Australian Office of Financial Management

Annual Report 2015-16

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Australian Government
Australian Office of Financial Management

12 October 2016

The Hon Scott Morrison MP
Treasurer
Parliament House
CANBERRA ACT 2600

Dear Treasurer

I have pleasure in presenting the Annual Report of the Australian Office of Financial Management for the year ending 30 June 2016 for presentation to the Parliament.

The Report has been prepared in accordance with section 46 of the *Public Governance, Performance and Accountability Act 2013*.

Part 2 *Performance* of this Annual Report includes the Australian Office of Financial Management Annual Performance Statement, which is prepared in accordance with section 39 of the *Public Governance, Performance and Accountability Act 2013*. In my opinion this Annual Performance Statement accurately reflects the Australian Office of Financial Management's performance for 2015-16.

Yours sincerely

Rob Nicholl
Chief Executive Officer

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AOFM

ITS ROLE

The AOFM supports and advances Australia's economic growth and stability, and the effective operation of its financial markets, through issuing debt, investing in financial assets and managing that debt and those investments for the Government

Contents

LIST OF TABLES

LIST OF CHARTS

AOFM

REVIEW BY THE CHIEF EXECUTIVE OFFICER

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Context

The AOFM's core responsibilities continue to be managing the Government's daily cash balances in the Official Public Account (OPA), meeting its financing requirements (through debt issuance), and managing the Australian Government Securities (AGS) portfolio. The annual term issuance program for 2015-16 was $96.4 billion in gross terms — the highest in any financial year to date.

Once again it was a year during which global financial market conditions were at times volatile but, with a backdrop of the large ongoing quantitative easing programs of major central monetary authorities, the environment was largely supportive of sovereign fixed income assets. The AGS market remained attractive to global sovereign bond investors due to a range of factors including liquidity, relative credit quality, relative yields, transparency and regularity of issuance.

Since 2011, the AOFM has been gradually lengthening the AGS yield curve with a view to constructing a debt portfolio to meet a range of future scenarios, such as external shocks that could impact the fiscal position, prolonged volatility in interest rates, and heightened funding risk. The higher costs associated with issuing longer dated securities are justified by the benefits of lengthening portfolio duration. Other benefits include increased issuance options, and greater diversity in the AGS investor base. This is a long-term strategy and it continues to be achieved at low cost by historical experience.

Although the proportion of AGS held by offshore investors has been steadily declining (and is now around 60 per cent compared with a peak of 76 per cent in 2012), global financial markets remain a significant influence on the AGS market. During the year there was continued speculation in financial markets about the likely pace of increases to the US federal funds rate given its ability to impact global bond markets. All other things equal, a rising US rate environment could see offshore demand for AGS ease and local bond yields increase. An offsetting factor, however, may be a continuation of extremely low (or even negative) yields on European and Japanese sovereign bonds. Attractive spreads to these markets may weigh in favour of continued demand for AGS in the year ahead.

Over 2015-16 there was a marked decline in AGS yields and the yield curve flattened appreciably. Yields fell by around 60 basis points at the short end and over 100 basis points at the long end. The AOFM's issuance and portfolio management strategy were appropriate given these moves.

Debt issuance and market development

The Treasury Bond issuance program was implemented through a combination of regular weekly competitive tenders, and syndications to establish new maturities. Consistency and transparency in the AOFM's operations and communications with financial markets again provided a strong foundation for achieving the required issuance volume, while developing the AGS market.

In undertaking gross Treasury Bond issuance of $92.6 billion in 2015-16, the AOFM was able to execute its planned portfolio strategy while also being responsive to a diverse investor base and providing continuing support for the 3 year, 10 year and 20 year futures contracts. Tender coverage ratios declined compared with the previous year, a reflection of the increase in primary issuance. The yield curve was again extended, with the establishment of a 2039 maturity. This new maturity consolidated the 20 year area of the curve and will support the 20 year Treasury Bond futures contract.

Gross issuance of Treasury Indexed Bonds for the year totalled $3.8 billion, most of which was issued via twice-monthly competitive tenders. A new 2040 maturity was established to extend the indexed yield curve and support domestic investor demand for long dated inflation linked bonds.

The AGS market continues to attract a diverse range of investors and has retained strong 'price making' competition amongst a number of intermediary banks. While there has been some increased concentration in primary market participation through a reduced number of banks active in bond tenders, this effect has been less pronounced in Australia than in most other sovereign markets.

Portfolio management

The interpretation of portfolio performance requires a strong element of judgment as changes to the structure of the portfolio can only be effected gradually and the core aims of minimising cost and reducing risk are often competing objectives. For example, the debt portfolio is de-risked by issuing longer-term debt; however, this will normally result in higher interest costs. Similarly, the cash management portfolio incurs increased carrying costs when cash balances are high; however, ample cash balances provide important cover for short-term or unforseen Budget financing requirements and are necessary for funding large bond maturities.

Issuance undertaken in 2015-16 further lengthened the average term to maturity of the portfolio. The lengthening strategy that has been in operation since 2011 has deferred the need to fund about $12 billion per year in maturities over the next five years. This is a considerable reduction in near-term funding risk. Ongoing borrowing costs have continued to decline, in line with the lower interest rate environment. On average, the cost of new Treasury Bond issuance in 2015-16 was 2.48 per cent, which compares with 3.79 per cent for the Treasury Bond portfolio as a whole.

The subdued inflation outlook resulted in relatively soft demand for Treasury Indexed Bonds, particularly during the second half of the year. The average cost of new issuance was 2.39 per cent, including the impact of inflation indexation, compared to 3.50 per cent for the indexed portfolio as a whole. Despite reduced investor appetite, the AOFM remains committed to supporting and developing the Treasury Indexed Bond market. Given that the indexed portfolio comprises only around 8.5 per cent of total long-term debt on issue, there is flexibility in how this broad aim is achieved.

While lower interest rates reduce borrowing costs, they also reduced the return on investments and assets. The gross average return was 2.38 per cent for the year, compared with 2.82 per cent for the previous year.

Residential mortgage-backed securities

In May 2015, the AOFM was issued a Direction to commence a program of regular divestment of the remaining residential mortgage backed securities (RMBS) portfolio. A program of monthly competitive auctions was developed and commenced in June 2015.

Four auctions were held between July and October 2015, before RMBS market conditions deteriorated to the point where the AOFM exercised its discretion to suspend the divestment process. As the Government is not a forced seller of the remaining portfolio, the AOFM (consistent with the intent of the Direction) favours holding the remaining, low risk portfolio over selling at a price that would incur a capital loss to the taxpayer. The suspension of auctions, and the AOFM's intentions, have been communicated clearly to the market. By the end of the year the outlook for RMBS had not improved markedly. The auctions achieved sales totalling $297 million, and a modest gain was realised on disposal of the assets.

In addition to investor appetite for RMBS, credit market conditions generally will influence the AOFM in its deliberations regarding any resumption of the RMBS divestment process.

Looking ahead

Over the past four to five years there has been much speculation about the outlook for global economic growth and inflation, changes to the conduct of monetary policy overseas, the increasing size of central bank balance sheets and the performance of sovereign bond markets. This speculation and uncertainty is likely to persist in the years ahead and the outlooks for each of these factors remain relevant to the AOFM's deliberations.

The AOFM is mindful that amongst this challenging and uncertain backdrop, issuance programs are projected to remain elevated. These factors have been taken into account in determining an appropriate long-term structure of the debt portfolio and the issuance strategy required to achieve it.

The AOFM remains focused on portfolio management objectives but does so with consideration of a number of market-related factors. These factors relate to maintaining an efficient and effective sovereign bond market to support domestic financial market operations more generally.

Given the heightened uncertainty around future global financial market conditions, the AOFM has identified a need to dedicate more resources to understanding, anticipating, and responding to the associated sources of risk. This will be achieved through continuing discussions with investors, leveraging the research capability of domestic and international institutions, and directing some internal resources to longer range issues.

Rob Nicholl
Chief Executive Officer

AOFM

PART 1
AOFM OVERVIEW

AOFM OVERVIEW

Role, function, outcome and program structure

The AOFM is responsible for the management of Australian Government debt. The AOFM also manages the Government's cash balances and invests in financial assets. The objectives of the AOFM are to:

1) meet the budget financing task in a cost-effective manner subject to acceptable risk.

2) facilitate the Government's cash outlay requirements as and when they fall due; and

3) be a credible custodian of the AGS market and where relevant other portfolio responsibilities.

The AOFM's debt management activities include the issuance of Treasury Bonds and Treasury Indexed Bonds. To support the efficient operation of the markets for these debt instruments, it maintains a securities lending facility that allows financial market participants to borrow bonds from the Reserve Bank of Australia (RBA).

The AOFM's cash management activities include the issuance of Treasury Notes for short-term funding, and investments in term deposits with the RBA.

The AOFM's investment management activities include managing investments in Australian RMBS under a Government program that supported competition in lending for housing.

The AOFM is part of the Treasury portfolio. It is accountable to the Secretary to the Treasury and to the Treasurer, and through the Treasurer to the Parliament and the public. However, it is a listed entity under the *Public Governance, Performance and Accountability Act 2013* (PGPA Act) and maintains its own accounts and is responsible for compliance with the Act separately to the Treasury. AOFM staff are employed under the *Public Service Act 1999*.

For budgetary purposes, the AOFM's activities comprise of one program directed to achieve the following outcome on behalf of the Australian Government: — the advancement of macroeconomic growth and stability. This is pursued through the effective operation of financial markets by issuing debt and investing in financial assets; and managing debt, investments and cash. The AOFM aims to manage net debt for which it is responsible at least cost, subject to an acceptable level of risk. It also issues bonds taking into account the Government's policy objectives of supporting the AGS market.

Organisational structure

During 2015-16, the AOFM used a six group operational structure, supported by a human resources manager. The allocation of roles and responsibilities within the Office ensures an appropriate segregation of duties and reporting lines. The six groups were:

- Treasury Services;
- Financial Risk;
- Investor Relations;
- Reporting;
- Finance, Settlements and Corporate; and
- Enterprise Risk and Assurance.

In addition, the AOFM supports the Australian Government's aims to transfer knowledge and skill to developing countries through related foreign aid programs. In 2015-16, AOFM staff members worked on programs organised by the Department of Foreign Affairs and Trade under the *Strongim Gavman Program* in Papua New Guinea and the *Solomon Islands Economic and Public Sector Governance Program* in the Solomon Islands. Both programs offer the host governments support for their debt and cash management activities.

AOFM

PART 2
OPERATIONS AND PEFORMANCE

PERFORMANCE AND OUTCOMES

Introduction

The role of the AOFM encompasses a number of principal functions that serve three key objectives. These key objectives are to: (1) meet the Budget financing task in a cost-effective manner subject to acceptable risk; (2) facilitate the Government's cash outlay requirements as and when they fall due; and (3) be a credible custodian of the AGS market and other portfolio responsibilities.

This part of the annual report is presented in two sections: Section 1 is focused on the PGPA Act requirement to provide an Annual Performance Statement; and Section 2 gives context to the outcomes achieved through the AOFM's operations to support its principal functions and discusses relevant market aspects of the environment in which the AOFM operates.

The principal functions of the AOFM are:

- issuing AGS to support the Government's financing task (including maturing debt) in accordance with broader Government policy objectives (such as promoting liquidity);
- managing the Government's daily cash balances through borrowing and investments;
- undertaking investments in financial assets according to policy directives, or as part of broader portfolio management;
- developing risk assessments that support the effective cost management of the debt and asset portfolios; and
- supporting the efficient operation of the Australian financial system through its debt issuance choices.

Section 1: Annual Performance Statement

The purpose of the AOFM is achieved through three key objectives (above). Table 1 presents the Annual Performance Statement, outlines these objectives, and provides a summary of key performance indicators and results for the year. The statement of results refers to detailed context in Section 2 of this part, which provides a comprehensive explanation of a range of outcomes important to the AOFM's achievement of annual and longer-term aims.

The Annual Performance Statement is prepared in accordance with paragraph 39(1)(a) of the PGPA Act.

Table 1: Annual Performance Statement 2015-16

Key performance indicator	Measure	Result
Objective: Meet the Budget financing task in a cost-effective manner subject to acceptable risk		
The financing task is met	Shortfall in volume ($) between actual issuance and planned issuance announced at the Budget and subsequent releases	The shortfall in issuance was zero, with the financing task for 2015-16 fully met through sufficient issuance ($96 billion) *Discussion from page 12*
Debt issuance is cost effective	Compare cost of funds (total accrual costs as a percentage of the average stock of debt) with the cash rate and the average 10 year bond rate	Debt issuance in 2015-16 was cost effective, and consistent with the AOFM strategy of lengthening the average term to maturity of the nominal portfolio to reduce refinancing risk and variability in interest costs. The effective yield of the AGS portfolio for 2015-16 was 3.74 per cent (2014-15: 4.06 per cent). The average yield of issuance for 2015-16 was 2.48 per cent (2014-15: 2.91 per cent). This is below the average 10 year bond rate for 2015-16 (2.61 per cent). The average term to maturity of the portfolio reached around seven years and 9.5 years for new issuance which is why effective yields are higher than the RBA targeted cash rate. *Refer discussion from pages 14 and 23-25*
Debt issuance is targeted to market demand and the capacity of the market to absorb issuance	Difference between the yields at tender with yields in the secondary market (issuance at yields significantly higher than secondary market yields could reflect the confidence of intermediaries they can distribute bonds readily into the market).	The weekly selection of bond maturities and issuance volumes for tenders facilitated continual efficient functioning of the primary market. This is reflected by average tender yields being below secondary market yields for Treasury

Table 1: Annual Performance Statement (continued)

Key performance indicator	Measure	Result
Objective: Meet the Budget financing task in a cost-effective manner subject to acceptable risk		
		Bonds (-0.43 basis points), and Treasury Indexed Bonds (-1.31 basis points). *Discussion from page 18*
Objective: Facilitate the Government's cash outlay requirements as and when they fall due		
Efficient cash management	Number of business days usage of the overdraft facility	Sufficient cash was available at all times to meet the Government's outlays such that there was no requirement during the year to use the RBA overdraft facility. *Discussion from page 28*
Objective: AOFM is a credible custodian of the AGS market and other portfolio responsibilities		
Secondary market for Treasury Bonds and Treasury Indexed Bonds is liquid and efficient	Annual turnover in the secondary market for Treasury Bonds and Treasury Indexed Bonds (turnover is widely accepted as a key measure of the ease with which bonds can be bought and sold).	Annual secondary market turnover for Treasury Bonds was $1.2 trillion and for Treasury Indexed Bonds $0.05 trillion in 2014-15. Liaison suggests that turnover in 2015-16 was broadly similar. This is adequate for the market to function effectively. *Discussion from page 19*
	Monitor usage of AOFM securities lending facility (shortages in the secondary market will result in banks having to rely on 'borrowing' bonds via the facility to cover commitments).	The securities lending facility was used 29 times (excluding intra-day uses), but only for small volumes and for short periods. *Discussion from page 19*

Section 2: Outcomes

This section outlines AOFM operations undertaken in 2015-16 toward achieving its principal functions, and reports on the aims underpinning them and its achievement of these functions. It is presented according to five primary operational considerations: bond issuance; debt portfolio management; cash portfolio management; RMBS portfolio management; and market engagement. The discussion of each refers to underlying aims, how they are achieved and outcomes.

Bond issuance

Aims

The AOFM currently has two term debt instrument choices — nominal Treasury Bonds and Treasury Indexed Bonds, for which the capital value is adjusted over time according to inflation outcomes. During times of Australian Government Budget deficits the main aim of Treasury Bond and Treasury Indexed Bond issuance is to meet the budget financing task; however the issuance program is also determined such that it will assist with meeting overall debt portfolio aims (such as increasing the average term to maturity of the portfolio). The AOFM plans its programs each year to undertake issuance in a cost effective manner.

The AOFM also aims to support the efficient operation of Australia's financial markets by being a credible custodian of the AGS market. This takes account of the following financial market activities:

- Treasury Bonds, Treasury Indexed Bonds and Treasury Bond futures are used by financial market participants as benchmarks for the pricing of other capital market instruments and to manage interest rate risk; and
- the existence of active and efficient physical and futures markets for sovereign debt strengthens the robustness of the financial system and reduces its vulnerability to shocks.

Another element of market efficiency that is important to issuers, intermediaries and investors is market liquidity. Bond market liquidity is broadly accepted to mean the ability to trade bonds immediately, at low cost, without materially moving prices. Strong liquidity is attractive to investors and reflects favourably on a sovereign bond market. There is no single measure of liquidity; it is an assessment by individuals (and institutions) based on a number of considerations. These considerations include, but are not restricted to, turnover in secondary markets, the frequency of primary market activity, bid-offer spreads, and the time it takes to execute 'large' transactions (something in itself that has a different meaning to different parties).

Approach to achieving these aims and market influences

An overriding aim of the issuance program is to meet the AOFM's key objective of achieving the Government's financing task in full. The annual issuance program is also devised on the basis of:

- formulating a strategy that will allocate issuance such that it balances promoting liquidity through building existing lines, against establishing new long-end maturities to support yield curve (and portfolio duration) extensions;

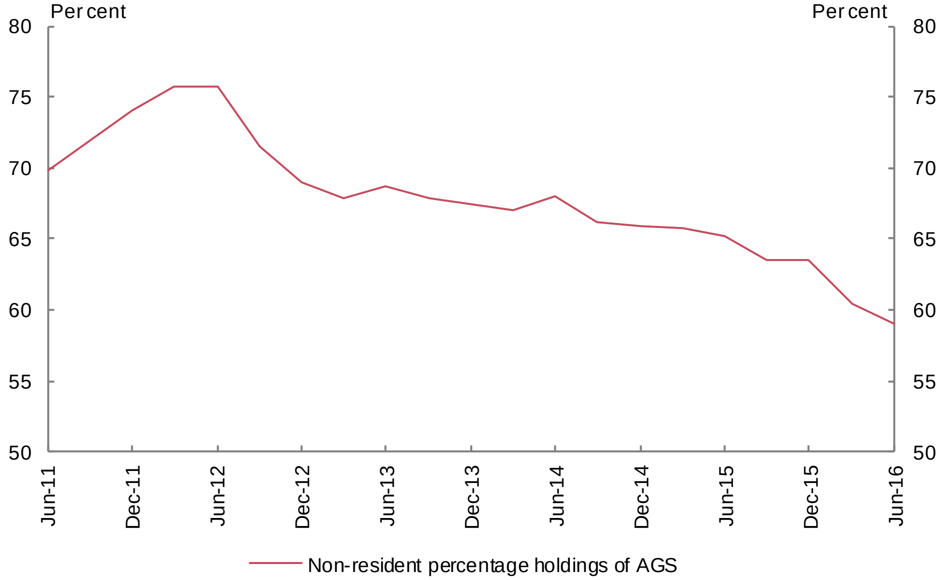
- issuing into and establishing new bond lines that will form part of the futures contracts throughout the year; and
- supporting bond lines in parts of the yield curve that reflect a concentration of interest by various investor types.

The AOFM only uses competitive tenders and syndications to conduct bond issuance. The use of competitive tenders remains the mainstay of AOFM's issuance operations; 98 Treasury Bond tenders and 17 Treasury Indexed Bond tenders were conducted during the year. Three new Treasury Bond lines and a new Treasury Indexed Bond line were launched via syndication.

The environment in which the funding task was completed reflects appreciable changes in the banking sector, where as a result of regulatory and cost changes the appetite of some banks to allocate balance sheet to fixed interest market-making has reduced. This has contributed to a concentration in the number of intermediaries active at tenders; Treasury Bond prices cheapening relative to futures prices; narrowing and negative swap spreads; and elevated costs to fund holdings of AGS.

Although AGS yields were at historically low levels, yields on Treasury Bonds relative to other highly rated sovereign bonds remained attractive to investors. However, non-resident holdings of AGS were on average around 62 per cent of the total outstanding during 2015-16, a continuation of the decline in recent years from a peak of around 76 per cent in 2012, as illustrated in Chart 1.

Chart 1: Non-resident holdings of Australian Government Securities



Source: Australian Bureau of Statistics and the AOFM

Outcomes

Meeting the Budget financing task

The financing task for 2015-16 was fully met. A total of over $96 billion of term debt was issued during the year.

At the time of the 2015-16 Budget, Treasury Bond and Treasury Indexed Bond issuance for the year was expected to total around $78 billion in face value terms. This volume rose over the course of the year to meet the Government's financing requirement and increase the cash balances managed by the AOFM. This left the AOFM in a strong operational position.

Treasury Bond Issuance

Gross Treasury Bond issuance for the year totalled $92.6 billion. The bulk of issuance was into existing bond lines in order to enhance the liquidity of them and in turn, the attractiveness of the AGS market. In addition, three new Treasury Bond lines were launched in 2015-16:

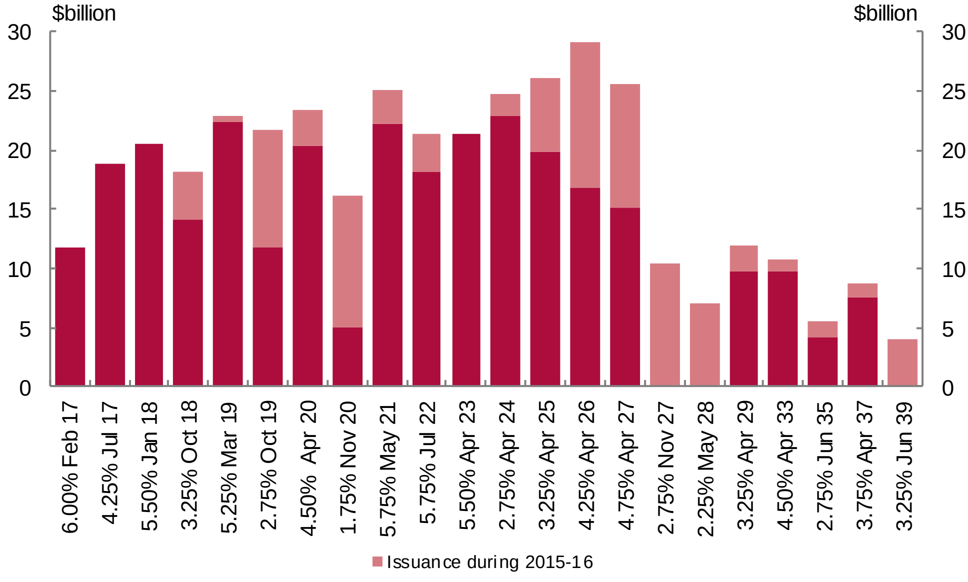
- new bond lines with maturity dates in November 2027 and May 2028 were opened to support the operation of the 10 year Treasury Bond futures contract and to reduce growth in the amount outstanding in surrounding bond lines, which will make it easier to manage maturity of those bonds lines; and

- a new bond line maturing in June 2039 was issued to consolidate the 20 year Treasury Bond yield curve and as support for operation of the 20 year Treasury Bond futures contract.

In selecting the bond lines to issue each week, the AOFM took account of its debt issuance strategy; prevailing market conditions; information from financial market contacts about investor demand; relative value considerations; scope for increasing the liquidity of outstanding bond lines; and the need to manage the maturity structure to limit funding risk. Two tenders were held during most weeks, typically comprising a tender of a long-dated bond line and a tender of a short-dated bond line. To facilitate tenders of very long-dated (around 20 year tenor) Treasury Bonds, three tenders were held in some weeks. The amount offered at each tender ranged from $300 million to $1.2 billion.

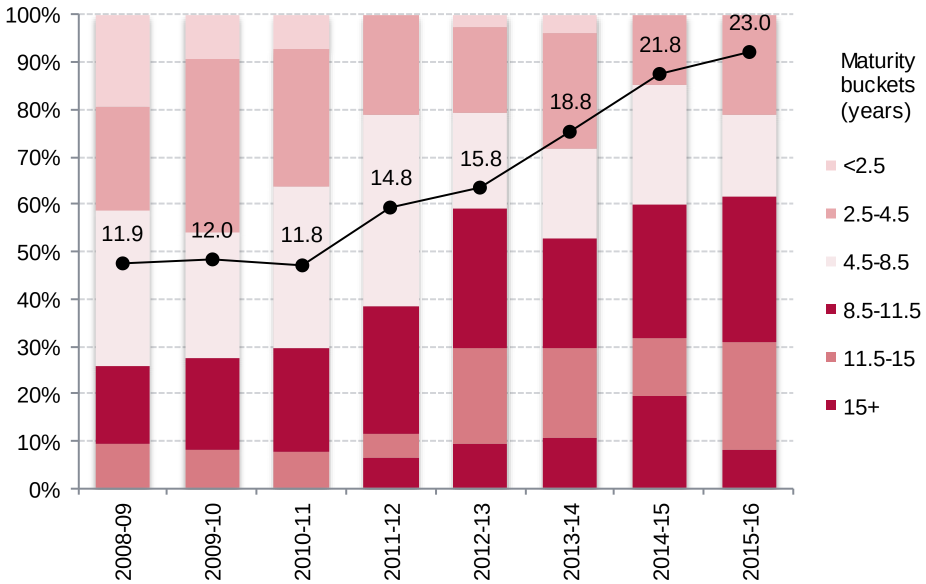
At the end of the year, there were 22 Treasury Bond lines with 14 of these lines having over $15 billion on issue and 18 having over $10 billion on issue. Chart 2 shows Treasury Bonds outstanding as at 30 June 2016 and the allocation of issuance across bond lines during 2015-16.

Chart 2: Treasury Bonds outstanding as at 30 June 2016 and issuance in 2015-16



The AOFM has for some years been pursuing a strategy of lengthening the average term to maturity (an alternative measure to duration) of the debt portfolio. This has been achieved through issuance choices biased towards longer bond lines, and extending the yield curve. This is demonstrated in Chart 3 which shows that more than 60 per cent of issuance in 2015-16 was allocated to longer bonds[1]. It also shows how the Treasury Bond yield curve has been progressively extended each year since 2011 to be just under 23 years (up from 11.8 years in 2011). Yield curve extensions have been integral to the lengthening strategy by providing additional long issuance points and broadening the appeal of the AGS market to longer duration investors.

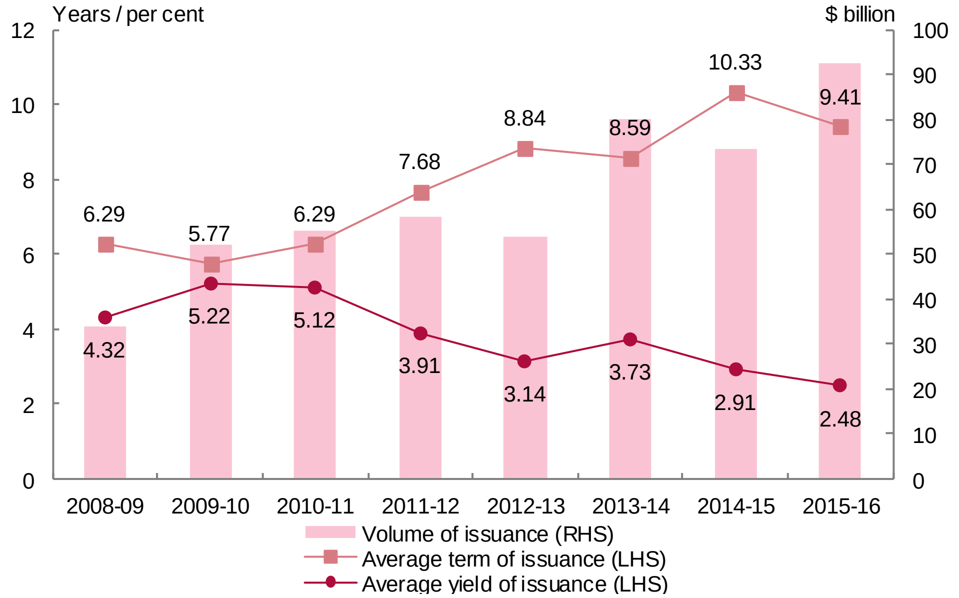
Chart 3: Treasury Bond issuance distribution by financial year and term to maturity of longest line (years)



A long issuance bias, together with the longer yield curve, allowed the AOFM to achieve an average term to maturity of 9.41 years on its Treasury Bond issuance during 2015-16 (see Chart 4). The Treasury Bond program benefited from historically low interest rates and was delivered cost effectively, with an average yield on issuance of 2.48 per cent.

1 Defined as 8.5 years or longer. The demarcation at this point reflects the typical term of the shortest bond in the 10 year Treasury Bond futures basket.

Chart 4: Treasury Bond issuance — average yield and term to maturity



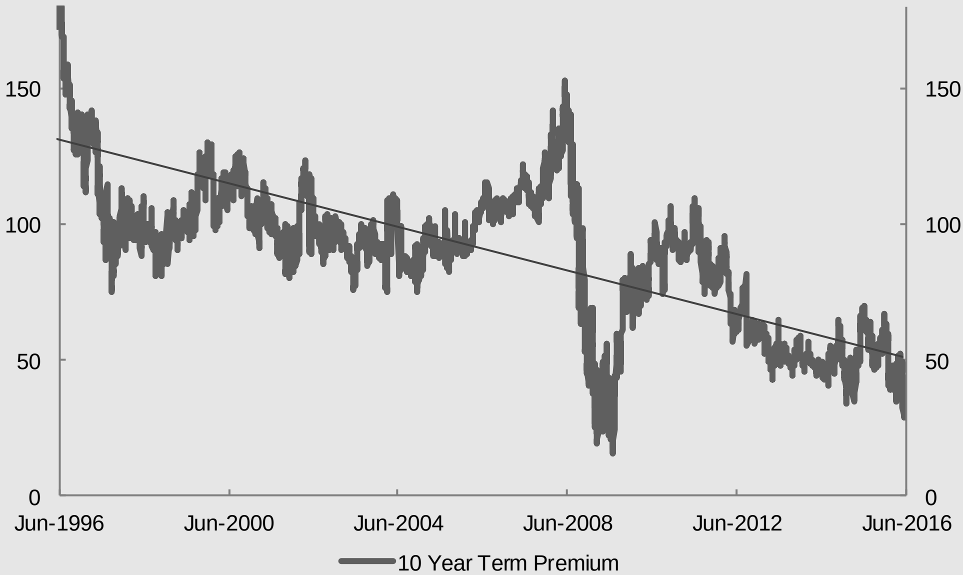
TERM PREMIUM FROM THE PERSPECTIVE OF A SOVEREIGN DEBT MANAGER

A key component of the cost-risk puzzle that contributes to the AOFM's deliberations on issuance strategy is the extra return investors demand for holding a longer-term bond as opposed to investing in a series of short-term bonds, known as the term premium. From the sovereign debt manager's perspective, the term premium provides an answer to the question: what is the cost of issuing debt out along the term structure, relative to issuing short term debt and consequently refinancing it in future periods?

Unfortunately, as market expectations are not directly observable, neither is the term premium. As such, many academics and practitioners over the years have contributed to a body of literature dedicated to term premium estimation. The AOFM has, in the past, utilised a variety of estimation techniques to help inform its strategic decision making processes. Most recently, a linear-regression based affine term structure model developed by economists Adrian, Crump and Moench (ACM) has been implemented. The AOFM has adapted the ACM model for AGS as a gauge of term premium within an Australian context. Chart 5 illustrates how the Australian fitted ACM term premium has evolved over time.

TERM PREMIUM FROM THE PERSPECTIVE OF A SOVEREIGN DEBT MANAGER (continued)

Chart 5: Australian Government Securities fitted ACM term premium estimation



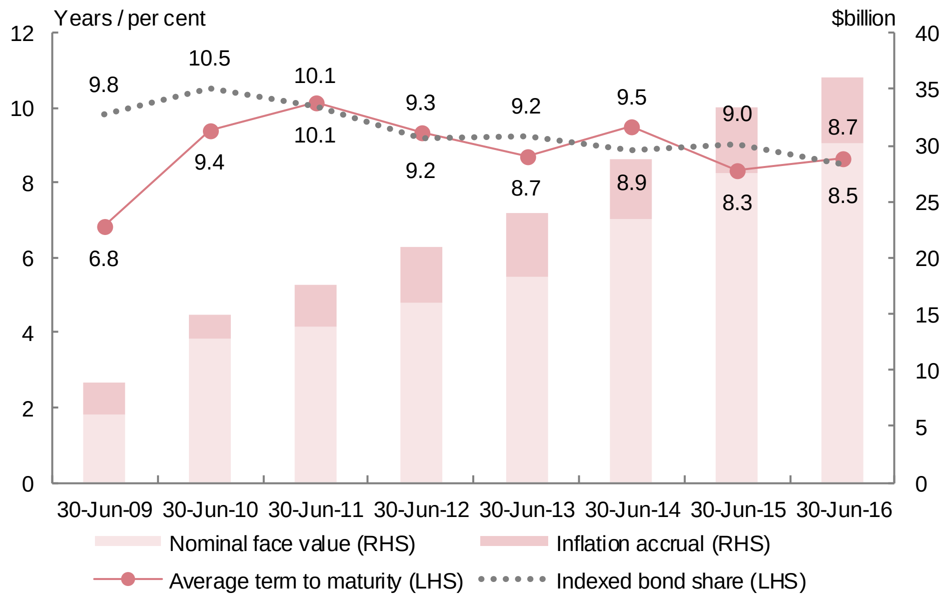
The profile of the estimated term premium clearly suggests compression relative to historical levels. This may be symptomatic of several factors including broad risk premia erosion globally, low interest rate environments and changing investor risk preferences in search of acceptable yield. From a sovereign debt manager's perspective, this compression implies a lower cost of issuing longer term debt relative to market expectations (and relative to issuing shorter term debt), as a lower term premium is paid to the investor.

The AGS fitted ACM model provides another information source that is used in conjunction with a variety of other quantitative and qualitative inputs to inform AOFM strategic decision making. At current levels, the lengthening strategy is supported by term premium estimates.

Treasury Indexed Bond Issuance

The AOFM's alternative long-term funding instruments to Treasury Bonds are Treasury Indexed Bonds, the capital values of which are adjusted with changes in the CPI. The issuance of these bonds typically attracts a different (and predominantly domestic) class of investor to nominal bonds and thus provides a source of diversification in the funding base. The regular issuance of indexed bonds re-commenced in 2009-10 following an extended absence from this market. While the indexed portfolio has been relatively stable as a share of the long term funding base for several years, the stock of indexed bonds has continued to grow steadily (as shown in Chart 6).

Chart 6: Treasury Indexed Bonds — average term to maturity and share of the long-term funding base

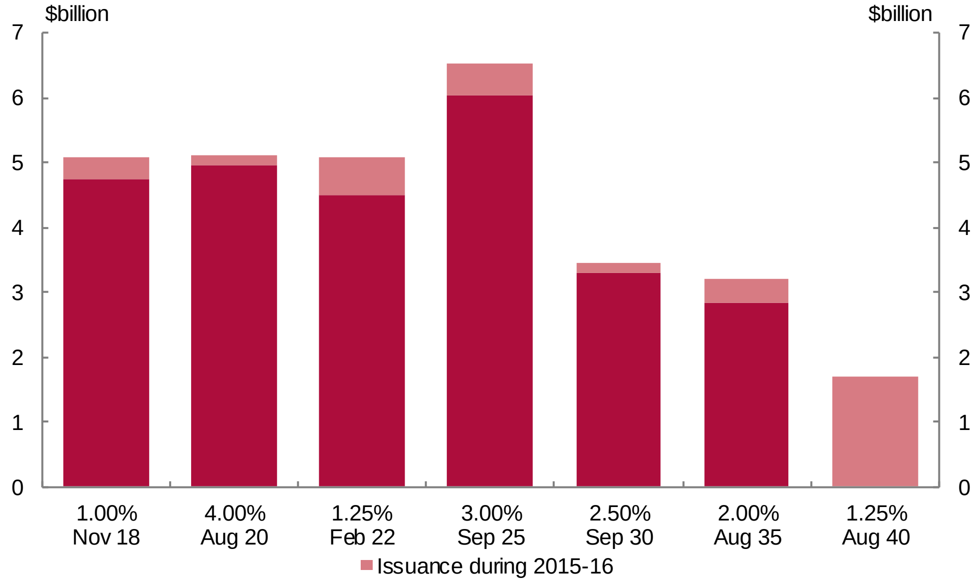


Treasury Indexed Bond issuance for the year totalled $3.8 billion. Two tenders for the issue of Treasury Indexed Bonds were conducted in most months. The volume of each line outstanding, relative yields and other prevailing market conditions were considered in the selection of which line to offer.

The inflation-linked yield curve was extended to around 25 years via the issue of a new Treasury Indexed Bond maturing in 2040. Demand for the issue was strong: $2.82 billion of orders were received for a $1.25 billion capped deal. The majority of the demand was from domestic fund managers.

Chart 7 shows the amount outstanding in each of the seven Treasury Indexed Bond lines as at 30 June 2016, and the allocation of issuance during the 2015-16 year.

Chart 7: Treasury Indexed Bonds outstanding as at 30 June 2016 and issuance in 2015-16



Efficiency of issuance

Table 2 summarises the results of Treasury Bond tenders conducted during the year. The results are shown as averages for each half-year and grouped by the maturity dates of the bonds offered.

Table 2: Summary of Treasury Bond tender results

Period	Maturity	Face value amount allocated ($m)	Weighted average issue yield (%)	Average spread to secondary market yield (basis points)	Average times covered
July - December 2015	Up to 2023	17,400	2.1290	-0.59	3.63
	2024 - 2039	22,000	2.9672	-0.26	2.58
January - June 2016	Up to 2023	17,200	1.9115	-0.68	3.39
	2024 - 2039	20,400	2.5782	-0.30	2.58

The average coverage ratio for all Treasury Bond tenders in 2015-16 was 2.99, a decrease from 3.66 in 2014-15. The average tender size of $786 million was larger than in 2014-15 due to the higher issuance program. Shorter-dated bond tenders generally received a greater volume of bids, which reflects core investor base interest.

The strength of bidding at tenders was reflected in competitive issue yield spreads to secondary market yields. At most Treasury Bond tenders the weighted average issue yields were below prevailing secondary market yields.

The average coverage ratio was 3.69 for Treasury Indexed Bond tenders, a decrease from 4.61 in 2014-15. At most tenders, the weighted average issue yields were below prevailing secondary market yields.

Full tender details are available in Part 5 of this annual report.

Market liquidity and efficiency

The Treasury Bond market operated smoothly throughout 2015-16 with liquidity and efficient price discovery being maintained throughout the year. Investors and intermediaries provide consistent feedback that liquidity in this market continues to compare favourably to other fixed interest markets in which they operate. Data on secondary market turnover in Treasury Bonds is obtained from the Australian Financial Market Association (which surveys banks for the data). At the time of finalising this report the data for 2015-16 were not available. At the time of finalising this report turnover data for 2015 16 were not available, although market liaison suggests that liquidity was broadly similar to during 2014-15, which saw turnover of around $1.2 trillion[2].

Although liquidity in Treasury Indexed Bonds remains good compared to global inflation-linked debt markets, it is more challenging than for Treasury Bonds. This is consistent with the relative liquidity of nominal and inflation-linked securities in other sovereign debt markets. Market participants reported that large trades may have to be executed carefully and over time, and can at times move market prices. Treasury Indexed Bond turnover in 2014-15 was around $50 billion. Market liaison suggests that liquidity may have deteriorated slightly in 2015-16.

Turnover in the Treasury Bond futures market is significantly higher than in the underlying Treasury Bonds. The three and 10 year Treasury Bond futures contracts are highly liquid: they are the ninth and eleventh most traded long-term interest rate futures products in the world, respectively[3]. Turnover in the 20 year contract is considerably lower. All contract close-outs in 2015-16 occurred smoothly.

The AOFM's securities lending facility allows market participants to borrow Treasury Bonds and Treasury Indexed Bonds for short periods when they are not otherwise available in the secondary market. This enhances the efficiency of the market by improving the capacity of intermediaries to continuously make two-way prices,

2 Source: AFMA, 2015 Australian Financial Markets Report.
3 World Federation of Exchanges 2016, WFE/IOMA 2015 Derivatives Market Survey.

reduces the risk of settlement failures and supports market liquidity. The facility was used 29 times for overnight borrowing in 2015-16 compared with 13 times during 2014-15. However, the volumes borrowed tended to be small, with the total face value amount lent in 2015-16 being $261 million, a decrease from $348 million in the previous year.

Debt portfolio management

Aims

In managing the Commonwealth's debt portfolio and meeting the Government's financing requirements, the AOFM seeks to minimise debt servicing costs over the medium term at an acceptable level of risk, by which is meant an acceptable level of variability in cost outcomes. It also seeks to maintain liquid bond lines to facilitate the issuance of debt at acceptable cost and to manage the refinancing risk that arises when bond lines mature.

To meet these aims the AOFM endeavours to execute a debt issuance strategy that appropriately accounts for the trade-offs between cost and risk while simultaneously providing effective and transparent stewardship of the AGS market in order to underpin confidence and promote participation in the market. Facilitating an efficient and resilient market allows for the Australian government to have continued access to financial markets.

The AOFM uses cost and risk measures that appropriately reflect the costs and risks faced by a sovereign debt manager. The primary cost measure used is historic accrual debt service cost. This includes interest payments made on AGS, realised market value gains and losses, capital indexation of indexed debt and the amortisation of any issuance premiums and discounts. Total accrual debt service cost can be expressed as a percentage of the stock of debt outstanding to provide the effective yield of the portfolio. The use of an historic accrual debt service cost measure excludes unrealised market value gains and losses.

An alternative measure of cost is 'fair value', which takes account of unrealised gains and losses resulting from movements in the market value of physical debt and assets. Debt service cost outcomes are presented in the AOFM's financial statements on this basis. A comprehensive income format is used that allows revenues and expenses on an historic basis to be distinguished from the effects of unrealised market value fluctuations. Fair value is useful in circumstances where it is possible that changes in market value may be realised in the future.

Approach to achieving the aims

Variability in portfolio outcomes can be measured in several ways. The AOFM calculates and compares several metrics to assess risk. In general, an acceptable level of risk can be characterised as an acceptable level of variation in interest cost outcomes over time. Debt issuance decisions made today impact the variability of future interest cost outcomes because of their influence on the maturity profile of the portfolio and hence the amount of debt that needs to be refinanced and therefore 're-priced' through time.

The AOFM influences the cost and risk profile of the portfolio primarily through the maturity structure of the debt securities it issues (and to a lesser extent, the mix between nominal and inflation linked securities). Issuing longer-term securities will typically involve paying higher debt service costs (in the presence of a positive term premium[4]) although this is compensated by reduced variability in future interest cost outcomes and lower exposure to refinancing or rollover risk[5]. Issuing shorter term debt securities by contrast will typically be cheaper (avoiding a term premium) but result in higher variability in cost outcomes through time and a greater debt refinancing task. Striking the right balance between these cost and risk considerations is the debt manager's ongoing challenge.

Strategic decision making around the portfolio is informed by an ongoing research program focussed on exploring the cost and risk characteristics of alternative portfolio structures and issuance strategies in light of prevailing fiscal and economic circumstances. Drawing on this research, a strategy for the structure and composition of issuance for the financial year was formulated and tested with the AOFM Advisory Board prior to seeking formal approval from the Treasurer. Separately, a range of complementary limits, thresholds, guidelines and targets governing the AOFM's operations were submitted to the Secretary to the Treasury for approval through an Annual Remit. In implementing the strategy, operational issuance decisions such as determining if, when, how much and which lines to issue each week were made by the AOFM over the course of the year. These operational decisions were influenced by several factors including general market conditions, relative value considerations and feedback from investors. The ongoing suitability of any issuance and portfolio strategy is constantly under review.

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4 The term premium is the additional yield demanded by investors in order to hold a long-term bond instead of a series of shorter-term bonds. Further exploration of the term premium and its relevance to the AOFM can be found in the Bond Issuance section.

5 Refinancing risk, also referred to as rollover risk, is the inability to renew maturing debt by further borrowing.

Outcomes

During the year, the total volume of Treasury Bonds outstanding increased by around $50 billion, to $385 billion.

Portfolio risk management

The AOFM's strategy was based on a continuation of lengthening the average term to maturity of the portfolio. This decision was influenced by a range of factors including a continuation of low outright bond yields, a below average term premium (which increases the attractiveness of longer term issuance), anticipated growth in the debt stock (and refinancing task) and an external environment characterised by heightened levels of volatility and uncertainty. In short, the opportunity to lengthen cost effectively and thereby limit growth in the risk profile of the portfolio as the stock of debt increased was a key driver of the AOFM's strategy.

Chart 8: Treasury Bond portfolio — modified duration, average term to maturity and cost of funds

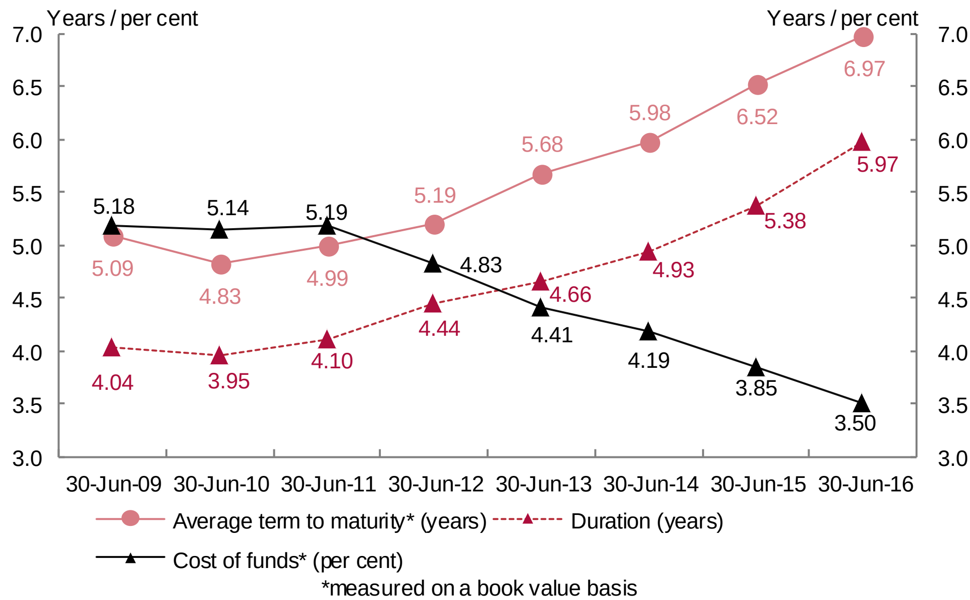
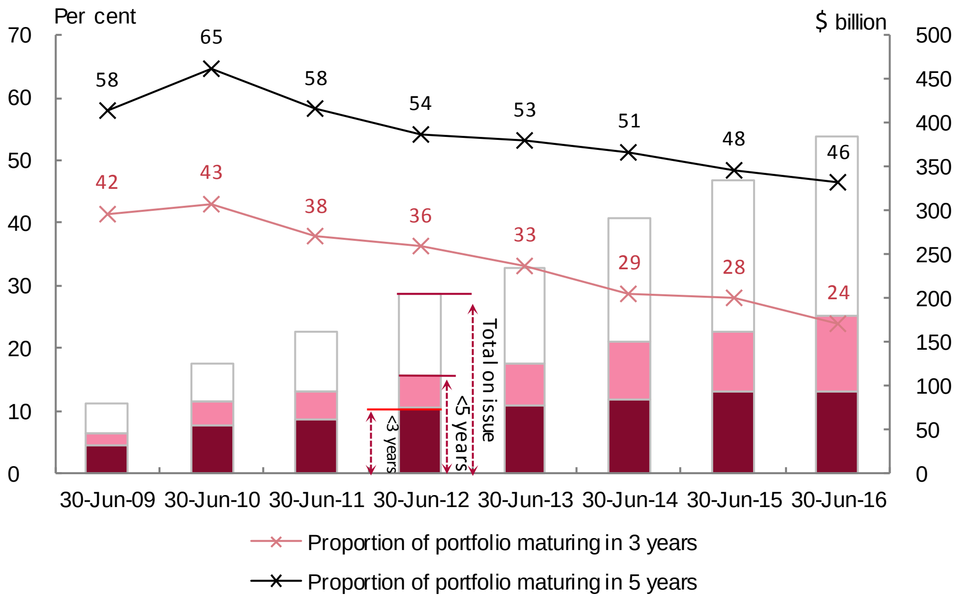


Chart 8 shows that the average term to maturity of the Treasury Bond portfolio was lengthened by 0.45 years to 6.97 years over 2015-2016 while duration increased by 0.59 years to 5.97 years. The effective cost of funds or yield on the Treasury Bond portfolio fell from 3.85 to 3.50 per cent over the same period[6].

6 These are point in time measures as at 30 June each year, in contrast to the debt servicing cost incurred throughout the year captured in Table 3.

The reduced inherent risk levels of the portfolio flowing from the lengthening strategy are demonstrated in Chart 9 below. The chart shows a steady decline in the short to medium term Treasury Bond refinancing task, measured as the proportion of the stock of Treasury Bonds on issue through time[7]. Whereas at 30 June 2010 the structure of the portfolio was such that 43 per cent and 65 per cent of bonds required refinancing over the next three and five year periods respectively, this has fallen to 24 per cent and 46 per cent. These reductions translate directly into lower medium-term gross borrowing programs. The AOFM estimates that annual Treasury Bond issuance will be about $12 billion per annum lower on average over the next five years as a result of the lengthening strategy. This is beneficial at a time when borrowing programs are at elevated levels.

Chart 9: Treasury Bond maturity profile



Portfolio cost

The debt servicing cost[8] of the net AGS debt portfolio managed by the AOFM in 2015-16 was $14.85 billion on an average book volume of $385.82 billion, representing a net cost of funds of 3.85 per cent for the financial year. The largest

7 In absolute dollar terms, the quantum of three and five year maturities in the portfolio has still grown although this has occurred at a considerably slower pace compared to growth in the overall stock of Treasury Bonds.

8 Debt servicing cost includes net interest expense (measured on an accruals basis and includes realised gains and losses on the disposal of assets or liabilities) plus foreign exchange revaluation gains and losses (now minimal). Unrealised changes in the market valuation of domestic debt and assets are not part of this measure.

component of net AGS debt is the Long Term Debt Portfolio (LTDP), comprised primarily of Treasury Bonds and Treasury Indexed Bonds, which incurred debt servicing costs of $15.49 billion on an average book volume of $411.43 billion, implying a cost of funds of 3.76 per cent. The difference between net AGS debt and the LTDP is attributable to the short term assets and liabilities the AOFM uses for liquidity management purposes (term deposits and Treasury Notes) and other residual assets (such as RMBS).

Chart 10: Net AGS debt and Long Term Debt Portfolio cost of funds analysis (per cent)

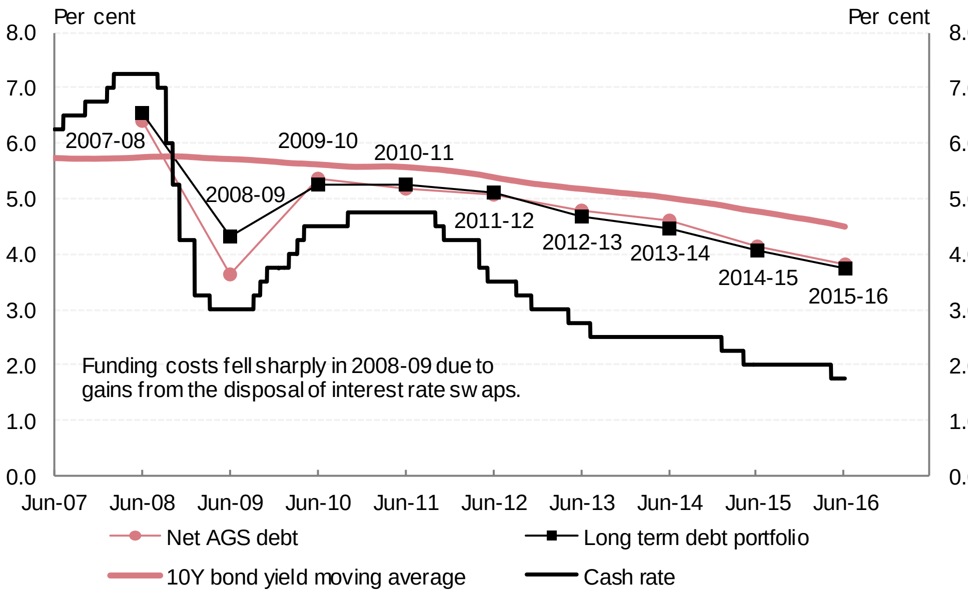


Chart 10 shows the funding cost profile of the net AGS debt portfolio and the LTDP back to 2007-08. These are contrasted with the cash rate and the 10 year moving average of the 10 year bond yield. In an environment where interest rates have been trending down, funding costs on the net debt portfolio and the LTDP have declined by 137 and 153 basis points respectively since 2010-11. This compares to declines of 300 basis points in the cash rate and 108 basis points in the 10 year bond yield moving average over the same period. Given the largely fixed cost structure of the net debt portfolio and the LTDP, changes in funding cost will always lag changes in the overnight cash rate (changing only when existing debt securities or assets mature or new securities are issued/investments placed). In a comparison with the 10 year bond yield moving average, funding costs have fallen further because of the relative 'over-representation' of recently issued debt in the portfolio through a period where issuance yields have been declining.[9]

Table 3 provides further details of the cost outcomes for the portfolio of debt and assets administered by the AOFM broken down by instrument and portfolio for 2014-15 and 2015-16.

Table 3: Commonwealth debt and assets administered by the AOFM

	Interest expense		Book volume		Effective yield	
	2014-15	2015-16	2014-15	2015-16	2014-15	2015-16
	$ million		$ million		per cent per annum	
Contribution by instrument						
Treasury fixed coupon bonds	(13,078)	(14,246)	(321,839)	(375,961)	4.06	3.79
Treasury inflation indexed bonds	(1,266)	(1,240)	(31,804)	(35,465)	3.98	3.50
Treasury notes	(163)	(129)	(6,800)	(6,419)	2.39	2.01
Foreign loans (a)	(2)	(1)	(6)	(6)	28.39	14.17
Gross physical AGS debt	(14,508)	(15,616)	(360,449)	(417,851)	4.03	3.74
Term deposits with the RBA	604	537	25,471	26,682	2.37	2.01
RMBS investments	194	112	5,147	3,314	3.78	3.37
State Housing Advances (c)	124	118	2,107	2,033	5.87	5.80
Gross assets (c)	922	766	32,725	32,029	2.82	2.39
Net AGS debt	**(13,586)**	**(14,850)**	**(327,724)**	**(385,822)**	**4.15**	**3.85**
Contribution by portfolio						
Long Term Debt Portfolio	(14,345)	(15,487)	(353,649)	(411,431)	4.06	3.76
Cash Management Portfolio	441	408	18,671	20,263	2.36	2.01
RMBS Portfolio	194	112	5,147	3,314	3.78	3.37
State Housing Portfolio (c)	124	118	2,107	2,033	5.87	5.80
Total debt and assets	**(13,586)**	**(14,850)**	**(327,724)**	**(385,822)**	**4.15**	**3.85**
Re-measurements (b)	(7,512)	(17,633)				
Total after re-measurements	**(21,098)**	**(32,483)**	**(327,724)**	**(385,822)**		

Note: Sub totals and totals are actual sum results, rounded to the nearest million dollars. Effective yields are based on actual results before rounding, rounded to two decimal places. Book volume is a through the year average.

(a) Interest expense and effective yield on foreign loans incorporates foreign exchange revaluation effects.

(b) Re-measurements refer to unrealised gains and losses from changes in the market valuation of financial assets and liabilities.

(c) State Housing Advances book volume for 2014-15 was incorrectly reported as $2,321 million in the 2014-15 Annual Report. The book volume and subsequent calculations of the effective yield on the portfolio have been amended in this year's Annual Report.

The debt servicing cost of gross debt increased in dollar terms by $1,108 million compared to the previous year. This was primarily due to an increase in the average volume of debt on issue from $360.45 billion in 2014-15 to $417.85 billion in 2015-16. In percentage terms however, the funding cost of gross debt declined by 29 basis points

9 Bond issuance over the past four financial years for instance accounts for around ¾ of the LTDP as at 30 June 2016. Bond yields over this period were on average significantly lower than the preceding years which largely explains why portfolio funding costs have fallen by more than the 10 year bond yield moving average.

(4.03 per cent to 3.74 per cent). This improvement was driven by the issuance of new bonds through the year at yields that were below the average of pre-existing (and maturing) debt. Low rates also reduced the yield on funds invested in term deposits from 2.37 to 2.01 per cent and RMBS investments from 3.78 to 3.37 per cent.

The return on gross assets in dollar terms for the period was $766 million, a decrease of $156 million compared to 2014-15. This was driven by a $83 million reduction in income from RMBS (resulting from the maturity and sale of existing investments and lower interest rates) as well as a $67 million reduction in income from term deposits (due to lower investment yields).

The net servicing cost of the combined portfolio of debt and assets was $14.85 billion. This was higher in dollar terms compared to 2014-15, due to the volume of debt on issue being higher than the previous year. As a percentage of net debt, servicing costs fell from 4.15 per cent to 3.85 per cent, a product of more expensive historically issued debt maturing and continued issuance over the year into a low interest rate environment.

Movements in market interest rates had an unfavourable impact on the market value of the portfolio in 2015-16. Unrealised losses from re-measurements amounted to $17.63 billion. This compares to an unrealised loss of $7.51 billion in the previous year. About 97 per cent of re-measurement losses are attributable to the higher market value of Treasury Bonds. As bond prices move in opposite directions to bond yields, it can be seen that the same favourable, lower interest rate environment responsible for driving down the AOFM's overall portfolio funding costs in 2015-16 (expressed as a percentage), was also responsible for this negative re-measurement impact.

As re-measurement items are highly volatile from one year to the next, they have no bearing on the AOFM's debt issuance strategy. Indeed were the AOFM to adopt a strategy designed to minimise the 'noise' from re-measurements, issuance would be limited to only very short-term debt securities, for example Treasury Notes and near maturity bonds, creating a portfolio structure that would maximise expected variability in debt servicing costs when measured in cash, accrual and public debt interest terms, while also maximising exposure to refinancing and funding risk. In practice, the AOFM has been seeking to reduce these risks, through allocating a greater proportion of issuance to long dated lines.

Cash management

Aims

The AOFM manages the daily cash balances of the Australian Government in the OPA.[10] The AOFM manages these balances so as to ensure that the Government is able to meet its financial obligations as and when they fall due. Other objectives are to minimise the cost of funding and the carrying cost of holding cash balances (which centres on holding only balances assessed as prudent to cover forecast needs and contingencies, while investing excess balances but at low or minimal risk). In minimising cost, the AOFM seeks to avoid use of the overdraft facility provided by the RBA.[11]

Approach to achieving the aims

Achieving the cash management objective involves formulating forecasts of Government cash flows, and developing and implementing appropriate strategies for short-term investments and debt issuance.

Cash balances not required immediately were invested in term deposits at the RBA, with the magnitudes and tenors of the term deposits determined by the AOFM. Maturity dates of term deposits were selected to most efficiently finance net outflows. Interest rates for term deposits at the RBA reflect the rates earned by the RBA in its open market operations.

Treasury Notes are issued to assist with management of the within-year funding requirement. The volume of Treasury Notes on issue ranged from $4 billion to $10 billion during 2015-16.

The size and volatility of the within-year funding requirement are reflected in changes in the short-term financial asset holdings managed by the AOFM, after deducting Treasury Notes on issue. Chart 11 shows movement in the funding requirement over the year.

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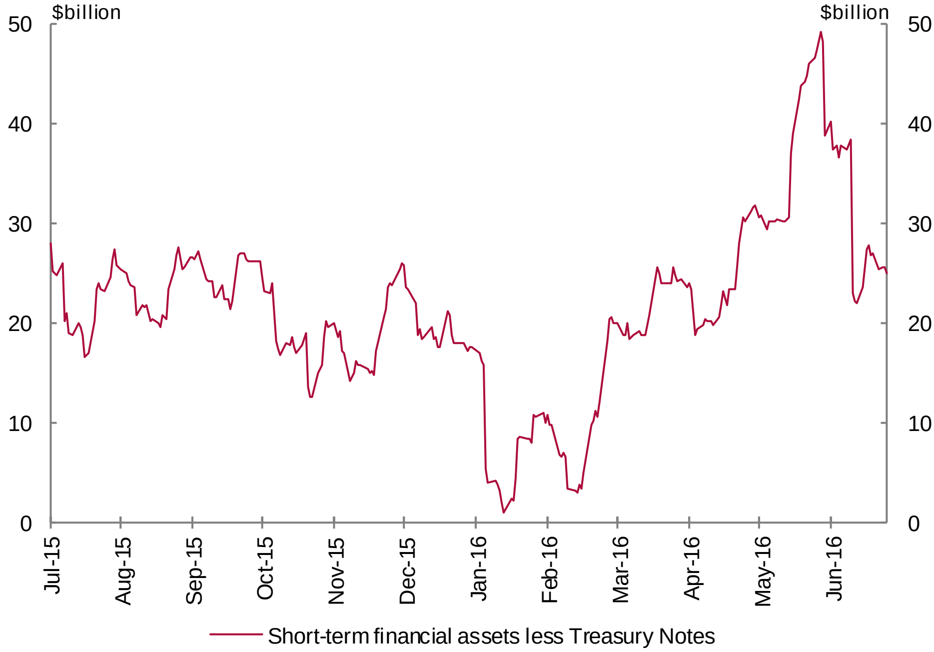
10 The OPA is the collective term for the Core Bank Accounts maintained at the RBA for Australian Government cash balance management.

11 The overdraft facility is more costly than equivalent short-term borrowing (for example, issuance of Treasury Notes). The terms of the facility provide that it is to cover only temporary shortfalls of cash and is to be used infrequently and, in general, only to cover unexpected events.

Chart 11: Within-year funding requirement 2015-16



Outcomes

The task of meeting the Government's financial obligations as and when they fall due was fully met, without use of the overdraft facility provided by the RBA.

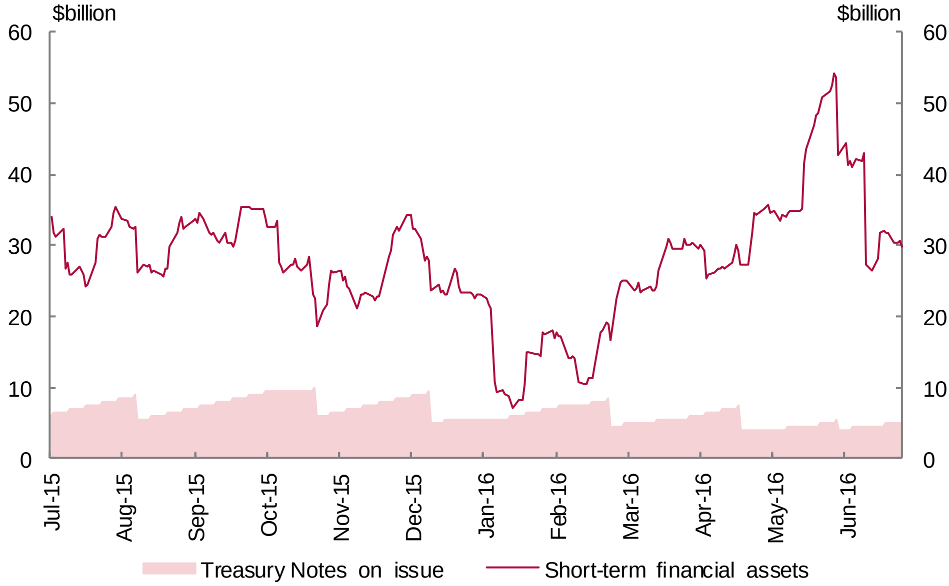
During 2015-16, the AOFM placed 314 term deposits with the RBA. The stock of term deposits fluctuated according to a range of factors influencing the AOFM's cash portfolio management needs and decisions. Term deposits ranged from a minimum of $6.5 billion in January 2016 to a maximum of $53.4 billion in June 2016.

The average yield obtained on term deposits during 2015-16 was 2.01 per cent, compared with 2.37 per cent in 2014-15. The decrease in average yield reflects the lower average level of interest rates that prevailed during 2015-16.

A total of $20 billion of Treasury Notes were issued in 2015-16 (in face value terms). The average coverage ratio at tenders was 3.19, a reduction from 3.57 in 2014-15. Yields were on average around eight basis points higher than Overnight Indexed Swap (OIS) rates for corresponding tenors (compared to around three basis points higher than OIS rates in 2014-15). Details are available in Part 5 of this annual report.

The movement in total short-term financial asset holdings managed by the AOFM (OPA cash balance plus term deposits with the RBA), together with the volume of Treasury Notes on issue during 2015-16 are shown in Chart 12.

Chart 12: Short-term financial asset holdings and Treasury Notes on issue 2015-16



In undertaking its cash management activities, the AOFM was required to maintain a 91-day moving average of the daily OPA cash balance below the Ministerially approved upper limit of $1.5 billion. This was achieved throughout the year.

Movements in the 91-day rolling average OPA cash balance over the year are shown in Chart 13.

Chart 13: 91-day moving average cash balance 2015-16

Residential mortgage-backed securities

Aim

During the period October 2008 to April 2013, the AOFM was directed to invest up to $20 billion in eligible RMBS to support competition in mortgage lending. In total, just under $15.5 billion was invested.[12] On 5 May 2015, the Treasurer issued a new Direction under the PGPA Act to divest the Government's RMBS portfolio through a regular competitive process.

The Treasurer's Direction stipulates that sales must not exceed $500 million per month and that the AOFM should exercise its discretion on timing and sales volume to minimise potential market disruptions. The Direction also provides the AOFM with discretion to cancel a sale or suspend the auction process when RMBS sales cannot occur at a price level that the AOFM considers to be acceptable.

Approach to achieving the aim

In accordance with the Treasurer's Direction, the AOFM commenced a competitive sales process for the Government's RMBS portfolio in June 2015. Under the current Direction, one auction was held on 24 June 2015 in which around $160.5 million in amortised face value of RMBS were sold.

The Australian RMBS market was not as strong during the 2015-16 financial year as it was during the two preceding years. Global credit market conditions deteriorated progressively throughout the second half of 2015 and into early 2016. For a large part of 2015-16, market conditions were not conducive to a competitive sales process for the Government's RMBS portfolio. As a consequence, the AOFM exercised its operational discretion to suspend RMBS auctions for the majority of the financial year.

Outcomes

Divestment process

During the 2015-16 financial year, the AOFM completed four monthly RMBS auctions between July and October 2015.[13] A summary of the sales achieved from these four auctions is provided in Table 4. The first three auctions resulted in bids being received that exceeded the reserve price set with reference to prevailing market prices prior to the commencement of each auction. In October 2015, no bids were received that met the RMBS auction reserve prices. RMBS auctions completed by the AOFM

12 Copies of each Direction are available on the AOFM website.

13 Full results for each auction are available on the AOFM's website at: <http://aofm.gov.au/publications/operational-and-public-notices/>

during 2015-16 achieved sales totalling $297 million in amortised face value terms. These sales realised gains totalling $1.71 million.

Table 4: RMBS divestments for 2015-2016

	Amortised face value ($m)	Gain on Sale ($m)
Jul-15		
PROGRESS 2012-1 A	26.11	0.44
RESIMAC 2011-1 A	67.58	0.25
SMHL 2010-1 A	2.50	0.01
Aug-15		
BARTON 2011-1 A2	39.36	0.33
ILLAWARRA 2010-1 A	40.52	0.25
SMHL 2008-2 A1	42.97	0.16
Sep-15		
IDOL 2010-1 A2	77.98	0.26
Oct-15		
N/A	0.00	0.00
Total	**297.01**	**1.71**

In November 2015, the AOFM announced the suspension of sales until at least February 2016, due to concerns that the sale of RMBS at market clearing prices may have added to the disruption then occurring in the secondary market. In February 2016, while the primary RMBS market had 're-opened' at a new equilibrium price, the AOFM announced that the suspension would continue until further notice, as this new equilibrium price level was considered to be unacceptable. As at the end of June 2016, prevailing market prices indicated that continuing a suspension of the auction process was prudent.

RMBS portfolio and market conditions

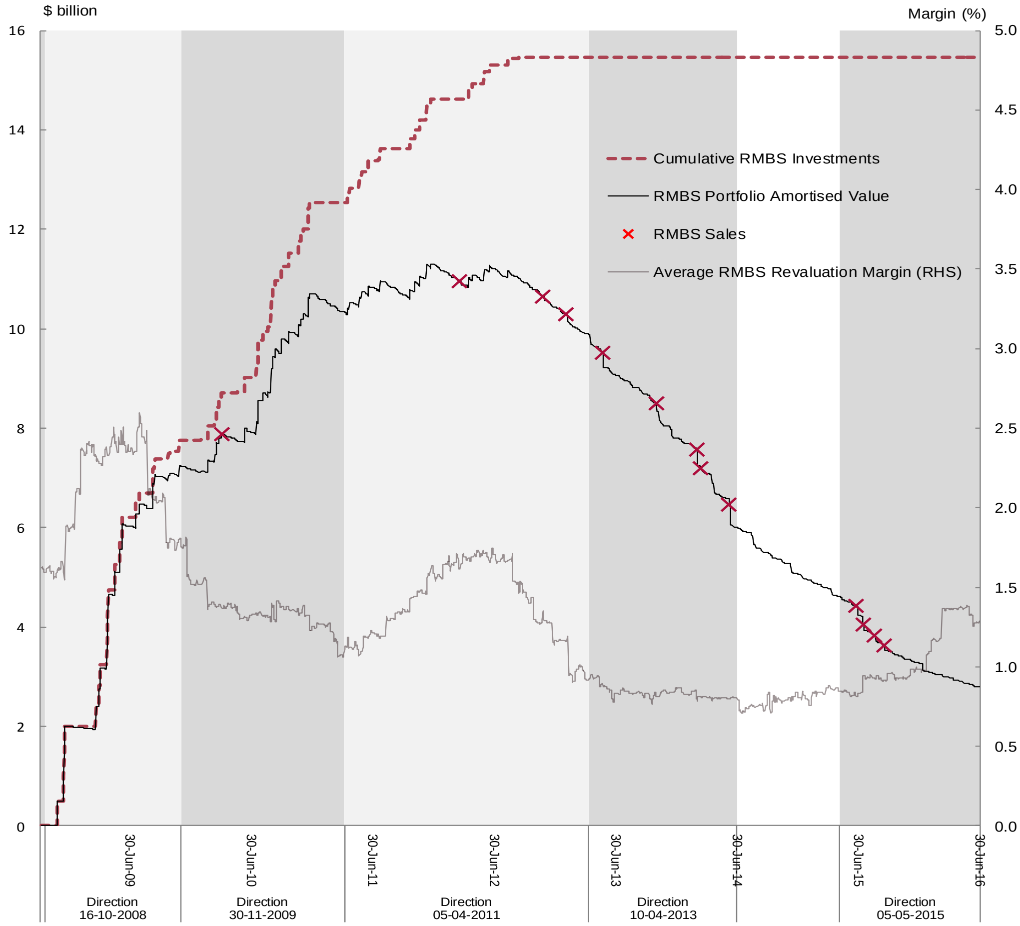
Chart 14 plots cumulative volumes purchased under the first four Directions in force between October 2008 and April 2013 on the same axis as the amortised value of the RMBS portfolio through time.[14] The latter series illustrates the $1.45 billion reduction in size of the RMBS portfolio, from $4.3 billion to $2.8 billion, that was achieved in 2015-16 through both natural amortisation and sales.

Chart 14 also highlights the widening in secondary market RMBS spreads that occurred through the year. It demonstrates that, in early 2016, RMBS spreads returned

14 The background shading in the chart highlights the time during which each Direction was in force.

to levels last seen around the time the AOFM made its final investments under the program, in the third quarter of 2012.[15]

Chart 14: RMBS investments, amortisation and divestments



Source: AOFM, Macquarie Debt Markets Analysis

The widening in spreads through much of 2015-16 represented a deterioration in domestic RMBS market conditions that was broadly consistent with global trends. Events such as the Greek debt crisis, global equity market volatility, and speculation

15 The AOFM was prepared to assess new investment proposals into 2013, but was scaled out by private sector investment, given the improvement in conditions as reflected by the tightening in RMBS spreads at this time. These improved conditions saw the Treasurer issue a Direction to cease new investment in April 2013 that allowed the AOFM to continue to divest its RMBS under certain conditions. It ceased with the repeal of the FMA Act in June 2014.

about the timing of US monetary policy tightening all contributed to a deterioration in global credit market conditions.

The AOFM considers that exercising its discretion to suspend the sales process both reduced the potential for additional market disruption and preserved taxpayer value. Thus, while divestment volumes were lower than expected, the AOFM acted in a manner that was consistent with its Direction.

Table 5 puts the RMBS sales made in 2015-16 into a historic context. Over the life of the program from October 2008 to June 2016, around $20.6 million in realised gains has been earned from RMBS divestments.

Table 5: RMBS divestments over time

Financial year	Amortised face value ($m)	Gain on Sale ($m)
2009-2010	73.79	-
2010-2011	-	-
2011-2012	50.00	-
2012-2013	510.58	5.29
2013-2014	885.00	12.60
2014-2015	160.50	1.00
2015-2016	297.01	1.71
Total	**1,976.88**	**20.60**

The average margin over the one month bank bill rate (weighted by each of AOFM's investments) for the RMBS book remained stable over the financial year at around 127 basis points. Interest income in 2015-16 was $109.9 million and, as noted earlier, sales in 2015-16 contributed a further $1.7 million in realised gains. Total accrual income of $111.6 million represented an annualised return of 3.37 per cent on the portfolio's average book value of $3.3 billion. This is lower than the corresponding return in 2014-15, due largely to lower prevailing short term interest rates.

Losses or gains in the mark-to-market value of the portfolio change with prevailing conditions and therefore vary at any particular point in time. These are not realised returns and so are excluded from the accrual returns, but are included as re-measurements within the AOFM's comprehensive income statement treatment.

The RMBS securities held by the AOFM are valued using indicative 'bid' margins for secondary market trading as estimated by an independent valuation service provider. The cumulative unrealised loss on the portfolio was $9.5 million as at the end of the financial year, a reduction in value of around $29.7 million versus the year before. This reduction was due mainly to the widening of revaluation spreads illustrated in

Chart 14. The total return on the RMBS portfolio for 2015-16, including re-measurements, was thus around $81.8 million, or approximately 2.47 per cent of the portfolio's average book value.

Market engagement

Aim

In order to achieve its core objectives the AOFM needs to maintain a comprehensive understanding of a wide range of market related issues including planned and possible major announcements and events, impacts on the global flow of capital, changing investor preferences, and the performance of banks that play the role of intermediaries — particularly in the primary AGS market, on which the AOFM relies for access to end investors. While this aim can in part be served by following announced regulatory changes there remains the need for a heavy emphasis on maintaining strong lines of communication directly with intermediaries and both directly (and indirectly through intermediaries) with end investors. Communication with intermediaries is frequent and with investors is based on an investor relations program. The program is underpinned by a strategy that is reviewed periodically, largely in response to changes in market conditions and/or the AOFM's planned issuance strategy.

Achieving the Aims

The Investor Relations strategy in 2015-16 again focused on identifying opportunities to realise further diversity in the AGS investor base while maintaining and managing engagement with current key investors.

There were four parts to the Investor Relations strategy:

- a targeted focus on direct engagement with investors from specific geographic regions, and of different type based on a review of the current investor base and emerging interest from new and potential investors;
- a lesser (although still regular) use of face-to-face investor meetings;
- increased use of opportunities to present to conferences or speaking events to groups of investors; and
- a greater use of the AOFM website to provide updates for investors.

Of greatest interest to investors throughout the year were discussions about AGS market conditions, AOFM plans for issuance and further market development, and AOFM perceptions as to the changing composition of the AGS investor base.

Outcomes

Activities throughout 2015-16 included slight changes to the previous year and were particularly focused on regions, countries and sectors where investors in AGS were growing in importance, number and their level of interest in specific and usually longer duration investments (this being of particular interest as the plans to lengthen the yield curve have been gradually implemented). The ability to access new investors has proven more difficult as global and Australian yields have fallen to historically low yields and relative yield spreads to other sovereign bond markets have contracted. The AUD, a major investment consideration for non-resident investors, remained relatively range bound over the period and quite volatile with many expecting it to further depreciate.

Of the 116 individual meetings held this year, 31 were with investors not previously met. This percentage of new investor meetings (27 per cent) was lower than the previous year (40 per cent). Overall this tends to suggest the breadth of the AGS investor base could be maturing, particularly in light of the strong growth in new investors over past years as the central bank community were actively allocating into AUD assets. All but four of these new investor meetings were with non-resident institutions. Fewer new investor meetings were held in Asia and Australia but they remain important due to the large number of established investors in both.

Two offshore regions however did stand out for new contacts. Investor roadshows to Tokyo and London contained 11 and 7 meetings respectively, with new investors.

Both of these cities have the largest concentration (by number of individual institutions) of current offshore investors (and seemingly potential investors). These cities, as well as parts of Europe, have a large proportion of private sector investors looking for longer duration and so those regions remained a major focus for AOFM investor engagement.

One area where the current investor base grew in importance was in Australia. Although non-resident investors are still considerably larger in number than their domestic counterparts and non-resident holdings of AGS is around 59 per cent, this proportion has been falling for the last four years. This was not due to non-resident investors buying less AGS, in fact outright holdings continued to rise. The main reason being was domestic investors were buying an increasingly larger proportion of increasing issuance volumes.

Just over 30 meetings were conducted with domestic investors this year (out of 116 investor meetings in total).

As well as face-to-face meetings and presentations, the AOFM again conducted a number of phone meetings with international and domestic investors through-out the year. Regular fortnightly calls with ten domestic Treasury Indexed Bond investors have assisted in the selection of individual lines to tender and were useful in gauging demand for Treasury Indexed Bond in general.

Table 6: Summary of investor relations activities in 2015-16

Activity	Details
Conferences, speaking engagements and investor roadshows	10 events
Presentations: Large engagements/ Roundtables	8 presentations
Approximate total audience size: Large Presentations	125 attendees
Individual meetings	116 investor meetings
Individual cities visited	19 cities
AOFM staff participating in investor relation activities	CEO, Head Investor Relations, Head Treasury Services, Senior Strategist Investor Relations, Communications Officer Investor Relations
Hosting banks: Investor roadshows, conferences, roundtable discussions	ANZ, Commonwealth Bank, Citi, Deutsche Bank, UBS, Westpac

Table 7: Timeline of investor relations activities in 2015-16

Date	Details
July 2015	Sydney
August 2015	Sydney, Asia: Hong Kong, Taiwan, Malaysia, Singapore
October 2015	Melbourne: CBA Fixed Income Conference, 1 presentation to 80 attendees
November 2015	Europe: UK, France
December 2015	Asia: China, Japan
February 2016	Sydney: UBS Treasury Indexed Bond Roundtable
March 2016	Scandinavia, Canberra: Deutsche Investor Mission; Sydney
April 2016	Sydney, Canberra

AOFM

PART 3

MANAGEMENT AND ACCOUNTABILITY

MANAGEMENT AND ACCOUNTABILITY

Governance of the AOFM

The AOFM's governance arrangements provide coordinated and systematic mechanisms that support an organisational culture which is risk-aware, ethical and diligent. Through effective governance practices, the AOFM achieves efficient and effective delivery of its core business objectives. Elements of the governance framework include:

- strategic, corporate and business planning processes;
- enterprise-wide risk management, assurance and compliance activities (including a comprehensive independent audit program), oversighted by an Audit Committee chaired by an independent member;
- performance frameworks that facilitate on-going monitoring through the provision of timely and relevant management reporting; and
- delegations, instructions and internal guidance regarding powers and duties to ensure adherence with relevant legislation, regulations, policies and expectations.

Overview of accountabilities

The AOFM is part of the Treasury portfolio. It is accountable to the Secretary to the Treasury and to the Treasurer, and through the Treasurer to the Parliament. As a listed entity under the PGPA Act the AOFM's CEO is accountable for the management and performance of the AOFM, namely with respect to the implementation of debt management and investment policies. This also extends to matters such as the maintenance of accounts and records, management of risks and compliance with legislation and policy.

The Secretary to the Treasury is responsible for advising the Treasurer on Government policy relating to debt management and investment activities. In order to undertake the required functions of the AOFM, the CEO is delegated powers and authorisations by the Treasurer and the Secretary to the Treasury for debt creation and issuance, investment, and portfolio management.

The CEO is supported by an Executive Group, and AOFM's portfolio activities are overseen by an Advisory Board, as well as being the subject of close financial market scrutiny.

The AOFM's corporate plan, policies and codes of conduct mirror AOFM values and these reflect high standards of integrity and accountability. Activities are designed to meet the requirements of legislative and regulatory frameworks, as well as the codes and practices expected of financial market participants.

Boards and Committees

AOFM Advisory Board

The Advisory Board is responsible for advising the Secretary to the Treasury (as Chair) on matters relevant to debt management parameters, investment policies and the suitability of AOFM's interactions with financial markets generally. The Board does not possess executive powers or decision-making authority but offers the Secretary comprehensive guidance based on external perspectives and practices and financial market experience and outlooks.

The Board met three times during 2015-16, with all meetings being held at the Treasury's Sydney Office. Members and their attendance at 2015-16 Board meetings is provided in the following table.

Table 1: Advisory Board meetings

Advisory Board members	Eligible meetings	Attendance
John Fraser, Secretary to the Treasury, Chair	3	3
Rob Nicholl, Chief Executive AOFM	3	3
Stein Helgeby, Deputy Secretary, Government and Resource Management Group, Department of Finance	3	3
Matthew Flavel, Acting Deputy Secretary, Fiscal Group, the Treasury	1	1
Michael Brennan, Deputy Secretary, Fiscal Group, the Treasury	2	2
Paul Bide, Consultant	3	3
Carol Austin, Consultant	3	3
Peter Warne, Consultant (a)	1	1
Anne Anderson, Consultant (b)	2	2
Stephen Knight (c)	-	-

(a) Peter Warne resigned from the Advisory Board December 2015.
(b) Anne Anderson was appointed to the Advisory Board November 2015.
(c) Stephen Knight was appointed to the Advisory Board May 2016.

On appointment to the Board, each external member is required to sign a declaration to maintain confidentiality in relation to the affairs of the Board and the AOFM's operations.

Executive Group

The role of the AOFM Executive Group is to assist and support the CEO in fulfilling his responsibilities to manage the AOFM (in particular, as the accountable authority under the PGPA Act, and pursuant to other Commonwealth legislation). Its activities include the: setting and tracking of strategic plans and performance targets; review of the AOFM's risk profile and setting of risk appetite; monitoring financial and compliance performance; and reviewing and advising on workforce planning initiatives. The Executive Group, which is chaired by the CEO and comprises the AOFM's senior executives, meets monthly.

Audit Committee

The Audit Committee monitors and reviews the AOFM's governance, risk management, internal control and financial reporting arrangements. It receives periodic briefings from AOFM management on changes to the business and risk contexts and operations. It oversees the assurance program including reports, indicator dashboards and briefings tabled by the AOFM's Assurance area and auditors. This information assists the Audit Committee to form its view on the AOFM's performance in relation to its obligations and the on-going effectiveness of the AOFM's risk and control frameworks.

Key activities of the Committee during 2015-16 included:

- advice on the preparation and review of the AOFM's financial statements;
- developments in the AOFM's risk profile and compliance performance, as reported through the quarterly risk and assurance reports, and the findings and recommendations of internal control reviews undertaken by the internal auditors;
- fraud control strategies and monitoring activities;
- monitoring the progress of: major corporate projects to improve business operations; initiatives to achieve the AOFM's workforce planning outcomes; and the implementation of audit recommendations; and
- reviewing the AOFM's preparedness to meet performance reporting obligations, in line with the new annual reporting requirement under the PGPA Act, as well as its approach to monitoring key performance indicators, and how these will be incorporated into the Annual Performance Statement.

The Committee met four times during 2015-16, with all meetings being held at the AOFM's office in Canberra. Members and their attendance at 2015-16 meetings is provided in the following table. The Audit Committee also met with the internal auditors and external auditors in closed sessions during the year.

Table 2: Audit Committee meetings

Audit Committee members	Eligible meetings	Attendance
Peter Warne, Independent Member, Chair (a)	2	2
Will Laurie, Independent Member, Chair (a)	2	2
David Lawler, Independent Member	4	4
Matthew King, Chief Financial Officer and Head of Financial and Parliamentary Division, Corporate Group, the Treasury	4	4
Samantha Montenegro, Chief Risk and Compliance Officer, AOFM	4	4

(a) Peter Warne resigned from his position as independent member and Chair of the Audit Committee, effective 31 December 2015. Mr Will Laurie was appointed to this position from 1 January 2016, and attended the November 2015 Audit Committee meeting as an observer.

Each member is required to sign a declaration to maintain confidentiality in relation to the affairs of the Committee and the AOFM, and are also required to provide an annual conflict of interest declaration.

External observers at Audit Committee meetings included the ANAO and its outsourced provider (KPMG), and the AOFM's internal auditor (PricewaterhouseCoopers). The AOFM Chief Financial Officer is an invited attendee. The AOFM CEO regularly attends meetings.

Other management committees

Portfolio Strategy Meeting

Portfolio Strategy Meetings (PSM) advise the CEO on operational debt portfolio and financial risk management issues, and review deal execution and general financial market conditions. Membership during 2015-16 included the CEO, Director of Financial Risk, Head of Treasury Services and Head of Investor Relations, with other senior staff holding relevant functional responsibilities invited as observers and contributors to topical papers. The PSM typically meets on a bi-monthly basis.

Cash Management Meeting

The Cash Management Meeting is held each week to review the government's cash portfolio position and short to medium term cash flow projections, including expected funding needs and possible new contingencies emerging. The meeting is chaired by the CEO, and attended by the Head of Treasury Services, Director of Financial Risk, together with other staff from the Treasury Services and Investor Relations Units. The development of plans to implement new maturity establishment (via syndications) is conducted through this forum.

Security Committee

The Security Committee performs an oversight role in respect of security management within the AOFM. Its membership comprises the CEO (as Chair), Chief Risk and Compliance Officer, Agency Security Advisor, and IT Security Advisor. The head of the Treasury Security Team is invited to attend ex officio to assist in security harmonisation. The Security Committee meets quarterly.

Management of fraud risk

The AOFM has a **low** risk appetite for fraud, and has taken comprehensive steps to prevent the occurrence of fraud.

A fraud control plan, and systems to ensure the regular identification, assessment and treatment of fraud risk vulnerabilities, is in place. These comply with the PGPA Act and Rule, and the Commonwealth Fraud Control Framework.

The fraud control plan establishes appropriate mechanisms for the prevention and detection of fraud incidents, including the recording and reporting of fraud incidents. Periodic review of the fraud control plan and fraud risk assessments are undertaken during the year.

Annually, the CEO provides a report to the Treasurer on the AOFM's fraud control activities. For 2015-16 the AOFM did not identify any instance of fraud or suspected fraud.

Enterprise risk

Risk management is integral to all aspects of the AOFM's activities and is the responsibility of all staff. The Executive Group, as the leadership and oversight group, have particular responsibilities to champion a positive risk-aware culture, oversight the considered evaluation of the risk environment, and support staff in the design, implementation and effective operation of appropriate treatments and controls.

The enterprise risk management framework provides for the ongoing, active and transparent management of uncertainty (threats and opportunities). Key reflection points are provided quarterly (at Executive Group meetings), and as part of the annual corporate planning activities. Assessments are used to inform strategy development, execution and operations. The enterprise framework captures information on emerging matters and key risks at both enterprise ('top-down', outward focussed) and business unit ('bottom-up', inward focussed) levels. Staff understand that risks are to be managed to a level that is consistent with the AOFM's risk appetite and tolerance statements (defined at a category-level).

The AOFM's enterprise risk framework is consistent with Commonwealth policy. During 2015-16, the framework attained an 'advanced' rating of maturity under the Comcover Benchmarking Program, consistent with the AOFM's aspirations.

The AOFM's enterprise risks are classified into three broad categories.

- Strategic risks: opportunities and exposures that impact on the AOFM's medium to long term objectives and strategies. These are owned and reviewed by the Executive Group on a quarterly basis.
- Portfolio risks: impact on portfolio management, investment and debt issuance activities; these are managed pursuant to the AOFM's financial risk management framework in consultation with the Advisory Board.
- Operational risks: relate to business as usual and corporate activities of the AOFM, and generally deal with matters of compliance, or the availability, integrity and/or actions of staff, providers, systems and/or processes.

As a stable and mature agency, the AOFM's most significant risks typically arise from uncertainty relating to external factors or major changes to business activities. Key entity risks that are under management include the:

- potential negative impact of market trends or disruptive technologies on the successful issuance of AGS to meet funding requirements;
- potential for the AOFM to lose AGS investor confidence through its actions or messaging;
- failure to adequately implement and operate internal systems and controls to ensure the continuity and accuracy of forecasts, tenders, payments and settlements; and
- failure to plan for the future with regards to our people, infrastructure or business model.

Business continuity arrangements

The AOFM has a comprehensive business continuity plan to ensure that its critical functions can continue in the event of a major disruption or the outbreak of a pandemic. These arrangements include the provision of full back up of IT and related business services that can be implemented when the AOFM's day-to-day business systems or office accommodation are not able to be used, or when AOFM staff are not available to perform key tasks.

In 2015-16, PricewaterhouseCoopers undertook an internal audit to assess the design and implementation of the AOFM's business continuity and disaster recovery planning framework. The internal audit rated the frameworks as having effective controls and aligned with better practice principles. Key strengths included:

- multiple back-up contingencies for time critical market operations;
- sound documentation and business impact assessments to determine recovery timeframes, which are comprehensively understood by team members and communicated to relevant parties; and
- the strong commitment to testing and validating business continuity and disaster recovery arrangements.

Business continuity plans were updated and tested during 2015-16, to reflect new arrangements for the provision of IT support by the Treasury under a shared services arrangement. Business continuity arrangements are supported by emergency procedures to manage the AOFM's response to a range of situations.

Assurance

The AOFM's enterprise risk framework is complemented by an assurance framework, which seeks to confirm the existence, operation and effectiveness of key controls. The framework is scaled to meet the needs of the AOFM and is modelled on better practice industry standards.

The AOFM's compliance with external obligations and internal controls and procedures is monitored through a co-sourced arrangement, with in-house assurance and compliance activities supplemented by the use of independent internal audit services.

During 2015-16, assurance and compliance activities provided structured assurance on the effectiveness and efficiency of the AOFM's governance arrangements, risk management and internal control environment. Key assurance activities undertaken in 2015-16 included:

- reviews of key frameworks and arrangements;
- project assurance for the re-implementation of the AOFM's treasury system;
- maintenance and performance of the AOFM's Anti-Money Laundering and Counter-Terrorism Financing Program under the *Anti-Money Laundering and Counter-Terrorism Financing Act* 2006;
- preparation of an annual report on compliance with the PGPA Act and the *Public Governance, Performance and Accountability Rule* 2014 (PGPA Rule); and
- completion of the annual compliance testing program, with monthly reporting provided to the Executive Group and quarterly reporting provided to the Audit Committee.

Information and output derived from the enterprise risk and assurance frameworks support the CEO in meeting the obligation to maintain a sound system of risk management and internal control pursuant to section 16 of the PGPA Act.

Internal audit

The AOFM's internal audit service provider is currently PricewaterhouseCoopers. Internal audit coverage is determined using a methodology aligned with professional internal audit standards, with due regard to the AOFM's operating and risk contexts. The Audit Committee endorses the internal audit strategy to the CEO for approval.

The internal auditor completed six framework and/or compliance reviews during 2015-16. Internal audit activities undertaken in 2015-16 included review of:

- portfolio management of RMBS and the divestment process;
- financial risk policies;
- debt issuance, confirmation and settlement;
- AOFM's management of a shared services Memorandum of Understanding with the Treasury;
- human resource operations and payroll control; and
- business continuity and disaster recovery planning

In its annual report on internal controls, the internal auditor concluded that AOFM continued to have a mature control environment (demonstrated by the nature and type of findings reported). Audit recommendations were aimed at enhancing the efficiency of the current control environment. At 30 June 2016, two internal audit recommendations remained outstanding and these were being addressed in accordance with agreed timelines.

Judicial decisions

In 2015-16, no matters relating to the AOFM were the subject of judicial proceedings, administrative tribunal hearings or consideration by the Commonwealth Ombudsman.

External reports on agency operations

There were no reports in 2015-16 on the operations of the AOFM by the Auditor-General (other than the report on financial statements); a Parliamentary committee; or the Commonwealth Ombudsman.

Capability Review

The Australian Public Service Commission (APSC) undertook a Capability Review of the AOFM at the request of the CEO. Dr Michael Vertigan AC was the chair of the review team; other senior members of the team were Ms Akiko Jackson and Ms Jennifer Rawson (DFAT).

For the AOFM review, external stakeholders interviewed included Australian and State Government agencies, domestic and international investors and comparable sovereign debt management organisations in other countries. The review was conducted as part of the AOFM workforce plan.

The review highlighted how the AOFM maintains a strong position amongst external stakeholders in regards to its credibility and competence. Furthermore, the assessed culture and outcome focus of the AOFM leave it very well placed to maintain these strengths. Scope for organisational improvement were identified in how the AOFM manages and motivates staff — while these are reflective of APS challenges generally, the AOFM faces both threats and opportunities specific to a relatively small organisation that offers limited career pathways to highly technically skilled staff.

However, the overall capability assessment was very positive with the AOFM being viewed as either well-placed or strong for seven of the ten categories of consideration. The report indicates the AOFM has highly capable staff who consistently deliver high quality outcomes in the core business. The review also highlighted opportunities for the AOFM to share its knowledge and expertise more widely within government. The full report of the review has been published on the APSC web site at: http://www.apsc.gov.au/priorities/capability-reviews.

Management of human resources

Workforce planning

The *AOFM Workforce Plan 2014-2018* actions include succession planning, recruitment improvement, increased organisational resilience, and review of the organisational structure. As a result of the plan and outcomes from the Capability Review, AOFM is improving its human resource development systems. Plan actions and outcomes are tracked by AOFM management.

Enterprise Agreement

The *AOFM Enterprise Agreement 2015-2018* was approved by the Fair Work Commission subject to an undertaking concerning staff at APS Level 2 and below. The agreement came into effect on 17 July 2015. No individual flexibility arrangements that vary the effect of the terms of this agreement have been made. The CEO has increased AOFM pay rates via a determination under subsection 24(1) of the *Public Service Act 1999*.

Training and development

In 2015-16, 80 per cent of staff participated in some form of internal or external training and $2,566 per full-time equivalent (FTE) was paid to external providers for the period to cover this training. Of the 3.5 days per FTE invested in skill development, 1.8 days per FTE were external courses, 1.2 days were invested in training in-house and the balance was study. Including participant time, the AOFM's commitment to training and development activity in 2015-16 represented 2.7 per cent of gross salary.

The AOFM workforce

Table 3 shows this workforce by broadband classification as at the beginning and end of 2015-16.

Table 3: Operative and paid inoperative staff as at 30 June 2016 and 2015

	Ongoing				Non-ongoing				
	Full-time		Part-time		Full-time		Part-time		
Classification	**Male**	**Female**	**Male**	**Female**	**Male**	**Female**	**Male**	**Female**	**Total**
2016									
AOFM1	-	2	-	-	-	-	-	-	**2**
AOFM2	16	8	1	2	-	1	-	-	**28**
AOFM3	5	1	-	-	-	-	-	-	**6**
AOFM4	1	-	-	-	-	-	-	-	**1**
CEO	1	-	-	-	-	-	-	-	**1**
Total	**23**	**11**	**1**	**2**	**-**	**1**	**-**	**-**	**38**
2015									
AOFM1	-	1	-	-	-	-	-	-	**1**
AOFM2	15	11	-	2	-	-	-	-	**28**
AOFM3	6	1	-	-	-	-	-	-	**7**
AOFM4	1	-	-	-	-	-	-	-	**1**
CEO	1	-	-	-	-	-	-	-	**1**
Total	**23**	**13**	**-**	**2**	**-**	**-**	**-**	**-**	**38**

Note: AOFM broadband classifications are linked to Australian Public Service classifications as follows: AOFM1 corresponds to APS1 to APS4, AOFM2 corresponds to APS5 to EL1, AOFM3 corresponds to EL2 and AOFM4 covers higher level EL2.

Two positions were staffed by AOFM to support knowledge transfer and technical capacity building in sovereign debt management in Papua New Guinea and the Solomon Islands during 2015-16. These positions are arranged under the *Strongim Gavman Program* and the *Solomon Islands Economic and Public Sector Governance Program* respectively. Assistance under the *Strongim Gavman Program* ceased in February 2016 after legislative change by the government of Papua New Guinea.

Eighty-eight per cent of AOFM staff have degree qualifications, with 25 per cent holding higher degrees and 25 per cent holding double degrees. Forty per cent have professional qualifications related to their role with the AOFM.

Employees who identify as indigenous

The AOFM does not have any staff who identify as indigenous.

Changes to senior management

The Head of Treasury Services retired in September 2015. He was replaced through a merit selection process.

Other staffing changes

Six ongoing and four non-ongoing employees were recruited during 2015-16.

There were nine staff departures during the year; six ongoing staff (including the retirement of the Head of Treasury Services noted above) and three non-ongoing.

Staff departures represented 24.9 per cent of average staffing levels in 2015-16 (15.1 per cent in 2014-15).

The retention rate for 2015-16 was 86.5 per cent, with an average annual retention rate of 89.3 per cent over the last five years.

Employment arrangements

All non-SES staff had terms and conditions set during 2015-16 by the *AOFM Enterprise Agreement 2015-2018* and a determination made under subsection 24(1) of the *Public Service Act 1999* by the CEO.

The CEO has his terms and conditions set by the Secretary through a determination made under subsection 24(1) of the *Public Service Act 1999*.

Remuneration

Pay rates as at 30 June 2016 are shown in Table 4. These rates were set in accordance with the *AOFM Enterprise Agreement 2015-2018* and a determination made under subsection 24(1) of the *Public Service Act 1999*.

Table 4: AOFM salary ranges

	30 June 2016	
Classification	Band low $	Band high $
AOFM1	41,115	75,138
AOFM2	73,125	149,047
AOFM3	173,748	217,185
AOFM4	233,683	292,104

Remuneration within the range for the classification depends on individual performance ratings. Performance appraisals balance what is achieved (outputs) with how those results are obtained (behaviours). Performance-linked bonuses are not paid.

Non-salary benefits provided to staff principally comprise superannuation and support for professional development through study assistance, short courses and payment of job-relevant professional society membership fees. A mobile phone, laptop, or other mobile device may be provided where there is a business need. Executive remuneration is reported in Note 4 of Part 4: Financial Statements.

Disability reporting mechanism

Since 1994, Commonwealth non-corporate entities have reported on their performance as policy adviser, purchaser, employer, regulator and provider under the Commonwealth Disability Strategy. In 2007-08, reporting on the employer role was transferred to the Australian Public Service Commission's State of the Service Report and the APS Statistical Bulletin. These reports are available at www.apsc.gov.au. From 2010-11, entities have no longer been required to report on these functions.

The Commonwealth Disability Strategy has been overtaken by the National Disability Strategy 2010-2020, which sets out a ten year national policy framework to improve the lives of people with disability, promote participation and create a more inclusive society. A high level two-yearly report will track progress against each of the six outcome areas of the Strategy and present a picture of how people with disability are faring. The first of these reports will be available in late 2014, and can be found at www.dss.gov.au.

Work health and safety

Health, wellbeing and safety services are provided by the Treasury under a Memorandum of Understanding. The AOFM has one Health and Safety Representative who assists staff in accordance with the *Work Health and Safety Act 2011*.

Work health and safety is a standing agenda item at Executive Group meetings.

Flu vaccinations were made available to staff in 2015-16. Counselling and related support is available under an Employee Assistance Programme provided by Optum. Additional online resources are provided to all staff to assist with safety, health and wellbeing promotion.

There were no compensable injury claims in 2015-16.

There have been no notices or investigations under Part 10 of the *Work Health and Safety Act 2011.*

Consultants

During 2015-16, nine new consultancy contracts were entered into involving total actual expenditure of $211,337. In addition, five ongoing consultancy contracts were active during 2015-16, involving total actual expenditure of $222,974. This is summarised in Table 5.

Annual reports contain information about actual expenditure on contracts for consultancies. Information on the value of contracts and consultancies is available on the AusTender website at www.tenders.gov.au.

The AOFM engages consultants where it requires specialist expertise or when independent research, review or assessment is required.

Prior to engaging consultants, the AOFM takes into account the skills, experience and resources required for the task, the skills available internally, and the cost-effectiveness of engaging external expertise. The decision to engage a consultant is made in accordance with the PGPA Act and related rules, including the *Commonwealth Procurement Rules* (CPRs), and relevant internal policies.

Table 5: Consultancy contracts

	2012-13	2013-14	2014-15	2015-16
Number of consultancy contracts				
New contracts	15	11	8	9
Ongoing contracts	3	4	4	5
Expenditure (including GST)				
New contracts	$93,060	$162,664	$126,851	$211,337
Ongoing contracts	$175,160	$91,287	$583,875	$222,974

Purchasing

The AOFM's purchasing activities comply with legislative requirements and Government policy, in particular the CPRs.

The CPRs are applied to the AOFM's activities through the *Accountable Authority Instructions* and supporting internal policies and procedures.

ANAO access clauses and exempt contracts

Four contracts in excess of $100,000 were entered into during the reporting period that did not provide for the Auditor-General to have access to the contractor's premises.

One contract was for the syndicated issuance of $1.25 billion of Australian Government Treasury Indexed Bonds (an August 2040 maturity) in August 2015. The AOFM appointed Deutsche Bank AG, UBS AG (Australia Branch) and Westpac Institutional Bank to act as joint-lead managers for the issue.

The second contract was for the syndicated issuance of $4 billion of Australian Government Treasury Bonds (a June 2039 maturity) in October 2015. The AOFM appointed Commonwealth Bank of Australia, Deutsche Bank AG, UBS AG (Australia Branch) and Westpac Institutional Bank to act as joint-lead managers for the issue.

The third contract was for the syndicated issuance of $4.6 billion of Australian Government Treasury Bonds (a November 2027 maturity) in January 2016. The AOFM appointed ANZ, Citi, UBS AG (Australia Branch) and Westpac Institutional Bank to act as joint-lead managers for the issue.

The forth contract was for the syndicated issuance of $7 billion of Australian Government Treasury Bonds (a May 2028 maturity) in May 2016. The AOFM appointed Citi, Commonwealth Bank of Australia, Deutsche Bank AG and UBS AG (Australia Branch) to act as joint-lead managers for the issue.

ANAO access clauses were not included in the contracts as the AOFM maintains all relevant information in relation to the contracted services. Under these contracts, $27.8 million (including GST) was paid.

No contract or standing offer has been exempted from being published in the Purchasing and Disposals Gazette on the basis that it would disclose exempt matters under the *Freedom of Information Act 1982*.

Procurement initiatives to support small business

The AOFM supports small business participation in the Commonwealth Government procurement market. Small and Medium Enterprises (SME) and Small Enterprise participation statistics are available on the Department of Finance's website.

www.finance.gov.au/procurement/statistics-on-commonwealth-purchasing-contract/

Consistent with paragraph 5.4 of the CPRs, the AOFM's procurement practices provide appropriate opportunities for SMEs to compete and ensure that SMEs are not unfairly discriminated against.

The AOFM recognises the importance of ensuring that small businesses are paid on time. The AOFM uses electronic systems to facilitate on-time payment performance and processes are in place to monitor payment deadlines and to ensure SMEs are properly compensated whenever payments are not made on-time.

The results of the Survey of Australian Government Payments to Small Business are available on the Treasury's website.

www.treasury.gov.au.

AOFM

PART 4
FINANCIAL STATEMENTS

Australian National
Audit Office

INDEPENDENT AUDITOR'S REPORT

To the Treasurer

I have audited the accompanying annual financial statements of the Australian Office of Financial Management for the year ended 30 June 2016, which comprise:

- Statement by the Chief Executive Officer and Chief Financial Officer;
- Statement of Comprehensive Income;
- Statement of Financial Position;
- Statement of Changes in Equity;
- Statement of Cash Flows;
- Administered Schedule of Comprehensive Income;
- Administered Schedule of Assets and Liabilities;
- Administered Reconciliation Schedule;
- Administered Schedule of Cash Flows; and
- Notes to and forming part of the financial statements.

Opinion

In my opinion, the financial statements of the Australian Office of Financial Management:

(a) comply with Australian Accounting Standards and the *Public Governance, Performance and Accountability (Financial Reporting) Rule 2015*; and

(b) present fairly the financial position of the Australian Office of Financial Management as at 30 June 2016 and its financial performance and cash flows for the year then ended.

My opinion should be read in conjunction with the rest of this report.

Accountable Authority's Responsibility for the Financial Statements

The Chief Executive Officer of the Australian Office of Financial Management is responsible under the *Public Governance, Performance and Accountability Act 2013* for the preparation and fair presentation of annual financial statements that comply with Australian Accounting Standards and the rules made under that Act and is also responsible for such internal control as the Chief Executive Officer determines is necessary to enable the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

GPO Box 707 CANBERRA ACT 2601
19 National Circuit BARTON ACT
Phone (02) 6203 7300 Fax (02) 6203 7777

Auditor's Responsibility

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

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

Australian National Audit Office

Jocelyn Ashford
Senior Executive Director

Delegate of the Auditor-General

Canberra
23 August 2016

AUSTRALIAN OFFICE OF FINANCIAL MANAGEMENT

Statement by the Chief Executive Officer and Chief Financial Officer

In our opinion, the attached financial statements for the year ended 30 June 2016:

- comply with subsection 42 (2) of the *Public Governance, Performance and Accountability Act 2013*;
- comply with applicable Australian Accounting Standards issued by the Australian Accounting Standards Board;
- comply with requirements prescribed by the *Public Governance, Performance and Accountability (Financial Reporting) Rule 2015*;
- present fairly the Australian Office of Financial Management's financial position, financial performance and cash flows; and
- have been prepared based on properly maintained financial records as required by subsection 41 (2) of the *Public Governance, Performance and Accountability Act 2013*.

In our opinion, and on the condition of receiving continuing appropriations from Parliament, there are reasonable grounds to believe that the Australian Office of Financial Management will be able to pay its debts as and when they fall due.

Signed

R Nicholl
Chief Executive Officer
23 August 2016

Signed

P Raccosta
Chief Financial Officer
23 August 2016

Statement of comprehensive income

for the period ended 30 June 2016

	Notes	2016 $'000	2015 $'000
NET COST OF SERVICES			
EXPENSES			
Employee benefits	4	**6,275**	6,401
Supplier expenses	4	**3,544**	3,364
Depreciation and amortisation	6	**253**	377
Write-down and impairment of assets		**-**	11
Total expenses		**10,072**	10,153
OWN-SOURCE INCOME			
Revenue:			
Staff secondments		**540**	601
Resources received free of charge		**320**	320
Gain on asset sales		**7**	-
Other		**14**	27
Total own-source income		**881**	948
Net cost of services		**9,191**	9,205
APPROPRIATION FUNDING			
Revenue from government		**11,184**	11,398
Total appropriation funding		**11,184**	11,398
Surplus (deficit)		**1,993**	2,193

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

Statement of financial position

as at 30 June 2016

	Notes	2016 $'000	2015 $'000
ASSETS			
Financial assets:			
Cash and cash equivalents		**100**	100
Receivables	5	**31,635**	28,713
Non-financial assets:			
Computers, plant and equipment	6	**44**	252
Leasehold improvements	6	**-**	55
Computer software	6	**1,272**	1,454
Supplier prepayments		**107**	87
Total assets		**33,158**	30,661
LIABILITIES			
Payables:			
Supplier payables		**124**	153
Salary and superannuation		**23**	215
Other payables		**6**	10
Provisions:			
Employee provisions	7	**2,110**	2,105
Other provisions	7	**160**	156
Total liabilities		**2,423**	2,639
Net assets		**30,735**	28,022
EQUITY			
Retained surplus		**28,044**	26,051
Contributed equity		**2,691**	1,971
Total equity		**30,735**	28,022

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

Statement of changes in equity
for the period ended 30 June 2016

	Notes	**2016 $'000**	2015 $'000
RETAINED SURPLUS			
Opening balance		**26,051**	23,858
Changes for period:			
Surplus (deficit)		**1,993**	2,193
Total retained surplus		**28,044**	26,051
CONTRIBUTED EQUITY			
Opening balance		**1,971**	1,892
Changes for period:			
Capital injection - capital budget	22	**720**	732
Return of capital(a)		**-**	(653)
Total contributed equity		**2,691**	1,971
Total equity		**30,735**	28,022

(a) On 17 October 2014, the *Omnibus Repeal Day (Autumn 2014) Act 2014* repealed *Appropriation Act 1 2011-12*. Funds not utilised at that time were returned to government.

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

Statement of cash flows
for the period ended 30 June 2016

	Notes	**2016 $'000**	2015 $'000
OPERATING ACTIVITIES			
Cash received:			
Appropriations		**9,780**	8,370
GST received		**3**	3
Services and other		**562**	662
Cash used:			
Employees		**(6,494)**	(6,205)
Suppliers		**(3,277)**	(2,167)
GST paid		**(9)**	(1)
Transfers to Official Public Account (OPA)(a)		**(764)**	(662)
Net cash from (used by) operating activities	9	**(199)**	-
INVESTING ACTIVITIES			
Cash received:			
Sale of computers, plant and equipment		**199**	-
Cash used:			
Purchase of computer software and plant and equipment		**-**	(600)
Net cash from (used by) investing activities		**199**	(600)
FINANCING ACTIVITIES			
Cash received:			
Appropriations - contributed equity		**-**	600
Net cash from (used by) financing activities		**-**	600
Net increase (decrease) in cash held		**-**	-
Plus cash held at the beginning of the reporting period		**100**	100
Cash at the end of the reporting period		**100**	100

(a) Non-appropriation receipts are required to be returned to the Official Public Account (OPA). They increase the AOFM's available appropriation under section 74 of the *Public Governance, Performance and Accountability Act 2013* and when subsequently drawn down for use by the AOFM they are recorded as appropriations.

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

Administered schedule of comprehensive income

for the period ended 30 June 2016

	Notes	2016 $'000	2015 $'000
EXPENSES			
Grants		**20**	20
Interest expense	11	**15,312,386**	14,473,098
Supplier expenses		**26,361**	17,872
Total expenses		**15,338,767**	14,490,990
INCOME			
Interest revenue	12	**764,638**	920,836
Other revenue		**79**	59
Total income		**764,717**	920,895
GAINS (LOSSES)			
Net foreign exchange gains (losses)		**(225)**	(1,254)
Net realised gains (losses)	13	**(301,435)**	(32,996)
Total gains (losses)		**(301,660)**	(34,250)
Surplus (deficit) before re-measurements		**(14,875,710)**	(13,604,345)
RE-MEASUREMENTS			
Net market revaluation gains (losses)	14	**(17,633,482)**	(7,511,634)
Total re-measurements		**(17,633,482)**	(7,511,634)
Surplus (deficit)		**(32,509,192)**	(21,115,979)

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

Administered schedule of assets and liabilities

as at 30 June 2016

	Notes	2016 $'000	2015 $'000
ASSETS			
Financial assets:			
Cash and cash equivalents		**622**	622
Investments	15	**31,733,083**	38,555,822
Loans to State and Territory Governments	15	**1,956,663**	2,033,155
Total assets		**33,690,368**	40,589,599
LIABILITIES			
Interest bearing liabilities:			
Australian Government Securities	16	**483,360,782**	409,936,490
Other:			
Accrued expenses		**29**	26
Total liabilities		**483,360,811**	409,936,516
Net assets		**(449,670,443)**	(369,346,917)

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

Administered reconciliation schedule

for the period ended 30 June 2016

	2016 $'000	2015 $'000
OPENING NET ASSETS AS AT 1 JULY	**(369,346,917)**	(316,005,624)
Administered schedule of comprehensive income:		
Expenses before re-measurements	**(15,338,767)**	(14,490,990)
Income before re-measurements	**764,717**	920,895
Gains (losses) before re-measurements	**(301,660)**	(34,250)
Re-measurements	**(17,633,482)**	(7,511,634)
Administered transfers (to) from Australian Government:		
Special appropriations (unlimited)	**676,252,763**	719,622,195
Transfers to OPA	**(724,067,003)**	(751,847,409)
Change in special account balance	**(94)**	(100)
Closing net assets as at 30 June	**(449,670,443)**	(369,346,917)

Administered schedule of cash flows
for the period ended 30 June 2016

	Notes	2016 $'000	2015 $'000
OPERATING ACTIVITIES			
Cash received:			
Interest receipts		**750,466**	908,529
Other		**140**	4,944
GST refunds		**1,940**	1,292
Cash used:			
Interest payments		**(17,053,997)**	(15,657,767)
Other		**(28,358)**	(24,056)
Net cash from (used by) operating activities	17	**(16,329,809)**	(14,767,058)
INVESTING ACTIVITIES			
Cash received:			
Capital proceeds from deposits		**598,200,000**	646,050,000
Capital proceeds from residential mortgage-backed securities		**1,449,694**	1,756,309
Repayments from advances and loans		**92,230**	90,681
Cash used:			
Acquisition of deposits		**(592,850,000)**	(653,200,000)
Net cash from (used by) investing activities		**6,891,924**	(5,303,010)
FINANCING ACTIVITIES			
Cash received:			
Capital proceeds from borrowings		**122,812,391**	102,471,230
Other receipts		**27,013**	7,934
Cash used:			
Repayment of borrowings(a)		**(65,560,276)**	(50,175,919)
Other payments		**(26,909)**	(7,861)
Net cash from (used by) financing activities		**57,252,219**	52,295,384
TRANSACTIONS WITH OPA			
Cash from:			
Appropriations		**676,252,724**	719,622,153
Special accounts		**5**	1
Cash to:			
Receipts		**(724,067,003)**	(751,847,409)
Special accounts		**(60)**	(61)
Net cash from (to) official public account		**(47,814,334)**	(32,225,316)
Net increase (decrease) in cash held		**-**	-
Plus cash held at the beginning of the reporting period		**622**	622
Cash at the end of the reporting period		**622**	622

(a) Includes redemption of debt issued on behalf of the States (where relevant).

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

Notes to and forming part of the financial statements
for the period ended 30 June 2016

Note 1: Summary of significant accounting policies

1.1 Basis of preparation of the financial statements

The Australian Office of Financial Management (AOFM), a 'listed entity' under the *Public Governance, Performance and Accountability Act 2013*, is a specialised agency responsible for the management of Australian Government debt and financial assets. The AOFM operates on a not-for-profit basis. The financial statements cover the AOFM as an individual entity and are for the reporting period 1 July 2015 to 30 June 2016. They are required by section 42 of the *Public Governance, Performance and Accountability Act 2013*, and are general purpose financial statements prepared on a going concern basis.

The financial statements have been prepared in accordance with:

- the *Public Governance, Performance and Accountability (Financial Reporting) Rule 2015* made under section 101 of the *Public Governance, Performance and Accountability Act 2013*; and

- Australian Accounting Standards, including Interpretations issued by the Australian Accounting Standards Board (AASB) that apply for the reporting period.

The financial statements have been prepared on an historical cost basis, except for certain assets and liabilities which are carried at fair value or on a discounted cash flow basis as required or allowable by relevant accounting standards.

The financial statements are presented in Australian dollars, and values are rounded to the nearest thousand dollars unless otherwise stated.

The continued existence of the AOFM in its present form, and with its present outcome and program, is dependent on government policy and on continuing appropriations by Parliament for the AOFM's administration and activities.

1.2 Significant accounting estimates and judgments

The preparation of financial statements requires the use of certain accounting estimates and assumptions that affect the reported carrying value of assets and liabilities and the value of reported revenue and expenses.

Financial instruments are predominantly carried on the Administered Schedule of Assets and Liabilities at fair value. Fair value is synonymous with market value and represents the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction in an active market under normal conditions between market participants. The AOFM's approach for determining fair value is discussed at Note 1.16.

1.3 Statement of compliance with International Financial Reporting Standards

(a) New Australian Accounting Standards applicable to the reporting period

During 2015-16 the AOFM adopted all applicable Australian Accounting Standards that became effective during the reporting period.

(b) New Australian Accounting Standards applicable in future reporting periods

A number of revised or new Australian Accounting Standards have been issued that are effective for future reporting periods. With the exception of AASB 16 *Leases* (effective for the 2019-20 financial year), AASB 124 *Related Party Disclosures* (effective for the 2016-17 financial year) and AASB 9 *Financial Instruments* (effective for the 2018-19 financial year) the revisions are not expected to materially affect the AOFM's assets, liabilities, revenue or expenses.

AASB 16 *Leases*

Currently, accounting standards distinguish between operating leases and finance leases. Lessees are required to recognise finance leases only on the balance sheet. Under AASB 16 the majority of leases will need to be recognised on the balance sheet by the lessees. The quantitative impact on the AOFM's departmental balance sheet arising from its property lease has not been determined.

AASB 124 *Related Party Disclosures*

Currently, AASB 124 *Related Party Disclosures* is not applicable to the AOFM as not-for-profit public sector entities are exempt from the requirements of the standard. This exemption has been removed for 2016-17 and subsequent reporting periods. On operation, the AOFM may be required to make additional disclosures for transactions with related parties, including other Australian Government entities.

AASB 9 *Financial Instruments*

Financial assets

Currently, all of the AOFM's administered financial assets, with the exception of loans to the State and the Northern Territory Governments, are designated at fair value through profit or loss. Loans to the State and the Northern Territory Governments are measured at amortised cost.

AASB 9 establishes new principles for determining the accounting treatment for financial assets. AASB 9 requires that a financial asset be measured at:

- amortised cost – where the business objective of the entity is to hold the instrument to collect its contractual cash flows (rather than trading to earn capital profits) and those contractual cash flows are in the nature of principal and interest on the principal outstanding; or

- fair value through other comprehensive income – where the business objective is achieved by collecting the contractual cash flows <u>and</u> selling financial assets, and those contractual cash flows are in the nature of principal and interest on the principal outstanding; or

- fair value through profit or loss – where the financial asset is held for trading to earn capital profits, or is designated as such to reduce an accounting mismatch.

Where an entity's objective for holding a financial asset changes, so too should the accounting treatment, where relevant. The sale of a financial asset for portfolio management, credit or liquidity reasons may not represent a change of purpose from one of collection of contractual cash flows.

The cash flows arising from the AOFM's administered investments are in the nature of principal and interest. Accordingly, the AOFM's objective for holding these assets will be relevant for determining their measurement. The AOFM currently holds term deposit investments to collect contractual cash flows; and holds residential mortgage-backed securities to collect contractual cash flows and for sale. On adoption of AASB 9 the AOFM may need to change its accounting treatment for its financial assets from fair value through profit or loss to amortised cost for term deposits, and fair value through other comprehensive income for residential mortgage-backed securities. For assets classified at amortised cost or at fair value through other comprehensive income an allowance for expected credit losses needs to be considered. The quantitative impact on the AOFM's administered financial assets has not been determined.

Financial liabilities

The classification requirements for financial liabilities remain largely unchanged in AASB 9 from AASB 139. Furthermore, except in limited circumstances (which are not applicable to the AOFM), AASB 9 prohibits the revocation of a previous designation of a financial liability as measured at fair value through profit or loss. Accordingly, the AOFM will be required to maintain its existing accounting treatment for those administered financial liabilities it holds when AASB 9 becomes operative. The AOFM is not expecting a quantitative impact on the measurement of its administered financial liabilities resulting from the accounting standard changes.

For financial liabilities carried at fair value through profit or loss, AASB 9 has adopted a revised disclosure for the presentation of unrealised fair value gains and losses due to own credit risk. These changes require the gain or loss to be apportioned between changes in credit risk (recognised in other comprehensive income) and other changes (recognised in profit or loss).

1.4 Departmental and administered items

Administered items are identified separately in the financial statements by different shading from departmental items.

Departmental assets, liabilities, revenue and expenses are those items that are controlled by the AOFM and used or incurred to deliver goods and services to the Government, including:

- computers, plant and equipment;
- liabilities for employee entitlements;
- receipts deemed appropriated under the *Public Governance, Performance and Accountability Act 2013*; and
- employee expenses and other administrative expenses.

Administered assets, liabilities, revenue and expenses are those items which are controlled by the Government and managed or overseen by the AOFM on behalf of the Government. These items include debt issued to finance the Government's fiscal requirements, investments of funds surplus to the Government's immediate financing needs and investments in residential mortgage-backed securities (RMBS) to meet the Government's policy objectives.

The purpose of separating administered and departmental items is to enable an assessment of the administrative efficiency of the AOFM in providing services to support the Government.

1.5 Revenue (Departmental)

(a) Revenue from Government — output appropriations

Amounts appropriated for departmental outputs for the year (adjusted for any formal additions and reductions) are recognised as revenue. Appropriation receivables are recognised (at their nominal amounts) for output appropriations that have not been drawn by the AOFM and have not been extinguished.

Under the Government's 'net cash appropriation framework' the AOFM receives an output appropriation equivalent to budgeted expenses less depreciation, amortisation and make good expenses.

(b) Resources received free of charge

Resources received free of charge are recognised as revenue when, and only when, a fair value can be reliably determined and the services would have been purchased had they not been donated. Use of those resources is recognised as an expense.

(c) Other revenue

Revenue from the rendering of a service is recognised by reference to the stage of completion of contracts or other agreements to provide the service.

1.6 Transactions with the Government as owner (Departmental)

(a) Capital injections

Capital appropriations received under the Government's 'net cash appropriation framework' are recognised directly in Contributed Equity in the financial year that the appropriation takes effect.

(b) Distributions to owners

Distributions to owners are deducted from Contributed Equity unless the distributions are in the nature of a dividend. Dividends are deducted from Retained Surplus.

1.7 Employee benefits (Departmental)

Liabilities for services rendered by employees are recognised at the end of the financial year to the extent that they have not been settled.

(a) Salaries

Outstanding salaries, and superannuation in relation to those salaries, are recognised at their nominal (undiscounted) amounts.

(b) Leave

The liability for employee benefits includes provision for annual leave and long service leave. No provision has been made for sick leave as sick leave is non-vesting and the average sick leave taken in future years by employees of the AOFM is estimated to be less than the annual entitlement for sick leave.

Long service leave and annual leave are measured at the present value of the estimated future cash flows to be made in respect of all employees at the end of the financial year. In determining the present value, the AOFM commissions an annual actuarial assessment of the anticipated attrition rates and pay increases through promotion and general increases. As a small Australian Government entity the AOFM uses the Department of Finance shorthand method for probability weighting the long service leave liability for those employees who have not yet reached 10 years of service as at the reporting date.

(c) Superannuation

The AOFM contributes to the Commonwealth Superannuation Scheme (CSS; a defined benefit scheme), Public Sector Superannuation Scheme (PSS; a defined benefit scheme), Public Sector Superannuation Accumulation Plan (PSSap; an accumulation scheme) and other nominated schemes on behalf of staff.

The AOFM makes employer contributions to the CSS and PSS superannuation schemes at rates determined by an actuary to be sufficient to meet the current cost to the Government of the superannuation entitlements of its employees. The liability for defined superannuation benefits payable to an employee upon termination of employment with the Australian Government is recognised in the financial statements of the Department of Finance and is settled by the Australian Government in due course. The AOFM accounts for its contributions to the CSS and PSS as if they were defined contribution plans.

An on-cost liability, based on actuarial assessment, has been recognised for employer superannuation contributions payable on accrued annual leave and long service leave as at the end of the financial year. Employer superannuation contributions are payable on leave benefits that are taken during service, but are not payable on leave benefits paid out on termination.

1.8 Leases (Departmental)

The AOFM has a property lease for 779 square metres in the Treasury Building, Parkes, ACT. The lease expired on 21 December 2015 and from that time reverted to a month-to-month leasing arrangement. A new lease is currently being negotiated.

As part of its remuneration packaging policies, the AOFM has entered into car salary packaging arrangements on behalf of certain employees. Under these arrangements the AOFM is responsible for making lease payments to the finance company from the employees' salary, but only whilst the employee remains in the employment of the AOFM.

1.9 Financial instruments (Departmental)

The AOFM classifies its departmental financial assets as loans and receivables. Loans and receivables primarily comprise amounts due from other parties for the reimbursement of staff costs associated with staff secondments. Loans and receivables are initially recognised at fair value and are subsequently measured at amortised cost.

Amounts due from the OPA for undrawn departmental appropriations are not financial instruments as they are not contractually based. Appropriation receivables are recognised at their nominal amounts.

Financial liabilities represent trade creditors and accruals and are recognised at the amounts at which they are expected to be settled.

Departmental financial assets and financial liabilities are predominantly denominated in Australian dollars, are non-interest bearing and their fair values approximate their carrying values. Accordingly, the AOFM is not exposed to interest rate risk or significant exchange rate risk on its departmental financial instruments. The AOFM's maximum exposure to credit risk on departmental financial assets approximates their carrying values. The AOFM's exposure to credit risk on its departmental financial instruments is immaterial.

1.10 Leasehold improvements, computers and plant and equipment (Departmental)

(a) Asset recognition threshold on acquisition

Purchases of leasehold improvements, computers and plant and equipment are recognised initially at cost in the Statement of Financial Position, except for purchases costing less than $1,000 which are expensed at the time of acquisition. The asset recognition threshold is applied to each functional asset, that is, items or components that form an integral part of an asset are grouped as a single asset.

(b) Revaluations

Following initial recognition at cost, valuations are conducted with sufficient frequency to ensure that the carrying amounts of assets do not materially differ from the assets' fair values as at the reporting date.

Fair value has been determined as depreciated replacement cost for leasehold improvements, and where available, market selling price in an active market for computers, plant and equipment.

Revaluation adjustments are made on a class basis. Revaluation increments for a class are credited directly to a revaluation reserve in Equity, except to the extent that they reverse a previous revaluation decrement for that class, in which case they are credited as revenue. Revaluation decrements for a class of assets are recognised as an expense, except to the extent that they reverse a previous revaluation increment for that class, in which case they are debited directly to a revaluation reserve in Equity.

For all assets, excluding leasehold improvements, revaluations are performed on a net basis. For leasehold improvements, revaluations are performed on a gross basis with accumulated amortisation on revaluation restated proportionately in accordance with the gross carrying amount of the asset.

(c) Depreciation

The depreciable value of leasehold improvements, computers and plant and equipment assets is written off over the estimated useful lives of the assets to the AOFM using the straight-line method of depreciation. Leasehold improvements are depreciated on a straight-line basis over the lesser of the estimated useful life of the improvements and the unexpired period of the lease. The depreciable value of leasehold improvements, computers and plant and equipment assets is based on a zero residual value.

Depreciation rates (useful lives) are reviewed at least annually and, if required, the remaining useful life of relevant assets is adjusted. Adjustments are recognised in the current, or current and future, reporting periods as appropriate.

Depreciation expenses have been determined by applying rates to new depreciable assets based on the following useful lives:

Sub-class of depreciable asset	**2016**	2015
Leasehold improvements	lease term	lease term
Artwork	100 years	100 years
Computers	3-5 years	3-5 years
Office equipment	5 years	5 years
Furniture	10 years	10 years

1.11 Computer software (Departmental)

Purchases of computer software are recognised at cost in the Statement of Financial Position except for purchases costing less than $10,000 which are expensed at the time of acquisition.

An item of software represents a software licence granted for greater than 12 months; or a developed software application.

Developed software is recognised by capitalising all directly attributable internal and external costs that enhance the software's functionality and therefore service potential.

Software assets are amortised on a straight-line basis over their anticipated useful lives, being three to ten years (2014-15: three to ten years). Software assets are carried at cost and are not subject to revaluation.

1.12 Taxation (Departmental)

The AOFM is exempt from all forms of taxation except for Fringe Benefits Tax (FBT) and the Goods and Services Tax (GST).

1.13 Reporting of administered activities

Except where otherwise stated, administered items are prepared on the same basis of accounting and using the same policies as for departmental items, including the application of Australian Accounting Standards.

With the adoption of fair value through profit or loss measurement for certain classes of financial assets and financial liabilities the AOFM presents its administered revenue and expenses into two categories:

- Surplus (deficit) before re-measurements; and
- Re-measurements.

The category 'surplus (deficit) before re-measurements' records a financial result that is consistent with an accruals (or amortised cost) basis of accounting under the historic cost accounting convention and is most relevant to the AOFM's role in managing its debt portfolio whereby debt and other financial instruments are predominately issued and held to maturity (and with portfolio restructuring a rarity and performed primarily for portfolio management, credit or liquidity purposes, rather than for profit making purposes). Where a financial asset is sold or a financial liability is redeemed prior to maturity, the realised gain or loss, calculated on an amortised cost basis, is recognised within this category. Realised and unrealised foreign currency gains and losses are also included in this category.

The category 're-measurements' provides information on the unrealised changes in the market valuation of the portfolio of administered financial assets and financial liabilities (which are carried at fair value) during the financial year. This is relevant for assessing changes in financial risk exposures and changes to the value of transactions managed from year to year. The revaluation effect will net to zero over the life of a financial instrument.

1.14 Recognition and de-recognition of financial instruments

The AOFM recognises a financial asset or financial liability when and only when it becomes a party to the contractual provisions of the financial instrument. A financial asset is de-recognised when the right to receive cash flows from the financial asset has expired or the risks and rewards of ownership have been transferred to another party. A financial liability is de-recognised when the obligation in the contract is discharged, cancelled or has expired.

The AOFM accounts for purchases and sales of financial instruments on a trade date basis, that is, the date on which transactions are executed. Depending on the transaction type this may be several days prior to settlement.

1.15 Classification and measurement of financial instruments

The AOFM classifies its administered financial assets into the following categories: financial assets at fair value through profit or loss; and loans and receivables. The AOFM classifies its financial liabilities in the following categories: financial liabilities at fair value through profit or loss; and other financial liabilities.

The AOFM has determined the classifications on the basis of how it manages and assesses the performance of its financial assets and financial liabilities. Where the AOFM's management monitors cost and risk in mark-to-market terms (but not necessarily only in those terms), the AOFM has classified the relevant financial assets and liabilities at fair value through profit or loss.

(a) Financial assets at fair value through profit or loss

This category comprises short-term Australian dollar denominated deposits and Australian dollar denominated residential mortgage-backed securities. Under section 58 of the *Public Governance, Performance and Accountability Act 2013*, the AOFM invests public money to manage the balance of the OPA and to meet government policy objectives.

These assets are measured at fair value on initial recognition and at fair value on subsequent measurement. Changes in carrying value are attributed between changes in amortised cost of the asset and other changes.

Changes in carrying value attributable to amortised cost are recognised in Interest Revenue. Other changes in carrying value (including unrealised changes in valuation due to a change in interest rates) are recognised in Re-measurements.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

This category primarily comprises concessional advances to the State and Northern Territory Governments under Commonwealth-State financing arrangements, which were not evidenced by the issue of securities (namely, housing advances and specific purpose capital advances).

Loans and receivables are measured at fair value on initial recognition and at amortised cost on subsequent measurement using the effective interest rate method. Changes in carrying value, including amortisation of premiums or discounts, are recognised in Interest Revenue.

(c) Financial liabilities at fair value through profit or loss

This category comprises all Australian Government Securities (AGS) debt with the exception of debt on allocation to State and Northern Territory Governments and overdues (debt that has reached maturity but has not been claimed by the investor). AGS primarily comprises Treasury Bonds, Treasury Indexed Bonds and Treasury Notes.

These liabilities are measured at fair value on initial recognition and at fair value on subsequent measurement. Changes in carrying value are attributed between changes in amortised cost of the liability and other changes. Changes in carrying value attributable to amortised cost are recognised in Interest Expense. Where a security is issued at a premium or discount to its par value, the premium or discount is recognised at that time and included in the carrying value of the liability. The premium or discount is amortised over the life of the security using the effective interest rate method and recognised in Interest Expense. Other changes in carrying value (including unrealised changes in valuation due to a change in interest rates) are recognised in Re-measurements.

For Treasury Indexed Bonds, the principal value appreciates over time in line with a six-month lagged Consumer Price Index (CPI) (the Weighted Average of Eight Capital Cities All-Groups Index). Capital accretion is recognised in Interest Expense over time with the quarterly release of the CPI.

As future inflation rates are uncertain, an estimate of the Australian Government's future redemption costs on maturity is not disclosed in the financial statements.

There are no options available to either the Australian Government or the holder of the securities to exchange or convert AGS. There are also no options to either party for early redemption.

(d) Other non-derivative financial liabilities

This category comprises perpetual debt on allocation to State and Northern Territory Governments and overdues.

These liabilities are measured at fair value on initial recognition and at amortised cost on subsequent measurement using the effective interest rate method. Changes in carrying value are recognised in Interest Expense.

1.16 Fair value estimation of financial instruments

Administered financial instruments are predominantly carried on the Administered Schedule of Assets and Liabilities at fair value. Where a financial instrument is traded in an active market, fair value is based on quoted market rates for an identical financial instrument as at the end of the financial year. Where market rates are unavailable because a financial asset or financial liability is not traded in an active market, valuation techniques are used, including quotes for similar instruments and discounted cash flow analysis to determine fair value. Fair value measurement requires maximising the use of market observable inputs and minimising the use of unobservable inputs. Where markets are distorted or illiquid, with pricing not necessarily reflective of underlying credit and cash flow fundamentals, assumptions may be necessary to derive the fair value of a financial instrument.

The fair value of Treasury Bonds, Treasury Indexed Bonds and Treasury Notes is based on observable market rates for identical instruments.

The fair value of term deposit investments with the Reserve Bank of Australia (RBA) is based on a zero coupon curve using the overnight cash rate and overnight indexed swap rates. These yields reflect a default free credit risk.

For residential mortgage-backed securities each issue is modelled to determine its weighted average life, which is tested and compared against other sources where available. Fair value is determined using the weighted average life, market quotes (where available) and assumptions based on credit quality considerations.

1.17 Other significant administered accounting policies

(a) Revenue

Interest revenue is earned on loans to State and Northern Territory Governments, residential mortgage-backed securities and term deposits. Interest is credited to revenue as it accrues and is calculated on an amortised cost basis using the effective interest rate method.

(b) Grants

Under the *Financial Agreement Act 1994*, the Australian Government assists the State and Northern Territory Governments to redeem maturing debt on allocation to them. Payments made under these arrangements are recognised in grants expenses as and when they fall due and payable.

(c) Borrowing costs

Borrowing costs are expensed as incurred.

(d) Securities lending facility

The AOFM has a securities lending facility available for Treasury Bonds and Treasury Indexed Bonds. The facility is operated by the RBA and is governed by the terms and conditions of an agency agreement between the RBA and the AOFM. The purpose of the facility is to enhance the efficiency of the bond markets by allowing bond market participants to borrow Treasury Bonds and Treasury Indexed Bonds (generally for a period of no more than several days) when they are not readily available from other sources in those markets.

Interest is payable under the facility when lending is overnight. Interest is not payable on intra-day lending. The temporary sale of AGS under the facility is recorded off-balance sheet. See Note 21 for details of transactions undertaken during the financial year under the facility.

Note 2: Objectives and activities of the AOFM

The AOFM's activities are focused on delivering to a single Government outcome — *the advancement of macroeconomic growth and stability, and the effective operation of financial markets, through issuing debt, investing in financial assets and managing debt, investments and cash for the Australian Government.*

The AOFM aims to achieve the government outcome through the following objectives:

- meeting the budget financing task in a cost-effective manner subject to acceptable risk;
- facilitating the government's cash outlay requirements as and when they fall due;
- being a credible custodian of the Australian Government Securities market and other portfolio responsibilities; and
- ensuring the AOFM is a well-managed organisation.

The AOFM manages a portfolio of debt and financial assets on behalf of the Australian Government. It issues Treasury Bonds and Treasury Indexed Bonds to finance budget deficits. It also manages the Government's cash in the OPA which is surplus to immediate requirements by making investments in term deposits. It uses these instruments, together with the issue of Treasury Notes, to manage the within-year financing task. It undertakes the administration, financial and operational risk management, and financial reporting of its portfolio of debt and assets. In managing its portfolio and undertaking these tasks it seeks to minimise accrual debt servicing costs over the medium term at an acceptable level of risk. Risk includes interest rate risk, credit risk, liquidity risk and refinancing risk.

Financing the budget

For many years debt issuance by the AOFM was undertaken solely with the objective of maintaining the Treasury Bond and Treasury Bond futures markets, as successive budget surpluses removed the need to borrow to fund the Budget. The Budget outlook changed in the *Updated Economic and Fiscal Outlook* published on 3 February 2009 and the objective of issuance changed to funding the Budget. Since this time, the AOFM has significantly increased debt issuance and intensified its engagement with investors (including overseas investors) and intermediaries.

Portfolio management

The cost and risk of the debt portfolio is managed through debt issuance and (where appropriate) investment activities. Since early 2009, debt issuance volumes have exceeded those necessary to maintain liquidity in Treasury Bonds and Treasury Bonds futures markets, affording the AOFM with a greater level of flexibility in setting its issuance program against an overarching objective of minimising cost subject to acceptable risk. In recent years the AOFM has lengthened the duration of its Treasury Bonds portfolio through longer term issuance as a means of reducing risk. The Treasury Bonds yield curve extends to 23 years currently (an extension of 11 years since 2011).

Cash management

The AOFM manages the overall level of cash in the OPA to ensure that the Government is able to meet its financial obligations as and when they fall due. To this end, it makes short-term borrowings by issuing Treasury Notes. It also invests in term deposits with the RBA. The AOFM holds continuing balances of short-term assets to allow it to respond flexibly and quickly to swings in cash requirements.

The OPA is recorded in the Department of Finance's financial statements and is not reported by the AOFM.

Investments in residential mortgage-backed securities (RMBS)

In September 2008, the Government announced that the AOFM would invest $4 billion in RMBS to support competition in the Australian residential mortgage market. The initiative was extended in October 2008 and again in November 2009 to a total program of up to $20 billion. In April 2013, the previous Government announced that due to improvements in market conditions, the AOFM would not make any new investments in RMBS. The AOFM invested $15.5 billion in RMBS over the life of the program.

On 5 May 2015, the Treasurer issued a direction to the AOFM to divest the RMBS portfolio through a regular competitive process. The AOFM is to use its discretion on the timing and sales volume to minimise potential market disruptions, however the sales volume must not exceed $500 million per month.

Trading of depository interests in Australian Government Securities

In November 2012, the *Commonwealth Inscribed Stock Act 1911* and the *Corporations Act 2001* were amended as part of the previous Government's Competitive and Sustainable Banking Package to enable trading of depository interests in Treasury Bonds and Treasury Indexed Bonds on financial markets in Australia. Ownership of a depository interest provides the investor with beneficial ownership of the underlying bond including the right to receive principal and interest.

The AOFM facilitated the establishment of infrastructure to allow these financial products to trade on the Australian Stock Exchange (ASX), where they are called Exchange-traded Treasury Bonds and Exchange-traded Treasury Indexed Bonds. Trading commenced on 21 May 2013.

The trading, settlement and administration of these financial products are governed by the *Corporations Act 2001*, market integrity rules made by the Australian Securities and Investments Commission, ASX market rules and contractual arrangements between the AOFM and the ASX (the financial market operator), and the AOFM and Computershare Investor Services Pty Limited (the registry provider).

Under the ASX market rules the Australian Government has the obligation to make payments of principal and interest to depository interest holders.

Legislation

The AOFM's borrowing and portfolio management activities comply with applicable legislative requirements. The key legislative mechanisms that governed these activities during the reporting period were as follows:

- the *Commonwealth Inscribed Stock Act 1911*, which represents the Australian Government's primary vehicle for the creation and issuance of stock, including Treasury Bonds, Treasury Indexed Bonds and Treasury Notes. It also provides a standing authority to the Treasurer to borrow in Australian currency;
  - There is a requirement under the Act for the Treasurer to issue a direction as to the maximum face value of stock that may be on issue under the Act. On 11 December 2013 the Treasurer issued a direction under section 51JA of the Act permitting the AOFM to borrow up to $500 billion.
- the *Loans Securities Act 1919*, which includes provisions relating to overseas borrowings, and provides authority to enter into swaps, securities lending, repurchase agreements and other financial arrangements;
- the *Financial Agreement Act 1994*, which formalises debt consolidation and redemption arrangements applying since 1 July 1990 between the Australian Government and the States and Territory Governments; and
- section 58 of *Public Governance, Performance and Accountability Act 2013*, which gives the Treasurer the power to invest public money in authorised investments.

Note 3: Financial risk management

The AOFM is exposed to financial risks arising from its portfolio of financial assets and liabilities — interest rate risk, inflation risk, liquidity and refinancing risk, credit risk and prepayment risk. These risks are controlled within a financial risk management framework that includes directions from the Treasurer and policies and limits approved by the Secretary to the Treasury and overseen by the CEO and senior management of the AOFM. The Secretary to the Treasury is advised by the Treasury, the AOFM CEO and the AOFM Advisory Board.

Timing mismatches between the Australian Government's receipts and expenditures cause large fluctuations in the volume of short-term assets and liabilities held by the AOFM, and thus in the overall size of its net portfolio, relative to the gross volume of debt outstanding. To provide stability in the management of the longer term component of its debt, long-term financing and short-term financing are managed through separate portfolios, the debt portfolio and the cash management portfolio. In addition, the AOFM's investments in RMBS and advances to State and Northern Territory Governments (which were made under previous Commonwealth-State financing arrangements and were not evidenced by the issue of securities) are held in separate portfolios.

(a) Interest rate risk

Interest rate risk represents the risk to debt servicing cost outcomes and investment return outcomes, and to the value of debt and financial assets caused by changes in interest rates. The AOFM largely holds its debt and assets until maturity (and with portfolio restructuring a rarity and performed primarily for portfolio management, credit or liquidity purposes, rather than for profit making purposes). Accordingly, in its ordinary course of business the primary measure used by the AOFM to assess cost and return is the accruals basis of accounting under the historic cost accounting convention. Market value measures of risk (which include unrealised changes in the valuation of financial assets and financial liabilities due to changes in interest rates) are considered to be secondary.

Debt portfolio

The debt portfolio is used to meet the Australian Government's budget financing needs and to support efficient Treasury Bonds and Treasury Bonds futures markets. Issuance is the primary mechanism for managing interest rate risk of the debt portfolio. That is, the AOFM manages the cost structure of the debt portfolio through the choice of instruments and bond series in issuing debt. The annual debt issuance strategy is informed by qualitative and quantitative factors to achieve an interest rate profile that appropriately balances cost and cost variability, investor demand, the refinancing task and financial market efficiency. The cost and interest rate risk of the debt portfolio is regularly measured and reported to senior management, the Secretary to the Treasury and the AOFM Advisory Board.

Cash management portfolio

The cash management portfolio is used to manage within-year timing mismatches between Australian Government receipts and expenditures. The cash management portfolio holds a fluctuating portfolio of short-term investments and short-term liabilities. The portfolio is managed to achieve an appropriate balance between refinancing risk and interest rate risk.

Residential mortgage-backed securities (RMBS)

Interest earned on RMBS comprises a floating interest rate (based on the one-month BBSW rate) plus a fixed margin set at the time each investment is acquired. The AOFM monitors movements in these interest rates as part of its management of the overall portfolio.

With the Government decision to divest the RMBS portfolio, market conditions are an important consideration in managing the sale of the portfolio.

See Note 19 for details of the AOFM's interest rate risk profile.

(b) Inflation risk

Treasury Indexed Bonds have their principal value indexed against the all Groups Australian CPI. The interest is a fixed real rate of interest payable on the accreted principal value. Accordingly these debt instruments expose the AOFM to inflation risk on interest payments and on the value of principal payable on maturity. There is a six month lag between the calculation period for the CPI and its impact on the value of interest and principal.

(c) Liquidity and refinancing risk

The AOFM manages liquidity risk by maintaining sufficient cash and short-term investments to ensure that the Government can meet its financial obligations, both planned and unplanned, as and when they fall due. The AOFM manages the daily volume of cash in the OPA by monitoring the projected daily transactions of major spending and revenue agencies, undertaking investment of funds that are surplus to immediate cash requirements and by issuing Treasury Notes. The 91-day rolling average balance of the OPA is kept below an upper limit set by the Treasurer and the Minister for Finance. The AOFM also has access to an overdraft facility with the RBA. The overdraft facility is not to be used in normal day-to-day operations but only to cover temporary, unexpected shortfalls of cash and it has a limit of $1 billion. Should circumstances arise for the overdraft to exceed this limit, Ministerial approval is required.

Refinancing risk is the risk that when maturing debt needs to be funded by debt issuance, it may have to be refinanced at a higher cost or market conditions may prevent sufficient funds from being raised in an orderly manner. The AOFM seeks to control refinancing risk by issuing along the entire yield curve. This creates a range of short-dated and mid-to-long-dated exposures that balance cost and refinancing patterns. In formulating its debt issuance strategy the AOFM considers the volume of debt in any one line and the maturity structure (including the number of bond lines and the maturity gaps between lines) of its debt.

Senior management monitors the daily balance in the OPA, holdings of short-term assets and short-term and long-term debt issuance activity.

See Note 19 for details of the maturity profile of AOFM's obligations arising from its financial liabilities as at year end.

(d) Credit risk

Credit risk is the risk of non-performance (including partial performance) by a counterparty to a financial contract, leading to a financial loss for the creditor.

The AOFM's investment activity is made in accordance with legislative requirements, delegations and directions from the Treasurer and policies and limits established by the Secretary to the Treasury. Section 58 of the *Public Governance, Performance and Accountability Act 2013* and associated rules specify authorised investments. Directions from the Treasurer may further limit the class of acceptable assets. The Secretary to the Treasury sets class and individual issuer exposure limits, including credit rating requirements. The AOFM CEO may impose additional limits.

Authorised investments and their limits are as follows:

Authorised investments under Section 58 of the *Public Governance, Performance and Accountability Act 2013*	**Limits framework for 2015-16**
Securities issued or guaranteed by the Commonwealth, a State or Territory.	Class limit of zero.
A deposit with a bank, including a deposit evidenced by a certificate of deposit.	RBA term deposits only and without limit.
Debt instruments with an investment grade credit rating that are issued or guaranteed by the government of a foreign country.	Class limit of zero.
Debt instruments with an investment grade credit rating that are issued or guaranteed by a financial institution whose members consist of foreign countries (which may also include Australia).	Class limit of zero.
Debt instruments with an investment grade credit rating that are denominated in Australian currency.	Class limit of zero.

See Note 19 for details of the AOFM's exposure to credit risk.

Residential mortgage-backed securities (RMBS)

The AOFM no longer makes new investments in RMBS, however, it continues to hold securities purchased prior to 9 April 2013. The credit quality of RMBS derives from the underlying quality of the mortgage assets and structural enhancements such as lenders' mortgage insurance, liquidity facilities, and the issue of different classes of securities.

As at 30 June 2016 all RMBS securities held by the AOFM were rated at AAA or equivalent.

Other assets and credit exposures

The AOFM has a credit risk exposure on its advances to the State and Northern Territory Governments. This risk is regarded as minimal.

To protect the Australian Government's financial position with respect to securities lending arrangements, the market value of the collateral securities taken from counterparties is greater than the market value of the Treasury Bonds or Treasury Indexed Bonds lent. There is a right to seek additional collateral if there is a decline in the market value of the collateral securities relative to the lent securities.

(e) Prepayment risk

All RMBS currently held by the AOFM are fully amortising, pass through instruments. This means that the principal collections from the underlying portfolio of mortgages are repaid to the holders of the securities thereby reducing the principal outstanding on them.

Due to the pass through nature of the RMBS, the repayment of principal is dependent upon the timing of principal repayments on the underlying mortgages and the operation of the cash flow waterfall. Accordingly, the rate at which principal is repaid varies over time and the actual date that the securities will be repaid in full cannot be precisely determined (this is referred to as prepayment risk).

The AOFM monitors the performance of each RMBS issue through a monthly report by the issuer. The report provides details of cash received from payments on the underlying mortgages, payments made, the rate of the loan principal repayments ahead of scheduled principal payments and the estimated weighted average remaining life of the securities.

Note 4: Expenses

	2016 $'000	2015 $'000
EMPLOYEE BENEFITS		
Wages and salaries	**5,162**	5,044
Superannuation	**879**	949
Leave entitlements	**14**	153
Other employee expenses	**220**	255
Total employee benefits	**6,275**	6,401

Senior Management Personnel

The following table details the remuneration (on an accruals basis) of senior management personnel included in Employee Benefits above.

	2016 $'000	2015 $'000
Short-term employee benefits:		
Salary and other short-term benefits	**337**	333
Annual leave accrued	**28**	27
Long service leave accrued	**9**	9
Post employment benefits:		
Superannuation	**48**	48
Total	**422**	417
Number of senior management personnel	**1**	1

The valuation of the long service leave provision includes the use of a discount factor to equate the expected future payments of the benefit to a net present value. Changes from year to year in the discount factor used to value long service leave have an impact on the level of remuneration reported for a financial year. As at 30 June 2016 the discount factor was 110.9 per cent (30 June 2015: 100.0 per cent).

	2016 $'000	2015 $'000
SUPPLIER EXPENSES		
ANAO - notional audit fee	**320**	320
Corporate support services	**818**	580
Market data services	**563**	504
Operating lease payments - premises	**272**	288
Depository and transaction services	**133**	144
Travel	**209**	260
Workers compensation premium	**14**	14
Other	**1,215**	1,254
Total supplier expenses	**3,544**	3,364

Note 5: Financial assets

	2016 $'000	2015 $'000
RECEIVABLES		
With related parties:		
Goods and services	**102**	70
Appropriations receivable (a)	**31,531**	28,642
GST and other	**2**	1
Total receivables	**31,635**	28,713
Receivables are expected to be recovered in:		
No more than 12 months	**6,905**	3,694
More than 12 months	**24,730**	25,019
	31,635	28,713
Receivables are aged as follows:		
Not overdue	**31,635**	28,713
Overdue	**-**	-
	31,635	28,713

(a) Appropriations receivable are appropriations controlled by the AOFM but held in the OPA under the Government's 'just-in-time' drawdown arrangements.

Note 6: Non-financial assets
Computers, plant and equipment

	2016 $'000	2015 $'000
COMPUTERS, PLANT AND EQUIPMENT		
Gross value	**73**	305
Accumulated depreciation	**(29)**	(53)
Total computers, plant and equipment	**44**	252
Reconciliation of gross value:		
Opening value	**305**	632
Purchases	**-**	2
Disposal	**(232)**	(70)
Revaluation	**-**	(259)
	73	305
Reconciliation of accumulated depreciation:		
Opening value	**(53)**	(243)
Depreciation charge for period	**(16)**	(134)
Disposal	**40**	59
Revaluation	**-**	265
	(29)	(53)

Computers, plant and equipment are carried at fair value.

In July 2015, the AOFM sold the majority of its information technology assets to the Department of the Treasury under a service agreement between the AOFM and the Department of the Treasury. Under the service agreement the Department of the Treasury provides information and communications technology services to the AOFM.

A valuation was conducted by an independent valuer, Australian Valuation Solutions, as at 31 March 2015. A revaluation gain of $6,235 was recorded. As at 30 June 2016, the AOFM had cumulative net revaluation losses of $63,615 for computers, plant and equipment which were recognised as expenses in the Statement of Comprehensive Income.

No indicators of impairment were identified for computers, plant and equipment.

Leasehold improvements

	2016 $'000	2015 $'000
LEASEHOLD IMPROVEMENTS		
Gross value	**1,475**	1,475
Accumulated depreciation	**(1,475)**	(1,420)
Total leasehold improvements	**-**	55
Reconciliation of gross value:		
Opening value	**1,475**	1,138
Purchases	**-**	-
Disposal	**-**	-
Revaluation	**-**	337
	1,475	1,475
Reconciliation of accumulated depreciation:		
Opening value	**(1,420)**	(973)
Depreciation charge for period	**(55)**	(113)
Disposal	**-**	-
Revaluation	**-**	(334)
	(1,475)	(1,420)

Leasehold improvements represent the enhancements made by the AOFM (as lessee) to its leased premises in the Treasury Building. The lease expired on 21 December 2015 and from that time reverted to a month-to-month arrangement. A new lease is currently being negotiated.

Leasehold improvements are carried at fair value. A valuation was conducted by an independent valuer, Australian Valuation Solutions, as at 31 March 2015. A revaluation gain of $2,635 was recorded. As at 30 June 2016, the AOFM had cumulative net revaluation losses of $10,502 for leasehold improvements which were recognised as expenses in the Statement of Comprehensive Income.

No indicators of impairment were identified for leasehold improvements.

Computer software

	2016 $'000	2015 $'000
COMPUTER SOFTWARE		
Gross value:		
Debt management system	**1,521**	4,179
Work in progress	**-**	585
Other	**98**	98
Accumulated amortisation	**(347)**	(3,408)
Total computer software	**1,272**	1,454
Reconciliation of gross value:		
Opening value	**4,862**	4,245
Purchases	**-**	617
Disposal	**(3,243)**	-
	1,619	4,862
Reconciliation of accumulated amortisation:		
Opening value	**(3,408)**	(3,278)
Amortisation charge for period	**(182)**	(130)
Disposal	**3,243**	-
	(347)	(3,408)

Computer software is carried at cost.

No indicators of impairment were identified for computer software.

Note 7: Provisions

	2016 $'000	2015 $'000
EMPLOYEE PROVISIONS		
Annual leave	**422**	417
Long service leave	**1,484**	1,474
Superannuation	**204**	214
Total employee provisions	**2,110**	2,105
Employee provisions are expected to be settled in:		
No more than 12 months	**444**	517
More than 12 months	**1,666**	1,588
	2,110	2,105
OTHER PROVISIONS		
Make-good on leasehold premises	**160**	156
Total other provisions	**160**	156
Other provisions are expected to be settled in:		
No more than 12 months	**160**	156
More than 12 months	**-**	-
	160	156
Reconciliation of movements in other provisions:		
Opening balance	**156**	140
Re-measurement	**4**	16
	160	156

Note 8: Non-financial assets carried at fair value

Fair value measurements

The following table discloses the quality of significant inputs used to determine the fair value of non-financial assets measured at fair value as at year end, by assigning a 3 level hierarchy to those valuations, being:

- Level 1 - The fair value is determined using unadjusted prices in active markets for identical assets.

- Level 2 - The fair value is determined using market inputs, other than quoted prices included within Level 1, that are observable for the asset either directly or indirectly.

- Level 3 - The fair value is determined using unobservable inputs for the asset.

		Level 1 inputs	Level 2 inputs	Level 3 inputs
	Last revalued	**2016 $'000**	**2016 $'000**	**2016 $'000**
Computers, plant and equipment	Mar-15	-	44	-
Leasehold improvements	Mar-15	-	-	-
Total		-	44	-
	Last revalued	2015 $'000	2015 $'000	2015 $'000
Computers, plant and equipment	Mar-15	-	252	-
Leasehold improvements	Mar-15	-	-	55
Total		-	252	55

Valuation technique and inputs for level 2 and level 3 fair value measurements

Computers, plant and equipment (level 2 inputs) are revalued using a market approach by referencing recent market evidence of comparable items in second-hand markets.

Leasehold improvements (level 3 inputs) are revalued using a depreciated replacement cost approach. This approach estimates the gross cost to replace the service potential of the asset using observable market inputs (current replacement cost), *less* the estimated economic benefits consumed by the AOFM over the expected useful life of the asset (unobservable input). The gross replacement cost has been determined by an independent qualified valuer using industry based costing guidelines.

The estimated consumed economic benefits is an unobservable valuation input, and was determined by the AOFM and an independent qualified valuer using judgment regarding physical, economic and legal factors.

Level 3 fair value measurements – sensitivity analysis for non-financial assets

The significant unobservable input in relation to leasehold improvements is the consumed economic benefits of the asset represented by the estimated useful life of the asset to the AOFM. A significant increase (decrease) in this input would result in a higher (lower) net fair value.

The current property lease expired on 21 December 2015. There is no renewal option within the lease. Accordingly the AOFM has depreciated its leasehold improvements over a useful life period that ceased at the end of the contracted lease term. The AOFM is negotiating a new lease in a separate block of the Treasury Building to its existing premises. Accordingly, the AOFM expects to continue to use its leasehold improvements for a short time only (around 6 months) beyond 30 June 2016.

Reconciliation for level 3 fair value measurements

The following table reconciles the opening and closing balances of level 3 fair value measurements.

	2016 $'000	2015 $'000
LEASEHOLD IMPROVEMENTS		
Net opening balance	**55**	165
Depreciation	**(55)**	(113)
Revaluation	**-**	3
Purchases	**-**	-
Disposal	**-**	-
Transfers into Level 3	**-**	-
Transfers out of Level 3	**-**	-
Net closing balance	**-**	55

Note 9: Cash flow reconciliation

The following table reconciles the AOFM's operating cash flows as presented in the Statement of Cash Flows to its net cost of services presented in the Statement of Comprehensive Income.

	2016 $'000	2015 $'000
Net cost of services	**(9,191)**	(9,205)
Add revenue from Government	**11,184**	11,398
Adjustments for non-cash items:		
Depreciation and amortisation	**253**	377
Write-down and impairment of assets	**-**	11
Revaluation increments recognised in revenue	**-**	(9)
Gain on sale of computers, plant and equipment	**(7)**	-
Assets not yet paid for	**-**	(19)
Appropriations extinguished	**-**	(653)
Change in receivables for capital budget items	**720**	132
Adjustments for changes in assets:		
(Increase) decrease in receivables	**(2,922)**	(3,162)
(Increase) decrease in supplier prepayments	**(20)**	865
Adjustments for changes in liabilities:		
Increase (decrease) in supplier payables	**(29)**	64
Increase (decrease) in salary and superannuation	**(192)**	21
Increase (decrease) in other payables	**(4)**	4
Increase (decrease) in employee provisions	**5**	160
Increase (decrease) in other provisions	**4**	16
Net cash from (used by) operating activities	**(199)**	-

Note 10: Contingent liabilities and assets

The AOFM is not aware of any quantifiable or unquantifiable contingencies as of the signing date that may have an impact on its operations.

Note 11: Administered expenses before re-measurements

	2016 $'000	2015 $'000
INTEREST EXPENSE		
Australian Government Securities:		
Treasury Bonds	**13,942,870**	13,043,830
Treasury Indexed Bonds	**1,239,782**	1,265,748
Treasury Notes	**128,846**	162,689
Other debt	**869**	809
Other interest costs	**19**	22
Total interest expense	**15,312,386**	14,473,098

Note 12: Administered income before re-measurements

	2016 $'000	2015 $'000
INTEREST REVENUE		
Loans to State and Northern Territory Governments:		
Perpetual debt	**239**	239
Advances	**117,909**	123,567
Investments:		
Deposits	**536,611**	603,662
Residential mortgage-backed securities	**109,879**	193,368
Total interest revenue	**764,638**	920,836

Note 13: Administered gains (losses) before re-measurements

	2016 $'000	2015 $'000
NET REALISED GAINS (LOSSES)		
Sale of residential mortgage-backed securities	**1,708**	1,001
Repurchase of debt	**(303,143)**	(33,997)
Total net realised gains (losses)	**(301,435)**	(32,996)

Total net realised gains (losses) represent the total proceeds paid or received from a sale of an asset or repurchase of debt prior to maturity, less the amortised cost carrying value using the effective interest method, at the time of sale or repurchase.

On 5 May 2015 the Treasurer issued a direction to the AOFM to divest the Australian Government's investments in residential mortgage-backed securities, through a regular competitive process.

As part of its cash management operations, and where appropriate, the AOFM may repurchase AGS that are due to mature within the next 12 months. During 2015-16 the AOFM repurchased (and cancelled) $15,267.5 million of Treasury Bonds (2014-15: $5,972.9 million).

Note 14: Administered re-measurements

	2016 $'000	2015 $'000
NET MARKET REVALUATION GAINS (LOSSES)		
Australian Government Securities:		
Treasury Bonds	**(17,160,338)**	(6,754,896)
Treasury Indexed Bonds	**(443,093)**	(744,451)
Other debt	**(755)**	(204)
Investments	**(29,296)**	(12,083)
Total net market revaluation gains (losses)	**(17,633,482)**	(7,511,634)

Net market revaluation gains (losses) represent the unrealised fair value gains (losses) on the portfolio of administered financial assets and financial liabilities. Changes in the carrying value of financial assets and financial liabilities are attributed between changes in the amortised cost carrying value and other changes in carrying value. Changes attributable to amortised cost are recognised in revenue before re-measurements or expenses before re-measurements. Other changes in carrying value (including due to a change in interest rates) are recognised as administered re-measurements. Where a financial asset is sold or a financial liability is repurchased during the financial year, the cumulative unrealised market value gain or loss at that time is reversed against administered re-measurements. The revaluation effect of unrealised re-measurements will net to zero over the life of a financial instrument, either at maturity or on de-recognition prior to maturity.

Note 15: Administered assets

	2016 $'000	2015 $'000
INVESTMENTS		
Designated at fair value through profit or loss:		
Deposits	**28,925,291**	34,267,830
Residential mortgage-backed securities	**2,807,792**	4,287,992
Total investments	**31,733,083**	38,555,822
Investments maturing:		
Within one year	**29,151,772**	34,640,519
In one to five years	**2,581,311**	3,826,456
In more than five years	**-**	88,847
	31,733,083	38,555,822

Investments were made under the authority of section 58 of the *Public Governance, Performance and Accountability Act 2013*.

The maturity profile is based on contractual maturity dates, with the exception of RMBS. For RMBS the maturity profile is based on the weighted average life of each investment.

The changes in deposits balances comprise:

	2016 $'000	2015 $'000
DEPOSITS		
Opening value	**34,267,830**	27,116,335
Acquisitions (face value)	**592,850,000**	653,200,000
Redemptions (face value)	**(598,200,000)**	(646,050,000)
Change in interest accruals and market value	**7,461**	1,495
	28,925,291	34,267,830

The changes in RMBS balances comprise:

	2016 $'000	2015 $'000
RESIDENTIAL MORTGAGE-BACKED SECURITIES		
Opening value	**4,287,992**	6,059,565
Principal repayments	**(1,150,976)**	(1,594,807)
Sales (face value)	**(297,010)**	(160,501)
Change in interest accruals and market value	**(32,214)**	(16,265)
	2,807,792	4,287,992

	2016 $'000	2015 $'000
LOANS TO STATE AND TERRITORY GOVERNMENTS		
At amortised cost:		
Perpetual debt:		
Principal	**7,973**	7,978
Accrued interest	**93**	93
Balance of special account (see Note 23)	**(1,037)**	(943)
Advances:		
Principal	**2,183,042**	2,275,272
Unamortised net discounts	**(233,681)**	(249,528)
Accrued interest	**269**	279
Other	**4**	4
Total loans to State and Territory Governments	**1,956,663**	2,033,155
Loans to State and Territory Governments maturing:		
Within one year (a)	**9,378**	9,660
In one to five years	**36,772**	34,032
In more than five years (a)	**1,910,513**	1,989,463
	1,956,663	2,033,155
Loans to State and Territory Governments are aged as follows:		
Not overdue	**1,956,663**	2,033,155

(a) minor changes were made to comparative figures.

Loans to State and Territory Governments are composed primarily of credit foncier loans. The maturity profile is based on the maturity date of each loan, disregarding principal repayments prior to that time.

The balance of the special account is for the repurchase of New South Wales and Victorian debt governed by the *Financial Agreement Act 1994*.

Note 16: Administered liabilities

	2016 $'000	2015 $'000
AUSTRALIAN GOVERNMENT SECURITIES		
Designated at fair value through profit or loss:		
Treasury Bonds	**436,936,500**	365,760,903
Treasury Indexed Bonds	**41,416,964**	38,175,835
Treasury Notes	**4,985,766**	5,977,920
Other debt	**7,710**	7,976
At amortised cost:		
Other debt	**13,842**	13,856
Total Australian Government Securities	**483,360,782**	409,936,490
Australian Government Securities maturing:		
Within one year (a)	**17,423,974**	42,156,263
In one to five years	**196,598,596**	145,547,086
In more than five years (a)	**269,338,212**	222,233,141
	483,360,782	409,936,490

(a) minor changes were made to comparative figures.

The maturity profile is based on contractual maturity dates.

Treasury Bonds

Treasury Bonds are denominated in Australian dollars and pay a fixed coupon semi-annually in arrears. Treasury Bonds are redeemable at face value on maturity. The AOFM issues Treasury Bonds primarily through a competitive auction process to registered bidders. In certain circumstances syndicated issuance may be undertaken.

As at 30 June 2016 the weighted average (*nominal*) issuance yield on Treasury Bonds was 3.52 per cent (30 June 2015: 3.87 per cent) and the weighted average market yield was 1.82 per cent (30 June 2015: 2.51 per cent).

	2016 $'000	2015 $'000
TREASURY BONDS		
Components of carrying value:		
Face value	**385,219,783**	335,186,219
Accrued interest	**4,003,230**	3,787,053
Unamortised net premiums	**10,973,758**	7,208,240
Market value adjustment	**36,739,729**	19,579,391
	436,936,500	365,760,903
Reconciliation of changes in carrying value:		
Opening value	**365,760,903**	313,875,056
Issuance (face value)	**92,600,000**	73,550,000
Maturities and redemptions (face value)	**(42,566,436)**	(29,299,932)
Changes in accruals and net premiums	**3,981,695**	880,883
Changes in market value adjustment	**17,160,338**	6,754,896
	436,936,500	365,760,903

Treasury Indexed Bonds

Treasury Indexed Bonds are denominated in Australian dollars and are capital-indexed with the principal value of the bond adjusted by reference to movements in the CPI (based on a six month lag). Interest payments are made quarterly in arrears, at a fixed rate, on the accreted capital value. At maturity, investors receive the adjusted capital value of the security. The AOFM issues Treasury Indexed Bonds primarily through a competitive auction process to registered bidders. In certain circumstances syndicated issuance may be undertaken.

As at 30 June 2016, the weighted average (*real)* issuance yield on Treasury Indexed Bonds was 1.80 per cent (30 June 2015: 1.97 per cent) and the weighted average market yield was 0.53 per cent (30 June 2015: 0.58 per cent).

	2016 $'000	2015 $'000
TREASURY INDEXED BONDS		
Components of carrying value:		
Face value	**30,179,141**	27,530,819
Capital accretion	**5,812,121**	5,881,648
Accrued interest	**71,811**	73,708
Unamortised net premiums	**1,174,582**	953,444
Market value adjustment	**4,179,309**	3,736,216
	41,416,964	38,175,835
Reconciliation of changes in carrying value:		
Opening value	**38,175,835**	32,418,652
Issuance (face value)	**3,800,000**	4,000,000
Maturities and redemptions (face value)	**(1,151,678)**	(534)
Changes in capital accretion	**(69,527)**	691,601
Changes in accruals and net premiums	**219,241**	321,665
Changes in market value adjustment	**443,093**	744,451
	41,416,964	38,175,835

Treasury Notes

Treasury Notes are a discount instrument, denominated in Australian dollars and repayable at face value on maturity. During 2015-16, $20,000 million of Treasury Notes were issued (2014-15: $22,000 million) and $21,000 million matured (2014-15: $21,000 million). The average tenor of issuance was around 4 months (2014-15: 4 months).

As at 30 June 2016, $5,000 million of Treasury Notes were on issue (30 June 2015: $6,000 million).

	2016 $'000	2015 $'000
TREASURY NOTES		
Components of carrying value:		
Face value	**5,000,000**	6,000,000
Accrued interest	**(16,133)**	(22,714)
Market value adjustment	**1,899**	634
	4,985,766	5,977,920

Note 17: Administered cash flow reconciliation

The following table reconciles the surplus (deficit) reported in the Administered Schedule of Comprehensive Income to net cash flows from operating activities reported in the Administered Schedule of Cash Flows.

	2016 $'000	2015 $'000
Surplus (deficit)	**(32,509,192)**	(21,115,979)
Adjustments for non-cash items:		
Amortisation and capital accretion of debt instruments	**(1,712,594)**	(1,368,206)
Amortisation of net discounts on Loans to State and Territory Governments	**(15,847)**	(17,487)
Net realised (gains) losses	**301,435**	32,996
Net foreign exchange (gains) losses	**225**	1,254
Re-measurements	**17,633,482**	7,511,634
Debt Retirement Reserve Trust Account contributions and interest payments	**39**	40
Adjustments for cash items:		
Capital accretion costs on redemption of debt	**(237,980)**	(227)
Accrual adjustments:		
Interest accruals on debt instruments	**215,181**	186,222
Interest accruals on financial assets	**(4,555)**	2,700
Accrued expenses	**(3)**	(5)
Net cash from (used by) operating activities	**(16,329,809)**	(14,767,058)

Note 18: Administered contingent liabilities and assets

The AOFM is not aware of any quantifiable or unquantifiable contingencies as of the signing date that may have an impact on its operations.

Note 19: Administered financial instruments

Interest rate risk

The AOFM's exposure to interest rate risk and corresponding weighted average effective interest rates from financial instruments as at the reporting date is set out below.

	Fixed interest rate	Floating interest rate	Non interest bearing	Weighted average interest
	2016 $'000	**2016 $'000**	**2016 $'000**	**2016 %**
Financial assets				
Cash	**-**	**-**	**622**	**-**
Loans to State and Territory Governments	**1,956,659**	**-**	**4**	**5.88**
Residential mortgage-backed securities	**-**	**2,807,792**	**-**	**3.12**
Deposits	**28,925,291**	**-**	**-**	**1.83**
Total financial assets	**30,881,950**	**2,807,792**	**626**	
Financial liabilities				
Treasury Bonds	**436,936,500**	**-**	**-**	**3.52**
Treasury Indexed Bonds	**41,416,964**	**-**	**-**	**1.80**
Treasury Notes	**4,985,766**	**-**	**-**	**1.91**
Other debt	**15,775**	**-**	**5,777**	**4.01**
Total financial liabilities	**483,355,005**	**-**	**5,777**	
	2015 $'000	2015 $'000	2015 $'000	2015 %
Financial assets				
Cash	-	-	622	-
Loans to State and Territory Governments	2,033,151	-	4	5.88
Residential mortgage-backed securities	-	4,287,992	-	3.31
Deposits	34,267,830	-	-	2.01
Total financial assets	36,300,981	4,287,992	626	
Financial liabilities				
Treasury Bonds	365,760,903	-	-	3.87
Treasury Indexed Bonds	38,175,835	-	-	1.97
Treasury Notes	5,977,920	-	-	2.02
Other debt	16,046	-	5,786	3.96
Total financial liabilities	409,930,704	-	5,786	

Financial instruments with a fixed interest rate expose the portfolio to changes in fair value with changes in interest rates, whilst those financial instruments at floating interest rates expose the portfolio to changes in debt servicing costs with changes in interest rates. The extent to which the AOFM can match the repricing profile of its financial assets with those of its financial liabilities is limited due to the differences in the volumes and the need for assets to be available for cash management or other purposes. Interest rates are nominal interest rates with the exception of Treasury Indexed Bonds (which are real interest rates).

Contractual maturities of financial liabilities

The following table discloses the undiscounted value of the contractual maturities of financial liabilities as at the reporting date, including estimated future interest payments.

	Less than 1 year	**1 to 2 years**	**2 to 5 years**	**5+ years**	**Total**
	2016 $'000	**2016 $'000**	**2016 $'000**	**2016 $'000**	**2016 $'000**
Treasury Bonds	**27,942,081**	**54,402,178**	**161,792,705**	**251,364,659**	**495,501,623**
Treasury Indexed Bonds	**876,386**	**876,386**	**15,974,299**	**25,582,853**	**43,309,924**
Treasury Notes	**5,000,000**	**-**	**-**	**-**	**5,000,000**
Other debt	**21,515**	**-**	**-**	**-**	**21,515**
Total	**33,839,982**	**55,278,564**	**177,767,004**	**276,947,512**	**543,833,062**
	2015 $'000	2015 $'000	2015 $'000	2015 $'000	2015 $'000
Treasury Bonds	48,131,060	34,617,366	138,521,417	210,376,630	431,646,473
Treasury Indexed Bonds	2,825,715	791,958	7,193,091	29,650,662	40,461,426
Treasury Notes	6,000,000	-	-	-	6,000,000
Other debt (a)	14,343	7,509	-	-	21,852
Total	56,971,118	35,416,833	145,714,508	240,027,292	478,129,751

(a) In the 2014-15 financial statements overdues and perpetual debt were excluded from this table. In the above presentation overdues and perpetual debt are included.

For Treasury Indexed Bonds, the interest payments and principal value are indexed against the CPI. There is a six month lag between the calculation period for the CPI and its impact on the value of interest and principal. Interest payments and principal value on redemption are projected at the CPI for the March quarter and held constant thereafter.

Credit risk

The following table sets out the AOFM's credit risk by asset class and credit rating as at the reporting date.

S&P or Fitch long-term rating	AAA	AA+	AA	
Moody's long-term rating	Aaa	Aa1	Aa2	Total
	2016 $'000	**2016 $'000**	**2016 $'000**	**2016 $'000**
Cash	**622**	**-**	**-**	**622**
Loans to State and Territory Governments	**1,147,660**	**782,421**	**732,614**	**2,662,695**
Residential mortgage-backed securities	**2,807,792**	**-**	**-**	**2,807,792**
Deposits	**28,925,291**	**-**	**-**	**28,925,291**
Total	**32,881,365**	**782,421**	**732,614**	**34,396,400**
	2015 $'000	2015 $'000	2015 $'000	2015 $'000
Cash	622	-	-	622
Loans to State and Territory Governments	1,109,557	1,191,535	242,643	2,543,735
Residential mortgage-backed securities	4,287,992	-	-	4,287,992
Deposits	34,267,830	-	-	34,267,830
Total	39,666,001	1,191,535	242,643	41,100,179

In the table, where a counterparty has a split rating between the rating agencies, the AOFM's exposure to the counterparty is allocated to the lower credit rating.

Cash and deposits are held with the RBA. The RBA does not issue debt in the wholesale market and accordingly does not have a credit rating. However, as Australia's central bank it is deemed to have the same credit rating as the Australian Government.

Net fair values

	Principal value	Carrying value	Fair value
	2016	**2016**	**2016**
	$'000	**$'000**	**$'000**
FINANCIAL ASSETS			
Cash	**622**	**622**	**622**
Loans to State and Territory Governments	**2,189,983**	**1,956,663**	**2,661,659**
Deposits	**28,900,000**	**28,925,291**	**28,925,291**
Residential mortgage-backed securities	**2,813,365**	**2,807,792**	**2,807,792**
Total financial assets	**33,903,970**	**33,690,368**	**34,395,364**
FINANCIAL LIABILITIES			
Treasury Bonds	**385,219,783**	**436,936,500**	**436,936,500**
Treasury Indexed Bonds	**35,991,262**	**41,416,964**	**41,416,964**
Treasury Notes	**5,000,000**	**4,985,766**	**4,985,766**
Other debt	**20,914**	**21,552**	**21,552**
Total financial liabilities	**426,231,959**	**483,360,782**	**483,360,782**
Net financial assets	**(392,327,989)**	**(449,670,414)**	**(448,965,418)**
	2015	2015	2015
	$'000	$'000	$'000
FINANCIAL ASSETS			
Cash	622	622	622
Loans to State and Territory Governments	2,282,311	2,033,155	2,542,793
Deposits	34,250,000	34,267,830	34,267,830
Residential mortgage-backed securities	4,261,351	4,287,992	4,287,992
Total financial assets	40,794,284	40,589,599	41,099,237
FINANCIAL LIABILITIES			
Treasury Bonds	335,186,219	365,760,903	365,760,903
Treasury Indexed Bonds	33,412,467	38,175,835	38,175,835
Treasury Notes	6,000,000	5,977,920	5,977,920
Other debt	20,692	21,832	21,832
Total financial liabilities	374,619,378	409,936,490	409,936,490
Net financial assets	(333,825,094)	(369,346,891)	(368,837,253)

Principal value is the face value of financial instruments, with the exception of Treasury Indexed Bonds which is the inflation adjusted capital value, comprising face value of $30,179.2 million and inflation accretion of $5,812.1 million as at 30 June 2016.

Loans to State and Territory Governments are carried at amortised cost. These transactions are not traded and, especially for those with the longest terms to maturity, a direct market benchmark to underpin fair value measurement does not exist. In estimating aggregate net fair value, the AOFM based its valuation from data on Treasury Bonds.

The following table discloses the quality of significant inputs used to determine the fair value of financial instruments measured at fair value, by assigning a 3 level hierarchy to those valuations, being:

- Level 1 inputs - the fair value method is determined using unadjusted quoted prices in active markets for identical financial instruments.
- Level 2 inputs - the fair value is estimated by using market inputs other than quoted prices included in Level 1, that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs - The fair value is determined from inputs not based on observable market data, or significant adjustments to observable market data.

	Level 1	Level 2	Level 3	Total
	2016 $'000	**2016 $'000**	**2016 $'000**	**2016 $'000**
FINANCIAL ASSETS				
Deposits	**-**	**28,925,291**	**-**	**28,925,291**
Residential mortgage-backed securities	**-**	**2,807,792**	**-**	**2,807,792**
Total	**-**	**31,733,083**	**-**	**31,733,083**
FINANCIAL LIABILITIES				
Treasury Bonds	**436,936,500**	**-**	**-**	**436,936,500**
Treasury Indexed Bonds	**41,416,964**	**-**	**-**	**41,416,964**
Treasury Notes	**4,985,766**	**-**	**-**	**4,985,766**
Other debt	**-**	**7,710**	**-**	**7,710**
Total	**483,339,230**	**7,710**	**-**	**483,346,940**
	2015 $'000	2015 $'000	2015 $'000	2015 $'000
FINANCIAL ASSETS				
Deposits	-	34,267,830	-	34,267,830
Residential mortgage-backed securities	-	4,287,992	-	4,287,992
Total	-	38,555,822	-	38,555,822
FINANCIAL LIABILITIES				
Treasury Bonds	331,624,497	34,136,406	-	365,760,903
Treasury Indexed Bonds	38,175,835	-	-	38,175,835
Treasury Notes	-	5,977,920	-	5,977,920
Other debt	-	7,976	-	7,976
Total	369,800,332	40,122,302	-	409,922,634

Residential Mortgage-Backed Securities

From September 2008 to April 2013 the AOFM acquired a portfolio of AAA or equivalent rated RMBS with face value of $15,462.6 million. In April 2013, the Government announced it would not make any more new investments in RMBS. In May 2015, the AOFM was directed to divest the portfolio through a regular competitive process.

The following table provides details of RMBS activity since this initiative was first announced in 2008:

	Opening Balance	Amount Invested	Principal Repayments	Sales	Closing Balance
	$'000	$'000	$'000	$'000	$'000
Financial Year					
2008-09	-	6,203,420	(179,281)	-	6,024,139
2009-10	6,024,139	2,819,540	(850,664)	(73,790)	7,919,225
2010-11	7,919,225	4,349,220	(1,438,640)	-	10,829,805
2011-12	10,829,805	1,930,430	(1,509,050)	(50,000)	11,201,185
2012-13	11,201,185	160,000	(1,771,242)	(510,585)	9,079,358
2013-14	9,079,358	-	(2,177,699)	(885,000)	6,016,659
2014-15	6,016,659	-	(1,594,807)	(160,501)	4,261,351
2015-16	**4,261,351**	**-**	**(1,150,976)**	**(297,010)**	**2,813,365**
Total		**15,462,610**	**(10,672,359)**	**(1,976,886)**	

Note 20: Market risk sensitivity of administered financial instruments

The following sensitivity analysis illustrates the *interest rate risk* sensitivity of administered financial instruments and the financial impact on profit or loss and equity.

Interest rate risk represents the risk that the fair value, or future cash flows of a financial instrument will fluctuate as a result of changes in interest rates.

The sensitivity analysis is calculated by applying a reasonably possible change in domestic interest rates (with all other variables held constant) on 30 June 2016 to financial positions held as at 30 June 2016.

The following assumptions have been made in undertaking the analysis:

- a sensitivity of 30 basis points has been used for domestic interest rates as at 30 June 2016 (40 basis points as at 30 June 2015), which is the standard rate required in accordance with the *Public Governance, Performance and Accountability (Financial Reporting) Rule 2015*;
- a parallel shift in domestic interest rates (real and nominal) occurs on 30 June 2016;
- for fixed rate financial instruments that are carried at fair value, changes in fair value only are considered relevant;
- for fixed rate instruments that are carried at amortised cost, interest rate risk is not considered relevant; and
- for floating rate instruments, the impact on interest revenue or interest expense represents an annualised estimate calculated as if the position as at 30 June 2016 were outstanding for the whole financial year.

The table below shows the financial impact on profit or loss and equity due to a reasonably possible change in domestic interest rates, with all other variables held constant, as at 30 June 2016.

Financial Instruments as at 30 June 2016	Impact on profit or loss and equity	
	$'000	$'000
	+30 basis points	-30 basis points
FINANCIAL ASSETS		
Changes in fair value:		
Deposits	(2,261)	2,261
Residential mortgage-backed securities	(16,549)	16,666
Changes in interest revenue:		
Residential mortgage-backed securities	8,440	(8,440)
FINANCIAL LIABILITIES		
Changes in fair value:		
Treasury Bonds	7,710,794	(7,940,459)
Treasury Indexed Bonds	969,235	(1,006,215)
Treasury Notes	2,569	(2,573)

The corresponding figures for the previous financial year are as follows:

Financial Instruments as at 30 June 2015	Impact on profit or loss and equity	
	$'000	$'000
	+40 basis points	-40 basis points
FINANCIAL ASSETS		
Changes in fair value:		
Deposits	(2,094)	2,094
Residential mortgage-backed securities	(36,878)	37,273
Changes in interest revenue:		
Residential mortgage-backed securities	17,045	(17,045)
FINANCIAL LIABILITIES		
Changes in fair value:		
Treasury Bonds	7,727,509	(8,019,096)
Treasury Indexed Bonds	1,120,582	(1,172,030)
Treasury Notes	4,495	(4,504)

Note 21: Securities lending facility

The AOFM has a securities lending facility for Treasury Bonds and Treasury Indexed Bonds, operated by the RBA. The purpose of the facility is to enhance the efficiency of the bond markets by allowing bond market participants to borrow Treasury Bonds and Treasury Indexed Bonds when they are not readily available in those markets. Bonds are lent on an intra-day or overnight basis. Where bonds are lent overnight the AOFM receives net interest income.

The following table details the security lending transactions completed during the reporting period.

	Number of transactions	Number of transactions	**Face value loaned**	Face value loaned
	2016 No.	2015 No.	**2016 $'000**	2015 $'000
SECURITIES LENT				
Overnight:				
Treasury Bonds	**-**	12	**-**	335,350
Treasury Indexed Bonds	**29**	1	**261,450**	13,000
Intra-day:				
Treasury Bonds	**4**	23	**909,000**	1,266,700
Treasury Indexed Bonds	**5**	4	**250,000**	85,500
Securities lent	**38**	40	**1,420,450**	1,700,550

Note 22: Disclosures of appropriations

The AOFM delivers a single outcome to Government — *the advancement of macroeconomic growth and stability, and the effective operation of financial markets, through issuing debt, investing in financial assets and managing debt, investments and cash for the Australian Government.*

Annual appropriations

	2016 $'000	2015 $'000
DEPARTMENTAL ANNUAL APPROPRIATIONS		
Annual appropriations		
Outputs	**11,187**	11,402
Departmental capital budget	**720**	732
Appropriation withheld(a)	**(3)**	(4)
Public Governance, Performance and Accountability Act 2013:		
Section 74 - retained receipts	**764**	662
Total departmental appropriations	**12,668**	12,792
Appropriation applied (current and prior years)	**(9,780)**	(8,970)
Variance	**2,888**	3,822

(a) On 17 June 2016, $3,000 relating to a savings measure was withheld via section 51 of the *Public Governance, Performance and Accountability Act 2013*.

For 2015-16, the variance in departmental appropriations to appropriations applied (spent) is explained by lower staff costs, administrative costs and capital expenditure than expected.

Unspent departmental annual appropriation

	2016 $'000	2015 $'000
UNSPENT DEPARTMENTAL ANNUAL APPROPRIATION		
Appropriation Act 1 2012-13	**-**	3,623
Appropriation Act 1 2013-14	**6,171**	12,327
Appropriation Act 1 2014-15	**12,792**	12,792
Appropriation Act 1 2015-16	**12,668**	-
Total	**31,631**	28,742
Represented By:		
Cash at Bank	**100**	100
Appropriation receivable	**31,531**	28,642
Total	**31,631**	28,742

Administered annual appropriations

	2016 $'000	2015 $'000
ADMINISTERED ANNUAL APPROPRIATIONS		
Annual appropriations	**10**	10
Total administered appropriations	**10**	10
Appropriation applied	**-**	-
Variance	**10**	10

Unspent administered annual appropriation

	2016 $'000	2015 $'000
UNSPENT ADMINISTERED ANNUAL APPROPRIATIONS		
Appropriation Act 1 2014-15 (a)	**-**	10
Appropriation Act 1 2015-16	**10**	-
Total	**10**	10

(a) On 6 May 2016, $10,000 for Appropriation Act 1 2014-15 no longer required by the AOFM was withheld via section 51 of the *Public Governance, Performance and Accountability Act 2013*.

Administered special appropriations (unlimited amount)

	2016 $'000	2015 $'000
SPECIAL APPROPRIATIONS EXPENDITURE		
Commonwealth Inscribed Stock Act 1911, sec 13AA		
Purpose: payment of principal and interest on money raised by Stock issued under the Act and principal and interest due to holders of depository interests in Stock issued under the Act	**67,572,801**	60,277,366
Commonwealth Inscribed Stock Act 1911, sec 13A		
Purpose: payment of costs and expenses incurred in relation to issuing and managing debt and issuing and managing depository interests	**28,298**	19,170
Commonwealth Inscribed Stock Act 1911, sec 13B		
Purpose: payment of costs and expenses incurred in repurchasing debt prior to maturity	**15,800,765**	6,119,956
Financial Agreement Act 1994, sec 5		
Purpose: debt redemption assistance and payment of interest to bond holders on behalf of the State and Northern Territory Governments on public debt under the Act(a)	**277**	279
Loans Securities Act 1919, sec 4		
Purpose: payment of principal and interest on money raised by stock issued under the Act	**621**	535
Public Governance, Performance and Accountability Act 2013, sec 58(7)		
Purpose: to make investments in the name of the Commonwealth of Australia	**592,850,000**	653,200,000
Public Governance, Performance and Accountability Act 2013, sec 77		
Purpose: refunds of monies received by the Australian Government	**-**	4,887
Total	**676,252,762**	719,622,193

(a) The 2015-16 amount includes $38,558 paid into the Debt Retirement Reserve Trust Account (2014-15: $40,358).

The following table details the investments (in face value terms) made in the name of the Commonwealth under the authority of section 58 of the *Public Governance, Performance and Accountability Act 2013*.

	2016 $'000	2015 $'000
INVESTMENTS MADE IN THE NAME OF THE COMMONWEALTH		
Opening value	**38,511,351**	33,116,659
Acquisitions	**592,850,000**	653,200,000
Redemptions and sales	**(599,647,986)**	(647,805,308)
Closing value	**31,713,365**	38,511,351

The following table details administered special appropriations that are available but were not used by the AOFM during the period:

	2016 $'000	2015 $'000
SPECIAL APPROPRIATIONS NOT USED		
Australian National Railways Commission Sale Act 1997, sec 67AW		
Purpose: payment of principal and interest on former debts of the National Railways Commission	**-**	-
Financial Management and Accountability Act 1997, sec 30A		
Purpose: payments of recoverable GST	**n/a**	-
Loans Redemption and Conversion Act 1921, sec 5		
Purpose: payment of principal, interest and costs of converting loans made in accordance with the Act	**-**	-
Loans Securities Act 1919, sec 5B		
Purpose: payment of money under a swap or repurchase agreement and any expenditure in connection with the negotiation, management or service of, or a repayment under, any such agreement	**-**	-
Loans Securities Act 1919, sec 5BA		
Purpose: payment of money to enter into securities lending arrangements	**-**	-
Moomba-Sydney Pipeline System Sale Act 1994, sec 19		
Purpose: payment of principal and interest on former debts of the Pipeline Authority	**-**	-
Public Governance, Performance and Accountability Act 2013, sec 74A		
Purpose: payments of recoverable GST	**-**	n/a
Snowy Hydro Corporatisation Act 1997, sec 22		
Purpose: payment of principal and interest on former debts of the Snowy Mountains Hydro Electricity Authority	**-**	-
Treasury Bills Act 1914, sec 6		
Purpose: payment of principal and interest on money raised by issuance of Treasury Bills	**-**	-

n/a- not applicable

Note 23: Special accounts (Administered)

Debt Retirement Reserve Trust Account (DRRTA)

Establishing Instrument — *Public Governance, Performance and Accountability Act 2013*, section 80.

Purpose — to fund the redemption of the State and Northern Territory debt governed by the *Financial Agreement Act 1994*. Monies standing to the credit of the DRRTA are applied to repurchase debt of the States and the Northern Territory.

	2016 $'000	2015 $'000
DEBT RETIREMENT RESERVE TRUST ACCOUNT		
Opening balance	**943**	843
Appropriation for reporting period:		
Commonwealth contributions	**20**	20
Interest amounts credited	**19**	20
Other receipts:		
State contributions	**60**	61
Available for payments	**1,042**	944
Payments made:		
Debt repayments	**(5)**	(1)
Balance	**1,037**	943
Balance represented by:		
Cash - held in the Official Public Account	**1,037**	943
Total balance carried to the next period	**1,037**	943

Monies standing to the credit of the Debt Retirement Reserve Trust Account are held on behalf of New South Wales and Victoria. These monies are held for the purposes prescribed by the *Financial Agreement Act 1994*.

Note 24: Budgetary report to outcome comparison

Explanations are provided for major variances between actual results for 2015-16 and the original budget, as reported in the 2015-16 Portfolio Budget Statements. Major variances are those relevant to the accountability and performance of the AOFM and are typically those amounts greater than $1 million for departmental activities and $20 million for administered activities.

Departmental

Comparison of the Outcome and Budget 2015-16 statement of comprehensive income

	Outcome 2016 $'000	Budget 2016(a) $'000	Variance 2016 $'000
NET COST OF SERVICES			
EXPENSES			
Employee benefits	**6,275**	6,885	(610)
Supplier expenses	**3,544**	5,433	(1,889)
Depreciation and amortisation	**253**	500	(247)
Total expenses	**10,072**	12,818	(2,746)
OWN-SOURCE INCOME			
Revenue	**881**	1,131	(250)
Total own-source income	**881**	1,131	(250)
Net cost of services	**9,191**	11,687	(2,496)
APPROPRIATION FUNDING			
Revenue from government	**11,184**	11,187	(3)
Total appropriation funding	**11,184**	11,187	(3)
Surplus (deficit)	**1,993**	**(500)**	**2,493**
Total comprehensive income	**1,993**	**(500)**	**2,493**

(a) Original Budget released in May 2015. The Budget figures are not audited.

Comparison of the Outcome and Budget 2015-16 statement of financial position

	Outcome 2016 $'000	Budget 2016(a) $'000	Variance 2016 $'000
ASSETS			
Financial assets:			
Cash and cash equivalents	**100**	100	-
Receivables	**31,635**	24,546	7,089
Non-financial assets:			
Infrastructure, plant and equipment	**44**	1,372	(1,328)
Computer software	**1,272**	2,343	(1,071)
Supplier prepayments	**107**	952	(845)
Total assets	**33,158**	29,313	3,845
LIABILITIES			
Payables	**153**	95	58
Provisions:			
Employee provisions	**2,110**	2,234	(124)
Other provisions	**160**	140	20
Total liabilities	**2,423**	2,469	(46)
Net assets	**30,735**	26,844	3,891
EQUITY			
Retained surplus	**28,044**	24,708	3,336
Contributed equity	**2,691**	2,136	555
Total equity	**30,735**	26,844	3,891

(a) Original Budget released in May 2015. The Budget figures are not audited.

Comparison of the Outcome and Budget 2015-16 statement of changes in equity

	Outcome 2016 $'000	Budget 2016(a) $'000	Variance 2016 $'000
RETAINED SURPLUS			
Opening balance	**26,051**	25,208	843
Changes for period:			
Surplus (deficit)	**1,993**	(500)	2,493
Total retained surplus	**28,044**	24,708	3,336
CONTRIBUTED EQUITY			
Opening balance	**1,971**	1,416	555
Changes for period:			
Capital injection - capital budget	**720**	720	-
Total contributed equity	**2,691**	2,136	555
Total equity	**30,735**	26,844	3,891

(a) Original Budget released in May 2015. The Budget figures are not audited.

Comparison of the Outcome and Budget 2015-16 statement of cash flows

	Outcome 2016 $'000	Budget 2016(a) $'000	Variance 2016 $'000
OPERATING ACTIVITIES			
Cash received	**10,345**	13,261	(2,916)
Cash used	**(10,544)**	(12,761)	2,217
Net cash from (used by) operating activities	**(199)**	500	(699)
INVESTING ACTIVITIES			
Cash received	**199**	-	199
Cash used	-	(1,220)	1,220
Net cash from (used by) investing activities	**199**	(1,220)	1,419
FINANCING ACTIVITIES			
Cash received	-	720	(720)
Net cash from (used by) financing activities	-	720	(720)
Net increase (decrease) in cash held	-	-	-
Plus cash held at the beginning of the reporting period	**100**	100	-
Cash at the end of the reporting period	**100**	100	-

(a) Original Budget released in May 2015. The Budget figures are not audited.

Significant variances in the Departmental financial statements

During 2015-16, the AOFM's average staffing level (ASL) was lower than projected in the Budget. The AOFM had an ASL of 35 during the reporting period against an ASL of 41 estimated at Budget.

During 2015‑16 the AOFM incurred lower than anticipated administrative costs (represented in supplier expenses) for undertaking its issuance program and managing its portfolio of financial assets and liabilities.

As at 30 June 2016, appropriations receivable (represented in receivables) were higher than projected in the 2015‑16 Budget by $7.1 million. This was due to a higher operating surplus than projected and lower capital expenditure than projected.

In addition, during 2015-16 the AOFM entered into an agreement with the Treasury to acquire information and communications technology services from the Treasury. As a consequence, the AOFM sold its information technology infrastructure to the Treasury. This was not forecast in the Budget.

Administered

The AOFM produces budget estimates of Australian Government Securities (AGS) debt for the Australian Government's Budget, which is released in May each year for the Budget year (the financial year commencing on the following 1 July) and three forward years.

The projections of AGS debt are a consequence of the expenditure, investment and revenue decisions and assumptions made by the Government in producing its Budget. As part of the Budget process, the AOFM receives an estimate of the aggregated annual financing task for the Budget year and forward years from the Treasury. The Headline Cash Deficit (which represents net cash flows *after* operating activities *and* investing activities for policy purposes; and *before* investments for liquidity purposes *and* financing activities) is the closest published aggregate to this financing task. The financing task plus the volume of maturing AGS debt and planned early repurchases of AGS debt (that would otherwise mature in a future year) determines the size of the debt issuance program in each year.

The volume of AGS debt that needs to be issued in face value terms to generate the required level of financing will depend on the future level of AGS yields (or interest rates) and the mix and tenor of debt to be issued. The mix and tenor of debt to be issued will be based on the debt management strategy for the period ahead.

A technical assumption is made about future AGS yields. It is assumed that the AGS yields for different tenors of debt will be the same as the prevailing observed market rates (at the time the budget estimates are prepared).

2015-16 Budget

In the 2015-16 Budget (released in May 2015) the Government estimated a Headline Cash Deficit of $44.8 billion for 2015-16. After maturing AGS debt of $37 billion (in face value terms) and the financing transactions of other agencies in the general government sector, the debt issuance program was set at $82 billion (in face value terms).

At the time of the Mid-Year Economic and Fiscal Outlook (released in December 2015) the Headline Cash Deficit deteriorated by $3.4 billion (to $48.2 billion) primarily driven by a lower underlying cash balance. The debt issuance program for 2015-16 was revised to $94.5 billion (an increase of $12.5 billion from Budget) to fund the higher deficit and to hold a higher level of investments used for cash management purposes. The larger task was managed through increased Treasury Bonds issuance.

At the time of the 2016-17 Budget (released in May 2016) the debt issuance program for 2015-16 was revised down slightly to $93 billion, and the Headline Cash Deficit was revised up to $51.5 billion.

By 30 June 2016 the debt issuance program reached $95.4 billion, slightly higher than projected at the time of release of the 2016-17 Budget.

Comparison of the Outcome and Budget 2015-16 administered schedule of comprehensive income

	Outcome 2016 $'mil	Budget(a) 2016 $'mil	Variance 2016 $'mil
INCOME			
Interest revenue	**765**	795	(30)
Other revenue	**-**	-	-
Total income	**765**	795	(30)
EXPENSES			
Grants	**-**	-	-
Interest expenses	**15,313**	15,560	(247)
Supplier expenses	**26**	1	25
Total expenses	**15,339**	15,561	(222)
GAINS (LOSSES)			
Net foreign exchange gains (losses)	**-**	-	-
Net realised gains (losses)	**(302)**	17	(319)
Total gains (losses)	**(302)**	17	(319)
Surplus (deficit) before re-measurements	**(14,876)**	(14,749)	(127)
RE-MEASUREMENTS			
Net market revaluation gains (losses)	**(17,633)**	3,604	(21,237)
Total re-measurements	**(17,633)**	3,604	(21,237)
Surplus (deficit)	**(32,509)**	(11,145)	(21,364)
Total comprehensive income (loss)	**(32,509)**	(11,145)	(21,364)

(a) Original Budget released in May 2015. The Budget figures are not audited.

Significant variances in income before re-measurements

During 2015-16 the AOFM's placement and maturity of term deposits with the RBA was significantly higher than was projected in the 2015-16 Budget figures. This was due to conducting issuance at a faster rate and using a more conservative cash management approach with regards to estimating the timing of certain government expenditures. Despite higher term deposit levels, due to lower than projected short term investment yields (50 basis points lower than projected by the end of 2015-16) interest revenue on term deposits was lower as compared with the 2015-16 Budget.

The AOFM suspended the sale of its RMBS assets in November 2015. Holding additional RMBS assets in 2015-16 compared to the projection has resulted in an increase to interest revenue which partially offset the lower interest earnings attained from term deposits for the period.

Significant variances in expenses before re-measurements

Interest expenses for 2015-16 were $247 million lower than forecast in the 2015-16 Budget. This is notwithstanding that AGS on issue as at 30 June 2016 was $5.7 billion higher than Budget forecasts.

The lower interest expenses are attributable to a number of factors, including:

- significantly lower than forecast CPI for the period resulting in lower capital accretion costs on Treasury Indexed Bonds;
- early repurchases of debt, which were not forecast in the Budget, resulting in a favourable impact on interest cost due to refinancing debt at lower interest rates;
- lower usage of Treasury Notes than forecast to manage the within-year cash management task; and
- slightly lower Treasury Bonds issuance yields as compared to Budget.

Significant variances in gains (losses) before re-measurements

During 2015-16, as part of its cash management operations, the AOFM repurchased $15,267.5 million of Treasury Bonds prior to maturity. The AOFM incurred a loss (in accrual terms) of $303.1 million. The early redemption of debt was not forecast in the Budget. The decision to repurchase debt was based on a number of factors, including prevailing market conditions.

This is partially offset by gains projected in the 2015-16 Budget prior to the AOFM suspending its RMBS sales program in November 2015. Actual gains on RMBS sales in 2015-16 totalled $1.7 million. Budget forecasts anticipated the full liquidation of the RMBS portfolio during 2015-16.

Significant variances in re-measurements

A technical assumption is made about future AGS interest rates in the Budget. It is assumed that the AGS yields for different tenors of debt will be the same as the prevailing observed market rates (at the time the budget estimates are prepared). Actual interest rates as at 30 June 2016 were significantly lower than at Budget (May 2015). The nominal yield on 10 year Australian government bonds dropped by around 67 basis points over this period. There is an inverse relationship between yield and price.

Comparison of the Outcome and Budget 2015-16 administered schedule of assets and liabilities

	Outcome 2016 $'mil	Budget(a) 2016 $'mil	Variance 2016 $'mil
ASSETS			
Financial assets:			
Cash and cash equivalents	**1**	1	-
Investments	**31,733**	22,418	9,315
Loans to State and Territory Governments	**1,956**	1,958	(2)
Total assets	**33,690**	24,377	9,313
LIABILITIES			
Interest bearing liabilities:			
Australian Government Securities	**483,360**	464,299	19,061
Other:			
Accrued expenses	**-**	-	-
Total liabilities	**483,360**	464,299	19,061
Net assets	**(449,670)**	(439,922)	(9,748)

(a) Original Budget released in May 2015. The Budget figures are not audited.

Significant variances in investments

As at 30 June 2016 the AOFM held $6.5 billion (in face value terms) in additional term deposit investments than projected in the 2015-16 Budget. This is due to a more conservative cash management approach and due to imprecisions in projecting the highly volatile daily flows of revenue, expenditure and financing items across the general government sector.

The 2015-16 Budget assumed the full liquidation of the AOFM's RMBS portfolio by 30 June 2016, however in November 2015 the divestment program was suspended due to unfavourable market conditions. As such, RMBS investments are $2.8 billion (in face value terms) higher than projected.

Significant variances in Australian Government Securities

The fair value of AGS debt outstanding as at 30 June 2016 was $19.1 billion higher than forecast in the Budget. As at 30 June 2016, AGS on issue was $5.7 billion (in face value terms) higher than projected in the 2015-16 Budget due to a larger financing task. In addition, the lower yields on AGS as compared to Budget have added $14.2 billion to the fair value of debt on issue at 30 June 2016.

Note 25: Compliance with statutory conditions for payments from the consolidated revenue fund

Section 83 of the Constitution provides that no amount may be paid out of the Consolidated Revenue Fund except under an appropriation made by law. The Department of Finance provided information to all agencies in 2011 regarding the need to conduct risk assessments in relation to compliance with the statutory conditions on payments from special appropriations, including special accounts. Non-compliance with statutory conditions on payments may constitute a breach of section 83 of the Constitution.

On 2 July 2013 the AOFM received further advice from the Department of Finance in relation to possible breaches of section 83 of the Constitution for what it called certain 'generic' payments. These are payments made by agencies pursuant to the *Remuneration Tribunal Act 1973*, the *Long Service Leave (Commonwealth Employees) Act 1976* and section 74A of the *Public Governance, Performance and Accountability Act 2013*.

The AOFM undertook a constitutional risk assessment for the 2015-16 financial year. No breaches of Section 83 were identified and the overall risk of a breach was considered low.

The Australian Government continues to have regard to developments in case law, including the High Court's most recent decision on Commonwealth expenditure in *Williams v Commonwealth [2014] HCA 23*, as they contribute to the larger body of law relevant to the development of Commonwealth programs. In accordance with its general practice, the Government will continue to monitor and assess risk and decide on any appropriate actions to respond to risks of expenditure not being consistent with constitutional or other legal requirements.

Note 26: Events subsequent to reporting date

No matter, transaction or event of a material or unusual nature has arisen in the interval between the end of the reporting period (30 June 2016) and the date of signing this report that has significantly affected or may significantly affect the AOFM's operations.

AOFM

PART 5

OTHER INFORMATION

OTHER INFORMATION

Agency financial performance

The AOFM recorded an operating surplus on agency activities of $1.99 million for the 2015-16 financial year, comprising total revenue of $12.06 million and expenses of $10.07 million. The surplus in 2015-16 was largely due to lower than anticipated operating costs.

As at 30 June 2016, the AOFM was in a sound net worth and liquidity position, reporting net assets of $30.74 million, represented by assets of $33.16 million and liabilities of $2.42 million.

As at 30 June 2016, the AOFM had unspent appropriations totalling $31.63 million of which $0.10 million was held in cash. Unspent appropriations are available to settle liabilities as and when they fall due and for future asset replacements and improvements.

Agency resource statement and resources for outcomes

Table 1: Expenses and resources for Outcome 1

Outcome 1: The advancement of macroeconomic growth and stability and the effective operation of financial markets, through issuing debt, investing in financial assets and managing debt, investments and cash for the Australian Government	**Budget(a) 2015-16 $'000**	**Actual Expenses 2015-16 $'000**	**Variation $'000**
Program1.1: Australian Office of Financial Management			
Departmental expenses			
Departmental appropriation	11,995	9,499	2,496
Expenses not requiring appropriation in the Budget year	820	573	247
Administered expenses before re-measurements			
Ordinary annual services (Appropriation Bill No.1)	10	-	10
Expenses not requiring appropriation	74,625	301,660	(227,035)
Special appropriations expenses			
Commonwealth Inscribed Stock Act 1911	15,375,089	15,337,859	37,230
Financial Agreement Act 1994	20	277	(257)
Loans Securities Act 1919	998	627	371
Total expenses for program1.1	**15,463,557**	**15,650,495**	**(186,938)**
	2015-16	**2015-16**	
Average staffing level (number)	**36**	**35**	**1**

(a) The Budget figure for 2015-16 is the estimated actual 2015-16 expenses, reported in table 2.1 of the Portfolio Budget Statements 2015-16.

Table 2: AOFM resource statement

		Actual available appropriation 2015-16 $'000	Payments made 2015-16 $'000	= Balance 2015-16 $'000
Ordinary annual services				
Departmental appropriation(a)(b)		40,647	9,016	31,631
Receipts from other sources (s74)(c)		764	764	-
Total departmental		41,411	9,780	31,631
Administered expenses				
Outcome 1		10	-	10
Total administered		10	-	10
Total ordinary annual services	**A**	41,421	9,780	31,641
Other services				
Departmental non-operating		-	-	-
Total other services	**B**	-	-	-
Total available annual appropriations (A+B)		41,421	9,780	31,641
Special appropriations - operating				
Commonwealth Inscribed Stock Act 1911		17,814,996	17,814,996	-
Financial Agreement Act 1994		277	277	-
Loans Securities Act 1919		621	621	-
Subtotal		17,815,894	17,815,894	-
Special appropriations - investing and financing				
Commonwealth Inscribed Stock Act 1911		65,586,868	65,586,868	-
Public Governance, Performance and Accountability Act 2013		592,850,000	592,850,000	-
Subtotal		658,436,868	658,436,868	-
Total special appropriations	**C**	676,252,762	676,252,762	-
Total appropriations excluding special accounts (A + B + C)		676,294,183	676,262,542	31,641
Special Accounts				
Debt Retirement Reserve Trust Account		1,042	5	1,037
Total Special Account	**D**	1,042	5	1,037
Total net resourcing and payments for AOFM (A + B + C + D)		676,295,225	676,262,547	32,678

(a) Actual available appropriation comprises *Appropriation Act (No.1) 2015-16* plus carried forward appropriation balances as at 1 July 2015.
(b) Includes capital budget appropriation for 2015-16 of $0.720 million.
(c) Receipts received under section 74 of the *PGPA Act*.

Grant programs

Under the *Financial Agreement Act 1994*, the Commonwealth is required to contribute to the Debt Retirement Reserve Trust Account to assist the state and Northern Territory governments to redeem maturing debt on allocation to them.

Monies standing to the credit of this Account are held for the purposes prescribed by the *Financial Agreement Act 1994*.

The contributions made by the Commonwealth are accounted for as grants in the AOFM's financial statements.

Advertising and market research

During 2015-16, the AOFM made no payments to market research organisations, polling organisations or direct mail organisations.

The AOFM incurred expenditure of $21,429 in advertising to promote Australian Government debt to investors. This was paid to Dentsu Mitchell for the placement of advertisements.

The AOFM incurred expenditure of $6,779 during 2015-16 to media advertising organisations for staff recruitment.

Freedom of information

Agencies subject to the *Freedom of Information Act 1982* (FOI Act) are required to publish information to the public as part of the Information Publication Scheme (IPS). This requirement is in Part II of the FOI Act and has replaced the former requirement to publish a section 8 statement in an annual report. Freedom of information (FOI) matters in respect of the AOFM are handled by the Treasury and all documents disclosed in response to FOI requests (other than personal or business information that would be unreasonable to publish) are published on the FOI Disclosure Log of the Treasury website. The Treasury reports on AOFM's FOI requests in an annual submission to the Office of the Australian Information Commissioner (OAIC) for inclusion in the OAIC's annual report. In 2015-16, the AOFM received one FOI request.

An agency plan showing what information is published in accordance with the IPS requirements, including material relevant to the AOFM, is accessible from the Treasury's website at www.treasury.gov.au.

Ecologically sustainable development

The AOFM's operations have an impact on the environment typical of office operations generally. Procurement and facilities management services are provided to the AOFM by the Treasury under a Memorandum of Understanding. Information on the environmental impact of these services is published in the Treasury's Annual Report.

Management structure of the AOFM's debt and assets

The assets and liabilities managed by the AOFM and held on its administered balance sheet in 2015-16 were AGS (Treasury Bonds, Treasury Indexed Bonds, Treasury Notes and other securities), term deposits placed with the RBA, RMBS and housing advances to the States under the various Commonwealth-State Housing Agreements.

For financial and risk management purposes, these assets and liabilities are allocated between four financial portfolios: Long-Term Debt, Cash Management, RMBS; and Housing Advances. This allocation recognises the different objectives, risks and management approaches required in each area.

The **Long-Term Debt Portfolio** contains debt denominated in Australian dollars and in foreign currencies. It includes all AGS, other than Treasury Notes, which are issued for cash management purposes.

As no borrowings have been undertaken in foreign currencies since 1987, the Long-Term Debt Portfolio holds only a small residual amount of foreign currency debt.

The **Cash Management Portfolio** is used to manage within-year variability in the Australian Government's financing requirement due to differences in the timing of Government payments and receipts. It is also used to provide for contingency liquidity in the unforseen event of an additional call on cash requirements separate to planned needs (such as reduced issuance capability during a major market dislocation event). It contains all the assets and liabilities not held in the other three portfolios.

The **RMBS Portfolio** contains residential mortgage-backed securities purchased through a Government investment program.

The **Housing Advances Portfolio** comprises loans for public housing made to the States and Territories. These loans, which were not evidenced by the issue of securities, were made under previous Commonwealth-State financing arrangements. The last of these loans is due to mature on 30 June 2042.

AGS issuance for 2015-16

Table 3: Treasury Bond tender results — 2015-16

Tender date	Coupon and maturity	Face value amount allocated ($m)	Weighted average issue yield (%)	Spread to secondary market yield (basis points)	Range of bids accepted (basis points)	Times covered
1-Jul-15	3.25% 21-Apr-2025	900	3.0447	-0.41	0.50	3.98
3-Jul-15	4.50% 15-Apr-2020	800	2.3140	-0.85	0.50	3.89
8-Jul-15	3.25% 21-Apr-2029	800	3.1215	-0.74	1.50	2.41
10-Jul-15	4.75% 21-Apr-2027	900	3.0445	0.58	1.00	3.27
15-Jul-15	4.25% 21-Apr-2026	900	3.0788	-0.07	1.00	2.19
17-Jul-15	1.75% 21-Nov-2020	800	2.3636	-0.49	0.50	3.95
24-Jul-15	3.25% 21-Apr-2025	900	2.8239	0.53	1.50	2.42
29-Jul-15	3.75% 21-Apr-2037	500	3.4350	-1.13	0.00	2.42
31-Jul-15	2.75% 21-Oct-2019	1,200	2.0142	-0.20	0.50	4.53
5-Aug-15	2.75% 21-Apr-2024	900	2.7166	0.16	1.00	2.42
7-Aug-15	1.75% 21-Nov-2020	800	2.2586	-0.65	0.50	3.23
12-Aug-15	5.75% 15-Jul-2022	800	2.4466	-0.22	1.00	2.33
14-Aug-15	4.25% 21-Apr-2026	900	2.8643	-0.32	1.00	1.78
19-Aug-15	3.25% 21-Apr-2025	900	2.7844	-0.25	0.25	3.54
21-Aug-15	3.25% 21-Oct-2018	800	1.8351	-0.64	1.00	4.54
26-Aug-15	4.75% 21-Apr-2027	900	2.7491	0.41	1.25	2.88
28-Aug-15	2.75% 21-Oct-2019	800	1.9313	-0.77	0.75	3.96
31-Aug-15	2.75% 21-Jun-2035	500	3.3234	-1.03	1.25	2.01
2-Sep-15	1.75% 21-Nov-2020	600	2.0927	-0.84	0.50	3.68
4-Sep-15	4.25% 21-Apr-2026	600	2.7347	-0.11	0.75	2.87
9-Sep-15	4.75% 21-Apr-2027	900	2.8630	-0.05	1.00	1.78
11-Sep-15	3.25% 21-Oct-2018	800	1.8738	-0.47	0.50	3.23
16-Sep-15	3.25% 21-Apr-2025	900	2.8027	-0.73	0.50	2.32
18-Sep-15	2.75% 21-Oct-2019	800	2.0313	-0.99	0.75	3.93
21-Sep-15	4.25% 21-Apr-2026	700	2.8083	-0.04	0.75	2.12
23-Sep-15	3.25% 21-Oct-2018	700	1.9037	-0.74	0.50	4.27
25-Sep-15	4.50% 21-Apr-2033	300	3.1734	-1.40	1.25	2.39
30-Sep-15	4.75% 21-Apr-2027	800	2.7473	-0.39	0.50	2.11
2-Oct-15	2.75% 21-Oct-2019	900	1.9379	-0.96	0.50	4.08
7-Oct-15	3.25% 21-Apr-2025	900	2.6210	-0.38	0.75	2.14
9-Oct-15	3.25% 21-Oct-2018	800	1.8836	-0.74	0.50	3.94
16-Oct-15	1.75% 21-Nov-2020	800	2.1153	0.03	1.00	3.75
21-Oct-15	4.25% 21-Apr-2026	900	2.7271	-0.16	1.00	2.14
23-Oct-15	2.75% 21-Oct-2019	800	1.9275	-0.75	0.75	3.23
26-Oct-15	4.75% 21-Apr-2027	900	2.8130	0.05	0.75	2.79
30-Oct-15	5.75% 15-Jul-2022	800	2.3085	-0.15	0.50	2.70
4-Nov-15	2.75% 21-Apr-2024	900	2.6348	-0.31	0.75	2.89
6-Nov-15	1.75% 21-Nov-2020	800	2.2333	-0.67	0.75	3.59
11-Nov-15	3.25% 21-Apr-2025	900	2.8839	-0.36	0.25	2.55
13-Nov-15	2.75% 21-Oct-2019	800	2.2231	-0.74	0.50	2.98
16-Nov-15	2.75% 21-Jun-2035	300	3.4754	-0.46	1.00	5.11
18-Nov-15	4.25% 21-Apr-2026	800	2.9723	-0.52	0.50	3.06
20-Nov-15	4.50% 15-Apr-2020	600	2.2367	-0.83	0.25	4.42
23-Nov-15	3.75% 21-Apr-2037	500	3.5482	-0.24	1.25	2.33

Table 3: Treasury Bond tender results — 2015-16 (continued)

Tender date	Coupon and maturity	Face value amount allocated ($m)	Weighted average issue yield (%)	Spread to secondary market yield (basis points)	Range of bids accepted (basis points)	Times covered
25-Nov-15	4.75% 21-Apr-2027	700	3.0424	0.12	0.75	2.36
27-Nov-15	1.75% 21-Nov-2020	800	2.2836	-0.61	0.50	3.30
2-Dec-15	4.25% 21-Apr-2026	900	2.8578	-0.47	0.75	1.76
4-Dec-15	2.75% 21-Oct-2019	800	2.2405	-0.45	0.75	3.29
7-Dec-15	4.50% 21-Apr-2033	300	3.3864	-0.16	0.75	2.53
9-Dec-15	4.75% 21-Apr-2027	800	2.9703	0.27	0.75	2.30
11-Dec-15	1.75% 21-Nov-2020	600	2.3840	-0.16	0.75	3.01
13-Jan-16	4.25% 21-Apr-2026	900	2.7546	-0.44	1.00	2.82
15-Jan-16	5.75% 15-Jul-2022	800	2.3549	-0.39	0.50	2.09
25-Jan-16	4.50% 15-Apr-2020	800	2.0487	-0.55	0.50	4.13
29-Jan-16	3.25% 21-Apr-2025	900	2.6128	-0.14	0.50	2.39
3-Feb-16	4.75% 21-Apr-2027	900	2.6156	0.01	0.50	2.44
5-Feb-16	2.75% 21-Oct-2019	800	1.9020	-0.42	0.75	3.03
8-Feb-16	3.25% 21-Apr-2029	500	2.8188	-0.09	0.50	2.95
10-Feb-16	4.25% 21-Apr-2026	600	2.4382	-0.18	0.50	3.15
12-Feb-16	5.25% 15-Mar-2019	600	1.7245	-1.05	0.75	2.97
17-Feb-16	4.75% 21-Apr-2027	900	2.5902	-0.25	0.75	2.21
19-Feb-16	3.25% 21-Oct-2018	800	1.7919	-0.31	0.75	3.52
24-Feb-16	4.25% 21-Apr-2026	900	2.4168	-0.32	0.50	2.12
26-Feb-16	2.75% 21-Oct-2019	800	1.7679	-0.58	0.50	3.08
2-Mar-16	2.75% 21-Nov-2027	900	2.5825	-0.25	0.50	2.04
4-Mar-16	1.75% 21-Nov-2020	800	2.0717	-0.58	0.50	3.63
7-Mar-16	3.25% 21-Apr-2029	500	2.8193	-0.24	0.25	2.72
9-Mar-16	4.25% 21-Apr-2026	700	2.5299	-0.51	0.50	2.81
11-Mar-16	2.75% 21-Oct-2019	500	2.0257	-1.10	0.50	3.92
16-Mar-16	2.75% 21-Nov-2027	900	2.7876	-0.96	0.25	3.41
18-Mar-16	5.75% 15-Jul-2022	800	2.2988	-0.59	0.75	3.04
21-Mar-16	2.75% 21-Jun-2035	500	3.1425	0.13	0.50	2.89
23-Mar-16	4.25% 21-Apr-2026	900	2.6511	-0.59	0.75	2.57
30-Mar-16	2.75% 21-Nov-2027	900	2.6315	-0.59	0.75	2.54
1-Apr-16	1.75% 21-Nov-2020	800	2.0315	-0.62	0.75	4.57
6-Apr-16	4.25% 21-Apr-2026	900	2.4350	-0.25	0.75	2.56
8-Apr-16	2.75% 21-Oct-2019	800	1.8521	-0.31	0.50	2.91
13-Apr-16	4.75% 21-Apr-2027	900	2.5657	-0.30	0.50	2.79
15-Apr-16	4.50% 15-Apr-2020	800	2.0112	-0.78	0.50	3.18
20-Apr-16	2.75% 21-Nov-2027	1,200	2.6663	-0.24	0.25	2.79
22-Apr-16	1.75% 21-Nov-2020	800	2.1570	-1.05	0.50	5.14
29-Apr-16	5.75% 15-May-2021	1,000	2.0575	-1.55	1.00	3.76
2-May-16	4.50% 21-Apr-2033	300	2.9324	0.37	1.25	2.45
4-May-16	4.25% 21-Apr-2026	700	2.4144	-0.24	0.75	2.89
6-May-16	1.75% 21-Nov-2020	700	1.7989	-0.65	0.50	3.24
18-May-16	4.75% 21-Apr-2027	900	2.3416	-0.34	0.25	1.94
20-May-16	1.75% 21-Nov-2020	1,000	1.7538	-0.87	0.50	3.47
25-May-16	2.75% 21-Nov-2027	900	2.4312	-0.38	4.50	2.50

Table 3: Treasury Bond tender results — 2015-16 (continued)

Tender date	Coupon and maturity	Face value amount allocated ($m)	Weighted average issue yield (%)	Spread to secondary market yield (basis points)	Range of bids accepted (basis points)	Times covered
27-May-16	2.75% 21-Oct-2019	1,000	1.6207	-0.93	0.50	3.01
31-May-16	4.75% 21-Apr-2027	1,000	2.3506	-0.48	0.50	2.05
3-Jun-16	1.75% 21-Nov-2020	900	1.7139	-0.78	0.25	3.30
6-Jun-16	3.75% 21-Apr-2037	300	2.7993	-0.57	1.50	2.48
8-Jun-16	5.75% 15-May-2021	1,100	1.7529	-0.46	0.75	2.66
10-Jun-16	3.25% 21-Apr-2029	500	2.3317	-0.40	0.75	3.06
17-Jun-16	2.75% 21-Nov-2027	1,000	2.1691	-0.34	0.75	2.06
22-Jun-16	4.25% 21-Apr-2026	900	2.2050	-0.33	0.50	2.47
24-Jun-16	1.75% 21-Nov-2020	1,000	1.7542	-0.31	1.25	2.45
27-Jun-16	5.75% 15-May-2021	600	1.6522	-0.28	0.75	4.18
Average over year to June 2016				-0.43	0.73	2.99
Average over 3 years to June 2016				-0.41	0.79	3.47
Average over 10 years to June 2016				-0.18	1.02	3.55

Table 4: Treasury Bond syndication results — 2015-16

Syndication date	Coupon and maturity	Face value amount allocated ($m)	Issue yield (%)	Joint Lead Managers
14-Oct-15	3.25% 21-Jun-2039	4,000	3.345	Commonwealth Bank of Australia, Deutsche Bank AG, UBS AG Australia Branch and Westpac Institutional Bank
20-Jan-16	2.75% 21-Nov-2027	4,600	2.865	ANZ, Citi, UBS AG Australia Branch and Westpac Institutional Bank
11-May-16	2.25% 21-May-2028	7,000	2.525	Citi, Commonwealth Bank of Australia, Deutsche Bank AG and UBS AG Australia Branch

Table 5: Treasury Indexed Bond tender results — 2015-16

Tender date	Coupon and maturity	Face value amount allocated ($m)	Weighted average issue yield (%)	Spread to secondary market yield (basis points)	Range of bids accepted (basis points)	Times covered
14-Jul-15	1.25% 21-Feb-2022	200	0.3914	-1.86	1.75	4.55
28-Jul-15	3.00% 20-Sep-2025	150	0.5090	-0.10	2.00	3.37
08-Sep-15	1.00% 21-Nov-2018	150	-0.0169	-1.69	1.75	3.99
22-Sep-15	2.50% 20-Sep-2030	150	0.8738	0.38	2.25	2.00
13-Oct-15	4.00% 20-Aug-2020	150	0.1557	-0.93	2.00	3.07
10-Nov-15	1.25% 21-Aug-2040	150	1.2698	-1.52	0.50	3.90
24-Nov-15	2.00% 21-Aug-2035	200	1.1176	-2.24	2.25	3.57
08-Dec-15	3.00% 20-Sep-2025	200	0.6514	-0.86	1.50	2.40
09-Feb-16	1.25% 21-Aug-2040	150	1.0126	-0.37	4.00	2.61
23-Feb-16	1.25% 21-Feb-2022	100	0.3380	-1.70	2.00	4.21
08-Mar-16	1.00% 21-Nov-2018	100	0.4051	-1.99	1.50	5.96
22-Mar-16	1.25% 21-Feb-2022	150	0.3530	-1.37	2.00	3.77
12-Apr-16	1.00% 21-Nov-2018	100	0.3797	-2.03	0.50	5.41
10-May-16	1.25% 21-Aug-2040	150	1.0050	-4.87	0.00	3.59
24-May-16	3.00% 20-Sep-2025	150	0.5321	-2.34	0.50	5.53
14-Jun-16	2.00% 21-Aug-2035	150	0.6922	-0.97	1.00	3.04
28-Jun-16	1.25% 21-Feb-2022	150	0.3569	2.22	4.75	1.73
Average over year to June 2016				-1.31	1.78	3.69
Average over 3 years to June 2016				-1.60	1.85	4.30

Table 6: Treasury Indexed Bond syndication results — 2015-16

Syndication date	Coupon and maturity	Face value amount allocated ($m)	Issue yield (%)	Joint Lead Managers
11-Aug-15	1.25% 21-Aug-2040	1,250	1.245	Deutsche Bank AG, UBS AG Australia Branch and Westpac Institutional Bank

Table 7: Treasury Note tender results — 2015-16

Tender date	Maturity	Face value amount allocated ($m)	Weighted average issue yield (%)	Spread to OIS (basis points)	Range of bids accepted (basis points)	Times covered
2-Jul-15	23-Oct-15	500	2.0088	5.88	3.0	3.83
9-Jul-15	23-Oct-15	500	1.9900	7.76	3.0	3.01
16-Jul-15	23-Oct-15	500	2.0098	6.12	3.0	3.72
23-Jul-15	11-Dec-15	500	1.9961	5.74	3.0	3.87
30-Jul-15	11-Dec-15	500	1.9877	5.48	6.0	3.14
6-Aug-15	11-Dec-15	500	1.9937	3.50	4.0	4.00
13-Aug-15	11-Dec-15	500	1.9939	4.18	4.0	3.89
20-Aug-15	11-Dec-15	500	1.9979	4.43	3.0	3.75
27-Aug-15	11-Dec-15	500	1.9908	8.26	3.0	3.66
3-Sep-15	11-Dec-15	500	2.0035	7.03	4.0	2.72
10-Sep-15	11-Dec-15	500	2.0302	8.02	4.0	3.17
17-Sep-15	11-Dec-15	500	2.0382	7.35	8.0	3.75
24-Sep-15	26-Feb-16	500	2.0144	8.51	6.0	2.91
1-Oct-15	26-Feb-16	500	2.0324	12.90	5.0	1.98
22-Oct-15	26-Feb-16	500	1.9422	4.53	8.0	4.02
29-Oct-15	26-Feb-16	500	1.8520	4.88	7.0	2.39
5-Nov-15	26-Feb-16	500	2.0081	6.74	9.0	2.03
12-Nov-15	26-Feb-16	500	2.0290	7.69	4.0	3.76
19-Nov-15	26-Feb-16	500	2.0675	9.04	6.0	2.93
26-Nov-15	26-Feb-16	500	2.0671	8.62	4.0	2.90
3-Dec-15	22-Apr-16	500	2.0480	5.56	5.0	3.61
10-Dec-15	22-Apr-16	500	2.0123	5.60	4.0	2.70
17-Dec-15	22-Apr-16	500	2.0609	8.36	8.0	3.90
14-Jan-16	22-Apr-16	500	2.0280	8.03	6.0	2.65
21-Jan-16	22-Apr-16	500	2.0142	9.42	8.0	3.44
28-Jan-16	22-Apr-16	500	2.0419	8.74	13.0	3.61
4-Feb-16	22-Apr-16	500	2.0725	10.95	4.0	2.75
18-Feb-16	3-Jun-16	500	2.0120	7.61	2.0	3.62
25-Feb-16	3-Jun-16	500	2.0142	7.92	4.0	3.80
3-Mar-16	3-Jun-16	500	2.0430	8.03	4.0	2.91
17-Mar-16	26-Aug-16	500	2.0241	10.66	6.0	3.70
31-Mar-16	26-Aug-16	500	2.0722	14.83	6.0	2.06
7-Apr-16	26-Aug-16	500	2.0732	16.90	4.0	2.10
14-Apr-16	26-Aug-16	500	2.0886	17.57	6.0	2.16
21-Apr-16	29-Jul-16	500	2.0725	15.51	8.0	2.30
12-May-16	29-Jul-16	500	1.7706	6.51	14.0	2.87
26-May-16	26-Aug-16	500	1.7529	6.93	4.0	2.83
2-Jun-16	26-Aug-16	500	1.7637	6.16	3.0	2.74
9-Jun-16	28-Oct-16	500	1.7614	9.72	7.0	3.96
23-Jun-16	28-Oct-16	500	1.7277	6.90	5.0	4.34
Average over year to June 2016				8.21	5.5	3.19
Average over 3 years to June 2016				2.97	5.2	3.51

Glossary

Accrual cost

A method of accounting based on recording revenue and expenses when they are incurred, regardless of when cash is exchanged.

Bank Bill Swap (BBSW) rate

The mid-rate of the market for bank accepted bills and negotiable certificates of deposit issued by banks designated by the Australian Financial Markets Association as 'Prime Banks', that have a remaining maturity of between one and six months. BBSW is used as a reference rate for various financial products.

Basis point

One hundredth of one per cent.

Bid-ask spread

The difference between the price (or yield) at which a market maker is willing to buy and sell a particular financial product or instrument.

Book value (or carrying amount)

The amount at which an asset or liability is recognised in the balance sheet. Under a fair value methodology, measurement is by reference to current market rates. Under an historic cost methodology, measurement is by reference to market value rates at the time the original transaction was conducted. The AOFM's assets and liabilities are measured at fair value, except for advances to State and Territory governments for public housing, which are measured at historic cost.

Cash Management Portfolio

The Cash Management Portfolio is a part of the overall portfolio of assets and liabilities managed by the AOFM. It contains short-term assets and liabilities and is used to manage the within-year variability in government cash flows.

Australian Government Securities (AGS)

Debt obligations of the Australian Government evidenced by the issue of securities or, nowadays, issued as inscribed stock. AGS on issue are predominantly Treasury Bonds, Treasury Indexed Bonds and Treasury Notes but also include small residual amounts of Australian Savings Bonds, Peace Saving Certificates and War Saving Certificates.

Coupon rate

A rate of interest paid on a bond, which is fixed for a specified period (usually the term of the bond). In the case of Treasury Bonds coupon interest is payable semi-annually, while for Treasury Indexed Bonds it is paid quarterly. In each case, the coupon rate is set on the date of announcement of first issuance of the bond line.

Credit risk

The risk of counterparty default creating financial loss. Credit risk is contingent on the combination of a default and there being pecuniary loss. The AOFM faces credit risk in relation to its settlement and investment activities.

Credit spread

The difference in yields between securities of different credit qualities. The credit spread reflects the additional net yield required by an investor from a security with more credit risk relative to one with less credit risk.

Discount

An amount by which the value of a security on transfer is less than its face (or par) value.

Discounting

Calculating the present value of a future amount.

Duration

Duration (expressed in years) represents the 'effective term' of a bond. It is the weighted average life of a bond or a portfolio of bonds. The weights are the relative cash flows associated with the bond or portfolio (the coupon payments and principal), discounted to their present value. See also 'modified duration'.

Exposure

The amount of money at risk in a portfolio. Exposure to a risk is calculated by measuring the current mark-to-market value that is exposed to that risk.

Face value

The amount of money indicated on a security, or inscribed in relation to a security, payable to the holder on maturity and used to calculate interest payments. In the case of a Treasury Indexed Bond, the face value is the principal or par value, unadjusted for changes in the Consumer Price Index.

Fixed rate

An interest rate calculated as a constant percentage of the face value or notional principal and generally payable quarterly, semi-annually or annually. Treasury Bonds pay a fixed coupon rate semi-annually.

Floating rate

An interest rate that varies according to a particular indicator, such as BBSW (the Bank Bill Swap Reference Rate). For example, the floating leg of an interest rate swap may provide for the interest paid to be reset every six months in accordance with BBSW.

Funding risk

The risk that an issuer is unable to raise funds, as required, in an orderly manner and without financial penalty. For the Australian Government, funding risk encompasses the ability to raise term funding to cover future Budget needs (including the maturities of Treasury Bonds and Treasury Indexed Bonds). This is distinct from re-financing risk, which relates to the ability to 'roll-over' or pay down short-term funding obligations.

Futures basket

A collection of like financial products or commodities, grouped together, that are used to define the benchmark for pricing a futures contract. The Australian Securities Exchange 3 year, 10 year and 20 year Treasury Bond futures baskets consist of collections of Treasury Bond lines that have an average term to maturity of approximately three, ten and twenty years respectively.

Futures contract

An agreement to buy or sell an asset at a specified date in the future at a price agreed today. The agreement is completed by physical delivery or cash settlement, or alternatively is offset prior to the expiration date. In Australia, standardised futures contracts are traded on the Australian Securities Exchange. Futures contracts traded on the Australian Securities Exchange include contracts for 3 year, 10 year and 20 year Treasury Bonds.

Historic cost

The basis of measurement where an asset or liability is recorded at fair value on initial recognition and, after initial recognition, by amortisation of the initial value using market rates at the time the transaction was conducted that gave rise to the asset or liability.

Interest

The charge for borrowing money, usually expressed as an annual percentage rate. For the AOFM financial statements, interest cost is the coupon payment (where relevant) adjusted for the amortised cost carrying value of a debt security. Where a debt security is issued at a premium or discount to its principal value, the premium or discount at issuance is recognised in amortised cost carrying value and amortised over the life of the security using the effective interest method. This amortisation is recognised in the interest cost.

For Treasury Indexed Bonds, the change in amortised cost carrying value includes capital accretion of the principal due to inflation. As capital accretion occurs, it is also recognised in the interest cost.

Interest rate risk

The risk that the value of a portfolio or security will change due to a change in interest rates. For example, the market value of a bond falls as interest rates rise.

Issuance

The sale of debt securities in the primary market.

Liquidity

The capacity for a debt instrument to be readily purchased or sold. A liquid market allows the ready buying or selling of large quantities of an instrument at relatively short notice, in reasonable volume and without significant movement in price.

Liquidity also refers to the ability to meet cash payment obligations.

Liquidity risk

The risk that a financial instrument will not be able to be readily purchased or sold.

Long-Term Debt Portfolio (LTDP)

The Long Term Debt Portfolio is the substantive part of the portfolio managed by the AOFM. It contains ongoing domestic and foreign currency liabilities.

Market risk

The risk that the price (value) of a financial instrument or portfolio of financial instruments will vary as market conditions change. In the case of a debt issuer and investor such as the AOFM, the principal source of market risk is from changes in interest rates.

Market value

The amount of money for which a security is traded in the market at a particular point in time.

Modified duration

A measure of the sensitivity of the market value of a debt security to a change in interest rates. It is measured as the percentage change in the market value of a debt instrument in response to a one percentage point change in nominal interest rates. Portfolios with higher modified durations tend to have more stable interest costs through time, but more volatile market values. Modified duration is related to duration by the equation:

$$\text{Modified duration} = \frac{\text{Duration (years)}}{1 + \text{yield to maturity}}$$

At times, 'modified duration' is abbreviated to 'duration', and desirably only in contexts where this will not lead to confusion.

Nominal debt

Debt that is not indexed to inflation. Treasury Notes and Treasury Bonds are examples of nominal debt.

Nominal interest rate

Interest rate that does not take account of the effects of inflation (in contrast to the 'real' interest rate).

Official Public Account (OPA)

The OPA is the collective term for the Core Bank Accounts maintained at the RBA for Australian Government cash balance management.

Operational risk

The risk of loss, whether direct or indirect, arising from inadequate or failed internal business processes or systems.

Overnight cash rate

The interest rate charged on overnight loans between financial intermediaries. The RBA manages the supply of funds available in the money market to keep the cash rate as close as possible to a target set by the Bank Board as an instrument of monetary policy.

Overnight Indexed Swap (OIS)

A fixed for floating interest rate swap in which one party agrees to pay another party a fixed interest rate in exchange for receiving the average overnight cash rate recorded over the term of the swap. The term to maturity of such swaps is typically between one week and one year. Financial market participants enter into overnight indexed swaps to manage their exposures to movement in the overnight cash rate.

Physical debt

Securities that give rise to debt, in contrast to derivatives (which give rise to a contingent liability). Treasury Bonds, Treasury Indexed Bonds and Treasury Notes represent physical debt.

Present value

The value today of a payment to be received (or made) in the future. If the opportunity cost of funds, or discount rate is 10 per cent, the present value of $100 to be received in two years is $\$100 \times [1/(1 + 0.10)^2] = \$82.64$.

Primary market

The market where securities are issued for the first time and where the sale proceeds go to the issuer. For example, the primary market for Treasury Bonds is when the bonds are sold at tender or by syndication by the AOFM on behalf of the Australian Government.

Real interest rate

An interest rate that has been adjusted to take account of the effects of inflation.

Repricing risk

The risk that interest rates will have increased when maturing debt needs to be refinanced.

Residential mortgage-backed security (RMBS)

A debt instrument issued by a special purpose vehicle to finance the securitisation of a pool of loans that is secured by residential mortgages.

Risk premium

The difference between the return available on a risk-free asset and the return available on a riskier asset.

Secondary market

The market where securities are bought and sold subsequent to original issuance. Investors trade securities between themselves (usually via intermediaries such as banks) in the secondary market.

Securities lending

An activity whereby securities are lent to a financial market participant for a fee.

Securities lending facility

A facility established by the AOFM in 2004 that uses repurchase agreements to lend Treasury Bonds and Treasury Indexed Bonds to market participants for short periods. The facility is operated by the RBA on behalf of the AOFM. It supports the efficient operation of these markets as it facilitates trading by enabling dealers to obtain specific lines of stock when they are not readily available from other sources.

Short-dated exposure

The proportion of a portfolio that will have its interest rate reset in the short-term. A portfolio with a high short-dated exposure will tend to have more volatile annual interest payments than a portfolio with low short-dated exposure.

Spread

The difference between two prices or yields.

Syndication

Where an issuer arranges a primary market transaction through a panel of banks but the bonds that are issued are purchased as a result of direct orders from end-investors during the syndication process. The final price and volume of issuance are typically determined as part of the process, but either or both could be pre-set at specific levels prior to commencement of the process.

Tender

A method of issuance whereby debt is sold through auction. The amount, coupon and maturity date of the stock are announced by the issuer. Registered participants then bid for their desired amounts of stock at interest rates at which they are prepared to buy. Bids are accepted from lowest interest rate (yield) upward until the issue amount has been filled. Stock is therefore allocated in order of lowest yield (and highest price).

Tenor

The tenor of a financial instrument is its remaining term to maturity.

Term deposit

A deposit held at a financial institution that has a fixed (short) term. When a term deposit is purchased, the lender (the customer) understands that the money can only be withdrawn after the term has ended, or after having given a predetermined number of days' notice.

Term premium

The extra return investors demand for holding a longer-term bond as opposed to investing in a series of short-term bonds.

Treasury Bond

A medium to long term debt security issued by the Australian Government that carries an annual rate of interest (the coupon rate), which is fixed over the life of the security and payable in six-monthly instalments (semi-annually) on the face, or par, value of the security. The bonds are repayable in full at face value on maturity.

Treasury Indexed Bond

A security issued by the Australian Government for which the capital value is adjusted periodically according to movements in the Consumer Price Index. Interest is paid quarterly at a fixed rate on the adjusted capital value. At maturity, investors receive the adjusted capital value of the bond — that is, the initial face value as adjusted for inflation over the life of the bond. Interest Indexed Bonds, another form of indexed bond, were also issued by the Commonwealth Government in the past but these have all now matured.

Treasury Note

A short-term debt security issued by the Australian Government at a discount and redeemable at par on maturity. The interest payable on the notes is represented by the difference between their issue value and their par or face value.

Two-way price

A price (or yield) at which a market-maker is prepared to both buy and sell a particular financial product or instrument. That is, the simultaneous quoting of a bid and an offer.

Yield

The expected rate of return expressed as a percentage of the net outlay or net proceeds of an investment.

Yield curve

Graphical representation on a specific date of the relationship between the yield on debt securities of the same credit quality, but different terms to maturity. When securities with longer terms to maturity have a higher yield than securities with shorter terms to maturity, the curve is said to have a positive slope. In the opposite case, the slope is said to be negative or inverse.

ACRONYMS

AASB	Australian Accounting Standards Board
ACM	Adrian, Crump and Moench
AFMA	Australian Financial Markets Association
AGS	Australian Government Securities
ANAO	Australian National Audit Office
AOFM	Australian Office of Financial Management
APS	Australian Public Service
APSC	Australian Public Service Commission
AUD	Australian dollar
BBSW	Bank Bill Swap Reference Rates
CEO	Chief Executive Officer
CPI	Consumer Price Index
CPR	Commonwealth Procurement Rules
DFAT	Department of Foreign Affairs and Trade
EL	Executive Level (APS Classification)
FOI	Freedom of Information
FTE	Full-time equivalent
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GST	Goods and Services Tax
HR	Human resources

IMF	International Monetary Fund
LTDP	Long-term Debt Portfolio
OAIC	Office of the Australian Information Commissioner
OECD	Organisation for Economic Co-operation and Development
OIS	Overnight Indexed Swap
OPA	Official Public Account
PGPA	*Public Governance, Performance and Accountability Act 2013*
PSM	Portfolio Strategy Meetings
RBA	Reserve Bank of Australia
RMBS	Residential Mortgage-backed Security
SES	Senior Executive Service
SME	Small and Medium Enterprises
US	United States of America
USD	United States dollar

INDEX OF COMPLIANCE WITH REQUIREMENTS

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INDEX

A

B

C

D

E

F

I

J

L

O

P

R

S

T