Australian Office of Financial Management

Annual Report 2011-12

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Australian Government

Australian Office of Financial Management

2 October 2012

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

Dear Deputy Prime Minister and Treasurer

I have pleasure in presenting the Annual Report of the Australian Office of Financial Management for the year ending 30 June 2012 for presentation to the Parliament.

The Report has been prepared in accordance with guidelines approved on behalf of the Parliament by the Joint Committee of Public Accounts and Audit.

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 FIGURES

LIST OF CHARTS

REVIEW BY THE CHIEF EXECUTIVE OFFICER

REVIEW BY THE CHIEF EXECUTIVE OFFICER

Context

The growing interest in Commonwealth Government Securities (CGS) continued throughout 2011-12. Against a backdrop of persistent economic uncertainty and financial market volatility, mainly deriving from the situation in Europe, investors have been increasingly attracted towards what has become generally known as either the 'diversification play' or 'safe haven switch' — both of which reflect a general shift of investment focus away from the European region and equity markets.

The heightened scrutiny applied by investors to differentiating between the credit ratings of sovereigns has also continued throughout the year. Just over 18 months ago Australia was one of 15 AAA rated sovereigns with a stable outlook, as rated by the three largest rating agencies. This group has now been reduced to just seven. This has increasingly brought the CGS market into a positive light and for most of the year all existing nominal bond lines have been issued into a market that reflects a very strong demand for CGS. This has reduced the borrowing costs to the Australian community (through new issuance with lower yields) and ensured that issuance of CGS has been smooth and readily absorbed into the market. Furthermore, the AOFM's commitment to transparency in its operations, together with the importance it places on using market feedback and its engagement with investors, underlie broad confidence in a resilient and well-functioning sovereign bond market for Australia.

The CGS issuance program will have peaked this last year given the Government's announcements that it will return the Budget to surplus in 2012-13. The AOFM remains conscious of the need to keep investors informed as to CGS market developments and we have done that throughout the year by advising investors and market intermediaries as to the slowing growth in the size of the market, which will arise from the reduced issuance programs planned for the years ahead. This will help to ensure that market expectations remain consistent with Government fiscal and debt portfolio policy intentions. The Government has highlighted its commitment in the last two Budgets to maintaining a liquid CGS market and it will continue to monitor the size of the market in relation to liquidity considerations. The AOFM continued to track market conditions throughout the year so as to gauge maintenance of this policy objective.

Through their investment decisions, investors continued throughout the year to acknowledge the strong positive trade links between Australia and the high-growth Asian region. This reflects a widespread acceptance that Australia is well-placed to benefit from the underlying medium to longer-term growth trend in Asia, despite its exposure to volatility in the performance of its largest trading partners in the short-term.

Bond issuance

During 2011-12, gross Treasury Bond issuance was approximately $58 billion. During the past year, ten year Treasury Bond yields declined over 200 basis points, while CGS continued to outperform other Australian dollar denominated debt securities.

The issuance program was less challenging throughout much of the year when compared with the past three years. The ongoing entry of new investors to the market and the prevailing conditions for strong demand for bonds more generally underpinned another successful issuance program. The presence of investors with a wider spectrum of investment mandates than previously experienced in the market for CGS has also contributed to CGS issuance being readily absorbed into the market.

Although CGS yields have declined substantially over the last year, they are still attractive on a global relative value basis, which has been an important factor in retaining investor interest in the Australian sovereign bond market.

Once again, the bulk of issuance was achieved by 'tapping' existing bond lines. This helps to reduce the cost of issuance while enhancing the liquidity and attractiveness of the bond portfolio. However, consistent with prudent overall portfolio management, opportunities were taken to launch four new Treasury Bond lines during 2011-12. The new lines were for maturity in October 2015 and July 2017 (to meet demand for short dated maturities); April 2024 (to support the operation of the 10 year Treasury Bond futures contracts); and April 2027 (to extend the yield curve to around 15 years).

Once again the AOFM pursued an issuance strategy that took into account areas of strongest demand. This helped to ensure the Government's financing task could be most efficiently met. The AOFM continues to recognise the need to retain flexibility in determining detail of the issuance task throughout the year. Therefore, prevailing market conditions, information based on market advice, relative value considerations, the aim of increasing liquidity in CGS generally, and the need to manage the maturity structure to limit refinancing risk all remained key considerations in developing the issuance program. This has highlighted the need for market vigilance and regular reappraisal of overall portfolio management strategies.

The practice of generally conducting two tenders per week, typically targeting a long dated bond line and a short dated bond line, was continued for the most part of 2011-12. Net new issuance of around $44 billion brought the outstanding stock of Treasury Bonds at 30 June 2012 to $205 billion. At year-end there were 18 Treasury Bond lines of which 11 have over $10 billion on issue.

In 2011-12 the market for Treasury Indexed Bonds remained similar in terms of demand, performance and outlook compared with the previous year. Issuance for the year totalled $2.14 billion, including a syndicated offer for a new Treasury Indexed Bond maturing in February 2022. This brought outstanding stock (in face value terms) to $16.07 billion. The volume of each line outstanding, relative yields and other prevailing market conditions were all considered in the selection of which indexed bond line to offer in any month.

Investor feedback remains positive regarding the Government's commitment to ongoing support for this segment of the market. Feedback from intermediaries and investors will continue to shape our considerations on the future structure of this part of the portfolio.

Turnover in the secondary market for Treasury Bonds and Treasury Indexed Bonds continued to grow broadly in line with increasing volumes on issue. A number of factors have contributed, amongst them were: continued improvement in investor perceptions about Australia (and the CGS market); an increasing strategic investment focus on CGS by central banks and sovereign wealth fund managers; and a strong competitive presence by a large number of price makers.

Portfolio management and outcomes

The Government's budget financing requirement in 2011-12 was fully met.

As in previous years, the Government's cash flows were highly variable over the course of the year. Over the last few years there have been changes to the pattern and timing of Government cash needs that have tended to result in a greater proportion of cash required in the first half of the year.

Improved demand dynamics have enabled the AOFM to actively target a longer average term to maturity for its issuance in 2011-12. This aims to reduce refinancing risk. In 2010-11 the nominal bond issuance program had a weighted average term to maturity of 6.29 years, while in 2011-12 this was raised to 7.68 years.

The average cost of funds for gross debt in 2011-12 was 5.07 per cent, representing a decrease on the previous year (which was 5.22 per cent). The average return on gross assets in 2011-12 was 5.02 per cent. Taken together, the net servicing cost of the combined portfolio of debt and assets for 2011-12 was $10.01 billion, which represented an 11 basis points reduction in effective yield, to 5.08 per cent (compared with 5.19 per cent last year). This represents the average outcome for 2011-12. The extent to which this result reflects a very strong pickup in demand for CGS in the second half of the year needs to take account of the fact that only new issuance for the year has attracted the low yields resulting from a strong rally in the CGS market. It is also important to note that the CGS market has continued to exhibit the characteristics of a highly resilient and well functioning market regardless of the movements in yields.

Residential mortgage-backed securities

Commencing with the Government's *Competitive and Sustainable Banking System* package the AOFM has been directed to invest up to $20 billion in residential mortgage backed securities (RMBS). The RMBS investment program was launched in 2008 due to the dislocation resulting from the global financial crisis. The Government has since announced its intention that the program be part of encouraging a transition towards a market that is not reliant on Government financial support. This has broadened the objective of the program beyond the initial aim of supporting competition from a diverse range of providers in the Australian market for residential and small business lending.

Throughout 2011-12 the AOFM's RMBS investment pricing has continued to balance the objective of maintaining a competitive flow of funds for new lending with the objective of attracting additional investors. A growing presence of other investors alongside the AOFM is taken to indicate that conditions in the Australian securitisation market are improving.

During the first half of 2011-12 RMBS market conditions continued to improve over the performance of the previous year. However, early 2012 revealed that the Australian securitisation market still faces challenges consistent with global credit concerns.

The AOFM continues to work closely with market participants in support of the Government's objectives, with an increasing focus on the need to encourage a transition towards a sustainable and innovative securitisation market that is not reliant on Government financial support.

Looking ahead

While the general impact of the global financial crisis continues to be felt around the world, the performance of the Australian economy relative to most other advanced nations and fiscal policy decisions have led to a substantially reduced outlook for net new issuance. Therefore, supporting liquidity in the CGS market will once again become a lead factor in AOFM thinking and operations. Further diversification of the CGS investor base will also remain an important consideration.

Consolidation of the yield curve extension to 15 years and delivering on previously announced commitments to maintain a mix of Treasury Indexed Bonds and nominal bonds as part of the overall portfolio will continue to be key tasks for the AOFM to manage. Volatility in international financial markets has continued through the past year and there would appear to be little prospect for an appreciable change to this situation in the near to medium-term.

Rob Nicholl
Chief Executive Officer

PART 1: AOFM OVERVIEW

AOFM OVERVIEW

Role, function, outcome and output structure

The Australian Office of Financial Management (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 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 the 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 and in short-term money market instruments, such as bank accepted bills and negotiable certificates of deposit.

During the 2011-12 year, the AOFM continued to invest in residential mortgage-backed securities under a Government program to support 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 prescribed agency under the *Financial Management and Accountability Act 1997* and maintains its own accounts separately from those of 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 on behalf of the Australian Government: the advancement of macroeconomic growth and stability; the effective operation of financial markets through issuing debt and investing in financial assets; and managing debt, investments and cash. The AOFM aims to manage its net debt portfolio at least cost, subject to an acceptable level of risk, and to improve the net worth of the Australian Government over time. It also issues bonds taking into account the Government's policy objectives to support the CGS market.

Organisational structure

During 2011-12, the AOFM operated using six groups with roles and responsibilities within the Office being structured to ensure an appropriate segregation of duties and reporting lines. These groups were supported by a human resources unit. The six groups were:

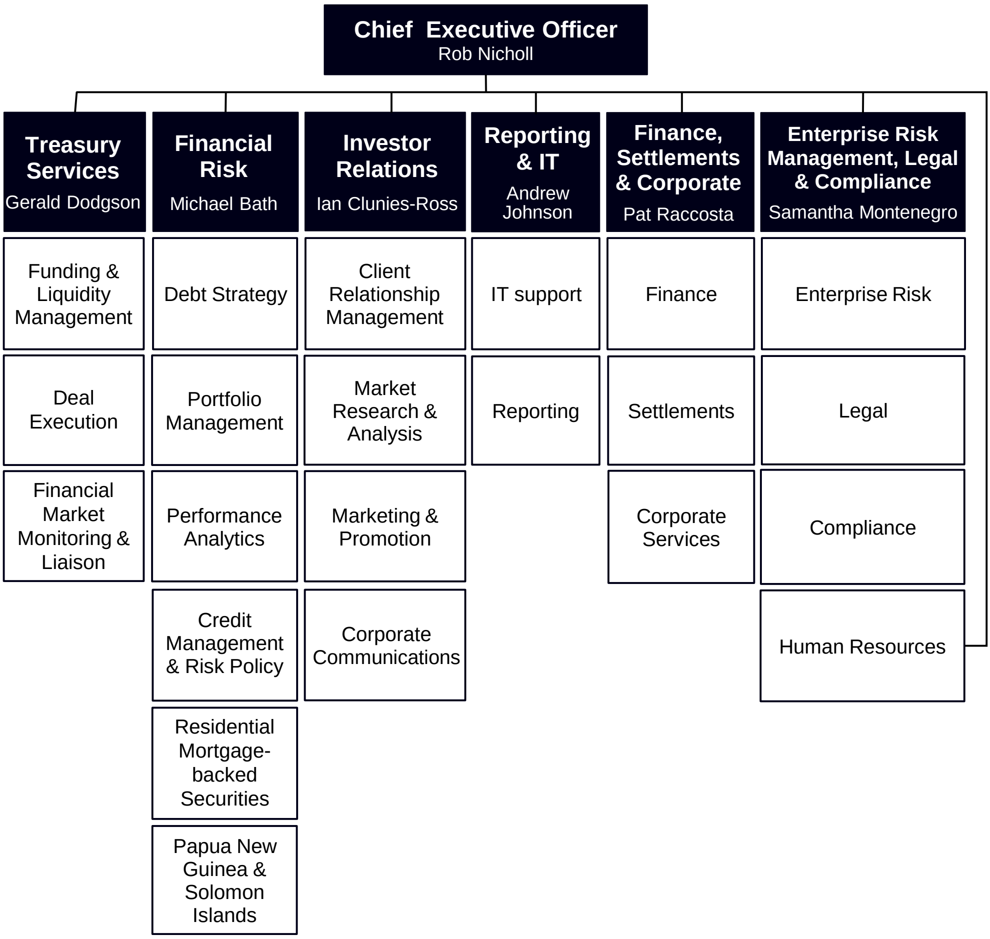
- Treasury services;
- Financial risk management;
- Investor relations;
- Reporting and IT;
- Finance, settlements and corporate; and
- Enterprise risk management, legal and compliance.

In 2011-12, the arrangements in relation to enterprise risk management were enhanced to better support the Executive Group's oversight of key business risks. The functions of risk management, legal and compliance were brought together in the Enterprise Risk Management, Legal and Compliance (ERMLC) Group. A Chief Risk and Compliance Officer was appointed in May 2012 to oversee the operations and work programs of this Group, and recruitment activities have commenced to resource its activities into 2012-13.

At 30 June 2012, the ERMLC Group has developed its business and work plans, and is in the process of developing the project plans to support delivery of a major review of the AOFM's Enterprise Risk Management Framework. The revised framework will bring together the various aspects of the AOFM's risk activities into an integrated monitoring and assessment format that supports the Executive Group in its management of agency specific risks.

In addition, the AOFM supports knowledge and skill transfer aims of the Australian Government through several foreign aid related avenues. For the whole financial year two staff members were placed on secondment programs organised by AusAID. One staff member was seconded under the *Strongim Gavman Program* to Papua New Guinea. Another staff member was seconded under the Regional Assistance Mission component of the *Financial and Economic Management Strengthening Program* to the Solomon Islands. Both programs offer these governments support for their debt management activities.

Figure 1: AOFM organisational structure



PART 2: OPERATIONS AND PERFORMANCE

OPERATIONS AND PERFORMANCE

Introduction

The principal functions of the AOFM are:

- funding the Budget through the issuance of Australian Government debt;
- managing the Australian Government's daily cash balances through short-term borrowings and investments;
- undertaking investments in financial assets in accordance with Government policy objectives;
- managing its portfolio of debt and financial assets in a cost effective manner, subject to acceptable risk; and
- supporting the efficient operation of Australia's financial system.

This section outlines the activities undertaken in 2011-12 and reports on AOFM performance against these functions.

Treasury Bond and Treasury Indexed Bond issuance

Objective

One objective of Treasury Bond and Treasury Indexed Bond issuance is to raise monies to fund the Australian Government Budget.

Another objective is to support the efficient ongoing operation of Australia's financial system. This second objective is achieved in the following ways:

- 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.

Achieving the objective

2011-12 was another year of volatility in global financial markets. Investor faith in sovereign issuers, especially in Europe, continued to wane as attempts by officials to solve the Eurozone's fiscal, debt and banking industry problems failed to convince investors that the situation could be stabilised. Hopes that public and financial sector balance sheets might be strengthened in the near-term by large-scale coordinated action were not met, as proponents of austerity and of fiscal stimulation proved unable to form agreement. Events in Europe contributed to a general slowing in the pace of the global economic recovery from the global financial crisis.

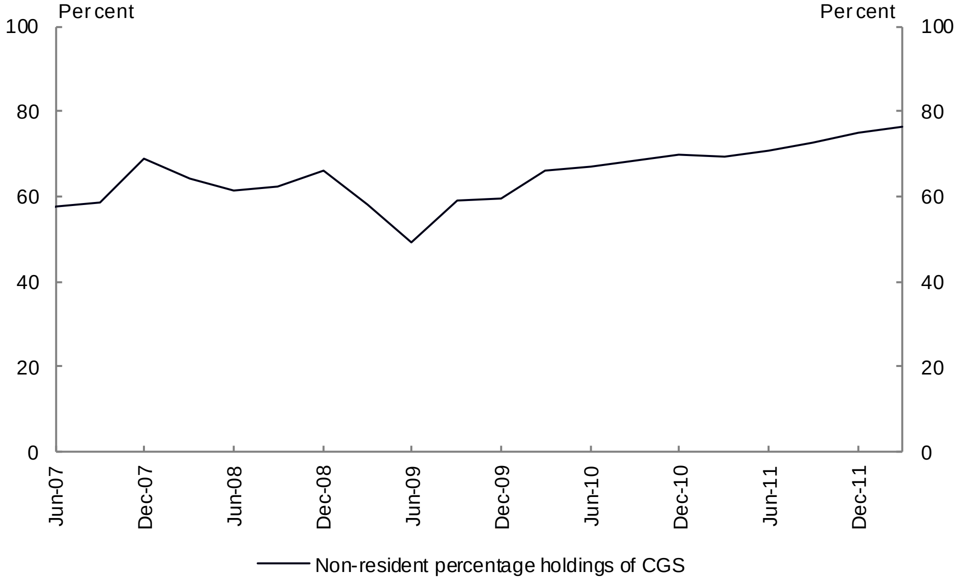
Australia as a sovereign issuer is well-positioned to satisfy its debt issuance requirements relative to most countries; this is in no small part because of its sovereign credit status as AAA (by all three major credit rating agencies) with a stable outlook.

In 2011-12 the RBA reduced the target cash rate by 100 basis points, while ten year Treasury Bond yields declined by over 200 basis points to historically low levels. Commonwealth Government Securities (CGS) outperformed other Australian dollar denominated debt securities, with the difference in yields between CGS and other debt securities at the end of the year being almost as wide as at the height of market dislocation in 2008-09.

Regular liaison with market-makers and investors was crucial to the efficient manner in which the financing task was completed during 2011-12. Investors remain comfortable with Australia's creditworthiness (in part because it is a member of a shrinking group of AAA-rated sovereigns) and have been encouraged by relatively high yields.

Offshore demand for CGS remains strong. Non-resident holdings of CGS were around 75 per cent of the total outstanding during 2011-12. The proportion of CGS held by offshore investors has steadily increased during recent years, as illustrated in Chart 1.

Chart 1: Non-resident Holdings of Commonwealth Government Securities



Treasury Bonds

Gross Treasury Bond issuance for the year totalled about $58 billion. The bulk of issuance was into existing bond lines in order to enhance their liquidity and in turn the attractiveness of the CGS market. This was particularly important to international investors.

Four new Treasury Bond lines were launched in 2011-12 as follows:

- new short-dated bond lines maturing in October 2015 and July 2017 were launched to allow issuance to be spread across a larger number of lines and to help limit the growth of the largest lines;

- a new bond line with a maturity date of April 2024 was opened in order to support the operation of the 10-year Treasury Bond futures contracts; and

- following a decision to extend the length of the yield curve to around 15 years, a new April 2027 bond line was issued.

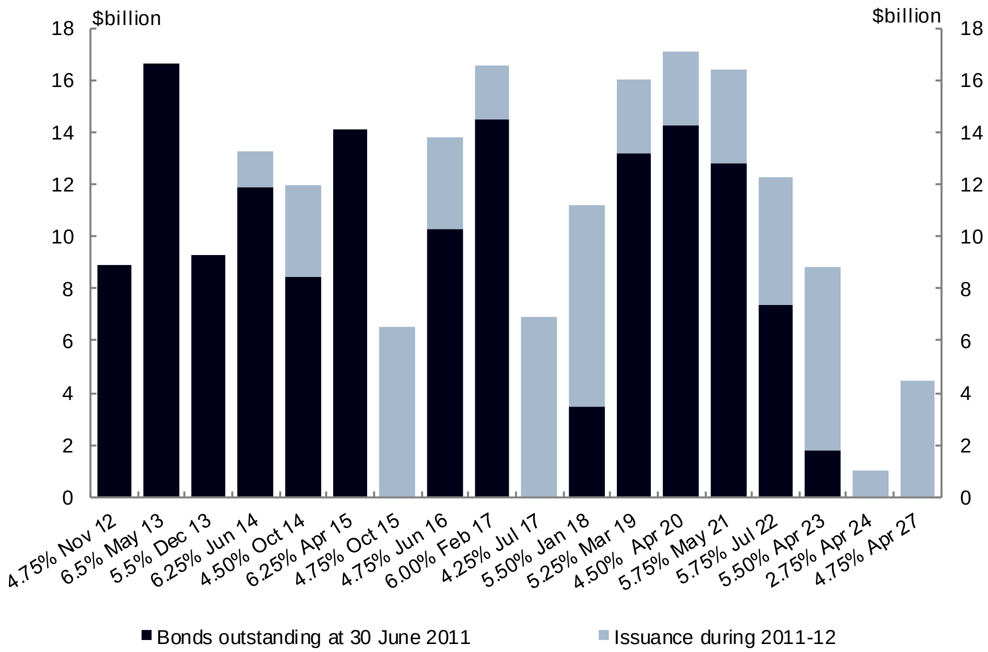
In selecting the bond lines to issue each week, the AOFM took account of prevailing market conditions; information from financial market contacts about investor demand; relative value considerations; the aim of increasing the liquidity of outstanding bond lines; and the need to manage the maturity structure to limit refinancing risk. Two tenders were held most weeks, typically comprising a tender of a long-dated bond line and the tender of a short-dated bond line, with the amount being offered at each tender usually being $700 million.

Lengthening the yield curve in a manner consistent with prudent sovereign debt management and market demand was announced in the 2011-12 Australian Government Budget. The April 2027 Treasury Bond was issued in October 2011 and it is planned for the length of the yield curve to be maintained at around 15 years as a matter of course.

Chart 2 shows the Treasury Bonds outstanding as at 30 June 2012 and issuance during the 2011-12 financial year.

During the year the total volume of Treasury Bonds on issue increased by around $44 billion, to $205 billion. At the end of the year there were 11 Treasury Bond lines with over $10 billion on issue.

Chart 2: Treasury Bonds outstanding as at 30 June 2012 and issuance in 2011-12



Treasury Indexed Bonds

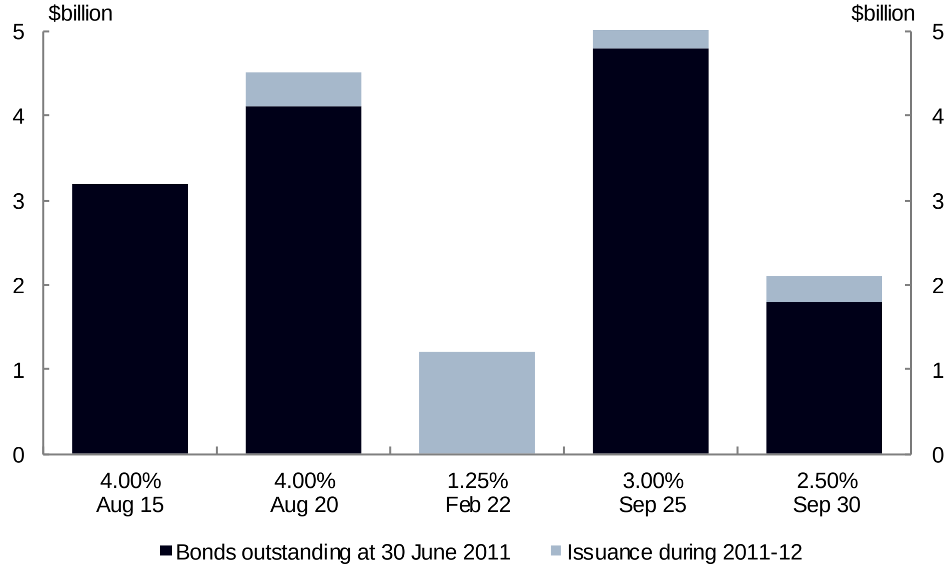
Treasury Indexed Bond issuance for the year totalled $2.14 billion.

Tenders for the issue of Treasury Indexed Bonds were generally conducted on a monthly basis. There was one syndicated offer of a new Treasury Indexed Bond maturing in February 2022.

The volume of each line outstanding, relative yields and other prevailing market conditions were all considered in the selection of which line to offer in any month.

Chart 3 shows the Treasury Indexed Bonds outstanding as at 30 June 2012 and issuance during the 2011-12 financial year.

Chart 3: Treasury Indexed Bonds outstanding as at 30 June 2012 and issuance in 2011-12



Aussie Infrastructure Bonds

In April 2009 the Government announced that its investment in NBN Co, the builder and operator of the National Broadband Network, would be partly funded through issuance of Aussie Infrastructure Bonds (AIBs).

This funding is obtained through the issuance of CGS as part of the Government's overall debt program. AIBs are not identified separately from other CGS at the time of issue, but amounts of AIB funding are reported separately in the Budget papers.

The entire $1.5 billion of the Government's equity investment in the National Broadband Network in 2011-12 was financed through the AIB process.

Securities Exchange Trading of CGS

On 12 December 2010 the Government, as part of its *Competitive and Sustainable Banking System* package, announced that it would facilitate the trading of CGS on a retail exchange platform in Australia.

The trading of CGS on a securities exchange will help to provide retail investors with a more visible pricing benchmark for investments they may wish to make in corporate bonds issued by Australian businesses, as well as help to further encourage retail investors to consider diversifying their savings through investments into fixed-income assets, such as government and corporate bonds.

In November 2011, the AOFM issued a standing request for proposals for the delivery of services for the retail trading of Treasury Bonds and Treasury Indexed Bonds on securities exchanges. The AOFM is currently working with an exchange operator to implement the exchange trading of Treasury Bonds and Treasury Indexed Bonds.

During the year the AOFM also conducted a procurement process for registry services to replace the current service provided by the RBA. The registry services being procured will have the functionality to support the retail exchange trading of CGS.

Performance

Funding the Budget

The Government's budget financing requirement in 2011-12 was fully met.

The budget underlying cash deficit for 2011-12 was higher than estimated at the time of the 2011-12 Australian Government Budget due to changes in economic circumstances reducing tax receipts, and both policy decisions and parameter changes that increased payments (as explained in the 2011-12 Australian Government Budget). The larger than expected budget financing task was managed primarily by increasing Treasury Bond issuance from the $46 billion planned at the beginning of the year to around $58 billion.

Market liquidity and efficiency

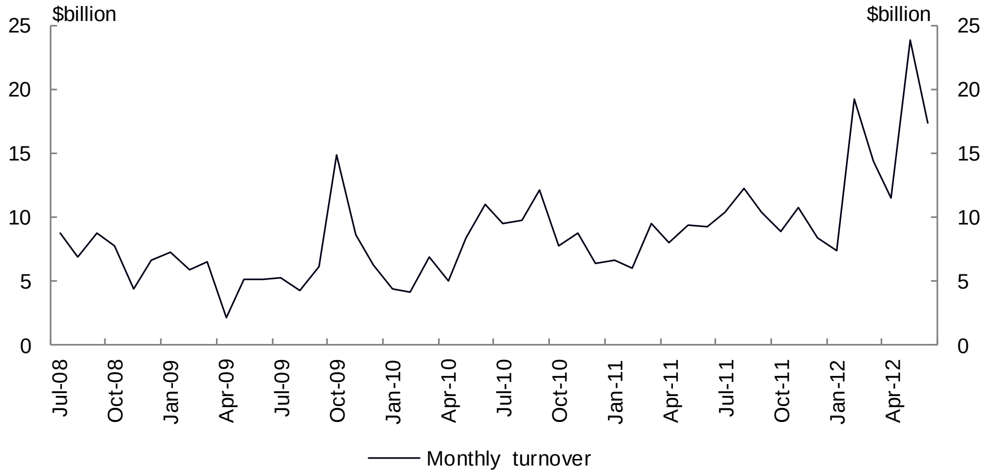
The Treasury Bond and Treasury Indexed Bond markets operated smoothly throughout 2011-12 with liquidity again being maintained throughout the year.

One indicator of liquidity is turnover in the secondary market. Charts 4 and 5 show the evolution of total secondary market turnover[1] from July 2008 through to June 2012. Turnover steadily increased over the period and was around $250 billion per month in 2011-12 for Treasury Bonds (totalling 28 per cent higher turnover than in 2010-11) and $13 billion per month for Treasury Indexed Bonds (totalling 50 per cent higher than in 2010-11).

Chart 4: Treasury Bond secondary market turnover

Source: Based on Austraclear data sourced from the RBA

Chart 5: Treasury Indexed Bond secondary market turnover

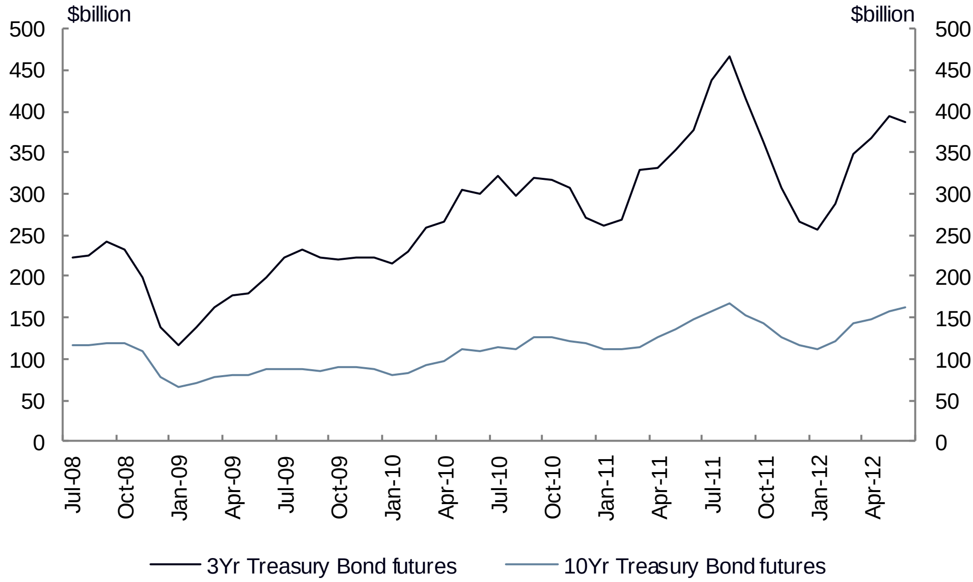


Source: Based on Austraclear data sourced from the RBA

1 Total turnover includes repurchase transactions based on Austraclear data sourced from the RBA.

Turnover in the Treasury Bond futures market is significantly higher than in the underlying Treasury Bonds. Treasury Bond futures continued to display strong liquidity in 2011-12 with the turnover of 3-year Treasury Bond futures contracts increasing by 9 per cent over the previous year and turnover of the 10-year contracts increasing by 13 per cent. Turnover in recent years is illustrated in Chart 6. All Treasury Bond futures contract close-outs in 2011-12 occurred smoothly.

Chart 6: Treasury Bond Futures market turnover
3 month moving average



Source: Based on data sourced from the Australian Securities Exchange.

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. This enhances the efficiency of the market by improving the capacity of intermediaries to make two-way prices and reducing the risk of settlement failures.

Turbulent market conditions during times of the year resulted in more use of the securities lending facility than during the previous year. The facility was used 66 times for overnight borrowing in 2011-12 compared with 47 instances of use in 2010-11. The face value amount lent was around $1.5 billion compared to $1.3 billion in 2010-11.

Efficiency of issuance

The AOFM continued to use competitive tender and syndication as the only means by which issuance of Commonwealth Government Securities was undertaken in 2011-12.

Tenders held during 2011-12 were well supported. Table 1 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 1: Summary 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 2011	Up to 2017	16,250	3.9331	-0.21	3.26
	2018 - 2027	15,500	4.3328	-0.07	2.61
January - June 2012	Up to 2017	7,700	3.3828	-0.35	3.69
	2018 - 2027	15,490	3.6479	-0.09	2.86

The average ratio of the volume of bids received to the amount of stock on offer was 3.02 for Treasury Bonds in 2011-12, a decrease from 3.91 in 2010-11. Six tenders had a coverage ratio less than two, compared to only one tender in 2010-11. Each of these tenders was for the issue of longer-dated bonds. Shorter-dated bond tenders generally received a greater volume of bids.

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

The average ratio of the volume of bids received to the amount of stock on offer was 3.47 for Treasury Indexed Bonds in 2011-12, a decrease from 4.13 in 2010-11. At around half of the tenders the weighted average issue yields were below prevailing secondary market yields.

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

Cash management

Objective

The AOFM manages the daily cash balances of the Australian Government in the Official Public Account (OPA).[2] The AOFM's primary objective in managing these

2 The Official Public Account (OPA) is the collective term for the Core Bank Accounts maintained at the RBA for Australian Government cash balance management.

balances is 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 the daily cash balances and to invest excess cash balances efficiently. In minimising cost the AOFM seeks to avoid any use of the overdraft facility provided by the RBA.[3]

Achieving the objective

Achieving the cash management objective involves undertaking appropriate short-term investments and debt issuance.

Cash balances not required immediately were invested outside the OPA for nominated periods of time, with the maturity dates set to coincide with financing large outlays. The types, magnitudes and tenors of the short-term investments were determined by the AOFM. Depending on market conditions and the duration of the cash surplus, investments were made in term deposits at the RBA and negotiable certificates of deposit (NCDs) issued by highly-rated Authorised Deposit-taking Institutions (ADIs). Investment other than with the RBA is not risk-free and therefore requires an appropriately higher rate of return.

- Interest rates for term deposits at the RBA are based on Overnight Indexed Swap rates.

- Interest rates for negotiable certificates of deposit reflect prevailing market rates.

In the first half of 2011-12 a review of unsecured lending to financial institutions (via NCDs) was conducted. The finding of that review was that the additional returns on this lending relative to returns on deposits at the RBA were insufficient to justify the additional risk at that time. Investments in NCDs ceased: no new NCDs were purchased after July and all NCDs purchased prior to then matured by October 2011.

Borrowing to support the cash management task is undertaken by the issue of Treasury Notes. At least $10 billion of notes were kept on issue at all times during 2011-12 with the aim of maintaining a liquid market.

The size and volatility of the within-year funding requirement are indicated by changes in the short-term financial asset holdings managed by the AOFM, after deducting Treasury Notes on issue. Chart 7 shows the movement in the funding requirement in 2011-12.

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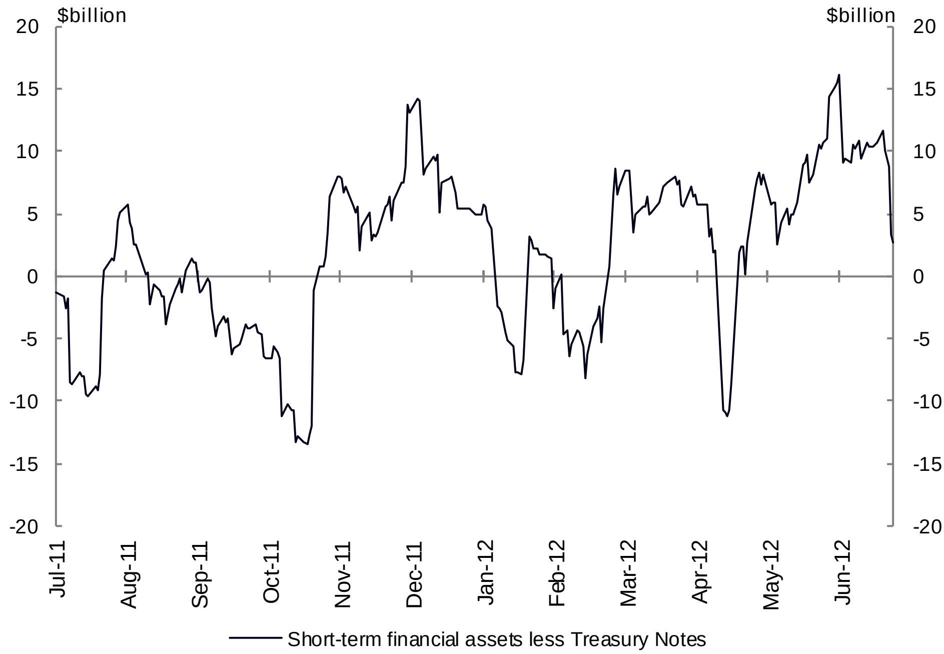
3 The overdraft facility is more costly than equivalent short-term borrowing (for example, issuance of Treasury Notes). The terms of the facility provide that it is to cover only temporary shortfalls of cash and is to be used infrequently and, in general, only to cover unexpected events.

Chart 7: Within-year funding requirement 2011-12



Performance

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

During 2011-12 the AOFM placed 348 term deposits with the RBA. The stock of term deposits fluctuated from a minimum of $2.2 billion in October 2011 to a maximum of $28.8 billion in June 2012.

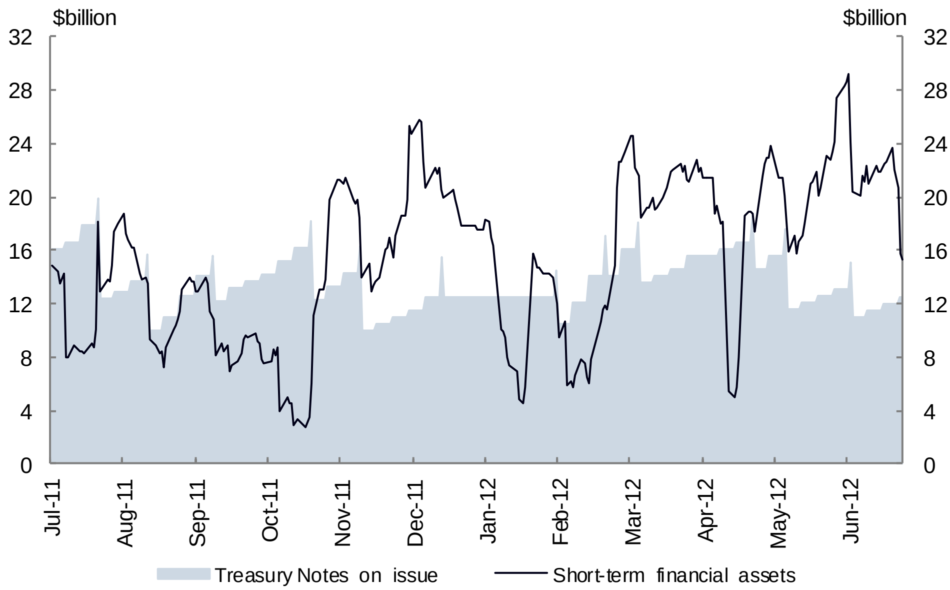
- The average yield obtained on term deposits during 2011-12 was 4.22 per cent, compared with 4.68 per cent in 2010-11. The decrease in average yield reflects the lower average level of interest rates that prevailed during 2011-12.

The face value amount invested in NCDs peaked at $4 billion in July. The average additional return in 2011-12 from investing in NCDs compared with investing funds on deposit at the RBA was approximately 23 basis points. This is estimated to have generated additional investment earnings totalling around $1 million. Although the average return pickup on these investments was higher than the 16 basis points achieved in 2010-11, additional earnings were lower due to substantially less investment activity.

A total of $53.8 billion of Treasury Notes were issued in 2011-12 (in face value terms). The tenders were well supported with an average cover ratio of 4.58. Yields averaged around 32 basis points less than bank bill yields of corresponding maturities (compared to 17 basis points less than bank bill yields in 2010-11). Yields were on average the same as Overnight Indexed Swap rates for corresponding tenors. Details are in Part 5 of this report.

The movement in total short-term financial asset holdings managed by the AOFM (OPA cash balance plus term deposits with the RBA and other short-term investments managed by the AOFM), together with the volume of Treasury Notes on issue, during 2011-12 are shown in Chart 8.

Chart 8: Short-term financial asset holdings and Treasury Notes on issue 2011-12

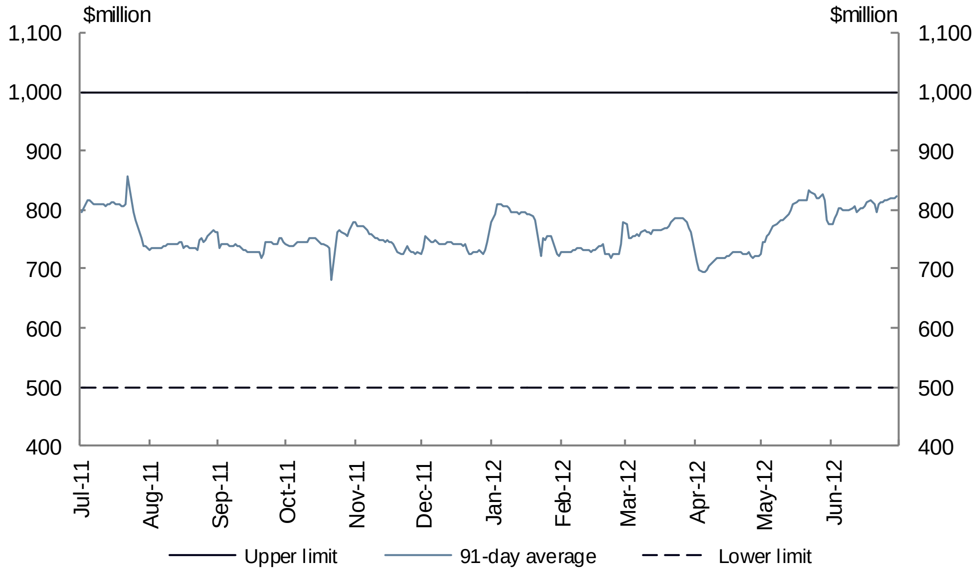


In undertaking its cash management activities, the AOFM is required to maintain the 91-day moving average of the daily OPA cash balance within operational limits around a target level. In 2011-12 these limits were the same as applied in 2010-11, with an operational target of $750 million and upper and lower limits of $1,000 million and $500 million respectively. There is also a Ministerially approved upper limit of $1.5 billion.

The 91-day moving average OPA cash balance was maintained within operational limits, and within the Ministerial limit, throughout the year.

Movements in the 91-day rolling average OPA cash balance over the year are shown in Chart 9.

Chart 9: 91-day moving average cash balance 2011-12



Minimising debt servicing costs subject to acceptable risk

Objective

In managing the government's debt portfolio, 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, while also managing the impact of its issuance on the CGS market.

In order to meet its objective, 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 CGS, 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. This measure of cost is the most appropriate in circumstances where financial assets and liabilities are intended to be held, or in the AOFM's case, to remain on issue until maturity. The use of an historical 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, that is 're-measurements'. Fair value is useful in circumstances where it is possible that changes in market value may be realised in the future.

Variability in cost outcomes, or risk, 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 cost outcomes over time. Abstracting from future financing tasks, debt issuance decisions made today will, by determining the maturity profile of the portfolio and hence the amount to be refinanced in any given year, impact on risk.

Achieving the objective

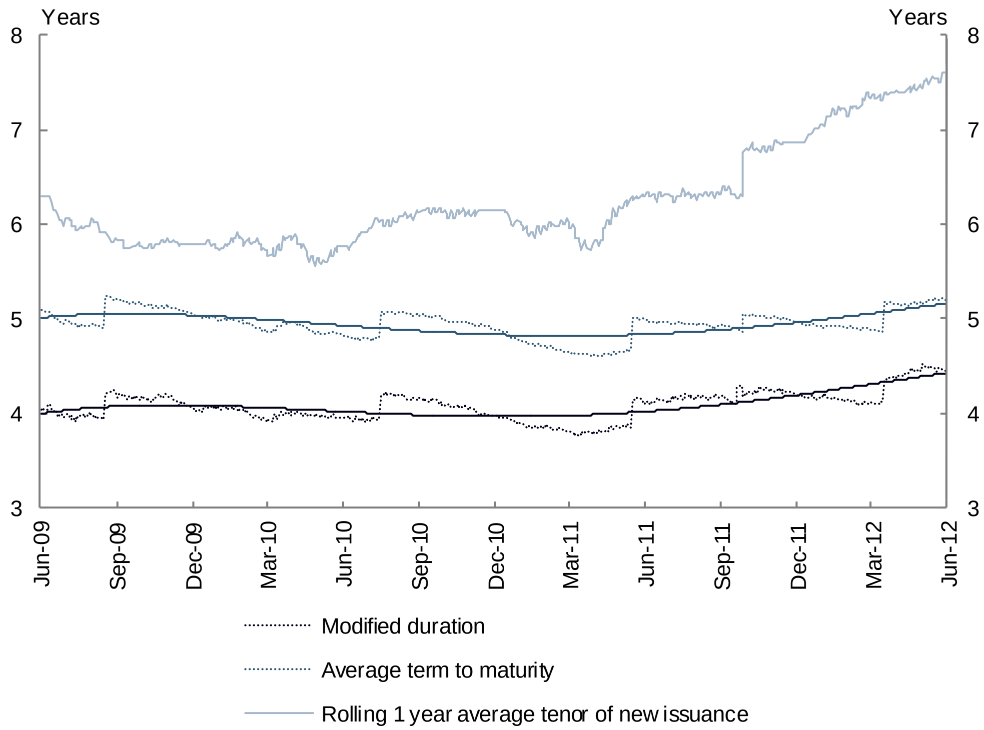
The AOFM influences the cost and risk profile of the portfolio primarily through its decision making on the composition, maturity and tender volume of the debt securities it issues. These decisions are framed through an annual debt issuance strategy approved by the Treasurer, which identifies the overall scale of the issuance task and its breakdown into different instrument classes. Within these broad strategy parameters approved by the Treasurer, the AOFM separately determines issuance weightings (specified as a range) applicable to different segments of the yield curve which are approved by the AOFM Chief Executive. Operational issuance decisions such as determining if, when, how much and what lines to issue each week, are made by the AOFM over the course of the year and are influenced by a range of factors including general market conditions, relative value considerations and feedback from investors.

To provide advice to the Treasurer and to inform strategic decision making, the AOFM is engaged in a constant process of research and review of alternative issuance strategies based on how they are likely to affect the longer term cost and risk profile of the Commonwealth's debt portfolio. Decisions announced in the 2011-12 Budget to lengthen the CGS yield curve to around 15 years and to maintain around 10 to 15 per cent of total long-term CGS in Treasury Indexed Bonds were both informed by this research program. The same is true of the 2011-12 issuance strategy where the AOFM targeted a higher proportion of issuance into mid and longer maturity segments of the nominal curve than has been the case in recent years.

Chart 10 shows that the weighted average tenor of issuance in 2011-12 was around 7.7 years, compared to 6.3 years in 2010-11. This lengthening of issuance in 2011-12 boosted the average term to maturity of the nominal portfolio from around 5.0 years

(30 June 2011) to 5.2 years (30 June 2012). Duration, which was boosted by falling bond yields in addition to the lengthening of issuance, increased from around 4.1 years (30 June 2011) to 4.4 years (30 June 2012)[4]. Looking forward to the next few years, the AOFM anticipates that both average term to maturity and duration will have slightly negative trajectories reflecting the relatively large weights in the portfolio of securities issued during and in the aftermath of the global financial crisis. At the time, the need to quickly ramp up issuance, combined with a general investor preference for shorter maturity lines, resulted in a number of relatively large bond lines being established in the front half of the yield curve. As these lines now approach maturity it is anticipated that the average term to maturity and duration of the portfolio will shorten in the near term. The AOFM's strategy of lengthening issuance has ensured that this decline will be shallower than it would otherwise have been.

Chart 10: Treasury Bonds — issuance tenor (rolling 1 year average), modified duration and average term to maturity

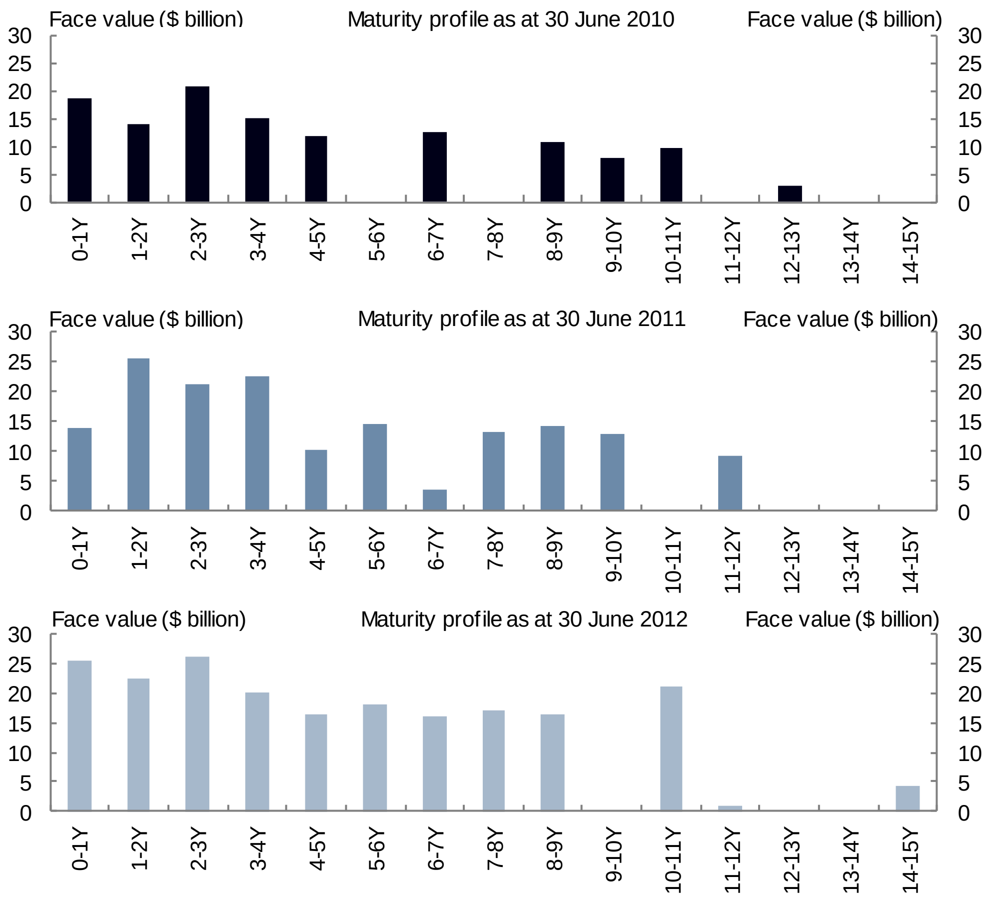


4 Chart 10 focuses solely on Treasury Bonds in order to highlight changes to the issuance strategy in 2011-12. Were other instrument classes such as Treasury Indexed Bonds or RMBS holdings to be included, the average term to maturity and duration parameters would be higher.

One of the key risk factors considered in the AOFM's strategic deliberations is how different issuance strategies influence the maturity or refinancing profile of the debt portfolio. Indeed the refinancing risks implicit to the CGS portfolio structure that emerged post the global financial crisis contributed to the AOFM's decision to lengthen issuance. Chart 11 highlights how the refinancing profile of the nominal portfolio has been gradually 'flattening' in recent years as a result of the AOFM's strategy to boost issuance in the mid and longer segments of the curve. With a flatter, more evenly distributed maturity profile, debt servicing costs are generally less susceptible to adverse interest rate movements in any given period, while refinancing requirements are less concentrated and therefore more easily managed.

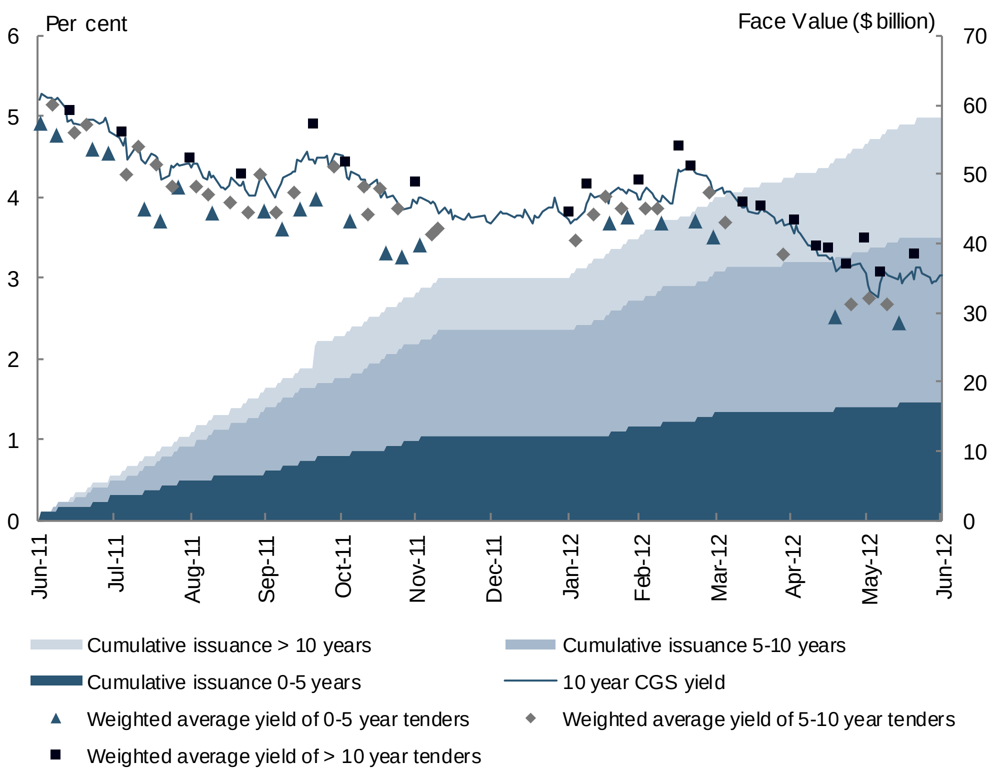
Chart 11 also highlights the extension of the nominal curve in 2011-12 with the establishment of a new 15 year benchmark. Extending the curve has provided the AOFM with more options for meeting the Government's financing requirements year to year while enabling debt outstanding to be spread across a wider tenor range (which is beneficial for managing refinancing risks).

Chart 11: Treasury Bond maturity profiles



Another consideration in framing and executing the annual issuance strategy is the need to support the liquid and efficient operation of the Commonwealth Government yield curve. This requires, among other things, good communication with investors, transparency, regular supply and a spread of issuance across the curve. Communication with investors and operational transparency have always been important considerations for the AOFM. Chart 12 (showing cumulative issuance in 2011-12 set against the weighted average yield of each Treasury Bond tender) highlights that in executing its strategy, the AOFM issued bonds regularly and widely across the yield curve in 2011-12. The chart also shows how issuance yields (borrowing costs) steadily declined throughout the year.

Chart 12: 2011-12 Treasury Bond issuance by tenor bucket and associated tender results



In terms of the indexed debt portfolio, 2011-12 was the first year of a transition towards the 10 to 15 per cent indexed debt share target band announced by the Australian Government in the 2011-12 Budget. As at 30 June 2012, Treasury Indexed Bonds (measured on an accreted book value basis) accounted for 9.2 per cent of total longer term debt on issue.

Box A: The benefits of lengthening issuance

The information presented in this section compares the variability in expected cost outcomes of two hypothetical portfolios, namely a 'long' and a 'short' portfolio. In this example, the long portfolio allocates a greater proportion of future issuance to bond lines positioned in the mid to longer segments of the curve than the short portfolio. Both have a common starting point

Chart 13 below reveals the debt service cost performance of the two portfolios under a simulated interest rate path that sees interest rates oscillating between a simulation range of 2 per cent and 8.5 per cent, over a peak to trough business cycle of 6-7 years. The bounds of this simulation range are consistent with minimum and maximum 10 year yields observed since the mid 1990s.

Chart 13: Debt servicing costs under hypothetical issuance strategies

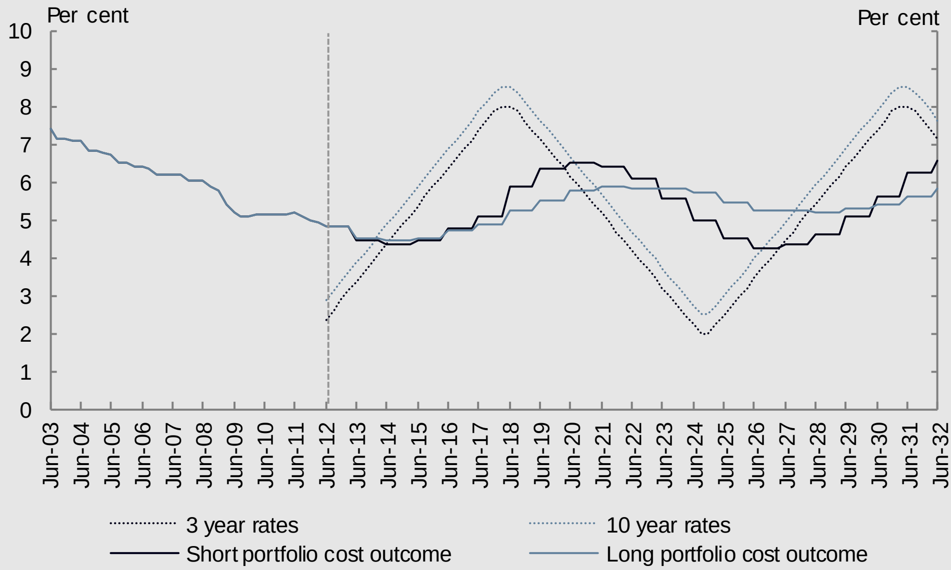


Chart 13 shows that under the assumed yield curve path, the 'long' portfolio exhibits less variability in cost outcomes than the 'short' portfolio. By 'locking in' the cost of debt for longer periods of time, the 'long' portfolio rolls over less frequently and as a consequence requires the refinancing (or repricing) of less debt each year on average. As a result, the 'long' portfolio is generally less sensitive to changes in interest rates than is the short portfolio. This greater cost-stability of the long portfolio provides insulation against increases in debt service costs when interest rates are rising, but it also slows the rate at which the portfolio passes through the benefits of lower interest rates.

Box A: The benefits of lengthening issuance (continued)

In recent years, the AOFM has been gradually lengthening the average tenor of its issuance (see Chart 10), a trend that will likely continue in 2012-13. With volatility and uncertainty continuing to be prominent features of global financial markets, the AOFM views such a strategy as providing the best fit with its core debt management objectives. It enables more stable cost outcomes to be delivered over time by locking in current interest rates, which are at historically low levels.

Performance

Reducing debt servicing cost at an acceptable level of risk

The debt servicing cost[5] of gross debt managed by the AOFM in 2011-12 was $11.42 billion. This represented a cost of funds of 5.07 per cent for the period. Table 2 provides further details of the cost outcomes for the combined portfolio by instrument and portfolio for 2010-11 and 2011-12.

Debt servicing costs on gross CGS debt increased by $2.15 billion compared with the previous year. This was largely the result of an increase in the average volume of debt on issue by $47.31 billion to $225.07 billion in 2011-12. The return on gross assets for 2011-12 increased by $37 million; this was again driven by an increase in the average volume of gross assets (up $2.53 billion to $28.12 billion) which more than offset the return-dampening effect of lower short-term interest rates.

Expressed on an effective yield basis, funding costs in 2011-12 for gross CGS debt fell 15 basis points to 5.07 per cent. Improvements were broadly based across all funding sources and were principally driven by declining CGS yields on bonds and notes issued during the year. Falling rates also reduced yields on funds invested in term deposits from 4.68 to 4.24 per cent and RMBS investments from 6.07 to 5.80 per cent.

Taken together, the net servicing cost of the combined portfolio of debt and assets was $10.01 billion, with an effective yield of 5.08 per cent. The corresponding figures for 2010-11 were $7.90 billion and 5.19 per cent, respectively.

To summarise, an increase in the volume of debt generated a larger net interest cost in 2011-12 in dollar terms. However, the effective cost of funds on the gross debt portfolio decreased in percentage terms, due primarily to falling interest rates. The increase in

5 Debt servicing cost includes net interest expenses (measured on an accruals basis) plus foreign exchange revaluation gains and losses (now minimal). Unrealised changes in the market valuation of domestic debt and derivatives are not part of this measure.

returns on the gross asset balance, in dollar terms, provided an additional offset to the interest cost on the portfolio compared to the previous year. However, the return on gross assets fell below the cost of gross debt in percentage terms, leading to a slightly higher effective yield on the net debt portfolio than on the gross debt portfolio.

Table 2: Commonwealth debt and assets administered by the AOFM

	Interest expense		**Book volume**		**Effective yield**	
	2010-11	2011-12	2010-11	2011-12	2010-11	2011-12
	$ million		$ million		per cent per annum	
Contribution by instrument						
Treasury Bonds	(7,526)	(9,642)	(145,936)	(192,038)	5.16	5.02
Treasury Indexed Bonds	(1,021)	(1,215)	(16,481)	(19,868)	6.19	6.12
Treasury Notes	(712)	(564)	(15,081)	(13,161)	4.72	4.29
Repurchase agreements (a)	(12)	-	(257)	-	4.75	0.00
Foreign loans (b)	(0)	(0)	(5)	(5)	7.98	8.49
Gross physical CGS debt	(9,272)	(11,421)	(177,760)	(225,072)	5.22	5.07
Term deposits with the RBA	391	587	8,372	13,842	4.68	4.24
Investments in bank paper	96	34	1,979	680	4.84	4.97
Term investments (c)	123	-	2,546	-	4.85	0.00
RMBS investments	607	637	10,005	10,978	6.07	5.80
State Housing Advances	158	154	2,685	2,620	5.89	5.86
Gross assets	1,375	1,412	25,587	28,120	5.38	5.02
Net CGS debt	**(7,896)**	**(10,009)**	**(152,173)**	**(196,952)**	**5.19**	**5.08**
Contribution by portfolio						
Long Term Debt Portfolio	(8,547)	(10,856)	(162,423)	(211,911)	5.26	5.12
Cash Management Portfolio	(114)	57	(2,440)	1,361	4.67	4.18
RMBS Portfolio	607	637	10,005	10,978	6.07	5.80
State Housing Portfolio	158	154	2,685	2,620	5.89	5.86
Total debt and assets	**(7,896)**	**(10,009)**	**(152,173)**	**(196,952)**	**5.19**	**5.08**
Re-measurements (d)	326	(20,566)				
Total after re-measurements	**(7,571)**	**(30,575)**	**(152,173)**	**(196,952)**		

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) Repurchase agreements using investments in State and Territory government bonds as collateral.
(b) Interest expense and effective yield on foreign loans incorporates foreign exchange revaluation effects.
(c) Investments in State and Territory government bonds.
(d) Re-measurements refer to unrealised gains and losses from changes in the market valuation of financial assets and liabilities.

Falling interest rates had a large negative revaluation effect on the portfolio in 2011-12, with unrealised losses from re-measurements amounting to $20.57 billion. This comprised unrealised losses of $20,494 million on gross debt and $72 million on asset holdings. Because re-measurement items are highly volatile and will generally show losses/gains when borrowing costs are declining/increasing, 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 (Treasury Notes for instance) 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 risk.

Chart 14 below provides a closer examination of the two largest components of the gross CGS debt portfolio, by comparing the effective book yield of the Treasury Indexed Bond portfolio (in nominal terms incorporating capital indexation effects) with that of the Treasury Bond portfolio since June 2009. During this relatively short period, Indexed Bonds have generally been a more volatile and, at times, more expensive source of funding than nominal debt for the period shown. That being said, the AOFM recognises that indexed bonds offer funding diversification benefits for the Commonwealth and is committed to supporting liquidity and efficiency in this market by boosting the share of indexed debt to at least 10 per cent of the long-term debt portfolio (as announced in the 2011-12 Australian Government Budget — Budget Paper No. 1)[6].

Chart 14: Treasury Indexed Bond vs. Treasury Bond cost of funds

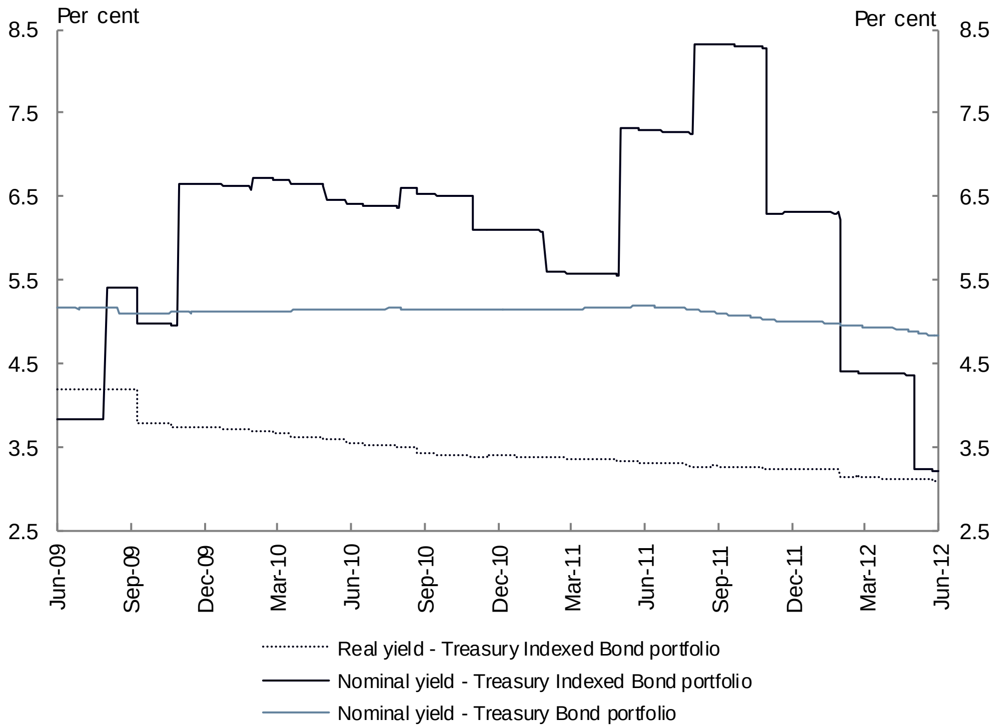


Chart 14 also demonstrates that despite lengthening issuance in recent years, the nominal portfolio has still benefited from falling interest rates, as evidenced by the

6 The indexed debt share of the portfolio is calculated on an accreted book value basis.

decline in effective yields. The fact that the AOFM had run a relatively shorter duration profile[7] entering into, during and in the period since the global financial crises has meant that the rate of 'pass through' from lower interest rates to lower debt servicing costs has been faster than it would otherwise have been. With bond yields reaching 60 year lows late in 2011-12 and with the continuing prospect for market conditions that support relatively low historic CGS yields, the AOFM sees benefits from lengthening the duration of new issuance and locking in historically low rates for an extended period. Notwithstanding downward pressure on the duration of the portfolio as shorter dated bonds approach maturity in the near term, this strategy will see the duration of the AOFM's debt portfolio rise in the medium-term.

Residential mortgage-backed securities

Objective

The Australian residential mortgage-backed securities (RMBS) market is acknowledged as a critical source of funding for smaller mortgage lenders. The global financial crisis that started in 2007-08 reduced the availability of funding through the Australian RMBS market, which in turn limited mortgage lenders' access to funding. In particular, RMBS margins widened to a point that rendered securitisation uncompetitive as a source of finance for lenders. This deterioration occurred despite the high quality of Australian RMBS and the fact that there has never been a credit-related loss on a rated prime Australian RMBS. While conditions and investor sentiment improved at times, the market continued to be affected by the fallout from the crisis and constrained lenders' ability to offer competitive mortgage products.

In view of these developments, the Government decided to invest in Australian RMBS to support competition in lending for housing during the market dislocation. In October 2008 the Treasurer directed the AOFM to invest up to $8 billion in eligible RMBS, of which up to $4 billion was to be invested in deals with sponsors that were not ADIs (Authorised Deposit-taking Institutions). In November 2009 the Treasurer extended the program by directing the AOFM to invest up to a further $8 billion in RMBS. This Direction also extended the objectives of the program to include supporting small business lending, through broadening the potential use of funds raised under the program.

In December 2010 the Treasurer announced, as part of the *Competitive and Sustainable Banking System* package, a further extension of the program. The subsequent Direction,

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7 Many of the AOFM's contemporaries in sovereign debt management around the world have tended to run liability portfolios with longer durations.

issued in April 2011, directed the AOFM to invest up to an additional $4 billion and thus a cumulative total of up to $20 billion in RMBS. Importantly, this direction also identified the need to encourage a transition towards a market that is not reliant on Government support.

Achieving the objective

RMBS market conditions and developments in the program

In 2011-12, the AOFM invested a total of $1.93 billion across 11 RMBS transactions from 8 issuers. Since inception of the program, the AOFM has invested $15.3 billion across 60 transactions from 20 issuers. Through amortisation and sales, $4.1 billion has been repaid, and $11.2 billion remained outstanding by the end of this financial year. Table 3 details our investment activity.

Table 3: RMBS investment activity

	Programme	Sponsor	Total Investment Amount	%	Outstanding Amount	%	Number of deals
ADI	SMHL	ME Bank	$2,114	13.8%	$1,418	12.7%	8
	Torrens	Bendigo and Adelaide Bank	$1,922	12.6%	$1,523	13.6%	6
	Reds	Bank of Queensland	$1,248	8.2%	$992	8.9%	3
	Apollo	Suncorp	$1,112	7.3%	$983	8.8%	3
	IDOL	ING	$853	5.6%	$715	6.4%	4
	Progress	AMP	$825	5.4%	$583	5.2%	4
	Harvey Trust	CUA	$493	3.2%	$322	2.9%	2
	Light Trust	People's Choice Credit Union	$434	2.8%	$332	3.0%	2
	PUMA	Macquarie	$405	2.6%	$405	3.6%	2
	WB	Wide Bay Australia	$404	2.6%	$302	2.7%	2
	GBS	Greater Building Society	$190	1.2%	$127	1.1%	1
	ConQuest	MyState	$170	1.1%	$152	1.4%	1
	Illawarra	IMB	$158	1.0%	$96	0.9%	1
	Pinnacle	Police & Nurses	$111	0.7%	$111	1.0%	1
	Barton	Community CPS Australia	$91	0.6%	$91	0.8%	1
	HBS	Heritage	$22	0.1%	$22	0.2%	1
	Total		**$10,550**	**68.9%**	**$8,174**	**73.0%**	**42**
Non-ADI	Resimac	Resimac	$1,502	9.8%	$952	8.5%	7
	FirstMac	FirstMac	$1,500	9.8%	$1,081	9.6%	5
	Challenger	Challenger	$1,000	6.5%	$583	5.2%	2
	Liberty	Liberty	$751	4.9%	$412	3.7%	4
	Total		**$4,753**	**31.1%**	**$3,028**	**27.0%**	**18**
	Total		**$15,303**		**$11,201**		**60**

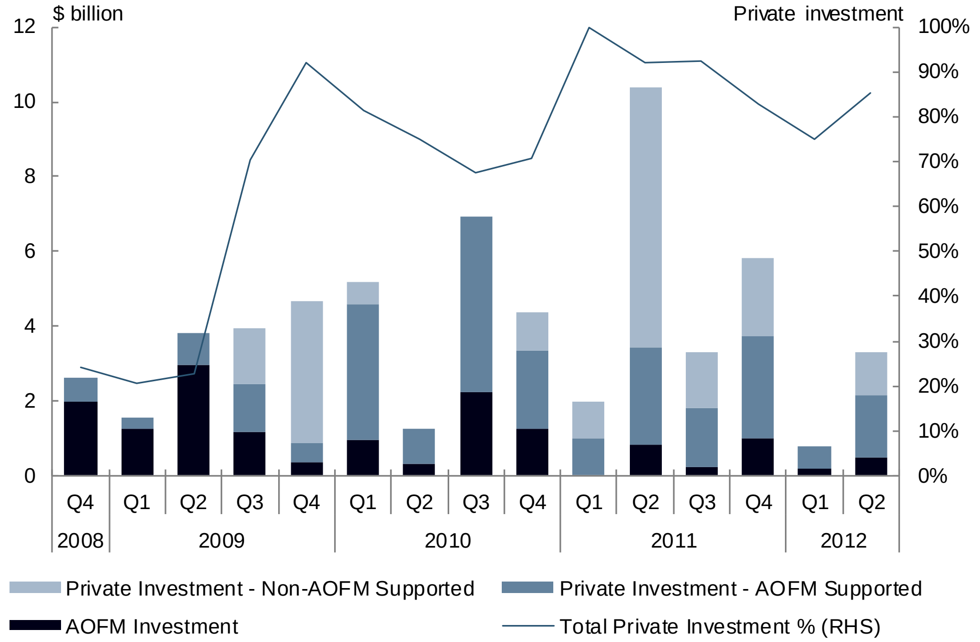
Market conditions were volatile through the year. The Australian RMBS market continued to face challenges consistent with global credit markets. Concerns over Europe and credit in general, dampened issuance and widened margins. In addition, the debut of covered bonds resulted in further volatility and uncertainty in the

Australian RMBS market in early 2012. Consequently, in line with reduced issuance, the AOFM's pace of investment was slower through the year.

Consistent with a lower level of issuance and a slower pace of investment, the volume of transactions supported by the AOFM decreased from over $14.7 billion in 2010-11 to just under $8.5 billion this year, and likewise the volume of prime RMBS transactions that were not supported by the AOFM almost halved from nearly $9 billion to $4.75 billion. This brought total public prime RMBS activity to $13.2 billion in 2011-12 from $23.7 billion the year before. It is interesting to note that all the non-AOFM supported deals this year were sponsored by the Australian major banks and their subsidiaries.

Particularly in keeping with the AOFM's objective of working towards a market that is not reliant on Government support, it is also worth noting that the participation of other investors was marginally higher again this year. Chart 15 shows the participation of AOFM and other investors in prime RMBS issues since the inception of the program. Participation from other investors averaged 23 per cent from inception until the end of June 2009, and has gradually grown from 81 per cent in 2009-10 to 82 per cent in 2010-11 and to 85 per cent of total market activity in 2011-12[8].

Chart 15: Prime RMBS market participation



8 Excluding transactions not supported by the AOFM reduces this proportion to 77 per cent (up from 70 per cent in 2010-11).

The net result of these activities is that the volume of Australian prime RMBS outstanding has now reduced to around $75 billion. The share of housing credit funded by securitisation also fell during 2011-12 to just below 8.5 per cent, according to the RBA.

In terms of margins, the typical benchmark of AAA rated senior tranche with a weighted average life of around three years progressively widened through the year, from around 100 basis points at the start of the financial year, to around 140-160 basis points by the end of the financial year. Similarly, margins widened for all tranches and accordingly, the cost of funding through RMBS and thus the net margin for investors was higher this year.

It was encouraging to see transactions tap pockets of demand where possible with the issuance of a variety of structures that included fixed rate bullet tranches aimed to attract index investors, and Yen and US dollar tranches aimed to attract offshore investors. Despite these efforts, the investor base for Australian RMBS did not deepen significantly over the year.

The AOFM continued to support structures designed to facilitate engagement with investors, by filling gaps in demand. For example, the AOFM continued to purchase some relatively small longer dated tranches, so as to facilitate the creation of RMBS securities with the weighted average life in demand. Likewise, the AOFM has been prepared to purchase tranches with a greater degree of sensitivity to mortgage prepayment rates so as to facilitate the creation of both bullet securities and scheduled amortisation tranches.

During the year, the AOFM also purchased, for the first time, a fixed rate bullet security. This was agreed in order to support the issuance of sufficient volume to enable this security to qualify for the UBS Composite Index which in turn would attract particular investors. In March 2012, and in spite of secondary markets implying otherwise, the AOFM was able to sell these securities at a tighter margin to swap than the equivalent margin at purchase.[9]

Performance

The funds raised by the RMBS issues supported by the AOFM have provided an important component of total lending for housing and small business since the inception of the program. Without this funding, new lending by the financial institutions supported, would have been lower and their ability to provide competition in the market, now and in the future, would have been curtailed. As such, the RMBS

9 Further detail on this sale is available on the AOFM website.

program has continued to positively contribute to mortgage competition again this year.

The investments made under the program continue to provide reasonable financial returns. Interest income in 2011-12 was $637 million, which represented an annualised return of 5.80 per cent on the average portfolio book value of $11.0 billion. This compares favourably with the AOFM's funding costs, detailed in Table 2. The average margin over the one month bank bill rate, weighted by each of AOFM's investments, for the book outstanding as at 30 June 2012 was around 133 basis points. In addition, capital repayments totalling $4.1 billion were received.[10]

The RMBS securities that the AOFM holds are valued in its accounts using indicative margins for secondary market trading as estimated by an independent valuation service provider. As secondary market margins have typically been higher than the margins set on issuance, the estimated market value of these securities has been less than their accrual book value. Accordingly, the RMBS portfolio had an unrealised loss stand of $152.6 million (or 1.36 per cent of the portfolio book value) as at 30 June 2012.[11] This represents a deterioration of $71.75 million for the financial year. 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. They are not 'realised' losses or gains, but are referred to as 're-measurements'.

Further information on the AOFM's investments in RMBS up to 30 June 2012 is given in Part 5 of this annual report.

Investor Relations

Objective

Investor Relations activities again focused on supporting smooth debt issuance through regular and consistent communication with investors. This was done through a range of investor engagements such as one-on-one meetings, presentations and discussions with small groups of investors. Regular investor contact allows for new investors to become aware of and current investors to remain up-to-date on the Australian economy, the Government's fiscal and debt positions underpinning its very

10 This includes the RMBS investments sold for portfolio management purposes in March 2010 and March 2012 with a total face value of $123.79 million. The AOFM announced the details of these sales shortly after each completion.

11 The AOFM uses market *bid* rates for revaluation purposes supplied by a third party revaluation service provider.

strong stable sovereign credit status, and the benefits of the CGS market more generally.

One of AOFM's main objectives has been to encourage diversity in the investor base via the entry of new investors with differing investment mandates, while maintaining relationships with strategically important investors. Diversity is obtained through a spread of investors over geography, sector, product and investment policies or mandates. A wide diversity of investors reduces the risk of very large moves in the demand for or sale of CGS, aiding in the maintenance of a liquid and orderly market and contributing to the AOFM achieving a lower cost of borrowing.

Outcomes

Investor Relations activity during 2011-12 involved the offshore markets sector, with visits to a similar number of countries and cities as the year before, and the domestic investor base. This year though, there was more direct investor contact. Sixteen more one-on-one meetings were held as well as a larger number of small group meetings or roundtable discussions. Fewer large conferences type presentations were attended in 2011-12 as the perceived benefit of these was not assessed as proportional to the preparation, effort and cost of international travel to attend them. For more information see Tables 4 and 5.

Although the AOFM participated in a smaller number of more targeted conferences, the ones which were attended were mainly held in Australia and usually had a more tightly selected audience, often with central bank investors as key attendees. Although AOFM participated in fewer conferences during 2011-12 than in the previous year, the nature of the selected conferences and roundtable discussions were highly relevant. On occasions the transcript of these discussions were later printed in financial magazines such as Asia Money or Kanga News, which have international investor reach through their subscription bases.

Good examples of the smaller discussion format were the domestic inflation linked roundtables, where AOFM provided updates to investors and received very useful direct feedback. These discussions were usually hosted by financial intermediaries (for example banks), as were most of the meetings and the conferences in which the AOFM participated. There are a number of benefits in having a financial intermediary arrange industry and investor related events and AOFM thanks all those institutions that have engaged with and provided assistance to the agency.

Table 4: Summary of investor relations activities in 2011-12

Activity	Details
Conferences, speaking engagements and investor meetings	16 events.
Approximate total audience size	550-650 attendees.
Individual meetings	96 investor meetings.
Hosted roundtable/small presentations	8 presentations with 46 investors.
Individual cities visited	25 cities.
Two AOFM staff members travel on each overseas trip	CEO, Head of Investor Relations, Director of Financial Risk, or a Senior Analyst from Investor Relations or Treasury Services.
Hosting banks	Bank of America Merrill Lynch (BoAML), Citi, Commonwealth Bank of Australia (CBA), Deutsche Bank (DB), Royal Bank of Canada, Royal Bank of Scotland, UBS, Westpac.

Table 5: Timeline of investor engagement activities in 2011-12

Activity	Details
July 2011	Sydney: RBS Linker Roundtable - discussion with 7 domestic investors.
September 2011	USA: Euromoney Conference - CEO was keynote speaker, 18 investor meetings plus 8 investors met through 2 in-house bank hosted presentations.
October 2011	Paris/London: 4 investor meetings in London plus met 5 investors through a bank hosted luncheon. Sydney: CBA Fixed Income conference - CEO was keynote speaker before 100 attendees. Sydney: Kanga News Sovereign and Semi Government Roundtable - discussion with the Semi Government issuers.
November 2011	Tokyo: 20 Japanese investor meetings plus 11 investors met through a bank hosted luncheon.
February 2012	Sydney: BoAML Asian Central Bank and Sovereign Wealth conference - CEO presented to 50 investors, 7 individual meetings.
February/March 2012	Europe: 18 investor meetings plus 15 investors met through 2 bank hosted luncheons.
March 2012	Canberra: DB Investor Mission - CEO presentation to 40 investors.
April 2012	Sydney/Melbourne: 14 domestic investor meetings. Sydney: ANZ Central Bank and Sovereign Wealth conference - CEO participated in a roundtable discussion before 50 investors.
May 2012	Sydney: Asia Money Roundtable - CEO participated in roundtable discussion. Sydney: Australian Business Economists luncheon - CEO speech to 100 financial market participants. Sydney: Kanga News Linker Roundtable - discussion with 10 financial financial market participants.
June 2012	South East Asia: 11 investor meetings.

In the first half of 2011-12, the AOFM undertook a small advertising campaign via print advertisement in Bloomberg Markets magazine and which directed interest to AOFM's Bloomberg page. This was over a three month period and also allowed for an AOFM digital banner to be displayed on six days when users logged on to their Bloomberg terminals. The digital banner linked to the AOFM Bloomberg page, which in turn lead through to the AOFM website. The campaign coincided with a major investor trip to North America and both activities were aimed at increasing awareness amongst the large private sector US investor group. Evaluation of the campaign highlighted increased activity on both the AOFM Bloomberg page and AOFM website over the period of the campaign.

Investor Relations was also tasked during the year with rebuilding the AOFM website as it is a major portal of information for the public and investors in particular. This is a major project which aims to redesign and update the entire website.

Public Register of Government Borrowing

The *Guarantee of State and Territory Borrowing Appropriation Act 2009* requires the AOFM to establish and publish a register recording the beneficial ownership, by country, of all Commonwealth Government Securities (CGS) and any Australian State or Territory government securities guaranteed by the Commonwealth.

The Act does not contain any mechanisms to compel the provision of information to the AOFM by the beneficial owners of these securities or persons holding these securities on their behalf. In the absence of a legal or regulatory compulsion to do so, nominee and custodial services firms have not provided information to AOFM due to their fiduciary and contractual obligations to their clients. Many investors wish for their holdings to remain confidential for valid commercial and other reasons.

This has severely limited the information available to the AOFM to form an opinion on the extent of beneficial ownership of the securities. Without information on the country of beneficial ownership information on the holdings of nominee/custodial firms alone provides a very limited indicator of 'offshore' CGS ownership.

During 2011-12, the AOFM published the register each quarter and following the latest update the register contains monthly data up to 30 June 2012. The register indicates that around $265.8 billion of CGS, together with State and Territory securities guaranteed by the Commonwealth, were on issue at year end. Country of ownership could be identified for $86.8 billion or 32.7 per cent, of which $38.7 billion was identified as Australian and $48.1 billion was offshore. Country of beneficial ownership could not be identified for around $179.0 billion or 67.3 per cent. Most of this unidentified component was held by nominee/custodial firms.

The Australian Bureau of Statistics (ABS) also collects and publishes information on the holdings of securities. The legal powers provided to the Australian Statistician enable the ABS to obtain information from nominee/custodial firms on security holdings, however, there are also set confidentiality requirements that can constrain how and to what extent the ABS publishes at a detailed country level.

The quarterly ABS publication *5302.0 Balance of Payments and International Investment Position, Australia* indicates that around 76.1 per cent of Commonwealth Government Securities were held by non-residents as at June 2012[12].

The annual ABS publication *5352.0 International Investment Position, Australia* provides information on the country of domicile for portfolio investment in debt securities. This information covers a broader range of debt securities, issued in Australia and overseas, than that covered by the AOFM register (that is State and Territory securities not guaranteed by the Commonwealth, as well as debt securities issued by financial intermediaries such as banks and those issued by companies).

The publication estimates that there was around $858.0 billion of this foreign portfolio investment in debt securities at 31 December 2011. The survey indicated the country of domicile breakdown as: the United States, $212.1 billion; United Kingdom, $172.6 billion; Japan, $58.0 billion; Luxembourg, $18.4 billion; Switzerland, $9.0 billion; Hong Kong, $7.8 billion; Singapore, $5.7 billion; New Zealand, $3.2 billion; Netherlands, $3.1 billion; France, $1.6 billion; Germany, $1.4 billion; and Ireland, $1.4 billion. The remainder of holdings were attributed to international bond markets, were unspecified, or were not published for confidentiality reasons.

Information technology operations

The AOFM's operations are highly dependent on its treasury system, which is used to support debt and financial asset deal capture, portfolio management and reporting, settlements, accounting and compliance activities. The AOFM is licensed to use its current system, Avantgard Quantum/Risk, until April 2014. The AOFM has an option (exercisable at its discretion) to extend its license for a further 2 years to April 2016.

During 2009-10 the AOFM commenced an open market testing and procurement process to identify a treasury system to replace the existing system. Given the central importance of the treasury system to the AOFM's operations, the agency committed significant resources to conduct due diligence assessments of the technical, commercial and legal elements of proposals received. This included desktop reviews of expression of interest and tender responses, product demonstrations, proof-of-concept testing of products, financial viability assessments of vendors, costing of proposals and contract negotiations with vendors.

12 Note this does not cover Commonwealth guaranteed securities issued by the State and Territory governments under the Act.

In February 2012 the AOFM terminated its selection process as no tender was assessed to represent a satisfactory value for money proposition to the AOFM due to technical, commercial and/or legal considerations.

The AOFM is re-evaluating its business case on how best to progress its treasury system requirements.

Operational risk

Operational risk is the risk of loss due to operational failures resulting from internal processes, people, systems, or from external events. It encompasses risks such as fraud risk, settlement risk, accounting risk, personnel risk and reputation risk.

The AOFM aims to manage its exposure to operational risk to acceptably minimum levels. It maintains a culture of prudence awareness, together with high ethical standards, which are reinforced by adherence to the Australian Public Service Code of Conduct and the Australian Financial Markets Association (AFMA) Code of Conduct. Responsibility for the design and monitoring of risk and compliance activities resides in the Enterprise Risk Management, Legal and Compliance (ERMLC) Group. A dedicated Enterprise Risk Management Unit maintains the currency and relevance of the AOFM's risk framework and registers, while the Compliance Unit monitors compliance with external obligations and internal controls and procedures. The ERMLC Group reports to the Audit Committee on matters relevant to risk management, internal controls and compliance.

Operational risk activities undertaken in 2011-12 included:

- internal audits of the control effectiveness over the payroll and finance functions, general IT control environment, and the securities issuance and lending operations, as well as an assessment of the AML/CTF program governance framework;
- preparation of the Certificate of Compliance for the AOFM's compliance with the financial management framework under the *Financial Management and Accountability Act 1997*; and
- a review of the AOFM's Chief Executive Instructions and internal financial delegations issued under the *Financial Management and Accountability Act 1997.*

Settlement operations

The AOFM is a low transaction volume, high transaction value environment. In 2011-12, it settled around $82.5 billion of payments of interest, principal and redemptions on CGS and around $1,071.9 billion in financial asset acquisitions, including term deposits with the Reserve Bank of Australia, money market and residential mortgage-backed securities. The AOFM also ensures that administered receipts are settled promptly and correctly by its transaction counterparties.

In 2011-12, the AOFM was not late in settling any payment obligations. There was one instance where compensation was sought from a counterparty for failing to settle a payment obligation in line with its contractual obligations.

Agency financial performance

The AOFM recorded an operating surplus on agency activities of $3.14 million for 2011-12 financial year, comprising total revenue of $13.44 million and expenses of $10.30 million. The surplus in 2011-12 was due largely to lower than anticipated costs of undertaking additional issuance activity in response to the financial crisis.

As at 30 June 2012, the AOFM was in a sound net worth and liquidity position, reporting net assets of $24.25 million, represented by assets of $26.72 million and liabilities of $2.47 million.

As at 30 June 2012, the AOFM had unspent appropriations totalling $25.70 million of which $0.1 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.

Cooperation with other debt managers

The AOFM supports the debt management activities of the Papua New Guinea and the Solomon Islands governments under the *Strongim Gavman Program* and the *Regional Assistance Mission* to the Solomon Islands. One staff member is seconded to each of these countries to help develop cash and debt management capabilities. Officials of the debt management agencies of the three countries, including the seconded AOFM staff, met in Brisbane in August 2011 to discuss their experience with debt management over the year and the development of management capabilities (including knowledge transfer).

During the year the AOFM also hosted visits by officials from Papua New Guinea and the Solomon Islands.

PART 3: MANAGEMENT AND ACCOUNTABILITY

MANAGEMENT AND ACCOUNTABILITY

Corporate governance

The Secretary to the Treasury holds responsibility for specific authorities over the AOFM's activities and is responsible for advising the Treasurer on Government policy relating to debt management and investment activities. The Secretary approves detailed debt management and investment policies, sets operational limits and addresses any breaches of those limits. In discharging his responsibilities, the Secretary is advised by the AOFM Advisory Board.

The Chief Executive Officer (CEO) of the AOFM is responsible for the day-to-day management and direction of the AOFM. The CEO exercises powers delegated by the Treasurer and the Secretary for debt creation and issuance, investment, portfolio management and management of the AOFM's staff. The CEO has final responsibility for all aspects of the financial management of the Office (which is treated separately from the financial management of the Treasury as the AOFM is a prescribed agency under the *Financial Management and Accountability Act 1997*). The AOFM reports to the Treasurer on issues pertaining to the management and performance of the portfolio, prepares an annual report for presentation to Parliament and provides information about its activities on its website.

AOFM Advisory Board

The AOFM Advisory Board provides advice to the Secretary on debt management policy and the operational strategy and performance of the AOFM. The Board does not possess executive powers or decision making authority. The Advisory Board members as at 30 June 2012 were:

- Dr Martin Parkinson PSM, Secretary to the Treasury, Chair;
- Tony Cole AO, Director of the Northern Territory Treasury Corporation, Chairman of the Melbourne Institute Advisory Board and Trustee Director to Commonwealth Superannuation Corporation;
- Rob Nicholl, CEO, AOFM;
- David Martine, Deputy Secretary, Budget Group, Department of Finance and Deregulation;

- Greg Maughan, Consultant;
- Nigel Ray, Executive Director, Fiscal Group, Treasury; and
- Peter Warne, Chairman of the Australian Leisure and Entertainment Property Group, Deputy Chairman WHK Group Ltd, Non Executive Director of ASX Limited and subsidiary companies and Macquarie Group Limited. He is also Chairman St Andrews Cathedral School Foundation Limited, Deputy Chairman Capital Markets Cooperative Research Centre Limited. He is also a Non-Executive Director of Next Financial Limited and the Securities Industry Research Centre of Asia Pacific and a number of other unlisted companies.

The Advisory Board met on three occasions in 2011-12.

Senior management committees

Several senior management committees operate to assist the CEO in the management of the Office and to facilitate communication, coordination and the assessment of risk and compliance management.

Executive Group

The Executive Group advises the CEO in determining policies and procedures governing the conduct of AOFM operations. Its activities include: the review and assessment of AOFM's risk exposures; monitoring compliance obligations; determining and monitoring the implementation of HR policies; overseeing and advising the CEO on significant OH&S matters; overseeing the corporate planning process, including internal and aggregate resourcing needs; and advising the CEO on significant corporate matters as they may arise.

Asset and Liability Committee

The Asset and Liability Committee advises the CEO on operational debt policy and financial risk management issues. The committee reviews policy and finance related operational settings, deal execution and market conditions. Its membership comprises of the CEO, the Director of Financial Risk, the Head of Treasury Services, Head of Investor Relations and the Head of Reporting and IT, together with other senior staff with relevant functional responsibilities.

Human Resources Committee

This committee advised on the management of human resources, including employment policies, training and development, recruitment, performance management and remuneration. It consisted of the CEO as Chair, the Head of Treasury

Services, the Director of Financial Risk, the Head of Investor Relations, the Head of Reporting and IT, the Chief Finance Officer, the Chief Risk and Compliance Officer and the Human Resource Manager. During 2011-12, the role of this Committee was incorporated into the responsibilities of the Executive Group.

Information Technology Steering Committee

This committee monitors IT service availability and security related incidents and oversees current and planned information technology projects and operations. Its membership comprises of the CEO (Chair), the Head of Reporting and IT, and the IT Manager.

Other elements of the governance framework

Other elements of the AOFM's governance framework include:

- formal delegations and authorisations from the Treasurer of powers under various Acts that provide the legal authority for the conduct of the AOFM's debt management and investment activities;
- formal delegations — Financial Management and Accountability (Finance Minister to Chief Executives) Delegation;
- policies, including a Balance Sheet Policy, Credit Policy and Liquidity Policy, and operational limits, approved by the Secretary to the Treasury;
- Chief Executive Instructions and internal financial delegations by the CEO under the *Financial Management and Accountability Act 1997*;
- a Contract Management Policy, which provides guidelines for managing contractual relationships with suppliers of goods and services based on Australian Government legislative requirements and best practice principles;
- a fraud risk assessment and Fraud Control Plan which complies with the Commonwealth Fraud Control Guidelines and includes appropriate fraud prevention, detection, investigation and reporting procedures; and
- the AOFM AML/CTF Program under the *Anti-Money Laundering and Counter-Terrorism and Financing Act 2006*.

Audit

Audit Committee

The AOFM Audit Committee reviews, monitors and recommends improvements to the risk management, internal control and financial reporting processes. It oversees the audit and compliance programs, making its assessments based on the information and reports it receives from the AOFM and auditors, at its quarterly meetings.

Key activities during 2011-12 included:

- reviewing the operation of the AOFM's risk and internal control environment, including the Certificate of Compliance process;
- approval of the AOFM's 2011-12 internal audit plan;
- monitoring the action taken by the AOFM on matters raised by auditors;
- advice on the preparation and review of the AOFM's financial statements;
- monitoring the progress of major agency projects; and
- providing its endorsement for a number of internal policies, procedures and training programs (for instance, the AOFM Conflicts of Interest Policy).

The Audit Committee membership as at 30 June 2012 comprised:

- Peter Warne, independent member of the AOFM Advisory Board (Chair);
- David Lawler, former Group Auditor, Financial Controller of Institutional Banking and Executive General Manager of the Commonwealth Bank of Australia. Audit Committee member of the Defence Materiel Organisation, the Australian Trade Commission, the Australian Agency for International Development, the Australian Sports Anti-Doping Authority and National ICT Australia;
- Brenton Goldsworthy, Manager, Assets, Liabilities and Intergenerational Report Unit, the Treasury;
- Samantha Montenegro, Chief Risk and Compliance Officer, AOFM (from May 2012); and
- Jason Dakin, Manager, Compliance, AOFM.

Invited attendees included the Australian National Audit Office (ANAO), the AOFM internal auditor (Deloitte Touche Tohmatsu) and the AOFM Chief Finance Officer. The AOFM CEO also attends meetings at his discretion.

The Committee met on four occasions during 2011-12.

Internal auditor

The AOFM's internal auditor, Deloitte Touche Tohmatsu undertook the following reviews during 2011-12:

- a review of the AOFM's securities issuance and lending activities;
- a review of the AOFM's payroll and finance function; and
- a review of the AOFM's general IT controls; and a review of the AOFM's AML/CTF program governance framework.

All audits concluded that the AOFM's internal controls were operating satisfactorily. Where recommendations were made, these were aimed at enhancing the efficiency and design of the current control environment. At 30 June 2012, recommendations had either been implemented or are in the process of being implemented in accordance with agreed timelines.

Australian National Audit Office reports

During 2011-12, the ANAO did not conduct any cross-agency audits which involved the AOFM.

Business continuity arrangements

The AOFM has business continuity and pandemic plans to ensure that its critical activities can continue in the event of a major disruption or influenza pandemic. These include the provision of back up arrangements that can be implemented when the AOFM's office accommodation is not able to be used or when AOFM staff are not available to perform key tasks. There is also an information technology (IT) disaster recovery plan which sets out the processes required to restore critical IT-reliant functions in the aftermath of a significant disruption. Business continuity plans were also updated and tested.

Judicial decisions

In 2011-12, no matters relating to the AOFM were the subject of judicial proceedings, tribunal hearings or consideration by the Ombudsman.

Management of human resources

Meeting workforce needs

The AOFM actively pursues a number of approaches to meet its workforce needs. In particular, the AOFM seeks to employ recent graduates and develop them through on-the-job experience, mentoring, assistance with further professional training and in-house development programs. This approach is tailored to maintain the core professional strength of the AOFM on a continuing basis. Employees accumulate practical knowledge of financial markets, debt management, public policy and government administration.

This strategy has been successful in attracting and retaining highly qualified professional staff.

Eighty-six per cent of AOFM employees have degree qualifications, with 23 per cent holding higher degrees and 21 per cent double degrees. Thirty-five per cent have professional qualifications.

The retention rate for 2011-12 was 88 per cent, with an average annual retention rate of 88 per cent over the previous five years.

Where specialised skills are needed that are not currently available within AOFM, the agency may recruit for positions that require such specialised skills (with this sometimes being on a fixed-term basis in response to a specific project or tasks that will not be ongoing).

A broad-band classification structure allows staff to advance between work levels within classification grades subject to work availability and performance. This can occur without formal competitive selection processes. Promotions across grades are made via merit selection.

Training and development

Staff are encouraged to participate in training and development activities relevant to their work responsibilities. The performance management system is designed to encourage employees to consider development activities during each performance cycle. Learning is fostered through on-the-job training, external courses, conferences, workshops and seminars.

Over the last five financial years, an average of 82 per cent of staff have participated in training or development supported by the AOFM. During this period, training averaged 4.2 days per full-time equivalent staff member (FTE) per year and the direct costs of training (paid to external parties) averaged $2,306 per FTE per year. In 2011-12, 91 per cent of employees participated in training, 4.4 days per FTE were invested in skill development and $2,078 per FTE was paid to external providers. Investment in training and development activity over the year was 3.9 per cent of gross salary.

The AOFM workforce

As at 30 June 2012, the AOFM employed 38.6 full-time equivalent staff under the *Public Service Act 1999*. Table 1 shows this workforce by broadband classification.

Table 1: Operative and paid inoperative staff as at 30 June 2011 and 2012

	Ongoing				Non-ongoing				
	Full-time		Part-time		Full-time		Part-time		
Classification	**Male**	**Female**	**Male**	**Female**	**Male**	**Female**	**Male**	**Female**	**Total**
2012									
AOFM1	0	2	0	1	0	0	0	0	**3**
AOFM2	14	10	1	3	0	1	0	0	**29**
AOFM3	6	1	0	0	0	0	0	0	**7**
AOFM4	1	0	0	0	0	0	0	0	**1**
CEO	1	0	0	0	0	0	0	0	**1**
Total	**22**	**13**	**1**	**4**	**0**	**1**	**0**	**0**	**41**
2011									
AOFM1	0	2	0	1	0	0	0	0	**3**
AOFM2	18	7	1	3	0	3	0	0	**32**
AOFM3	5	1	0	0	0	0	0	0	**6**
AOFM4	1	0	0	0	0	0	0	0	**1**
CEO	1	0	0	0	0	0	0	0	**1**
Total	**25**	**10**	**1**	**4**	**0**	**3**	**0**	**0**	**43**

Note: AOFM broadband classifications are nominally 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 staff were located overseas during the year to support capacity building in sovereign debt management in Papua New Guinea and the Solomon Islands under the *Strongim Gavman Program* and the *Regional Assistance Mission to the Solomon Islands* respectively.

Changes to senior management

Ms Samantha Montenegro joined AOFM as Chief Risk and Compliance Officer at the end of April 2012. This filled a need identified by the Deloitte's review of AOFM compliance activities. There were no other changes to senior management.

Other staffing changes

In addition to the Chief Risk and Compliance Officer, two ongoing and one non-ongoing employees were recruited during 2011-12. This represents replacement for normal turnover.

There were six staff departures during the year. Three non-ongoing staff completed short-term engagements and three ongoing staff exited. Two of these employees took up positions in the private sector. For ongoing employees, departures represented 7.5 per cent of average staffing levels in 2011-12 (5.5 per cent in 2010-11).

Employment arrangements

Bargaining for a new three-year enterprise agreement commenced on 13 May 2011 and concluded 11 August 2011. Fair Work Australia approved the *AOFM Enterprise Agreement 2011-2014* on 30 August 2011 after a 90 per cent 'Yes' vote by affected staff. The new enterprise agreement came into effect on 6 September 2011 and it covers employment terms and conditions for all non-SES staff.

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

Remuneration

Pay rates as at 30 June 2012 are shown in Table 2. These rates were negotiated in the context of the Government's remuneration policy and take account of relevant market rates. AOFM sets a conservative benchmark against financial services organisations using data provided by the Financial Institutions Remuneration Group. These data cover a wide range of public and private sector financial institutions, including banks, corporate treasuries and State debt management agencies. AON Hewitt provided independent advice in applying the data to the AOFM.

Table 2: AOFM salary ranges

Classification	30 June 2012 Band Low $	Band High $
AOFM1	37,445	71,509
AOFM2	64,834	139,070
AOFM3	162,117	202,646
AOFM4	218,041	272,551

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 studies assistance, short courses and payment of job-relevant professional society membership fees. A mobile phone, Blackberry, laptop, or other mobile device may be provided where there is a business need. Executive remuneration is reported in Note 12 of Part 4: Financial statements.

Work health and safety

Health, wellbeing and safety services are provided by the Department of The Treasury under a Service Level Agreement. The AOFM has one Health and Safety Representative who assists employees in accord with the *Work Health and Safety Act 2011*.

In March 2012, AOFM went to the market for specialist expertise in work health and safety as part of due diligence under the *Work Health and Safety Act 2011*. Providers were asked to conduct a risk assessment of our Canberra operations with a view to having appropriate systems in place to comply with the *Work Health and Safety Act 2011*. This was to include an assessment of hazards and their associated risks and risk management. David Segrott of Australian Health and Safety Services Pty Ltd conducted a physical inspection of the AOFM premises, reviewed our extant work health and safety policies, and interviewed all senior managers.

The final report was submitted in early June 2012 and it was circulated to all AOFM Executive members. All recommendations have been considered and, where appropriate, action has been taken.

All AOFM Executive members have been briefed on work health and safety due diligence. Work health and safety is a standing item on the Executive Group Agenda.

The AOFM established an online resource for work health and safety concerns that allows all staff to see issues that are raised and actions taken. Material Safety Data Sheets are also posted here.

Consultation with AOFM workers is ongoing for AOFM employees. Cooperation and coordination between AOFM and other Persons Conducting a Business or Undertaking (PCBUs) is in its early phases.

Staff members have access to a number of ongoing health activities, including health-related educational seminars, outdoor fitness programs, and other exercise classes. Flu vaccinations, health assessments, and dietary assistance were also provided in 2011-12. Counselling and other support is available under an Employee Assistance Program provided by PPC Worldwide.

There were no compensable injury claims in 2011-12.

Up to December 2011, the AOFM was not the subject of any directions under section 45 of the *Occupational Health and Safety Act 1991* and received no notices under that Act. From 1 January 2012, there have been no notices or investigations under part 10 of the *Work Health and Safety Act 2011.*

Changes to disability reporting in annual reports

Since 1994, Commonwealth departments and agencies 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, departments and agencies are no longer required to report on these functions.

The Commonwealth Disability Strategy has been overtaken by a new National Disability Strategy which sets out a ten year national policy framework for improving life for Australians with disability, their families and carers. A high level report to track progress for people with disability at a national level will be produced by the Standing Council on Community, Housing and Disability Services to the Council of Australian Governments and will be available at www.fahcsia.gov.au. The Social Inclusion Measurement and Reporting Strategy agreed by the Government in December 2009 will also include some reporting on disability matters in its regular *How Australia is Faring* report and, if appropriate, in strategic change indicators in agency Annual Reports. More detail on social inclusion matters can be found at www.socialinclusion.gov.au.

Consultants

During 2011-12, seven new consultancy contracts were entered into involving total actual expenditure of $106,910. In addition, three ongoing consultancy contracts were active during 2011-12 year, involving total actual expenditure of $239,480. This is summarised in Table 3.

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 www.tenders.gov.au.

The AOFM engages consultants where it lacks specialist expertise or when independent research, review or assessment is required. Consultants are typically engaged to investigate or diagnose a defined issue or problem; carry out defined reviews or evaluations; or provide independent advice of a specific nature.

Prior to engaging consultants, the AOFM takes into account the skills 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 FMA Act and related regulations including the *Commonwealth Procurement Guidelines (CPGs)* and relevant internal policies.

Table 3: Consultancy contracts

	2009-10	2010-11	2011-12
Number of consultancy contracts			
New contracts	4	12	7
Ongoing contracts	2	2	3
Expenditure (including GST)			
New contracts	$90,801	$319,000	$106,910
Ongoing contracts	$119,276	$159,905	$239,480

Purchasing

The AOFM's purchasing activities are carried out to comply with legislative requirements and Government policy, in particular the *Commonwealth Procurement Guidelines (CPGs)* (December 2008).

The CPGs are applied to AOFM's activities through the Chief Executive's Instructions and supporting internal policy and procedural documentation.

ANAO access clauses and exempt contracts

Two contracts were let during the reporting period in excess of $100,000 that did not provide for the Auditor-General to have access to the contractor's premises. One contract was for the syndicated issuance of $3.25 billion of Australian Government debt in October 2011. The AOFM appointed Deutsche Bank AG (Sydney Branch), Citigroup Global Markets Australia and UBS AG (Australia Branch) as Joint-Lead Managers for the issue. The AOFM appointed ANZ Banking Group, Commonwealth Bank of Australia and Westpac Banking Corporation as Co-Managers for the issue. The second contract was for the syndicated issuance of $0.90 billion of Australian Government debt in February 2012. The AOFM appointed Deutsche Bank AG, Merrill Lynch International (Australia) Limited, The Royal Bank of Scotland plc Australia Branch and UBS AG (Australia Branch) 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 issuance. Under these contracts, $6.848 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*.

FINANCIAL STATEMENTS

Australian National
Audit Office

INDEPENDENT AUDITOR'S REPORT

To the Treasurer

I have audited the accompanying financial statements of the Australian Office of Financial Management for the year ended 30 June 2012, which comprise: a Statement by the Chief Executive Officer and Chief Finance Officer; Statement of comprehensive income; Balance sheet; Statement of changes in equity; Statement of cash flows; Schedule of commitments; Administered schedule of comprehensive income; Administered schedule of assets and liabilities; Administered reconciliation schedule; Administered schedule of cash flows; Administered schedule of commitments; and Notes to and forming part of the Financial statements, comprising a Summary of significant accounting policies; and other explanatory information.

Chief Executive's Responsibility for the Financial Statements

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

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 Australian Office of Financial Management's preparation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Australian Office of Financial Management's internal control.

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An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of accounting estimates made by the Chief Executive of the Australian Office of Financial Management, as well as evaluating the overall presentation of the financial statements.

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

Independence

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

Opinion

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

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

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

Australian National Audit Office

Michael J Watson

Michael J Watson
Group Executive Director

Delegate of the Auditor-General

Canberra

20 August 2012

AUSTRALIAN OFFICE OF FINANCIAL MANAGEMENT

Statement by the Chief Executive Officer and Chief Finance Officer

In our opinion, the attached financial statements for the year ended 30 June 2012 are based on properly maintained financial records and give a true and fair view of the matters required by the Finance Minister's Orders made under the *Financial Management and Accountability Act 1997,* as amended.

Signed	Signed
R Nicholl Chief Executive Officer 20 August 2012	P Raccosta Chief Finance Officer 20 August 2012

Statement of comprehensive income

for the period ended 30 June 2012

	Notes	2012 $'000	2011 $'000
EXPENSES			
Employee benefits	4A	**6,305**	5,591
Supplier expenses	4B	**3,625**	5,866
Depreciation and amortisation	4C	**354**	315
Write-down and impairment of assets	4D	**13**	14
Total expenses		**10,297**	11,786
LESS:			
OWN-SOURCE INCOME			
Revenue:			
Sale of goods and rendering of services	5A	**523**	583
Other revenue	5B	**487**	483
Total own-source revenue		**1,010**	1,066
Gains:			
Reversal of previous asset write-downs	5C	**15**	-
Total gains		**15**	-
Total own-source income		**1,025**	**1,066**
Net cost of services		**9,272**	10,720
APPROPRIATION FUNDING			
Revenue from government	5D	**12,413**	15,896
Total appropriation funding		**12,413**	15,896
Comprehensive income		**3,141**	5,176

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

Balance sheet
as at 30 June 2012

	Notes	**2012 $'000**	2011 $'000
ASSETS			
Financial assets:			
Cash and cash equivalents		**100**	100
Receivables	6A	**25,726**	18,801
		25,826	18,901
Non-financial assets:			
Infrastructure, plant and equipment	7A,7C	**550**	577
Intangibles	7B,7C	**289**	430
Other non-financial assets	7D	**57**	140
		896	1,147
Total assets		**26,722**	20,048
LIABILITIES			
Payables:			
Supplier payables	8A	**473**	317
Other payables	8B	**165**	141
		638	458
Provisions:			
Employee provisions	9A	**1,702**	1,381
Other provisions	9B	**136**	133
		1,838	1,514
Total liabilities		**2,476**	1,972
Net assets		**24,246**	18,076
EQUITY(a)			
Retained surplus		**19,721**	16,580
Contributed equity		**4,525**	1,496
Total equity		**24,246**	18,076

The above statement should be read in conjunction with the accompanying notes.
(a) Refer to the Statement of changes in equity.

Statement of changes in equity

for the period ended 30 June 2012

	2012	2011
	$'000	$'000
RETAINED SURPLUS		
Opening balance	**16,580**	11,404
Changes for period:		
Comprehensive income	**3,141**	5,176
Total retained surplus	**19,721**	16,580
CONTRIBUTED EQUITY		
Opening balance	**1,496**	1,246
Changes for period:		
Contributions by government:		
Capital injection - departmental capital budget	**3,029**	250
Distributions to owners:		
Return of capital	**-**	-
Total contributed equity	**4,525**	1,496
Total equity	**24,246**	18,076

Statement of cash flows

for the period ended 30 June 2012

	Notes	**2012 $'000**	2011 $'000
OPERATING ACTIVITIES			
Cash received:			
Ordinary appropriations		**9,022**	11,270
GST received		**12**	194
Goods and services(a)		**711**	804
Cash used:			
Employees		**(5,953)**	(5,674)
Suppliers		**(3,067)**	(5,767)
GST paid		**(14)**	(13)
Transfers to Official Public Account(a)		**(711)**	(804)
Net cash from (used by) operating activities	10	**-**	10
INVESTING ACTIVITIES			
Cash used:			
Purchase of property, plant and equipment		**(198)**	(430)
Net cash from (used by) investing activities		**(198)**	(430)
FINANCING ACTIVITIES			
Cash received:			
Appropriations - contributed equity		**198**	430
Net cash from (used by) financing activities		**198**	430
Net increase (decrease) in cash held		**-**	10
Plus cash held at the beginning of the reporting period		**100**	90
Cash at the end of the reporting period	10	**100**	100

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

(a) Non-appropriation receipts are required to be returned to the Official Public Account. They increase the AOFM's available appropriation under section 31 of the *Financial Management and Accountability Act 1997* and when subsequently drawn down for use by the AOFM they are recorded as ordinary appropriations.

Schedule of commitments

as at 30 June 2012

	2012	2011
	$'000	$'000
BY TYPE		
Commitments payable:		
Operating leases(a)	**1,170**	1,499
Other commitments(b)	**1,816**	2,574
	2,986	4,073
Commitments receivable:		
GST recoverable on commitments	**(1)**	(42)
	(1)	(42)
Net commitments by type	**2,985**	4,031
BY MATURITY		
Commitments payable:		
Operating leases:		
One year or less	**328**	328
From one to five years	**842**	1,171
Over five years	**-**	-
	1,170	1,499
Other commitments:		
One year or less	**1,242**	1,868
From one to five years	**574**	706
Over five years	**-**	-
	1,816	2,574
Commitments receivable:		
GST recoverable on commitments:		
One year or less	**(1)**	(42)
From one to five years	**-**	-
Over five years	**-**	-
	(1)	(42)
Net commitments by maturity	**2,985**	4,031

Note: Commitments are GST inclusive and where an input tax credit is available to the AOFM, the recoverable GST is reported in commitments receivable.

(a) Operating leases are effectively non-cancellable and comprise:

Nature of lease	General description of leasing arrangement
Lease for office accommodation	• The lease term is for 15 years less one day with no option to renew and lease payments are subject to review on each second anniversary of the lease commencement date (22 December 2000).
Motor vehicle leases	• The novation of lease rental payments over motor vehicles.

(b) Other commitments relate to contractual obligations for the provision of consultancies, payroll services, market data and news services, fiscal agency agreements and service agreements with other parties, including Commonwealth bodies.

Administered schedule of comprehensive income

for the period ended 30 June 2012

	Notes	2012 $'000	2011 $'000
Income before re-measurements			
Interest revenue	16A	**1,412,392**	1,375,603
Other revenue	16B	**270**	243
Total income before re-measurements		**1,412,662**	1,375,846
Expenses before re-measurements			
Grants	17A	**23**	26
Interest expense	17B	**11,413,881**	9,272,857
Supplier expenses	17C	**6,992**	-
Total expenses before re-measurements		**11,420,896**	9,272,883
Gains (losses) before re-measurements			
Net foreign exchange gains (losses)	18A	**(254)**	1,299
Net gains (losses) on sale of financial instruments	18B	**(8,229)**	208
Total gains (losses) before re-measurements		**(8,483)**	1,507
Operating result before re-measurements		**(10,016,717)**	(7,895,530)
Re-measurements			
Net market revaluation gains (losses)	19	**(20,565,780)**	325,857
Total re-measurements		**(20,565,780)**	325,857
Comprehensive income		**(30,582,497)**	(7,569,673)

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

Administered schedule of assets and liabilities

as at 30 June 2012

	Notes	2012 $'000	2011 $'000
ASSETS			
Financial assets:			
Cash and cash equivalents		**622**	622
Investments (under FMA section 39)(a)	20A	**25,576,490**	25,031,377
Receivables	20B	**2,540,531**	2,618,174
Accrued revenue	20C	**444**	456
Total administered assets		**28,118,087**	27,650,629
LIABILITIES			
Interest bearing liabilities:			
Commonwealth Government Securities	21A	**269,785,350**	201,770,418
		269,785,350	201,770,418
Payables:			
Accrued expenses	21B	**93**	93
		93	93
Total liabilities		**269,785,443**	201,770,511
Net assets		**(241,667,356)**	(174,119,882)

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

(a) FMA = *Financial Management and Accountability Act 1997*.

Administered reconciliation schedule
for the period ended 30 June 2012

	2012 $'000	2011 $'000
Opening administered assets less administered liabilities	**(174,119,882)**	(123,970,319)
Administered income and expenses		
Administered income before re-measurements	**1,412,662**	1,375,846
Administered gains (losses) before re-measurements	**(8,483)**	1,507
Administered expenses before re-measurements	**(11,420,896)**	(9,272,883)
Re-measurements - net market revaluation gains (losses)	**(20,565,780)**	325,857
Administered transfers (to) from Australian Government:		
Special appropriations (unlimited)	**1,154,358,608**	386,835,783
Transfers to OPA	**(1,191,323,494)**	(429,415,601)
Change in special account balance	**(91)**	(72)
Closing administered assets less administered liabilities	**(241,667,356)**	(174,119,882)

Administered schedule of cash flows
for the period ended 30 June 2012

	Notes	2012 $'000	2011 $'000
OPERATING ACTIVITIES			
Cash received:			
Interest receipts		**1,424,742**	1,412,267
Other(a)		**3,642**	243
GST refunds		**509**	-
Cash used:			
Interest payments		**(11,031,801)**	(9,497,554)
Other(a)		**(3,371)**	-
Net cash from (used by) operating activities	22	**(9,606,279)**	(8,085,044)
INVESTING ACTIVITIES			
Cash received:			
Capital proceeds from deposits		**1,063,850,000**	285,500,000
Capital proceeds from discount securities		**5,800,043**	10,391,367
Capital proceeds from fixed interest securities		**-**	4,345,966
Capital proceeds from residential mortgage-backed securities		**1,558,683**	1,438,640
Repayments from advances and loans		**97,873**	95,727
Cash used:			
Acquisition of deposits		**(1,067,700,000)**	(281,200,000)
Acquisition of discount securities		**(2,229,108)**	(9,726,974)
Acquisition of fixed interest securities		**-**	(788,706)
Acquisition of residential mortgage-backed securities		**(1,930,043)**	(4,349,220)
Net cash from (used by) investing activities		**(552,552)**	5,706,800
FINANCING ACTIVITIES			
Cash received:			
Capital proceeds from borrowings		**117,992,348**	119,320,219
Proceeds from repurchase transactions		**-**	6,209,459
Other receipts		**755**	1,331
Cash used:			
Repayment of borrowings(b)		**(70,869,295)**	(74,363,416)
Repayment of repurchase transactions		-	(6,209,459)
Net cash from (used by) financing activities		**47,123,808**	44,958,134
TRANSACTIONS WITH OPA			
Cash received from Official Public Account:			
Appropriations		**1,154,358,560**	386,835,735
Special accounts		**712**	1,307
Cash used from Official Public Account:			
Appropriations		**(1,191,323,494)**	(429,415,601)
Special accounts		**(755)**	(1,331)
Net cash from (to) official public account		**(36,964,977)**	(42,579,890)
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

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

(a) Includes interest coupons on Treasury Bonds issued to bond market participants under the AOFM's securities lending facility.

(b) Includes redemption of debt issued on behalf of the States.

Administered schedule of commitments

as at 30 June 2012

	2012 $'000	2011 $'000
BY TYPE		
Commitments payable:		
Other commitments(a)	**335**	-
	335	-
Commitments receivable:		
Other commitments(a)	**(23)**	-
	(23)	-
Net commitments by type	**312**	-
BY MATURITY		
Commitments payable:		
Other commitments:		
One year or less	**335**	-
	335	-
Commitments receivable:		
Other commitments:		
One year or less	**(23)**	-
	(23)	-
Net commitments by maturity	**312**	-

(a) As at 30 June 2012 the AOFM had no open transactions under its securities lending facility (30 June 2011: nil).

Notes to and forming part of the financial statements

for the period ended 30 June 2012

Note 1: Summary of significant accounting policies

1.1 Basis of preparation of the financial statements

The Australian Office of Financial Management (AOFM), a 'prescribed agency' under the *Financial Management and Accountability Act 1997* (Commonwealth), 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 2011 to 30 June 2012. They are required by section 49 of the *Financial Management and Accountability Act 1997*, and are general purpose financial statements prepared on a going concern basis.

The financial statements have been prepared in accordance with:

- the Finance Minister's Orders (FMOs) for financial reporting (being the *Financial Management and Accountability Orders* (Financial Statements for Reporting Periods Ending on or after 1 July 2011) made under section 63 of the *Financial Management and Accountability Act 1997*);

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

- other authoritative pronouncements of the AASB, which includes the *Framework for the Preparation and Presentation of Financial Statements*.

Since 2005 the AASB has adopted International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) for the purposes of setting Australian Accounting Standards. In some instances the Australian Accounting Standards are modified for the private and public not-for-profit sectors.

The financial statements have been prepared on an accruals basis under the historic cost accounting convention, as modified by the revaluation of certain classes of financial assets and financial liabilities, certain classes of infrastructure, plant and equipment and employee entitlements.

The financial statements are presented in Australian dollars, and values are rounded to the nearest thousand dollars unless disclosure of the full amount is specifically required by the FMOs.

Liabilities and assets which are unrecognised in the Agency Balance Sheet or the Administered Schedule of Assets and Liabilities are reported in Note 11 (departmental) and Note 23 (administered).

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

Subject to one exception, no accounting assumptions or estimates have been identified that have a significant risk of causing a material adjustment to carrying amounts of assets and liabilities within the next reporting period. The residential mortgage-backed securities (RMBS) held by the AOFM are fully amortising instruments. The repayment of principal on each RMBS security is dependent on the payment priorities set out in the issuance documentation and the timing of principal repaid on each RMBS security may vary over its life and cannot be precisely forecast. For valuation purposes, the repayment profile is estimated to produce a weighted average life for each security. The weighted average life represents a measure of the estimated point in time in which a holder of a security will receive (in undiscounted terms) repayment of 50 per cent of the principal invested. The weighted average life of each security is estimated, including on the basis of actual repayment history where available. The estimated weighted average life is an important factor in the valuation of RMBS securities.

1.3 Statement of compliance with International Financial Reporting Standards

In some circumstances compliance with Australian Accounting Standards will not lead to compliance with International Financial Reporting Standards. Paragraph 16 of AASB 101 *Presentation of Financial Statements* requires that where an entity's financial statements comply with International Financial Reporting Standards, then such compliance shall be made in an explicit and unreserved statement in the notes to the financial statements.

These financial statements and associated notes do not fully comply with International Financial Reporting Standards, due to the application of not-for-profit provisions in AASB 116 *Property, Plant and Equipment* relating to the accounting treatment arising from revaluations.

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

The AOFM would need the Finance Chief Executive's approval to apply a new Australian Accounting Standard prior to its mandatory application date, unless it was adopted early in the FMOs.

During 2011-12 the AOFM adopted all applicable Australian Accounting Standards that became effective during 2011-12. These pronouncements did not have a material impact on the amounts reported for the current and prior years.

(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 9 *Financial Instruments* (effective for the 2015-16 financial year) the revisions are not expected to materially affect the accounting treatment of the AOFM's assets, liabilities, revenue or expenses.

AASB 9 Financial Instruments

The IASB has been progressively replacing the current standard for the measurement and recognition of financial instruments (IAS 39 *Financial Instruments: Recognition and Measurement* (in Australia AASB 139)) with a new standard IFRS 9 *Financial Instruments* (in Australia AASB 9).

IFRS 9/AASB 9 currently contains the requirements for the recognition and measurement of financial assets and liabilities and their derecognition. The requirements for amortised cost and impairment and hedge accounting are expected to be incorporated into the standard at a later stage.

Financial assets

Currently, the AOFM classifies its administered financial assets into the following categories: financial assets at fair value through profit or loss; and loans and receivables (which requires measurement at amortised cost). The AOFM determines which classification applies to each class of financial assets on the basis of how it manages the assets and assesses the performance of the financial assets. Where the AOFM's management monitors cost and risk in mark-to-market terms (and not necessarily only in those terms) the AOFM designates the relevant financial assets at fair value through profit or loss.

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 rules for determining the accounting treatment for financial assets. AASB 9 requires that a financial asset is to be carried at fair value through profit or loss, except 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, and in which case the financial asset is to be carried at amortised cost. 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 would not represent a change of purpose from one of collection of contractual cash flows to one of trading to earn capital profits.

Under AASB 9, derivatives are deemed to be held for trading to earn capital profits, and accordingly must be carried at fair value through profit or loss.

From a preliminary examination, the AOFM has assessed that all of its non-derivative financial assets may need to be carried at amortised cost under the new standard. AASB 9 has retrospective application, and accordingly on the first day of the reporting period that AASB 9 becomes operational (1 July 2015 for the 2015-16 financial year) the AOFM would need to re-state its financial asset values as at 30 June 2014 and 30 June 2015 and disclose the financial impact of the change in accounting treatment and make other transition disclosures required by AASB 9.

The financial impact of the change cannot currently be quantified.

Financial liabilities

Currently, the AOFM classifies its financial liabilities into the following categories: financial liabilities at fair value through profit or loss; and other financial liabilities (which requires measurement at amortised cost). The AOFM determines which classification applies to each class of financial liability on the basis of how it manages and assesses the performance of the financial liability.

All of the AOFM's administered financial liabilities, with the exception of debt on allocation to the State and Northern Territory Governments, are designated at fair value through profit or loss. Debt on allocation to the State and Northern Territory Governments are measured at amortised cost.

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 financial liabilities it is holding when AASB 9 becomes operative.

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. 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), unless such a presentation would create or enlarge an accounting mismatch.

1.4 Departmental and administered 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 *Financial Management and Accountability Act 1997*; 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 to support competition in the residential mortgage market and to meet government policy objectives.

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

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

1.5 Revenue (Departmental)

The revenue described in this note is revenue relating to the departmental activities of the AOFM.

(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 lapsed.

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. Other revenue includes amounts received and receivable for salary packaging arrangements for staff and transfers of annual leave and long service leave entitlements from other government agencies.

1.6 Transactions with the Government as owner (Departmental)

(a) Equity injections

Amounts which are designated as 'equity injections' for a year (less any formal reductions) are recognised directly in Contributed Equity in the Balance Sheet in the financial year that the appropriation takes effect.

Appropriation receivables are recognised (at their nominal amounts) for equity injections that have not been drawn by the AOFM and have not lapsed.

For 2011-12 the AOFM received a capital injection of $3.029 million (2010-11: $0.250 million) under the Government's 'net cash appropriation framework'. Under this framework, the AOFM is provided with capital funding in the form of an equity injection for the replacement of departmental infrastructure, plant and equipment and computer software.

(b) Distributions to owners

Distributions to owners are deducted from Contributed Equity in the Balance Sheet unless the distributions are in the nature of a dividend. Dividends are deducted from Retained Surplus in the Balance Sheet. No distributions to owners were made in 2011-12 (2010-11: $nil).

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 all 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.

The AOFM obtains advice from the Australian Government Actuary on the valuation of its leave liabilities. Leave liabilities are calculated on the basis of employees' remuneration at the end of the financial year adjusted for expected increases in remuneration effective from 1 July.

Liabilities for annual leave are measured at the nominal amount required to settle the obligation.

All long service leave employee benefits 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 of the long service leave liability, the AOFM commissions an annual actuarial assessment by the Australian Government Actuary of the anticipated attrition rates and pay increases through promotion and inflation. The Australian Government Actuary has recommended the application of the shorthand method, as prescribed by the FMOs, for determining the present value of the long service leave liability.

(c) Superannuation

Staff and contractors of the AOFM contribute 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.

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 Deregulation and is settled by the Australian Government in due course. This defined benefit liability is reported by the Department of Finance and Deregulation as an administered item. 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 in the Balance Sheet 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)

A distinction is made between finance leases and operating leases. Finance leases effectively transfer from the lessor to the lessee substantially all risks and benefits incidental to ownership of leased non-current assets. Under operating leases the lessor effectively retains substantially all such risks and benefits.

The AOFM holds operating leases only. Operating lease payments are charged as an expense on a straight-line basis over the lease term.

1.9 Cash (Departmental)

Cash means notes and coins held and any deposits held at call with a bank. Deposits held with a bank that are not at call are classified as investments. Cash is recognised at its nominal amount.

1.10 Financial instruments (Departmental)

The AOFM recognises a financial asset or financial liability on its Balance Sheet when and only when it becomes a party to the contractual provisions of the instrument. A financial asset is de-recognised when the right to receive cash flows from the financial asset has expired or substantially all 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 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 Official Public Account (OPA) for undrawn departmental appropriations are not financial instruments as they are not contractually based.

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

All 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.

1.11 Infrastructure, plant and equipment (Departmental)

(a) Asset recognition threshold on acquisition

Purchases of infrastructure, plant and equipment are recognised initially at cost in the Balance Sheet, except for purchases costing less than $500, 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

Basis

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, in accordance with AASB 116 *Property, Plant and Equipment*.

Fair value has been determined as depreciated replacement cost for leasehold improvements and 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 of the same asset class. Revaluation decrements for a class of assets are recognised as an expense directly through the Statement of Comprehensive Income except to the extent that they reverse a previous revaluation increment for that class. Upon disposal, any revaluation reserve relating to the asset sold is transferred to Retained Surplus.

For all assets, excluding leasehold improvements, any accumulated depreciation or amortisation as at the revaluation date is eliminated against the gross carrying amount of the asset. For leasehold improvements, accumulated amortisation on revaluation is restated proportionately in accordance with the gross carrying amount of the asset.

Frequency

Infrastructure, plant and equipment assets are formally revalued every three years. All infrastructure, plant and equipment assets were revalued as at 31 March 2012.

Assets acquired after the commencement of a revaluation are not captured by the revaluation.

Conduct

All valuations are conducted by an independent qualified valuer.

(c) Impairment

All infrastructure, plant and equipment assets were assessed for impairment at the end of the financial year. No allowance for impairment was required.

(d) Depreciation

The depreciable value of infrastructure, 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 infrastructure, 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 an asset 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	**2012**	2011
Leasehold improvements	lease term	lease term
Computers	3-5 years	3-5 years
Office equipment	5 years	5 years
Furniture	10 years	10 years

The aggregate amount of depreciation allocated to each class of asset during the reporting period is disclosed at Note 4C.

1.12 Computer software (Departmental)

Purchases of computer software are recognised at cost in the Balance Sheet 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 five years (2010-11: three to five years). Software assets are carried at cost and are not subject to revaluation.

An impairment assessment was made as at the end of the financial year and an impairment allowance was not required.

1.13 Taxation (Departmental)

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

Revenue, expenses, assets and liabilities are recognised net of GST, except:

- where the amount of GST incurred is not recoverable from the Australian Taxation Office; and
- for receivables and payables (where GST is applicable).

Receipts and payments in the Statement of Cash Flows are recorded at their GST inclusive amounts.

All supplies provided by the AOFM are input taxed under the GST legislation, except for remuneration benefits provided to staff and staff secondments in Australia. In accordance with applicable GST regulations the AOFM is entitled to a reduced input tax credit (equal to 75 per cent of the GST paid) on some purchases, such as security transaction services, which are applied in making input taxed supplies.

1.14 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.

1.15 Exemption from FMOs

Section 17.2 of the FMOs provides an exemption to the AOFM from presenting its Administered Statement of Comprehensive Income, and associated notes, in accordance with the Annexure to the FMOs. Instead, the AOFM is required to comply with AASB 101 *Presentation of Financial Statements* for presenting its Administered Schedule of Comprehensive Income.

Paragraph 85 of AASB 101 encourages reporting entities to adopt a presentation for reporting revenue and expenses that is most relevant to users in understanding the entity's financial performance.

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:

- operating result before re-measurements; and
- re-measurements.

The category 'operating result 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 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 financial liability is bought back 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 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.

1.16 Recognition and de-recognition of financial instruments

The AOFM recognises a financial asset or financial liability in its Administered Schedule of Assets and Liabilities 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 and substantially all 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.

1.17 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. See Note 24A for further details of the AOFM's financial instrument categories.

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) Non-derivative financial assets at fair value through profit or loss

This category comprises short-term Australian dollar denominated deposits, negotiable certificates of deposit and Australian dollar denominated semi-government bonds and residential mortgage-backed securities. Under section 39(2) of the *Financial Management and Accountability Act 1997*, the AOFM invests public money for the purpose of managing the balance of the OPA , to smooth debt issuance between financial years (by undertaking debt issuance earlier than would otherwise be required and investing the proceeds in highly liquid assets until required) and to support the residential mortgage market.

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 in the Administered Schedule of Comprehensive Income. Where a security is acquired 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 asset. The premium or discount is amortised over the life of the security using the effective interest rate method and 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 in the Administered Schedule of Comprehensive Income.

(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. The AOFM classifies a financial asset as a loan and receivable (as opposed to a financial asset at fair value through profit or loss) in circumstances where the cost and risk of the asset are not being monitored in mark-to-market terms.

Currently, this category comprises debt on allocation to, and advances made to, the State and Northern Territory Governments.

Until July 1990, the Australian Government borrowed on behalf of the State and Northern Territory Governments and allocated a portion of the proceeds of its Treasury Bond raisings to those Governments to fund the redemption of previous allocations of raisings. Until 1986, the Australian Government also borrowed on behalf of the State and Northern Territory Governments to raise new borrowings. In addition to Treasury Bond allocations, there are outstanding balances on stock issued by the States prior to 1 January 1924 and taken over by the Australian Government in 1927 (under the original *Financial Agreement Act*). The States and the Northern Territory are responsible for meeting all obligations as to interest and principal on the debt on allocation to them in accordance with the provisions of the *Financial Agreement Act 1994* (the current agreement). As at 30 June 2012 approximately $8 million of perpetual debt with no fixed maturity date issued by New South Wales and Victoria remained outstanding under the arrangements governed by the *Financial Agreement Act 1994* (30 June 2011: $9 million). All other debt has been redeemed. Redemption of the perpetual debt is at the discretion of the relevant State.

In addition to debt governed by the *Financial Agreement Act 1994*, from 1945 to 1989 the Australian Government made 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). The principal value of these advances outstanding (for which the AOFM is responsible for administering) was $2,875 million as at 30 June 2012 (30 June 2011: $2,973 million).

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

For financial assets measured at amortised cost, interest revenue earned but not yet received is recognised in Accrued Revenue in the Administered Schedule of Assets and Liabilities.

(c) Non-derivative financial liabilities at fair value through profit or loss

Currently this category comprises all Commonwealth Government Securities (CGS) debt with the exception of debt on allocation to State and Northern Territory Governments and overdues. CGS 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 in the Administered Schedule of Comprehensive Income. 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 in the Administered Schedule of Comprehensive Income.

For Treasury Indexed Bonds, the principal value appreciates over time with the rate of inflation (in line with a six-month lagged consumer price index). As future inflation rates are uncertain, an estimate of the Australian Government's future redemption cost on maturity is not disclosed in the financial statements. Capital accretion is recognised in Interest Expense over time.

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

(d) Other non-derivative financial liabilities

This category comprises 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 method. Changes in carrying value are recognised in Interest Expense in the Administered Schedule of Comprehensive Income.

For financial liabilities measured at amortised cost, interest incurred but not yet paid is recognised as Accrued Expenses in the Administered Schedule of Assets and Liabilities.

1.18 Fair value estimation of financial instruments

Where a financial instrument is traded in an active market, fair value is based on quoted market rates 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. 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.

Fair value is synonymous with market value and represents the estimated exchange equivalent price using relevant inputs from reference markets and valuation techniques. Fair value is determined on the presumption that the reporting entity is a going concern and is operating in an active market under normal conditions, without any intention or need to liquidate, curtail materially the size of its activities or undertake transactions on adverse terms.

(a) Non-derivative financial instruments at fair value

The fair value of Treasury Bonds is based on discounted cash flows using a zero coupon curve valuation methodology created from observable market rates. The zero coupon curve is based on market yields of the most liquid Treasury Bond lines as at the end of the financial year.

The fair values of Treasury Indexed Bonds are based on observable market quotes for each issue.

The fair values of domestic semi-government debt investments are based on observable market quotes for each issue.

The fair value of term deposit investments with the 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. The valuation approach for Treasury Notes is largely equivalent.

The fair value of short-term marketable securities is based on a zero coupon curve using the overnight cash rate and bank bill swap rates.

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.

As the secondary market for the Australian Government's foreign currency denominated debt is largely illiquid, the valuation approach for foreign currency denominated debt is based on deposit and swap rates in each relevant foreign currency.

1.19 Other significant administered accounting policies

(a) Revenue

All administered revenue is revenue relating to the activities performed by the AOFM on behalf of the Australian Government.

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

Net interest earnings on securities lending transactions are reported as revenue when received.

(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 as grants expenses as and when they fall due and payable.

(c) Borrowing costs

In accordance with section 21.1 of the FMOs borrowing costs are expensed as incurred. Under AASB 123 *Borrowing Costs*, borrowing costs directly attributable to a qualifying asset may be capitalised or expensed. A qualifying asset is an asset that takes a substantial period of time to get ready for its intended use or sale. The AOFM's borrowing program does not specifically raise funds for qualifying assets.

(d) Cash

The AOFM maintains a number of administered operational bank accounts with the RBA. Interest is not paid on these accounts. Deposits are recognised at their nominal amounts.

(e) 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 market 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 the market.

The securities lending facility operates by entering into two simultaneous repurchase agreements with the party wishing to borrow securities — a repurchase agreement (the sale of securities to the party and agreement to buy them back at a future time at an agreed price) and a reverse-repurchase agreement (the purchase of securities from the party and agreement to sell them back at a future time at an agreed price). The net effect of these two transactions is that the Australian Government holds securities as collateral, and not cash, for securities loaned to bond market participants.

The exchange of securities is market value matched subject to a 2 per cent initial margin imposed by the AOFM for credit risk mitigation purposes. There is provision for making margin calls after initial exchange where the securities pledged as collateral by the other party fall in value relative to the Treasury Bonds or Treasury Indexed Bonds loaned under the facility. The repurchase and reverse-repurchase agreements are at-call, that is, they do not have set terms.

Interest is payable under the facility where lending is overnight. Interest is not payable on intra-day lending. The interest rate payable by the other party is the RBA target cash rate. The interest rate payable by the AOFM is the target cash rate less a margin. Net interest earnings of the Australian Government are reported as revenue when received. The temporary sale of CGS under the facility is recorded off-balance sheet. See Note 26 for details of transactions undertaken during the financial year under the facility.

(f) Repurchase agreements

The AOFM has established Global Master Repurchase Agreements with a number of members of its investment facility dealing panel for the purpose of entering into repurchase transactions on financial assets that it holds (primarily semi-government bonds).

A repurchase transaction involves the sale of a financial asset and agreement to buy it back at an agreed price, at a future date or on demand. The exchange of securities for cash is market value matched. There is provision for repricing in circumstances where the securities fall or rise in value by more than a threshold amount. Interest is payable by the AOFM on the value of cash received at an agreed (fixed) market interest rate set at the time the transaction is struck.

As the AOFM has not transferred the risks and rewards of ownership of the financial asset sold, the financial asset continues to be recorded in the Administered Schedule of Assets and Liabilities and is not de-recognised. See Note 24J for details of repurchase transactions during the financial year.

(g) Foreign currency

Transactions denominated in a foreign currency are converted at the exchange rate at the date of the transaction. Foreign currency receivables and payables are translated at the exchange rates current as at the end of the financial year. Net foreign exchange gains and losses (both realised and unrealised) arising from foreign currency transactions are reported in the Administered Schedule of Comprehensive Income.

Note 2: Objectives and activities of the AOFM

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 projected budget deficits. It also manages the Government's cash in the Official Public Account (OPA) which is surplus to immediate requirements by making investments in term deposits, money market instruments and semi-government bonds. 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.

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 forecast 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 promotional activities with investors (including overseas investors) and intermediaries.

Portfolio management

The cost and risk of the debt portfolio is managed through debt issuance and investment activities.

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 and buys short-dated securities.

The OPA is recorded in the Department of Finance and Deregulation's financial statements and is not reported by the AOFM. The AOFM holds continuing balances of short-term assets to allow it to respond flexibly and quickly to swings in cash requirements.

Investments in residential mortgage-backed securities

In September 2008, the Government announced that the AOFM would invest up to $4 billion in residential mortgage-backed securities (RMBS) to support competition in the Australian residential mortgage market. In October 2008, this initiative was extended to $8 billion, including $4 billion to be invested in RMBS securities by issuers that were not authorised deposit taking institutions. In November 2009, the Government extended the program by up to an additional $8 billion subject to market conditions. An additional objective of the extended program was to provide support for lending to small business through participating lenders agreeing to direct some of the proceeds received for lending to small business. In December 2010, the Government announced an extension to the program by up to an additional $4 billion (bringing the program to $20 billion) as part of its Competitive and Sustainable Banking Package. In April 2011, the Treasurer issued a direction which limits investments to RMBS issues made by lenders that operate independently of the four major Australian banks.

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* represents the Australian Government's primary vehicle for the creation and issuance of domestic stock, including Treasury Bonds, Treasury Indexed Bonds and Treasury Notes. It also provides a standing authority to the Treasurer to borrow in Australian currency up to a statutory maximum;
  - on 28 June 2012, *Appropriation Act (No.2) 2012-13* received royal assent. The Act includes an amendment to the *Commonwealth Inscribed Stock Act 1911* to increase the legislative limit on borrowing to $300 billion from $250 billion;
- the *Loans Redemption and Conversion Act 1921* gives the Treasurer the power to borrow money necessary for the purpose of paying off, repurchasing or redeeming any loan;
- the *Loans Securities Act 1919* includes provisions relating to overseas borrowings, and provides authority to enter into swaps, securities lending, repurchase agreements and other financial arrangements;
- the *Loans (Temporary Revenue Deficits) Act 1953* gives the Treasurer the power to borrow to meet expected within-year deficits of the Consolidated Revenue Fund. All borrowings raised under the authority of this Act must be repaid in the same financial year;
- the *Financial Agreement Act 1994* formalises debt consolidation and redemption arrangements applying since 1 July 1990 between the Australian Government and the States and Territories; and
- section 39 of the *Financial Management and Accountability Act 1997* 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 comprising interest rate risk, inflation risk, exchange rate risk, refinancing risk, liquidity 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 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 residential mortgage-backed securities 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. Accordingly, the primary measure used to assess cost and return is the accruals basis of accounting under the historic cost accounting convention. Market value measures (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 AOFM manages the interest rate structure of the debt portfolio through the choice of instruments and bond series in issuing debt. 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 holds a fluctuating portfolio of short-term investments and debt securities. Given the short tenor of the financial instruments in this portfolio, the level of interest rate risk is considered to be low.

Residential mortgage-backed securities

Interest earned on the majority of residential mortgage-backed securities 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.

See Note 24B for details of the AOFM's interest rate risk profile.

(b) Inflation risk

The AOFM currently has five series of Treasury Indexed Bonds on issue. These instruments have their principal value indexed against the (all Groups) Australian Consumer Price Index (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) Exchange rate risk

Exchange rate risk arises from debt denominated in foreign currency. Only a small residual amount of such debt remains in the AOFM's portfolio and the AOFM seeks to repurchase this debt when available on acceptable terms. The volume of foreign currency debt remaining is monitored by senior management.

See Note 24C for details of the AOFM's exposure to foreign exchange risk.

(d) Liquidity & 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, by issuing Treasury Notes and by entering into repurchase agreements. The 91-day rolling average balance of the OPA is kept within a limit set by the Treasurer and the Minister for Finance and Deregulation. 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.

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 annual debt issuance strategy the AOFM considers the volume of debt in any one line and the maturity structure (including number of bond lines and maturity gaps between lines) of its debt. The AOFM CEO approves the debt issuance program.

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 24D for details of the maturity profile of AOFM's cash flow obligations arising from its liability position as at year end.

(e) Credit risk

The AOFM's investment activity is made in accordance with legislative limits, delegations and directions from the Treasurer and policies and limits established by the Secretary to the Treasury. Section 39 of the *Financial Management and Accountability Act 1997* and associated regulations specify authorised investments. Directions from the Treasurer 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 approves the individual issuer names eligible for investment and from time to time may impose further restrictions on class and individual issuer exposure limits.

Eligible investments and their limitations are as follows:

Eligible investment classes	**Limits framework**
Securities issued or guaranteed by the Commonwealth, a State or Territory.	Class and individual issuer limits.
AAA rated or equivalent debt securities issued or guaranteed by the government of a foreign country in Australian dollars.	Class and individual issuer limits.
AAA rated or equivalent debt securities issued by a financial institution or supranational in Australian dollars.	Class and individual issuer limits.
Bank accepted bills of exchange and negotiable certificates of deposit rated at least A1 or equivalent issued in Australian dollars by an authorised deposit taking institution, where the remaining term to maturity is no more than 12 months.	Class, credit rating and individual issuer limits.
Commercial paper issued in Australian dollars rated at least A1+ or equivalent where the remaining term to maturity is no more than 12 months.	Class and individual issuer limits.

Eligible investment classes	Limits framework
Deposits with the Reserve Bank of Australia.	No limits apply.
AAA rated or equivalent residential mortgage-backed securities issued in Australia.	A limit of $20 billion invested in face value terms with no single issuer limits.

See Note 24E for details of the AOFM's exposure to credit risk.

Residential mortgage-backed securities (RMBS)

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. At the time of acquisition, each RMBS security must meet a range of eligibility criteria set by the AOFM, including AAA (or equivalent) credit rating by at least two ratings agencies and denomination in Australian dollars. Mortgages backing the securities must be secured by a mortgage insurable prime mortgage over Australian residential property and meet various limits, including mortgage loan size and loan-to-value ratios. Each mortgage pool must be subject to independent review to provide assurance that the eligibility criteria have been met. The AOFM monitors the performance of each RMBS issue through a monthly report by the issuer on mortgage portfolio characteristics. As at 30 June 2012 all RMBS securities held by the AOFM were rated 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 at least 2 per cent greater than the market value of the Treasury Bonds or Treasury Indexed Bonds lent. The AOFM has the right to seek additional collateral if there is a decline in the market value of the collateral securities relative to the lent securities.

With respect to repurchase transactions, if at any time the Australian Government has a net exposure of greater than $1 million in aggregate for all repurchase transaction exposures to a counterparty, the AOFM may require that the net exposure be eliminated by the repricing of the transactions with the counterparty. The AOFM undertakes repurchase transactions only with counterparties that have a short-term credit rating of at least A1 (or equivalent), and with whom the AOFM has an executed Global Master Repurchase Agreement.

(f) Prepayment risk

The majority of RMBS acquired 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.

Principal and interest on the underlying loans are received by the servicer and paid to an issuer bank account. On a scheduled basis, typically monthly, in accordance with a set priority of payments (a 'cash flow waterfall'), the cash collected is used to pay any taxes, fees and expenses of the issuer, and interest and principal due on each class of outstanding RMBS. 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

	2012 $'000	2011 $'000
Note 4A: Employee benefits		
Wages and salaries	**4,929**	4,665
Superannuation	**844**	830
Leave and other entitlements	**293**	(147)
Other employee expenses	**239**	243
Total employee benefits	**6,305**	5,591
Note 4B: Supplier expenses		
ANAO - notional audit fee	**303**	294
Corporate support services	**671**	377
Market data services	**644**	650
Operating lease rentals(a)	**317**	317
Registry, depository and transaction services(b)	**118**	665
Syndicated debt issuance and associated services(b)	**-**	1,952
Travel	**251**	303
Workers compensation premium	**20**	18
Other	**1,301**	1,290
Total supplier expenses	**3,625**	5,866
Supplier expenses are made up of:		
Provision of goods - related entities	**1**	1
Provision of goods - external entities	**42**	41
Provision of services - related entities	**1,504**	1,663
Provision of services - external entities	**2,078**	4,161
	3,625	5,866
Note 4C: Depreciation and amortisation		
Depreciation of infrastructure, plant and equipment:		
Computers, plant and equipment	**119**	97
Leasehold improvements	**79**	67
Amortisation of intangibles:		
Computer software	**156**	151
Total depreciation and amortisation	**354**	315
Note 4D: Write-down and impairment of assets		
Computers, plant and equipment - disposed	**2**	1
Computers, plant and equipment - revaluation decrement	**11**	-
Leasehold Improvements - disposed	**-**	13
Total write-down and impairment of assets	**13**	14
Total expenses	**10,297**	11,786

(a) Amounts relate to minimum lease payments only. Novated lease payments from salary packaging of motor vehicles are disclosed in ‘other employee expenses’.

(b) From 29 June 2011, costs and expenses incurred in relation to issuing and managing debt are made against an administered appropriation.

Note 5: Income

	2012	2011
	$'000	$'000
Note 5A: Sale of goods and rendering of services		
With related entities:		
Staff secondments to other agencies	**523**	583
Total sale of goods and rendering of services	**523**	583
Note 5B: Other revenue		
Resources received free of charge - ANAO audit services	**303**	294
Other	**184**	189
Total other revenue	**487**	483
Note 5C: Gains		
Reversal of previous asset write-downs		
Leasehold improvements	**15**	-
Total gains	**15**	-
Note 5D: Revenue from government		
Appropriations - departmental output	**12,413**	15,896
Total revenue from government	**12,413**	15,896
Total income	**13,438**	16,962

Note 6: Financial assets

	2012 $'000	2011 $'000
Note 6A: Receivables		
With related parties:		
Goods and services	**126**	133
Appropriations receivable(a):		
Output	**21,999**	17,897
Equity injection	**662**	662
Departmental capital budget	**2,937**	106
With external parties:		
Other	**2**	3
Total receivables	**25,726**	18,801
Receivables are expected to be recovered in:		
No more than 12 months	**3,065**	136
More than 12 months	**22,661**	18,665
	25,726	18,801
Receivables are aged as follows:		
Not overdue	**25,726**	18,800
Overdue	**-**	1
	25,726	18,801

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

Note 7: Non-financial assets

	2012 $'000	2011 $'000
Note 7A: Infrastructure, plant and equipment		
Computers, plant and equipment:		
Gross value - at cost	**16**	290
Accumulated depreciation	**(1)**	(105)
	15	185
Gross value - at 2012 valuation (fair value)	**274**	-
Accumulated depreciation	**(32)**	-
	242	-
Gross value - at 2009 valuation (fair value)	**-**	146
Accumulated depreciation	**-**	(100)
	-	46
Under construction	**-**	17
	-	17
	257	248
Leasehold improvements:		
Gross value - at cost	**3**	-
Accumulated depreciation	**-**	-
	3	-
Gross value - at 2012 valuation (fair value)	**1,050**	-
Accumulated depreciation	**(760)**	-
	290	-
Gross value - at 2009 valuation (fair value)	**-**	972
Accumulated depreciation	**-**	(643)
	-	329
	293	329
Total infrastructure, plant and equipment	**550**	577

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

All revaluations are independent and are conducted in accordance with the revaluation policy stated at Note 1.11. In 2011-12, the revaluations were conducted by an independent valuer, the Australian Valuation Office. As at 31 March 2012, a net revaluation increment was made of $4,078 being a revaluation increment of $15,059 for leasehold improvements and a revaluation decrement of $10,981 for computers, plant and equipment. The full value of the revaluation adjustments were recognised in the Statement of Comprehensive Income. As at 30 June 2012, the AOFM had cumulative net revaluation losses of $13,137 for leasehold improvements and $69,850 for computers, plant and equipment which were recognised as expenses in the Statement of Comprehensive Income.

Note 7: Non-financial assets (continued)

	2012 $'000	2011 $'000
Note 7B: Intangibles		
Computer software (purchased):		
Gross value - at cost	**3,335**	3,320
Accumulated amortisation	**(3,046)**	(2,890)
Total intangibles	**289**	430

No indicators of impairment were identified for intangible assets.

The following tables reconcile the opening and closing balances of infrastructure, plant and equipment, and intangible assets.

	Leasehold improvements 2012 $'000	**Computers, plant and equipment** 2012 $'000	**Computer software (purchased)** 2012 $'000	**Total** 2012 $'000
Note 7C: Reconciliation of opening and closing balances				
As at 1 July 2011				
Gross book value	**972**	**453**	**3,320**	**4,745**
Acc depreciation/amortisation	**(643)**	**(205)**	**(2,890)**	**(3,738)**
Net book value 1 July 2011	**329**	**248**	**430**	**1,007**
Additions:				
By purchase	**28**	**141**	**15**	**184**
Depreciation/amortisation charge	**(79)**	**(119)**	**(156)**	**(354)**
Disposals:				
Gross book value	**-**	**(11)**	**-**	**(11)**
Acc depreciation/amortisation	**-**	**9**	**-**	**9**
Revaluation:				
Gross book value	**53**	**(293)**	**-**	**(240)**
Acc depreciation/amortisation	**(38)**	**282**	**-**	**244**
Net book value 30 June 2012	**293**	**257**	**289**	**839**
As at 30 June 2012				
Gross book value	**1,053**	**290**	**3,335**	**4,678**
Acc depreciation/amortisation	**(760)**	**(33)**	**(3,046)**	**(3,839)**
	293	**257**	**289**	**839**

Note 7: Non-financial assets (continued)

	Leasehold improvements	Computers, plant and equipment	Computer software (purchased)	Total
	2011	2011	2011	2011
	$'000	$'000	$'000	$'000
Note 7C: Reconciliation of opening and closing balances (continued)				
As at 1 July 2010				
Gross book value	972	391	3,033	4,396
Acc depreciation/amortisation	(607)	(130)	(2,739)	(3,476)
Net book value 1 July 2010	365	261	294	920
Additions:				
By purchase	44	85	287	416
Depreciation/amortisation charge	(67)	(97)	(151)	(315)
Disposals:				
Gross book value	(44)	(23)	-	(67)
Acc depreciation/amortisation	31	22	-	53
Net book value 30 June 2011	329	248	430	1,007
As at 30 June 2011				
Gross book value	972	453	3,320	4,745
Acc depreciation/amortisation	(643)	(205)	(2,890)	(3,738)
	329	248	430	1,007

	2012	2011
	$'000	$'000
Note 7D: Other non-financial assets		
Prepayments	**57**	140
Total other non-financial assets	**57**	140
Other non-financial assets are expected to be recovered in:		
No more than 12 months	**57**	140
More than 12 months	**-**	-
	57	140

No indicators of impairment were identified for other non-financial assets.

Note 8: Payables

	2012 $'000	2011 $'000
Note 8A: Supplier payables		
With related entities:		
Trade creditors and accruals(a)	**380**	52
With external parties:		
Trade creditors and accruals(a)	**93**	265
Total supplier payables	**473**	317
Supplier payables are expected to be settled in:		
No more than 12 months	**473**	303
More than 12 months	**-**	14
	473	317
Note 8B: Other payables		
Salaries and wages	**137**	108
Superannuation	**23**	18
Tax and other	**5**	15
Total other payables	**165**	141
Other payables are expected to be settled in:		
No more than 12 months	**165**	141
More than 12 months	**-**	-
	165	141

(a) Settlement is usually made net 30 days.

Note 9: Provisions

	2012 $'000	2011 $'000
Note 9A: Employee provisions		
Annual leave	**443**	408
Long service leave	**1,076**	819
Superannuation	**183**	154
Total employee provisions	**1,702**	1,381
Employee provisions are expected to be settled in:		
No more than 12 months	**327**	303
More than 12 months	**1,375**	1,078
	1,702	1,381

	2012 $'000	2011 $'000
Note 9B: Other provisions		
Make-good on leasehold premises(a)	**136**	133
Total other provisions	**136**	133
Other provisions are expected to be settled in:		
No more than 12 months	**-**	-
More than 12 months	**136**	133
	136	133
Reconciliation of movements in other provisions:		
Opening balance	**133**	130
Re-measurement	**3**	3
Closing balance	**136**	133

(a) In accordance with the terms of its lease agreement for office accommodation, the AOFM is required to restore its leased premises to original condition at the conclusion of the lease in 2015. The AOFM has made a provision to recognise this obligation.

Note 10: 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.

	2012 $'000	2011 $'000
Net cost of services	**(9,272)**	(10,720)
Add revenue from Government	**12,413**	15,896
Adjustments for non-cash items:		
Depreciation and amortisation	**354**	315
Write-down and impairment of assets	**2**	14
Revaluation decrements recognised in expenses	**11**	-
Revaluation increments recognised in revenue	**(15)**	-
Infrastructure, plant and equipment and intangibles accruals	**14**	15
Adjustments for changes in assets:		
(Increase) decrease in receivables	**(6,925)**	(5,210)
(Increase) decrease in other prepayments	**83**	(42)
(Decrease) increase in capital appropriations receivable	**2,831**	(181)
Adjustments for changes in liabilities:		
Increase (decrease) in employee provisions	**321**	(118)
Increase (decrease) in other provisions	**3**	3
Increase (decrease) in other payables	**24**	32
Increase (decrease) in supplier payables	**156**	6
Net cash from (used by) operating activities	**-**	10

The following table reconciles cash and cash equivalents reported in the Statement of Cash Flows to items that comprise cash and cash equivalents in the Balance Sheet.

Reconciliation of cash and cash equivalents in Balance Sheet and the Statement of Cash Flows

	2012 $'000	2011 $'000
Items in Balance Sheet		
Financial assets - cash and cash equivalents	**100**	100
Total items in the Balance Sheet	**100**	100
Total as per Statement of Cash Flows	**100**	100

Note 11: Contingent liabilities and assets

Unquantifiable contingencies

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

Remote contingencies

The AOFM has indemnified a number of contractors providing goods and services under contract for losses incurred by the contractor due to, amongst other things, the AOFM's failure to observe certain terms of contract, or for wrongful, unlawful or negligent acts committed by the AOFM. The AOFM is not aware of any event that has occurred that may trigger action under the indemnities.

Furthermore, under a number of contracts, the contractor's liability to the AOFM for losses arising from certain circumstances is capped. The AOFM has assessed that the likelihood of significant losses above the liability cap is remote.

Note 12: Executive remuneration

Remuneration means any money, consideration or benefit including wages, salaries, performance pay, accrued leave entitlements (excluding superannuation on-costs), superannuation contributions (including notional contributions made to defined benefits schemes at a rate determined by the Department of Finance and Deregulation), the cost of motor vehicles, housing, commuting, fringe benefits tax and allowances. Remuneration does not include reimbursement of out-of-pocket expenses incurred for work related purposes. Where the AOFM is not entitled to an input tax credit, remuneration includes the non-recoverable GST amount. AOFM employees are not eligible to receive performance bonuses.

Remuneration expenses (on an accruals basis) for officers in the senior executive service

Actual remuneration expensed(a) during the financial year	**2012 $'000**	2011 $'000
Short-term employee benefits:		
Salary and other short-term benefits(d)	**308**	231
Annual leave accrued	**25**	19
	333	250
Post employment benefits:		
Superannuation(b)(d)	**43**	83
	43	83
Termination benefits:		
Separation payments	**-**	-
	-	-
Other long-term benefits:		
Long service leave(c)	**10**	28
	10	28
Total	**386**	361

(a) Excludes officers not in the Senior Executive Service on acting arrangements in positions that are Senior Executive Service positions, and Senior Executive Service officers not employed for the full year whose total remuneration was less than $150,000 for the year.

(b) Superannuation contributions are paid into the employee's superannuation scheme at a rate determined by the Department of Finance and Deregulation. The contributions made by the AOFM into a defined benefit scheme do not necessarily correspond with the officer's benefit under the scheme which is governed by legislation. Superannuation also includes amounts paid under salary sacrifice arrangements.

(c) The value of the long service leave provision at the end of June is determined based on advice from the Australian Government Actuary. The valuation includes the use of a discount rate to equate the expected future payments of the benefit to a net present value. The discount rate is determined based on future expectations of long-term salary increases and the long-term bond rate. Changes from year to year in the discount rate used to value long service leave have an impact on the level of remuneration reported for a financial year. As at 30 June 2012 the discount rate was 100.0 per cent (30 June 2011: 92.7 per cent).

(d) The salary component in the above table is produced on an accruals basis and does not include amounts paid into superannuation under salary sacrifice arrangements, which are shown under superannuation. The salary component in the equivalent table in the 2010-11 financial statements was produced on a cash basis and included amounts paid into superannuation under salary sacrifice arrangements. The 2011 figures have been recast to reflect these changes.

Note 12: Executive remuneration (continued)

The following table discloses the number (on a headcount basis) and reportable remuneration of senior executive service (SES) officers for the reporting period.

Average reportable remuneration paid (on a cash basis) to officers in the senior executive service(a)

	Senior Executives	Reportable salary(b)	Contributed superannuation(c)	Reportable allowances(d)	Bonus paid	Total
	2012	**2012**	**2012**	**2012**	**2012**	**2012**
	No.	**$'000**	**$'000**	**$'000**	**$'000**	**$'000**
Total reportable remuneration						
$360,000 to $389,999	**1**	**323**	**43**	**-**	**-**	**366**
Total	**1**					
	2011	2011	2011	2011	2011	2011
	No.	$'000	$'000	$'000	$'000	$'000
Total reportable remuneration						
Less than $150,000	1	130	18	-	-	148
$300,000 to $329,999	1	262	65	-	-	327
Total	2					

(a) The above table is based on cash remuneration over the financial year. The equivalent table in the 2010-11 financial statements was based on annualised remuneration as at 30 June.
(b) ‘Reportable salary’ is the average actual gross payments paid (less any bonuses paid) and reportable fringe benefits (at the net amount prior to ‘grossing up’ for the purposes of deriving taxable value of fringe benefits) for senior executives in that reportable remuneration band during the reporting period as per each individual’s payment summary.
(c) The ‘contributed superannuation’ amount is the average actual superannuation contributions paid to senior executives in that reportable remuneration band during the reporting period, including any salary sacrificed amounts, as per each individual’s payslips.
(d) ‘Reportable allowances’ is the average actual allowances paid to senior executives in that reportable remuneration band during the reporting period as per each individual’s payment summary.

Note 12: Executive remuneration (continued)

Average reportable remuneration paid (on a cash basis) of officers not in the senior executive service(a)

The following table discloses the number (on a headcount basis) and reportable remuneration of officers not in the SES who had reportable remuneration of $150,000 or more for the reporting period.

	Highly Paid Staff	**Reportable salary(b)**	**Contributed superannuation(c)**	**Reportable allowances(d)**	**Bonus paid**	**Total**
	2012	**2012**	**2012**	**2012**	**2012**	**2012**
	No.	**$'000**	**$'000**	**$'000**	**$'000**	**$'000**
Total reportable remuneration						
$150,000 to $179,999	**7**	**135**	**21**	**-**	**-**	**156**
$180,000 to $209,999	**1**	**156**	**21**	**6**	**-**	**183**
$210,000 to $239,999	**4**	**186**	**34**	**1**	**-**	**221**
$240,000 to $269,999	**3**	**212**	**32**	**2**	**-**	**246**
$300,000 to $329,999	**1**	**268**	**40**	**-**	**-**	**308**
Total	**16**					
	2011	2011	2011	2011	2011	2011
	No.	$'000	$'000	$'000	$'000	$'000
Total reportable remuneration						
$180,000 to $209,999	2	143	20	24	-	187
$210,000 to $239,999	4	172	40	5	-	217
$270,000 to $299,999	2	204	34	45	-	283
Total	8					

(a) The 2011 table has been recast to include officers seconded overseas, who were not included in the equivalent note in the 2010-11 financial statements.
(b) 'Reportable salary' is the average gross payments (less any bonuses paid) and reportable fringe benefits (at the net amount prior to 'grossing up' for the purposes of deriving the taxable value of fringe benefits) for staff in that reportable remuneration band during the reporting period as per each individual's payment summary and exempt foreign employment income.
(c) The 'contributed superannuation' amount is the average actual superannuation contributions paid to officers in that reportable remuneration band during the reporting period, including any salary sacrificed amounts.
(d) 'Reportable allowances' is the average actual allowances paid to officers in that reportable remuneration band during the reporting period as per each individual's payment summary.

Note 13: Remuneration of auditors

Financial statement audit services are provided free of charge to the AOFM. The fair value of the audit services provided by the Australian National Audit Office was:

	2012	2011
	$'000	$'000
Remuneration of auditors	**303**	294

Auditors' remuneration is disclosed inclusive of GST.

No other services were provided by the Auditor-General.

Note 14: Average staffing level

The average staffing level (paid only) for the AOFM during the year was:

	2012	2011
Average staffing level	**40**	37

Note 15: Compensation and debt relief in special circumstances

Departmental
No 'Act of Grace' payments were made during the reporting period (2010-11: nil).
No waivers of amounts owing to the Government were made pursuant to subsection 34(1) of the *Financial Management and Accountability Act 1997* during the reporting period (2010-11: nil).
No payments were made under the 'Defective Administration Scheme' during the reporting period (2010-11: nil).
No payments were made under section 73 of the *Public Service Act 1999* during the reporting period (2010-11: nil).
No payments were made under ex-gratia programs during the reporting period (2010-11: nil).
Administered
No 'Act of Grace' payments were made during the reporting period (2010-11: nil).
No waiver of amounts owing to the Government were made pursuant to subsection 34(1) of the *Financial Management and Accountability Act 1997* during the reporting period (2010-11: nil).
No payments were made under the 'Defective Administration Scheme' during the reporting period (2010-11: nil).
No payments were made under section 73 of the *Public Service Act 1999* during the reporting period (2010-11: nil).
No payments were made under ex-gratia programs during the reporting period (2010-11: nil).

Note 16: Administered income before re-measurements

	2012 $'000	2011 $'000
Note 16A: Interest revenue(a)		
Loans to State and Territory Governments:		
State and Territory debt	**252**	272
Advances	**153,628**	158,006
Investments (under FMA section 39):(b)		
Deposits	**587,421**	391,459
Discount securities	**33,794**	95,803
Fixed interest securities	**-**	123,107
Residential mortgage-backed securities	**637,297**	606,956
Total interest revenue	**1,412,392**	1,375,603
Note 16B: Other revenue		
Securities lending and other revenue	**270**	243
Total other revenue	**270**	243
Total administered income	**1,412,662**	1,375,846

(a) Recognised using the effective interest rate method.
(b) FMA = *Financial Management and Accountability Act 1997*.

Note 17: Administered expenses before re-measurements

	2012 $'000	2011 $'000
Note 17A: Grants		
Public Sector:		
State and Territory Governments(a)	**23**	26
Total grants	**23**	26
Note 17B: Interest expense		
Commonwealth Government Securities interest:(b)		
Treasury Bonds	**9,633,418**	7,526,579
Treasury Indexed Bonds	**1,215,321**	1,020,994
Treasury Notes	**564,428**	712,357
Other debt	**689**	702
	11,413,856	9,260,632
Interest on repurchase agreements	**-**	12,203
Other interest costs	**25**	22
Total interest expense	**11,413,881**	9,272,857
Note 17C: Supplier expenses		
Registry and other costs(c)	**611**	-
Syndication fees(c)	**6,381**	-
Total supplier expenses	**6,992**	-
Total administered expenses	**11,420,896**	9,272,883

(a) Grants represent Commonwealth contributions into the Debt Retirement Reserve Trust Account — see Note 27G.
(b) Recognised using the effective interest rate method.
(c) From 29 June 2011 the *Commonwealth Inscribed Stock Act 1911* was amended to provide an appropriation to meet the costs and expenses of issuance and sale of stock, and the cost of managing stock issued under the Act. Previously these costs were met through departmental appropriations.

Note 18: Administered gains (losses) before re-measurements

	2012 $'000	2011 $'000
Note 18A: Net foreign exchange gains (losses)		
Foreign currency denominated loans and securities	**(254)**	1,299
Total net foreign exchange gains (losses)	**(254)**	1,299
Note 18B: Net gains (losses) on sale of financial instruments(a)		
Sale of fixed interest assets	**-**	270
Repurchase of debt	**(8,229)**	(62)
Total net gains (losses) on sale of financial instruments	**(8,229)**	208
Total gains (losses) before re-measurements	**(8,483)**	1,507

(a) Total net gains (losses) on sale of financial instruments represents the total proceeds paid or received from a sale or termination, less the amortised cost carrying value using the effective interest method at the time of sale or termination.

Note 19: Administered re-measurements

	2012 $'000	2011 $'000
Net market revaluation gains (losses)(a)		
Commonwealth Government Securities	**(20,493,844)**	335,829
Deposits and discount securities	**(11)**	138
Fixed interest securities	**-**	(1,615)
Residential mortgage-backed securities	**(71,925)**	(8,495)
Total net market revaluation gains (losses)	**(20,565,780)**	325,857

(a) 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 the time of the sale is reversed against administered re-measurements. The revaluation effect will net to zero over the life of a financial instrument, either at maturity or on termination prior to maturity.

Note 20: Administered assets(a)

	2012 $'000	2011 $'000
Note 20A: Investments (under FMA section 39)(b)		
Designated at fair value through profit or loss:		
Deposits	**14,503,321**	10,665,514
Discount securities	**-**	3,587,119
Residential mortgage-backed securities	**11,073,169**	10,778,744
Total investments (under FMA section 39)	**25,576,490**	25,031,377
Investments maturing:(c)		
Within one year	**14,728,902**	14,437,161
In one to five years	**8,019,502**	8,161,823
In more than five years	**2,828,086**	2,432,393
	25,576,490	25,031,377
Note 20B: Receivables		
At amortised cost:		
Loans to State and Territory Governments:		
Principal	**2,882,873**	2,981,452
Balance of special account(d)	**(657)**	(566)
Unamortised net discounts	**(341,685)**	(362,712)
Total receivables	**2,540,531**	2,618,174
Receivables maturing:		
Within one year	**1,984**	1,811
In one to five years	**30,805**	27,626
In more than five years	**2,507,742**	2,588,737
	2,540,531	2,618,174
Receivables are aged as follows:		
Not overdue	**2,540,531**	2,618,174
Overdue	**-**	-
	2,540,531	2,618,174
Note 20C: Accrued revenue		
Accrued interest on loans to State and Territory Governments	**444**	456
Total accrued revenue	**444**	456
Accrued revenue maturing:		
Within one year	**444**	456
	444	456

(a) Where the AOFM applies fair value accounting to a financial asset, the aggregate value of the financial asset is recorded against a single financial statement class. Where the historic cost accounting convention is applied, the value of a financial asset is disaggregated and recorded against several financial statement classes (for example, the principal value of a financial asset is classified separately to coupons receivable on the asset).

(b) FMA = *Financial Management and Accountability Act 1997*.

(c) The maturity profile is based on contractual repricing dates, with the exception of residential mortgage-backed securities. For residential mortgage-backed securities the maturity profile is based on the weighted average life of each investment and disregarding estimated principal repayments prior to that time.

(d) Refer to Note 27G for special account balances.

Note 21: Administered liabilities(a)

	2012 $'000	2011 $'000
Note 21A: Commonwealth Government Securities		
Designated at fair value through profit or loss:		
Treasury Bonds	**231,650,136**	166,082,689
Treasury Indexed Bonds	**25,668,180**	19,645,142
Treasury Notes	**12,446,064**	16,021,226
Other debt	**7,154**	6,728
	269,771,534	201,755,785
At amortised cost:		
Other debt	**13,816**	14,633
Total Commonwealth Government Securities	**269,785,350**	201,770,418
Commonwealth Government Securities maturing:(b)		
Within one year	**38,813,911**	30,365,227
In one to five years	**99,811,565**	87,445,736
In more than five years	**131,159,874**	83,959,455
	269,785,350	201,770,418
Note 21B: Accrued expenses		
Interest payable on other debt (at amortised cost)	**93**	93
Total accrued expenses	**93**	93
Accrued expenses maturing:		
Within one year	**93**	93
	93	93

(a) Where the AOFM applies fair value accounting to a financial liability, the aggregate value of the financial liability is recorded against a single financial statement class. Where the historic cost accounting convention is applied, the value of a financial liability is disaggregated and recorded against several financial statement classes (for example: the principal value of a financial liability is classified separately from coupons payable on the liability).

(b) The maturity profile is based on contractual repricing dates.

Note 22: Administered cash flow reconciliation

The following table reconciles cash as per the Administered Schedule of Assets and Liabilities to the Administered Cash Flow Schedule. It also reconciles comprehensive income reported in the Administered Schedule of Comprehensive Income to net cash flows from operating activities reported in the Administered Cash Flow Schedule.

	2012	2011
	$'000	$'000
Reconciliation of cash and cash equivalents as per Administered schedule of assets and liabilities to Administered cash flow statement		
Cash and cash equivalents as per:		
Schedule of administered cash flows	**622**	622
Schedule of administered assets and liabilities	**622**	622
Difference	-	-
Reconciliation of comprehensive income to net cash from operating activities		
Comprehensive income	**(30,582,497)**	(7,569,673)
Adjustments for non-cash items		
Amortisation and capital accretion of debt instruments	**(233,852)**	(209,912)
Amortisation of net discounts on Loans to State and Territory Governments	**(21,027)**	(21,221)
Amortisation of net premiums on financial assets	**(19)**	36,956
Net (gain) loss on sale of financial instruments	**8,229**	(208)
Net foreign exchange (gains) losses	**254**	(1,299)
Re-measurements	**20,565,780**	(325,857)
Debt Retirement Reserve Trust Account contributions and interest payments(a)	**48**	48
Accrual Adjustments		
Interest accruals on debt instruments	**623,408**	(14,826)
Interest accruals on financial assets	**33,397**	20,948
Net cash used by operating activities	**(9,606,279)**	(8,085,044)

(a) Debt Retirement Reserve Trust Account contributions and interest payments increase the balance of the Debt Retirement Reserve Trust Account (see Note 27G) but comprise a notional payment only.

Note 23: Administered contingent liabilities and assets

Unquantifiable contingencies

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

Remote contingencies

(i) The Government has indemnified agents of foreign currency denominated loans issued by the Australian Government outside Australia against any loss, liability, costs, claims, charges, expenses, actions, or demands due to any misrepresentation by the Australian Government and any breach of warranties. The AOFM is not aware of any event that has occurred that may trigger action under the indemnities.

(ii) In the unlikely event of default by a borrower of Treasury Bonds or Treasury Indexed Bonds under the securities lending facility, the AOFM would be in a position to sell the securities pledged by the borrower to offset the increased liability to the Government. As at 30 June 2012 there were no open transactions under the AOFM's securities lending facility (30 June 2011: nil).

Note 24: Administered financial instruments

Note 24A: Categories of administered financial assets and liabilities

Under Australian Accounting Standards a financial instrument must be measured at fair value on initial recognition. After initial recognition the accounting treatment for a financial instrument is dependent on the category under which the financial instrument is classified. The following table illustrates the AOFM's financial instruments by category:

	2012	2011
	$'000	$'000
Administered financial assets		
Cash	**622**	622
Loans and receivables (at amortised cost):		
Loans to State and Territory Governments	**2,540,531**	2,618,174
Accrued interest on loans to State and Territory Governments	**444**	456
	2,540,975	2,618,630
Fair value through profit or loss (designated by the AOFM):		
Investments	**25,576,490**	25,031,377
Carrying amount of financial assets	**28,118,087**	27,650,629
Administered financial liabilities		
Fair value through profit or loss (designated by the AOFM):		
Treasury Bonds	**231,650,136**	166,082,689
Treasury Indexed Bonds	**25,668,180**	19,645,142
Treasury Notes	**12,446,064**	16,021,226
Other debt	**7,154**	6,728
	269,771,534	201,755,785
Other financial liabilities (at amortised cost):		
Other debt	**13,816**	14,633
Interest payable on other debt	**93**	93
	13,909	14,726
Carrying amount of financial liabilities	**269,785,443**	201,770,511
Net assets	**(241,667,356)**	(174,119,882)

Note 24B: Interest rate risk

The AOFM's exposure to interest rate risk and corresponding weighted average effective interest rates from financial instruments is set out below. The maturity profile is based on contractual repricing dates except for residential mortgage-backed securities in which the maturity profile is based on the weighted average life of each security. Those financial instruments with a fixed interest rate expose the net debt portfolio to changes in fair value with changes in interest rates, whilst those financial instruments at floating interest rates expose the net debt 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 by the differences in the volumes and the need for assets to be available for cash management or other purposes.

Note 24: Administered financial instruments (continued)

Note 24B: Interest rate risk (continued)

	Fixed interest rate	Floating interest rate	Non interest bearing	Maturing in 1 year or less	Maturing in 1 to 5 years	Maturing in 5 years or more	Total	Weighted average interest(a)
	2012	2012	2012	2012	2012	2012	2012	2012
	$'000	$'000	$'000	$'000	$'000	$'000	$'000	%
Financial assets								
Cash	**-**	**-**	**622**	**622**	**-**	**-**	**622**	**-**
Loans to State and Territory Governments	**2,540,962**	**-**	**13**	**2,428**	**30,805**	**2,507,742**	**2,540,975**	**5.88**
Deposits	**14,503,321**	**-**	**-**	**14,503,321**	**-**	**-**	**14,503,321**	**3.50**
Residential mortgage-backed securities	**-**	**11,073,169**	**-**	**225,581**	**8,019,502**	**2,828,086**	**11,073,169**	**4.93**
Total financial assets	**17,044,283**	**11,073,169**	**635**	**14,731,952**	**8,050,307**	**5,335,828**	**28,118,087**	
Financial liabilities								
Treasury Bonds	**231,650,136**	**-**	**-**	**26,361,886**	**93,969,362**	**111,318,888**	**231,650,136**	**4.86**
Treasury Indexed Bonds	**25,668,180**	**-**	**-**	**-**	**5,835,179**	**19,833,001**	**25,668,180**	**3.02**
Treasury Notes	**12,446,064**	**-**	**-**	**12,446,064**	**-**	**-**	**12,446,064**	**3.56**
Other debt	**15,231**	**-**	**5,832**	**6,054**	**7,024**	**7,985**	**21,063**	**3.58**
Total financial liabilities	**269,779,611**	**-**	**5,832**	**38,814,004**	**99,811,565**	**131,159,874**	**269,785,443**	
Net assets	**(252,735,328)**	**11,073,169**	**(5,197)**	**(24,082,052)**	**(91,761,258)**	**(125,824,046)**	**(241,667,356)**	

(a) Interest rates are nominal interest rates with the exception of Treasury Indexed Bonds (which are real interest rates).

Note 24: Administered financial instruments (continued)

Note 24B: Interest rate risk (continued)

	Fixed interest rate	Floating interest rate	Non interest bearing	Maturing in 1 year or less	1 to 5 years	5 years or more	Total	Weighted average interest(a)
	2011	2011	2011	2011	2011	2011	2011	2011
	$'000	$'000	$'000	$'000	$'000	$'000	$'000	%
Financial assets								
Cash	-	-	622	622	-	-	622	-
Loans to State and Territory Governments	2,618,627	-	3	2,267	27,626	2,588,737	2,618,630	5.88
Deposits	10,665,514	-	-	10,665,514	-	-	10,665,514	4.75
Discount securities	3,587,119	-	-	3,587,119	-	-	3,587,119	4.91
Residential mortgage-backed securities	-	10,778,744	-	184,528	8,161,823	2,432,393	10,778,744	6.13
Total financial assets	16,871,260	10,778,744	625	14,440,050	8,189,449	5,021,130	27,650,629	
Financial liabilities								
Treasury Bonds	166,082,689	-	-	14,338,068	81,943,916	69,800,705	166,082,689	5.19
Treasury Indexed Bonds	19,645,142	-	-	-	5,501,820	14,143,322	19,645,142	3.27
Treasury Notes	16,021,226	-	-	16,021,226	-	-	16,021,226	4.75
Other debt	15,521	-	5,933	6,026	-	15,428	21,454	3.45
Total financial liabilities	201,764,578	-	5,933	30,365,320	87,445,736	83,959,455	201,770,511	
Net assets	(184,893,318)	10,778,744	(5,308)	(15,925,270)	(79,256,287)	(78,938,325)	(174,119,882)	

(a) Interest rates are nominal interest rates with the exception of Treasury Indexed Bonds (which are real interest rates).

Note 24: Administered financial instruments (continued)

Note 24C: Foreign exchange risk

Foreign exchange risk arises from debt the AOFM holds in foreign denominated currencies and represents the risk to debt servicing costs and the value of the net debt portfolio caused by a change in foreign exchange rates. Currently the AOFM's foreign exchange risk arises from contractual obligations on foreign currency loans and securities. The AOFM's exposure to foreign exchange risk is not material.

The Australian equivalent principal value of foreign currency loans and securities is disclosed in the following table:

	2012 **AUD $'000**	2011 AUD $'000
FOREIGN CURRENCY DENOMINATED LIABILITIES		
Current:		
Pounds sterling	**79**	79
Japanese yen	**5**	5
Swiss francs	**52**	57
Euros	**7**	7
	143	148
Non-current:		
United States dollars	**5,221**	4,955
Pounds sterling	**-**	621
	5,221	5,576
Total foreign currency denominated liabilities	**5,364**	5,724
FOREIGN CURRENCY DENOMINATED ASSETS		
Current:		
Pounds sterling	**3**	3
	3	3
Non-current:		
Pounds sterling	**-**	621
	-	621
Total foreign currency denominated assets	**3**	624

Note 24: Administered financial instruments (continued)

Note 24D: Contractual maturities of financial liabilities

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

	Less than 1 year	1 to 2 years	2 to 5 years	5+ years	Total
	2012 $'000	**2012 $'000**	**2012 $'000**	**2012 $'000**	**2012 $'000**
Treasury Bonds	**36,513,347**	**31,961,426**	**83,591,591**	**111,822,333**	**263,888,697**
Treasury Indexed Bonds(a)	**717,390**	**717,390**	**7,016,893**	**18,772,253**	**27,223,926**
Treasury Notes	**12,500,000**	**-**	**-**	**-**	**12,500,000**
Other debt(b)	**437**	**437**	**6,533**	**-**	**7,407**
Total	**49,731,174**	**32,679,253**	**90,615,017**	**130,594,586**	**303,620,030**
	2011 $'000	2011 $'000	2011 $'000	2011 $'000	2011 $'000
Treasury Bonds	23,038,860	33,562,722	69,832,029	80,596,071	207,029,682
Treasury Indexed Bonds(a)	647,169	647,169	6,898,598	16,140,539	24,333,475
Treasury Notes	16,100,000	-	-	-	16,100,000
Other debt(b)	415	415	1,245	5,370	7,445
Total	39,786,444	34,210,306	76,731,872	96,741,980	247,470,602

(a) The interest payments and principal value are indexed against the (all groups) Australian Consumer Price Index (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.

(b) Perpetual debt and overdue debt has been excluded from this analysis.

Note 24: Administered financial instruments (continued)

Note 24E: Credit risk

The following table sets out the AOFM's credit risk by asset class and credit rating as at 30 June. 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.

The AOFM's assets are of strong credit quality. The AOFM's exposure to credit risk under the securities lending facility and its repurchase agreements as at year end is zero.

S&P or Fitch long-term rating **Moody's long-term rating**	**AAA** **Aaa**	**AA+ to AA-** **Aa1 to Aa3**	**A+ to A-** **A1 to A3**	**Total**
	2012 **$'000**	**2012** **$'000**	**2012** **$'000**	**2012** **$'000**
By instrument				
Cash(a)	**622**	**-**	**-**	**622**
Loans to State and Territory Governments	**1,771,626**	**1,464,202**	**-**	**3,235,828**
Deposits(a)	**14,503,321**	**-**	**-**	**14,503,321**
Residential mortgage-backed securities	**11,073,169**	**-**	**-**	**11,073,169**
Total	**27,348,738**	**1,464,202**	**-**	**28,812,940**
	2011 $'000	2011 $'000	2011 $'000	2011 $'000
By instrument				
Cash(a)	622	-	-	622
Loans to State and Territory Governments	2,058,576	697,552	-	2,756,128
Deposits(a)	10,665,514	-	-	10,665,514
Discount securities	-	3,339,127	247,992	3,587,119
Residential mortgage-backed securities	10,778,744	-	-	10,778,744
Total	23,503,456	4,036,679	247,992	27,788,127

(a) 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.

Note 24: Administered financial instruments (continued)

Note 24F: Residential mortgage-backed securities

The AOFM has acquired a portfolio of AAA rated (or equivalent) residential mortgage-backed securities with a face value of $15,303 million.

Details of residential mortgage-backed securities acquired by the AOFM since the Government announced this initiative in September 2008 are contained in the following tables.

	Opening balance	Amount invested	Principal repayments	Sales	Invested as at Year end
	$'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**
Total		**15,302,610**	**(3,977,635)**	**(123,790)**	
Program limit		**20,000,000**			
Remaining funds available to invest		**4,697,390**			

Note 24: Administered financial instruments (continued)

Note 24G: Net fair values of administered financial assets and liabilities

	Principal value(a)	Total carrying amount	Aggregate net fair value
	2012 $'000	**2012 $'000**	**2012 $'000**
Administered financial assets (recognised)			
Cash	**622**	**622**	**622**
Loans to State and Territory Governments(b)	**2,882,217**	**2,540,975**	**3,235,171**
Deposits	**14,500,000**	**14,503,321**	**14,503,321**
Residential mortgage-backed securities	**11,201,185**	**11,073,169**	**11,073,169**
Total financial assets (recognised)	**28,584,024**	**28,118,087**	**28,812,283**
Administered financial liabilities (recognised)			
Treasury Bonds	**205,387,900**	**231,650,136**	**231,650,136**
Treasury Indexed Bonds	**20,957,021**	**25,668,180**	**25,668,180**
Treasury Notes	**12,500,000**	**12,446,064**	**12,446,064**
Other debt	**19,038**	**21,063**	**21,063**
Total financial liabilities (recognised)	**238,863,959**	**269,785,443**	**269,785,443**
Net financial assets (recognised)	**(210,279,935)**	**(241,667,356)**	**(240,973,160)**
	2011 $'000	2011 $'000	2011 $'000
Administered financial assets (recognised)			
Cash	622	622	622
Loans to State and Territory Governments(b)	2,980,886	2,618,630	2,755,562
Deposits	10,650,000	10,665,514	10,665,514
Discount securities	3,600,000	3,587,119	3,587,119
Residential mortgage-backed securities	10,829,805	10,778,744	10,778,744
Total financial assets (recognised)	28,061,313	27,650,629	27,787,561
Administered financial liabilities (recognised)			
Treasury Bonds	161,242,900	166,082,689	166,082,689
Treasury Indexed Bonds	18,144,012	19,645,142	19,645,142
Treasury Notes	16,100,000	16,021,226	16,021,226
Other debt	19,588	21,454	21,454
Total financial liabilities (recognised)	195,506,500	201,770,511	201,770,511
Net financial assets (recognised)	(167,445,187)	(174,119,882)	(173,982,950)

(a) Comprises the face value of financial instruments, with the exception of Treasury Indexed Bonds where the inflation adjusted capital value at the end of the financial year is included in the principal figure.

(b) Loans to State and Territory Governments are recognised 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.

Note 24: Administered financial instruments (continued)

Note 24G: Net fair values of administered financial assets and liabilities (continued)

The following table discloses the quality of significant inputs used to determine the fair value of all financial assets and financial liabilities measured at fair value as at year end, by assigning a 3 level hierarchy to those valuations.

	Level 1(a)	Level 2(b)	Level 3(c)	Total
	2012	**2012**	**2012**	**2012**
	$'000	**$'000**	**$'000**	**$'000**
Administered financial assets (measured at fair value only)				
Deposits	**-**	**14,503,321**	**-**	**14,503,321**
Residential mortgage-backed securities	**-**	**11,073,169**	**-**	**11,073,169**
	-	**25,576,490**	**-**	**25,576,490**
Administered financial liabilities (measured at fair value only)				
Treasury Bonds	**222,644,567**	**9,005,569**	**-**	**231,650,136**
Treasury Indexed Bonds	**25,668,180**	**-**	**-**	**25,668,180**
Treasury Notes	**-**	**12,446,064**	**-**	**12,446,064**
Other debt	**-**	**7,154**	**-**	**7,154**
	248,312,747	**21,458,787**	**-**	**269,771,534**
	2011	2011	2011	2011
	$'000	$'000	$'000	$'000
Administered financial assets (measured at fair value only)				
Deposits	-	10,665,514	-	10,665,514
Discount securities	-	3,587,119	-	3,587,119
Residential mortgage-backed				-
securities	-	10,778,744	-	10,778,744
	-	25,031,377	-	25,031,377
Administered financial liabilities (measured at fair value only)				
Treasury Bonds	166,082,689	-	-	166,082,689
Treasury Indexed Bonds	19,645,142	-	-	19,645,142
Treasury Notes	-	16,021,226	-	16,021,226
Other debt	-	6,728	-	6,728
	185,727,831	16,027,954	-	201,755,785

(a) The fair value method is determined using unadjusted quoted prices in active markets for identical financial instruments.

(b) The fair value is determined by price quotations in non-active markets for identical financial instruments, or from price quotations in an active market for similar assets or liabilities or from other inputs that are observable by market data. The fair value is estimated by using inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices).

(c) The fair value is determined from inputs not based on observable market data. This includes significant adjustments to observable market data.

Note 24: Administered financial instruments (continued)

Note 24H: Movement in commonwealth government securities on issue (face value)

	Opening balance	Issuance	Maturities/ Redemptions	Other	Closing balance
	2012 $'000	**2012 $'000**	**2012 $'000**	**2012 $'000**	**2012 $'000**
Treasury Bonds	**161,242,900**	**58,200,000**	**(14,055,000)**	**-**	**205,387,900**
Treasury Indexed Bonds(a)	**13,929,000**	**2,140,000**	**-**	**-**	**16,069,000**
Treasury Notes	**16,100,000**	**53,800,000**	**(57,400,000)**	**-**	**12,500,000**
Other debt(b)	**19,588**	**-**	**(821)**	**271**	**19,038**
Total	**191,291,488**	**114,140,000**	**(71,455,821)**	**271**	**233,975,938**
	2011 $'000	2011 $'000	2011 $'000	2011 $'000	2011 $'000
Treasury Bonds	124,695,087	55,350,000	(18,802,187)	-	161,242,900
Treasury Indexed Bonds(a)	11,415,265	3,250,000	(736,265)	-	13,929,000
Treasury Notes	11,000,000	60,600,000	(55,500,000)	-	16,100,000
Other debt(b)	22,331	-	(1,332)	(1,411)	19,588
Total	147,132,683	119,200,000	(75,039,784)	(1,411)	191,291,488

(a) The inflation adjusted capital accretion for Treasury Indexed Bonds is excluded from these amounts.
(b) This includes foreign currency denominated amounts. Changes in value due to foreign currency translation are shown in the 'Other' column. The foreign currency denominated face value is restated into Australian dollars for the opening and closing values using end of year exchange rates.

Note 24I: Movement in investments held (face value)

	Opening balance	Acquisitions	Maturities/ Redemptions	Other	Closing balance
	2012 $'000	**2012 $'000**	**2012 $'000**	**2012 $'000**	**2012 $'000**
Deposits	**10,650,000**	**1,067,700,000**	**(1,063,850,000)**	**-**	**14,500,000**
Discount securities	**3,600,000**	**2,250,000**	**(5,850,000)**	**-**	**-**
Residential mortgage-backed securities	**10,829,805**	**1,930,430**	**(1,559,050)**	**-**	**11,201,185**
Total	**25,079,805**	**1,071,880,430**	**(1,071,259,050)**	**-**	**25,701,185**
	2011 $'000	2011 $'000	2011 $'000	2011 $'000	2011 $'000
Deposits	14,950,000	281,200,000	(285,500,000)	-	10,650,000
Discount securities	4,295,000	9,800,000	(10,495,000)	-	3,600,000
Fixed interest securities	3,552,470	783,000	(4,335,470)	-	-
Residential mortgage-backed securities	7,919,225	4,349,220	(1,438,640)	-	10,829,805
Total	30,716,695	296,132,220	(301,769,110)	-	25,079,805

Note 24: Administered financial instruments (continued)

Note 24J: Repurchase agreements

From time to time the AOFM enters into repurchase transactions against its holdings of semi-government bonds in order to provide short-term funding to meet anticipated shortfalls in the OPA. A repurchase transaction involves the sale of a financial asset and agreement to buy it back at an agreed price, at a future specified date or on demand. Interest is payable by the AOFM on the value of cash received at an agreed (fixed) market interest rate set at the time the transaction is struck.

No transactions were conducted in 2011-12.

The following repurchase transactions were executed in 2010-11:

Debt security	Number of transactions	Interest paid	Face value of bonds sold
	2011	2011	2011
	No.	$'000	$'000
NSWTC 7% 01 Dec 10	1	999	600,000
SAFA 5.75% 15 Jun 11	7	5,356	2,600,000
TASCORP 5.75% 15 Jun 11	2	990	600,000
WATC 7% 15 Apr 11	7	4,858	2,301,000
	17	12,203	6,101,000

Note 25: Market risk sensitivity of administered financial instruments

AASB 7 *Financial Instruments: Disclosures* requires each entity with financial instruments to present a market risk sensitivity analysis for each type of market risk exposure arising from financial instruments held. Market risk represents the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market prices.

The main types of market risk the AOFM's portfolio of debt and financial assets is exposed to are domestic *interest rate risk* and domestic *inflation risk.* Moreover, by generally issuing/buying and holding to maturity, the market risk most relevant to the AOFM is the risk of fluctuations to future interest cash flows and principal amounts arising from changes in interest rates and inflation. The risk of fluctuations in the fair value of the AOFM's net debt portfolio is of a secondary order.

Accordingly, the AOFM has focused its market risk sensitivity analysis on an accruals (or amortised cost) basis of accounting under the historic cost accounting convention, as it provides the best predictive value of future cash flows (and hence costs and returns) arising from the AOFM's portfolio of debt and financial assets.

(a) Interest rate risk sensitivity analysis

Domestic nominal interest rates impact on debt servicing costs when the AOFM enters the primary market to raise new borrowings or refinance maturing debt. When the AOFM borrows to repay maturing debt, there is a risk that debt servicing costs will change due to the interest rate on the new debt being higher or lower than the interest rate on the maturing debt. Furthermore, when the AOFM enters the market to raise new borrowings the interest cost locked-in will be dependent on the absolute level of market interest rates at that time.

Australian dollar denominated residential mortgage-backed securities investments provide for the AOFM to receive interest at a floating interest rate plus a fixed margin set at the time each investment is acquired. When interest rates rise (fall), investment return will also rise (fall).

As the manager of the Government's liquidity, the AOFM holds a fluctuating portfolio of Australian dollar deposits and discount securities. These investments have fixed interest rates and given their use for cash management purposes they have very short terms to maturity (generally no more than a few months). When these investments mature and new investments are made the return may change due to re-investment at higher or lower interest rates.

Note 25: Market risk sensitivity of administered financial instruments (continued)

Under previous Commonwealth-State financing arrangements the Australian Government made concessional Australian dollar loans to the States and the Northern Territory. These loans are of a fixed interest credit foncier nature. Changes in market interest rates do not cause changes in future cash flows of interest or principal.

At 1 July 2012, if domestic interest rates had experienced an immediate 100 basis point parallel upward (downward) movement across the yield curve, and if that change were to persist for the 12 months to 30 June 2013, with all other variables held constant, the effect on the AOFM's operating result before re-measurements (calculated on an accruals basis) and equity position for the year ended 30 June 2013 would be as follows:

Operating result sensitivity to changes in domestic interest rates(a) (calculated on an accruals basis)

		-1%		+1%	
Change in interest rates from 1 July 2012 for 12 months to 30 June 2013	**Carrying amount as at 30 Jun 2012 $'000**	**Impact on profit 2012-13 $'000**	**Impact on equity 2012-13 $'000**	**Impact on profit 2012-13 $'000**	**Impact on equity 2012-13 $'000**
Financial assets					
Cash	**622**	**-**	**-**	**-**	**-**
Loans to State and Territory Governments	**2,540,975**	**-**	**-**	**-**	**-**
Deposits	**14,503,321**	**(144,359)**	**(144,359)**	**144,359**	**144,359**
Residential mortgage-backed securities	**11,073,169**	**(115,428)**	**(115,428)**	**115,428**	**115,428**
Financial liabilities					
Treasury Bonds	**231,650,136**	**174,443**	**174,443**	**(156,840)**	**(156,840)**
Treasury Indexed Bonds	**25,668,180**	**-**	**-**	**-**	**-**
Treasury Notes	**12,446,064**	**108,808**	**108,808**	**(108,808)**	**(108,808)**
Other debt	**21,063**	**-**	**-**	**-**	**-**
Total increase (decrease) in accrual result (before re-measurements)		**23,464**	**23,464**	**(5,861)**	**(5,861)**

(a) Changes in nominal interest rates only.

Note 25: Market risk sensitivity of administered financial instruments (continued)

The corresponding figures for the previous 12 months are as follows:

Operating result sensitivity to changes in domestic interest rates(a) (calculated on an accruals basis)

		-1%		+1%	
Change in interest rates from 1 July 2011 for 12 months to 30 June 2012	Carrying amount as at 30 Jun 2011 $'000	Impact on profit 2011-12 $'000	Impact on equity 2011-12 $'000	Impact on profit 2011-12 $'000	Impact on equity 2011-12 $'000
Financial assets					
Cash	622	-	-	-	-
Loans to State and Territory Governments	2,618,630	-	-	-	-
Deposits	10,665,514	(104,763)	(104,763)	104,763	104,763
Discount securities	3,587,119	(33,466)	(33,466)	33,466	33,466
Residential mortgage-backed securities	10,778,744	(130,506)	(130,506)	130,506	130,506
Financial liabilities					
Treasury Bonds	166,082,689	219,342	219,342	(203,623)	(203,623)
Treasury Indexed Bonds	19,645,142	-	-	-	-
Treasury Notes	16,021,226	144,430	144,430	(144,430)	(144,430)
Other debt	21,454	-	-	-	-
Total increase (decrease) in accrual result (before re-measurements)		95,037	95,037	(79,318)	(79,318)

(a) Changes in nominal interest rates only.

(b) Inflation risk sensitivity analysis

The AOFM currently has five series of Treasury Indexed Bonds on issue. These instruments have their principal value indexed against the (all Groups) Australian Consumer Price Index (CPI). The interest is a fixed real rate of interest payable on the accreted principal value. Accordingly these debt instruments expose the AOFM to cash flow 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. As the CPI increases, debt servicing costs and the principal payable on maturity also rises.

Note 25: Market risk sensitivity of administered financial instruments (continued)

At 1 July 2012, if the CPI were to experience an immediate 1 per cent increase (decrease) and that change were to persist for 12 months to 30 June 2013, with all other variables held constant, the effect on the AOFM's operating result before re-measurements (calculated on an accruals basis) and equity position for the year ended 30 June 2013 would be as follows:

Operating result sensitivity to changes in the consumer price index (calculated on an accruals basis)

		-1%		+1%	
Change in CPI from 1 July 2012 for 12 months to 30 June 2013	**Carrying amount as at 30 Jun 2012 $'000**	**Impact on profit 2012-13 $'000**	**Impact on equity 2012-13 $'000**	**Impact on profit 2012-13 $'000**	**Impact on equity 2012-13 $'000**
Financial assets					
Cash	**622**	-	-	-	-
Loans to State and Territory Governments	**2,540,975**	-	-	-	-
Deposits	**14,503,321**	-	-	-	-
Residential mortgage-backed securities	**11,073,169**	-	-	-	-
Financial liabilities					
Treasury Bonds	**231,650,136**	-	-	-	-
Treasury Indexed Bonds	**25,668,180**	**234,469**	**234,469**	**(235,172)**	**(235,172)**
Treasury Notes	**12,446,064**	-	-	-	-
Other debt	**21,063**	-	-	-	-
Total increase (decrease) in accrual result (before re-measurements)		**234,469**	**234,469**	**(235,172)**	**(235,172)**

Note 25: Market risk sensitivity of administered financial instruments (continued)

The corresponding figures for the previous 12 months are as follows:

Operating result sensitivity to changes in the consumer price index (calculated on an accruals basis)

Change in CPI from 1 July 2011 for 12 months to 30 June 2012	Carrying amount as at 30 Jun 2011 $'000	-1% Impact on profit 2011-12 $'000	-1% Impact on equity 2011-12 $'000	+1% Impact on profit 2011-12 $'000	+1% Impact on equity 2011-12 $'000
Financial assets					
Cash	622	-	-	-	-
Loans to State and Territory Governments	2,618,630	-	-	-	-
Deposits	10,665,514	-	-	-	-
Discount securities	3,587,119	-	-	-	-
Residential mortgage-backed securities	10,778,744	-	-	-	-
Financial liabilities					
Treasury Bonds	166,082,689	-	-	-	-
Treasury Indexed Bonds	19,645,142	207,319	207,319	(205,149)	(205,149)
Treasury Notes	16,021,226	-	-	-	-
Other debt	21,454	-	-	-	-
Total increase (decrease) in accrual result (before re-measurements)		207,319	207,319	(205,149)	(205,149)

Assumptions and methods used

Interest rate risk sensitivity has been measured assuming that for the next 12 months domestic interest rates are 100 basis points higher and lower across the entire yield curve than those observed as at year end. The analysis was performed as follows:

- the sensitivity of debt servicing costs for the next 12 months on Treasury Bonds comprised the difference between:
  - debt servicing costs on the planned issuance program to refinance maturing debt and to raise new borrowings for the next 12 months at the observed or estimated market yield for the relevant line of stock as at year end; and

Note 25: Market risk sensitivity of administered financial instruments (continued)

- debt servicing costs on the planned issuance program to refinance maturing debt and to raise new borrowings for the next 12 months at yields that are 100 basis points higher and lower than the observed or estimated market yield for the relevant line of stock as at year end;

• the sensitivity of debt serving costs for the next 12 months on Treasury Notes comprised the difference between:

- debt servicing costs on Treasury Notes held at the end of the financial year for the full 12 months at the observed or estimated rate as at year end; and

- debt servicing costs on Treasury Notes held at the end of the financial year for the full 12 months at yields 100 basis points higher and lower than the observed or estimated rate as at year end. The 100 basis point shift is applied from the date the positions held as at year end mature and is held constant at that level thereafter;

• the sensitivity of returns for the next 12 months on residential mortgage-backed securities comprised the difference between:

- the return at the relevant reference market interest rate at the end of the financial year (being the one-month BBSW rate plus specific fixed margin set for each security at the time of acquisition); and

- the return at a yield that is 100 basis points higher and lower than the relevant reference market interest rate as at year end plus the fixed margin for each security. The 100 basis point shift is applied from the date of the first rate re-set after the end of the financial year and is held constant at that level thereafter;

• the sensitivity of returns for the next 12 months on term deposits comprised the difference between:

- the return on term deposits held at the end of the financial year for the full 12 months at the relevant reference market interest rate (being the relevant Overnight Indexed Swap (OIS) rate) as at year end; and

Note 25: Market risk sensitivity of administered financial instruments (continued)

- the return on term deposits held at the end of the financial year for the full 12 months at a yield that is 100 basis points higher and lower than the relevant OIS rate as at year end. The 100 basis point shift is applied from the date of the first re-investment after the end of the financial year and is held constant at that level thereafter.

Inflation risk sensitivity has been measured assuming that for each quarter in the next financial year the CPI is 1 per cent higher and lower (when compared to the year before) than in the base case. The analysis was performed as follows:

- the sensitivity of debt servicing costs for the next financial year on Treasury Indexed Bonds comprised the difference between:

  - debt servicing costs for the next financial year on the basis that inflation persists at the average rate experienced in the financial year (base case); and

  - debt servicing costs for the next financial year on the basis that the CPI index is higher and lower by 1 per cent than the assumed base case level for each quarter.

For the purposes of calculating sensitivity analysis, it has been assumed that the AOFM will issue $35,000 million of Treasury Bonds and $2,000 million of Treasury Indexed Bonds during the 2012-13 financial year (2011-12 assumptions: $51,000 million and $2,000 million respectively). It is also assumed that the volume of Treasury Notes outstanding as at 30 June 2012 of $12,500 million will remain at these levels for the full 12 months to 30 June 2013 (2011-12 assumption: $16,100 million). It is assumed that the volume of term deposit investments will remain at levels as at 30 June 2012 of $14,500 million for the full 12 months to 30 June 2013 (2011-12 assumption: $10,650 million). Residential mortgage-backed securities will have a principal repayment rate based on an estimated cash flow waterfall for each issue acquired to 30 June 2012. During 2012-13 the AOFM will make further investments of $3,600 million in RMBS (2011-12 assumption: $6,628 million). These new issues have been modelled to have no principal repayments in 2012-13 (2011-12 assumption: $nil). Interest earned on investments is assumed to be returned to the OPA when received and not re-invested.

The sensitivity analysis does not consider possible adjustments that the AOFM might make to the composition of its portfolio in response to the assumed interest rate changes.

(c) Fair value sensitivity

The fair value sensitivity of the net debt portfolio (excluding loans to State and Territory Governments, which are measured on an accruals basis) to changes in domestic interest rates as at 30 June 2012 was $120.5 million per basis point (30 June 2011: $81.3 million per basis point). This means that a 1 basis point (or 0.01 per cent) parallel increase (decrease) in interest rates across the yield curve would result in a favourable (unfavourable) change of $120.5 million.

Note 26: 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 market by allowing bond market participants to borrow Treasury Bonds and Treasury Indexed Bonds when they are not readily available in the market. Bonds are lent on an intra-day or overnight basis. Where bonds are lent overnight the AOFM receives interest income. The following table details the security lending transactions completed during the year:

	Number of transactions	Number of transactions	**Face value loaned**	Face value loaned
	2012	2011	**2012**	2011
	No.	No.	**$'000**	$'000
Treasury Bonds:				
April 2012	**-**	8	**-**	329,600
May 2013	**-**	9	**-**	151,000
December 2013	**17**	1	**538,341**	141,000
October 2014	**-**	2	**-**	25,000
April 2015	**-**	16	**-**	484,309
June 2016	**3**	2	**370,300**	70,500
February 2017	**10**	8	**174,300**	185,710
July 2017	**7**	-	**137,000**	-
January 2018	**18**	1	**582,180**	10,200
March 2019	**10**	1	**334,100**	5,000
April 2020	**1**	-	**10,000**	-
May 2021	**1**	1	**80,000**	58,000
July 2022	**1**	-	**235,000**	-
Treasury Indexed Bonds:				
August 2015	**1**	-	**5,000**	-
August 2020	**-**	4	**-**	146,500
September 2025	**9**	1	**122,300**	8,000
Securities lent	**78**	54	**2,588,521**	1,614,819
Lending comprised:				
Overnight:				
Treasury Bonds	**56**	42	**1,338,121**	1,096,319
Treasury Indexed Bonds	**10**	5	**127,300**	154,500
Intra-day:				
Treasury Bonds	**12**	7	**1,123,100**	364,000
Treasury Indexed Bonds	**-**	-	**-**	-
Securities lent	**78**	54	**2,588,521**	1,614,819

	2012	2011
	$'000	$'000
Income on overnight lending(a):		
Treasury Bonds	**244**	146
Treasury Indexed Bonds	**26**	58
	270	204

(a) Income on loan transactions is recognised when received and is reported at Note 16B.

In 2011-12 no security lending transactions were open at the start of the financial year (2010-11: two loan transactions for stock with a face value of $83.5 million). In 2011-12 no security lending transactions were outstanding at the end of the financial year (2010-11: nil).

Note 27: Disclosures of appropriations

Note 27A: Annual appropriations

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

Annual appropriations

	Appropriation Act		FMA Act				
	Annual appropriation	Appropriation reduced(c)	Section 30	Section 31 (GST ex)	Total appropriation	Appropriation applied	Variance(d)
	2012	2012	2012	2012	2012	2012	2012
	$'000	$'000	$'000	$'000	$'000	$'000	$'000
Departmental							
Ordinary annual services(a)(b)	**15,442**	**-**	**-**	**706**	**16,148**	**(9,215)**	**6,933**
Other services							
Equity	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total departmental	**15,442**	**-**	**-**	**706**	**16,148**	**(9,215)**	**6,933**
Administered							
Ordinary annual services							
Outcome 1	**10**	**(10)**	**-**	**-**	**-**	**-**	**-**
Total administered	**10**	**(10)**	**-**	**-**	**-**	**-**	**-**

(a) Amounts presented in this table exclude GST where the GST is recoverable from the ATO.
(b) Amounts under Ordinary annual services include capital budget appropriations of $3.029 million which are recognised directly in Contributed Equity in the Balance Sheet.
(c) Reductions are presented in Note 27C. This administered reduction is legally affected under *Appropriation Act (No. 1) 2011-12* when the AOFM's annual report is tabled in Parliament.
(d) The variance is explained by the deferral of the purchase of a new Treasury management system budgeted for 2011-12, and lower than anticipated costs of undertaking additional issuance activity in response to the financial crisis.

Note 27: Disclosures of appropriations (continued)

Note 27A: Annual appropriations (continued)

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

Annual appropriations (continued)

	Appropriation Act		FMA Act				
	Annual appropriation	Appropriation reduced(c)	Section 30	Section 31 (GST ex)	Total appropriation	Appropriation applied	Variance(e)
	2011	2011	2011	2011	2011	2011	2011
	$'000	$'000	$'000	$'000	$'000	$'000	$'000
Departmental							
Ordinary annual services(a)(b)	16,146	-	-	797	16,943	(11,396)	5,547
Other services							
Equity(d)	-	-	-	-	-	(287)	(287)
Total departmental	16,146	-	-	797	16,943	(11,683)	5,260
Administered							
Ordinary annual services							
Outcome 1	10	(10)	-	-	-	-	-
Total administered	10	(10)	-	-	-	-	-

(a) Amounts presented in this table exclude GST where the GST is recoverable from the ATO.
(b) Amounts under Ordinary annual services include capital budget appropriations.
(c) Reductions are presented in Note 27C. This administered reduction is legally affected under *Appropriation Act (No. 1) 2010-11* when the AOFM's annual report is tabled in Parliament.
(d) During 2010-11 the AOFM drew against its equity injection to extend its software licence for its debt management system.
(e) The AOFM reallocated future years' outputs appropriations into 2010-11 to meet the costs of a syndicated issuance of Treasury Indexed Bonds. The volume of issuance was less than anticipated and so in consequence were the costs of syndication. This largely explains the variance reported for departmental ordinary annual services.

Note 27: Disclosures of appropriations (continued)

Note 27A: Annual appropriations (continued)

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

Departmental Capital Budget(a)

	Appropriation Act		FMA Act		Appropriation applied		
	Annual capital budget	**Appropriation reduced(c)**	**Section 32**	**Total capital budget**	**Non-financial assets(b)**	**Other purposes**	**Variance**
	2012	**2012**	**2012**	**2012**	**2012**	**2012**	**2012**
	$'000	**$'000**	**$'000**	**$'000**	**$'000**	**$'000**	**$'000**
Departmental							
Ordinary annual services - departmental capital budget	**3,029**	**-**	**-**	**3,029**	**(198)**	-	**2,831**
Total departmental	**3,029**	**-**	**-**	**3,029**	**(198)**	**-**	**2,831**
	2011	2011	2011	2011	2011	2011	2011
	$'000	$'000	$'000	$'000	$'000	$'000	$'000
Departmental							
Ordinary annual services - departmental capital budget	250	-	-	250	(144)	-	106
Total departmental	250	-	-	250	(144)	-	106

(a) The AOFM does not receive Administered capital budget funding.
(b) Amounts presented in this table exclude GST where the GST is recoverable from the ATO.
(c) Reductions are presented in Note 27C.

Note 27: Disclosures of appropriations (continued)

Note 27B: Unspent annual appropriation

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

	2012 $'000	2011 $'000
Unspent departmental annual appropriation		
Appropriation Act 2 2000-01	**662**	662
Appropriation Act 1 2006-07	**1,703**	1,703
Appropriation Act 3 2006-07	**100**	100
Appropriation Act 1 2007-08	**2,964**	2,964
Appropriation Act 1 2008-09	**2,677**	2,677
Appropriation Act 1 2009-10	**5,112**	5,112
Appropriation Act 1 2010-11	**5,547**	5,547
Appropriation Act 1 2011-12	**6,933**	-
Total	**25,698**	18,765
Represented by:		
Cash at bank	**100**	100
Appropriation receivable - output	**21,999**	17,897
Appropriation receivable - equity injection	**662**	662
Appropriation receivable - departmental capital budget	**2,937**	106
	25,698	18,765

	2012 $'000	2011 $'000
Unspent administered annual appropriation		
Appropriation Act 1 2010-11	**-**	10
Appropriation Act 1 2011-12	**10**	-
Total	**10**	10

Note 27: Disclosures of appropriations (continued)

Note 27C: Reduction in administered items

The AOFM receives an annual administered appropriation of $10,000 to meet potential payments that may arise on certain overdues that matured some time ago and an alternative appropriation source does not exist. The unspent and uncommitted funds arising from this appropriation are returned to the Budget on an annual basis.

For 2011-12 the AOFM received an appropriation authority of $10,000 in *Appropriation Act (No. 1) 2011-12* for this purpose. Section 11 of *Appropriation Act (No.1) 2011-12* creates an automatic reduction to the appropriation on tabling of the AOFM's annual report in Parliament where it identifies that an administered appropriation is no longer required, either in full or part.

The following table specifies the reduction in the annual administered appropriation for the AOFM. It reduces the AOFM's annual administered appropriation of $10,000 appropriated in *Appropriation Act (No. 1) 2011-12* to nil.

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

	2012 **$0.00**
Reduction in administered items	
Total administered items appropriated 2011-12	**10,000.00**
Less administered items required by the agency as per Appropriation Act, section 11:	
Appropriation Act (No. 1) 2011-2012	**0.00**
Total administered items required by the agency	**0.00**
Total reduction in administered items - effective 2012-13	**10,000.00**

Note 27: Disclosures of appropriations (continued)

Note 27D: Administered special appropriations (unlimited amount)

The following table details administered special appropriations applied by the AOFM:

	2012 $'000	2011 $'000
Airports (Transitional) Act 1996, section 78		
Purpose: payment of principal and interest on former debts of the Federal Airports Corporation	**-**	-
Australian National Railways Commission Sale Act 1997, section 67AW		
Purpose: payment of principal and interest on former debts of the National Railways Commission	**-**	-
Commonwealth Inscribed Stock Act 1911, section 6		
Purpose: payment of principal and interest on money raised by Stock issued under the Act	**80,657,340**	84,433,082
Commonwealth Inscribed Stock Act 1911, section 13A		
Purpose: payment of costs and expenses incurred in relation to issuing debt and managing debt(a)	**7,502**	-
Commonwealth Inscribed Stock Act 1911, section 13B		
Purpose: payment of costs and expenses incurred in repurchasing debt prior to maturity(a)	**1,833,904**	-
Financial Agreement Act 1994, section 5		
Purpose: debt redemption assistance and payment of interest to bond holders on behalf of the States and Northern Territory on public debt under the Act	**289**	312
Financial Management and Accountability Act 1997, section 30A		
Purpose: payments of recoverable GST	**-**	-
Financial Management and Accountability Act 1997, section 39(9)		
Purpose: to make investments in the name of the Commonwealth of Australia(b)	**1,071,859,151**	296,180,266

(a) On 29 June 2011, *Appropriation Act (No.2) 2011-12* received royal assent. The Act includes amendments to the *Commonwealth Inscribed Stock Act 1911*, including the establishment of standing appropriations.

(b) The AOFM draws appropriations to make investments. Some of these investments are used to manage the daily variations in the balance of the Official Public Account (OPA). The cash flows into and out of the OPA are highly variable from day to day and so in consequence are the number, size and timing of these investments. The amount reported for 2011 includes $102.189 million for the repurchase of Treasury Bonds prior to maturity.

Note 27: Disclosures of appropriations (continued)

Note 27D: Administered special appropriations (unlimited amount) (continued)

	2012 $'000	2011 $'000
Loans Redemption and Conversion Act 1921, section 5		
Purpose: payment of principal, interest and costs of converting loans made in accordance with the Act	**-**	-
Loans Securities Act 1919, section 4		
Purpose: payment of principal and interest on money raised by stock issued under the Act	**423**	463
Loans Securities Act 1919, section 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(c)	**-**	6,221,662
Loans Securities Act 1919, section 5BA		
Purpose: payment of money to enter into securities lending arrangements	**-**	-
Moomba-Sydney Pipeline System Sale Act 1994, section 19		
Purpose: payment of principal and interest on former debts of the Pipeline Authority	**-**	-
Qantas Sale Act 1992, section 18		
Purpose: payment of principal and interest on former debts of Qantas	**-**	-
Snowy Hydro Corporatisation Act 1997, section 22		
Purpose: payment of principal and interest on former debts of the Snowy Mountains Hydro Electricity Authority	**-**	-
Treasury Bills Act 1914, section 6		
Purpose: payment of principal and interest on money raised by issuance of Treasury Bills	**-**	-
Total	**1,154,358,609**	386,835,785

(c) During 2010-11 the AOFM conducted (for the first time) repurchase transactions with a number of members of its investment facility dealing panel.

Note 27: Disclosures of appropriations (continued)

Note 27E: Special appropriations (refund provisions)

In 2010-11 and 2011-12 the AOFM did not use section 28 of the *Financial Management and Accountability Act 1997* which provides for repayments of monies received by the Commonwealth where no other appropriation exists to refund the monies received.

Note 27F: Special appropriations (FMA section 39)

Investment of public money: Special appropriations under section 39 of the FMA Act in face value terms(a)	**2012 $'000**	2011 $'000
Amount invested brought forward from previous period	**25,079,805**	30,716,695
Investments made during the year(b)	**1,071,880,430**	296,232,220
Investments redeemed during the year	**(1,071,259,050)**	(301,869,110)
Amount invested carried to the next period (at face value)(c)	**25,701,185**	25,079,805

FMA = *Financial Management and Accountability Act 1997*.

(a) The 2010-11 amounts include repurchase of debt prior to maturity.

(b) This does not equate to actual expenditures made to acquire investments as investments are quoted in face value terms. See Note 27D for expenditures made.

(c) See Note 24I for details of investments held and Note 16 for details of investment income. The figures for 2011 include $100 million of Treasury Bonds which were repurchased under FMA section 39 (shown in investments made) and then redeemed (shown in investments redeemed). This accounts for the difference between the figures in the above table and the totals of the acquisitions and maturities/redemptions columns of Note 24I.

Note 27: Disclosures of appropriations (continued)

Note 27G: Special accounts (Administered)

Debt Retirement Reserve Trust Account (DRRTA)

Establishing Instrument — *Financial Management and Accountability Act 1997*, section 21.

Purpose —to fund the redemption of the State and 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.

	2012 $'000	2011 $'000
Balance brought forward from previous period	**566**	494
Appropriation for reporting period	**23**	26
Interest amounts credited	**25**	22
Other receipts:		
State and Territory contributions	**755**	1,331
Available for payments	**1,369**	1,873
Total increase	**803**	1,379
Payments made:		
Debt repayments	**(712)**	(1,307)
Total decrease	**(712)**	(1,307)
Balance	**657**	566
Balance represented by:		
Cash - held in the Official Public Account	**657**	566
Total balance carried to the next period	**657**	566

Note 27H: Assets held in trust (Administered)

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

Details of balances, payments and receipts in relation to the Debt Retirement Reserve Trust Account are provided in Note 27G: Special accounts (Administered).

Note 28: Reporting of outcomes

The AOFM delivers a single 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.

	Outcome 1	Outcome 1
	2012	2011
	$'000	$'000
Expenses		
Administered	**11,420,896**	9,272,883
Departmental	**10,297**	11,786
Total expenses	**11,431,193**	9,284,669
Own-source income		
Administered		
Interest	**1,412,392**	1,375,603
Other	**270**	243
Gains (losses)	**(20,574,263)**	327,364
Total administered	**(19,161,601)**	1,703,210
Departmental		
Other(a)	**722**	772
Total departmental	**722**	772
Total own-source income	**(19,160,879)**	1,703,982
Net cost/(contribution) of outcome	**30,592,072**	7,580,687

(a) Excludes resources received free of charge from the ANAO.

Note 29: Net cash appropriation arrangements

The following table reports the amount of depreciation and amortisation expenses for which the AOFM no longer receives revenue appropriations.

	2012	2011
	$'000	$'000
Total comprehensive income excluding expenses previously funded through revenue appropriations(a)	**3,495**	5,491
Less:depreciation/amortisation expenses previously funded through revenue appropriation	**(354)**	(315)
Total comprehensive income as per the Statement of Comprehesive Income	**3,141**	5,176

(a) From 2010-11, the Government introduced net cash appropriation arrangements, where revenue appropriations for depreciation/amortisation expenses ceased. The AOFM now receives a separate capital budget.

Note 30: 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 and Deregulation 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.

The AOFM undertook a risk assessment for the 2011-12 financial year. No breaches of Section 83 were identified and the overall risk of a breach was considered low.

Note 31: Events occurring after reporting date

There have been no significant events occurring after the reporting date that would materially affect these financial statements.

PART 5: OTHER INFORMATION

Other information

Funding

Table 1 places the AOFM's asset and liability management activities in 2011-12 in the context of budget financing for the Australian Government and in particular as it covers the General Government Sector. Flows managed by the AOFM are shown in blue.

Table 1: General Government Sector funding requirement and funding sources

Source of funds	Actual 2011-12 ($billion)	Use of funds	Actual 2011-12 ($billion)
		Headline budget balance	47.0
Debt issuance[a]		**Debt redemption**[a]	
Treasury Bonds	62.8	Maturing Treasury Bonds	12.3
Treasury Indexed Bonds	2.6	Treasury Notes (net)	4.1
Total	**65.3**	Early CGS debt repurchases	1.8
		Total	**18.2**
Financial assets		**Financial assets**	
Change in Official Public Account balance at the RBA	0.3	Change in AOFM asset holdings	0.3
Change in other general government sector investments	1.2	**Total**	**0.3**
Total	**1.6**	**Other applications of funds**	
		Other financing (net) [b]	1.3
		Other general government sector borrowings (net)	0.1
		Total	**1.4**
Total	**66.9**	**Total**	**66.9**

(a) Cash flows rather than face value of securities.
(b) Includes other general government sector flows not elsewhere classified.
Not all totals may sum exactly due to rounding.

Agency resource statement and resources for outcomes

Table 2: AOFM resource statement

		Actual available appropriation 2011-12 $'000	-	Payments made (a) 2011-12 $'000	=	Balance 2011-12 $'000
Ordinary annual services						
Departmental appropriation(b) (c)		33,545		8,509		25,036
Receipts from other sources (s31)(d)		706		706		-
Total departmental		34,251		9,215		25,036
Administered expenses						
Outcome 1		10		-		10
Total administered		10		-		10
Total ordinary annual services	**A**	34,261		9,215		25,046
Other services						
Departmental non-operating		662		-		662
Total other services	**B**	662		-		662
Total available annual appropriations (A + B)		34,923		9,215		25,708
Special appropriations non-capital						
Commonwealth Inscribed Stock Act 1911		11,630,165		11,630,165		-
Financial Agreement Act 1994		289		289		-
Loans Securities Act 1919		423		423		-
Subtotal		11,630,877		11,630,877		-
Special appropriations capital						
Commonwealth Inscribed Stock Act 1911		70,868,581		70,868,581		-
Financial Management and Accountability Act 1997		1,071,859,151		1,071,859,151		-
Subtotal		1,142,727,732		1,142,727,732		-
Total special appropriations	**C**	1,154,358,609		1,154,358,609		-
Total appropriations excluding special accounts (A + B + C)		1,154,393,532		1,154,367,824		25,708
Special Accounts						
Debt Retirement Reserve Trust Account						
Opening balance		566		-		-
Appropriation receipts		23		-		-
Non-appropriation receipts to special account						-
Interest amount credited		25		-		-
State and Territory contributions		755		-		-
Payments made		-		712		-
Total Special Account	**D**	1,369		712		657
Total net resourcing and payments for AOFM (A + B + C + D)		1,154,394,901		1,154,368,536		26,365

(a) Amounts presented in this table exclude GST where the GST is recoverable from the ATO.
(b) *Appropriation Bill (No. 1) 2011-12* plus carried forward cash balances as at 1 July 2011.
(c) Includes capital budget appropriation.
(d) Receipts received under s31 of *the Financial Management and Accountability Act 1997*.

Table 3: 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) 2011-12 $'000**	**Actual Expenses 2011-12 $'000**	**Variation $'000**
Program 1.1: Australian Office of Financial Management			
Departmental expenses			
Departmental appropriation	11,271	9,640	1,631
Expenses not requiring appropriation in the Budget year	621	657	(36)
Administered expenses before re-measurements			
Ordinary annual services (Appropriation Bill No.1)	10	-	10
Special appropriations expenses			
Commonwealth Inscribed Stock Act 1911	11,525,172	11,428,388	96,784
Loans Securities Act 1919	400	692	(292)
Financial Agreement Act 1994	28	299	(271)
Total for Program 1.1	11,537,502	11,439,676	97,826
	2010-11	**2011-12**	
Average staffing level (number)	**37**	**40**	

(a) The Budget figure for 2011-12 is the estimated actual 2011-12 expenses, reported in table 2.1 of the *Portfolio Budget Statements 2012-13*.

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 2011-12, the AOFM made no payments to market research organisations, polling organisations or direct mail organisations.

The AOFM incurred expenditure of $133,852 in campaign advertising to promote Australian Government debt to investors. Of this $17,281 was paid to Vinten Browning for development of the advertisements and $116,571 was paid to Mediabrands Australia Pty Ltd for placement of the advertisements.

In addition, the AOFM incurred expenditure of $36,145 during 2011-12 to media advertising organisations for staff recruitment. No advertising expenditure on an individual position was over $11,900.

Freedom of information

Agencies subject to the *Freedom of Information Act 1982* (the Act) are required to publish information on a website as part of the Information Publication Scheme (IPS) provisions in Part II of the Act. This requirement has replaced the former requirement to publish a section 8 statement in an annual report. Freedom of Information (FOI) matters in respect to the AOFM are handled by the Treasury. Treasury reports on AOFM's FOI requests in an annual submission to the Office of the Australian Information Commissioner (OAIC) for inclusion in OAIC's annual report.

An agency plan showing what information is published in accordance with the IPS requirements, including material relevant to AOFM, is accessible from 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 Treasury under a Service Level Agreement. Information on the environmental impact of these services is published in the Treasury's Annual Report.

Structure of AOFM's portfolio

The assets and liabilities managed by the AOFM and held on its administered balance sheet in 2011-12 were Commonwealth Government Securities (Treasury Bonds, Treasury Indexed Bonds, Treasury Notes and other securities), short-term money market investments, term deposits placed with the RBA, residential-mortgage backed securities (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 portfolios: the Long-Term Debt Portfolio, the Cash Management Portfolio, the RMBS Portfolio and the Housing Advances Portfolio. 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 Commonwealth Government Securities, other than Treasury Notes, which are issued for cash management purposes.

As no borrowings have been undertaken in foreign currencies since 1987 the 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 receipts and outlays. It contains all the assets and liabilities not held in the other three portfolios.

The **RMBS Portfolio** contains residential mortgage-backed securities purchased by the AOFM.

The **Housing Advances Portfolio** comprises loans for public housing made by the Commonwealth 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.

Residential mortgage-backed securities portfolio

The AOFM's investments in residential mortgage-backed securities up to 30 June 2012 are shown in Table 3.

Table 4: AOFM's RMBS investments up to 30 June 2012

Pricing date	Settlement date	Issuer	Issue name	Tranche	Expected WAL* at closing (years)	Coupon (per cent)	Original face value ($m)
14-Nov-08	21-Nov-08	FirstMac	FirstMac Mortgage Funding Trust Series 2-2008	Class A1	0.7	1M BBSW + 1.25%	132.00
14-Nov-08	21-Nov-08	FirstMac	FirstMac Mortgage Funding Trust Series 2-2008	Class A2	3.5	1M BBSW + 1.50%	325.00
14-Nov-08	21-Nov-08	FirstMac	FirstMac Mortgage Funding Trust Series 2-2008	Class AB	5.0	1M BBSW + 1.80%	39.00
17-Nov-08	9-Dec-08	Members' Equity Bank	SMHL Securitisation Fund 2008-2	Class A1	2.8	1M BBSW + 1.30%	500.00
4-Dec-08	12-Dec-08	Challenger	Challenger Millennium Series 2008-2 Trust	Class A	2.8	1M BBSW + 1.35%	481.00
4-Dec-08	12-Dec-08	Challenger	Challenger Millennium Series 2008-2 Trust	Class AB	4.5	1M BBSW + 1.75%	19.00
10-Dec-08	15-Dec-08	RESIMAC	RESIMAC Premier Series 2008-1	Class A2	1.5	1M BBSW + 1.20%	280.00
10-Dec-08	15-Dec-08	RESIMAC	RESIMAC Premier Series 2008-1	Class A3	4.5	1M BBSW + 1.40%	204.75
10-Dec-08	15-Dec-08	RESIMAC	RESIMAC Premier Series 2008-1	Class AB	4.5	1M BBSW + 1.70%	15.25
6-Mar-09	26-Mar-09	CUA	Series 2009-1 Harvey Trust	Class A1	3.6	1M BBSW + 1.40%	350.00
13-Mar-09	18-Mar-09	Bendigo and Adelaide Bank	TORRENS Series 2009-1 Trust	Class A2	4.2	1M BBSW + 1.35%	475.00
23-Mar-09	30-Mar-09	AMP Bank	Progress 2009-1 Trust	Class A2	4.0	1M BBSW + 1.30%	425.00
3-Apr-09	21-Apr-09	Bank of Queensland	Series 2009-1 REDS Trust	Class A1	4.2	1M BBSW + 1.30%	500.00
9-Apr-09	20-Apr-09	Liberty Financial	Liberty Prime Series 2009-1	Class A1	0.1	1M BBSW + 0.90%	14.50
9-Apr-09	20-Apr-09	Liberty Financial	Liberty Prime Series 2009-1	Class A2	0.9	1M BBSW + 1.20%	164.70
9-Apr-09	20-Apr-09	Liberty Financial	Liberty Prime Series 2009-1	Class A3	3.2	1M BBSW + 1.40%	283.00
9-Apr-09	20-Apr-09	Liberty Financial	Liberty Prime Series 2009-1	Class AB	4.0	1M BBSW + 1.65%	37.80
15-Apr-09	24-Apr-09	Challenger	Challenger Millennium Series 2009-1 Trust	Class A2	0.5	1M BBSW + 1.00%	38.20
15-Apr-09	24-Apr-09	Challenger	Challenger Millennium Series 2009-1 Trust	Class A3	1.5	1M BBSW + 1.30%	152.50
15-Apr-09	24-Apr-09	Challenger	Challenger Millennium Series 2009-1 Trust	Class A4	4.3	1M BBSW + 1.45%	289.00
15-Apr-09	24-Apr-09	Challenger	Challenger Millennium Series 2009-1 Trust	Class AB	4.4	1M BBSW + 1.70%	20.30
11-May-09	14-May-09	Members' Equity Bank	SMHL Securitisation Fund 2009-1	Class A2	3.7	1M BBSW + 1.35%	500.00
21-May-09	28-May-09	RESIMAC	RESIMAC Premier Series 2009-1	Class A2	0.5	1M BBSW + 1.00%	10.00
21-May-09	28-May-09	RESIMAC	RESIMAC Premier Series 2009-1	Class A3	2.9	1M BBSW + 1.40%	435.00
21-May-09	28-May-09	RESIMAC	RESIMAC Premier Series 2009-1	Class AB	4.1	1M BBSW + 1.70%	13.80
1-Jun-09	5-Jun-09	FirstMac	FirstMac Mortgage Funding Trust Series 1-2009	Class A3	2.9	1M BBSW + 1.40%	458.00
1-Jun-09	5-Jun-09	FirstMac	FirstMac Mortgage Funding Trust Series 1-2009	Class AB	5.0	1M BBSW + 2.20%	40.62
9-Jul-09	16-Jul-09	Wide Bay Australia	WB Trust 2009-1	Class A1	0.5	1M BBSW + 1.10%	16.00
9-Jul-09	16-Jul-09	Wide Bay Australia	WB Trust 2009-1	Class A2	3.5	1M BBSW + 1.40%	282.50
9-Jul-09	16-Jul-09	Wide Bay Australia	WB Trust 2009-1	Class AB	5.4	1M BBSW + 1.60%	1.00
14-Jul-09	28-Jul-09	Australian Central Credit Union	Light Trust No. 2	Class A1	4.0	1M BBSW + 1.30%	190.00
20-Aug-09	4-Sep-09	Suncorp Metway	APOLLO Series 2009-1 Trust	Class A3	3.6	1M BBSW + 1.30%	499.20
28-Aug-09	11-Sep-09	Greater Building Society	GBS Receivables Trust No. 4	Class A1	4.3	1M BBSW + 1.35%	190.00

Table 4: AOFM's RMBS investments up to 30 June 2012 (continued)

Pricing date	Settlement date	Issuer	Issue name	Tranche	Expected WAL* at closing (years)	Coupon (per cent)	Original face value ($m)
14-Oct-09	21-Oct-09	Liberty Financial	Liberty Prime Series 2009-2	Class A2	1.0	1M BBSW + 0.90%	35.00
14-Oct-09	21-Oct-09	Liberty Financial	Liberty Prime Series 2009-2	Class A3	3.3	1M BBSW + 1.40%	58.50
14-Oct-09	21-Oct-09	Liberty Financial	Liberty Prime Series 2009-2	Class AB	4.0	1M BBSW + 1.65%	6.30
21-Oct-09	28-Oct-09	RESIMAC	RESIMAC Premier Series 2009-2	Class A2	3.3	1M BBSW + 1.40%	38.10
21-Oct-09	28-Oct-09	RESIMAC	RESIMAC Premier Series 2009-2	Class AB	3.5	1M BBSW + 1.95%	18.30
10-Nov-09	24-Nov-09	FirstMac	FirstMac Mortgage Funding Trust Series 2-2009	Class A2	3.5	1M BBSW + 1.40%	195.40
10-Nov-09	24-Nov-09	FirstMac	FirstMac Mortgage Funding Trust Series 2-2009	Class AB	5.0	1M BBSW + 1.95%	19.74
22-Jan-10	29-Jan-10	AMP Bank	Progress 2010-1 Trust	Class AB	5.2	1M BBSW + 1.80%	36.00
9-Feb-10	17-Feb-10	Bank of Queensland	Series 2010-1 REDS Trust	Class A	3.1	1M BBSW + 1.30%	250.00
25-Feb-10	10-Mar-10	CUA	Series 2010-1 Harvey Trust	Class A1	2.9	1M BBSW + 1.35%	143.00
5-Mar-10	15-Mar-10	Members' Equity Bank	SMHL Securitisation Fund 2010-1	Class A	2.6	1M BBSW + 1.35%	250.00
17-Mar-10	24-Mar-10	Bendigo and Adelaide Bank	TORRENS Series 2010-1 Trust	Class A	2.8	1M BBSW + 1.35%	123.00
26-Mar-10	31-Mar-10	IMB	Illawarra Series 2010-1 RMBS Trust	Class A	3.0	1M BBSW + 1.35%	157.50
12-May-10	17-May-10	RESIMAC	RESIMAC Premier Series 2010-1	Class A	2.4	1M BBSW + 1.65%	10.00
28-May-10	9-Jun-10	Suncorp Metway	APOLLO Series 2010-1 Trust	Class A2	6.0	1M BBSW + 1.10%	300.00
2-Jul-10	14-Jul-10	Members' Equity Bank	SMHL Securitisation Fund 2010-2E	Class A3	5.7	1M BBSW + 1.10%	250.00
8-Jul-10	20-Jul-10	Bendigo and Adelaide Bank	TORRENS Series 2010-2 Trust	Class A3	3.0	1M BBSW + 1.10%	19.50
8-Jul-10	20-Jul-10	Bendigo and Adelaide Bank	TORRENS Series 2010-2 Trust	Class A4	5.8	1M BBSW + 1.10%	476.50
23-Jul-10	4-Aug-10	MyState Financial	ConQuest 2010-2 Trust	Class A2	1.5	1M BBSW + 1.40%	20.00
23-Jul-10	4-Aug-10	MyState Financial	ConQuest 2010-2 Trust	Class A3	5.0	1M BBSW + 1.30%	139.25
23-Jul-10	4-Aug-10	MyState Financial	ConQuest 2010-2 Trust	Class AB	3.7	1M BBSW + 1.85%	10.75
11-Aug-10	18-Aug-10	Liberty Financial	Liberty Prime Series 2010-1	Class A2	3.3	1M BBSW + 1.25%	90.00
11-Aug-10	18-Aug-10	Liberty Financial	Liberty Prime Series 2010-1	Class AB	4.0	1M BBSW + 1.65%	10.40
18-Aug-10	27-Aug-10	Bank of Queensland	Series 2010-2 REDS Trust	Class A2	6.2	1M BBSW + 1.10%	497.60
26-Aug-10	2-Sep-10	Macquarie Bank	PUMA Masterfund P-16	Class A3	6.3	1M BBSW + 1.15%	247.50
6-Sep-10	9-Sep-10	FirstMac	FirstMac Mortgage Funding Trust Series 1-2010	Class A3	4.7	1M BBSW + 1.30%	164.00
6-Sep-10	9-Sep-10	FirstMac	FirstMac Mortgage Funding Trust Series 1-2010	Class AB	3.6	1M BBSW + 2.20%	26.77
23-Sep-10	28-Sep-10	Members' Equity Bank	SMHL Securitisation Fund 2010-3	Class A2	6.1	1M BBSW + 1.10%	290.00
14-Oct-10	20-Oct-10	ING Bank (Australia)	IDOL Trust Series 2010-1	Class A2	7.5	1M BBSW + 1.10%	250.00
10-Nov-10	18-Nov-10	Australian Central Credit Union	Light Trust No. 3	Class A3	5.4	1M BBSW + 1.20%	243.50
19-Nov-10	25-Nov-10	RESIMAC	RESIMAC Premier Series 2010-2	Class A2	4.8	1M BBSW + 1.25%	148.00
26-Nov-10	3-Dec-10	Police and Nurses Credit Socie	Pinnacle Series Trust 2010-T1	Class A2	7.2	1M BBSW + 1.25%	96.50
26-Nov-10	3-Dec-10	Police and Nurses Credit Socie	Pinnacle Series Trust 2010-T1	Class AB	6.7	1M BBSW + 2.00%	14.60

Table 4: AOFM's RMBS investments up to 30 June 2012 (continued)

Pricing date	Settlement date	Issuer	Issue name	Tranche	Expected WAL* at closing (years)	Coupon (per cent)	Original face value ($m)
10-Dec-10	16-Dec-10	Bendigo and Adelaide Bank	TORRENS Series 2010-3 Trust	Class A5	4.6	1M BBSW + 1.10%	395.00
10-Dec-10	16-Dec-10	Bendigo and Adelaide Bank	TORRENS Series 2010-3 Trust	Class AB	4.7	1M BBSW + 1.80%	20.00
15-Dec-10	21-Dec-10	Wide Bay Australia	WB Trust 2010-1	Class A2	6.6	1M BBSW + 1.25%	81.20
15-Dec-10	21-Dec-10	Wide Bay Australia	WB Trust 2010-1	Class AB	6.2	1M BBSW + 2.00%	23.00
17-Mar-11	24-Mar-11	Members' Equity Bank	SMHL Securitisation Fund 2011-1^				0.00
7-Apr-11	14-Apr-11	Community CPS	Barton Series 2011-1 Trust	Class A2	6.5	1M BBSW + 1.25%	90.90
8-Apr-11	13-Apr-11	Liberty Financial	Liberty Prime Series 2011-1	Class A2	4.0	1M BBSW + 1.30%	50.75
15-Apr-11	20-Apr-11	Macquarie Bank	PUMA Masterfund P-17	Class A2	5.6	1M BBSW + 1.15%	157.50
13-May-11	19-May-11	RESIMAC	RESIMAC Premier Series 2011-1	Class A	2.9	1M BBSW + 1.25%	170.00
13-May-11	19-May-11	RESIMAC	RESIMAC Premier Series 2011-1	Class AB	2.4	1M BBSW + 1.75%	22.00
20-May-11	27-May-11	AMP Bank	Progress 2011-1 Trust	Class A2	5.8	1M BBSW + 1.15%	138.00
10-Jun-11	17-Jun-11	ING Bank (Australia)	IDOL Trust Series 2011-1	Class A1	3.6	1M BBSW + 1.10%	206.00
11-Jul-11	14-Jul-11	Heritage Building Society	HBS Trust 2011-1	Class AB	5.5	1M BBSW + 1.95%	21.60
14-Jul-11	21-Jul-11	Bendigo and Adelaide Bank	TORRENS Series 2011-1(E) Trust	Class A3	6.6	1M BBSW + 1.20%	195.00
14-Jul-11	21-Jul-11	Bendigo and Adelaide Bank	TORRENS Series 2011-1(E) Trust	Class AB	5.6	1M BBSW + 1.75%	27.50
12-Oct-11	19-Oct-11	Members' Equity Bank	SMHL Securitisation Fund 2011-2	Class A	3.0	1M BBSW + 1.25%	175.25
12-Oct-11	19-Oct-11	Members' Equity Bank	SMHL Securitisation Fund 2011-2	Class AB	5.3	1M BBSW + 2.10%	25.25
28-Oct-11	4-Nov-11	Bendigo and Adelaide Bank	TORRENS Series 2011-2 Trust	Class A2	6.3	1M BBSW + 1.50%	163.75
28-Oct-11	4-Nov-11	Bendigo and Adelaide Bank	TORRENS Series 2011-2 Trust	Class AB	6.3	1M BBSW + 2.50%	26.25
11-Nov-11	18-Nov-11	ING Bank (Australia)	IDOL Trust Series 2011-2	Class A1	2.7	1M BBSW + 1.35%	146.50
11-Nov-11	18-Nov-11	ING Bank (Australia)	IDOL Trust Series 2011-2	Class A2	5.0	5.50%	50.00
23-Nov-11	8-Dec-11	Suncorp Metway	APOLLO Series 2011-1 Trust	Class A2	5.9	1M BBSW + 1.50%	250.00
23-Nov-11	8-Dec-11	Suncorp Metway	APOLLO Series 2011-1 Trust	Class AB	5.9	1M BBSW + 2.50%	63.00
20-Dec-11	22-Dec-11	FirstMac	FirstMac Mortgage Funding Trust Series 2-2011	Class A3	7.0	1M BBSW + 1.65%	87.70
20-Dec-11	22-Dec-11	FirstMac	FirstMac Mortgage Funding Trust Series 2-2011	Class AB	5.7	1M BBSW + 2.75%	11.70
29-Mar-12	12-Apr-12	ING Bank (Australia)	IDOL Trust Series 2012-1	Class A1	3.2	1M BBSW + 1.45%	200.00
13-Apr-12	23-Apr-12	Members' Equity Bank	SMHL Securitisation Fund 2012-1	Class A3	2.8	1M BBSW + 1.50%	123.50
17-May-12	29-May-12	AMP Bank	Progress 2012-1 Trust	Class A	3.4	1M BBSW + 1.55%	195.65
17-May-12	29-May-12	AMP Bank	Progress 2012-1 Trust	Class AB	5.9	1M BBSW + 2.85%	30.78
1-Jun-12	14-Jun-12	RESIMAC	RESIMAC Premier Series 2012-1	Class A2	2.4	1M BBSW + 1.65%	137.00
							15302.61

*Weighted average life

^The AOFM final allocation was zero

Tender results for debt issuance

Table 5: Treasury Bond tender results — 2011-12

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-11	4.75% 21-Oct-2015	1,250	4.9022	N/A	2.50	3.51
6-Jul-11	5.25% 15-Mar-2019	700	5.1236	-0.64	1.50	4.60
8-Jul-11	4.50% 21-Oct-2014	700	4.7621	-0.04	0.50	5.47
13-Jul-11	5.50% 21-Apr-2023	700	5.0571	0.21	1.00	3.44
15-Jul-11	5.50% 21-Jan-2018	700	4.7799	-1.26	0.50	4.03
20-Jul-11	4.50% 15-Apr-2020	700	4.8933	-0.42	1.00	3.61
22-Jul-11	4.75% 15-Jun-2016	700	4.5949	-0.26	1.00	5.96
29-Jul-11	4.75% 21-Oct-2015	1,000	4.5374	-0.76	1.00	3.23
3-Aug-11	5.50% 21-Apr-2023	700	4.7824	0.74	1.00	2.79
5-Aug-11	5.50% 21-Jan-2018	700	4.2675	0.25	3.00	2.18
10-Aug-11	5.75% 15-May-2021	700	4.6041	-1.34	3.00	1.70
12-Aug-11	4.50% 21-Oct-2014	700	3.8581	-0.19	0.50	3.77
17-Aug-11	4.50% 15-Apr-2020	700	4.4018	-0.32	1.00	3.21
19-Aug-11	4.75% 15-Jun-2016	700	3.7038	-0.12	1.50	3.51
24-Aug-11	5.50% 21-Jan-2018	700	4.1122	0.22	2.50	2.62
26-Aug-11	6.00% 15-Feb-2017	700	4.1157	-0.93	1.00	3.98
31-Aug-11	5.75% 15-Jul-2022	700	4.4786	-0.39	1.00	2.52
2-Sep-11	4.25% 21-Jul-2017	1,000	4.1173	N/A	2.50	3.21
7-Sep-11	5.50% 21-Jan-2018	700	4.0336	-0.89	0.50	3.36
9-Sep-11	4.75% 21-Oct-2015	750	3.8063	0.88	2.50	2.13
16-Sep-11	4.25% 21-Jul-2017	1,000	3.9308	-0.67	2.00	2.04
21-Sep-11	5.75% 15-Jul-2022	700	4.2802	0.77	1.50	1.91
23-Sep-11	5.50% 21-Jan-2018	700	3.8112	0.12	1.50	1.71
28-Sep-11	5.75% 15-May-2021	850	4.2619	0.19	2.00	1.58
30-Sep-11	4.75% 15-Jun-2016	700	3.8246	-0.04	2.00	2.14
5-Oct-11	5.50% 21-Jan-2018	700	3.8044	-0.31	1.50	2.12
7-Oct-11	6.25% 15-Jun-2014	700	3.5901	-0.49	1.00	3.31
12-Oct-11	4.25% 21-Jul-2017	700	4.0550	0.75	1.50	3.26
14-Oct-11	4.50% 21-Oct-2014	700	3.8512	-0.38	1.00	2.70
21-Oct-11	4.75% 21-Oct-2015	700	3.9834	0.59	1.00	2.69
28-Oct-11	5.50% 21-Jan-2018	700	4.3800	0.25	1.00	2.84
2-Nov-11	5.50% 21-Apr-2023	700	4.4139	-0.36	1.50	2.32
4-Nov-11	6.25% 15-Jun-2014	700	3.7028	0.28	0.50	2.49
9-Nov-11	5.25% 15-Mar-2019	700	4.1178	0.53	0.50	2.22
11-Nov-11	4.25% 21-Jul-2017	700	3.7820	-0.55	0.50	3.09
16-Nov-11	5.75% 15-May-2021	650	4.0958	-0.17	1.00	3.45
18-Nov-11	4.50% 21-Oct-2014	750	3.3067	0.17	1.00	2.50
23-Nov-11	4.50% 15-Apr-2020	700	3.8532	0.07	1.50	2.34
25-Nov-11	4.75% 15-Jun-2016	700	3.2483	-0.42	0.50	3.39
30-Nov-11	5.50% 21-Apr-2023	700	4.1591	1.16	2.50	1.33
2-Dec-11	4.75% 21-Oct-2015	700	3.3996	-0.79	1.50	3.11
7-Dec-11	4.25% 21-Jul-2017	700	3.5229	-0.96	1.50	2.88
9-Dec-11	5.25% 15-Mar-2019	700	3.6105	0.05	2.00	1.82

Table 5: Treasury Bond tender results — 2011-12 (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
1-Feb-12	5.75% 15-Jul-2022	700	3.8059	0.09	1.00	2.70
3-Feb-12	5.50% 21-Jan-2018	700	3.4589	-0.11	0.50	2.47
8-Feb-12	5.50% 21-Apr-2023	700	4.1581	-0.19	1.50	2.85
10-Feb-12	4.25% 21-Jul-2017	700	3.7834	-0.91	1.00	4.31
15-Feb-12	5.75% 15-May-2021	700	4.0036	-0.39	0.50	3.08
17-Feb-12	4.75% 15-Jun-2016	700	3.6643	-1.32	0.50	4.96
22-Feb-12	5.50% 21-Jan-2018	700	3.8443	0.18	1.00	3.21
24-Feb-12	4.75% 21-Oct-2015	700	3.7420	-0.30	1.00	4.12
29-Feb-12	5.50% 21-Apr-2023	700	4.1909	0.09	1.00	2.61
2-Mar-12	4.25% 21-Jul-2017	700	3.8550	0.00	1.50	3.21
7-Mar-12	5.25% 15-Mar-2019	700	3.8459	-0.41	1.00	2.10
9-Mar-12	6.00% 15-Feb-2017	700	3.6813	-0.37	1.00	3.20
16-Mar-12	4.75% 21-Apr-2027	490	4.6245	-0.30	1.00	2.49
21-Mar-12	5.75% 15-Jul-2022	700	4.3695	0.70	1.50	2.42
23-Mar-12	4.50% 21-Oct-2014	700	3.6904	-0.96	1.50	3.00
28-Mar-12	4.50% 15-Apr-2020	700	4.0381	0.31	0.50	2.37
30-Mar-12	4.75% 21-Oct-2015	700	3.5109	0.09	1.00	2.68
4-Apr-12	4.25% 21-Jul-2017	700	3.6686	-0.14	1.00	2.74
11-Apr-12	5.50% 21-Apr-2023	700	3.9160	0.10	1.00	2.16
18-Apr-12	5.75% 15-Jul-2022	700	3.8691	-0.09	1.00	2.61
27-Apr-12	5.50% 21-Jan-2018	700	3.2856	0.00	1.00	2.24
2-May-12	5.50% 21-Apr-2023	700	3.7115	-0.60	1.00	2.97
11-May-12	5.75% 15-Jul-2022	700	3.3819	-0.31	0.50	4.28
16-May-12	5.50% 21-Apr-2023	700	3.3628	-0.22	1.00	3.86
18-May-12	4.75% 21-Oct-2015	700	2.5189	0.64	1.00	3.97
23-May-12	5.75% 15-Jul-2022	700	3.1479	-0.21	0.50	3.14
25-May-12	4.25% 21-Jul-2017	700	2.6524	0.49	1.00	3.42
30-May-12	4.75% 21-Apr-2027	700	3.4844	0.19	2.00	3.22
1-Jun-12	5.75% 15-May-2021	700	2.7450	0.50	2.00	2.24
6-Jun-12	5.50% 21-Apr-2023	700	3.0680	0.05	1.00	2.73
8-Jun-12	5.50% 21-Jan-2018	700	2.6600	-1.25	1.50	4.81
13-Jun-12	6.00% 15-Feb-2017	700	2.4438	-1.12	1.50	5.00
20-Jun-12	2.75% 21-Apr-2024	1,000	3.2816	N/A	5.50	2.28
Average over year to June 2012				-0.15	1.30	3.02
Average over 3 years to June 2012				-0.09	1.13	3.50
Average over 10 years to June 2012				0.05	1.18	3.62

Table 6: Treasury Indexed Bond tender results — 2011-12

Tender date	Coupon and maturity	Face value amount allocated ($m)	Weighted average issue yield (%)	Spread to secondary market yield (basis points)	Times covered
19-Jul-11	4.00% 20-Aug-2020	100	2.1300	2.00	2.35
19-Jul-11	2.50% 20-Sep-2030	100	2.3500	1.00	2.35
23-Aug-11	4.00% 20-Aug-2020	100	1.6100	0.50	2.70
23-Aug-11	3.00% 20-Sep-2025	100	1.8700	6.50	1.85
27-Sep-11	4.00% 20-Aug-2020	50	1.5050	1.00	5.20
18-Oct-11	4.00% 20-Aug-2020	50	1.8000	-1.00	5.46
22-Nov-11	4.00% 20-Aug-2020	100	1.3750	-2.00	3.50
22-Nov-11	2.50% 20-Sep-2030	100	1.8350	0.00	3.07
20-Mar-12	3.00% 20-Sep-2025	140	1.5700	-2.50	3.94
17-Apr-12	1.25% 21-Feb-2022	140	1.0500	1.00	3.38
22-May-12	2.50% 20-Sep-2030	100	1.1050	-1.50	4.42
19-Jun-12	1.25% 21-Feb-2022	150	0.5350	-1.50	3.43
Average over year to June 2012				0.29	3.47
Average over 3 years to June 2012				-0.86	3.80

Table 7: Treasury Note tender results — 2011-12

Tender date	Maturity	Face value amount allocated ($m)	Weighted average issue yield (%)	Range of bids accepted (basis points)	Times covered	Spread to OIS (basis points)	Spread to BBSW (basis points)
7-Jul-11	09-Sep-11	500	4.7083	4.0	4.09	-4.10	-22.55
14-Jul-11	09-Sep-11	500	4.6829	5.0	4.90	-2.04	-21.38
14-Jul-11	21-Oct-11	800	4.6493	7.0	4.29	-0.62	-32.96
21-Jul-11	21-Oct-11	1,000	4.6352	1.0	6.51	-7.48	-27.81
21-Jul-11	11-Nov-11	1,000	4.6354	2.0	5.70	-6.11	-28.92
28-Jul-11	21-Oct-11	500	4.6400	0.0	8.58	-16.00	-36.50
4-Aug-11	21-Oct-11	500	4.5644	14.0	4.36	-7.43	-42.03
4-Aug-11	11-Nov-11	300	4.5477	9.0	5.32	-13.39	-43.33
11-Aug-11	21-Oct-11	1,000	4.1715	15.0	4.22	-10.08	-67.21
11-Aug-11	11-Nov-11	1,000	3.9886	15.0	4.44	-14.14	-83.47
18-Aug-11	21-Oct-11	1,000	4.3347	19.0	4.81	-22.08	-53.17
25-Aug-11	21-Oct-11	600	4.3590	14.0	6.38	-18.17	-48.82
25-Aug-11	11-Nov-11	1,000	4.3114	7.0	5.54	-10.99	-56.94
1-Sep-11	11-Nov-11	1,000	4.4924	22.0	2.82	-7.76	-31.76
1-Sep-11	16-Dec-11	500	4.3549	13.0	3.68	-7.89	-43.77
8-Sep-11	11-Nov-11	1,000	4.4722	13.0	2.36	-14.88	-35.98
8-Sep-11	16-Dec-11	500	4.3769	12.0	2.23	-13.81	-46.69
15-Sep-11	11-Nov-11	1,000	4.5494	34.0	1.92	5.87	-30.41
22-Sep-11	16-Dec-11	500	4.4679	31.0	6.10	2.99	-28.81
29-Sep-11	16-Dec-11	500	4.5940	31.0	4.86	13.33	-21.71
6-Oct-11	16-Dec-11	500	4.6459	3.0	4.23	15.07	-8.70
6-Oct-11	03-Feb-12	500	4.5152	13.0	3.94	19.84	-13.75
13-Oct-11	16-Dec-11	500	4.6726	8.0	4.53	16.42	-9.30
13-Oct-11	03-Feb-12	500	4.5785	10.0	4.55	22.59	-13.56

Table 7: Treasury Note tender results — 2011-12 (continued)

Tender date	Maturity	Face value amount allocated ($m)	Weighted average issue yield (%)	Range of bids accepted (basis points)	Times covered	Spread to OIS (basis points)	Spread to BBSW (basis points)
20-Oct-11	03-Feb-12	1,000	4.5699	8.0	5.42	13.15	-14.11
20-Oct-11	09-Mar-12	1,000	4.5228	11.0	5.42	17.87	-16.99
27-Oct-11	03-Feb-12	1,000	4.4691	18.0	4.27	12.72	-22.39
3-Nov-11	03-Feb-12	1,000	4.3820	4.0	5.83	2.20	-26.63
10-Nov-11	24-Feb-12	1,000	4.2191	14.0	3.56	6.88	-37.30
10-Nov-11	09-Mar-12	1,000	4.1684	11.0	3.05	6.78	-40.41
17-Nov-11	24-Feb-12	500	4.1860	1.0	8.20	1.31	-38.63
24-Nov-11	09-Mar-12	500	4.0352	4.0	6.37	-1.98	-52.92
1-Dec-11	24-Feb-12	500	4.1227	9.0	5.22	-7.90	-42.85
8-Dec-11	09-Mar-12	1,000	4.0286	8.0	3.47	-5.14	-49.14
15-Dec-11	24-Feb-12	1,000	4.0656	15.0	3.12	-4.41	-44.08
15-Dec-11	09-Mar-12	1,000	4.0332	15.0	2.42	-2.34	-49.89
15-Dec-11	27-Apr-12	1,000	3.8631	16.0	2.30	1.71	-58.87
2-Feb-12	27-Apr-12	1,000	3.9319	8.0	3.58	-1.41	-37.65
2-Feb-12	11-May-12	1,000	3.8970	13.0	3.86	-1.55	-40.80
9-Feb-12	11-May-12	1,000	4.1316	15.0	2.29	1.81	-23.92
9-Feb-12	08-Jun-12	600	4.1260	10.0	3.30	5.36	-26.82
16-Feb-12	27-Apr-12	1,000	4.1736	8.0	2.23	5.36	-17.97
16-Feb-12	11-May-12	1,000	4.1598	7.0	2.99	6.78	-19.82
23-Feb-12	27-Apr-12	1,000	4.1976	5.0	2.56	2.16	-17.99
23-Feb-12	11-May-12	1,000	4.1738	6.0	3.50	1.65	-21.54
23-Feb-12	08-Jun-12	1,000	4.1839	5.0	2.95	6.26	-22.55
1-Mar-12	11-May-12	1,000	4.2308	8.0	2.72	4.17	-16.18
1-Mar-12	08-Jun-12	1,000	4.2162	11.0	3.34	6.05	-19.59
8-Mar-12	11-May-12	1,000	4.2074	5.0	3.14	1.98	-20.87
8-Mar-12	27-Jul-12	1,000	4.1649	7.0	4.15	7.23	-32.02
15-Mar-12	08-Jun-12	500	4.2181	1.0	6.54	3.90	-23.68
22-Mar-12	08-Jun-12	500	4.1964	2.0	6.58	2.58	-22.30
29-Mar-12	08-Jun-12	500	4.1530	1.0	6.21	4.39	-20.08
29-Mar-12	27-Jul-12	500	4.0650	1.0	7.49	2.96	-29.60
12-Apr-12	27-Jul-12	500	4.0172	8.0	6.43	3.88	-21.73
19-Apr-12	27-Jul-12	500	3.9420	5.0	7.40	-0.22	-21.31
26-Apr-12	27-Jul-12	1,000	3.8134	10.0	2.96	0.34	-31.16
26-Apr-12	10-Aug-12	1,000	3.8125	11.0	3.15	3.41	-29.90
3-May-12	27-Jul-12	1,000	3.6403	5.0	5.58	-0.09	-25.57
10-May-12	27-Jul-12	1,000	3.4768	10.0	4.52	-7.47	-25.88
10-May-12	07-Sep-12	1,000	3.4123	5.0	5.39	-1.01	-29.00
17-May-12	27-Jul-12	500	3.4732	2.0	7.25	-9.23	-27.47
24-May-12	10-Aug-12	500	3.2508	8.0	6.73	-0.65	-27.16
31-May-12	10-Aug-12	500	3.1660	11.0	6.64	-0.76	-34.73
7-Jun-12	07-Sep-12	1,000	3.1702	7.0	3.62	-0.43	-33.10
7-Jun-12	26-Oct-12	1,000	3.0304	8.0	3.61	2.27	-40.07
14-Jun-12	07-Sep-12	500	3.2197	5.0	5.22	-1.27	-34.65
21-Jun-12	07-Sep-12	500	3.3530	11.0	3.96	2.63	-21.28
28-Jun-12	07-Sep-12	500	3.3895	7.0	6.81	4.68	-16.96
Average over year to June 2012				9.59	4.58	0.23	-31.55
Average over 3 years to June 2012				7.34	5.14	1.36	-23.28

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 Reference Rates (BBSW)

Reference rates for bank bills accepted by approved banks published each business day by the Australian Financial Markets Association.

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

(Also known as 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 Australian Government advances to State and Territory governments for public housing, which are measured at historic cost.

Bullet security

A security that repays principal owing to investors as a lump sum at a predetermined future date.

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.

Commonwealth Government Securities (CGS)

Debt obligations of the Commonwealth evidenced by the issue of securities or, nowadays, issued as inscribed stock. CGS 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 investment transactions.

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.

Derivative

A financial instrument for which its price is dependent upon or derived from one or more underlying assets (for example stocks, bonds, commodities, currencies and indexes). The derivative itself is a contract between two or more parties. The most common derivatives are swaps, options, futures and forwards.

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, as being due to be paid on maturity.

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 the 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 the BBSW.

Foreign Debt Portfolio

The non-domestic currency component of the Long-Term Debt Portfolio. Following the elimination of the foreign currency derivatives exposure, this portfolio now consists of a single US dollar denominated loan that was issued in the 1980s.

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 both long-term fund raising to cover future Budget needs and the short-term mismatches in the timing of Government outlays and receipts.

Futures basket

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

Futures contract

An agreement between two parties that commits one party to buy an underlying financial instrument or commodity and another (counter) party to sell a financial instrument or commodity at a specific price at a future date. The agreement is completed at a specified expiration date by physical delivery or cash settlement, or alternatively is offset prior to the expiration date. In Australia standardised futures contracts are traded on the Sydney Futures Exchange. Futures contracts traded on the Sydney Futures Exchange include contracts for 3-year and 10-year Treasury Bonds.

Historic cost

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 its 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 drops as interest rates rise.

Issuance

The sale of debt securities in the primary market.

Kangaroo bonds

Australian dollar denominated bonds issued in the Australian capital market by foreign borrowers.

Liquidity

The capacity for a debt instrument to be readily sold. A liquid market allows the ready buying or selling of large quantities of an instrument 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

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

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).

Operational risk

The risk of loss, whether direct or indirect, arising from inadequate or failed internal processes, people or systems, or from external events. It encompasses risks inherent in the agency's operating activities such as fraud risk, settlement risk, legal risk, accounting risk, personnel risk and reputation risk.

Overnight cash rate

The interest rate charged on overnight loans between financial intermediaries. The Reserve Bank 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.

Overnight indexed swaps are quoted by reference to the fixed interest rate leg of the swap. For example, the 3 month OIS rate is the interest rate for the fixed leg of an overnight indexed swap with a term to maturity of 3 months. Interest rates for term deposits placed by the AOFM with the RBA are set by reference to quoted rates for overnight interest swaps.

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

An amount that represents 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 by the AOFM on behalf of the Australian Government.

Real interest rate

The interest rate that has been adjusted to take account of the effects of inflation. For example, if the coupon interest rate on a bond is 6.5 per cent and the inflation rate is 3 per cent then the real rate of interest on that bond is 3.5 per cent.

Repurchase agreement (Repo)

An agreement under which the seller of a security agrees to buy it back at a specified time and price.

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. A description of the principal features of a typical RMBS transaction can be found on pages 30-31 of the AOFM's 2008-09 Annual Report.

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 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 Reserve Bank of Australia 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.

Securitisation

The process of converting a pool of assets into marketable financial instruments. The rights and obligations relating to the assets are assigned or transferred to a special purpose vehicle (typically a trust), which issues securities to pay for the assets. The cash flow from the asset pool is used to service the securities and any other costs of the special purpose vehicle.

Semi-government bond

A bond issued in the Australian capital market by Australian State or Territory governments.

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.

Special purpose vehicle (SPV)

A financial trust established for a special purpose. A special purpose vehicle used in an Australian RMBS transaction is typically a bankruptcy-remote trust established for the sole purpose of acquiring a pool of mortgages from a mortgage lender and then issuing RMBS to finance those mortgages.

Spread

The difference between two prices or yields.

Swap

A financial transaction in which two counterparties agree to exchange streams of payments occurring over time according to predetermined rules.

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 term. These are generally short-term with maturities ranging anywhere from a month to a few years. 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 margin over the expected path of cash rates that investors require to compensate for having invested at fixed interest in long-term debt.

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. Treasury Notes are issued to cover short-term mismatches between the Australian Government's outlay and revenue streams. They are used in circumstances in which cash holdings may be temporarily low such as changes in the AOFM's holdings of term deposits with the Reserve Bank of Australia; soon after a large maturity; or at long intervals ahead of large revenue collections.

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
ADIs	Authorised Deposit-taking Institutions
AFMA	Australian Financial Markets Association
ANAO	Australian National Audit Office
AOFM	Australian Office of Financial Management
APEC	Asia-Pacific Economic Cooperation
APS	Australian Public Service
AUD	Australian dollar
BBSW	Bank Bill Swap Reference Rates
CEO	Chief Executive Officer
CGS	Commonwealth Government Securities
CPI	Consumer Price Index
EL	Executive Level (APS Classification)
ERMLC	Enterprise Risk Management, Legal and Compliance Group
FBT	Fringe Benefit Tax
FMA Act	*Financial Management and Accountability Act 1997*
FMO	Finance Minister's Orders
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GST	Goods and Service Tax

HR	Human resources
IT	Information technology
LTDP	Long-term Debt Portfolio
OECD	Organisation for Economic Co-operation and Development
OIS	Overnight Indexed Swap
OPA	Official Public Account
RAMSI	Regional Assistance Mission to the Solomon Islands
RBA	Reserve Bank of Australia
RITS	Reserve Bank Information and Transfer System
RMBS	Residential Mortgage-backed Security
SES	Senior Executive Service
TIB	Treasury Indexed Bond
USD	United States dollar

INDEX OF COMPLIANCE WITH REQUIREMENTS

Requirement (continued)	Page
Part 5: Other information	151
AOFM financial and staffing resources summary	155
AOFM resource statement by outcome	154
Freedom of information and information publication scheme	156
Advertising and market research	155
Grant programs	155
Ecologically sustainable development and environmental performance	156
Portfolio structure	156-157

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INDEX