the daily number of RTGS transactions has grown strongly in recent years and averaged 37 100 in 2011/12, around 20 per cent higher than in 2007/08.



The RITS Low Value Clearing Service (LVCS) allows RITS Members to exchange low-value payments files (such as for the direct entry system used for payroll credits) across different networks, either SWIFT or an industry Community of Interest Network (COIN). This means that an institution preferring to use one network for file exchanges does not need to connect to the other network to exchange files with participants preferring to use the other network. The LVCS has been operational since June 2010 and is used by nine institutions to exchange files for 13 RITS Members.

Reflecting the critical importance of RITS to the Australian financial system, the Reserve Bank invests significantly in its technical and business infrastructure and operational resourcing. This is to ensure that RITS operates to extremely high standards of availability and resilience, and that its settlement services evolve to meet the changing needs of the payments system. In managing RITS, the Bank aims to recover its operating costs from RITS Members. Capital and development costs of major upgrades and functional enhancements, such as the examples below, are absorbed by the Bank as a policy-related expense.

As part of the ongoing program to maintain and enhance the RITS technical architecture, the SWIFT infrastructure that supports RITS and the Reserve Bank's own high-value payment transactions and that of its official customers was replaced in 2011/12. The new infrastructure has resulted in a significant improvement in performance. On 12 June, the highest volume day during 2011/12, throughput rates were equivalent to processing the day's total SWIFT payments volume in less than one hour, an 80 per cent improvement on that recorded on a similar peak day during the previous financial year.

Major infrastructure work planned for completion in 2012/13 includes an upgrade of the RITS certificate authority, which provides security credentials for accessing and operating the RITS user interface. Work will also commence on the replacement of the core RITS platform, which provides the RTGS queue and related ESA settlement processing.

The 2011 Annual Report described work to develop the RITS LVSS, which enables RITS Members to provide settlement instructions to RITS for low-value clearings (such as the direct entry system and cheques) at around the same time as clearing activity takes place between institutions. The LVSS builds on the technical infrastructure for the LVCS. Changes to RITS for this service were implemented in stages during 2011/12.

The LVSS replaces legacy arrangements whereby the settlement instructions for all clearing information exchanged during the day is aggregated and sent to the Reserve Bank on the evening of exchange, prior to settlement across RITS at 9.00 am on the next business day. In May 2012, settlement instructions for the direct entry system commenced using the new arrangements and it is expected that remaining low-value clearings will migrate to the LVSS by October 2012.

Initially, settlement of all these clearings will continue to be at 9.00 am on the business day following exchange. However, the changes made to RITS for the LVSS will also enable settlement for these low-value clearings to occur on the same day as clearing files are exchanged. This 'same-day settlement' for the direct entry system is one of the objectives noted in the conclusions of the 'Innovation Review of the Payments System Board', and is expected to be implemented by the end of 2013.

Over the coming year, the Reserve Bank will be considering further enhancements to RITS and related payments services to assist in meeting some of the objectives of the Innovation Review. These will include improvements in the Bank's LVCS to provide the capability to split and sort bulk files and produce a settlement instruction for the LVSS.

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

The Reserve Bank provides settlement and safe custody services to around 50 overseas central banks to settle their Australian dollar transactions. Reflecting increased overseas demand for Australian dollar investments, the amount held in custody by the Bank for these institutions increased by \$21.3 billion to \$62.2 billion over the year.

Currency

The Reserve Bank is responsible for ensuring that there are sufficient high-quality banknotes in circulation to meet the public's 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:

- ensures that sufficient banknotes are printed 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 2012 there were around 1.1 billion banknotes worth $53.6 billion on issue. The $50 and $100 banknotes continue to account for the majority of banknotes on issue, with a combined share of 91 per cent of the value and 65 per cent of the number of banknotes in circulation.

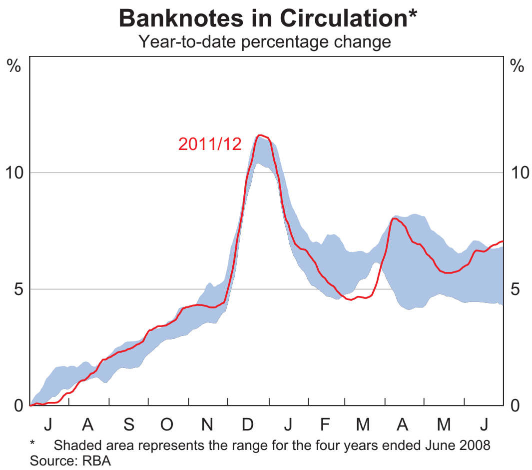
Banknotes on Issue
$ million

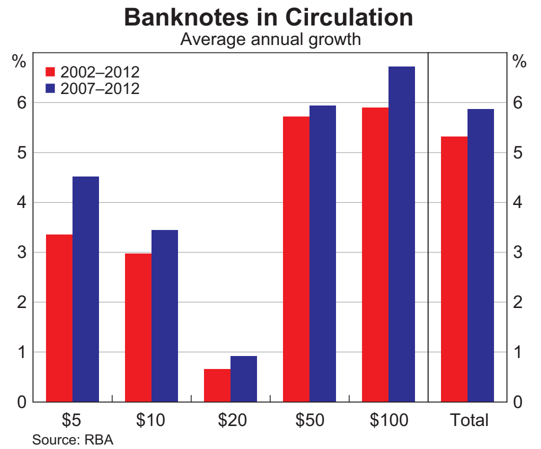
At end June	$5	$10	$20	$50	$100	Total
2004	533	791	2 533	15 941	14 224	34 022
2005	539	837	2 584	16 740	14 924	35 624
2006	572	857	2 690	18 044	15 903	38 066
2007	591	894	2 846	19 228	16 730	40 289
2008	614	917	2 732	20 111	17 690	42 064
2009	644	954	2 651	23 721	20 117	48 087
2010	673	983	2 653	23 711	20 740	48 760
2011	731	1 010	2 796	24 288	21 234	50 059
2012	737	1 059	2 980	25 663	23 156	53 595

Source: RBA

The value of banknotes on issue increased by 7.1 per cent in 2011/12. Following sharp growth in demand for banknotes immediately after the global financial crisis, and subdued growth in the ensuing two years, growth in banknote demand over the past year has returned to levels consistent with that experienced in the years leading up to the financial crisis.

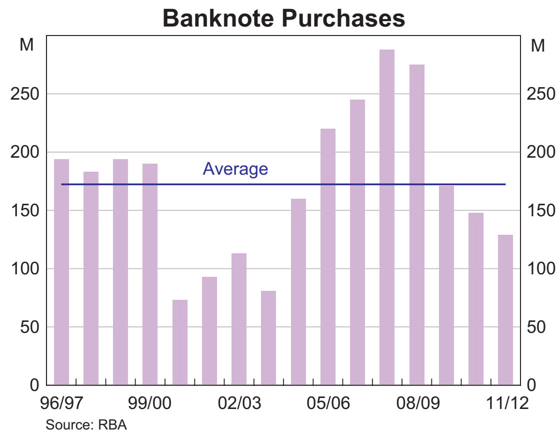
The average annual rate of growth in the total value of banknotes on issue over the five years to June 2012 was 5.9 per cent, which is slightly above the average annual growth rate of 5.3 per cent over the past 10 years. Demand for all denominations of banknotes has been growing more strongly in recent years. The aggregate growth in banknotes on issue is driven by stronger growth in the high-value denominations.





New Banknote Purchases

The Reserve Bank purchased 129 million banknotes from Note Printing Australia Limited (NPA) in 2011/12, 19 million fewer banknotes than in 2010/11. The Bank's purchases consisted of 29 million $5 banknotes, 29 million $10 banknotes, 40 million $50 banknotes and 31 million $100 banknotes. No $20 banknotes were purchased.



Distribution

The Reserve Bank maintains a contingency holding of banknotes to meet seasonal fluctuations in demand, and to mitigate the risks associated with systemic shocks and production disruptions. The Reserve Bank and the major commercial banks have established arrangements to ensure that the commercial banks can access these banknotes to meet their customer needs. The commercial banks also have large banknote holdings at cash-in-transit company depots and their branches throughout the country to ensure there is sufficient stock to meet normal and unexpected demand.

As noted above, demand for banknotes has typically grown at around 5–6 per cent per year. However, the pattern of growth within each year is highly seasonal. The major commercial banks can purchase banknotes from the Reserve Bank throughout the year but, in general, the majority are purchased during the months leading up to Christmas and Easter. In January and after Easter, the commercial banks sell banknotes back to the Reserve Bank that are deemed fit for circulation but surplus to their requirements. In addition, throughout the year the commercial banks return to the Reserve Bank banknotes that they deem are not suitable for circulation (see below).

Over 2011/12, the Reserve Bank issued 243 million banknotes to the major commercial banks, of which 121 million had previously been in circulation and 122 million were new. On the other side, the Bank received about 182 million banknotes from the commercial banks in 2011/12, including 93 million surplus fit banknotes and 89 million banknotes deemed no longer fit for circulation.

Banknote Quality

The Reserve Bank aims to maintain a high quality of banknotes in circulation in order to ensure they meet the functional requirements of the public, and to make it more difficult for counterfeits to be passed or remain in circulation. Achieving these objectives is important to maintaining public confidence in Australia's banknotes.

The commercial banks and cash-in-transit companies play an important role in achieving the Reserve Bank's quality objectives. For this reason, the Reserve Bank provides incentives for the major banks and cash-in-transit companies to remove unfit banknotes from circulation. These arrangements enable cash industry participants to invest in banknote processing equipment, which enhances their ability to sort banknotes and remove poor-quality banknotes from circulation.

Banknotes that are determined to be unfit by the commercial banks and cash-in-transit companies are returned to the Reserve Bank's National Note Processing and Distribution Centre (NNPDC), where their authenticity and quality is confirmed. Banknotes that are confirmed as being unfit are destroyed and fit banknotes are packaged for reissue. Of the banknotes returned to the NNPDC and processed during 2011/12, 88.9 million were deemed unfit and destroyed.

Periodically, banknotes are damaged in circulation beyond the normal levels of wear and tear. The Reserve Bank's policy is to pay value for severely damaged banknotes that can be verified as being genuine. This includes banknotes that are damaged or contaminated as a result of natural disasters. Most damaged banknotes receive full value, but where a large piece of a banknote is missing, partial value is paid.

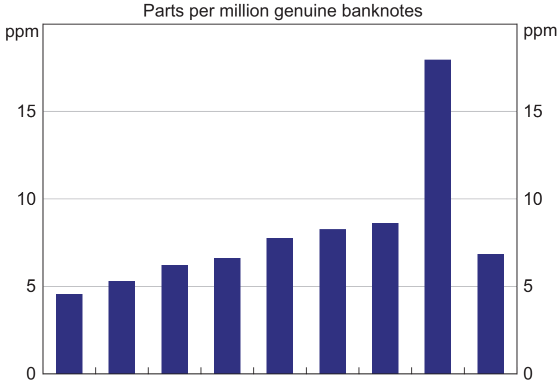
All damaged and contaminated banknotes are returned to the Reserve Bank for validation, assessment and destruction. In 2011/12, the Reserve Bank processed around 16 900 damaged banknote claims and paid out $6.1 million. This represents a significant decline from the $11.6 million in claims paid in 2010/11, which was boosted by a large number of high-value claims resulting from natural disasters in that year.

Counterfeiting in Australia

In 2011/12, a total of 7 781 counterfeits were detected in circulation with a nominal value of $410 795. This corresponds to around 6.9 counterfeits detected per million genuine banknotes in circulation, a level that is low by international standards. The level of counterfeiting declined substantially from the previous year, following the arrests in November 2010 of several persons allegedly associated with a well-organised criminal operation in New South Wales. The number of counterfeits detected has now returned to levels consistent with previous experience.

Counterfeits Detected

Parts per million genuine banknotes



Source: RBA

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

Counterfeit Banknotes in Australia
2011/12

	$5	$10	$20	$50	$100	Total
Number	13	56	186	6 923	603	7 781
Nominal value ($)	65	560	3 720	346 150	60 300	410 795
Parts per million	0.1	0.5	1.3	13.6	2.7	6.9

Source: RBA

Community Liaison

The Reserve Bank is actively involved in a number of banknote awareness initiatives involving law enforcement agencies and the community. During the year, counterfeit information sessions were conducted with state police in New South Wales, South Australia and the Northern Territory. Presentations have also been conducted for business, school and community groups with the aim of increasing knowledge about banknotes in the community.

Banknote Research and Development

The Reserve Bank conducts a research and development program that examines innovative technologies and develops features that can enhance the security of polymer banknotes. As part of this program, the Bank collaborates with a range of third parties, including private companies, research institutions and universities. The Reserve Bank also cooperates with other central banks to explore issues and develop research programs regarding counterfeit deterrence.

In 2011/12, the Reserve Bank continued its involvement in two major international initiatives related to the combat of counterfeiting: the Central Bank Counterfeit Deterrence Group, a working group of central banks and banknote printing authorities that monitors and responds to threats posed by emerging counterfeiting technologies; and the Reproduction Research Centre, an anti-counterfeiting testing facility operated by a small group of central banks.

Numismatic Banknote Sales

The Reserve Bank conducted numismatic banknote sales in July and August 2012 for all denominations of banknotes produced in 2011. These banknotes were sold to the public at fixed prices during a six-week sale period.

Note Printing Australia

Note Printing Australia Limited (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 established by the Reserve Bank Board. Specifically, NPA's prime function is the efficient and cost-effective production of Australian banknotes of high quality and security, in accordance with the specifications and requirements of the Bank. The charter also permits NPA to undertake other 'non-core' activities, including the development and production of passports for the Department of Foreign Affairs and Trade (DFAT), as well as the production of 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. In all of these 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 2012, the Board comprised five Bank executives: Michele Bullock, Assistant Governor (Currency) as Chair; Keith Hall, Assistant Governor (Banking and Payments); Darryl Ross, Chief Financial Officer; Lindsay Boulton, Head of Banking Department; and Michelle McPhee, Head of Risk Management. The Chief Executive Officer of NPA is Bernhard Imbach.

In 2011/12, NPA delivered 129.1 million banknotes for Australia and 139.3 million banknotes to other countries, including Chile, Brunei and Papua New Guinea. NPA also produced 1.8 million passports for DFAT over the year.

NPA recorded a loss after tax of $1.9 million in 2011/12, compared with a profit of $4.4 million in 2010/11. The financial accounts of NPA are consolidated with those of the Reserve Bank.

Securency

Securency International Pty Ltd manufactures polymer substrate for banknotes used in Australia and many other countries. It is a joint venture between the Reserve Bank and Innovia Films, a UK-based company that makes the base polymer film used by Securency to manufacture its substrate products.

Securency is governed by a Board of Directors, comprising equal numbers of directors appointed by the two joint-venture partners and the Managing Director. At present, the Reserve Bank appointed directors are Darryl Ross (Chairman) and John Akehurst, a non-executive member of the Reserve Bank Board.

In late 2010 the Reserve Bank and Innovia Films announced their intention to undertake a joint sale of the company. This joint process was terminated late in 2011, after Innovia advised the Bank that it was no longer a seller. The Bank continues to explore divestment of its interest in Securency.

Proceedings against NPA and Securency

As noted in the 2011 Annual Report, NPA and Securency were charged in July and August 2011 with conspiring to bribe public officials in a number of countries during the period between 1999 and 2004. Additional charges were laid against NPA in September 2011. A number of former employees of NPA and Securency, including a former Chief Executive of each of these companies, were also charged. Over 2011/12, NPA and Securency continued to cooperate with the Australian Federal Police and the Commonwealth Director of Public Prosecutions.

International Financial Cooperation

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

Group of Twenty (G-20)

The G-20 continues to facilitate international cooperation on economic and financial policy issues. G-20 Leaders met in Cannes in November 2011 and in Los Cabos in June 2012, with much of the ongoing work continuing to be overseen by finance ministers, central bank governors, and their deputies. At the Cannes Summit, it was announced that Australia would be the host country for the G-20 in 2014.

At the Cannes and Los Cabos Summits, G-20 Leaders released 'Action Plans' for the 'Framework for Strong, Sustainable and Balanced Growth'. The Framework is a mechanism under which G-20 members collectively assess whether their policies are consistent with these three aims, and endorse further policy actions as necessary. Ensuring that G-20 members are accountable for meeting their commitments contained in these action plans has been a focus of the Framework process, and the first assessment of progress in meeting past commitments was completed in 2012. The Reserve Bank and Australian Treasury are members of a working group that is guiding this exercise.

Reform of the international monetary system has been a priority for the G-20 in recent years, and work on this topic is currently being taken forward by a working group on the International Financial Architecture (co-chaired by the Australian Treasury). The Reserve Bank also made regular contributions to the G-20's work in this area over the past year. The G-20 helped facilitate an agreement to increase the resources available for International Monetary Fund (IMF) lending (discussed below), and has provided input into discussions on IMF surveillance and the IMF quota formula. At the Cannes Summit, leaders also released a set of principles for cooperation between the IMF and regional financial arrangements, and endorsed an Action Plan for local currency bond markets.

The Reserve Bank has actively contributed to the G-20's work on commodities. In November 2011 the G-20 published a study group report on the determinants of commodity price volatility, while the focus in 2012 has been on the macroeconomic consequences of price movements.

Another ongoing priority for the G-20 is financial regulation. This year's work has focused on implementation of agreed reforms, such as the Basel III capital and liquidity standards.

Financial Stability Board (FSB)

Since the financial crisis began, the FSB has played a central role in improving the international financial architecture – the set of rules, standards and institutional frameworks relevant to financial regulation and financial institutions. FSB members include representatives from 24 economies (including all the G-20 countries), 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).

The Reserve Bank, which along with the Australian Treasury represents Australia on the FSB, has remained actively engaged with the FSB over the past year. The Governor is a member of the FSB Plenary (the ultimate decision-making body) and two of the FSB's committees. The Head of Financial Stability Department is a member of a group that provides analytical support on assessing global financial vulnerabilities. The Bank is also involved in several specific FSB working groups, as detailed below.

The FSB has continued to regularly assess vulnerabilities in the global financial system, as well as coordinating, and in several cases initiating, international reform efforts in key areas relating to financial stability. As discussed in the March 2012 *Financial Stability Review*, a high priority for the FSB over recent years has been dealing with systemically important financial institutions (SIFIs), to address the 'too-big-to-fail' problem they can engender. At their November 2011 Summit, the G-20 Leaders endorsed a policy framework for SIFIs that the FSB had developed in close coordination with the BCBS. Some specific elements of this framework focus on institutions that are systemically important in a global context (G-SIFIs) to reflect the greater risks these institutions pose to the global financial system. As part of this policy framework, the BCBS finalised a methodology for identifying global systemically important banks, including additional capital requirements that will apply to them. Another key part of the framework is a new standard on effective resolution regimes, which promotes the essential features that countries should have in their resolution frameworks for financial institutions.

With the G-SIFI framework now largely established, the G-20 asked the FSB to extend the G-SIFI framework to domestic systemically important banks, a project being undertaken by the BCBS (discussed further below). The FSB is also coordinating SIFI work in other areas. For example, an FSB workstream, in consultation with the International Organization of Securities Commissions (IOSCO), is developing methodologies for identifying global systemically important non-bank financial entities. A Reserve Bank officer is involved in this work. Another FSB workstream, in conjunction with the International Association of Insurance Supervisors, issued its proposed identification methodology for global systemically important insurers.

The FSB has continued its efforts to strengthen the regulation and oversight of the 'shadow banking' system, i.e. those non-bank financial institutions that engage in bank-like activities and hence are in the credit intermediation chain but do not face the same prudential regulation as banks. In October 2011, the FSB released a report outlining high-level principles for monitoring shadow banking systems. Following that report, five workstreams were established to develop policy recommendations, focusing on the following activities/entities: banks' interactions with shadow banking entities; money market funds (MMFs); shadow banking entities other than MMFs; securitisation; and securities lending and repos. The five workstreams are scheduled to provide their recommendations by the end of 2012. The Reserve Bank is represented on the third and fifth workstreams.

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

- monitoring, and facilitating, the progress of reforms of over-the-counter (OTC) derivatives markets to meet G-20 commitments, to reduce the scope for contagion
- reviewing progress towards implementation of its 2010 recommendations to improve the intensity and effectiveness of SIFI supervision as well as the additional recommendations in its October 2011 *Progress Report on Implementing the Recommendations on Enhanced Supervision*. A senior official from the Australian Prudential Regulation Authority (APRA) has been contributing to the FSB's work in this area
- releasing in April 2012 the *FSB Principles for Sound Residential Mortgage Underwriting Practices*, which is a principles-based framework to promote sound lending practices. The Head of Financial Stability Department was part of the expert team that developed these principles

1 For further detail, see *Financial Stability Review*, March 2012.

- sponsoring the development of a common global standard for legal entity identifiers, which will uniquely identify parties to financial transactions. This initiative is expected to enhance financial stability by, for example, improving risk management in firms. The standard has now been issued by the International Organization for Standardization and the identifiers are expected to be in use from March 2013.

In May, the Governor attended a meeting of the new FSB Regional Consultative Group (RCG) for Asia, which is one of six regional groups established as part of the FSB's outreach activities. Comprising FSB members and non-members from the region, the Asia RCG discussed current vulnerabilities in the global financial system, as well as key topics on the FSB work agenda, and provided an opportunity for non-members to have an input into the FSB policymaking process.

In early 2012, a senior officer from Financial Stability Department was seconded to the FSB for eight months, to assist the FSB in its work projects and to enhance the links between the two organisations.

Bank for International Settlements (BIS)

The BIS and its associated committees continue to 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 economic conjuncture, discuss vulnerabilities in the global financial system and other issues affecting the operations of central banks.

The Governor or Deputy Governor attends the regular bimonthly meetings of governors at the BIS. Over the past year, in addition to the conjunctural discussion, issues discussed have included the risks associated with high public debt levels, the effects of central bank bond-purchase programs, and OTC derivatives markets reform. The Governor or Deputy Governor also participates in meetings of the Asian Consultative Council, which focuses on financial and monetary developments in Asia and provides direction for the work of the BIS in Asia.

The Assistant Governor (Financial Markets) represents the Reserve Bank on two BIS committees: the Committee on the Global Financial System (CGFS) and the Markets Committee. The CGFS discusses vulnerabilities in the global financial system and structural developments in financial markets, while the Markets Committee focuses on how current events affect the functioning of financial markets. In the past year, the CGFS has considered issues such as access to central counterparties in OTC derivatives markets; global liquidity indicators; the development and selection of macroprudential instruments; and the use of credit ratings by central banks. The Markets Committee had extensive discussion about the various policy initiatives implemented by central banks over the year in response to the ongoing financial turbulence.

The Assistant Governor (Financial Markets) is currently chairing a Markets Committee working group on collateral policies of central banks, while the Head of Domestic Markets Department is currently participating in a CGFS working group on the implications of increased demand for collateral assets. A senior officer from Financial Stability Department is participating in a CGFS working group on the selection and application of macroprudential instruments. In the past year, the Head of International Department participated in a CGFS working group on global liquidity, while a senior officer from Domestic Markets Department participated in a CGFS study group on the system-wide implications of liquidity regulation.

Basel Committee on Banking Supervision (BCBS)

A key aspect of the BCBS' work over the past year has been to encourage and monitor implementation of Basel III, the new capital and liquidity standards that aim to improve the resilience of banks to financial and economic shocks. In January 2012, the BCBS started a comprehensive process to monitor its members' implementation of Basel III. The Assistant Governor (Financial System) and the Chairman of APRA represent Australia on the BCBS, while the Governor and Chairman of APRA represent Australia on the BCBS' oversight body, the Group of Governors and Heads of Supervision (GHOS). This monitoring work is ongoing, and the BCBS provides regular updates on progress to both the FSB and the G-20.

Over the past year, APRA released capital and liquidity proposals, detailing how it will implement Basel III in Australia. To make one of the liquidity requirements workable in Australia, given the limited supply of government securities, APRA and the Reserve Bank have agreed that the Bank will establish a committed liquidity facility that authorised deposit-taking institutions (ADIs) can access, subject to an appropriate fee; the committed amount would cover the shortfall between an ADI's liquid asset holdings and the regulatory requirement (see chapter on 'Operations in Financial Markets' for further information).

The BCBS has also worked, at the request of the FSB, to develop a framework for national approaches to identifying domestic systemically important banks (D-SIBs), which also addresses issues associated with the additional capital that may be imposed on them. A consultation paper outlining a principles-based methodology – which is appropriate given the diversity of national financial systems – was released recently by the BCBS. A senior officer from Financial Stability Department has been involved in the Macroprudential Supervision Group (MPG) of the BCBS that developed the principles. The MPG has also worked on the technical details outstanding on the BCBS' methodology for global systemically important banks (G-SIBs), as well as reviewing the results of the 2010 and 2011 G-SIB data collection exercises and assessments. In its contributions in the MPG on both G-SIBs and D-SIBs, the Bank liaises closely with APRA.

Among the many other projects currently being undertaken by the BCBS is joint work with IOSCO to determine margin requirements for non-centrally cleared derivatives. The Australian Securities and Investments Commission (ASIC) represents Australia on the relevant working group; several senior Bank officers were involved in preparing the associated consultation document which was released recently.

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.

In April 2012, in conjunction with the Technical Committee of IOSCO, the CPSS released new Principles for Financial Market Infrastructures (PFMIs). At the same time, an assessment methodology and disclosure framework was released for public consultation. The PFMIs, which were drawn up by a CPSS-IOSCO Steering Group, including the Bank's Head of Payments Policy Department, seek to consolidate, update and strengthen existing standards for systemically important payment systems, central counterparties and securities settlement systems. They also extend their coverage to trade repositories and incorporate specific guidance for infrastructures serving OTC derivatives markets.

Building upon the PFMIs and work undertaken by the FSB on the resolution of banks, the CPSS and IOSCO have jointly considered recovery and resolution recommendations for financial market infrastructure (FMI). A consultative report was released in July 2012 outlining the issues that should be taken into account for different types of FMI and seeking views on a number of technical points related to these issues. The Reserve Bank contributed to this and other specific workstreams.

One important issue in this area is how to achieve fair and open access to central-clearing services. The Bank participates in work on this topic through its membership of the OTC Derivatives Regulators' Forum, an international group that provides regulators with a means to cooperate and share information in relation to OTC derivatives, central counterparties and trade repositories. Two complementary working groups, one under the CGFS and another under the CPSS-IOSCO, have also considered the question of access and, in November 2011, the CGFS released a report assessing the potential implications for financial stability and efficiency of alternative access arrangements. CPSS-IOSCO addressed similar questions in the PFMIs.

The Reserve Bank also participated in a CPSS working group on innovation in retail payments, which released a report in May 2012, and a joint CPSS-BCBS working group on managing settlement risk in foreign exchange transactions, which released a consultation paper in August 2012.

International Monetary Fund (IMF)

As in recent years, the IMF's work over the past year sought to assess and address the risks to the global economic outlook. The IMF has provided financial assistance to a number of member countries, bolstered its own lending capacity, and made further progress towards reforming its surveillance practices and governance arrangements.

In June 2012, various member countries committed to make a total amount of US$456 billion available for additional IMF lending. Much of this amount had already been committed by April, including a commitment from Australia of US$7 billion. These additional resources will be drawn upon if needed to meet the future financing needs of member countries.

The IMF continued to support its member countries through financial assistance programs over the year in review. The most prominent was the €28 billion extended arrangement for Greece, which was approved in March 2012 as part of a €173 billion package funded jointly by euro area member states and the IMF. The IMF also continued to provide substantial financial assistance, via scheduled disbursements, to Portugal and Ireland under programs that were agreed in 2010/11.

A number of reforms have also been made to the IMF's lending facilities over the past year. The Precautionary Credit Line, which was available only on a precautionary basis, was replaced by the more flexible Precautionary and Liquidity Line, which also allows member countries to access funding when faced with an actual balance of payments need. A new Rapid Financing Instrument was also introduced to assist countries facing urgent balance of payments needs, including those arising from natural disasters, post-conflict situations and commodity price shocks.

The IMF has continued its efforts to improve its surveillance. In 2012, the Fund released a Pilot External Sector Report, which examines the drivers of members' external positions and the associated risks. The IMF Executive Board also approved a new Decision on Bilateral and Multilateral Surveillance, which is designed to facilitate improvements to the coverage and consistency of IMF surveillance.

The package of quota and governance reforms that was agreed in 2010 is still to be implemented, with the aim being to receive the necessary consent from member countries by October 2012. The main reforms include a doubling of quotas, a realignment of quota shares towards 'dynamic' emerging market and developing members, and a shift to an all-elected Executive Board. A review of the quota formula has also commenced, and is due to be completed by January 2013.

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 continued to support the Constituency Office directly by providing an advisor with expertise in financial markets and financial sector issues.

Australia is currently undergoing an IMF Financial Sector Assessment Program (FSAP) review. This is a follow-up to Australia's first FSAP conducted in 2005/06 and is consistent with a recent commitment of FSB members to undergo an FSAP every five years. The focus of FSAP assessments is on the stability of the financial sector and the quality of financial supervisory and crisis management arrangements. A stress test of the banking system and a review of progress in addressing key recommendations from the previous FSAP are also key elements of the current review. The agencies that form the Council of Financial Regulators, including the Reserve Bank, prepared background material for the IMF on Australia's financial regulatory framework, financial crisis management arrangements and financial stability policy framework. An FSAP 'advance mission' visited in May while the main mission visited in July 2012. During their visits, IMF staff held discussions with senior officials from the Bank, Treasury, APRA and ASIC. The IMF also met with private sector banks and non-financial businesses. Given the focus on financial stability, the IMF staff had extensive discussions with senior officers from Financial Stability Department. An overall financial stability assessment by the IMF is expected to be released in late 2012, to coincide with its regular annual review of the Australian economy and policy, known as the Article IV Consultation.

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, to 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 Deputy Governor level, the Monetary and Financial Stability Committee (MFSC) focused on enhancing 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. Over the next two years, the Assistant Governor (Financial Markets) will be chairing the Working Group on Financial Markets, which has responsibility for the analysis and development of foreign exchange, money and bond markets (including the Asian Bond Funds) in the region.

An EMEAP meeting in Auckland in November 2011 was attended by senior EMEAP representatives, including RBA staff

At the Governors' and Deputies' meetings, members discussed issues such as the potential implications of high commodity prices, capital flow volatility and international regulatory developments for the EMEAP region. Members also considered the potential flow-on effects of the European sovereign debt situation and European bank deleveraging.

EMEAP is responsible for the ongoing oversight of Asian Bond Fund 1, a US dollar-denominated Asian bond fund, and Asian Bond Fund 2, comprising eight local currency-indexed bond funds and a Pan Asia Index Bond Fund (PAIF). In May 2012, Deputy Governor Philip Lowe was elected as PAIF Supervisory Committee Chair following Ric Battellino's retirement as Deputy Governor.

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. OECD staff recently held discussions with domestic authorities, including the Reserve Bank, as input for the OECD's next economic survey of Australia, due to be released later in 2012.

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 current financial sector developments in Europe, especially bank deleveraging, the capital market implications of increased longevity, financial education and financial consumer protection.

Government Partnership Fund (GPF)

The Reserve Bank continued its involvement with Bank Indonesia (BI) under the auspices of the Australian Government's GPF. This program supports an exchange of skills and knowledge between Australian public sector institutions and their Indonesian counterparts through a series of attachments and workshops.

In 2011/12, a total of 16 BI officers were attached to the Reserve Bank, bringing the total number of attachments to 145 since the start of the program in 2005/06. The attachments continue to cover policy and operational areas of the Bank, including economic research, payments policy and settlements, financial markets and financial stability, as well as human resources. Among the visits by Reserve Bank staff to BI, Reserve Bank economists participated in a workshop in March 2012 on sectoral analysis, short-term forecasting and financial stability issues, representing the culmination of research work over the previous year.

South Pacific Central Bank Cooperation

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

In December 2011, South Pacific Governors met in Apia, Samoa. This group comprises the central banks of those countries in the region with their own currencies – Australia, New Zealand, Fiji, Papua New Guinea, Samoa, Solomon Islands, Tonga and Vanuatu. Representatives from the IMF's Pacific Financial Technical Assistance Centre also participated in the meeting. The main issues discussed were the effects of slower global growth on the Pacific Islands, economic prospects for the region and the challenges for monetary policy. The Governors also met with the major regional commercial banks to discuss banking issues.

A Reserve Bank officer commenced a two-year secondment to the National Reserve Bank of Tonga in May 2012. Another officer, based in Sydney, is working with the Economics Department of the Reserve Bank of Fiji (RBF) on several research projects and several RBF officers will also participate in a Reserve Bank training course. In addition, the Bank continued to provide financial support to an officer of the Bank of Papua New Guinea (PNG) 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 the Bank of PNG to undertake studies at an Australian university in the areas of economics, finance or computing.

Bilateral Relations and Cooperation

As in previous years, the Reserve Bank continued to receive a number of visitors from overseas. Predominantly from foreign central banks, the visits covered the full range of the Bank's activities and included visitors or delegations from Botswana, Brazil, China, India, Indonesia, Iraq, Korea, Mongolia, the Netherlands and Vietnam.

The Reserve Bank in the Community

Activities of the State Offices

In addition to its Head Office located in Sydney, the Reserve Bank has State 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.

Since 2001, the Reserve Bank has devoted significant resources to building relationships across a broad cross-section of the business community, with a view to gaining firsthand insights into conditions in different industries and regions within the national economy. The staff involved in the liaison program conducted around 900 interviews around the country over the year in review, with information from these meetings reported to Head Office and incorporated in the material prepared for the monthly Board meetings and the quarterly *Statement on Monetary Policy*. In this way, information obtained from liaison is used to complement standard sources, such as data from the Australian Bureau of Statistics and business surveys, in forming the Bank's assessments of the economy.

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

Liaison with Small Businesses

The Reserve Bank continues to convene its Small Business Advisory Panel. This Panel was established in 1993 and meets annually to discuss issues relating to the provision of finance and the broader economic environment

1. Senior Representative Karen Hooper (left) and Economist Marileze van Zyl of the Queensland State Office, on board a helicopter over Curtis Island **2.** A view from the helicopter of one of the LNG plants under construction on Curtis Island for small businesses. Membership of the Panel is drawn from a range of industries across the country. The Panel represents 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.

In May 2012, the Reserve Bank also convened a Small Business Finance Roundtable to better understand current concerns of this sector with regard to access to finance, as well as consider the characteristics of small businesses and the challenges faced by the sector. A summary of the discussion, together with links to the discussion papers presented at the roundtable, is provided in the June 2012 issue of the *Bulletin*.

Museum of Australian Currency Notes

The Reserve Bank's Museum houses a permanent collection of artefacts and also hosts periodic exhibitions. The permanent collection exhibits the story of Australia's banknotes against the backdrop of the nation's broader social and economic history. It displays the types of money used before Federation – from an early colonial rum bottle through to Australia's first gold coins. In a time sequence, 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.

A new 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 money boxes dating from the early 20th century, including the only known example of the first series of the Commonwealth Bank money boxes, and illustrated literature and comic books from the 1950s and 1960s that encouraged children's interest in saving.

Nearly 12 500 people visited the Museum in 2011/12, slightly lower than in the previous two years owing to a brief period of closure. There were over 1 200 visitors on Australia Day 2012, with attendance also boosted by the Reserve Bank's participation in NAIDOC Week, History Week and its collaboration with other museums in the precinct through 'The History Trail' schools program. A wide cross-section of the public visited the Museum, including school groups which accounted for around 20 per cent of total visitors. Many school groups received a short presentation on the role of the Reserve Bank or, in the case of senior economics students, a talk on the Australian economy. Other school groups, including those in junior primary, received presentations on the role of money and features of Australian banknotes. The Museum was also visited by several groups of new migrants learning about the nation's currency. Most of the information in the Museum is on the Bank's museum website, which was renovated during the past year.

Assistance for Research and Education

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

In 2011/12, 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.

1, 2. Over 1 200 people visited the Reserve Bank's Museum on Australia Day in 2012 **3.** Rebecca Oliver (Note Issue Department) talked about banknote security to pupils from Perth who visited the Bank in April 2012 **4.** Antoinette Perri (Note Issue Department) showed some giant-sized copies of banknotes to Year 2 students from Beecroft Primary School during their visit to the RBA in March 2012

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 2011/12, these conferences included the 24th Conference for PhD Students in Economics and Business, held at the University of Queensland; the Economic Society of Australia's 40th Conference of Economists, held in Canberra, and also the 41st Conference of Economists, held in Melbourne; the 17th Melbourne Money and Finance Conference; the Australasian Meeting of the Econometric Society, held at Deakin University; the University of New South Wales 24th Australasian Finance and Banking Conference; the Financial Integrity Research Network PhD Tutorial, held at the University of Queensland; the Paul Woolley Centre's Study of Capital Market Dysfunctionality Conference 2011, held at the University of Technology, Sydney; the National Honours Colloquium at the University of New South Wales; the 7th Annual Workshop on Macroeconomic Dynamics, held at the University of Sydney; the International Schumpeter Society Conference 2012, hosted by the University of Queensland; and the 17th Australasian Macroeconomics Workshop held at Monash University. The Bank also provided financial support for the Annual Meeting of the Asia/Pacific Group on Money Laundering, held in Brisbane.

The total value of support offered for research and education in 2011/12 was $265 000.

The Reserve Bank sponsors an annual essay competition across Australia designed to engage and support undergraduate students of economics. The competition is organised jointly with the University of New South Wales Economics Society. In 2011, students were invited to discuss the economic consequences of natural disasters (against the background of the Queensland floods, Cyclone Yasi and other natural disasters across the nation). Shuanyu Christine Ma (Australian National University) wrote the winning essay, the runner-up was Stephanie Parsons (Griffith University) and the best essay from a first-year student was by Hans Zhu (University of Melbourne). These students were presented with prizes at a ceremony at the Reserve Bank in November 2011. For the 2012 competition, students have been invited to submit an essay on 'China's Economic Performance'.

In conjunction with the Australian Prudential Regulation Authority (APRA), the Reserve Bank has continued sponsorship of the Brian Gray Scholarship Program, initiated in 2002 in memory of a former senior officer of the Bank and APRA. Three scholarships were awarded under this program in 2012. Two are for honours studies (in Economics at the University of Western Australia and Commerce/Science at the University of New South Wales), while the third is for a PhD in Finance at Flinders University. The cost to the Bank of these scholarships in 2011/12 was around $19 000.

Over the past year, the Reserve Bank hosted visits by numerous researchers (including academics, postgraduate students, journalists, heritage architects and designers) who were interested in accessing the rich archive of records about the Bank's own activities as well as banking activities in Australia that predate the creation of the central bank. Archival records have been inherited from other financial institutions and, since the Reserve Bank was formerly the government printer for materials other than banknotes, the Bank's archives also include a historical collection of Australian stamps, vouchers and posters. The Bank dealt with many written requests from researchers that required Bank staff to research and retrieve archival records, and it has provided access to the archives by members of the public making specific enquiries. 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. A program to digitise some of the Bank's most significant historical records is under way, with thousands of records scanned and made available to researchers in 2011/12. Professor Selwyn Cornish of the Australian National University continued his research for the next volume of the official history of the Reserve Bank, covering the period 1975–2000.

Charitable Activities

During the year the Reserve Bank made its 10th annual contribution of $50 000 to the Financial Markets Foundation for Children, of which the Governor is Chairman. In July 2012, in its seventh 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, a major one involving dollar-matching staff payroll deductions to the Reserve Bank Benevolent Fund. In late 2011, the Bank matched donations of $3 665 to the MS Society raised by Reserve Bank staff participating in the 'Sydney to the Gong' charity bike ride.

Reserve Bank staff also interacted with the community in a number of volunteering capacities in the past year, including the Cancer Council's Biggest Morning Tea fundraiser, Pink Ribbon and Daffodil Days, Oxfam Trailwalker and Coastrek for the Fred Hollows Foundation.

The Reserve Bank's contributions under all these initiatives in 2011/12 totalled $112 527. In addition, the Bank facilitates staff salary sacrificing under a Workplace Giving Program.

Management of the Reserve Bank

Operating Costs

Most of the Reserve Bank's operating costs are incurred in pursuing its objectives in the areas of monetary policy and financial stability, from its operational responsibilities in banking and settlements, and in providing currency securely to the Australian community. Specific new initiatives in 2011/12 included establishing a representative office in Beijing in late 2011, to provide enhanced monitoring of economic and financial conditions in China. In addition, there were new business initiatives around enhancing banking and currency systems to ensure that business requirements continue to be met, and in order to improve customer access to these systems. The Bank also began managing some new services for Australian government agencies, which adds to costs but will deliver additional revenue as well. Work health and safety systems were strengthened, especially around risk controls and hazard management, partly in response to new legislative requirements resulting from the introduction of the *Work Health and Safety Act 2011* (WHS Act) on 1 January 2012. The program of upgrading the Bank's financial and administrative systems also continued. Total operating costs, including the program of new initiatives, rose by 5.6 per cent in 2011/12.

Staff costs continue to represent the single largest operating expense for the Reserve Bank, accounting for around 63 per cent of costs in 2011/12. Changing business requirements and efficiency improvements in certain areas led to higher costs of staff redundancies in 2011/12.

Operating Costs[(a)]
$ million

	2007/08	2008/09	2009/10	2010/11	2011/12
Staff costs	119.1	132.6	141.6	148.1	156.7
Other costs	77.2	82.8	83.3	86.0	90.4
Underlying operating costs	196.3	215.4	224.9	234.1	247.1
Cost of redundancies	0.2	2.0	0.5	1.3	1.9

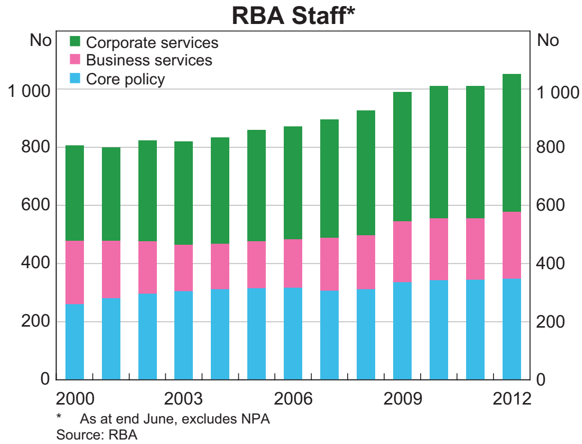
(a) Costs associated with the ongoing operation of the Reserve Bank, excluding Note Printing Australia

Almost half of the Reserve Bank's expenditure arises from activities linked to its responsibilities for formulating and implementing monetary policy, while a little more than 10 per cent derives from its responsibilities for the payments system and financial system stability. About a quarter of costs are incurred in providing banking and payment settlement services, including provision of transactional banking services to agencies of the Australian Government and operating the real-time interbank settlement system. Around 15 per cent of costs are related to issuance and distribution of banknotes.

Composition of Operating Costs
Per cent

	2011/12
Monetary Policy	45
Financial and Payment System Stability	11
Banking and Payment Settlement Services	28
Currency	16

Our People



Over the year to June 2012, the total number of employees at the Reserve Bank increased by 41 to 1 051, a rise of 4.1 per cent. The increase in staff numbers was concentrated in the business and support areas of the Bank and primarily reflected preliminary work to upgrade banking systems. Most employees are located at the Reserve Bank's Head Office in Sydney. Just over 5 per cent of the Bank's workforce works at the Bank's Business Resumption Site in outer Sydney, reflecting the Bank's ongoing focus on risk management and contingency planning. A further 5 per cent are located elsewhere in Australia – at the Bank's Canberra Branch and in the State Offices in Adelaide, Brisbane, Melbourne and Perth. Some Bank staff are also located in Craigieburn, Melbourne, where they undertake banknote research and development, counterfeit examination and facility management functions. (The staff of Note Printing Australia itself are not employees of the Bank.) Staff in the State Offices assist in the Bank's monitoring of economic and financial developments across the country, liaise with individual firms and agencies in both the public and private sectors, and provide a vehicle for communicating the operation of monetary policy to the wider community. The Bank also maintains a presence in London and New York as part of its foreign exchange reserves management and financial market analysis. The Bank's recently established office in Beijing is staffed by one appointment from Head Office and one locally engaged employee.

The Reserve Bank's single largest recruitment exercise continues to be the Graduate Development Program. Thirty-three graduates began the Program this year, accounting for around one-quarter of the Bank's annual recruitment. This share has fallen from one-third last year as the number of people hired on fixed-term contracts to work on Bank projects has increased.

The Reserve Bank's cadetship scheme continues to prove effective as a recruitment vehicle. The program provides two months of work experience, before the university honours year begins, for high-potential students who have completed three years of undergraduate study. The program provides financial support during the honours year for those who accept a place on the next Graduate Development Program. In 2011/12, 40 per cent of the new graduates had previously been cadets.

The Reserve Bank also employed 15 staff under its traineeship scheme. The scheme is designed to assist those without qualifications to enter the workforce, with formal training (and accreditation) forming part of the program.

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 negotiated a new Workplace Agreement during the year, which provided for a 3.5 per cent salary increase in 2011/12 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 in the Workplace Agreement.

The Reserve Bank provides opportunities for staff to engage in continuous professional development with employer support. This takes a number of forms, including financial support for employees undertaking part-time study in disciplines related to their work and for full-time, postgraduate study at universities in

Australia and overseas. 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 Bank has had staff on secondment with the Commonwealth Departments of the Treasury and Prime Minister and Cabinet, the International Monetary Fund, the Bank for International Settlements, the Bank of England, the Bank of Canada and the Reserve Bank of Tonga. At the same time, the Bank has hosted secondees from the Federal Reserve Bank of New York, the Bank of England, the Sveriges Riksbank, the Australian Prudential Regulation Authority (APRA) and the West Australian Treasury.

Facilities

The Reserve Bank owns premises in locations where there is a business need to do so, including its Head Office building in Sydney; a conference/training centre in Kirribilli, Sydney; office buildings in Melbourne and Canberra; the Note Printing Australia facility at Craigieburn, north of Melbourne; and the Business Resumption Site in outer Sydney. In addition to the buildings it owns, the Bank leases accommodation for its State Offices in Adelaide, Brisbane and Perth – where its 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 $0.5 million to $316.4 million in 2011/12. Surplus accommodation in these properties is leased to external tenants; gross income from these leases amounted to $8.0 million in 2011/12.

During the year, the Reserve Bank continued to strengthen the resilience of facilities supporting critical operations. In Melbourne, the auxiliary power generator system was upgraded, ensuring greater reliability in the event of interruptions to the mains supply. A similar upgrade is under way in Head Office and is due for completion at the end of 2012. A program to upgrade the Head Office's hydraulic systems also commenced during the year. The Canberra Branch was refurbished and building services upgraded, significantly improving reliability and energy efficiency. At the Craigieburn facility, the electrical sub-mains were upgraded to ensure greater reliability and adequate electrical supply for future needs.

Environmental Management

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

- reducing energy, water and paper consumption
- increasing the recycling of paper, co-mingled waste and printing cartridges
- adopting environmentally sustainable designs for office fit-outs
- use of 50/50 recycled paper
- greater use of fuel-efficient vehicles.

Significant improvements were achieved during the year in review in energy and water use for most of the Reserve Bank's facilities. This reflects the ongoing results of earlier initiatives and greater emphasis on sustainability and the monitoring of energy and water use. In Head Office, there were reductions in electricity consumption of around 8 per cent and in gas consumption of around 18 per cent, reflecting new operating practices. Smaller reductions were recorded in other sites, with the biggest user of energy – Craigieburn –

achieving a reduction in electricity consumption of around 7 per cent. Water consumption was reduced across the Bank's facilities by 3 per cent; the largest reduction was achieved in Head Office, with a decline of around 14 per cent.

The volume of waste produced by the Reserve Bank fell by 25 per cent during the year, mainly owing to lower production levels at Craigieburn. As a result, the proportion of recycled waste fell slightly. The acquisition of hybrid and diesel vehicles for the pool fleet is another initiative that is helping to reduce the Bank's overall environmental impact.

The Reserve Bank's EMC will continue to set targets to facilitate further reductions in energy and water consumption, and it is also pursuing opportunities already identified to reduce gas and electricity consumption further.

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 five years is shown below.

Spending on Consultancies[(a)]
$

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

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

In 2011/12, the largest expenditure on consultants was for advice on compliance with new work health and safety legislation. Other consultancies covered communication, corporate governance, crisis management, data security, remuneration and banknotes.

Risk Management

Objectives and Governance Structure

The Reserve Bank is exposed to a broad range of risks in carrying out its responsibilities. The most significant risks are those associated with the financial assets held by the Bank to support its operations in financial markets. However the Bank also faces operational risks through its banking, settlement and note issue functions and from the administration of the organisation itself. As with most central banks, the Reserve Bank seeks to manage its risk profile carefully. This reflects the view that the fulfilment of its policy objectives and other functions would be jeopardised if the risks it faces were not managed to the appropriate standard. That said, the Bank recognises that it cannot entirely eliminate the risks involved in its activities and seeks to manage those risks to a level consistent with its risk appetite.

Under the Reserve Bank's risk management framework, prime responsibility for the identification and control of risks on a day-to-day basis rests with the management function of each operational area. This is based on the recognition that line managers are best placed within the organisation to evaluate their risk environment and develop and monitor the effectiveness of the controls which are put place to mitigate these risks. The Bank's management also promotes an active risk management culture, which emphasises that careful analysis and control of risk is vital to achieving all business and policy objectives successfully.

Oversight of the Reserve Bank's arrangements for risk management is undertaken by the Risk Management Committee. This Committee is chaired by the Deputy Governor and comprises the Assistant Governors for Banking and Payments, Corporate Services, Currency and Financial Markets; the Chief Financial Officer; the Heads of Audit, Human Resources and Risk Management; and the General Counsel and Deputy Secretary. It is responsible for ensuring that all the risks facing the Bank – with the exception of those arising directly out of the Bank's monetary, financial stability and payments policy functions – are effectively evaluated and managed. The Committee meets every three months, or more frequently if required, and informs the Executive Committee and the Reserve Bank Board's Audit Committee of its activities.

The Risk Management Committee is assisted in its responsibilities by the Risk Management Unit (RMU). The Unit's main role is to help departments identify, evaluate and mitigate their risk environment within a broadly consistent framework across the Reserve Bank. It also monitors performance and risk associated with the Bank's activities in financial markets and provides support to the business areas in the implementation of fraud control systems. The RMU reports directly to the Deputy Governor.

The Audit Department coordinates closely with – but remains separate from – the RMU. Audit provides an independent assurance that the risk management framework is effective and applied across the Reserve Bank. The Audit Department also has a separate brief to test the adequacy of procedures and controls at all levels of the Bank. The RMU itself is subject to audit review. The Audit Department reports to the Board's Audit Committee, which meets quarterly or more frequently if required.

As noted, the Reserve Bank's risk management policy covers financial, market, credit, operational and other risks inherent in carrying out its central banking activities, but not the risks associated with the Bank's core monetary, financial stability and payments policy functions. These remain the responsibility of the Governor and the Reserve Bank and Payments System Boards. Governance of the business risks in Note Printing Australia

Limited and Securency International Pty Ltd – companies that are respectively fully owned and partly owned by the Reserve Bank – is the responsibility of the boards of the companies. Over the past year, the reporting arrangements for these boards to the Reserve Bank Board were strengthened.

Portfolio Risks

The Reserve Bank holds domestic and foreign currency-denominated financial instruments to support its operations in financial markets in pursuit of its policy objectives. These instruments comprise the bulk of the Bank's assets and expose the balance sheet to financial risks, the largest of which are exchange rate risk, interest rate risk and credit risk. The Bank aims to minimise risk where appropriate. It does not entirely eliminate these portfolio risks as this would interfere with its ability to implement its policy objectives. Instead, the risks are managed to an acceptable level through a number of controls, which are discussed below. The primary responsibility for managing these risks rests with the Financial Markets Group. The role of the RMU is to monitor these risks and ensure ongoing compliance with the control framework. 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.

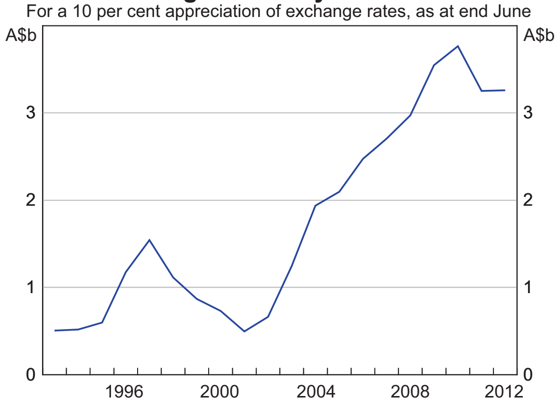
Exchange rate risk

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 Reserve 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. There was no change in the currency composition of the foreign portfolio over the past year. The allocations are 45 per cent in US dollars, 45 per cent in euros, 5 per cent in Japanese yen and 5 per cent in Canadian dollars (see chapter on 'Operations in Financial Markets').

The exchange rate risk on the portfolio is similar to that of a year earlier, as the value of the foreign currency reserves portfolio was broadly unchanged in Australian dollar terms. At the current level of reserves, a 10 per cent appreciation in the Australian dollar would result in valuation losses of around $3.3 billion.

Exchange Rate Risk on RBA Foreign Currency Portfolio

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



Source: RBA

Interest rate risk

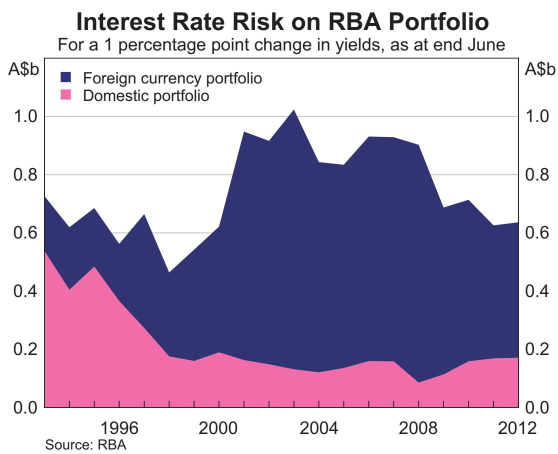
The value of the Reserve Bank's financial assets is also exposed to movements in market interest rates as the bulk of the portfolio is made up of domestic and foreign fixed-income securities. As the cashflow on these securities is fixed, changes in market yields affect the present value of this income stream. In general, a rise in market yields will cause a fall in the value of these securities while a fall in 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 and will be more sensitive in present value terms to discounting than near-term cashflows.

The Reserve Bank holds domestic securities for policy-related purposes. At the end of June 2012, total holdings of domestic securities were $33 billion, around $1 billion higher than a year earlier owing to an increase in holdings of securities held under repurchase agreements (repos). The sensitivity of the domestic portfolio to movements in market yields was little changed, as the bulk of domestic securities are held under repos with short terms to maturity. The average term of the Bank's domestic repo book at the end of June was around three weeks.

The Reserve Bank is exposed to very little interest rate risk on its balance sheet liabilities. Banknotes on issue comprise around two-thirds of total liabilities and carry no interest cost to the Bank. The most significant of the other liabilities are deposits held by the Australian Government and government agencies, and settlement balances held by authorised deposit-taking institutions (ADIs). These deposits have short maturities that broadly match 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 remained at 18 months for the US, European and Canadian portfolios and 12 months for the Japanese portfolio.

The overall level of interest rate risk on the Reserve Bank's domestic and foreign financial assets rose marginally over the year. The Bank would incur a valuation loss of about $640 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. 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. The residual exposure is low – the Bank faces a loss only if the counterparty fails to repurchase securities sold under repo and the market value of the securities falls below the agreed repurchase amount.

The Reserve Bank manages this exposure by applying an appropriate margin ('haircut') to the securities and requiring that these securities be of high quality. In February, the Bank implemented a new initial margin framework and reviewed the range of securities it is willing to accept under repo in its domestic market operations. The degree of over-cover required now ranges from 1 to 23 per cent, and increases with the risk profile of the security. Given its policy role, the Bank does not apply specific credit criteria on the counterparties with which it is willing to deal in its domestic market operations. Rather, to be eligible to participate in the Reserve Bank's open market operations, counterparties must be members of the Reserve Bank Information and Transfer System (RITS) and be able to ensure efficient and timely settlement of transactions with membership of 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, and 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 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 rated at least A-. The Bank has sought to reduce risk associated with foreign exchange swaps further by adding an additional level of legal protection. Internationally recognised two-way credit support annexes (CSAs) are being implemented by the Bank to collateralise its foreign exchange swap transactions. This will involve 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 Risks

As part of its day-to-day activities, the Reserve Bank faces risks that can affect the operation of its systems or prevent its internal processes from functioning effectively. These operational risks are similar to those faced by other financial institutions, and are monitored carefully to ensure that the services delivered by the Bank are maintained at the highest possible standard.

While all parts of the Reserve Bank face operational risks of varying degrees, the most significant are those associated with the financial transactions undertaken by the Bank either to support its own activities or on behalf of its clients. Over the course of 2011/12, the Bank's Financial Markets Group executed around 73 000 transactions, generating an average daily settlement value of around $27 billion. This is broadly in line with recent years.

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 RITS. Given the pivotal nature of these activities, any operational failure could have widespread consequences for the financial system. As such, the Bank's risk management framework supports a continuing focus on controlling the main operational risks associated with these functions.

The information technology (IT) systems that underpin the Reserve Bank's policy and business operations are highly complex and require ongoing maintenance and support. The framework in place to manage the risks associated with these systems is controlled by extensive monitoring, reconciliation and reporting functions. In addition to this, Bank staff are constantly evaluating IT industry developments to ensure its systems reflect current technology and remain robust. The Bank has an ongoing program, conducted under standard guidelines for project management, to manage any enhancements to infrastructure or applications. 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 put in place where required. Assessment 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.

Given the nature of its activities, the loss of Head Office facilities or IT systems caused by a natural disaster or other disruptive event represents a key risk to the Reserve Bank. As such, extensive back-up plans and capacity have been put in place to ensure continuity of critical business services if access to Head Office facilities and IT systems is lost. The Bank's Business Resumption Site (BRS), located north-west of the Sydney metropolitan area, is central to these arrangements. Some staff are based permanently at the site to ensure that a number of critical services can be maintained if Head Office is unexpectedly inaccessible. In addition, all business areas regularly test their back-up arrangements to cover a range of contingency scenarios, including working from the BRS or an alternative location. The results of the tests are monitored by the Risk Management Committee. During the year in review, three Bank-wide tests were conducted at the BRS, including tests covering a total loss of both facilities and systems at Head Office.

A significant operational risk facing any financial institution is that its staff may engage in fraud or undertake unauthorised transactions, exposing the institution to significant financial loss or reputational damage. The Reserve Bank has an ongoing program to evaluate fraud risks and enhance its fraud control structures. These include having a clear decision-making hierarchy, with all staff involved in financial dealing having well-defined limits to their authority to take risks or otherwise commit the Bank, and controls over computer access at both the user and administrator levels. These arrangements are further enhanced by independent front-, 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 within the organisation. Regular staff training in fraud awareness is also conducted and monitored to ensure that all staff are actively engaged in fraud prevention.

The Reserve Bank's employee Code of Conduct outlines the high standard of integrity and propriety that is expected of staff in carrying out their duties. The Fraud Control Policy and arrangements by which suspicious behaviour can be reported anonymously are part of this framework, 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.

Government Guarantee Scheme

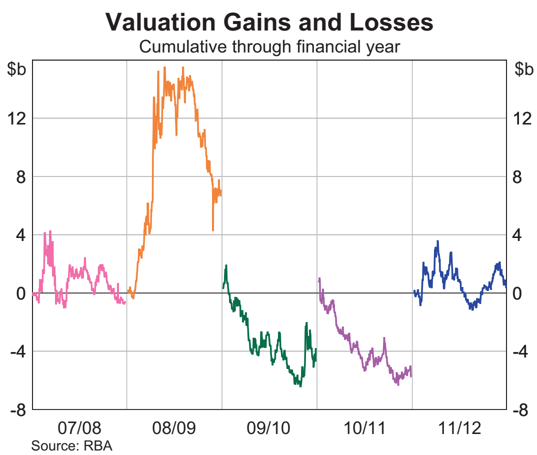
The Reserve Bank manages on behalf of the Government the Guarantee Scheme for Large Deposits and Wholesale Funding and the Guarantee for State and Territory Borrowing. Applications for new guaranteed liabilities under both schemes have closed, but the Bank continues to have responsibility for collecting fees on existing liabilities. A total of $0.9 billion in fees was collected on behalf of the Government in 2011/12.

Earnings and Distribution

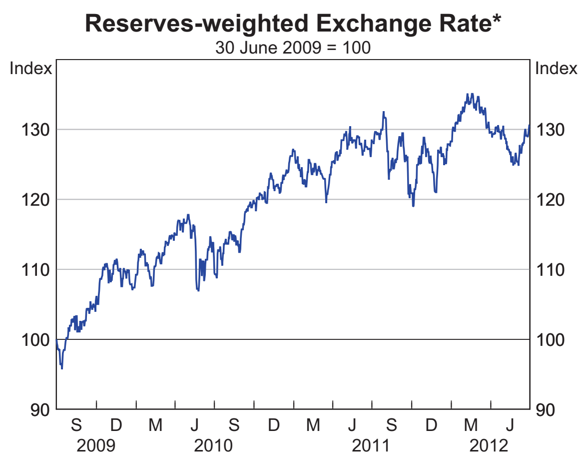
The Reserve Bank's balance sheet is largely made up of financial assets, primarily used for the purpose of conducting operations in financial markets in pursuit of monetary policy objectives. These assets include Australia's foreign exchange reserves as well as domestic securities used to carry out liquidity management operations. The counterpart liabilities to these assets are banknotes on issue, deposits of the Australian Government and other customers, as well as capital and reserves. While the Bank's balance sheet fluctuates in size, total assets averaged around $80 billion in 2011/12. The management of these assets is discussed in the chapter on 'Operations in Financial Markets' and a discussion of the associated risks is in the chapter on 'Risk Management'.

The Bank's earnings come from two sources: underlying earnings (mainly net interest) and valuation gains or losses. Underlying earnings arise because the Bank does not pay interest on a large proportion of its liabilities, particularly banknotes in circulation and capital and reserves. In contrast, almost all of its assets earn interest. Valuation gains or losses result from the fluctuation in the value of the Bank's assets with changes in exchange rates and yields on securities. An appreciation of the Australian dollar exchange rate 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; until then they remain unrealised.

Valuation gains and losses are volatile, as market interest rates and the exchange rate can fluctuate across wide ranges over time. The Reserve Bank, however, has limited discretion to manage these foreign exchange and interest rate risks since, as noted, its financial assets are mainly held for policy purposes. Consequently, if the exchange rate appreciates significantly, as it did in the previous two financial years, large valuation losses are inevitable. The potential for such volatility to result in accounting losses is heightened when interest rates around the world (and therefore underlying earnings) are extremely low, as at present. The movements in the exchange rate for the Australian dollar were around a flatter path in 2011/12, with smaller valuation effects than in the preceding two years, when the exchange rate appreciated noticeably.



Source: RBA



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

Source: RBA

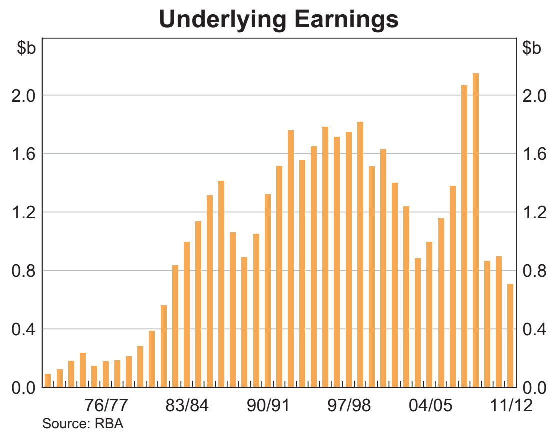
The distribution of the Reserve Bank's earnings is determined by section 30 of the *Reserve Bank Act 1959*. Underlying earnings and realised gains and losses are available for distribution in terms of the Act.

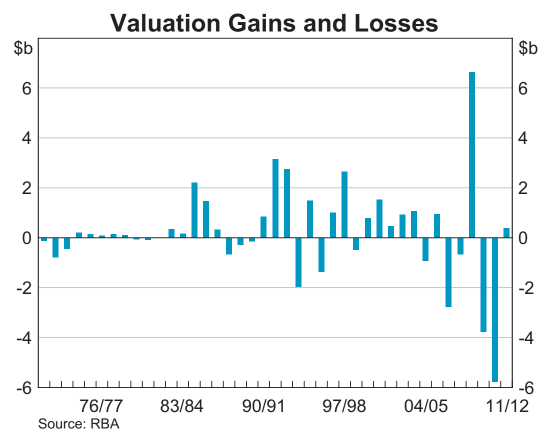
Unrealised gains are not available for distribution, but are transferred to an unrealised profits reserve where they are retained to absorb future valuation losses or until the relevant assets are sold and the gains realised. This feature of the legislative framework reflects sound central banking practice, as it prevents the distribution of unrealised gains, which would reduce the Reserve Bank's capacity to absorb any future valuation losses. Unrealised losses are, in the first instance, also transferred to this reserve, to be offset against unrealised gains accumulated from previous years. If unrealised losses exceed previously accumulated unrealised gains, as occurred in the previous two financial years, the amount by which they do so is initially offset against other sources of income, namely underlying earnings and realised gains, with any remaining losses absorbed by the Reserve Bank Reserve Fund (RBRF), the Bank's permanent general reserve.

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 2012 the Bank recorded an accounting profit of $1 076 million, compared with a loss of $4 889 million in the previous financial year. The accounting profit in 2011/12 comprised:

- underlying earnings of $710 million, lower than in the previous financial year mainly due to the falls in interest rates in Australia and overseas. In nominal terms, underlying earnings are at their lowest level since before the float of the Australian dollar, reflecting the extremely low level of interest rates around the world
- realised valuation gains of $405 million, primarily arising from the sale of foreign securities as overseas market yields fell over the course of the year. The Reserve Bank realised valuation gains of $37 million on domestic securities. Notwithstanding the volatility in currencies, gains of $59 million were realised from foreign exchange sold at favourable exchange rates in the course of managing international reserves and conducting business for customers
- unrealised valuation losses of $39 million, partly resulting from the appreciation of the Australian dollar against the euro, which more than offset unrealised gains on foreign and domestic securities and foreign exchange gains from the depreciation of the Australian dollar against the US dollar and yen.



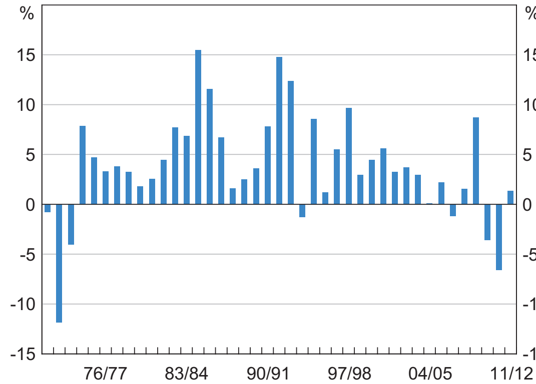


As there were no unrealised gains from earlier years held in the Reserve for Unrealised Profits on Investments, the unrealised loss on investments was charged against other sources of income to determine earnings available for distribution in terms of the Reserve Bank Act. Earnings available for distribution – the sum of underlying earnings and realised gains less unrealised losses on investments – amounted to $1 096 million in 2011/12.

The composition and distribution of the accounting profit in 2011/12, and of historical profits and losses, are summarised in the table on page 64.

RBA Profits*

Per cent of balance sheet



* Accounting profit is estimated prior to 1998

Source: RBA

Reserves and Dividend

The RBRF is established by the Reserve Bank Act and has been funded over the years by transfers from earnings available for distribution. Under the Reserve Bank Act, sums may be credited to the RBRF from earnings available for distribution as determined by the Treasurer, after consulting the Board. The balance of distributable earnings after any such transfer is payable as a dividend to the Australian Government. The RBRF is essentially the Bank's capital, with its primary purpose being to provide the capacity to absorb losses when it is necessary to do so. The RBRF was substantially depleted in 2009/10 and 2010/11 as it absorbed accounting losses.

The Board reviews the adequacy of the RBRF against the market risks held on the Bank's balance sheet. With the substantial depletion of the RBRF in previous financial years, the Board will seek to replenish this reserve over time to a level more appropriate to the risks faced by the Bank. After consultation with the Board, the Deputy Prime Minister and Treasurer has determined that a sum of $596 million be placed to the credit of the RBRF from earnings available for distribution in 2011/12 and a sum of $500 million will be paid as a dividend to the Australian Government. The transfer to the RBRF will increase the balance of this reserve to $1 913 million. The purpose of this transfer is to start to replenish the Bank's capital following recent losses, i.e. it does not reflect any heightened concern about the credit quality of either the Bank's assets or the expanded range of collateral it holds. The dividend is usually paid early in the financial year following the year in which profits are earned.

In addition to the RBRF, the Reserve Bank maintains a number of other financial reserves. As noted, unrealised gains are transferred to the Unrealised Profits Reserve to absorb future valuation losses or to be realised, and distributed, when the relevant assets are sold. Since this reserve was fully exhausted by the large valuation losses of the past two financial years, the unrealised loss on investments of $19 million recorded in 2011/12 will be charged against other income; the balance of this reserve remains nil.

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 non-traded assets and the cost at which they were acquired. The total balance in these reserves stood at $4 375 million on 30 June 2012, $454 million higher than a year earlier. This mainly reflects the increase in the Australian dollar value of the Reserve Bank's gold holdings.

The balance of the RBRF plus asset revaluation reserves stood at 7.8 per cent of total assets on 30 June 2012.

The Reserve Bank's financial statements (and accompanying Notes to the Accounts) for the 2011/12 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									500	–	500

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

Source: RBA

Statutory Obligations

Equal Employment Opportunity

The Reserve Bank is required under the *Equal Employment Opportunity (Commonwealth Authorities) Act 1987* to report to the Australian Parliament each year on its equity and diversity program. The *Equity & Diversity Annual Report 2011*, which reviews the Bank's diversity profile, employee engagement with existing policies and progress with the program, was tabled in Parliament on 22 September 2011.

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 Bank's Diversity Program, namely existing policies and procedures, and the Diversity Plan. While the existing policies and procedures seek to embed equity and diversity 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 Equity & Diversity Policy Committee, a consultative body responsible for monitoring the development and implementation of equity and diversity initiatives, policies and practices.

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

- gain an understanding of the issues related to work-life balance that are important to staff, and use that information to contribute to equity and diversity policy deliberations
- better understand the factors influencing the career experience of women
- continue improving the accessibility of the Bank's computing systems, information and building facilities for its staff and the community
- understand the needs of a maturing workforce, and use that information to assist in workforce planning and knowledge retention.

While the focus for the previous reporting period was on enhancing the Reserve Bank's culture of inclusiveness, the major focus this year was to better understand the equity and diversity issues associated with career progression and development, employee participation and work-life balance. To do this, the Bank commissioned a focus group study, which provided useful information for the Bank to consider in developing the new Diversity Plan. Consultation through the Equity & Diversity Policy Committee and Diversity Contact Managers also provided useful feedback in preparation for release of the new Plan to employees.

Full details and outcomes of the equity and diversity program will be included in the Reserve Bank's *Equity & Diversity Annual Report 2012*.

Work Health & Safety, Compensation and Rehabilitation

The Reserve Bank is required, in terms of the *Work Health and Safety Act 2011* (WHS Act) and the conditions of its licence as a Licensed Authority under the *Safety, Rehabilitation and Compensation Act 1988*, to report each year on matters of work health and safety, workers' compensation and rehabilitation, 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 work health and safety (WHS), and compliance with the relevant legislation and the Bank's Conditions of Licence was confirmed in 2012 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 2012/13, by maintaining Tier 3 status in each area. From 1 July 2011 to 30 June 2012, there were 60 reported WHS incidents. Of these, six resulted in accepted claims, two additional claims were accepted for incidents occuring outside of this period. The accepted claims were supported by in-house rehabilitation case management when required. Of the reported incidents, eight were notified to Comcare while the remaining incidents were relatively minor in nature. Twenty-eight of the 60 incidents were sustained during lunchtime sporting activities.

The Reserve Bank continued to foster a preventative, proactive and duly diligent safety culture by demonstrating visible commitment to safety from the Bank's senior and executive management. A key focus of the Bank's activities during the year was to ensure robust implementation of the WHS Act across the Bank's worksites. As part of the Bank's continuous improvement program, it facilitated a project aimed at ensuring the Bank would fully comply with the new legislation, involving a review of all WHS-related policies and procedures across the organisation and establishment of consultation arrangements with workers and relevant external organisations. The Bank continued to provide ongoing training to workers, health and safety representatives and management on the legislative changes and contemporary WHS matters, including mental health. The Bank's Health & Well Being 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.

Freedom of Information (FOI)

The Reserve Bank is an Australian Government agency subject to the *Freedom of Information Act 1982* (FOI Act). The section of the Bank's website dedicated to the FOI Act can be found at www.rba.gov.au/foi.

Sixteen requests for access to documents under the FOI Act were received in 2011/12. Access was granted in full in response to one request and in part in response to four requests. No relevant documents were found in response to six requests. Access to documents was denied in response to one request, and four requests were withdrawn. The Reserve Bank continued to publish on its website information that has been released in response to FOI access requests, in line with the requirements of the disclosure log provisions of the FOI Act.

No applications were received for the internal review of a decision in 2011/12.

The estimated number of staff hours spent dealing with all aspects of FOI requests in 2011/12 was around 294 hours, down from an estimated 450 hours in 2010/11. The total cost to the Reserve Bank of administering the FOI Act in 2011/12 is also estimated to have fallen to about $88 000, from around $134 000 in the previous year. Charges levied and received amounted to $865. The reduction in both staff hours and costs is attributable to receiving two fewer requests this year and the overall complexity of requests being significantly less than in 2010/11.

Ministerial Directions

The Reserve Bank received no new directions from its responsible Minister, the Deputy Prime Minister and Treasurer, or from any other Minister during 2011/12. The Bank continued to be bound by:

- the Finance Minister's (CAC Act Procurement) Directions 2009, which require the Reserve Bank to apply the Commonwealth Procurement Guidelines when undertaking a covered procurement, i.e. where the value of the property or service being procured exceeded $400 000 for non-construction services or more than $9 million for construction services. From 1 July 2012, the Bank is bound by the Finance Minister's (CAC Act Procurement) Directions 2012, which require the Bank to apply the Commonwealth Procurement Rules when undertaking a procurement above the same thresholds

- the National Code of Practice for the Construction Industry and the Australian Government Implementation Guidelines for the National Code of Practice for the Construction Industry.

No General Policy Orders made under section 48A of the *Commonwealth Authorities and Companies Act 1997* (CAC Act) were first applied, or continued to apply, to the Reserve Bank under section 28 of the CAC Act during 2011/12.

Financial Statements

For the year ended 30 June 2012

Directors' Statement

In the opinion of the directors, the financial statements for the year ended 30 June 2012 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
5 September 2012

Frank Campbell
Assistant Governor (Corporate Services)

Balance Sheet – as at 30 June 2012

Reserve Bank of Australia and Controlled Entities

	Note	2012 $M	2011 $M
Assets			
Cash and cash equivalents	6	164	1 209
Australian dollar securities	1(b), 15	32 648	31 834
Foreign exchange	1(b), 15	43 296	37 727
Gold	1(c), 15	4 027	3 599
Property, plant and equipment	1(d), 8	448	454
Loans, advances and other assets	7	496	490
Total Assets		81 079	75 313
Liabilities			
Deposits	1(b), 9	18 000	17 504
Distribution payable to Australian Government	1(f), 3	500	–
Other liabilities	10	2 615	2 411
Australian notes on issue	1(b), 15	53 595	50 059
Total Liabilities		74 710	69 974
Net Assets		6 369	5 339
Capital and Reserves			
Reserves:			
Unrealised profits reserves	1(e), 5	41	61
Asset revaluation reserves	1(e), 5	4 375	3 921
Reserve Bank Reserve Fund	1(e), 5	1 913	1 317
Capital	1(e)	40	40
Total Capital and Reserves		6 369	5 339

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

Statement of Comprehensive Income – for the year ended 30 June 2012

Reserve Bank of Australia and Controlled Entities

	Note	2012 $M	2011 $M
Income			
Interest revenue	2	1 875	1 930
Net gains on securities and foreign exchange	2	386	–
Dividend revenue	2	4	4
Fees and commissions	2	24	20
Other income	2	97	98
Total Income		2 386	2 052
Expenses			
Interest expense	2	889	798
Net losses on securities and foreign exchange	2	–	5 786
General administrative expenses	2	370	303
Other expenses	2	51	54
Total Expenses		1 310	6 941
Net Profit/(Loss)		1 076	(4 889)
Other Comprehensive Income			
Gains/(losses) on:			
Gold	5	427	(147)
Shares in international and other institutions	5	23	(26)
Properties, plant and equipment	5	4	7
Total Other Comprehensive Income		454	(166)
Total Comprehensive Income		1 530	(5 055)

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

Statement of Distribution – for the year ended 30 June 2012

Reserve Bank of Australia and Controlled Entities

	Note	2012 $M	2011 $M
Net Profit/(Loss)		1 076	(4 889)
Transfer (to)/from unrealised profits reserves	5	20	23
Transfer from Reserve Bank Reserve Fund	5	–	4 866
Earnings available for distribution		1 096	–
Distributed as follows:			
Transfer to Reserve Bank Reserve Fund	5	596	–
Payable to Australian Government	3	500	–
		1 096	–

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

Statement of Changes in Capital and Reserves – for the year ended 30 June 2012

Reserve Bank of Australia and Controlled Entities

	Note	Asset revaluation reserves $M	Unrealised profits reserves $M	Reserve Bank Reserve Fund $M	Capital $M	Earnings available for distribution $M	Total capital and reserves $M
Balance as at 30 June 2010		4 087	84	6 183	40	–	10 394
Plus:							
Net Profit/(Loss)	2	–	(23)	(4 866)	–	–	(4 889)
Gains/(losses) on:							
Gold	5	(147)					(147)
Shares in international and other institutions	5	(26)					(26)
Property, plant and equipment	5	7					7
Other comprehensive income		(166)					(166)
Total comprehensive income for 2010/11							(5 055)
Less:							
Transfer to distribution payable to Australian Government	3	–	–	–	–	–	–
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 Australian Government	3	–	–	–	–	(500)	(500)
Balance as at 30 June 2012		4 375	41	1 913	40	–	6 369

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

Cash Flow Statement – for the year ended 30 June 2012

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. In the RBA's view, due to the nature of central banking activities, this statement does not shed additional light on the RBA's financial results. For the purpose of this statement, cash includes the notes and coin held at the Reserve Bank and overnight settlements balances due from other banks.

	2012 Inflow/ (outflow) $M	2011 Inflow/ (outflow) $M
Cash flows from operating activities		
Interest received on investments	1 961	1 975
Interest received on loans, advances, and on net overnight settlements balances	41	42
Loan management reimbursement	1	1
Banking service fees received	23	20
Dividends received	9	4
Rents received	9	8
Net payments for and proceeds from investments	(5 957)	2 244
Interest paid on deposit liabilities	(778)	(629)
Interest paid on currency note holdings of banks	(123)	(133)
Staff costs (including redundancy)	(177)	(174)
Property, plant and equipment	(38)	(39)
Other	(31)	(10)
Net cash provided by operating activities	(5 060)	3 309
Cash flows from investment activities		
Net expenditure on property, plant and equipment	(17)	(25)
Net cash used in investment activities	(17)	(25)
Cash flows from financing activities		
Profit payment to Australian Government	–	(750)
Net movement in deposit liabilities	496	(3 483)
Net movement in loans and advances	–	1
Net movement in notes on issue	3 536	1 300
Other	–	5
Net cash used in financing activities	4 032	(2 927)
Net increase/(decrease) in cash	(1 045)	357
Cash at beginning of financial year	1 209	852
Cash at end of financial year	164	1 209

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

Cash Flow Statement – for the year ended 30 June 2012 (continued)

Reserve Bank of Australia and Controlled Entities

Reconciliation of cash	Note	2012 $M	2011 $M
Cash		29	22
Overnight settlements systems	6	135	1 187
		164	1 209

Reconciliation of net cash provided by operating activities to Net Profits in terms of the *Reserve Bank Act 1959*	Note	2012 $M	2011 $M
Net Profit/(Loss)		1 076	(4 889)
Increase/(decrease) in interest payable		(25)	13
Net loss/(gain) on overseas investments	2	(426)	94
Net loss/(gain) on Australian dollar securities	2	(188)	26
Net loss/(gain) on foreign currency	2	228	5 666
Decrease/(increase) in income accrued on investments		140	(25)
Depreciation of property	8	7	8
Depreciation of plant and equipment	8	18	18
Net payments for and proceeds from investments		(5 957)	2 399
Other		67	(1)
Net cash provided by operating activities		(5 060)	3 309

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

Notes to and Forming Part of the Financial Statements – 30 June 2012

Reserve Bank of Australia and Controlled Entities

Note 1 – Accounting Policies

The Reserve Bank of Australia (RBA) reports its financial statements in accordance with the *Reserve Bank Act 1959* and the *Commonwealth Authorities and Companies Act 1997* (CAC Act). These financial statements for the year ended 30 June 2012 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 2011/12. 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 2012.

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 unless another currency is indicated. The RBA is classified as a for-profit public sector entity for purposes of financial disclosure. Fair values are used for the RBA's major assets, including domestic and foreign marketable securities, gold and foreign currency, as well as for properties, plant and equipment. Revenue and expenses are brought to account on an accruals basis. All revenues, expenses and profits of the RBA are from ordinary activities.

These financial statements were approved and authorised for issue by a resolution of the Board of the Reserve Bank of Australia on 4 September 2012.

(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 capital as at 30 June 2012 were \$151.2 million, \$37.8 million and \$113.4 million, respectively (\$143.3 million, \$28.0 million and \$115.3 million as at 30 June 2011).

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

Securency International Pty Ltd

The RBA has a 50 per cent share in Securency International Pty Ltd (Securency), a joint venture with Innovia Films. Securency markets and manufactures the polymer substrate on which Australia's banknotes are printed. In November 2010, the RBA announced it was pursuing a joint sale with Innovia Films of its half share in Securency. This process was terminated late in 2011, after Innovia advised the Bank that it was no longer a seller. Subsequently, the Bank is pursuing the sale of its half interest in Securency. Macquarie Capital Advisers is the Bank's adviser. Accordingly, the investment in Securency is classified as held for sale in accordance with AASB 5 – *Non Current Assets Held for Sale and Discontinued Operations*. This is based on the expectation that the carrying amount of the asset will be recovered through a sale transaction within one year. The RBA's investment in Securency is included in Note 7. The value of the RBA's investment in Securency was not impaired as at 30 June 2012.

Legal issues

During 2011 charges were laid against several former employees of NPA and Securency, and against the companies, alleging that they conspired to provide, or offer to provide, benefits to foreign public officials that were not legitimately due. The Reserve Bank has accounted for, or provided for, the costs or estimated costs associated with 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 Comprehensive Income and the Balance Sheet on the date these transactions are arranged (not when the transactions are settled). Bank deposits and repurchase agreements are brought to account on settlement date.

Financial assets

Australian dollar securities

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

Foreign exchange

Foreign exchange holdings are invested mainly in securities issued by the governments of the United States, Germany, France, the Netherlands, 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 of the securities. The face value is received at maturity. Foreign securities, except those held under buy repurchase agreements, are classified under AASB 139 as 'at fair value through profit or loss', as they are held for trading in the course of managing the portfolio of foreign exchange reserves. In accordance with this standard, the securities are valued at market bid prices on balance date; realised and unrealised gains or losses are taken to profit. Only realised gains and losses are available for distribution in accordance with the Reserve Bank Act (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. Where the Bank enters into a buy repurchase agreement, the Bank records a receivable equating to the consideration paid. The difference between the purchase and sale price is accrued over the term of the agreement and recognised as interest revenue (see page 82 for the treatment of sell repurchase agreements).

Foreign currency swaps

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

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 BIS' net asset value, less a discount of 30 per cent. When declared, dividends are recognised as revenue in the Statement of Comprehensive Income.

Financial liabilities

Deposit liabilities

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

Australian notes on issue

Notes on issue are recorded at face value. Prior to 2005/06, the RBA periodically adjusted its liability for note series that had ceased to be issued – to reflect the likelihood that the remaining notes on issue from these series would not be presented for redemption – and the gains were included in accounting profits. If the written-down notes are subsequently presented, the RBA charges an expense against profits. In 2011/12, notes with a face value of $254 636 which had previously been written down were presented to the RBA and expensed ($227 643 in 2010/11).

The RBA pays interest on working balances of currency notes held by banks under cash distribution arrangements.

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 in accordance with AASB 116 – *Property, Plant and Equipment*. Valuation gains (and losses) are generally transferred to (from) the relevant Revaluation Reserve. Valuation losses which exceed the balance in the relevant asset revaluation reserve are expensed. Subsequent valuation gains are included in income, to the extent that the gains offset prior losses treated as an expense.

Property

Formal valuations of all the RBA's Australian properties are conducted annually; overseas properties are formally valued on a triennial basis. Australian properties are valued by an independent valuer; overseas properties are valued by local independent valuers. The most recent independent valuation of overseas properties was at 30 June 2010. In accordance with AASB 116, properties are recognised at fair value, which reflects observable prices and is based on the assumption that assets would be exchanged between knowledgeable, willing parties at arm's length. Reflecting the specialised nature of the respective assets, the value of the Craigieburn property has been determined on the basis of vacant possession, while the RBA's Business Resumption Site in outer metropolitan Sydney is valued at depreciated replacement cost. The latest valuations have been incorporated in the accounts. Annual depreciation is based on fair values and assessments of the useful remaining life of the relevant asset, determined by the independent valuer.

Plant and equipment

Plant and equipment is valued by independent valuers on a triennial basis. The most recent independent valuation was 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
Fitout and furniture	5–13
Computer equipment	
– hardware	3–5
– software	3–5
Office equipment	4–5
Motor vehicles	5
Plant	4–20

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

(e) Capital and Reserves

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

The Reserve Bank Reserve Fund (RBRF) is also established by the Reserve Bank Act and is, in all respects, essentially capital. It is a general reserve maintained by the RBA to provide for events which are contingent and non-foreseeable, including to cover losses from exceptionally large falls in the market value of its holdings of domestic and foreign securities that cannot be absorbed by its other resources. The RBRF also provides for other risks to which the RBA is exposed, including fraud and operational risk. This reserve 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. 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 and accounting practice.

Unrealised gains and losses on the asset which represents the staff superannuation funds are also recognised in the Statement of Comprehensive Income in accordance with the 'corridor' approach under AASB 119 – *Employee Benefits*. These amounts are reflected in the Reserve for Unrealised Profits on Superannuation (refer Note 1(h)). A sum of $20 million representing an unrealised loss on the RBA's superannuation asset was transferred to this reserve in 2011/12.

Balances of asset revaluation reserves reflect differences between the fair value of a number of the RBA's 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 not included in accounting profits. The unrealised gains on these assets are not distributable until the gains are realised through the sale of the relevant asset.

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

(f) Profits

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

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

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

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

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

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

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

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

(g) Provisions

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

(h) Superannuation funds

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

(i) Rounding

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

(j) New accounting standards

A number of new accounting standards and amendments to current standards may be applied from 1 July 2012. The main changes relevant to the RBA relate to the revised standards AASB 119 – *Employee Benefits* and AASB 13 – *Fair Value Measurement*. The Bank is assessing the impact of these amendments. The revised standards will be first applied in the financial statements for the year ending 30 June 2014.

Note 2 – Net Profits

	Note	2012 $M	2011 $M
Interest revenue			
Overseas investments	1(b), 4	325	391
Australian dollar securities	1(b), 4	1 508	1 497
Overnight settlements	4	41	41
Gold loans	1(c), 4	–	–
Loans, advances and other	4	1	1
		1 875	1 930
Net gains on securities and foreign exchange			
Overseas investments	1(b)	426	–
Australian dollar securities	1(b)	188	–
Foreign currency	1(b)	(228)	–
		386	–
Dividend revenue			
Earnings on shares in Bank for International Settlements	1(b)	4	4
Fees and commissions			
Banking services fees received		24	20
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		66	63
Other		21	25
		97	98
Total		2 386	2 052
Less:			
Interest expense			
Deposit liabilities	1(b), 4	753	643
Currency note holdings of banks	1(b), 4	123	133
Repurchase agreements	1(b), 4	13	22
		889	798
Net losses on securities and foreign exchange			
Overseas investments	1(b)	–	94
Australian dollar securities	1(b)	–	26
Foreign currency	1(b)	–	5 666
		–	5 786
General administrative expenses			
Staff costs		192	141
Superannuation costs	1(h), 14	45	45
Special redundancy/retirement payments		2	2

Note 2 – Net Profits (Continued)

	Note	2012 $M	2011 $M
Depreciation of property	1(d), 8	7	8
Depreciation of plant and equipment	1(d), 8	18	18
Premises and equipment	1(d)	38	39
Materials used in note and security products		48	36
Travel		3	3
Consultants' fees, legal fees and payments to contractors		8	5
Other		9	6
		370	303
Other expenses			
Agency business reimbursement		7	3
Subsidiary income tax		3	2
Cash distribution expenses		5	5
Other		36	44
		51	54
Total		1 310	6 941
Net Profit		1 076	(4 889)

Staff costs in 2011/12 include an expense of $34.4 million associated with the increase in the balance of the provision for post-employment benefits (in 2010/11 there was income of $4.6 million) (refer Note 10). Post-employment healthcare costs of $34.5 million are included in Staff costs ($4.5 million in 2010/11). The large increase in these provisions mainly reflected the fall in the discount rate, as measured by the yield on Commonwealth Government bonds. Excluding provisions, staff costs rose by 5.6 per cent in 2011/12.

The RBA's aggregate research and development expenditure recognised as an expense in 2011/12 was $0.6 million ($0.6 million in 2010/11); this is included in Other expenses.

Note 3 – Distribution Payable to Australian Government

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 Australian Government (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 Reserve for Unrealised Profits on Investments 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 Reserve for Unrealised Profits on Investments and offset against unrealised profits accumulated from previous years. 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 amount absorbed by the RBRF.

In 2011/12, the Bank recorded an accounting profit of $1 076 million. Earnings available for distribution were $1 096 million, comprising underlying earnings of $710 million plus realised gains of $405 million minus $19 million in unrealised investment losses. Unrealised losses of $20 million on the Bank's superannuation assets were absorbed by an unrealised profits reserve.

After consulting the Reserve Bank Board, the Deputy Prime Minister and Treasurer has determined that a sum of $500 million will be paid from earnings available for distribution as a dividend to the Australian Government and that $596 million will be placed to the credit of the RBRF.

	2012 $M	2011 $M
Opening balance	–	750
Distribution to Australian Government	–	(750)
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 2012

	Average balance $M	Interest $M	Average annual interest rate %
Interest revenue			
Overseas investments	42 192	325	0.8
Australian dollar securities	32 589	1 508	4.6
Overnight settlements	983	41	4.1
Gold loans	52	–	0.3
Loans, advances and other	21	1	4.2
	75 837	1 875	2.5
Interest expense			
Banks' Exchange Settlement balances	1 252	52	4.1
Deposits from governments	15 898	672	4.1
Deposits from overseas institutions	696	24	3.4
Currency note holdings of banks	2 872	123	4.2
Overseas repurchase agreements	1 712	–	–
Domestic repurchase agreements	294	13	4.5
Other deposits	166	5	3.5
	22 890	889	3.9
Analysis for the year ended 30 June 2011			
Interest revenue total	71 650	1 930	2.7
Interest expense total	20 916	798	3.8

Interest revenue for 2011/12 includes $1 138 million calculated using the effective interest method for financial assets not at fair value through profit and loss ($1 214 million in 2010/11). Interest expense for 2011/12 includes $889 million calculated using the effective interest method for financial liabilities not at fair value through profit and loss ($798 million in 2010/11).

Note 5 – Capital and Reserves

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

	Note	2012 $M	2011 $M
Asset revaluation reserves			
Gold	1(c)		
Opening balance		3 473	3 620
Net revaluation adjustments		427	(147)
As at 30 June		3 900	3 473
Shares in international and other institutions	1(b), 7		
Opening balance		259	285
Net revaluation adjustments		23	(26)
As at 30 June		282	259
Bank property, plant and equipment	1(d), 8		
Opening balance		189	182
Net revaluation adjustments		4	7
As at 30 June		193	189
Total asset revaluation reserves	1(e)		
Opening balance		3 921	4 087
Net revaluation adjustments		454	(166)
As at 30 June		4 375	3 921
Unrealised profits reserves			
Reserve for unrealised profits on investments	1(e)		
Opening balance		–	–
Net transfers (to)/from Statement of Distribution		–	–
As at 30 June		–	–
Reserve for unrealised profits on superannuation	1(h)		
Opening balance		61	84
Net transfers (to)/from Statement of Distribution		(20)	(23)
As at 30 June		41	61
Total unrealised profits reserves			
Opening balance		61	84
Net transfers (to)/from Statement of Distribution		(20)	(23)
As at 30 June		41	61
Reserve Bank Reserve Fund	1(e)		
Opening balance		1 317	6 183
Transfers (to)/from Statement of Distribution		596	(4 866)
As at 30 June		1 913	1 317
Capital			
Opening and closing balance		40	40

Note 6 – Cash and Cash Equivalents

This includes net amounts of $135 million owed to the RBA for overnight clearances of financial transactions through the clearing houses; an amount of $1 187 million was owed to the RBA at 30 June 2011. Other cash and cash equivalents includes NPA's bank deposits.

Note 7 – Loans, Advances and Other Assets

	Note	2012 $M	2011 $M
Shareholding in Bank for International Settlements	1(b)	325	302
Superannuation asset	1(h),14	41	61
Officers' Home Advances		5	6
Investment in Securency	1(a)	54	54
Computer software and intangibles	1(d)	16	14
Other		55	53
As at 30 June		496	490

The Reserve Bank of Australia holds a share of 50 per cent in Securency International Pty Ltd (formerly Securency Pty Ltd), which is incorporated in Victoria, Australia, and whose principal activity is the marketing and manufacture of polymer substrate. The Bank jointly controls Securency International (Securency) with a joint-venture partner.

As outlined in Note 1, the RBA is seeking to divest its half interest in Securency, which is classified as held for sale in accordance with AABS 5 – *Non Current Assets Held for Sale and Discontinued Operations*.

During 2011/12, the RBA acquired $3.0 million of computer software and intangibles ($4.8 million in 2010/11) and amortised $2.3 million ($2.2 million in 2010/11). At 30 June 2012 the gross book value of the RBA's computer software and intangibles amounted to $27.1 million and accumulated amortisation on these assets was $10.9 million ($23.2 million and $9.6 million, respectively, at 30 June 2011). The RBA had no contractual commitments as at 30 June 2012 for the acquisition of computer software and intangibles ($0.6 million at 30 June 2011).

As at 30 June 2012, other assets included receivables of $32.2 million, none of which are impaired (at 30 June 2011 other assets included receivables of $33.3 million).

Note 8 – Property, Plant and Equipment

	Land $M	Buildings $M	Plant and Equipment $M	Total $M
Gross Book Value as at 30 June 2011	132	199	138	469
Accumulated depreciation	–	–	(15)	(15)
Net Book Value	132	199	123	454
Additions	–	5	13	18
Depreciation expense	–	(7)	(18)	(25)
Net revaluation increment/(decrement)	–	2	–	2
Disposals	–	–	(1)	(1)
Net additions to net book value	–	–	(6)	(6)
Gross Book Value as at 30 June 2012	132	199	150	481
Accumulated depreciation	–	–	(33)	(33)
Net Book Value	132	199	117	448

The net book value of buildings as at 30 June 2012 includes expenditure of $4.0 million on work in progress which has been capitalised in the carrying amount of these assets ($1.0 million as at 30 June 2011). Additions include expenditure of $6.8 million on work in progress that was capitalised during 2011/12 ($8.4 million in 2010/11).

As at 30 June 2012, the RBA had contractual commitments of $6.7 million to acquire buildings, plant and equipment ($3.3 million at 30 June 2011); all of which are due within one year ($3.3 million in 2010/11).

Note 9 – Deposits

	2012 $M	2011 $M
Banks' Exchange Settlement balances	1 567	2 413
Australian Government	15 861	14 247
State governments	2	2
Foreign governments, foreign institutions and international organisations	542	779
Other depositors	28	63
As at 30 June	18 000	17 504

Note 10 – Other Liabilities

	Note	2012 $M	2011 $M
Provisions	1(g)		
Provision for accrued annual leave		16	15
Provision for long service leave		37	31
Provision for post-employment benefits		117	83
Provision for workers' compensation		–	–
		170	129
Other			
Amounts outstanding under repurchase agreements (contract price)	1(b)	1 535	1 666
Interest accrued on deposits		12	37
Other		898	579
		2 445	2 282
Total Other Liabilities as at 30 June		2 615	2 411

The provision for workers' compensation at 30 June 2012 was $340 000 ($323 000 at 30 June 2011).

During 2011/12, annual leave of $9.6 million was accrued by staff, while $8.9 million of accrued leave was used. Staff accrued and used long service leave of $4.9 million and $3.1 million, respectively, in 2011/12.

The RBA provided an additional $34.0 million for post-employment benefits in 2011/12; a decrease in the discount rate increased the provision by $41.3 million, while benefits of $4.5 million were paid out of the provision. The balance of the provision for post-employment benefits will change if assumptions regarding the length of staff service, the longevity of retired staff, future movements in medical costs or the discount rate vary.

At 30 June 2012, $7.3 million of the provision for accrued annual leave was due within 12 months ($6.8 million at 30 June 2011); $3.6 million of the provision for long service leave was due within 12 months ($3.0 million at 30 June 2011); and $3.9 million of the provision for post-employment benefits was due within 12 months ($2.7 million at 30 June 2011).

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

The RBA has a contingent liability, amounting to $53.4 million at 30 June 2012 ($53.5 million at 30 June 2011), 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 Bank has accounted for, or provided for, the costs associated with the charges laid against NPA and Securency during 2011. In light of uncertainties, it is not possible to make reliable estimates of all of the potential costs associated with these claims or potential claims against these companies at the date of preparing these accounts.

Note 12 – Key Management Personnel

The group of Key Management Personnel of the Reserve Bank comprises members of the Reserve Bank Board, members of the Payments System Board and Assistant Governors, who have responsibility for planning, directing and controlling the activities of the Bank. No new positions were added to the group of Key Management Personnel in 2011/12. A total of 23 directors and executives occupied these positions over the course of 2011/12 (the same as in 2010/11).

Fees of non-executive members of the Reserve Bank Board and the Payments System Board are determined by the Remuneration Tribunal. The positions of Governor and Deputy Governor were declared as Principal Executive Offices (PEOs) within the jurisdiction of the Remuneration Tribunal in July 2011 in terms of the *Remuneration Tribunal Act 1973*. The Reserve Bank Board was declared as the employing body of these Offices and, on a recommendation from the Board's Remuneration Committee (comprising three non-executive directors), the Board set total remuneration for the Governor and Deputy Governor as $986 778 (including salary of $842 285) and $700 000 (including salary of $593 782), respectively, consistent with total remuneration declared by the Remuneration Tribunal. No adjustment was made to the Governor's remuneration in 2011/12. Total remuneration of the position of Deputy Governor was determined by the Remuneration Tribunal on the appointment to this position.

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. Consistent with section 67 of the Reserve Bank Act, remuneration is not tied to Australian Public Service classification bands.

The RBA is required to disclose remuneration of directors, executives and management in terms both of AAS and the FMOs. There are significant differences between these two standards of disclosure as to the definition of remuneration, the basis of measurement and the coverage of staff.

Disclosures under AAS

Disclosure of remuneration of key management personnel is made under AAS on the basis of AASB 124 – *Related Party Disclosures*. Disclosures of remuneration in terms of AASB 124 are on an accruals basis and cost to the Bank, including all leave and all fringe benefit tax charges, in addition to compensation and benefits. The aggregate remuneration of the RBA's key management personnel in terms of AASB 124 is shown in Table A.

Table A: Remuneration of Key Management Personnel

	2012 $	2011 $
Short-term employee benefits	5 103 308	4 930 190
Post-employment benefits	953 023	931 105
Other long-term benefits	502 594	219 587
Share based payments	–	–
Termination benefits	–	–
Total compensation	6 558 925	6 080 882

Under AASB 124, short-term benefits include cash salary and, where relevant for executives, lump-sum payments, annual leave, motor vehicle benefits, car parking, health benefits and the fringe benefits tax paid or payable on these benefits. Post-employment benefits include superannuation benefits and, in the case of staff, health benefits. Other long-term benefits include long service leave. The rise in other long-term benefits in 2011/12 mainly reflects the revaluation of the provision for long service leave arising from the appointment of the Deputy Governor and the promotion to fill the vacant Assistant Governor position caused by this appointment. Members of the RBA's staff may salary sacrifice in exchange for certain benefits.

As at 30 June 2012 and 30 June 2011 there were no loans by the RBA to key management personnel.

There were no related party transactions with Board members or executives. Transactions with director related entities which occurred in the normal course of the RBA's operations were conducted on terms no more favourable than similar transactions with other employees or customers; such transactions were incidental and for small amounts. As the Board of NPA comprised executives of the RBA in 2011/12 and 2010/11, no directors' fees were paid in these years.

Disclosure under FMOs

The Bank also discloses information on remuneration of directors, executives and management in terms of Division 23 of the FMOs. The required disclosures are shown in Tables B to E below. The aggregates in Table B are reported on an accruals basis for executives only. Figures for non-executive directors are shown in Table E.

Table B: Executive Remuneration[(a)]

	2012 $	2011 $
Short-term employee benefits		
Salary	4 132 556	4 045 541
Annual leave accrued	48 462	27 186
Performance-related payments	60 482	–
Other[(b)]	239 044	246 649
Total short-term employee benefits	4 480 544	4 319 376
Post-employment benefits		
Superannuation	880 234	861 700
Other[(c)]	20 000	19 952
Total post-employment benefits	900 234	881 652
Other long-term benefits		
Long service leave	123 184	99 419
Total other long-term benefits	123 184	99 419
Termination benefits	–	–
Total employment benefits	5 503 962	5 300 447

(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 $150 000. Figures for annual and long service leave include the net 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.

The figures in Tables C and D below report average remuneration for staff in the remuneration bands shown; these figures are reported on a cash basis. The apparent reduction in significant components of average remuneration in some remuneration bands between 2011 and 2012 reflects a number of factors including turnover of staff at different remuneration levels and the fact that there were 26 pay days in 2011/12 compared with 27 the previous year. No adjustment was made to the remuneration of the Governor in 2011/12. Lump-sum performance-related payments were available for all senior positions in 2011/12, except for the positions of Governor and Deputy Governor. Any difference between the figures in Table C and remuneration determined by the Board for the positions of Governor and Deputy Governor is due to differences in measurement between the FMOs and the Remuneration Tribunal.

Table C: Executive Remuneration[(a)]

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	167 824	33 505	–	6 848	208 177
$450 000 to $479 999	1	386 940	83 375	–	–	470 315
$480 000 to $509 999	1	406 688	86 881	–	6 934	500 503
$510 000 to $539 999	1	441 670	89 206	–	7 165	538 041
$540 000 to $569 999	1	460 103	92 906	–	7 438	560 447
$570 000 to $599 999	2	470 241	101 186	–	13 911	585 338
$630 000 to $659 999	1	516 370	107 909	–	11 124[(f)]	635 403
$990 000 to $1 019 999	1	815 735	179 407	–	–	995 142
	9					

30 June 2011

Remuneration band	Number of staff	Reportable salary[(b)]	Contributed superannuation[(c)]	Reportable allowances[(d)]	Lump-sum payment[(e)]	Total
Total remuneration:						
$240 000 to $269 999	2	217 842	44 583	–	–	262 425
$510 000 to $539 999	1	431 754	97 727	–	–	529 481
$540 000 to $569 999	3	460 973	96 754	–	–	557 727
$570 000 to $599 999	1	475 340	100 303	–	–	575 643
$750 000 to $779 999	1	614 706	138 692	–	–	753 398
$1 020 000 to $1 049 999	1	839 765	183 653	–	–	1 023 418
	9					

(a) Table C is based on remuneration for the group of executives, including the Governor, Deputy Governor and Assistant Governors, included for reporting purposes under AASB 124 who received remuneration of more than $150 000 during the reporting period, including from part-time arrangements. Each row is an average figure based on the number of individuals in each band. The components of this table are measured on a cash basis in accordance with the provisions of the FMOs.

(b) 'Reportable salary' includes gross payments (less any lump-sum amounts paid), the taxable value of reportable fringe benefits and exempt foreign employment income. The taxable value of reportable fringe benefits is the equivalent of the benefit received by staff excluding the tax payable on such benefits; the cost of fringe benefits shown under AAS in Table A and for the aggregates shown in Table B includes tax payable.

(c) The 'contributed superannuation' amount is the average actual superannuation contributions paid, including any salary sacrificed amounts.

(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 capacity as Assistant Governor.

Table D includes disclosures for RBA and NPA staff. The increase in the number of staff in 2012 in the remuneration band '$150 000 to $179 999' reflects that normal salary increases resulted in a higher number of 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 the RBA staff shown in Table D was 3.5 per cent in 2011/12. Lump-sum performance-based payments and modest career increments were also paid to some individuals within this group in 2011/12. 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 2012

Remuneration band	Number of staff	Reportable salary[(b)]	Contributed superannuation[(c)]	Reportable allowances[(d)]	Lump-sum payment[(e)]	Total
Total remuneration:						
$150 000 to $179 999	141	129 642	28 903	324	3 407	162 276
$180 000 to $209 999	54	152 760	36 950	50	3 770	193 530
$210 000 to $239 999	30	173 176	41 539	7	5 071	219 793
$240 000 to $269 999	22	201 062	44 710	8	8 370	254 150
$270 000 to $299 999	11	227 688	51 700	68	7 695	287 151
$300 000 to $329 999	3	246 795	42 899	–	19 977	309 671
$330 000 to $359 999	9	271 163	62 674	–	8 992	342 829
$390 000 to $419 999	3	332 413	66 286	–	6 071	404 770
$420 000 to $449 999	3	348 839	69 713	–	6 384	424 936
$450 000 to $479 999	2	377 974	84 097	–	7 180	469 251
$480 000 to $509 999	1	393 567	86 211	–	7 248	487 026
$540 000 to $569 999	1	414 992	45 230	–	101 207	561 429
	280					

30 June 2011

Remuneration band	Number of staff	Reportable salary[(b)]	Contributed superannuation[(c)]	Reportable allowances[(d)]	Lump-sum payment[(e)]	Total
Total remuneration:						
$150 000 to $179 999	117	130 992	29 969	26	1 377	162 364
$180 000 to $209 999	59	155 408	37 161	4	1 637	194 210
$210 000 to $239 999	29	176 588	43 213	5	2 623	222 429
$240 000 to $269 999	16	203 183	43 848	2	2 088	249 121
$270 000 to $299 999	10	226 734	51 526	–	7 408	285 668
$300 000 to $329 999	5	250 882	50 188	–	7 449	308 519
$330 000 to $359 999	4	276 733	66 943	–	–	343 676
$360 000 to $389 999	2	319 964	63 208	–	–	383 172
$390 000 to $419 999	4	344 218	68 543	–	–	412 761
$420 000 to $449 999	1	368 308	74 396	–	–	442 704
$450 000 to $479 999	1	382 683	77 263	–	–	459 946
$480 000 to $509 999	2	385 400	59 512	10 383	34 585	489 880
	250					

(a) Table D shows remuneration for staff of the RBA and NPA whose reportable remuneration was $150 000 or more in the year, and whose remuneration was not required to be disclosed in Table C. Each row shows an average figure based on the number of staff in each remuneration band. These figures are disclosed on a cash basis.
(b) 'Reportable salary' includes gross payments (less any lump-sum amounts paid), the taxable value of reportable fringe benefits and exempt foreign employment income. The taxable value of reportable fringe benefits is the equivalent of the benefit received by staff excluding the tax payable on such benefits.
(c) The 'contributed superannuation' amount is the average actual superannuation contributions paid, including any salary sacrificed amounts.
(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: Remuneration of Non-Executive Directors[a]

	Number of directors	
	2012	**2011**
$0 to $29 999	4	4
$30 000 to $59 999	5	5
$60 000 to $89 999	5	5
Total	14	14
Total remuneration received	639 334	598 932

(a) This table includes total remuneration received (or due and receivable) by non-executive directors who are members of the Reserve Bank Board or the Payments System Board.

Note 13 – Remuneration of Auditor

Fees paid or payable to the statutory auditor (Auditor-General of the Commonwealth of Australia) for audit services (excluding GST) totalled $364 500 in 2011/12 ($396 100 in 2010/11); this includes audit services in relation to the RBA's subsidiary Note Printing Australia Limited. These fees are included in Consultants' Fees, Legal Fees and Payments to Contractors in Note 2.

Note 14 – Superannuation Funds

Two superannuation funds are operated pursuant to the Reserve Bank Act: 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 2011/12.

The OSF is a hybrid fund. Most members receive a Bank-funded defined benefit in accordance with the rules of the fund; other member benefits include unitised defined contribution accumulation balances, which comprise the RBA's productivity and superannuation guarantee contributions and members' personal contributions, plus earnings on these contributions. The OSF is classified as a single-employer plan for the purposes of AASB 119 – *Employee Benefits*. The UK Pension Scheme is a defined benefit scheme.

Funding valuation

Full independent actuarial valuations of the OSF and UK Pension Scheme are conducted every three years to determine funding for these schemes. The most recent funding valuation of the OSF was at 30 June 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 – *Financial Reporting by Superannuation Plans*. Under this standard, the accrued benefits of the OSF were determined as the value of the future benefits payable to members (allowing for future salary increases), discounted using the expected rate of return on the assets held to fund these benefits. At the time of the triennial review, the surplus of the OSF on this measure was $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 2012 amounted to $33.2 million (assets of $743.7 million less accrued benefits of $710.5 million).

Consistent with the Actuary's funding recommendation, the RBA maintained its contribution rate to the OSF at 18.3 per cent of salaries in 2011/12.

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 2012, measured in accordance with AAS 25, was $0.6 million (assets of $18.2 million compared with accrued benefits of $17.6 million).

Accounting valuation

For financial statement purposes, the financial positions of the superannuation schemes are valued in accordance with AASB 119. Under AASB 119, accrued benefits are determined by discounting future benefits payable to current fund members at the yield on government bonds of similar maturity on the reporting date. The approach under AASB 119, in contrast with the results of the actuaries' triennial valuations noted above, does not take into account that the assets held by the superannuation schemes to fund future benefits have 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 3.90 per cent (5.38 per cent in 2010/11), future salary increases of 3.5 per cent (3.5 per cent in 2010/11), future pension increases of 3.5 per cent (3.5 per cent in 2010/11) and an assumed return on plan assets of 7.1 per cent (8.5 per cent in 2010/11). The discount rate decreased over 2011/12 as a result of the reduction in yields on Australian Government bonds. The actual return on plan assets of the OSF for 2011/12 was 2.4 per cent (8.1 per cent in 2010/11). The assumptions used for the UK Pension Scheme were a discount rate of 4.25 per cent (5.4 per cent in 2010/11), future salary increases of 4.95 per cent (5.65 per cent in 2010/11), future pension increases of 2.95 per cent (3.65 per cent in 2010/11) and an assumed return on plan assets of 2.42 per cent (4.1 per cent in 2010/11). The actual return on plan assets of the UK Pension Scheme for 2011/12 was 21.2 per cent (10.0 per cent in 2010/11). 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 surpluses in the OSF. At 30 June 2012 accumulation balances in the OSF totalled $176.0 million ($165.4 million as at 30 June 2011).

Asset Distribution as at 30 June

	Per cent of fund assets			
	OSF		UK Pension Scheme	
	2012	2011	2012	2011
Cash and short-term securities	4.4	6.3	–	1.6
Fixed interest securities	12.2	7.2	–	–
Indexed securities	1.7	1.5	94.0	91.9
Domestic shares	39.3	42.7	6.0	6.5
Foreign shares	6.0	3.8	–	–
Property				
Direct	5.0	4.3	–	–
Indirect	12.0	15.9	–	–
Private equity and alternative investments	19.4	18.3	–	–
Total	100.0	100.0	100.0	100.0

Note 14 – Superannuation Funds (Continued)

	OSF		UK Scheme		Total	
	2012 $M	2011 $M	2012 $M	2011 $M	2012 $M	2011 $M
Opening balances:						
Net market value of assets	730	691	17	18	747	710
Accrued benefits	(976)	(928)	(13)	(14)	(989)	(942)
Surplus/(deficit)	(246)	(236)	4	4	(242)	(232)
Effect of asset cap	–	–	(2)	(3)	(2)	(3)
Actuarial (gains)/losses not included in balance sheet under Corridor	307	320	(1)	(2)	306	318
Opening superannuation asset	61	84	–	–	61	83
Change in net market value of assets	13	39	2	(2)	15	37
Change in accrued benefits	(436)	(49)	(1)	1	(437)	(48)
Change in asset cap	–	–	(1)	–	(1)	–
Change in actuarial (gains)/losses not included in balance sheet under Corridor	402	(12)	–	–	402	(12)
Total change in superannuation asset	(21)	(22)	–	–	(21)	(22)
Closing 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
Closing superannuation asset	41	61	–	–	41	61
Actuarially assumed return on plan assets	58	54	1	1	58	55
Benefit payments	(36)	(33)	(1)	(1)	(36)	(34)
Actuarial gains/(losses) on assets	(26)	1	1	1	(25)	2
Contributions from RBA to defined benefit schemes	21	20	–	–	21	20
Contributions tax	(3)	(3)	–	–	(3)	(3)
Exchange rate gains/(losses)	–	–	–	(3)	–	(3)
Change in net market value of assets	13	39	2	(2)	15	37

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

Note 14 – Superannuation Funds (Continued)

	OSF		UK Scheme		Total	
	2012 $M	2011 $M	2012 $M	2011 $M	2012 $M	2011 $M
Current service cost	(34)	(33)	–	–	(34)	(33)
Interest cost	(47)	(43)	(1)	(1)	(48)	(44)
Benefit payments	36	33	1	1	36	34
Contributions tax	3	3	–	–	3	3
Experience adjustments on benefits	(31)	(31)	–	–	(31)	(31)
Effects of changes in benefit actuarial assumptions	(363)	22	(1)	(1)	(363)	21
Exchange rate gains/(losses)	–	–	–	2	–	2
Change in accrued benefits	(436)	(49)	(1)	1	(437)	(48)
Actuarial (gains)/losses on assets	26	(1)	(1)	(1)	25	(3)
Experience adjustments on benefits	31	31	–	–	31	31
Effects of changes in benefit actuarial assumptions	363	(22)	1	1	363	(21)
Amortisation of actuarial gains/(losses)	(18)	(20)	1	–	(17)	(19)
Exchange rate gains/(losses)	–	–	–	–	–	–
Change in actuarial losses not included in balance sheet under Corridor	402	(12)	–	–	402	(12)
Superannuation expense/(income) included in Statement of Comprehensive Income						
Current service cost	34	33	–	–	34	33
Interest cost	47	44	1	1	48	44
Assumed return on plan assets	(58)	(54)	(1)	(1)	(58)	(55)
Amortisation of actuarial (gains)/losses under Corridor	18	20	(1)	–	17	19
Effect of asset cap	–	–		–	–	–
Productivity and superannuation guarantee contributions	4	4	–	–	4	4
Total superannuation expense/(income)	45	46	–	–	45	46

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:

	2012 $M	2011 $M	2010 $M	2009 $M	2008 $M
OSF					
Closing balances:					
Net market value of assets	744	730	691	652	755
Accrued benefits	(1 412)	(976)	(928)	(829)	(679)
Surplus/(deficit)	(668)	(246)	(236)	(177)	76
Experience adjustments on assets	(26)	1	2	(150)	(90)
Experience adjustments on benefits	(31)	(31)	(3)	(54)	(20)
UK Scheme					
Closing balances:					
Net market value of assets	18	17	18	20	22
Accrued benefits	(14)	(13)	(14)	(14)	(16)
Surplus	4	4	4	7	6
Experience adjustments on assets	1	1	1	(1)	2
Experience adjustments on benefits	–	–	–	–	–

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

Note 15 – Financial Instruments and Risk

As the central bank of Australia, the RBA is responsible for implementing monetary policy and managing Australia's foreign reserve assets. As a consequence, the RBA holds a range of financial assets, including Australian dollar securities, foreign government securities, repurchase agreements, 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 as well as 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 – *Financial Instruments: Disclosures* requires disclosure of information relating to financial instruments; their significance and performance; terms and conditions; fair values; risk exposures and risk management.

Financial Risk

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

Market risk

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

Foreign exchange risk

Foreign exchange risk is the risk that the fair value or cash flows of foreign currency assets and liabilities will fluctuate because of movements in exchange rates. Foreign exchange risk arises from the RBA's foreign currency assets, which are held to support its operations in the foreign exchange market. The value of these assets, measured in Australian dollars, varies with movements in the value of the Australian dollar exchange rate against the currencies in which the assets are invested. An appreciation in the exchange rate results in valuation losses, while a depreciation leads to valuation gains. The overall level of foreign currency exposure is determined by policy considerations and the Bank does not seek to reduce foreign exchange risk. The RBA's net foreign currency exposure as at 30 June 2012 was $35.9 billion ($35.8 billion as at 30 June 2011). 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 also undertakes foreign currency swaps to assist its daily domestic market operations. These instruments carry no foreign exchange risk since the exchange rates at which both legs of the transaction are settled are agreed at the time the swap is undertaken.

Concentration of foreign exchange

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

	Per cent of foreign exchange	
	2012	**2011**
US dollar	45	45
Euro	45	45
Canadian dollars	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.

	2012 $M	**2011 $M**
Change in profit/equity due to a 10 per cent appreciation in the reserves-weighted value of the A$	–3 267	–3 258
Change in profit/equity due to a 10 per cent depreciation in the reserves-weighted value of the A$	3 993	3 982

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 managed 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.

Sensitivity to interest rate risk

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

	2012 $M	2011 $M
Change in profit/equity due to movements of +/–1 percentage point across yield curves:		
Foreign currency securities	–/+467	–/+456
Australian dollar securities	–/+171	–/+169

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

Other price risk

The RBA holds shares as a member of the BIS. This membership is mainly to maintain and develop strong relationships with other central banks which are to Australia's advantage. Shares in the BIS are owned exclusively by its member central banks and monetary authorities. For accounting purposes, the RBA treats 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 collateral only of low credit risk against buy repurchase agreements and gold loans.

Cash invested under repurchase agreements in overseas markets is secured by collateral in the form of government securities or securities issued by US agencies; the RBA takes and maintains collateral to the value of 102 per cent of the cash invested. Cash invested under domestic buy repurchase agreements is secured by securities issued by Australian governments, 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 2012, the RBA was under contract to purchase $4.4 billion of foreign currency ($0.2 billion at 30 June 2011) and sell $9.5 billion of foreign currency ($0.3 billion at 30 June 2011). As of that date there was a net unrealised gain of $110 million on these swap positions included in net profit ($4 million unrealised gain at 30 June 2011). The exposure of these contracts to credit risk is the cost of re-establishing the contract in the market if a counterparty fails to fulfill its obligations.
2. ***Interest rate futures*** – As at 30 June 2012, the amount of credit risk on interest rate futures contracts was approximately $0.7 million ($1.4 million at 30 June 2011). As at 30 June 2012 there was an unrealised loss brought to account on those contracts of $0.03 million ($0.6 million unrealised loss at 30 June 2011).

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 2012 or 30 June 2011.

	Risk rating of security/issuer[a]	Risk rating of counterparties[a]	Per cent of investments	
			2012	2011
Australian dollar securities				
Holdings – Commonwealth Government Securities	AAA	na	1.9	0.6
Holdings – semi-government securities	AAA	na	4.0	4.3
	AA	na	4.0	5.9
Securities sold under repurchase agreements	AAA	AA	–	0.2
	AAA	A	0.1	0.2
	AA	AA	–	0.1
Securities held under repurchase agreements	AAA	AA	9.1	11.9
	AAA	A	8.6	7.4
	AAA	BBB	0.1	0.1
	AAA	Other[b]	0.7	0.3
	AA	AA	7.1	6.1
	AA	A	2.6	2.6
	AA	BBB	0.1	–
	AA	Other[b]	0.2	0.1
	A	AA	0.5	1.8
	A	A	1.3	0.5
	A	BBB	–	0.1
Foreign investments				
Holdings of securities	AAA	na	17.2	29.9
	AA	na	18.1	1.5
	A	na	0.5	0.5
Securities sold under repurchase agreements	AAA	AA	–	0.9
	AAA	A	–	0.8
	AA	A	1.8	–
Securities held under repurchase agreements	AAA	AAA	–	0.4
	AAA	AA	0.5	8.3
	AAA	A	1.2	5.5
	AA	AA	1.8	–
	AA	A	11.9	0.5
	AA	BBB	0.2	–
Deposits	na	AAA	–	1.7
Other	na	AA	0.1	–
	na	A	0.1	–
Gold loans	na	AAA	0.1	0.1
Other			6.2	7.7
			100.0	100.0

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

Liquidity risk

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

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

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

Maturity Analysis – as at 30 June 2012

	Balance sheet total $M	Contracted maturity $M					No specified maturity $M	Weighted average coupon rate %	Weighted average effective rate %
		On demand	0 to 3 months	3 to 12 months	1 to 5 years	Over 5 years			
Assets									
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)	–	–	–	–		

Maturity Analysis – as at 30 June 2011

	Balance sheet total $M	Contracted maturity $M					No specified maturity $M	Weighted average coupon rate %	Weighted average effective rate %
		On demand	0 to 3 months	3 to 12 months	1 to 5 years	Over 5 years			
Assets									
Cash and cash equivalents	1 209	–	1 187	–	–	–	22	4.50	4.50
Australian dollar securities									
Securities sold under repurchase agreements	404	–	41	–	156	207	–	6.55	5.29
Securities purchased under repurchase agreements	23 203	–	23 078	125	–	–	–	4.82	4.82
Other securities	8 111	–	3 247	1 721	1 961	1 182	–	5.47	4.99
Accrued interest	116	–	78	38	–	–	–	na	na
	31 834								
Foreign exchange									
Balances with central banks	305	7	298	–	–	–	–	0.12	0.12
Securities sold under repurchase agreements	1 234	–	–	186	467	581	–	2.14	2.14
Securities purchased under repurchase agreements	10 797	–	10 797	–	–	–	–	0.45	0.45
Other securities	24 011	–	3 275	7 653	5 275	2 824	4 984	1.60	1.22
Deposits with BIS	1 261	2	1 258	–	–	–	1	0.06	0.06
Accrued interest	119	–	67	50	2	–	–	na	na
	37 727								
Gold									
Gold loans	46	–	–	46	–	–	–	0.30	0.30
Gold holdings	3 553	–	–	–	–	–	3 553	na	na
	3 599								
Property, plant & equipment	454	–	–	–	–	–	454	na	na
Loans and advances	6	–	–	–	–	6	–	3.91	3.91
Other assets	484	–	33	–	–	–	451	na	na
Total assets	75 313	9	43 359	9 819	7 861	4 800	9 465	2.79	2.61
Liabilities									
Deposits	17 504	6 854	10 650	–	–	–	–	4.53	4.53
Distribution payable to Australian Government	–	–	–	–	–	–	–	na	na
Other liabilities	2 411	–	2 273	–	–	–	138	1.12	1.12
Australian notes on issue	50 059	–	–	–	–	–	50 059	0.23	0.23
Total liabilities	69 974	6 854	12 923	–	–	–	50 197	1.34	1.34
Capital and reserves	5 339								
Total balance sheet	75 313								
Local Currency									
Swaps									
Contractual outflow	(7)	–	(7)	–	–	–	–	na	na
Contractual inflow	163	–	163	–	–	–	–	na	na
	156	–	156	–	–	–	–		
Foreign Currency									
Swaps									
Contractual outflow	(340)	–	(340)	–	–	–	–	na	na
Contractual inflow	184	–	184	–	–	–	–	na	na
	(156)	–	(156)	–	–	–	–		

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.

	2012 $M	2011 $M
Assets accounted for under AASB 139		
At fair value through Profit or Loss	38 283	33 366
Loans and receivables	37 912	37 487
Available for sale	325	302
Assets accounted for under other standards	4 559	4 158
Total assets as at 30 June	81 079	75 313
Liabilities accounted for under AASB 139		
At fair value through Profit or Loss	15	1
Not at fair value through Profit or Loss	74 020	69 842
Liabilities accounted for under other standards	175	131
Total liabilities as at 30 June	74 210	69 974

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 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
As at 30 June 2011				
Assets at fair value through Profit or Loss				
Domestic government securities	4 927	3 587	–	8 514
Foreign government securities	22 370	2 477	–	24 847
Foreign currency swap gains	–	5	–	5
Available for sale				
Shares in international and other institutions	–	–	302	302
	27 297	6 069	302	33 668
Liabilities at fair value through Profit or Loss				
Foreign currency swap losses	–	1	–	1
	–	1	–	1

Note 16 – Subsequent Events

There have been no events subsequent to 30 June 2012 to be disclosed.

Auditor-General for Australia

Australian National
Audit Office

INDEPENDENT AUDITOR'S REPORT

To the Treasurer

Report on the Financial Statements

I have audited the accompanying financial statements of the Reserve Bank of Australia and the controlled entities for the year ended 30 June 2012, which comprise: a Directors' Statement; Balance Sheet; 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

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includes evaluating the appropriateness of the accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

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

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:

1. the financial statements of the Reserve Bank of Australia:

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

   (b) give a true and fair view of the matters required by the Finance Minister's Orders including the consolidated entity's financial position as at 30 June 2012 and of its financial performance and cash flows for the year then ended.

2. the financial statements also comply with *International Financial Reporting Standards* as disclosed in Note 1.

Australian National Audit Office

Ian McPhee
Auditor-General

Canberra
5 September 2012

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.

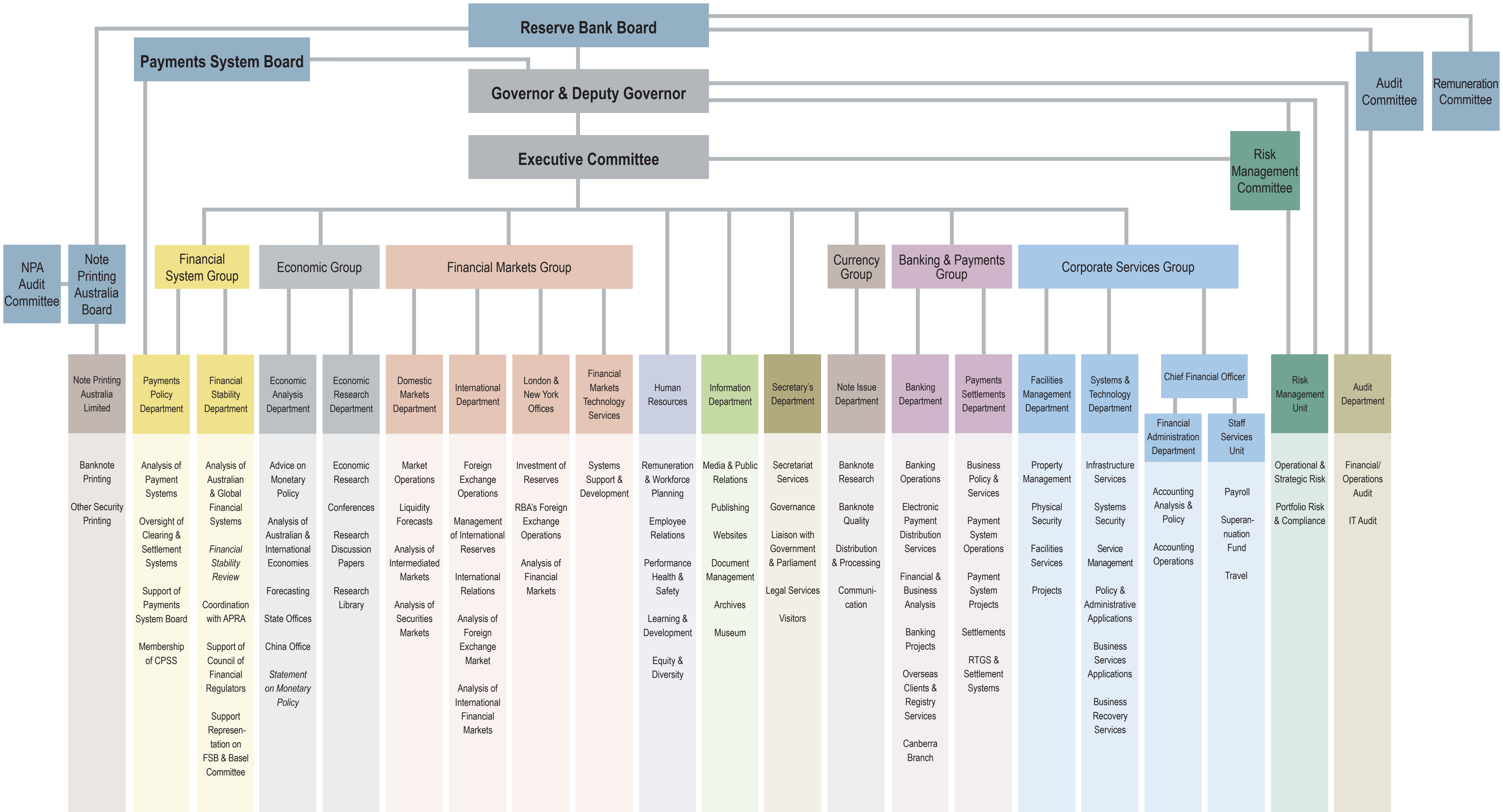
	Transactional Banking		Registry	
	2010/11 $ million	2011/12 $ million	2010/11 $ million	2011/12 $ million
Revenue				
– Service fees	18.0	21.7	0.5	0.6
– Other revenue	5.8	6.8	0.1	–
Total	23.8	28.5	0.6	0.6
Expenditure				
– Direct costs	14.5	19.1	0.3	0.3
– Indirect costs	2.3	2.6	0.1	0.1
Total	16.8	21.7	0.4	0.4
Net profit/(loss)	7.0	6.8	0.2	0.2
Net profit/(loss) after taxes[a]	4.8	4.8	0.2	0.1
Assets[b]				
– Domestic markets investments	743.4	648.4	1.2	1.3
– Other assets	10.0	12.7	0.1	–
Total	753.4	663.1	1.3	1.3
Liabilities[b]				
– Capital and reserves	25.0	25.0	1.0	1.0
– Deposits	721.5	623.8		
– Other liabilities	6.9	14.3	0.3	0.3
Total	753.4	663.1	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

Organisational Chart

September 2012



Executives of the Reserve Bank

September 2012

Governor:	Glenn Stevens
Deputy Governor:	Philip Lowe

Economic Group

Assistant Governor: Christopher Kent

Economic Analysis Department

Head:	Jonathan Kearns
Deputy Heads:	Ellis Connolly
	Marion Kohler
	David Orsmond

Economic Research Department

Head:	Alexandra Heath
Deputy Head:	Michael Plumb

Financial Markets Group

Assistant Governor: Guy Debelle

Domestic Markets Department

Head:	Chris Aylmer
Deputy Head:	Matthew Boge

International Department

Head:	Chris Ryan
Deputy Heads:	James Holloway
	James Whitelaw

Financial System Group

Assistant Governor: Malcolm Edey

Financial Stability Department

Head:	Luci Ellis
Deputy Head:	Christopher Thompson

Payments Policy Department

Head:	Tony Richards
Deputy Heads:	Darren Flood
	Mark Manning

Banking and Payments Group

Assistant Governor: Keith Hall

Banking Department

Head:	Lindsay Boulton
Deputy Heads:	Stephanie Connors
	Paul Phibbs

Payments Settlements Department

Head:	Nola McMillan
Deputy Heads:	David Brown
	Peter Gallagher

Currency Group

Assistant Governor: Michele Bullock

Note Issue Department

Head:	Michael Andersen
Deputy Head:	Keith Drayton

Corporate Services Group

Assistant Governor: Frank Campbell

Financial Administration Department

Chief Financial Officer:	Darryl Ross
Chief Manager:	Colleen Andersen

Staff Services Unit

Chief Manager: Michael Davies

Facilities Management Department

Head: Richard Mayes

Systems & Technology Department

Chief Information Officer:	Sarv Girn
Chief Manager:	Peter Speranza

Secretary's Department

Secretary:	Anthony Dickman
Deputy Secretary:	Peter Stebbing
General Counsel:	Catherine Parr
Deputy General Counsel:	Peter Jones

Audit Department

Head:	John Veale

Information Department

Head:	Jacqui Dwyer

Human Resources Department

Head:	Melissa Hope

Risk Management Unit

Head:	Michelle McPhee

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Glossary

AAS	Australian Accounting Standards
ACC	Asian Consultative Council (of the BIS)
ADI	Authorised deposit-taking institution
AOFM	Australian Office of Financial Management
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
BCBS	Basel Committee on Banking Supervision
BI	Bank Indonesia
BIS	Bank for International Settlements
BRS	Business Resumption Site
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
CLF	Committed Liquidity Facility
CLS	Continuous linked settlement
COIN	Community of Interest Network
CPSS	Committee on Payment and Settlement Systems (of the BIS)
CSA	Credit support annex
DFAT	Department of Foreign Affairs and Trade
D-SIB	Domestic systemically important bank
ECB	European Central Bank
EMEAP	Executives' Meeting of East Asia-Pacific Central Banks
EMC	Environmental Management Committee
ES	Exchange settlement
ESA	Exchange Settlement Account
FMI	Financial market infrastructure
FOI	Freedom of Information
FSB	Financial Stability Board
FSAP	Financial Sector Assessment Program
G-20	Group of Twenty
G-SIB	Global systemically important bank
G-SIFI	Global SIFI
GPF	Government Partnership Fund (with Indonesia)
HQLA	High-quality liquid assets
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
ISO	International Organization for Standardization
IT	Information technology
LVCS	Low Value Clearing Service
LVSS	Low Value Settlement Service
MFSC	Monetary and Financial Stability Committee
MMF	Money market funds
MPG	Macroprudential Supervision Group
NAIDOC	National Aborigines and Islanders Day Observance Committee
NNPDC	National Note Processing and Distribution Centre
NPA	Note Printing Australia Limited
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
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
RMB	Renminbi
RMBS	Residential mortgage-backed securities
RMU	Risk Management Unit
RTGS	Real-time gross settlement
SIFI	Systemically important financial institution
SWIFT	Society for Worldwide Interbank Financial Telecommunication
WHS	Work health and safety

Legislative 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 the relevant information, this index of legislative requirements identifies where that information appears in the Bank's Annual Report.