Australian Office of Financial Management

Annual Report 2010-11

ISBN 978-0-642-74733-4

Printed by CanPrint Communications Pty Ltd.

Australian Government
Australian Office of Financial Management

13 September 2011

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 2011 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

Treasury Building Langton Crescent CANBERRA ACT 2600 • Telephone: (61-2) 6263 1111 • Facsimile: (61-2) 6263 1222

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 beginning of 2010-11 brought with it a reassessment globally on how different markets and economies weathered the consequences of the financial crisis and its associated recessionary impacts. Governments in a number of countries have spent a considerable amount of political and financial capital addressing these impacts. However the speed and extent to which a number of underlying sovereign credit and liquidity issues re-emerged, particularly in Europe, created renewed volatility in financial markets.

Sovereign debt and credit issues in a number of major advanced economies, and speculation about the ability of some emerging economies to contain inflationary pressure while maintaining high rates of economic growth, have both had implications for Australia and its bond market. The scrutiny applied by investors to differentiating between the credit statuses of sovereigns, even within specific credit rating bands, has sharpened rather than reduced. This has increasingly brought Australia into a positive light for investors and asset managers.

At the same time, there has been greater attention to the links between Australia and the Asian region. Views on this continue to vary markedly, but a prevailing view seems to be that Australia's rich resource endowments and skilled workforce leave it well-placed to benefit from the underlying growth trend emerging in Asia. Investors in Commonwealth Government Securities (CGS) have increasingly made strategic decisions to allocate a part of their portfolios to Australian bonds, reflecting a positive medium to long-term outlook for Australia and the Asian region more broadly.

Investors will increasingly assess Australia's currency, economic and financial fundamentals to determine whether CGS remain an attractive option to them. Key considerations will undoubtedly include Australia's exposure to volatility in the demand for and prices of its commodity exports (together with its close geographic proximity to the current centre of global growth) and the underlying potential for economic growth. They will also focus on the medium to long-term management of Australia's fiscal position; the efficiency of its financial markets (including further measures to comply with the regulatory framework for international banking); the extent to which unemployment and monetary policy impact domestic demand; and Australia's AAA sovereign credit status (and the yields on its bonds).

Bond issuance

Gross Treasury Bond issuance for the year in total was approximately $55 billion. This program was readily absorbed by the market reflecting investor confidence in Australia's underlying economic, fiscal and credit risk fundamentals. It also reflects positively on the AOFM and its approach in terms of transparency, attention to market feedback, engagement with investors and sound issuance processes.

During the year the AOFM issued into areas of strongest demand to ensure the Government's financing task could be most efficiently met, and continued a strategy of supporting liquidity in the market for CGS as required. A strong currency, higher stock of bonds outstanding and changes in international markets (including the changing perceptions and requirements of investors), has resulted in the CGS market assuming a new status in a global context. These factors have all helped to contribute to supporting demand for the issuance task. However, the increased focus on CGS as an investment option has brought a range of portfolio management and issuance considerations for the AOFM, highlighting the need for continued market vigilance and constant review of the strategies supporting management of the overall portfolio.

The opportunity was taken to launch four new Treasury Bond lines in 2010-11 and these targeted the short, medium and longer segments of the existing yield curve. The new lines were for maturity in October 2014; June 2016 and January 2018; and April 2023 (this latter line to maintain the length of the yield curve and support the operation of the 10-year Treasury Bond futures contract). All new Treasury Bond lines are now being issued with maturity dates that fall on either 21 January, 21 April, 21 July or 21 October. Therefore, future maturities will coincide with quarterly tax collections, which will assist in refinancing the Bonds when they fall due.

Treasury Indexed Bond issuance for 2010-11 totalled $3.25 billion, including a syndicated offer for the new Treasury Indexed Bond maturing in September 2030. Investor feedback has been very positive regarding the Government's commitment in the 2011-12 Budget 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 for both Treasury Bonds and Treasury Indexed Bonds in the secondary market continues to grow broadly in line with increasing volumes on issue. A number of factors have contributed, amongst them are: 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 2010-11 was fully met and this was achieved using a similar mix of debt instruments to that in 2009-10.

About $5 billion of pre-funding undertaken in 2009-10 and the subsequent investment of it in short-dated semi-government bonds with maturity dates on or before the maturity of the June 2011 Treasury Bond, was a successful measure in smoothing the issuance task across 2009-10 and 2010-11. Arrangements were also established to repo semi-government bonds, adding to the AOFM's cash management flexibility.

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. These changes have emerged for a number of reasons, such as the requirement to meet intergovernmental commitments developed over recent years. The AOFM reviewed these changes during the year to ensure that the annual issuance programs for 2011-12 and coming years take all relevant influences into account.

The average cost of funds for 2010-11 was 5.22 per cent. The average return on gross assets in 2010-11 was 5.38 per cent. Taken together, the net servicing cost of the combined portfolio of debt and assets for 2010-11 was $7.90 billion, which represented a 17 basis points reduction in effective yield, to 5.19 per cent. This represents the average outcome for the year, although yields on CGS fell most throughout the second half of the year. Key influences on yield curve movements during this period include anchoring of short-term interest rate expectations around the RBA cash rate of 4.75 per cent, and a 'flight to quality safe investments' like CGS as a result of the increasingly heightened uncertainty in global financial markets.

Residential mortgage-backed securities

In December 2010, the Treasurer announced a further extension of the residential mortgage-backed securities (RMBS) program as part of the Government's *Competitive and Sustainable Banking System* package. In April 2011, the AOFM was directed to invest up to an additional $4 billion; this taking the cumulative total of the AOFM's investment mandate from $16 billion to $20 billion. Furthermore, at the time of the December announcement, the Government identified the need to encourage a transition towards a market that is not reliant on on-going Government support. Implementation of the RMBS program has successfully contributed to the preservation of securitisation as an important channel of financing.

The AOFM's pricing of RMBS investments has continued to balance the objective of maintaining a competitive flow of funds for new lending with the objective of attracting other investors. The presence of other investors alongside the AOFM is one of several indicators that conditions in the Australian securitisation market are improving. In several recent deals the AOFM has been scaled back due to demand from other investors; in one deal it was scaled out of the need for participating.

While 2010-11 concluded with RMBS market conditions having continued to improve, the Australian market still faces some challenges consistent with events in global credit markets generally. That said, over the course of 2010-11 private sector participation in primary issuance improved, with there being a number of other transactions without the need for support from the AOFM.

Several innovative structures have enabled issuers to tap new sources of domestic and overseas demand. The AOFM supported a number of these structures through purchasing tranches with a greater degree of sensitivity to mortgage prepayment rates. This has facilitated the creation of bullet securities and scheduled amortisation tranches.

Looking ahead

What lies ahead for the AOFM in terms of the international context in which it must operate is unlikely to be a return to the past – at least for the foreseeable future. It will continue to face the challenges of issuing into a volatile global financial market. In terms of its tasks domestically, the year ahead requires an issuance program similar in magnitude to 2010-11, with the 2011-12 Australian Government Budget indicating a return to surplus in the following year and thereafter. While the impacts of the global financial crisis shifted the focus of the AOFM from supporting liquidity in the CGS market to the need for building issuance quickly and effectively to match the changing underlying Budget position, the forthcoming years will not require a continuation of this latter focus. However, the need to further diversify the CGS investor base will grow rather than abate as the CGS market has grown not only in size but stature, attracting investor attention previously not experienced. Diversity in the investor base will aim to facilitate liquidity in CGS.

Careful thought will need to be given to a range of issues that will set the direction for the future shape of the portfolio. The Government's support for an extension of the yield curve (with the AOFM having announced its plan to extend the curve out to 15 years in AOFM Operational Notice No. 3/2011 on the agency's website) and its announcement to maintain a mix of Treasury Indexed Bonds and nominal bonds as part of the overall portfolio will be important for the AOFM to implement. Therefore, seeking a balance between the minimisation of debt servicing costs and the pursuit of broader policy objectives, while at the same time keeping a 'weather eye' to changes in market conditions that could ultimately impact the demand for CGS, will remain core to the AOFM's challenges.

Former CEO retires

Mr Neil Hyden retired as Chief Executive Officer of the AOFM in November 2010. He had spent seven years in the position and during that time implemented a range of procedures and arrangements to support the efficiency and accountability of the organisation. It was Neil Hyden who guided the organisation through the challenges arising from the onset of the global financial crisis, a period during which quick responses and sound judgement were required to successfully navigate rapidly evolving events. His considerable efforts in this regard have been widely appreciated and we wish him the best of health and good fortune in his retirement.

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 2010-11 year, the AOFM continued to invest in residential mortgage-backed securities under a Government program to support competition in lending for housing. It also invested in short-dated securities issued by State and Territory governments (following similar investments the previous year).

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. This program is 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.

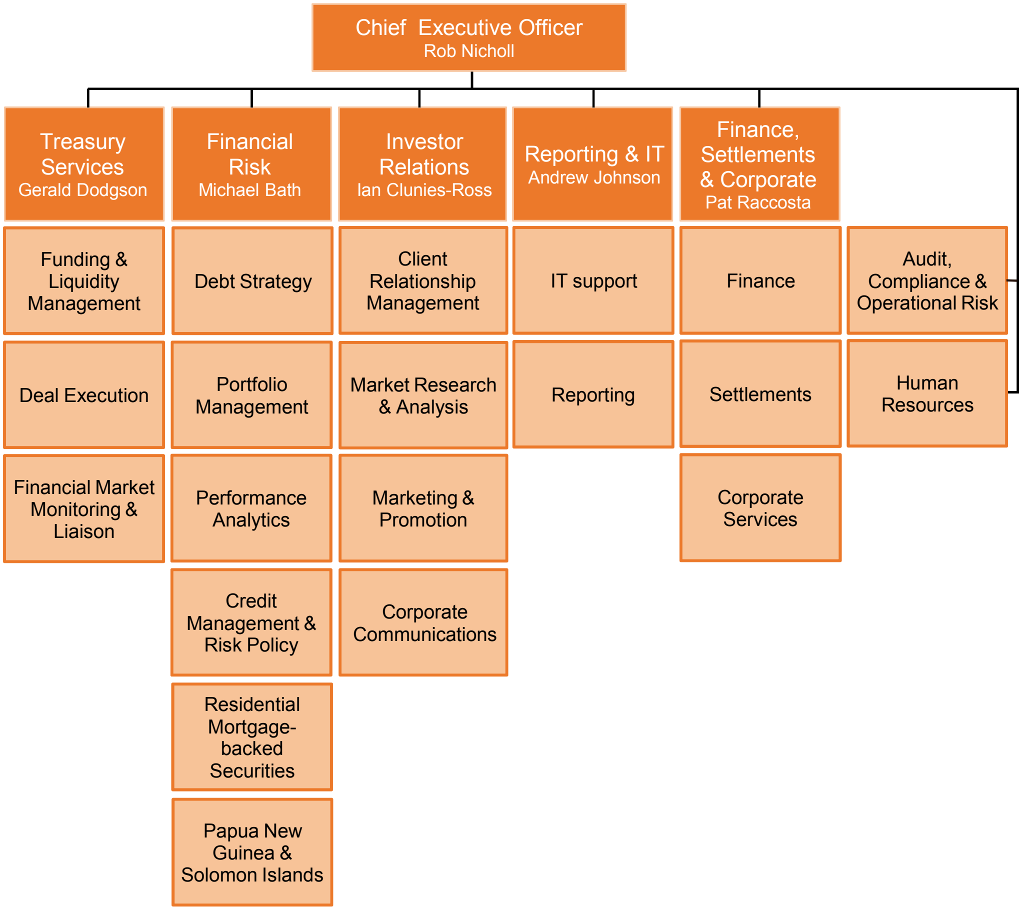
Organisational structure

During 2010-11, 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. The six groups were:

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

They were supported by a human resources unit. In addition, a 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. The secondments were organised through AusAID.

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 2010-11 and reports on their performance.

In January 2011 the AOFM was presented with the Sovereign Risk Manager of the Year award by *Risk Magazine* in London. This is the second time in three years that the AOFM has won this award. It was given in recognition of AOFM's efficient issuance strategy and residential mortgage-backed securities program undertaken in 2010.

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 as it is required from time to time.

Another objective is to support the efficient ongoing operation of Australia's financial system. This 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

The 2010-11 debt issuance task occurred against the backdrop of concerns about the strength and sustainability of economic recovery in a global context following the global financial crisis. Contributing to these concerns were the further emergence of stresses and falling confidence in European sovereign debt markets; enduring weaknesses in overseas financial sector balance sheets; and the growing realisation that fiscal consolidation across many of the major advanced economies is likely to be increasingly difficult to achieve.

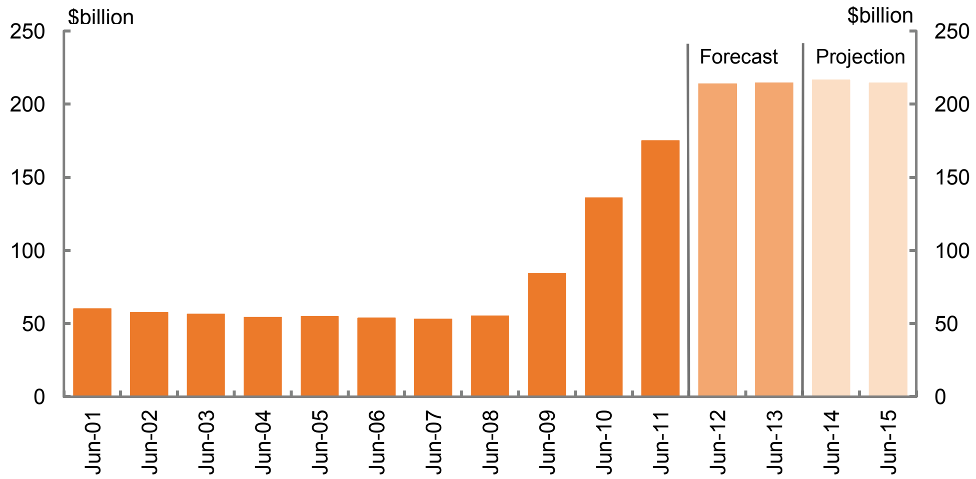
Chart 1 shows the stock of gross Australian Government debt on issue as a proportion of GDP compared with several other OECD countries over recent years.

Chart 1: Gross Government debt as a percentage of GDP

Source: Treasury, International Monetary Fund 2011 — *World Economic Outlook April 2011: Tensions from the Two-Speed Recovery — Unemployment, Commodities, and Capital Flows*, World Economic and Financial Surveys, IMF, Washington USA, Table A8 *Major Advanced Economies: General Government Fiscal Balances and Debt*, p 195.

Australia's position is very favourable compared to the OECD comparator countries. The AOFM's debt issuance over recent years is reflected by the increased outstanding stock of CGS as shown in Chart 2.[1]

Chart 2: Australian Government bonds outstanding (face value)



Debt issuance was as challenging in 2010-11 as it was the previous year. The size of the issuance program made necessary by the impacts of the global financial crisis required a focus on ensuring a successful uptake of new bond issuance. This involved the AOFM issuing largely in those parts of the yield curve to meet market demand and continuing its direct engagement with investors so as to diversify the investor base while understanding the key considerations for existing investors. The task was also assisted by investors' perceptions of Australia's high credit quality, the relative strength of the Australian economy and fiscal outlook, and comparatively attractive yields. These factors resulted in the relatively large volume of issuance in 2010-11 being absorbed smoothly by financial markets. This was important to underpin fiscal certainty for the Government and financial market stability.

Non-resident holdings of Commonwealth Government Securities (CGS) were around 70 per cent of the total outstanding during 2010-11. The proportion of CGS held by offshore investors has fluctuated between just under 50 per cent to just over 70 per cent during the past six years. The low point was at the beginning of 2009-10 and the previous high point was in late 2007-08 just prior to the onset of the global financial crisis.

1 Bonds include Treasury Bonds and Treasury Indexed Bonds, with forecast and projection amounts consistent with the *2011-12 Australian Government Budget – Budget Paper No.1.*

Treasury Bonds

Gross Treasury Bond issuance for the year totalled approximately $55 billion. The bulk of issuance was into certain existing bond lines in order to enhance their liquidity and attractiveness. This was particularly important to international investors who have been strong supporters of the CGS market.

Four new Treasury Bond lines were launched in 2010-11 as follows:

- A new short-dated bond line maturing in October 2014 was launched to allow issuance to be spread across a larger number of lines and help limit the growth of the largest lines.

- New bond lines maturing in June 2016 and January 2018 were launched to fill in gaps in those parts of the yield curve.

- A new bond line with a maturity date of April 2023 was launched in order to maintain the length of the yield curve and support the operation of the 10-year Treasury Bond futures contract.

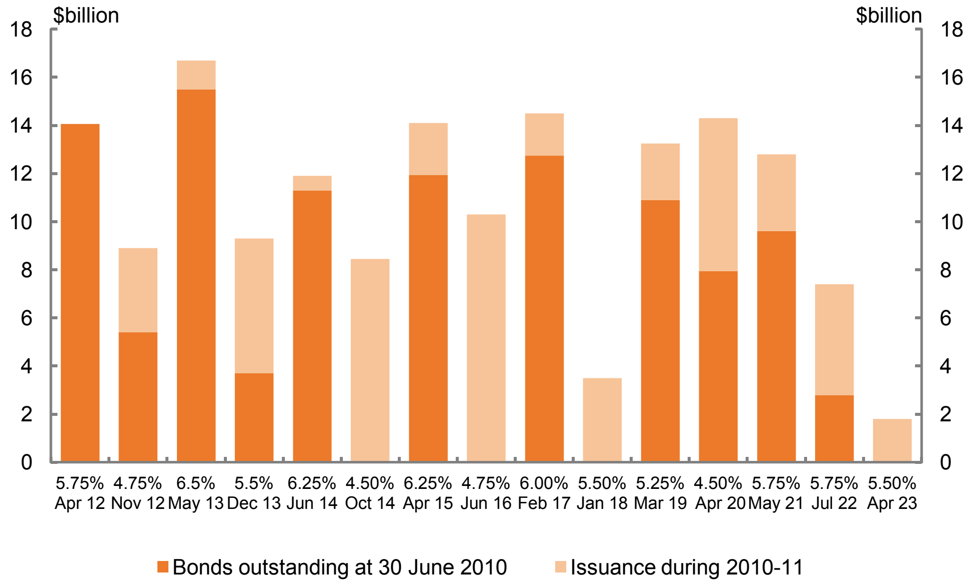
During the year it was decided that in future, new Treasury Bond lines will have maturity dates that fall on either 21 January, 21 April, 21 July or 21 October (three of the four Treasury Bonds launched in 2010-11 mature on such dates). These dates coincide with large Commonwealth revenue collections. Aligning maturity dates for Treasury Bonds with these revenue collection dates will facilitate the financing of Treasury Bond maturities.

In selecting the bond lines to issue each week, the AOFM took account of prevailing market conditions; information from financial market contacts concerning 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. As in 2009-10, two tenders were held most weeks, typically comprising of a tender for the issue of $500 million of a long-dated bond line and a tender for the issue of $700 million of a short-dated bond line.

Chart 3 shows the Treasury Bonds outstanding as at 30 June 2011 and issuance during the 2010-11 financial year.

During the year the total volume of Treasury Bonds on issue increased by around $37 billion, to $161 billion. At the end of the year there were nine Treasury Bond lines with over $10 billion on issue.

Chart 3: Treasury Bonds outstanding as at 30 June 2011 and issuance in 2010-11



Treasury Indexed Bonds

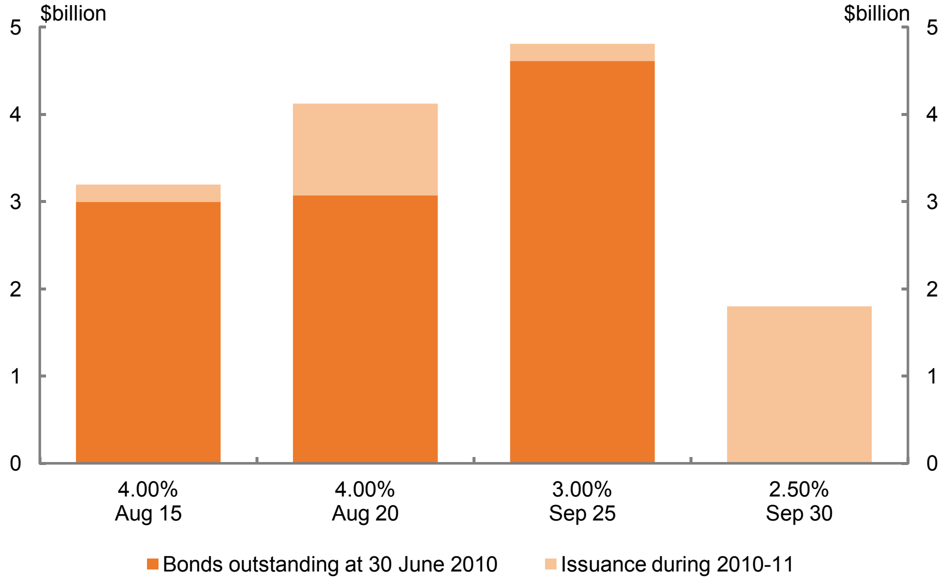
Treasury Indexed Bond issuance for the year totalled $3.25 billion.

During the year ten tenders for the issue of Treasury Indexed Bonds were conducted. There was also a syndicated offer for the new Treasury Indexed Bond maturing in September 2030.

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 4 shows the Treasury Indexed Bonds outstanding as at 30 June 2011 and issuance during the 2010-11 financial year.

Chart 4: Treasury Indexed Bonds outstanding as at 30 June 2011 and issuance in 2010-11



Infrastructure Bonds

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

This funding will be through the issuance of CGS as part of the Government's overall debt program. Aussie Infrastructure Bonds will not be identified separately from other CGS at the time of issue, but will be reported separately in the Budget papers.

The Government's equity investment in NBN Co Limited in 2010-11 was fully met with funds from the Building Australia Fund; therefore, Aussie Infrastructure Bonds were not required in 2010-11.

Securities Exchange Trading of CGS

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

The trading of CGS on a securities exchange should 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.

Performance

Funding the Budget

The Government's budget financing requirement in 2010-11 was fully met.

The budget underlying cash deficit for 2010-11 was higher than estimated at the time of the 2010-11 Australian Government Budget due to lower than expected revenue and the impact natural disasters in early 2011 (as explained in the 2011-12 Australian Government Budget). The larger than expected budget financing task was managed in part by increased issuance of Treasury Notes.

Part of the budget financing requirement in 2010-11 was met by $5 billion of pre-funding undertaken in 2009-10. Most of the proceeds from this pre-funding were invested in short-dated semi-government bonds with maturity dates on or before the maturity dates of Treasury Bonds maturing in 2010-11.

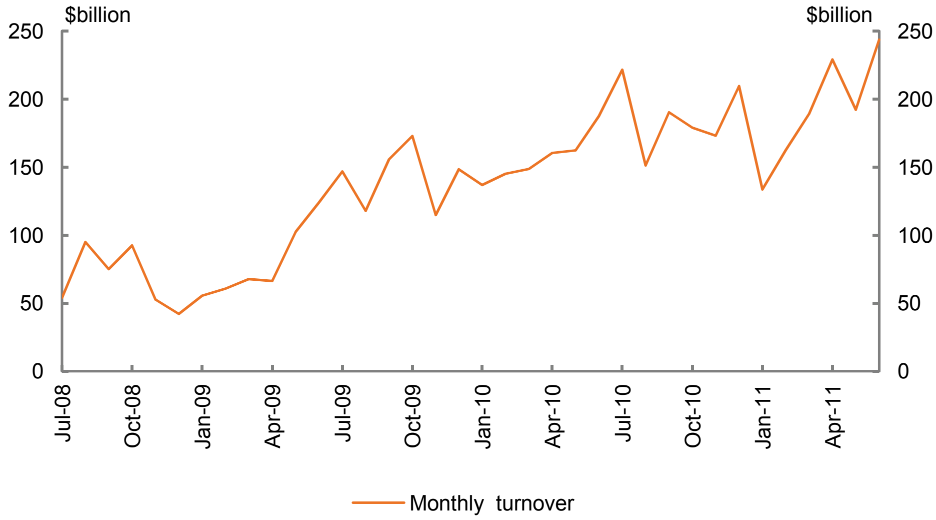
Market liquidity and efficiency

The Treasury Bond market operated smoothly throughout 2010-11 with liquidity being maintained throughout the year.

One measure of liquidity is turnover in the secondary market. Chart 5 shows the evolution of total secondary market turnover[2] from July 2008 through to June 2011. As a proportion of total outstanding stock on issue, monthly turnover has consistently remained at around 100 per cent (except for several months during mid 2008-09).

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

Chart 5: Treasury Bond secondary market turnover



Source: Based on Austraclear data sourced from the RBA.

The Australian Government bond market displayed improved liquidity in 2010-11 with:

- Treasury Bond turnover having increased by 27 per cent in 2010-11 compared to 2009-10;
- Treasury Indexed Bond turnover having increased by 21 per cent in 2010-11 compared to 2009-10; and
- the turnover of 3-year Treasury Bond futures contracts having increased by 29 per cent in 2010-11 compared to 2009-10; and turnover of the 10-year contracts having increased by 35 per cent.

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. More settled market conditions resulted in less use of the securities lending facility in 2010-11 compared with the previous year. The facility was used 47 times for overnight borrowing in 2010-11 compared with 60 instances of use in 2009-10. The face value amount lent was around $1.3 billion compared to $2.4 billion in 2009-10.

All Treasury Bond futures contract close-outs in 2010-11 occurred smoothly.

Efficiency of issuance

Issuance of Commonwealth Government Securities in 2010-11 was by competitive tender, apart from the syndicated offering of the new 2030 Treasury Indexed Bond.

Tenders held during 2010-11 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 2010	Up to 2016	16,500	4.8820	-0.18	3.61
	2017 - 2023	10,450	5.1490	0.00	3.77
January - June 2011	Up to 2016	15,300	5.1104	-0.29	4.38
	2017 - 2023	13,050	5.4203	0.07	3.86

The average ratio of the volume of bids received to the amount of stock on offer was 3.91 for Treasury Bonds in 2010-11, a slight increase on the averages for previous years. This was a good outcome given the relatively large volume of issuance in 2010-11. Only one tender had a coverage ratio less than two.[3]

The strength of bidding at tenders was also reflected in the issue yield spreads to the secondary market. At many Treasury Bond tenders, the weighted average issue yields obtained were below prevailing secondary market yields. The average spreads obtained on Treasury Bond tenders during the year were lower than those in recent years.

The average ratio of the volume of bids received to the amount of stock on offer was 4.13 for Treasury Indexed Bonds in 2010-11, broadly in line with averages for previous years. At five of the ten tenders the weighted average issue yields were below prevailing secondary market yields.

Full tender details are given in Part 5 of this annual report for Treasury Bonds and Treasury Indexed Bonds.

3 This occurred on 7 July 2010 in connection with the issue of a new 2016 Treasury Bond. As is always the case for the launch of a new Treasury Bond, a larger than normal amount was offered for sale at this tender, which contributed to the low coverage ratio.

Cash management

Objective

The AOFM manages the daily cash balances of the Australian Government in the Official Public Account (OPA).[4] The AOFM's primary objective in managing these 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 balances and to invest excess balances efficiently. In minimising cost the AOFM seeks to avoid undue use of the overdraft facility provided by the RBA.[5]

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, investments can be made in term deposits at the RBA, negotiable certificates of deposit issued by highly-rated Authorised Deposit-taking Institutions (ADIs), and short-dated bonds issued by Australian State and Territory governments (semi-government bonds). Investment outside 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 and semi-government bonds reflect prevailing market rates for those instruments.

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 2010-11 to maintain a liquid market.

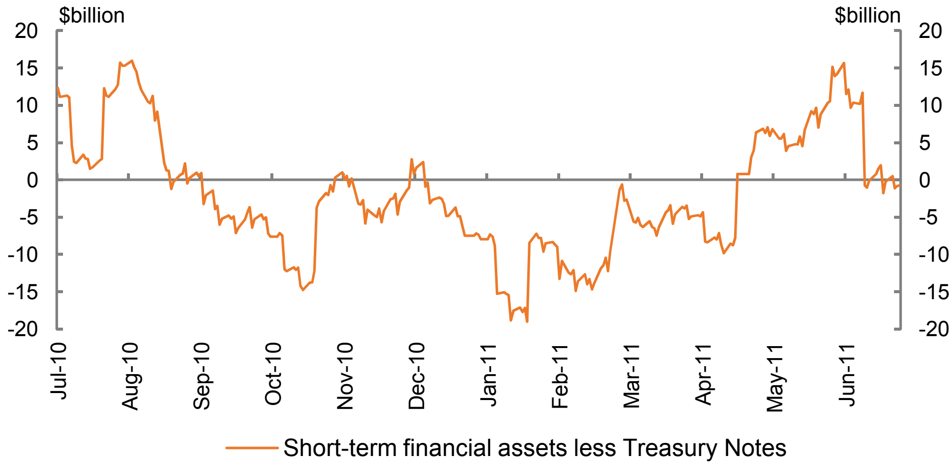
4 The Official Public Account (OPA) is the collective term for the Core Bank Accounts maintained at the RBA for Australian Government cash balance management.

5 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.

As noted earlier, part of the budget financing requirement in 2010-11 was met by pre-funding undertaken in 2009-10, with the bulk of the proceeds from this pre-funding invested in semi-government bonds that matured 2010-11. In 2010-11 the AOFM undertook repurchase transactions for the first time to borrow for cash management purposes, using the holdings of semi-government bonds as collateral. This proved a successful mechanism for its purpose.

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 6 shows the movement in the funding requirement in 2010-11.

Chart 6: Within-year funding requirement 2010-11



Performance

The objective of meeting the Government's financial obligations as and when they fall due was met, with the overdraft facility provided by the RBA accessed only once in 2010-11 (on Friday 6 August 2010 for an amount of $626 million, with the facility being cleared on Monday 9 August 2010).

During 2010-11 the AOFM placed 395 term deposits with the RBA. The stock of term deposits fluctuated from a maximum of $23.6 billion in June 2011 to a minimum of $250 million in January 2011.

- The average yield obtained on term deposits during 2010-11 was 4.68 per cent, compared with 3.60 per cent in 2009-10. The increase in average yield reflects the higher average level of interest rates that prevailed during 2010-11.

Investments in negotiable certificates of deposit were undertaken when excess funds were available for investment and there was an appreciably higher return from investing in such instruments compared with placing funds on deposit at the RBA.

The face value amount invested in negotiable certificates of deposit peaked at $5.8 billion in August 2010. The average additional return in 2010-11 from investing in negotiable certificates of deposit compared with investing funds on deposit at the RBA was approximately 16 basis points per annum. This is estimated to have generated additional investment earnings in 2010-11 totalling around $2.4 million.

Eighty-four tenders for Treasury Notes were conducted during the year, for the issue of $60.6 billion (in face value terms). The tenders were well supported with an average cover ratio of 5.63. Yields averaged around 17 basis points less than bank bill yields of corresponding maturities. 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 2010-11 are shown in Chart 7.

In undertaking its cash management activities, the AOFM is required to maintain the 91-day rolling average of the daily OPA cash balance within operational limits around a target level. In 2010-11 these limits were the same as applied in 2009-10, 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 8.

Chart 7: Short-term financial asset holdings and Treasury Notes on issue 2010-11

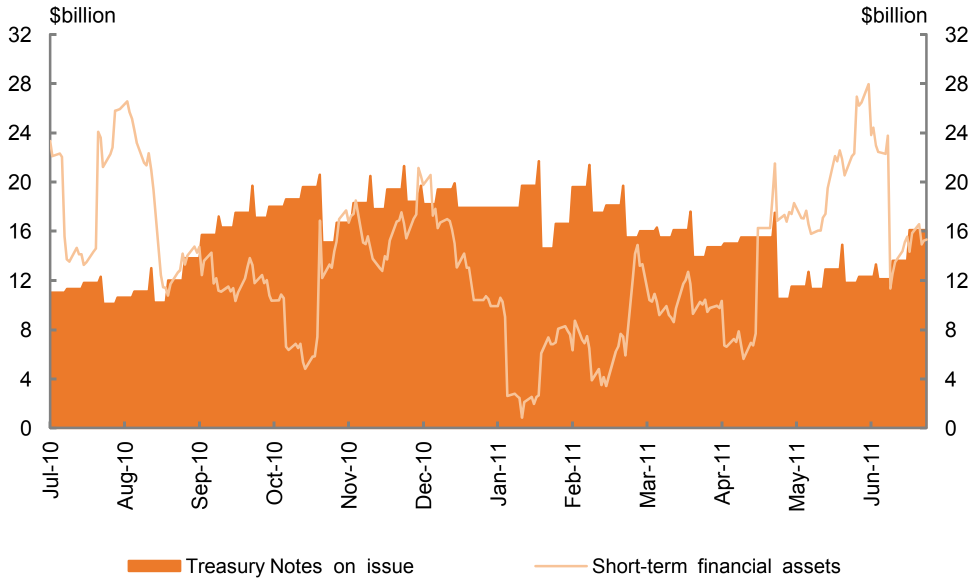
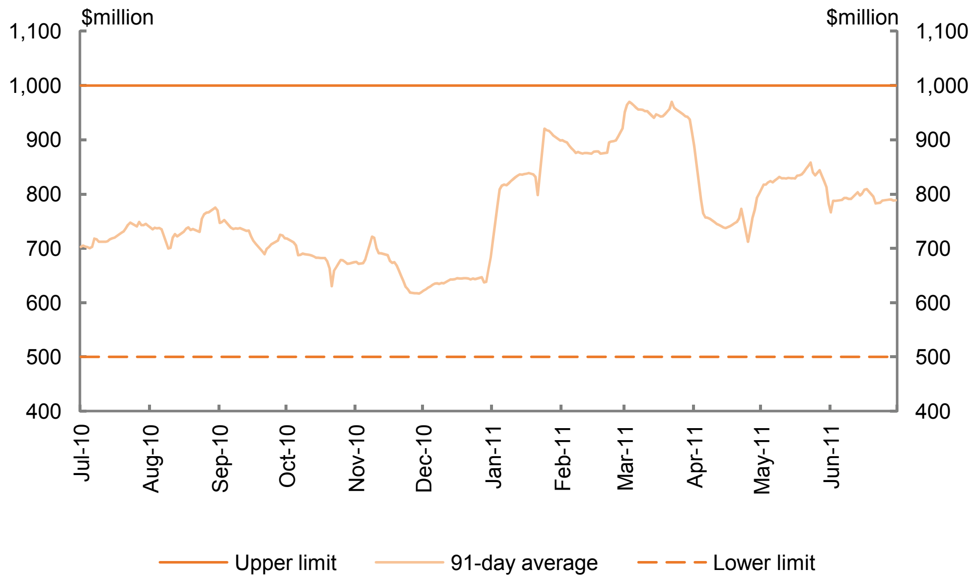


Chart 8: 91-day moving average cash balance 2010-11



Future of the Commonwealth Government Securities Market

In light of the experiences arising from the global financial crisis, an anticipated return to budget surplus in coming years, new global bank liquidity requirements, and market expectations regarding the amount of future outstanding stock of CGS, the Government consulted a panel of financial market participants and financial regulators on issues impacting a policy decision on the future of the CGS market.[6] The review was discussed in the 2011-12 Australian Government Budget.

The panel, which was chaired by the Treasury, noted that the global financial crisis had affirmed the value in maintaining a liquid CGS market of sufficient size to support the long term stability of the financial markets and to ensure the Government is well placed to respond to sudden events that cause large fiscal impacts. It was also noted that there had been an increased allocation into Australian dollar denominated securities by international investors, and that new global bank liquidity standards for banks, agreed by the Basel Committee for Banking Supervision in December 2010, will mean that Australian banks tend to hold larger amounts of CGS on their balance sheets than has previously been the case.

The Government indicated that a primary objective will continue to be maintaining liquidity in the CGS market to support the three- and ten- year bond futures market.

In addition, the Government will continue its support of liquidity in the Treasury Indexed Bond market by maintaining around 10 to 15 per cent of the total CGS market in indexed securities. It has also indicated support for the AOFM to lengthen the CGS yield curve incrementally, in a manner consistent with prudent sovereign debt management and market demand.

To maintain a liquid and efficient bond market that supports the three- and ten- year bond futures market and the requirements of the new global bank liquidity standards, the panel proposed that the CGS market be maintained around its current size — that is, around 12 to 14 per cent of GDP over time. The Government is considering this issue taking into account the views of the panel (this was discussed in the 2011-12 Australian Government Budget).

---

6 The panel consisted of representatives from the AOFM, the Treasury, the Reserve Bank of Australia, the Australian Prudential Regulation Authority, the NSW Treasury Corporation, the Treasury Corporation of Victoria, and a number of private sector financial market participants.

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.

The primary measure used in balancing cost and risk is historic accrual debt servicing cost. This includes interest on physical debt, realised market value gains and losses, capital indexation of inflation-linked debt and the amortisation of any issuance premiums and discounts. However, it does not include unrealised market value gains and losses. Accrual debt servicing cost is the most appropriate measure of cost in circumstances where financial assets and liabilities are intended to be held, or to remain on issue until maturity and there is little likelihood that unrealised market value gains and losses will actually be realised.

Information on unrealised market value gains and losses is useful in circumstances where it is possible that they may be realised in the future. In the AOFM's financial statements, debt servicing cost outcomes are presented on a 'fair value' basis that include movements in the unrealised market value of physical debt, assets and interest rate derivatives. 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'.

Achieving the objective

The AOFM influences the cost and risk profile of the portfolio primarily through its decision making on the volume, composition and maturity of the debt securities it issues. The selection of bond lines and the size of tenders for instance have a direct bearing on the cost and risk of the overall portfolio. Issuance through CGS continues to serve debt management and market supporting policy objectives and so factors such as the overall maturity structure of the portfolio, market conditions and the relative demand and cost of different bond lines are all considered when issuance decisions are made.

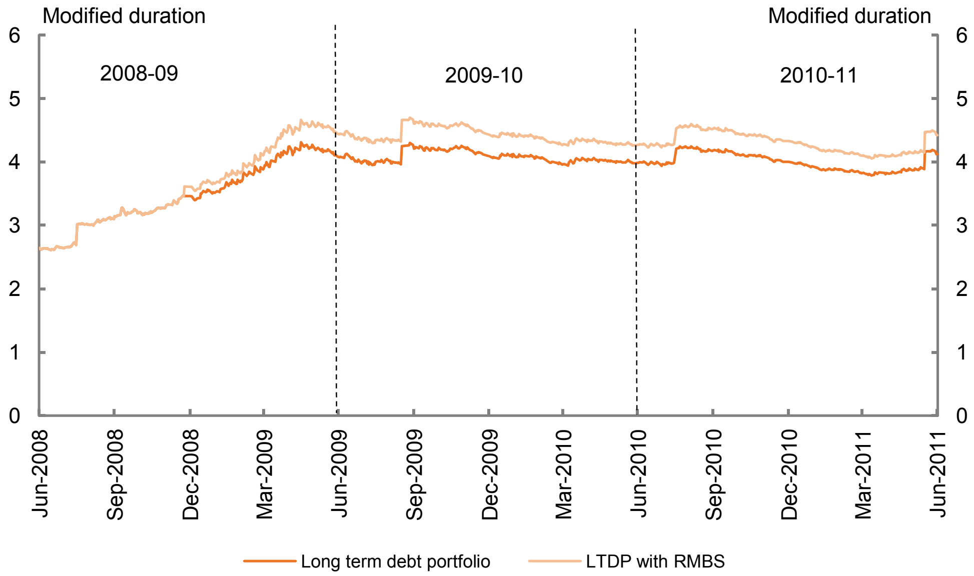
For Treasury Bonds, the AOFM seeks to spread issuance across the yield curve. Typically (but not always) two tenders are undertaken per week, with one in the short to mid part of the curve (for example, one to six years) and the other in the long part of the curve (for example, seven years and beyond). The tenders may be of different sizes, providing flexibility in the maturity profile of the portfolio as it changes in size over time. During 2010-11, the AOFM also modified the mix of long and short bond issuance in response to market conditions from time to time.

Historically, AOFM research has found that debt issued for long periods at fixed rates of interest pays higher interest rates than shorter-term debt, because lenders tend to demand a higher return for having their funds locked away for longer periods. For many years the AOFM obtained savings in debt servicing costs by using interest rate swaps to lower the duration of the debt on its balance sheet (in other words, the AOFM swapped its longer term fixed-rate debt into shorter term floating-rate debt). However, over recent years market yield curves have flattened, which diminished the savings available from this approach. As a result, in 2008 the AOFM concluded that under the circumstances targeting duration by using swaps no longer provided a firm basis for achieving future savings in debt servicing cost. The last swap matured in May 2010.

The AOFM continues to assess how the length of the yield curve and the composition of bond lines impacts portfolio management objectives, but it still does not find a compelling case to target a relatively low duration. On the contrary, recent research has supported the extension to 15 years of the nominal yield curve as indicated in the 2011-12 Australian Government Budget. The results of this research suggest that the risk-reducing benefits of increasing liability duration in line with the issuance strategy of extending the curve are likely to outweigh the costs.

Chart 9 shows the longer term trend in portfolio duration. Following the 2008 decision to discontinue the existing interest rate risk management framework, the duration of the nominal component of the long term debt portfolio rose from 2.5 to 4 as interest rate swaps were unwound, and then stabilised around 4 as a natural consequence of the composition of debt on issue. Moreover, the accumulation by the AOFM of floating rate notes such as residential mortgage-backed securities over recent years has had the consequence of further extending the portfolio duration. The AOFM has remained comfortable with the cost and risk characteristics of the portfolio resulting from the extension of duration associated with issuance decisions and the accumulation of floating rate notes over the past few years.

Chart 9: Modified Duration of the AOFM's Long Term Debt Portfolio



Maintaining around 10 to 15 per cent of the CGS market in indexed debt is consistent with the AOFM's portfolio management objectives. Indexed debt currently comprises around 10 per cent of CGS on issue.

Performance

Reducing debt servicing cost at an acceptable level of risk

The debt servicing cost[7] of gross debt managed by the AOFM in 2010-11 was $9.27 billion. This represented a cost of funds of 5.22 per cent for the period. Table 2 provides further details of the cost outcomes for the combined portfolio by instrument and portfolio for 2009-10 and 2010-11.

Debt servicing costs on gross CGS debt increased by $2.94 billion compared with the previous year. This was largely the result of an increase in the average volume of debt on issue by $53.28 billion to $177.76 billion in 2010-11. The return on gross assets for 2010-11 increased by $52 million to $1.38 billion; this was despite the average book volume falling by $6.26 billion. The increase reflected a combination of factors including higher short-term interest rates in 2010-11 versus the previous year.

7 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.

Taken together, the net servicing cost of the combined portfolio of debt and assets was $7.90 billion, with an effective yield of 5.19 per cent. The corresponding figures for 2009-10 were $4.96 billion and 5.36 per cent, respectively.

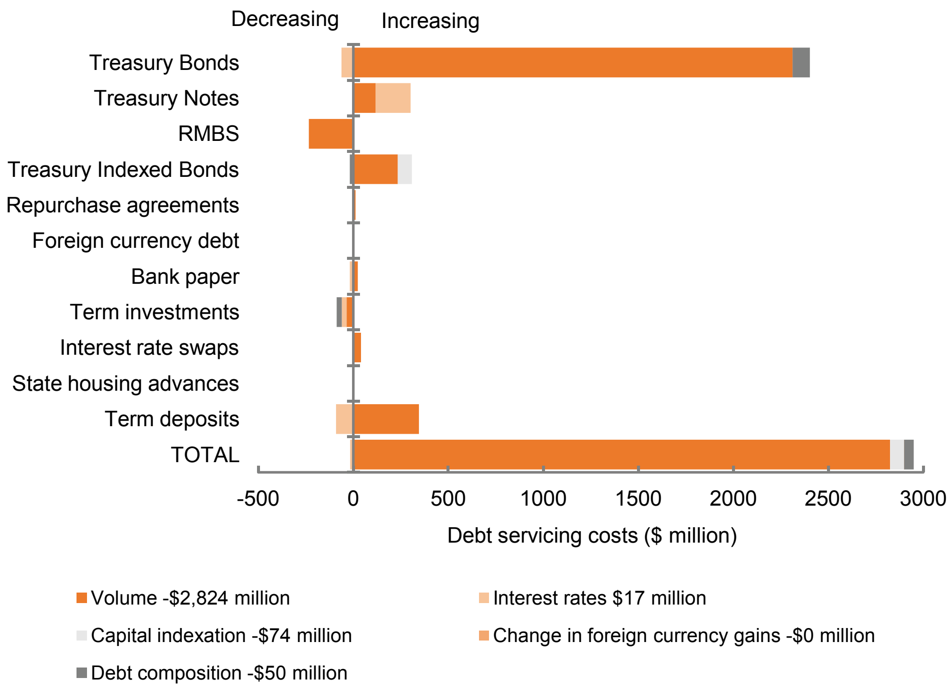
Table 2: Australian Government debt and assets administered by the AOFM

	Interest expense		Book volume		Effective yield	
	2009-10	2010-11	2009-10	2010-11	2009-10	2010-11
	$ million		$ million		per cent per annum	
Contribution by instrument						
Treasury Bonds	(5,186)	(7,526)	(100,956)	(145,936)	5.14	5.16
Treasury Indexed Bonds	(731)	(1,021)	(11,826)	(16,481)	6.18	6.19
Treasury Notes	(411)	(712)	(11,691)	(15,081)	3.51	4.72
Repurchase agreements (a)	-	(12)	-	(257)		4.75
Foreign loans (b)	(0)	(0)	(6)	(5)	2.98	7.98
Gross physical CGS debt	(6,328)	(9,272)	(124,479)	(177,760)	5.08	5.22
Interest rate swaps	41	-	-	-		
Gross CGS debt (after swaps)	(6,287)	(9,272)	(124,479)	(177,760)	5.05	5.22
Term deposits with the RBA	647	391	17,996	8,372	3.60	4.68
Investments in bank paper	102	96	2,579	1,979	3.97	4.84
Term investments (c)	37	123	1,326	2,546	2.80	4.85
RMBS investments	374	607	7,190	10,005	5.20	6.07
State Housing Advances	162	158	2,757	2,685	5.89	5.89
Gross assets	1,323	1,375	31,848	25,587	4.16	5.38
Net CGS debt	**(4,964)**	**(7,896)**	**(92,631)**	**(152,173)**	**5.36**	**5.19**
Contribution by portfolio						
Long Term Debt Portfolio	(5,900)	(8,547)	(112,707)	(162,423)	5.24	5.26
Cash Management Portfolio	400	(114)	10,129	(2,440)	3.95	4.67
RMBS Portfolio	374	607	7,190	10,005	5.20	6.07
State Housing Portfolio	162	158	2,757	2,685	5.89	5.89
Total debt and assets	**(4,964)**	**(7,896)**	**(92,631)**	**(152,173)**	**5.36**	**5.19**
Re-measurements (d)	(2,773)	326				
Total after re-measurements	**(7,737)**	**(7,571)**	**(92,631)**	**(152,173)**		

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.
(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 revaluations effects.
(c) Investments in State and Territory government bonds.
(d) Re-measurements refer to unrealised changes in the market valuation of financial assets and liabilities.

Chart 10 sets out the components by instrument of the change in the debt servicing cost of the portfolio, broken down to show contributions from changes in the overall volume of debt and in the composition of the portfolio, and from movements in interest rates, exchange rates and the Consumer Price Index (CPI).

Chart 10: Change in debt servicing cost between 2009-10 and 2010-11

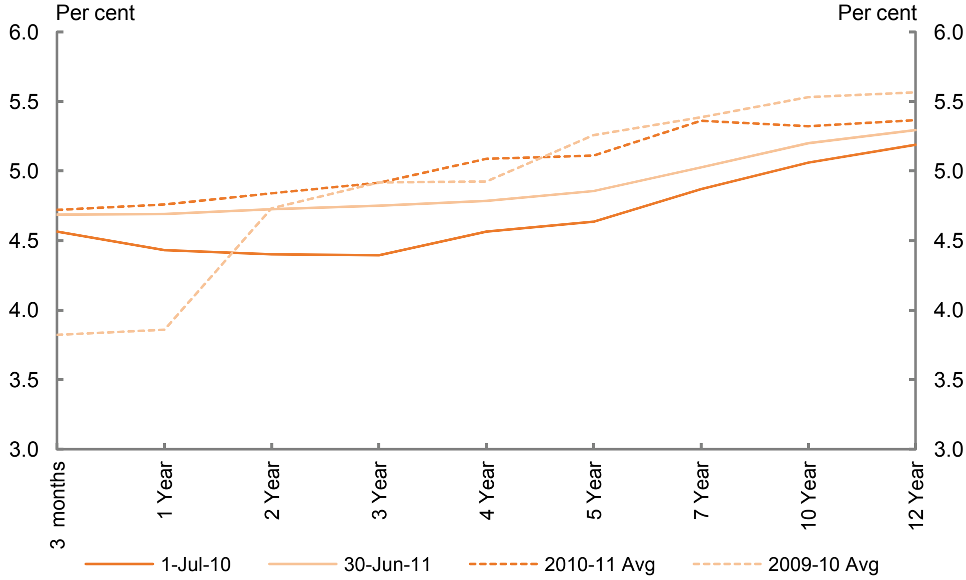


The increase in total debt servicing costs was due predominantly to the significant increase in the volume of Treasury Bonds on issue, which added an extra $2.34 billion to total debt servicing cost in 2010-11 compared to the previous year. Higher volumes of Treasury Notes and Treasury Indexed Bonds, combined with fewer term deposits being on issue through the year were also factors contributing to rising total debt servicing costs in 2010-11.

The main offset or savings relative to 2009-10 came from RMBS and term investments. Higher RMBS investment balances contributed an extra $233 million in interest revenue during 2010-11 compared to the previous year. Term investments comprised of short-dated semi-government bond holdings generated an additional $86 million in revenue from 2009-10 to 2010-11.

As shown in Chart 11, nominal interest rates had differing effects on the portfolio with the yield curve on average considerably flatter in 2010-11 because of higher short-term interest rates and generally lower longer term rates. Specifically, total interest costs associated with Treasury Notes increased by $183 million while interest earnings on short-term investments (term deposits, term investments and bank paper) increased by $134 million due to higher short-term interest rates. Lower longer term interest rates contributed to a $62 million reduction in interest costs on Treasury Bonds.

Chart 11: CGS Yield Curves



Note: One, three and six month average rates in the chart are average Treasury Note yields. Average CGS yields have been presented only for bond lines that were on issue for the entirety of 2009-10 and 2010-11.

Key influences on yield curve movements during this period include the anchoring of short-term interest rate expectations around 4.75 per cent and investors' flight to quality to safe investments like CGS as a result of the heightened uncertainty in global financial markets.

With regard to the other determinants of the change in total debt service cost, there was an increase in cost of around $74 million attributable to Treasury Indexed Bonds. This stemmed from the impact of consumer price index changes on the capital value of Treasury Indexed Bonds compared to the prior year. Purchases of bank paper had an insignificant effect on the year-on-year change in debt servicing costs, as did the components of the portfolio that are in the process of being run down (the state housing advances and foreign currency debt). Finally, as mentioned above, no new interest rate swaps have been entered into by the AOFM since 16 November 2007, and the only changes in debt servicing cost arising from swaps occurred as a result of the gains made in 2009-10 not having been replicated.

Movements in market interest rates had a moderately favourable impact on the market value of the portfolio in 2010-11, with unrealised gains from re-measurements amounting to $326 million. This was comprised of unrealised gains of $466 million on nominal debt, partially offset by unrealised losses of $132 million on indexed debt and $8 million on RMBS investments.[8]

In summary, a significant increase in the volume of debt generated a larger net interest cost in 2010-11 in dollar terms. However, the effective cost of funds on the gross debt portfolio remained quite steady in percentage terms. Moreover, increases of 72 and 87 basis points in the returns on short-term asset balances and RMBS to 4.67 per cent and 6.07 per cent, respectively, resulted from higher short-term interest rates. These returns further offset the interest cost on the portfolio. Thus, in percentage terms, the yield on the overall net debt portfolio managed by the AOFM fell by 17 basis points to 5.19 per cent in 2010-11.

Residential mortgage-backed securities

Objective

The Australian residential mortgage-backed securities (RMBS) market provides an important 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 in the Australian RMBS market through 2008-09 and 2009-10, 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. In November 2009 the Treasurer extended the program by directing the AOFM to invest up to a further $8 billion in RMBS, together with $246 million remaining from the initial program. 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.

---

8 To put these numbers in context, the market value sensitivity of the net debt portfolio managed by the AOFM to a one basis point interest rate movement as at 30 June 2011 was $84.7 million, with nominal bonds alone comprising $68.1 million per basis point and indexed debt $16.5 million per basis point.

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, 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. It 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 2010-11, the AOFM agreed to support 21 RMBS transactions from 14 issuers, investing just under $4.35 billion. Since inception of the program the AOFM has invested around $13.37 billion across 49 transactions from 19 issuers.

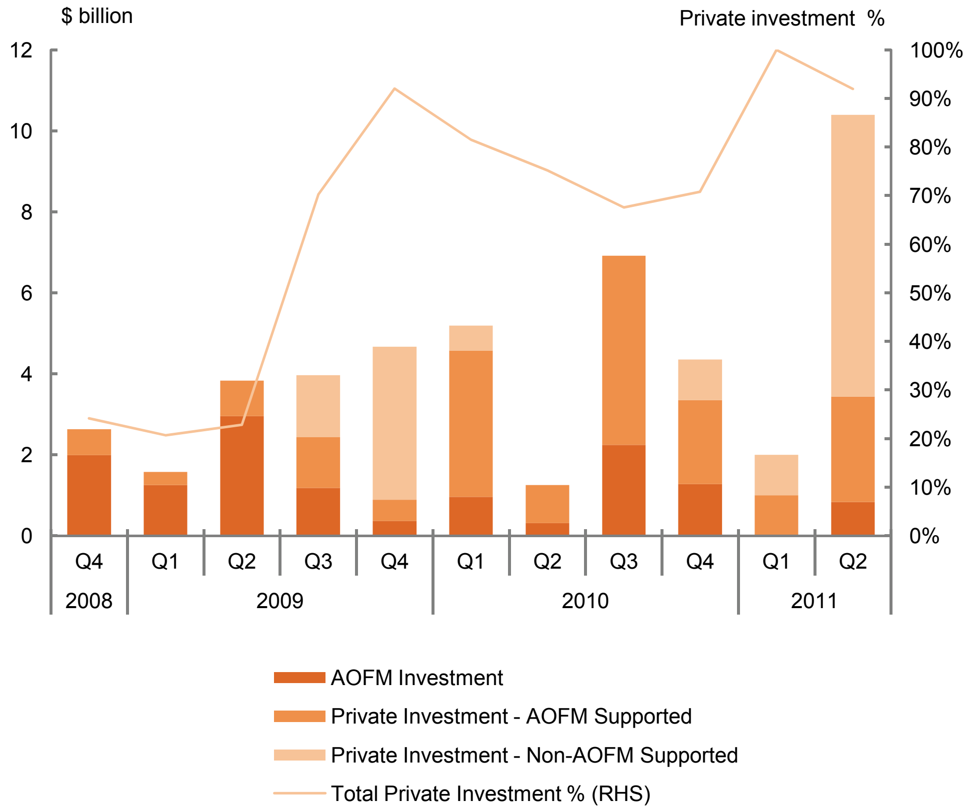
Throughout the year, the AOFM continued to invest via the two investment channels established the previous financial year, namely the serial (or 'pipeline') approach and the reverse enquiry channel.[9] While the former ended in December 2010, the latter approach continues to be utilised and is now the only investment channel.

Market conditions have continued to improve during the year. Having said that, the Australian RMBS market continued to face challenges consistent with global credit markets. The improvement in RMBS sentiment over the course of 2010-11 brought an overall increase in the level of private sector participation in primary issuance. Furthermore, the improvement in conditions extended to pricing in both the primary and secondary markets. Primary supply also picked up and 2010-11 saw the return of three of the largest Australian banks to the RMBS market, as well as the completion of a number of other transactions without the support of the AOFM.

Chart 12 shows the participation of AOFM and other investors in RMBS issues since the inception of the program. Participation from other investors averaged 23 per cent from inception until the end of June 2009, while throughout 2009-10 and 2010-11 it averaged over 81 per cent. In the first six months of calendar year 2011, this proportion rose to around 93 per cent of total market activity.[10]

9 These channels were described in detail in the 2009-10 Annual Report.
10 Excluding transactions not supported by the AOFM reduces this proportion to 81 per cent.

Chart 12: RMBS market participation



While the volume of transactions supported by the AOFM rose to over $14.7 billion in 2010-11 from around $9.1 billion the year before, there was also an increase in the volume of transactions that were not supported by the AOFM to just under $9 billion from $5.9 billion. This brings total public RMBS activity to $23.7 billion in 2010-11, from around $15.1 billion the year before. Notably, in the first half of calendar year 2011 there was significant issuance from larger Australian banks and their subsidiaries, as pricing levels moved into line with other sources of funding. As a result of these developments, the volume of Australian RMBS outstanding stabilised during 2010-11 at around $80 billion. The share of housing credit funded by securitisation also showed signs of levelling out during 2010-11 at just below 10 per cent, according to the June 2011 RBA Bulletin.

During 2010-11 investor demand returned for RMBS with longer weighted average lives of up to three years. Commensurate with this improvement in demand, the margin on a AAA rated senior tranche with a weighted average life of around three years improved, falling from around 130 basis points or higher over the bank bill rate at the start of the financial year, to around 100 basis points over the bank bill rate by the end of the financial year.

The return of demand for longer maturities has resulted in new transaction structures shifting away from the style supported by the AOFM throughout much of 2010, which sought to attract bank balance sheet demand for shorter life tranches, towards more traditional structures.

In the first half of 2011, the AOFM was asked to purchase some relatively small longer dated tranches, so as to facilitate the creation of RMBS securities with a weighted average life of around three years. This aimed to meet investor demand for this type of paper. Had the AOFM not been prepared to do so, falling prepayment rates would have given rise to the traditional structure having a weighted average life of closer to four years, ruling out some investor appetite in the process.

The AOFM also supported a number of innovative structures designed to facilitate engagement with new investors and previous RMBS investors who have been disengaged since the global financial crisis. For example, 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. These innovative structures have enabled issuers to tap new sources of domestic and overseas demand.

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 financial institutions other than the major banks would have been lower and their ability to provide competition to the major banks, now and in the future, would have been curtailed. Together, the broad based improvement in market conditions and prices in RMBS markets over the past year, the substantial increase in participation by investors other than the AOFM, and the maintenance of origination capacity of smaller financial institutions and mortgage originators reliant on securitisation, all suggest that the RMBS program has been one of several positive contributors to mortgage competition in the last year.

The investments made under the program are also providing reasonable financial returns. Interest income in 2010-11 was $607 million, which represented an annualised return of 6.07 per cent on the average portfolio book value of $10.005 billion. This compares favourably with the AOFM's funding costs, detailed in Table 2. All the securities purchased under the program have been floating-rate notes, paying a weighted average margin of just under 130 basis points over the one month bank bill rate as at 30 June 2011. In addition, capital repayments of $2.5 billion have been received.[11]

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. Despite continued pricing improvements through the narrowing of spreads over the course of 2010-11, the RMBS portfolio had an unrealised loss of $80.8 million (or 0.81 per cent of the portfolio book value) as at 30 June 2011.[12] 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.

Further information on the AOFM's investments in RMBS up to 30 June 2011 is given in Part 5 of this annual report.

Investor relations

Objective

The Investor Relations Unit has been working to raise the profile of CGS among institutional investors through promotional and educational activities. Efforts have focused on the continued diversification of the investor base. This is an important step towards maintaining a liquid and orderly market, which will in turn contribute to lowering the costs of government borrowing through higher demand for CGS.

Achieving the objective

Maintaining regular direct contact with current and potential investors has been the primary engagement strategy for the AOFM. This has been done through face-to-face meetings, speaking engagements and presentations. Follow-up contact was made after all meetings and investor details were added into the client relationship management database.

11 Additionally, the AOFM sold RMBS investments with a face value of $73.79 million in March 2010 for portfolio management purposes. It announced the details of this sale shortly after its completion.

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

A secondary, but growing, focus has been on developing communications with investors through other mediums. This has involved establishing a new dedicated section for investors on the AOFM website, regular investor updates and research pieces via email and initiating the development of print and digital advertisements for placement in financial publications in 2011-12.

Performance

During 2010-11 AOFM officers conducted a large number of bilateral meetings, speaking engagements and presentations as summarised in Table 3. Most of the meetings were arranged with the assistance of the CGS market making financial intermediaries. The AOFM continues to be grateful for their support.

Many of the meetings were with investors who are regularly investing in CGS and so feedback from this group is helpful in understanding issues about the state of the market. The AOFM also met with a number of new and potential investors.

The new investor relations webpage was created within the guidelines pertaining to the provision of information disclosing credit ratings in Australia[13] and released under a Creative Commons 'BY' licence as required by IP Principle 11(b) of the updated *Statement of IP Principles* (released in October 2010).

The AOFM also undertook the creative development of a small targeted advertising campaign this year. A full page print advertisement will appear in three monthly editions and the annual edition of the *Bloomberg Markets* magazine in 2011-12 and a digital banner will be displayed on all Bloomberg terminals over seven days. The advertising campaign was scheduled to coincide with an AOFM investor roadshow to the United States and presentation at a New York Euromoney Conference to target investors in Australian dollar securities.

---

13 Australian Securities & Investments Commission 2010, *Information Sheet 99: Disclosure of credit ratings in Australia*, sourced from http:www.asic.gov.au.

Table 3: Investor relations activities in 2010-11

Activity	Details
Conferences and speaking engagements	9 events
Approximate total audience size	850-950 attendees (comprising of approximately 66% investors)
Individual meetings	82 meetings
Individual cities visited	27 cities (some were visited more than once): Europe 10, North America 2, South/Central America 3, Asia 8, Australia 3, Middle East 1
Two AOFM staff members would travel on each trip	CEO, Head of Investor Relations, Director of Financial Risk, or Investor Relations' Senior Analyst
Provided assistance to the Treasurer	Input into 2 presentations. The Treasurer presented to investors in New York and London
Banks used to organise investor meetings	ANZ, Bank of America Merrill Lynch, Citi, Commonwealth Bank of Australia, Deutsche Bank, JP Morgan, Royal Bank of Canada, Royal Bank of Scotland, UBS, Westpac
Timeline of investor engagement activities	
August 2010	South America and United States of America: 7 investor meetings. Australia: 15 investor meetings.
September 2010	United Kingdom: CEO was a keynote speaker at the Euromoney Australian Debt Capital Markets Forum (London) with 150 investors in attendence. United Kingdom & Europe: CEO presentation to 30 investors hosted by UBS, 23 investor meetings.
October 2010	South East Asia: 6 investor meetings. Sydney: CBA Fixed Income Investor Conference which included a CEO presentation to 45 investors and 1 investor meeting.
November 2010	Abu Dhabi: Official Monetary and Financial Institutiona forum and 1 investor meeting.
February 2011	Singapore: Citibank Asian Investor Conference - Director of Finacial Risk presented to 120 investors. Taiwan: Head of Investor Relations presented to 70 investors hosted by CBA and 4 investor meetings (Taipei, Manila, Singapore).
March 2011	Hangzhou, China: Bank of America Merrill Lynch Asian Central Bank Conference - Head of Investor Relations presented to 80 investors and 8 investor meetings. Hong Kong: 2 investor meetings.
May 2011	South East/North Asia meetings: CEO was a keynote speaker at the Euromoney Australian & New Zealand Debt Capital Markets Forum (Singapore) and conducted 14 investor meetings. Sydney: Australian Business Economists Luncheon: 100 attendees.
June 2011	Wolfsberg: UBS Reserves Management Seminar- CEO presented to 100 central banks/sovereign wealth funds as well as conducted numerous investor meetings with attendees plus 1 investor meeting in Zurich.

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 the 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 2010-11, the AOFM published the register each quarter and following the latest update the register contains monthly data up to 30 June 2011. The register indicates that around $231.0 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 $87.2 billion or 37.7 per cent, of which $53.3 billion was identified as Australian and $33.9 billion was offshore. Country of beneficial ownership could not be identified for around $143.8 billion or 62.3 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 70.8 per cent of Commonwealth Government Securities were held by non-residents as at 30 June 2011.[14]

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).

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

The publication estimates that there was around $766.1 billion of this foreign portfolio investment in debt securities at 31 December 2010. The survey indicated the country of domicile breakdown as: the United Kingdom, $182.6 billion; United States, $168.1 billion; Japan, $54.1 billion; Luxembourg, $13.3 billion; Switzerland, $10.1 billion; China[15], $9.3 billion; New Zealand, $4.2 billion; Netherlands, $4.2 billion; unspecified European Union, $3.4 billion; Singapore, $2.3 billion; Bermuda, $1.1 billion; and France, $1.1 billion. The remainder of holdings were attributed to international bond markets, were unspecified, or were not published for confidentiality reasons.

Information technology operations

Treasury System

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. In September 2010, the AOFM negotiated an extension of the licence for its current system, Avantgard Quantum/Risk. This extension will cover the period from April 2012 to April 2014.

During 2009-10 the AOFM commenced an open market testing and procurement process to identify a treasury system to replace the existing system. There are a number of systems to choose from, all offer different functionality, costs and support arrangements. Given the central importance of the treasury system to AOFM's operations, the agency has committed significant resources to the due diligence assessment of the fit of prospective treasury systems to meet AOFM requirements during 2010-11.

The AOFM requested Expressions of Interest (EOI) to provide a treasury system through the Government's tendering system AusTender in June 2010. Five vendors were subsequently short-listed and invited to participate in a closed Request for Tender (RFT) process in December 2010. Following an evaluation of the tenders and demonstrations two vendors were selected in April 2011 to proceed to a solution proof of concept testing stage.

The next steps will require AOFM to use the evaluation outcomes to select a preferred vendor and complete contract negotiations.

15 Including Hong Kong.

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. The Compliance Unit monitors compliance with detailed controls and procedures, while the Operational Risk and Compliance Committee and the Audit Committee provide oversight.

Operational risk activities undertaken in 2010-11 included:

- internal audits of controls and monitoring of RMBS investment portfolio, IT Controls and Compliance Risk Framework review;
- 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 2010-11, it settled around $90.8 billion of payments of interest, principal and redemptions on CGS and around $296.1 billion in financial asset acquisitions, including term deposits with the Reserve Bank of Australia, money market, fixed interest and residential mortgage-backed securities. The AOFM also ensures that administered receipts are settled promptly and correctly by its transaction counterparties.

In 2010-11, the AOFM was not late in settling any payment obligations. There were no instances where compensation was sought from a counterparty because of it 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 $5.17 million for 2010-11 financial year, comprising total revenue of $16.96 million and expenses of $11.79 million. The surplus in 2010-11 was due largely to the AOFM reallocating 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 so too were the costs of syndication.

As at 30 June 2011, the AOFM was in a sound net worth and liquidity position, reporting net assets of $18.08 million, represented by assets of $20.05 million and liabilities of $1.97 million.

As at 30 June 2011, the AOFM had cash and unspent appropriations totalling $18.77 million. These funds are held 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 Honiara in August 2010 to discuss their experience with debt management over the year and the development of management capabilities.

In March 2011, a representative of the AOFM spoke at the Asian Development Bank's Second Asian Regional Public Debt Management Forum.

During the year the AOFM also hosted visits by officials from China, Indonesia and Papua New Guinea. The AOFM also met with delegates travelling to Australia under the auspices of the Pacific Financial Technical Assistance Centre.

AOFM staff engaging in robust debate at the annual Tri-party meeting with debt managers from Papua New Guinea and the Solomon Islands, hosted by the Central Bank of Solomon Islands in Honiara, August 2010. Pictured are (from left to right): Michael Bath, Director Financial Risk; Neil Hyden, former Chief Executive Officer; Matthew Wheadon, then Senior Advisor to the Solomon Islands Ministry of Finance's Debt Management Unit; and Cyril Teboua, Director Debt Management Unit, Solomon Islands Ministry of Finance.
Photo Source: *The Solomon Star* newspaper.

A HISTORY OF TREASURY BOND TENDERS AND PERFORMANCE

A HISTORY OF TREASURY BOND TENDERS AND PERFORMANCE

Introduction

The Australian Government first introduced competitive price tenders for Treasury Bonds in August 1982. The key feature of this approach is that the issuer sets the volume of securities issued while the market determines the issuance yield. The bids at tender provide a snapshot of the demand for securities and a number of metrics are available for assessing tender performance.

The reasons for moving to a tender system and trends in tender activity over the last thirty years provide an historical context for reviewing the performance of tenders. Historical trends provide a context for assessing tender results since the onset of the global financial crisis.

Debt issuance before the introduction of tenders

Prior to tenders, the Australian Government borrowed through individual cash loans and a more flexible continuous offer mechanism known as the TAP system. Under these arrangements the Government set the yield and the market would determine how much was purchased.

The financial environment in which the TAP system operated was very different to that of today. At the heart of the financial system was a banking sector that was heavily regulated. There were quantitative restrictions on lending and assets, restrictions on financial products that could be offered by different types of institutions, and restrictions on the terms and conditions of financial products such as tenor, size and yields. Controls[1] on the proportion of bank balance sheets to be held in quality assets created a captive market for government debt issuance. Operating in parallel was a largely unregulated non-bank financial intermediary (NBFI) sector. The

1 Trading banks were subject to the Liquid Government Securities (LGS) convention that was eventually replaced by a Prime Assets Ratio (PAR) in May 1985. Savings banks were subject to a Prescribed Assets Ratio and Liquid Assets Ratio, which were replaced by a Reserve Assets Ratio in August 1982. The removal of the distinction between trading and savings banks in December 1989 brought all banks under the PAR. The PAR was subsequently reduced and eventually abolished in 1999.

exchange rate was essentially fixed, but was subject to periodic change. Capital controls were also in place.

These regulations made the banking sector less competitive compared with the NBFI sector, with the latter experiencing rapid growth. Growth of the unregulated sector undermined the ability to implement effective monetary policy.

Financial deregulation in Australia took place gradually over the 1970s and 1980s. The removal of interest rate ceilings on bank deposits began in December 1980, while all other controls on tenors and size were abolished in August 1984. Most remaining ceilings on other bank interest rates (including lending) were removed in April 1985.[2] Reserve ratios on the banking sector were reduced throughout the 1970s and 1980s.

Under the TAP system there was considerable uncertainty as to whether the Government's financing needs would be met by the financial market. The Government had the capacity to fund shortfalls by issuing Public Treasury Bills[3] to the RBA. This potential for monetising debt was both unlimited and unpredictable which reduced the effectiveness of monetary policy and tied debt management to monetary policy.[4]

The TAP mechanism was not sustainable with increasingly flexible interest rates. As a result, a tender system was first adopted for short-term Treasury Notes in December 1979 and for Treasury Bonds in August 1982. The move to a tender approach supported the Government moving to fully funding its Budget without recourse to central bank financing.[5] This effectively separated monetary policy from debt management.

The adoption of tenders for debt issuance was critical in freeing up the key risk-free market yield in the economy. This proved essential for the financial innovation that was to occur in the financial markets in the following years.

---

2 With the exception of the 13.5 per cent cap on owner-occupier housing loans under $100,000 which was removed for new loans in April 1986.

3 At a concessionary 1 per cent interest rate below market interest rates.

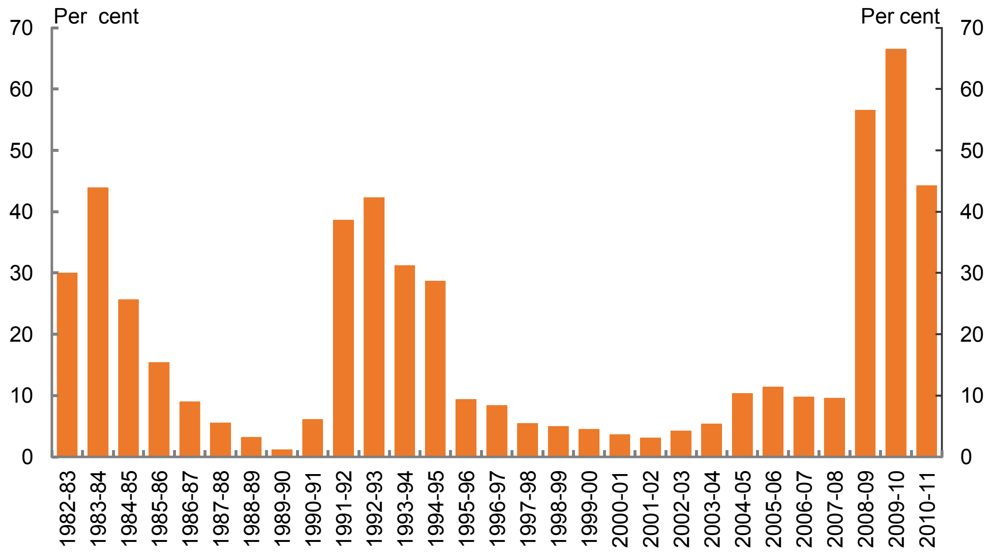
4 For example, if the RBA attempted to tighten monetary conditions and the Government did not also raise interest rates at TAP, then market demand for the bonds would be weak and the RBA would end up monetising the debt defeating the initial monetary policy intent.

5 This was formalised by agreement between the RBA and Treasury in 1986. A short-term overdraft facility at the RBA remains, however, protocols are that this is only used in unforseen circumstances, for short periods until the next tender and the Government is charged a penalty commercial overdraft rate for it use.

Tender activity

The volume of Treasury Bonds issued through tenders on a yearly basis and expressed as a proportion of the outstanding stock of Treasury Bonds at the start of each year, is shown in Chart 1. The tender data includes bond issuance undertaken by the Commonwealth on behalf of the States and Territories up until 1990.[6]

Chart 1: Treasury Bond tender volumes relative to market size



The early years: August 1982 to July 1989

In these early years, the tender system was required to issue yearly volumes that were 30 to 40 per cent of the size of the Treasury Bond market at that time. The market was relatively illiquid and secondary market prices could change sharply in response to tender volumes and seasonal liquidity factors.

Issuance tended to be in a series of one-off issues into new stocks at a particular maturity date with a coupon at prevailing market rates. This more or less continued the issuance pattern that had arisen under the TAP system. By June 1985, there were 125 individual bond lines along a yield curve extending to 20 years.

In the latter half of the 1980s, tender activity was reduced as the budget position gradually returned to surplus. In order to promote domestic liquidity foreign currency

6 The Commonwealth ceased funding the States' new money requirements in 1984 but continued refinancing maturities of Treasury Bonds issued on their behalf until 1990.

debt was actively reduced through exercising early call options and undertaking market repurchases. This permitted greater Treasury Bond issuance than would have otherwise been the case. Secondly, debt managers commenced a benchmark line strategy which involved directing issuance into a smaller number of bond lines to build up their volume. Thirdly, additional issuance into these new benchmark lines funded the early redemption of other illiquid stocks (through the RBA).

By June 1990 the number of individual bond lines had been reduced to 74, with a yield curve extending to 15 years. Around 55 per cent of Treasury Bonds were in the 'more liquid' benchmark lines.

Return to the market: April 1991 to June 1995

As a result of the recession in the early 1990s, the Commonwealth returned to the market to fund the budget task. Tender activity at this time constituted around 30 to 40 per cent of the market size and provided a significant boost to liquidity. The strategy of issuing into deep liquid benchmark bond lines continued. By June 1995 the number of bond lines had been reduced to 52 with a yield curve extending to 12 years. Around 95 per cent of the stock was now in liquid benchmark bond lines.

A declining market: July 1995 to June 2003

Throughout the late 1990s the stock of Treasury Bonds declined and tender activity fell to levels below the volume of maturing bonds. Tender activity focussed on new long-term bond lines in order to maintain a Treasury Bond curve with a tenor of 12-13 years. To further consolidate liquidity, the AOFM[7] undertook a small number of conversion tenders in which some of the less actively traded benchmark lines[8] were exchanged for new stocks.

Other Commonwealth securities were discontinued in order to maintain liquidity in Treasury Bonds. The Treasury Adjustable Rate Bonds maturing in 1998 and 2000 were not replaced with new lines and issuance into Treasury Indexed Bonds stopped in early 2003. Issuance of Treasury Notes discontinued in 2003, as assets in the form of term deposits with the RBA became the main cash management tool.

By June 2003, the number of individual Treasury Bond lines had declined to 17, spread across a yield curve extending out to 12 years with over 99 per cent of these bonds in deep liquid benchmark lines.

---

7 The AOFM came into existence on 1 July 1999 and took over debt issuance and management previously undertaken by the Treasury.
8 In particular, the 10 per cent February 2006 and 10 per cent October 2007 bond lines.

Maintaining the market: July 2003 to January 2009

The then Government made a policy decision in 2003 to maintain a market for Treasury Bonds having considered the need for it to be maintained against the possibility of future borrowing requirements. This was compared against the potential costs of re-establishing the market in the future. It also considered the broader benefits of the CGS market for the efficient functioning of Australian financial markets. Primarily because of these broader benefits, the focus became one of supporting the continued operation of the Treasury Bond futures market.

The periodic issuing and building of volume quickly in new 5 and 13 year benchmark Treasury Bond lines, with a target of $5 billion per line, became the practice. These lines would be available to enter the underlying bond baskets for the 3 and 10 year bond futures contracts. The Treasury Bond program was capped by the level of bond maturities[9] at this time which meant the Treasury Bond market remained at about $50-$55 billion outstanding.

In addition, a Stock Lending Facility was created in 2004 to provide market participants with access to Treasury Bonds when stocks became short in the physical market. This provided a temporary access to stock that was tightly held and unavailable from elsewhere in the market. Participants were required to post other CGS as collateral and the use of the facility was at a penalty rate.

Notwithstanding these policies, some signs of illiquidity in the Treasury Bond market had begun to emerge by 2008. In particular, some significant and persistent divergence between bond futures and the pricing of the physical stock underpinning the baskets had emerged and there were more frequent instances of individual Treasury Bond stocks becoming very tight in the repo market. These developments risked reducing the effectiveness of the bond futures market.

To address these issues, the Government took the decision to boost liquidity in the Treasury Bond market through additional issuance and to widen the range of securities eligible as collateral for the Stock Lending Facility. In July 2008, additional tenders commenced, including: switch tenders where Treasury Bonds were exchanged for other non Commonwealth Securities, for bond lines showing signs of tightness in the market, as well as for new bond lines.

Return to the market: February 2009 to June 2011

Tender activity increased substantially in February 2009 as the impacts of the global financial crisis began to hit Australia. Tender activity was rapidly increased with twice

---

9 The legal authority to borrow was limited to financing maturities.

weekly tenders of $500-$700 million per tender of Treasury Bonds. It also decided to immediately re-establish the Treasury Note market to provide for short-term financing options. In October 2009 the Treasury Indexed Bond market was re-opened to diversify the investor base.

Trends in tender performance

The previous section highlights that there have been considerable variations in tender activity since the tender approach was adopted in 1982. This section examines the performance of these Treasury Bond tenders using common tender assessment metrics as well as some alternate measures.

With tenders, bids are ranked from lowest to highest yield[10] and stock is allocated to bidders in this order until the announced tender volume is met. Under a multiple price auction approach the successful bidders then buy the bonds at the yield they have bid.

The volume of securities sold provides little insight into the performance of tenders other than in the rare cases of uncovered tenders where investors are not prepared to make sufficient bids *at any price* to clear the tender.[11]

Range of accepted bids at tender and the spread between the tender yield and the secondary market

The range of accepted bids or the difference between the best and worst yields accepted at a tender is a commonly used measure of tender performance. A narrower range is considered to reflect stronger demand. A wider range can reflect a lack of demand and possibly uncertainty in the market around where pricing levels should lie.

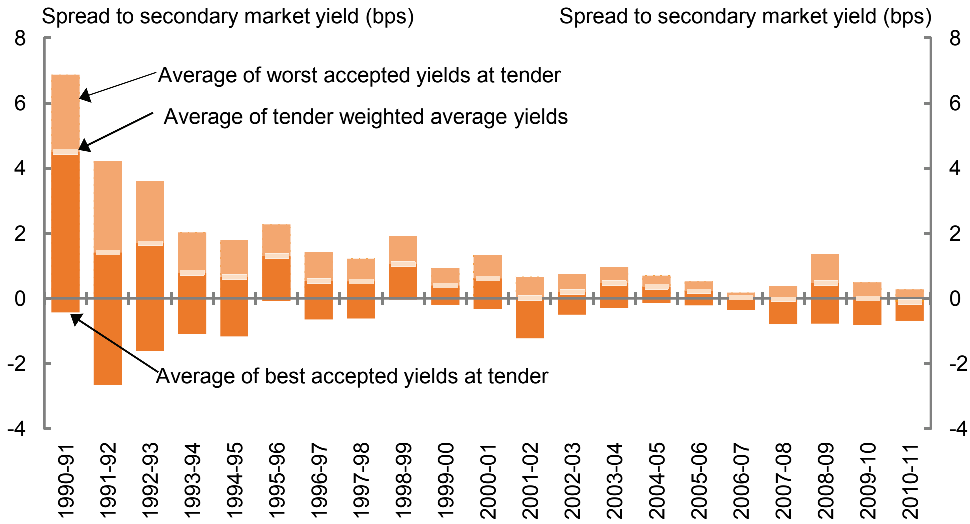
Another commonly used measure of tender performance is the spread between the weighted average tender yield and the prevailing secondary market yield. Generally it is expected that the yield at tender will be close to that prevailing in the secondary market. This can be affected by the efficiency and liquidity of the secondary market and the size of tenders compared to normal secondary market parcels. A measure of spread abstracts from the general level of interest rates, which are influenced by broader economic conditions and allows for tender comparisons over time.

Chart 2 shows the tender weighted average yield expressed as a spread to the prevailing secondary market yield at the time of the tender. It also shows the best and

10 Equivalently ordered from the highest to lowest price bid.
11 This occurred in some United Kingdom Gilt auctions in 2009 and 1995.

worst accepted bids. For each year there is a weighted average, by tender volumes, of the respective tender figures in that year. The average range of accepted bids is reflected by the height of the columns in the chart. The light coloured bars show where the average tender yield sat within the range of accepted bids.

Chart 2: Range of accepted bids and spread of tender yields to market



The chart shows a general compression in the range of accepted bids at tenders (hereafter 'range accepted') and a narrowing in the spread of tender yields to the secondary market yield (hereafter 'tender spreads') over the years. There are, however, fluctuations from year-to-year.

The range accepted was very wide in the early tender years, averaging around 30 basis points in the 1980s. This dropped to around 8 basis points towards the end of the decade.[12] The range accepted (during a period of increased tender activity) remained relatively wide at around 5-7 basis points between 1990-91 and 1992-93, but narrowed to around 2-3 basis points between 1993-94 and 1994-95. Tender spreads were initially wide (2-4 basis points), when issuance recommenced after an absence of almost two years, but improved to under 1 basis point. This probably reflected the increased liquidity associated with a greater volume on issue and the adoption of the strategy of building benchmark Treasury Bond lines.

Notwithstanding the lower tender activity during 1995 — 2003 and a reduction in the size of the Treasury Bond market, the range covered and tender spreads continued to

12 The range of accepted bids could not be displayed in the spread form used in the chart for the 1980s because prevailing secondary market yield data are not available prior to 1991.

improve. During this period the range accepted averaged around 1.9 basis points and tender spreads averaged around 0.7 basis points. This may have reflected the relative scarcity of new bond issuance in a market that was still quite liquid. Also the move to full electronic bidding at tenders and a substantial reduction in the time taken to inform the market of tender results, along with the growth of the bond futures market, may have assisted market participants in managing the risks of bidding at tenders. This would also have contributed to better outcomes.

Following the decision in 2003 to maintain the CGS market, there was a further improvement in the range accepted and tender spread results which continued through to 2007. The range accepted narrowed to 0.8 basis points on average and the tender spread narrowed further to 0.2 basis points. This was at least partly attributable to the greater certainty about the future of the market and the focus on boosting liquidity through targeted tenders and the availability of a stock lending facility.

Tender results weakened in 2008 as the effects of the global financial crisis on liquidity created dislocation in the financial system. There was some loss of liquidity in the Treasury Bond market notwithstanding the increase in demand for CGS as part of a 'flight to quality' response. However, this was minor compared with the loss of liquidity in the money, derivatives and securitisation markets at the time. The range of accepted bids widened to around 1.9 basis points and the tender spread widened to 0.8 basis points (it had been close to zero in 2007).

Notwithstanding the significant increase in tender activity in 2009, the range of accepted bids and tender spreads held at the wider levels that had emerged in 2008. In 2008-09 the range of accepted bids (around 2 basis points) and tender spreads (around 0.5 basis points) were wider than they had been for over a decade; although considerably better than in the early 1990s (4.4 basis points and 1.2 basis points respectively) when tender activity had similarly increased.

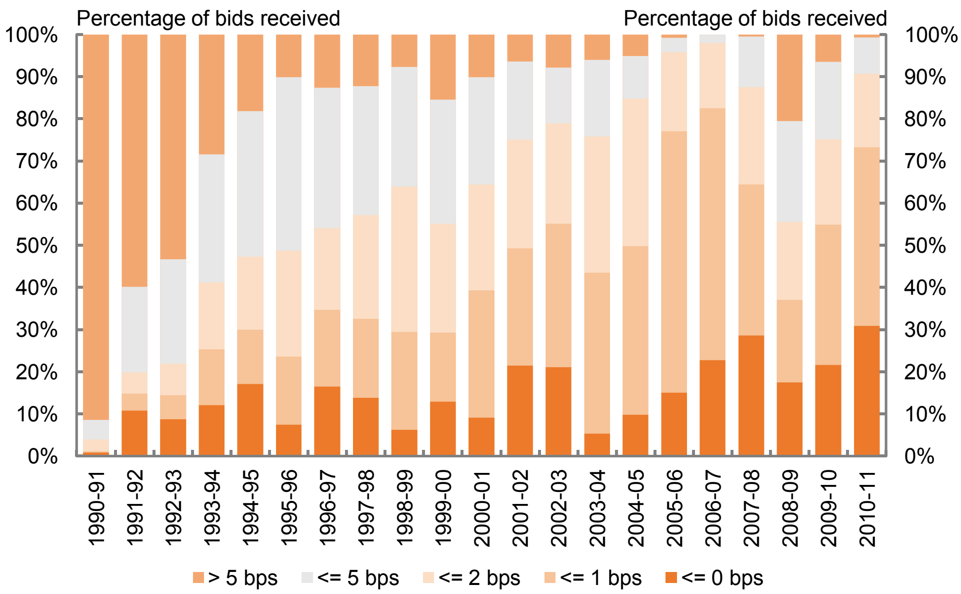
Tender results again improved in 2009-10 and 2010-11. The range of accepted bids contracted to 1.3 and 1.0 basis point over these two years returning to levels seen in the mid 2000s, but not quite as strong as the levels just prior to the onset of the global financial crisis. Remarkably, tender spreads tightened to under market mid rates in 2009-10 and 2010-11. In fact, the average tender spread in 2010-11 was better than any prior year since bond tenders commenced.

Distribution of bids at tender

Yet another way of viewing tender performance is to analyse the distribution of tender bids including those bids that were not accepted (the 'tender tails'). Generally, stronger tenders are expected to have a tighter distribution without long tails of uncompetitive bids. Uncompetitive bids may not be accepted in tenders, but could signal something about the depth of market demand for securities, which could be relevant in circumstances where financing had to be quickly increased.

Chart 3 shows the proportion of bids received at different pricing levels expressed as spreads to the prevailing secondary market yield at the time of the tender. In the Treasury Bond market, there is normally a trading spread of 2 basis points between the bid and offer rates — translating to a bid rate of 1 basis point above the mid rate. Given tender volumes are for amounts greater than standard market parcels, a bid that is 2 basis points wider (or better) than the mid rate could be viewed as a quality bid.

Chart 3: Composition of bids received at tenders relative to prevailing secondary market yields



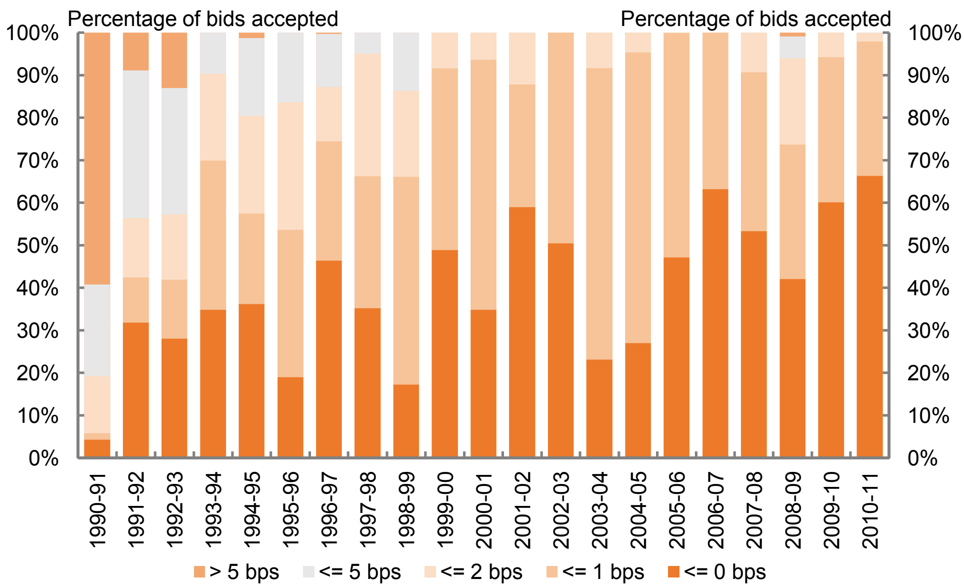
The chart shows that the proportion of bids at stronger pricing levels has improved significantly since the early 1990s. The proportion of quality bids broadly increased most years, reaching a peak in 2006-07 at around 98 per cent of all bids. The quality of the bids received at tender started to deteriorate with the onset of the global financial crisis in 2008 and with increased tender activity from the start of 2009. The proportion fell back to 87.5 and 55.6 per cent in 2007-08 and 2008-09 respectively, but subsequently rebounded strongly in 2009-10 and 2010-11. Since tender activity increased in early 2009, around 78.2 per cent of tender bids have been within 2 basis points or better of market mid rates. These results compare favourably with the experience of the early 1990s where quality bids on average made up only about 31 per cent of the bids received.

Another way of assessing the depth of the market is to calculate how much the average tender spread would have increased, if the tender volumes had been higher and as a result more of these tail bids had been accepted. This counterfactual requires the somewhat heroic assumption that tender bids (in terms of volume and price) would not have changed if higher tender volumes had been announced and on this basis is not a useful predictor of the future. Nonetheless, it may be indicative of the comparative state of general demand for Treasury Bonds between different periods.

Since early 2009 when tender volumes were increased in response to the global financial crisis, doubling the bids accepted could have increased average tender spreads by 0.5 basis points. A comparable calculation for the early 1990s period indicated a rise in average tender spreads of around 3 basis points.

Chart 4 shows the distribution for bids accepted at tender only. This chart shows, notwithstanding deterioration in the quality of demand following the global financial crisis, that many of the lower quality bids were not required. A very small proportion of bids greater than 2 basis points away from the secondary market yield in 2008-09 were picked up, but this was quickly reversed in 2009-10 and 2010-11.

Chart 4: Composition of bids accepted at tenders relative to prevailing secondary market yields

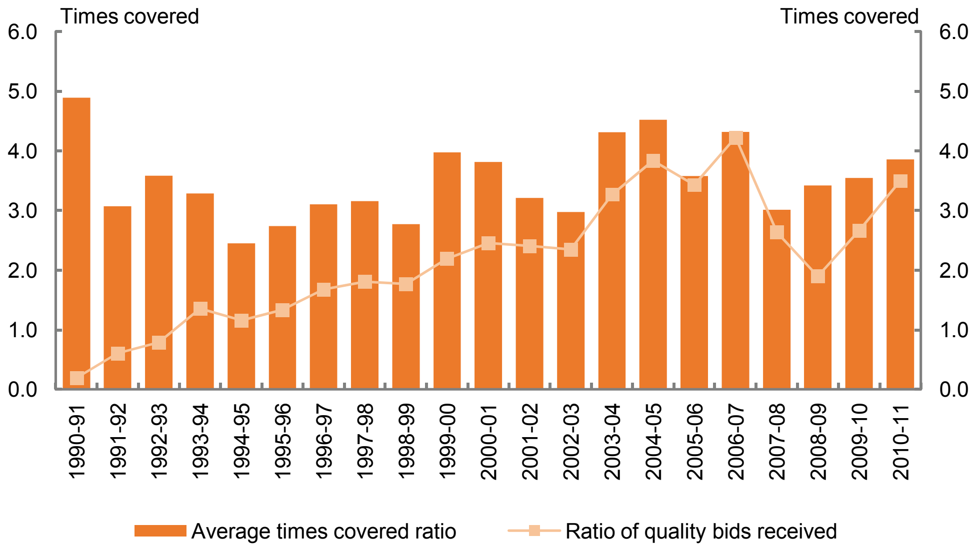


Times covered ratio at tender

Another commonly used measure of tender performance is the tender times covered ratio. This is defined as the volume of all bids received divided by the volume of bids accepted at tender. It is usually interpreted, rather simplistically, as how much more (proportionately) could have been issued at tender. This also has very limited usefulness as a predictive indicator because it is not clear bidding behaviour is completely independent of the pre-announced volume for tender. However, a coverage ratio less than one indicates that an issuer will fail to meet its tender objective.

Chart 5 shows the average coverage ratio achieved at tenders back to 1990-91. In the 1980s, the average was around 2.7; in the 1990s and early 2000s the average was around 3.1, improving further to an average of around 4.0 after 2003 but prior to the global financial crisis. During 2008 it dropped to an average of 3.0 but has picked up to average 3.7 since early 2009.

Chart 5: Times covered at tenders



Note: The ratio of quality bids received is defined as the bids with a spread to the market mid rate 2 basis points or better, divided by the volume of accepted bids.

The tender times covered ratio does not distinguish between the quality of the bids received and a high cover ratio may disguise bids that are quite unattractive to the issuer. It therefore is a relatively blunt indicator of the strength of market demand at tenders.

Accordingly, Chart 5 also shows a modified coverage ratio, which takes into account the quality of the bids received. It is defined as the ratio of quality bids received (those with a spread to the market mid rate 2 basis points or better) divided by the volume of accepted bids. Note a ratio less than one does not indicate a failure to cover a tender on this modified measure.

The chart shows a steady improvement in coverage by quality bids over the period since the early 1990s. It declined following the onset of the global financial crisis. It has recovered strongly since 2008-09 to be close to peak levels seen prior to the crisis.

Conclusion

The move to a tender system was a critical component of financial deregulation in the 1980s. The move to a tender system along with the floating of the exchange rate was a necessary condition for there to be an effective and independent control of monetary policy. It was also a necessary condition for financial innovation and the development of Australian financial markets to provide an efficient mechanism for pricing and transferring risk.

Australian governments, the AOFM and Treasury have attempted to support the efficiency of the Treasury Bond market through their debt management policy, strategies and operations. The tender system has provided a very effective system for financing fiscal policy and has met the challenge of raising significant funds over the last thirty years. Tender performance has steadily improved over time, mirroring the increasing depth and efficiency of the Australian financial market.

There does not seem to be any one particular factor that has, over time, lead to an improved quality of tender outcomes (in terms of price and stronger demand). However, it is reasonable to suggest that a focus on supporting liquidity (whatever the overall size of the CGS market at the time), improved efficiency of financial markets (through a number of reforms), greater transparency and predictability in tender activity, and improvements in the tender process (and more particularly the speed with which results are known to bidders) have all contributed positively to reducing the Government's costs of financing. They suggest that should it be required, the Government will have ready access to markets without experiencing fiscal dislocation.

Tender performance during the global financial crisis weakened initially but rebounded strongly and has performed considerably better than it did in a comparable period in the early 1990s.

Table 1: Historical bond tender results 1982-83 to 2010-11

Period	Tender volumes		Tender performance					
	Amount accepted ($ million)	Amount bid ($ million)	Range of accepted bids (basis points)	Weighted average yield spread to market (basis points)	Share of quality bids* received (per cent)	Share of quality bids* accepted (per cent)	Times covered total	Times covered by quality bids*
1982-83	5,594	12,917	50.2	..	..	..	2.3	..
1983-84	9,554	30,683	45.4	..	..	..	3.2	..
1984-85	7,550	17,255	17.9	..	..	..	2.3	..
1985-86	5,504	14,435	17.9	..	..	..	2.6	..
1986-87	3,402	7,857	13.8	..	..	..	2.3	..
1987-88	2,201	6,384	7.8	..	..	..	2.9	..
1988-89	1,200	3,859	8.5	..	..	..	3.2	..
1989-90	400	638	56.3	..	..	..	1.6	..
1990-91	2,000	9,784	7.3	4.5	3.9	19.3	4.9	0.2
1991-92	11,995	36,801	6.9	1.4	19.9	56.4	3.1	0.6
1992-93	16,591	59,488	5.2	1.7	22.0	57.3	3.6	0.8
1993-94	16,693	54,838	3.1	0.8	41.2	90.3	3.3	1.4
1994-95	19,293	47,198	3.0	0.7	47.3	80.4	2.4	1.2
1995-96	7,599	20,786	2.4	1.3	48.7	83.6	2.7	1.3
1996-97	6,814	21,122	2.1	0.5	54.1	87.1	3.1	1.7
1997-98	4,504	14,221	1.8	0.5	57.1	95.0	3.2	1.8
1998-99	3,696	10,241	1.9	1.1	63.9	86.4	2.8	1.8
1999-00	3,198	12,718	1.1	0.4	55.1	100.0	4.0	2.2
2000-01	2,303	8,781	1.7	0.6	64.4	100.0	3.8	2.5
2001-02	1,798	5,769	1.9	0.0	75.0	100.0	3.2	2.4
2002-03	2,400	7,138	1.2	0.2	78.9	100.0	3.0	2.3
2003-04	2,998	12,929	1.2	0.5	75.8	100.0	4.3	3.3
2004-05	5,498	24,865	0.8	0.4	84.8	100.0	4.5	3.8

* The ratio of quality bids received is defined as the bids with a spread to the market mid rate of 2 basis points or better, divided by the volume of accepted bids.

Table 1: Historical bond tender results 1982-83 to 2010-11 (continued)

Period	Tender volumes		Tender performance					
	Amount accepted ($ million)	Amount bid ($ million)	Range of accepted bids (basis points)	Weighted average yield spread to market (basis points)	Share of quality bids* received (per cent)	Share of quality bids* accepted (per cent)	Times covered total	Times covered by quality bids*
2005-06	6,099	21,832	0.7	0.2	95.8	100.0	3.6	3.4
2006-07	5,199	22,438	0.5	0.0	98.0	100.0	4.3	4.2
2007-08	5,002	15,060	1.2	0.0	87.5	100.0	3.0	2.6
2008-09	30,799	105,221	2.1	0.5	55.6	94.0	3.4	1.9
2009-10	52,151	184,876	1.3	0.0	75.1	100.0	3.5	2.7
2010-11	55,190	212,823	1.0	-0.1	90.7	99.9	3.9	3.5
Aug 82 to Jul 89	35,405	94,027	29.5	..	..	..	2.7	..
Apr 91 to Jun 95	66,572	208,108	4.4	1.2	31.6	71.0	3.1	1.0
Jul 95 to Jun 03	32,312	100,775	1.9	0.7	58.4	91.2	3.1	1.8
Jul 03 to Dec 07	23,395	92,881	0.8	0.2	89.9	100.0	4.0	3.6
Jan 08 to Jan 09	6,898	20,593	1.9	0.8	64.7	91.1	3.0	1.9
Feb 09 to Jun 11	132,642	486,569	1.3	0.0	78.2	99.0	3.7	2.9

* The ratio of quality bids received is defined as the bids with a spread to the market mid rate of 2 basis points or better, divided by the volume of accepted bids.

PART 3: MANAGEMENT AND ACCOUNTABILITY

Management and accountability

Corporate governance

The Secretary to the Treasury provides general oversight of 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 separate 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 2011 were:

- Dr Martin Parkinson PSM, Secretary to the Treasury, Chair (replacing Dr Ken Henry in April 2011);
- Tony Cole AO, Executive Director of Mercer Investment Nominees (Australia) Pty. Ltd., Director of the Northern Territory Treasury Corporation, Chairman of the Melbourne Institute Advisory Board and Trustee Director of Australian Reward Investment Alliance;
- Rob Nicholl, CEO, AOFM (replacing Neil Hyden in January 2011);

- 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 & 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 four occasions in 2010-11.

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 Committee

An Executive Committee coordinates the overall management of the Office, including consideration of strategic issues, coordination of priorities, financial management, organisational arrangements and resource management. Its membership comprises of the CEO as Chair and senior Business Practice Leaders.

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 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 advises on the management of human resources, including employment policies, training and development, recruitment, performance management and remuneration. It consists 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 and the Human Resource Manager.

Information Technology Steering Committee

This committee 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.

Operational Risk and Compliance Committee

This committee manages operational risks. It recommends and determines compliance priorities and control procedures and oversees the identification, categorisation and prioritisation of operational risks. Its membership comprises of the CEO, 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 and the Compliance 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 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 is a forum for the review of audit and related issues. It approves the AOFM's internal audit plan; reviews audit reports and advises on action to be taken on matters raised by AOFM's auditors; advises on the preparation and review of the AOFM's financial statements; reviews operational risks and endorses the plans for implementation of fraud controls and awareness training.

The Audit Committee membership at 30 June 2011 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;
- Elizabeth Clegg, Manager, Government Investment, Risk and Debt Policy Unit, the Treasury; 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 2010-11.

Internal auditor

Since appointing the new internal auditor, Deloitte Touche Tohmatsu, on 19 November 2010 the following reviews were conducted in 2010-11:

- a review of the AOFM's RMBS investment portfolio, which found that internal controls were operating satisfactorily and provided recommendations to enhance the control environment. All recommendations are being implemented;
- a review of the IT General Controls; findings from this review will be presented during the 2011-12 financial year; and

- a review of the Compliance Risk Framework; findings from this review will be presented during the 2011-12 financial year.

Australian National Audit Office reports

The ANAO's cross-agency audit on the *Protection and Security of Electronic Information held by Australian Government Agencies* identified no significant or moderate audit issues in relation to the AOFM. Based on the audit work performed, only one audit finding was applicable to the AOFM. This finding was applicable to all the audited agencies, it required all agencies to review their policies and procedures for completeness.

During 2010-11, the ANAO did not conduct any other 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. During the year, IT hardware at the business continuity site was upgraded and virtualisation was implemented. These changes provide improved availability and access to production servers. Remote desktop technology was also implemented. This allows the more rapid mobilisation of laptop computers at the business continuity site. Business continuity plans were also updated and tested.

Judicial decisions

In 2010-11, 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 pursues a build strategy to meet workforce needs. 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. The AOFM builds on skills acquired through academic endeavours to develop more specialised skills and experience related to the AOFM's work requirements. Employees accumulate practical knowledge of financial markets, debt management, public policy and government administration.

Where specialised skills are needed that are not currently available within AOFM, the normal build strategy is not practicable. AOFM may recruit for positions that require such specialised skills.

AOFM provides challenging and interesting work in a professional and dynamic work environment. The relatively small size of AOFM means that staff are better aware of the overall strategies and operations of the AOFM and how the various parts of the organisation work together to complement the output of the Office as a whole. They can experience different aspects of financial markets and transactions and importantly, observe how public policy objectives interact with financial markets and the Government's financing and investment tasks. Staff are called upon to use a wider range of financial, policy and administrative skills than they might in a larger organisation. As a result they can learn and gain experience over a broad field relatively quickly. Learning is well integrated into job requirements.

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.

The build strategy has been successful in attracting and retaining highly qualified professional staff. For example, the 2011 graduate campaign attracted more than a hundred high quality applicants. In addition, the retention rate for 2010-11 was 92 per cent, with an average of 84 per cent over the previous five years.

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 each performance cycle. Learning is fostered through on-the-job training, external courses, conferences, workshops and seminars. AOFM also uses staff secondment arrangements (mostly with Treasury) to give staff development opportunities, and to supplement resource needs during anticipated periods of peak work, or for large projects. This also benefits staff being seconded to AOFM.

Over the last five financial years, an average of 75 per cent of staff have participated in training or development supported by the AOFM. During this period, training averaged 3.9 days per full-time equivalent staff member (FTE) per year and the direct costs of training (paid to external parties) averaged $2,416 per FTE per year. In 2010-11, 98 per cent of employees participated in training, 3.3 days per FTE were invested in skill development and $1,640 per FTE was paid to external providers. Payments for training and development activity over the year amounted to 2.5 per cent of direct salary costs.

The AOFM workforce

As at 30 June 2011, the AOFM employed 41.0 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 2010 and 2011

	Ongoing				Non-ongoing				
	Full-time		Part-time		Full-time		Part-time		
Classification	**Male**	**Female**	**Male**	**Female**	**Male**	**Female**	**Male**	**Female**	**Total**
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**
2010									
AOFM1	0	2	0	0	0	0	0	0	**2**
AOFM2	16	6	0	3	0	0	0	0	**25**
AOFM3	5	1	0	0	1	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	**23**	**9**	**0**	**3**	**1**	**0**	**0**	**0**	**36**

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.

Eighty-six per cent of AOFM employees have degree qualifications, with 28 per cent holding higher degrees and 21 per cent double degrees. Thirty per cent have professional qualifications.

Changes to senior management

Mr Neil Hyden retired from the position of CEO on 25 November 2010. Mr Hyden worked in the Australian Public Service for 45 years and spent most of that time in the Treasury. He also spent four years as Executive Director on the Board of the World Bank.

Mr Michael Bath acted as CEO from 26 November 2010 through 23 January 2011.

Mr Rob Nicholl commenced as CEO on 24 January 2011. Mr Nicholl has extensive public policy experience and knowledge of the financial markets, having held the position of Deputy Secretary, Economic and Financial Policy Division, Tasmanian Department of Treasury and Finance. He has also worked as Senior Adviser to the Tasmanian Deputy Premier. Prior to joining the public service, he spent several years in academia, including as Research Fellow at the Department of Economics, University of Tasmania and Lecturer, Department of Economics, University of Alberta, Canada.

Other staffing changes

In addition to the CEO, six ongoing and three non-ongoing employees were recruited during 2010-11. The changes represented turnover in the position of Portfolio Manager-RMBS and increasing capacity in other areas of AOFM. Treasury Services, Reporting and IT, and Financial Risk Groups along with the Compliance Unit benefited from this increased capacity.

Aside from the CEO's retirement, there were two staff departures during the year. Both employees took up positions in the private sector. For ongoing employees, departures represented 5.5 per cent of average staffing levels in 2010-11 (13.9 per cent in 2009-10).

Employment arrangements

Employment terms and conditions for all non-SES staff are set by the *AOFM Enterprise Agreement 2010-2011*. Bargaining for a new three-year enterprise agreement commenced on 13 May 2011 and had not concluded prior to 30 June 2011.

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 2011 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. Mercer Human Resource Consulting provided independent advice in applying the data to the AOFM.

Table 2: AOFM salary ranges

	30 June 2011	
	Base rate	Grade rate
Classification	$	$
AOFM1	36,711	67,088
AOFM2	63,563	130,286
AOFM3	150,108	187,635
AOFM4	201,889	252,362

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 or laptop computer may be provided where there is a business need. Executive remuneration is reported in Note 12 of Part 4: Financial statements.

Occupational health and safety

Occupational health and safety services are provided by the Treasury under a Service Level Agreement. The Office has one Health and Safety Representative who assists employees in accord with Health and Safety Management Arrangements and the *Occupational Health and Safety Act 1991*.

Staff members have access to a number of ongoing health activities, including health-related educational seminars, outdoor fitness programs, and other excercise classes. Flu vaccinations, health assessments, and dietary assistance were also provided in 2010-11. To prevent injuries in the workplace and to enhance the safety of staff, workplace assessments were conducted for all new starters. The desks in the front office were replaced to enable ergonomic adjustments for individual workstations. Counselling and other support is available under an Employee Assistance Program provided by Davidson Trahaire.

There were no compensable injury claims in 2010-11 and no accidents, injuries or dangerous occurrences were reported by employees. One minor incident occurred with a contractor who injured a hand whilst using a tilting meeting room chair. All chairs were inspected for functionality and no defects were identified. Operator training was initiated for contractors using these chairs and no further incidents occurred. The Office was not the subject of any directions under section 45 of the *Occupational Health and Safety Act 1991* and received no notices under this Act.

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 2010-11, 12 new consultancy contracts were entered into involving total actual expenditure of $319,000. In addition, two ongoing consultancy contracts were active during 2010-11 year, involving total actual expenditure of $159,905. This is summarised in Table 3. Details of consultancy contracts of $10,000 or more let during 2010-11 are provided in Table 4.

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.

Table 3: Consultancy contracts

	2008-09	2009-10	2010-11
Number of consultancy contracts			
New contracts	5	4	12
Ongoing contracts	2	2	2
Expenditure (including GST)			
New contracts	$20,994	$90,801	$319,000
Ongoing contracts	$131,336	$119,276	$159,905

Table 4: Consultancy contracts of $10,000 or more let during 2010-11

Consultant name	Description	Contract Value	Selection process(a)	Justification(b)
Blake Dawson	Provision of independent advice on HR matters	$21,314	Direct sourcing	C
Deloitte Touche Tohmatsu	Provision of Internal audit services	$378,000	Open Tender	C
Hewitt Associates	Advice on remuneration benchmarking	$31,361	Direct sourcing	C
Infact Consulting	Advice on treasury systems	$200,362	Open Tender	B
Total		**$631,037**		

(a) Explanation of selection process terms
Open Tender — A procurement procedure in which a request for tender is published inviting all business that satisfy the conditions for participation to submit tenders. Public tenders are generally sought from the Australian Government AusTender internet site.
Direct sourcing — A form of restricted tendering, available only under certain defined circumstances, with a single potential supplier or suppliers being invited to bid because of their unique expertise and/or their special ability to supply the goods and/or services sought.
(b) Justification for decision to use consultancy:
A — Skills currently unavailable within agency.
B — Need for specialised or professional skills.
C — Need for independent research or assessment.

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

One contract was 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. The contract was for the syndicated issuance of $1.25 billion of Australian Government debt in September 2010. The AOFM appointed JP Morgan Australia Limited, the Royal Bank of Scotland plc (Australia Branch) and UBS AG (Australia Branch) as Joint-Lead Managers for the issue. The AOFM appointed Merrill Lynch International (Australia) Limited, Citigroup Global Markets Australia Pty Limited, Commonwealth Bank of Australia and Deutsche Bank AG (Sydney Branch) as Co-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 this contract, $2.060 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

Report on the Financial Statements

I have audited the accompanying financial statements of the Australian Office of Financial Management for the year ended 30 June 2011, 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; Schedule of Asset Additions; Schedule of Administered Items 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 Australian Office of Financial Management's Chief Executive 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 the Chief Executive determines is necessary to enable the preparation of the financial statements that 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 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.

GPO Box 707 CANBERRA ACT 2601
19 National Circuit BARTON ACT 2600
Phone (02) 6203 7300 Fax (02) 6203 7777

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

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

Independence

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

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 2011 and of its financial performance and cash flows for the year then ended.

Australian National Audit Office

Michael J Watson
Group Executive Director

Delegate of the Auditor-General

Canberra

September 2011

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 2011 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 1 September 2011	P Raccosta Chief Finance Officer 1 September 2011

Statement of comprehensive income

for the period ended 30 June 2011

	Notes	2011 $'000	2010 $'000
EXPENSES			
Employee benefits	4A	**5,591**	5,243
Supplier expenses	4B	**5,866**	9,788
Depreciation and amortisation	4C	**315**	296
Write-down and impairment of assets	4D	**14**	1
Total expenses		**11,786**	15,328
OWN-SOURCE INCOME			
Revenue:			
Sale of goods and rendering of services	5A	**583**	532
Other revenue	5B	**483**	682
		1,066	1,214
Total own-source income		**1,066**	1,214
Net cost of services		**10,720**	14,114
APPROPRIATION FUNDING			
Revenue from government	5C	**15,896**	12,569
Total appropriation funding		**15,896**	12,569
Comprehensive income (loss)		**5,176**	(1,545)

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

Balance sheet

as at 30 June 2011

	Notes	2011 $'000	2010 $'000
ASSETS			
Financial assets:			
Cash and cash equivalents		**100**	90
Receivables	6A	**18,801**	13,591
		18,901	13,681
Non-financial assets:			
Infrastructure, plant and equipment	7A,7C	**577**	626
Intangibles	7B,7C	**430**	294
Other non-financial assets	7D	**140**	98
		1,147	1,018
Total assets		**20,048**	14,699
LIABILITIES			
Payables:			
Supplier payables	8A	**317**	311
Other payables	8B	**141**	109
		458	420
Provisions:			
Employee provisions	9A	**1,381**	1,499
Other provisions	9B	**133**	130
		1,514	1,629
Total liabilities		**1,972**	2,049
Net assets		**18,076**	12,650
EQUITY(a)			
Retained surplus		**16,580**	11,404
Contributed equity		**1,496**	1,246
Total equity		**18,076**	12,650

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 2011

	2011 $'000	2010 $'000
RETAINED SURPLUS		
Opening balance	**11,404**	12,949
Changes for period:		
Comprehensive income (loss)	**5,176**	(1,545)
Total retained surplus	**16,580**	11,404
CONTRIBUTED EQUITY		
Opening balance	**1,246**	3,423
Changes for period:		
Contributions by government:		
Capital injection - departmental capital budget	**250**	-
Distributions to owners:		
Return of capital - unused depreciation funding	**-**	(2,177)
Total contributed equity	**1,496**	1,246
Total equity	**18,076**	12,650

Statement of cash flows

for the period ended 30 June 2011

	Notes	2011 $'000	2010 $'000
OPERATING ACTIVITIES			
Cash received:			
Ordinary appropriations		**11,270**	14,616
GST received		**194**	500
Goods and services(a)		**804**	918
		12,268	16,034
Cash used:			
Employees		**5,674**	4,912
Suppliers		**5,767**	9,940
GST paid		**13**	7
Transfers to Official Public Account(a)		**804**	918
		12,258	15,777
Net cash from (used by) operating activities	10	**10**	257
INVESTING ACTIVITIES			
Cash used:			
Purchase of property, plant and equipment		**430**	230
		430	230
Net cash from (used by) investing activities		**(430)**	(230)
FINANCING ACTIVITIES			
Cash received:			
Appropriations - contributed equity		**430**	-
		430	-
Net cash from (used by) financing activities		**430**	-
Net increase (decrease) in cash held		**10**	27
Plus cash held at the beginning of the reporting period		**90**	63
Cash at the end of the reporting period	10	**100**	90

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 2011

	2011 $'000	2010 $'000
BY TYPE		
Commitments payable:		
Operating leases(a)	**1,499**	1,924
Other commitments(b)	**2,574**	2,722
	4,073	4,646
Commitments receivable:		
GST recoverable on commitments	**(42)**	(46)
	(42)	(46)
Net commitments by type	**4,031**	4,600
BY MATURITY		
Commitments payable:		
Operating leases:		
One year or less	**328**	351
From one to five years	**1,171**	1,398
Over five years	**-**	175
	1,499	1,924
Other commitments:		
One year or less	**1,868**	1,791
From one to five years	**706**	930
Over five years	**-**	1
	2,574	2,722
Commitments receivable:		
GST recoverable on commitments:		
One year or less	**(42)**	(43)
From one to five years	**-**	(3)
Over five years	**-**	-
	(42)	(46)
Net commitments by maturity	**4,031**	4,600

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.

Schedule of asset additions[a]
for the period ended 30 June 2011

	Notes	2011 $'000	2010 $'000
BY ASSET TYPE			
Leasehold improvements	7C	**44**	17
Computers, plant and equipment	7C	**85**	218
Computer software	7C	**287**	50
Total asset additions by asset type		**416**	285
BY FUNDING SOURCE			
Funded from ordinary appropriations:			
Leasehold improvements		**-**	17
Computers, plant and equipment		**-**	218
Computer software		**-**	50
		-	285
Funded from equity appropriations:			
Leasehold improvements		**44**	-
Computers, plant and equipment		**85**	-
Computer software		**287**	-
		416	-
Total asset additions by funding source		**416**	285

The above schedule should be read in conjunction with the accompanying notes.
(a) This schedule is prepared on an accruals and not a cash basis.

Schedule of administered items

Income and expenses administered on behalf of Government

for the period ended 30 June 2011

	Notes	2011 $'000	2010 $'000
Income before re-measurements			
Interest revenue	16A	**1,375,603**	1,436,315
Other revenue	16B	**243**	281
Total income before re-measurements		**1,375,846**	1,436,596
Expenses before re-measurements			
Grants	17A	**26**	28
Interest expense	17B	**9,272,857**	6,348,013
Total expenses before re-measurements		**9,272,883**	6,348,041
Gains (losses) before re-measurements			
Net foreign exchange gains (losses)	18A	**1,299**	334
Net gains (losses) on sale of financial instruments	18B	**208**	(52,587)
Total gains (losses) before re-measurements		**1,507**	(52,253)
Operating result before re-measurements		**(7,895,530)**	(4,963,698)
Re-measurements			
Net market revaluation gains (losses)	19	**325,857**	(2,772,676)
Total re-measurements		**325,857**	(2,772,676)
Comprehensive income (loss)		**(7,569,673)**	(7,736,374)

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

Schedule of administered items (continued)
Assets and liabilities administered on behalf of Government
as at 30 June 2011

	Notes	2011 $'000	2010 $'000
ASSETS			
Financial assets:			
Cash and cash equivalents		**622**	622
Investments (under FMA section 39)(a)	20A	**25,031,377**	30,710,034
Receivables	20B	**2,618,174**	2,694,170
Accrued revenue	20C	**456**	478
Total administered assets		**27,650,629**	33,405,304
LIABILITIES			
Interest bearing liabilities:			
Commonwealth Government Securities	21A	**201,770,418**	157,375,520
		201,770,418	157,375,520
Payables:			
Accrued expenses	21B	**93**	103
		93	103
Total liabilities		**201,770,511**	157,375,623
Net assets	22	**(174,119,882)**	(123,970,319)

The above schedule should be read in conjunction with the accompanying notes.
(a) FMA = *Financial Management and Accountability Act 1997*.

Schedule of administered items (continued)
Administered cash flows
for the period ended 30 June 2011

	2011 $'000	2010 $'000
OPERATING ACTIVITIES		
Cash received:		
Interest receipts(a)	**1,412,267**	1,385,924
Other	**243**	281
	1,412,510	1,386,205
Cash used:		
Interest payments(a)	**9,497,554**	6,620,495
	9,497,554	6,620,495
Net cash from (used by) operating activities	**(8,085,044)**	(5,234,290)
INVESTING ACTIVITIES		
Cash received:		
Capital proceeds from deposits	**285,500,000**	353,350,000
Capital proceeds from fixed interest securities	**4,345,966**	2,812,038
Capital proceeds from discount securities	**10,391,367**	11,370,527
Capital proceeds from residential mortgage-backed securities	**1,438,640**	924,455
Repayments from advances and loans	**95,727**	93,516
	301,771,700	368,550,536
Cash used:		
Acquisition of deposits	**281,200,000**	341,800,000
Acquisition of fixed interest securities	**788,706**	4,372,381
Acquisition of discount securities	**9,726,974**	14,608,490
Acquisition of residential mortgage-backed securities	**4,349,220**	2,819,540
	296,064,900	363,600,411
Net cash from (used by) investing activities	**5,706,800**	4,950,125
FINANCING ACTIVITIES		
Cash received:		
Capital proceeds from borrowings	**119,320,219**	91,464,035
Proceeds from repurchase transactions	**6,209,459**	-
Other receipts	**1,331**	85
	125,531,009	91,464,120
Cash used:		
Repayment of borrowings(b)	**74,363,416**	43,939,148
Repayment of repurchase transactions	**6,209,459**	-
	80,572,875	43,939,148
Net cash from (used by) financing activities	**44,958,134**	47,524,972

(a) Master Agreements between the Australian Government and interest rate swap counterparties provide for transactions to be settled on a net basis. Amounts above are reported on a net basis. Net swap interest receipts for 2010-11 were nil (2009-10: $63.590 million), whilst aggregate swap interest receipts for 2010-11 were nil (2009-10: $127.541 million). Net swap interest payments for 2010-11 were nil (2009-10: nil), whilst aggregate swap interest payments for 2010-11 were nil (2009-10: $63.951 million).
(b) Includes redemption of debt issued on behalf of the States.

Schedule of administered items (continued)
Administered cash flows (continued)
for the period ended 30 June 2011

	2011 $'000	2010 $'000
Net increase (decrease) in cash held	**42,579,890**	47,240,807
Plus cash held at the beginning of the reporting period	**622**	622
Cash from Official Public Account:		
Appropriations	**386,835,735**	414,967,129
Special accounts	**1,307**	183
	386,837,042	414,967,312
Cash to Official Public Account:		
Receipts	**(429,415,601)**	(462,208,034)
Special accounts	**(1,331)**	(85)
	(429,416,932)	(462,208,119)
Cash at the end of the reporting period	**622**	622

Schedule of administered items (continued)
Administered commitments
as at 30 June 2011

	2011 $'000	2010 $'000
BY TYPE		
Commitments payable:		
Other commitments(a)	-	90,340
	-	90,340
Commitments receivable:		
Other commitments(a)	-	(90,350)
	-	(90,350)
Net commitments by type	-	(10)
BY MATURITY		
Commitments payable:		
Other commitments:		
One year or less	-	90,340
	-	90,340
Commitments receivable:		
Other commitments:		
One year or less	-	(90,350)
	-	(90,350)
Net commitments by maturity	-	(10)

(a) As at 30 June 2011 the AOFM had no open transactions under its securities lending facility (30 June 2010: two open transactions). The repurchase price of Treasury Bonds sold by the Australian Government to other parties under the facility as at 30 June 2011 was nil (30 June 2010: $90.340 million) on Treasury Bonds with a face value of nil (30 June 2010: $83.460 million). The sale price of securities acquired by the Australian Government from other parties as collateral under the facility as at 30 June 2011 was nil (30 June 2010: $90.350 million) on securities with a face value of nil (30 June 2010: $89.645 million). These transactions are not recorded on the AOFM's Schedule of Assets and Liabilities Administered on Behalf of Government.

Notes to and forming part of the financial statements

for the period ended 30 June 2011

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 financial statements cover the AOFM as an individual entity and are for the reporting period 1 July 2010 to 30 June 2011. 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 2010)* 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 (including derivative financial instruments), 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 Schedule of Assets and Liabilities Administered on Behalf of Government 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) acquired 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 early adopted in the FMOs.

During 2010-11 the AOFM adopted all applicable Australian Accounting Standards that became effective during 2010-11. 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 2013-14 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 International Accounting Standards Board 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 derecognition. The requirements for amortised cost and impairment and hedge accounting are expected to be released shortly.

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 changes so too should the accounting treatment, where relevant. The sale of financial assets carried at amortised cost 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 AASB 9 is adopted (1 July 2013 for the 2013-14 financial year) the AOFM would need to re-state its financial asset values as at 30 June 2012 and 30 June 2013 in accordance with the new requirements and re-state its 2012-13 comparative profit and loss results.

This would entail de-recognising the unrealised fair value gains and losses on the portfolio of administered financial assets on the financial asset values as at 30 June 2012 and 30 June 2013 and the unrealised fair value gains and losses reported in profit and loss for the 2012-13 financial year.

The AOFM is well placed to meet this change as its financial management information system maintains both amortised cost and mark–to-market information for each class of financial asset.

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 financial liabilities when AASB 9 becomes operative.

For financial liabilities carried at fair value through profit or loss, AASB 9 has adopted 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 separation of administered and departmental items is to enable assessment of the administrative efficiency of the AOFM in providing goods and 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 are undrawn by the AOFM and have not lapsed.

On 1 July 2010, the Government's new 'net cash appropriation framework' came into effect. Under this arrangement, agencies receive an output appropriation equivalent to budgeted expenses less depreciation, amortisation and make good expenses. In addition, a capital budgeting regime has been introduced to provide a cash appropriation for budgeted expenditures for the replacement of departmental infrastructure, plant and equipment and intangibles. The capital appropriations are not recognised as revenue from Government in the Statement of Comprehensive Income.

(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 if they had 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 are undrawn by the AOFM and have not lapsed.

For 2010-11 the AOFM received a capital injection of $0.250 million under the new '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 intangibles.

(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 2010-11 (2009-10: $2.177 million being the return to Budget of unused depreciation funding).

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 Australian Government 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.

In addition, a liability has been recognised at the end of the financial year for outstanding superannuation contributions payable in relation to the final fortnight of the financial year.

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 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 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 3 years. All infrastructure, plant and equipment assets were last revalued as at 31 March 2009.

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	**2011**	2010
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 3 to 5 years (2009-10: 3 to 5 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

Administered revenue, expenses, assets, liabilities and cash flows are presented in the Schedule of Administered Items and related notes. 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.

(a) Administered cash transfers to and from the Official Public Account (OPA)

Administered appropriations from the OPA (such as appropriations for the repayment of maturing debt) or transfers by the AOFM of administered receipts to the OPA (such as proceeds from the issuance of debt) are not reported. This accounting treatment seeks to report the Government's transactions with parties outside the General Government Sector and acknowledges that these transactions with the OPA are internal to the Administered entity. An exception to the above policy relates to the disclosure of administered cash flows, given that cash transferred between the OPA and the AOFM's administered bank accounts is necessary for the completeness of the cash flow disclosures.

1.15 Exemption from FMOs

Section 17.5 of the FMOs provides an exemption to the AOFM from presenting its Schedule of Income and Expenses Administered on Behalf of Government, 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 revenue and expenses.

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 has presented its administered revenue and expenses into two categories:

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

The category 'administered 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 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 'administered 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 Schedule of Assets and Liabilities Administered on Behalf of Government 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 (and 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, bank accepted bills and 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 as Interest Revenue in the Schedule of Income and Expenses Administered on Behalf of Government. 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 as Re-measurements in the Schedule of Income and Expenses Administered on Behalf of Government.

(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 2011 approximately $9 million of perpetual debt with no fixed maturity date issued by New South Wales, Victoria and South Australia remained outstanding under the arrangements governed by the *Financial Agreement Act 1994* (30 June 2010: $10 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 $2,973 million as at 30 June 2011 (30 June 2010: $3,068 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 as Interest Revenue in the Schedule of Income and Expenses Administered on Behalf of Government.

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

(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 as Interest Expense in the Schedule of Income and Expenses Administered on Behalf of Government. 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 as Re-measurements in the Schedule of Income and Expenses Administered on Behalf of Government.

For Treasury Indexed Bonds, the principal value appreciates over time with the rate of inflation (in line with a 6 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 as Interest Expense in the Schedule of Income and Expenses Administered on Behalf of Government.

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

(e) Derivative financial instruments

Derivatives are required by AASB 139 *Financial Instruments: Recognition and Measurement* to be measured at fair value on initial recognition and at fair value on subsequent measurement. The accounting treatment for changes in fair value depends on whether the derivative is designated as a hedging instrument, and on the nature of the hedge.

The AOFM has not designated a hedge relationship between its derivatives and physical CGS debt portfolio. Accordingly, interest rate swaps the AOFM enters into are classified at fair value through profit or loss.

Changes in the carrying value of interest rate swaps are attributed between changes in amortised cost and other changes. Changes in carrying value attributable to amortised cost are recognised as Interest Expense (for the pay leg) and as Interest Revenue (for the receive leg) in the Schedule of Income and Expenses Administered on Behalf of Government. Other changes in carrying value (including unrealised changes in valuation due to a change in interest rates) are recognised as Re-measurements in the Schedule of Income and Expenses Administered on Behalf of Government.

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 and the receive legs of interest rate swaps. 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

During the financial year the AOFM 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 Schedule of Assets and Liabilities Administered on Behalf of Government and is not de-recognised. See Note 24K 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 Schedule of Income and Expenses Administered on Behalf of Government.

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

Until 30 June 2008 the AOFM used interest rate swaps to reduce the accrual cost of its borrowing by exchanging fixed rate exposure for floating rate exposure. It stopped doing this because interest rate structures had reduced the potential savings. The portfolio of interest rate swaps was wound down and the last interest rate swap contract matured on 18 May 2010. The cost and risk of the debt portfolio is now 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 discount securities. In December 2009 it extended the range of eligible investments for short-term cash management purposes to include semi-government bonds with maturities of less than one year. During 2010-11 the AOFM undertook repurchase transactions by temporarily selling these semi-government bonds for short-term funding of the OPA.

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.

Legislation

The AOFM's borrowing and portfolio management activities comply with applicable legislative requirements and accounting standards. 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 29 June 2011, *Appropriation Act (No.2) 2011-12* received royal assent. The Act includes a number of amendments to the *Commonwealth Inscribed Stock Act 1911*, including increasing the legislative limit on borrowing to $250 billion; repealing the special circumstances provision; and establishing standing appropriations to meet the expenses incurred to issue and manage debt, and expenses incurred in repurchasing debt prior to maturity;
- 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 residential mortgage-backed securities comprises a floating interest rate (based on the 1-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 24C for details of the AOFM's interest rate risk profile.

(b) Inflation risk

The AOFM currently has four 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 24D 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 maintains the daily volume of cash in the OPA, within a limit set by the Treasurer and the Minister for Finance and Deregulation, 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 entering into repurchase agreements. 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.

During the financial year, the AOFM changed the maturity date for new Treasury Bond lines issued to the 21st of the month (from the 15th), in order to more closely align semi-annual coupon payments and repayment of principal on their maturity with tax receipts into the OPA. Over time this will assist in reducing the size of timing mismatches between the Government's receipts and expenditures.

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 24E 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.

Eligible investment classes	Limits framework
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.
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. 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.

See Note 24F 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 issue must meet a range of eligibility criteria set by the AOFM, including AAA (or equivalent) credit rating by at least two ratings agencies, denomination in Australian dollars and fully amortising. Mortgages backing the securities must be secured by a first registered 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 by a leading accounting firm 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 2011 all RMBS securities held by the AOFM were rated AAA or equivalent.

See Note 24G for details of the AOFM's portfolio of RMBS investments.

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 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 RMBS.

See Note 24G for details of the AOFM's portfolio of RMBS investments.

Note 4: Expenses

	2011 $'000	2010 $'000
Note 4A: Employee benefits		
Wages and salaries	**4,665**	3,926
Superannuation	**830**	728
Leave and other entitlements	**(147)**	342
Other employee expenses	**243**	247
Total employee benefits	**5,591**	5,243
Note 4B: Supplier expenses		
Corporate support services	**377**	417
Market data services	**650**	596
Operating lease rentals(a)	**317**	322
Registry, depository and transaction services	**665**	639
Syndicated debt issuance and associated services	**1,952**	6,194
Travel	**303**	279
Workers compensation premium	**18**	20
Other(b)	**1,584**	1,321
Total supplier expenses	**5,866**	9,788
Supplier expenses are made up of:		
Provision of goods - related entities	**1**	1
Provision of goods - external entities	**41**	37
Provision of services - related entities	**1,663**	1,693
Provision of services - external entities	**4,161**	8,057
	5,866	9,788
Note 4C: Depreciation and amortisation		
Depreciation of infrastructure, plant and equipment:		
Computers, plant and equipment	**97**	97
Leasehold improvements	**67**	66
Amortisation of intangibles:		
Computer software	**151**	133
Total depreciation and amortisation	**315**	296
Note 4D: Write-down and impairment of assets		
Computers, plant and equipment - disposed	**1**	1
Leasehold Improvements - disposed	**13**	-
Total write-down and impairment of assets	**14**	1
Total expenses	**11,786**	15,328

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

(b) Includes notional ANAO financial statement audit fees of $0.294 million (2009-10: $0.295 million).

Note 5: Income

	2011 $'000	2010 $'000
Note 5A: Sale of goods and rendering of services		
With related entities:		
Staff secondments to other agencies	**583**	532
Total sale of goods and rendering of services	**583**	532
Note 5B: Other revenue		
Resources received free of charge - ANAO audit services	**294**	295
Other	**189**	387
Total other revenue	**483**	682
Note 5C: Revenue from government		
Appropriations - departmental output	**15,896**	12,569
Total revenue from government	**15,896**	12,569
Total income	**16,962**	13,783

Note 6: Financial assets

	2011 $'000	2010 $'000
Note 6A: Receivables		
With related parties:		
Goods and services	**133**	167
Appropriations receivable(a):		
Output	**17,897**	12,466
Equity injection	**662**	949
Departmental capital budget	**106**	-
With external parties:		
Other	**3**	9
Total receivables	**18,801**	13,591
Receivables are expected to be recovered in:		
No more than 12 months	**136**	176
More than 12 months	**18,665**	13,415
	18,801	13,591
Receivables are aged as follows:		
Not overdue	**18,800**	13,591
Overdue	**1**	-
	18,801	13,591

(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

	2011 $'000	2010 $'000
Note 7A: Infrastructure, plant and equipment		
Computers, plant and equipment:		
Gross value - at cost	**290**	224
Accumulated depreciation	**(105)**	(37)
	185	187
Gross value - at 2009 valuation (fair value)	**146**	167
Accumulated depreciation	**(100)**	(93)
	46	74
Under construction	**17**	-
	17	-
	248	261
Leasehold improvements:		
Gross value - at 2009 valuation (fair value)	**972**	972
Accumulated depreciation	**(643)**	(607)
	329	365
Total infrastructure, plant and equipment	**577**	626

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 2008-09, the revaluations were conducted by an independent valuer, the Australian Valuation Office. As at 31 March 2009, a revaluation increment was made of $58,642 being $4,015 for leasehold improvements and $54,627 for computers, plant and equipment. The full value of the revaluation increments for each class of assets was recognised in revenue to reverse previous revaluation decrements recognised as expenses. As at 30 June 2011 the AOFM had cumulative net revaluation losses of $28,196 for leasehold improvements and $58,869 for computers, plant and equipment which were previously recognised as expenses in the Statement of Comprehensive Income.

	2011 $'000	2010 $'000
Note 7B: Intangibles		
Computer software (purchased):		
Gross value - at cost	**3,320**	3,033
Accumulated amortisation	**(2,890)**	(2,739)
Total intangibles	**430**	294

No indicators of impairment were identified for intangible assets.

Note 7: Non-financial assets (continued)

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

	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				
As at 1 July 2010				
Gross book value	**972**	**391**	**3,033**	**4,396**
Accumulated depreciation/ amortisation	**(607)**	**(130)**	**(2,739)**	**(3,476)**
Net book value 1 July 2010	**365**	**261**	**294**	**920**
Additions:				
Purchases	**44**	**85**	**287**	**416**
Depreciation/amortisation charge	**(67)**	**(97)**	**(151)**	**(315)**
Disposals:				
Gross book value	**(44)**	**(23)**	**-**	**(67)**
Accumulated 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**
Accumulated depreciation/ amortisation	**(643)**	**(205)**	**(2,890)**	**(3,738)**
	329	**248**	**430**	**1,007**

Note 7: Non-financial assets (continued)

	Leasehold improvements 2010 $'000	Computers, plant and equipment 2010 $'000	Computer software (purchased) 2010 $'000	Total 2010 $'000
Note 7C: Reconciliation of opening and closing balances (continued)				
As at 1 July 2009				
Gross book value	955	186	3,018	4,159
Accumulated depreciation/ amortisation	(541)	(45)	(2,641)	(3,227)
Net book value 1 July 2009	414	141	377	932
Additions:				
Purchases	17	218	50	285
Depreciation/amortisation charge	(66)	(97)	(133)	(296)
Disposals:				
Gross book value	-	(13)	(35)	(48)
Accumulated depreciation/ amortisation	-	12	35	47
Net book value 30 June 2010	365	261	294	920
As at 30 June 2010				
Gross book value	972	391	3,033	4,396
Accumulated depreciation/ amortisation	(607)	(130)	(2,739)	(3,476)
	365	261	294	920

	2011 $'000	2010 $'000
Note 7D: Other non-financial assets		
Prepayments	**140**	98
Total other non-financial assets	**140**	98
Other non-financial assets are expected to be recovered in:		
No more than 12 months	**140**	98
More than 12 months	**-**	-
	140	98

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

Note 8: Payables

	2011 $'000	2010 $'000
Note 8A: Supplier payables		
With related entities:		
Trade creditors and accruals(a)	**52**	34
With external parties:		
Trade creditors and accruals(a)	**265**	277
Total supplier payables	**317**	311
Supplier payables are expected to be settled in:		
No more than 12 months	**303**	282
More than 12 months	**14**	29
	317	311
Note 8B: Other payables		
Salaries and wages	**108**	75
Superannuation	**18**	13
Tax and other	**15**	21
Total other payables	**141**	109
Other payables are expected to be settled in:		
No more than 12 months	**141**	109
More than 12 months	**-**	-
	141	109

(a) Settlement is usually made net 30 days.

Note 9: Provisions

	2011 $'000	2010 $'000
Note 9A: Employee provisions		
Annual leave	**408**	389
Long service leave	**819**	984
Superannuation	**154**	126
Total employee provisions	**1,381**	1,499
Employee provisions are expected to be settled in:		
No more than 12 months	**303**	613
More than 12 months	**1,078**	886
	1,381	1,499
Note 9B: Other provisions		
Make-good on leasehold premises(a)	**133**	130
Total other provisions	**133**	130
Other provisions are expected to be settled in:		
No more than 12 months	**-**	-
More than 12 months	**133**	130
	133	130
Reconciliation of movements in other provisions:		
Opening	**130**	125
Re-measurement	**3**	5
Closing	**133**	130

(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

Australian Accounting Standards allow the presentation of a Statement of Cash Flows using the direct method or the indirect method. The direct method reports gross operating cash flows based on the accounting records of the entity. The indirect method represents a reconciliation of operating cash flows to an entity's operating result.

The FMOs require the AOFM to prepare its Statement of Cash Flows under the direct method. Where a Statement of Cash Flows is reported using the direct method, Australian Accounting Standards require a reconciliation of the entity's operating result (or net cost of services) as reported in the Statement of Comprehensive Income to the net cash from Operating Activities reported in the Statement of Cash Flows. This is equivalent to the indirect method.

The table below represents this reconciliation:

	2011 $'000	2010 $'000
Net cost of services	**(10,720)**	(14,114)
Add revenue from Government	**15,896**	12,569
Adjustments for non-cash items:		
Depreciation and amortisation	**315**	296
Write-down and impairment of assets	**14**	1
Appropriations returned to government	**-**	(2,177)
Infrastructure, plant and equipment and intangibles accruals	**15**	(55)
Adjustments for changes in assets:		
(Increase) decrease in receivables	**(5,210)**	3,296
(Increase) decrease in other prepayments	**(42)**	(8)
(Decrease) increase in capital appropriations receivable	**(181)**	-
Adjustments for changes in liabilities:		
Increase (decrease) in employee provisions	**(118)**	317
Increase (decrease) in other provisions	**3**	5
Increase (decrease) in other payables	**32**	21
Increase (decrease) in supplier payables	**6**	106
Net cash from (used by) operating activities	**10**	257

Note 10: Cash flow reconciliation (continued)

Australian Accounting Standards require a reconciliation of cash and cash equivalents reported in the Statement of Cash Flows to items that comprise cash and cash equivalents in the Balance Sheet. The table below represents this reconciliation:

	2011	2010
	$'000	$'000
Items in Balance Sheet		
Financial assets - cash and cash equivalents	**100**	90
Total items in the Balance Sheet	**100**	90
Total as per Statement of Cash Flows	**100**	90

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.

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 for officers in the senior executive service

Actual remuneration expensed(a) during the financial year	**2011 $'000**	2010 $'000
Short-term employee benefits:		
Salary (including annual leave taken)(b)	**271**	243
Annual leave accrued	**19**	21
	290	264
Post employment benefits:		
Superannuation(b)(c)	**41**	54
	41	54
Termination benefits:		
Separation payments	**-**	-
	-	-
Other long-term benefits:		
Long service leave(d)	**28**	14
	28	14
Total	**359**	332

(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) Salary and superannuation excludes accruals for amounts due but unpaid as at the end of the financial year.
(c) Superannuation contributions are paid into the employees' 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.
(d) The value of 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 2011 the discount rate was 92.7 per cent (96.7 per cent as at 30 June 2010).

Note 12: Executive remuneration (continued)

Annualised remuneration

The following table shows the fixed annualised remuneration package for the AOFM's substantive Senior Executive Service officer as at 30 June:

Annual remuneration package for substantive senior executive as at 30 June 2011		**Fixed elements**		
	No.	**Salary $'000**	**Other $'000**	**Total $'000**
Total remuneration:				
$300,000 to $329,000	**1**	**314**	**-**	**314**
Total	**1**	**314**	**-**	**314**

Annual remuneration package for substantive senior executive as at 30 June 2010		**Fixed elements**		
	No.	**Salary $'000**	**Other $'000**	**Total $'000**
Total remuneration:				
$240,000 to $270,000	1	268	-	268
Total	1	268	-	268

In addition to fixed remuneration Senior Executive Service officers receive the following package benefits:

- annual leave — 20 days per year;
- long service leave — in accordance with the *Long Service Leave (Commonwealth Employees) Act 1976*; and
- superannuation contributions paid into an Australian Government Superannuation scheme at a rate determined by the Department of Finance and Deregulation.

Remuneration of officers not in the senior executive service

During 2010-11 the AOFM employed 5 officers (2009-10: 4) (excluding overseas seconded staff) whose total salary paid for the financial year was $150,000 or more. These officers were not members of the Senior Executive Service and are not disclosed in remuneration in the above tables.

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:

	2011 **$'000**	2010 $'000
Remuneration of auditors	**294**	295

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:

	2011	2010
Average staffing level	**37**	36

Note 15: Compensation and debt relief in special circumstances

Departmental
No 'Act of Grace' payments were made during the reporting period (nil for 2009-10).
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 (nil for 2009-10).
No payments were made under the 'Defective Administration Scheme' during the reporting period (nil for 2009-10).
No payments were made under section 73 of the *Public Service Act 1999* during the reporting period (nil for 2009-10).
No payments were made under ex-gratia programs during the reporting period (nil for 2009-10).
Administered
No 'Act of Grace' payments were made during the reporting period (nil for 2009-10).
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 (nil for 2009-10).
No payments were made under the 'Defective Administration Scheme' during the reporting period (nil for 2009-10).
No payments were made under section 73 of the *Public Service Act 1999* during the reporting period (nil for 2009-10).
No payments were made under ex-gratia programs during the reporting period (nil for 2009-10).

Note 16: Income before re-measurements administered on behalf of Government

	2011 $'000	2010 $'000
Note 16A: Interest revenue(a)		
Loans to State and Territory Governments:		
State and Territory debt	**272**	309
Advances	**158,006**	162,248
Deposits	**391,459**	647,350
Discount securities	**95,803**	102,438
Fixed interest securities	**123,107**	63,942
Residential mortgage-backed securities	**606,956**	374,145
Swaps interest	**-**	85,883
Total interest revenue	**1,375,603**	1,436,315
Note 16B: Other revenue		
Securities lending and other revenue	**243**	281
Total other revenue	**243**	281
Total income administered on behalf of Government	**1,375,846**	1,436,596

(a) Recognised using the effective interest rate method.

Note 17: Expenses before re-measurements administered on behalf of Government

	2011 $'000	2010 $'000
Note 17A: Grants		
Public Sector:		
State and Territory Governments(a)	**26**	28
Total grants	**26**	28
Note 17B: Interest expense		
Commonwealth Government Securities interest:(b)		
Treasury Bonds	**7,526,579**	5,186,144
Treasury Indexed Bonds	**1,020,994**	705,405
Treasury Notes	**712,357**	410,596
Other debt	**702**	803
	9,260,632	6,302,948
Swaps interest	**-**	45,047
Interest on repurchase agreements	**12,203**	-
Other interest costs	**22**	18
Total interest expense	**9,272,857**	6,348,013
Total expenses administered on behalf of Government	**9,272,883**	6,348,041

(a) Grants represent Commonwealth contributions into the Debt Retirement Reserve Trust Account — see Note 27G.

(b) Recognised using the effective interest rate method.

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

	2011 $'000	2010 $'000
Note 18A: Net foreign exchange gains (losses)		
Foreign currency denominated loans and securities	**1,299**	334
Total net foreign exchange gains (losses)	**1,299**	334
Note 18B: Net gains (losses) on sale of financial instruments(a)		
Sale of fixed interest assets	**270**	(26,833)
Repurchase of debt	**(62)**	(25,754)
Total net gains (losses) on sale of financial instruments	**208**	(52,587)
Total gains (losses) before re-measurements	**1,507**	(52,253)

(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

	2011 $'000	2010 $'000
Net market revaluation gains (losses)(a)		
Commonwealth Government Securities	**335,829**	(2,829,175)
Deposits and discount securities	**138**	(131)
Fixed interest securities	**(1,615)**	36,377
Residential mortgage-backed securities	**(8,495)**	64,263
Interest rate swaps	**-**	(44,010)
Total net market revaluation gains (losses)	**325,857**	(2,772,676)

(a) Net market revaluation gains (losses) represents 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: Assets administered on behalf of Government[a]

	2011 $'000	2010 $'000
Note 20A: Investments (under FMA section 39)(b)		
Designated at fair value through profit or loss:		
Deposits	**10,665,514**	14,960,696
Discount securities	**3,587,119**	4,259,203
Fixed interest securities	**-**	3,620,934
Residential mortgage-backed securities	**10,778,744**	7,869,201
Total investments (under FMA section 39)	**25,031,377**	30,710,034
Investments maturing:(c)		
Within one year	**14,437,161**	23,246,837
In one to five years	**8,161,823**	7,175,920
In more than five years	**2,432,393**	287,277
	25,031,377	30,710,034
Note 20B: Receivables		
At amortised cost:		
Loans to State and Territory Governments:		
Principal	**2,981,452**	3,078,596
Balance of special account(d)	**(566)**	(494)
Unamortised net discounts	**(362,712)**	(383,932)
Total receivables	**2,618,174**	2,694,170
Receivables maturing:		
Within one year	**1,811**	1,930
In one to five years	**27,626**	26,219
In more than five years	**2,588,737**	2,666,021
	2,618,174	2,694,170
Receivables are aged as follows:		
Not overdue	**2,618,174**	2,694,170
Overdue	**-**	-
	2,618,174	2,694,170
Note 20C: Accrued revenue		
Accrued interest on loans to State and Territory Governments	**456**	478
Total accrued revenue	**456**	478
Accrued revenue maturing:		
Within one year	**456**	478
	456	478

(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: Liabilities administered on behalf of Government[(a)]

	2011 $'000	2010 $'000
Note 21A: Commonwealth Government Securities		
Designated at fair value through profit or loss:		
Treasury Bonds	**166,082,689**	130,252,730
Treasury Indexed Bonds	**19,645,142**	16,198,297
Treasury Notes	**16,021,226**	10,899,702
Other debt	**6,728**	8,703
	201,755,785	157,359,432
At amortised cost:		
Other debt	**14,633**	16,088
Total Commonwealth Government Securities	**201,770,418**	157,375,520
Commonwealth Government Securities maturing:(b)		
Within one year	**30,365,227**	31,201,906
In one to five years	**87,445,736**	65,227,210
In more than five years	**83,959,455**	60,946,404
	201,770,418	157,375,520
Note 21B: Accrued expenses		
Interest payable on other debt (at amortised cost)	**93**	103
Total accrued expenses	**93**	103
Accrued expenses maturing:		
Within one year	**93**	103
	93	103

(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 to coupons payable on the liability).

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

Note 22: Administered reconciliation table

	2011 $'000	2010 $'000
Opening administered assets less administered liabilities	**(123,970,319)**	(68,993,137)
Administered income and expenses:		
Administered income before re-measurements	**1,375,846**	1,436,596
Administered gains (losses) before re-measurements	**1,507**	(52,253)
Administered expenses before re-measurements	**(9,272,883)**	(6,348,041)
Re-measurements - net market revaluation gains (losses)	**325,857**	(2,772,676)
Administered transfers (to) / from Australian Government:		
Special appropriations (unlimited)	**386,835,783**	414,967,174
Transfers to OPA	**(429,415,601)**	(462,208,034)
Change in special account balance	**(72)**	52
Closing administered assets less administered liabilities	**(174,119,882)**	(123,970,319)

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 2011 there were no open transactions under the AOFM's securities lending facility (30 June 2010: two).

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.

Under AASB 139 derivatives must be classified at fair value through profit or loss. The classification of non-derivative financial assets and liabilities is dependent upon condition based tests in AASB 139. The following table illustrates AOFM's financial instruments by category:

	2011	2010
	$'000	$'000
Administered financial assets		
Cash	**622**	622
Loans and receivables (at amortised cost):		
Loans to State and Territory Governments	**2,618,174**	2,694,170
Accrued interest on loans to State and Territory Governments	**456**	478
	2,618,630	2,694,648
Fair value through profit or loss (designated by the AOFM):		
Investments	**25,031,377**	30,710,034
Carrying amount of financial assets	**27,650,629**	33,405,304
Administered financial liabilities		
Fair value through profit or loss (designated by the AOFM):		
Treasury Bonds	**166,082,689**	130,252,730
Treasury Indexed Bonds	**19,645,142**	16,198,297
Treasury Notes	**16,021,226**	10,899,702
Other debt	**6,728**	8,703
	201,755,785	157,359,432
Other financial liabilities (at amortised cost):		
Other debt	**14,633**	16,088
Interest payable on other debt	**93**	103
	14,726	16,191
Carrying amount of financial liabilities	**201,770,511**	157,375,623
Net assets	**(174,119,882)**	(123,970,319)

Note 24: Administered financial instruments (continued)

Note 24B: Interest Rate Swaps

Under the interest rate risk management framework which applied before 2008-09 for the purposes of managing the cost and interest rate risk associated with the debt portfolio, the AOFM entered into domestic interest rate swap contracts under which it was obliged to receive and pay interest at fixed and/or floating interest rates. These swaps were not held for trading purposes, nor were they designated for hedge accounting. In 2008-09 the AOFM began running down its portfolio of interest rate swaps and on 18 May 2010 the last interest rate swap contract matured.

The following table outlines the notional principal amount of swaps outstanding. The notional principal amounts are not exchanged and act as a reference on which interest payments are calculated.

	2011 **$'000**	2010 $'000
Notional principal - opening balance	**-**	2,425,000
New swap transactions	**-**	-
Matured	**-**	(2,425,000)
Closing balance	**-**	-

Note 24: Administered financial instruments (continued)

Note 24C: Interest rate risk

The AOFM's exposure to interest rate risk and corresponding weighted average effective interest rates as at 30 June 2011 for each class of financial assets and financial liabilities 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.

2011 By instrument As at 30 June 2011	Fixed interest rate $'000	Floating interest rate $'000	Non interest bearing $'000	Maturing in 1 year or less $'000	1 to 5 years $'000	5 years or more $'000	Total $'000	Weighted average interest(a) %
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 exception to Treasury Indexed Bonds (which are real interest rates).

Note 24: Administered financial instruments (continued)

Note 24C: Interest rate risk (continued)

2011 By portfolio As at 30 June 2011	Fixed interest rate $'000	Floating interest rate $'000	Non interest bearing $'000	Maturing in 1 year or less $'000	1 to 5 years $'000	5 years or more $'000	Total $'000	Weighted average interest(a) %
Long term debt portfolio								
Financial assets	8,227	-	3	96	-	8,134	8,230	2.96
Financial liabilities	(185,743,352)	-	(5,933)	(14,344,094)	(87,445,736)	(83,959,455)	(185,749,285)	(a)
Net assets	(185,735,125)	-	(5,930)	(14,343,998)	(87,445,736)	(83,951,321)	(185,741,055)	
Cash management portfolio								
Financial assets	14,252,633	-	622	14,253,255	-	-	14,253,255	4.79
Financial liabilities	(16,021,226)	-	-	(16,021,226)	-	-	(16,021,226)	4.75
Net assets	(1,768,593)	-	622	(1,767,971)	-	-	(1,767,971)	
Residential mortgage-backed securities								
Financial assets	-	10,778,744	-	184,528	8,161,823	2,432,393	10,778,744	6.13
Financial liabilities	-	-	-	-	-	-	-	-
Net assets	-	10,778,744	-	184,528	8,161,823	2,432,393	10,778,744	
State and Territory Government advances								
Financial assets	2,610,400	-	-	2,171	27,626	2,580,603	2,610,400	5.89
Financial liabilities	-	-	-	-	-	-	-	-
Net assets	2,610,400	-	-	2,171	27,626	2,580,603	2,610,400	
Total net assets	(184,893,318)	10,778,744	(5,308)	(15,925,270)	(79,256,287)	(78,938,325)	(174,119,882)	

(a) Financial liabilities in the debt portfolio comprise debt instruments that incur a nominal interest rate and debt instruments that incur a real interest rate. As at 30 June 2011, the weighted average interest rate of debt instruments at nominal interest rates was 5.19 per cent and the weighted average interest rate of debt instruments at real interest rates was 3.27 per cent.

Note 24: Administered financial instruments (continued)

Note 24C: Interest rate risk (continued)

2010 By instrument As at 30 June 2010	Fixed interest rate $'000	Floating interest rate $'000	Non interest bearing $'000	Maturing in 1 year or less $'000	1 to 5 years $'000	5 years or more $'000	Total $'000	Weighted average interest(a) %
Financial assets								
Cash	-	-	622	622	-	-	622	-
Loans to State and Territory Governments	2,694,645	-	3	2,408	26,219	2,666,021	2,694,648	5.88
Deposits	14,960,696	-	-	14,960,696	-	-	14,960,696	4.50
Discount securities	4,259,203	-	-	4,259,203	-	-	4,259,203	4.83
Fixed interest securities	3,620,934	-	-	3,620,934	-	-	3,620,934	4.78
Residential mortgage-backed securities	-	7,869,201	-	406,004	7,175,920	287,277	7,869,201	6.06
Total financial assets	25,535,478	7,869,201	625	23,249,867	7,202,139	2,953,298	33,405,304	
Financial liabilities								
Treasury Bonds	130,252,730	-	-	19,121,099	65,227,210	45,904,421	130,252,730	5.16
Treasury Indexed Bonds	16,198,297	-	-	1,175,134	-	15,023,163	16,198,297	3.50
Treasury Notes	10,899,702	-	-	10,899,702	-	-	10,899,702	4.52
Other debt	18,924	-	5,970	6,074	-	18,820	24,894	3.71
Total financial liabilities	157,369,653	-	5,970	31,202,009	65,227,210	60,946,404	157,375,623	
Net assets	(131,834,175)	7,869,201	(5,345)	(7,952,142)	(58,025,071)	(57,993,106)	(123,970,319)	

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

Note 24: Administered financial instruments (continued)

Note 24C: Interest rate risk (continued)

2010 By portfolio As at 30 June 2010	Fixed interest rate $'000	Floating interest rate $'000	Non interest bearing $'000	Maturing in 1 year or less $'000	1 to 5 years $'000	5 years or more $'000	Total $'000	Weighted average interest %
Long term debt portfolio								
Financial assets	9,728	-	3	107	-	9,624	9,731	2.97
Financial liabilities	(146,469,951)	-	(5,970)	(20,302,307)	(65,227,210)	(60,946,404)	(146,475,921)	(a)
Net assets	(146,460,223)	-	(5,967)	(20,302,200)	(65,227,210)	(60,936,780)	(146,466,190)	
Cash management portfolio								
Financial assets	22,840,833	-	622	22,841,455	-	-	22,841,455	4.61
Financial liabilities	(10,899,702)	-	-	(10,899,702)	-	-	(10,899,702)	4.52
Net assets	11,941,131	-	622	11,941,753	-	-	11,941,753	
Residential mortgage-backed securities								
Financial assets	-	7,869,201	-	406,004	7,175,920	287,277	7,869,201	6.06
Financial liabilities	-	-	-	-	-	-	-	-
Net assets	-	7,869,201	-	406,004	7,175,920	287,277	7,869,201	
State and Territory Government advances								
Financial assets	2,684,917	-	-	2,301	26,219	2,656,397	2,684,917	5.89
Financial liabilities	-	-	-	-	-	-	-	-
Net assets	2,684,917	-	-	2,301	26,219	2,656,397	2,684,917	
Total net assets	(131,834,175)	7,869,201	(5,345)	(7,952,142)	(58,025,071)	(57,993,106)	(123,970,319)	

(a) Financial liabilities in the debt portfolio comprise debt instruments that incur a nominal interest rate and debt instruments that incur a real interest rate. As at 30 June 2010, the weighted average interest rate of debt instruments at nominal interest rates was 5.16 per cent and the weighted average interest rate of debt instruments at real interest rates was 3.50 per cent.

Note 24: Administered financial instruments (continued)

Note 24D: 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:

	2011 AUD $'000	2010 AUD $'000
FOREIGN CURRENCY DENOMINATED LIABILITIES		
Current:		
Pounds sterling	**79**	93
Japanese yen	**5**	5
Swiss francs	**57**	55
Euros	**7**	8
	148	161
Non-current:		
United States dollars	**4,955**	6,243
Pounds sterling	**621**	731
	5,576	6,974
Total foreign currency denominated liabilities	**5,724**	7,135
FOREIGN CURRENCY DENOMINATED ASSETS		
Current:		
Pounds sterling	**3**	3
	3	3
Non-current:		
Pounds sterling	**621**	731
	621	731
Total foreign currency denominated assets	**624**	734

Note 24: Administered financial instruments (continued)

Note 24E: 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.

			2011		
Contractual maturities	**Within 1 year $'000**	**1 to 2 years $'000**	**2 to 5 years $'000**	**>5 years $'000**	**Total $'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**

			2010		
Contractual maturities	**Within 1 year $'000**	**1 to 2 years $'000**	**2 to 5 years $'000**	**>5 years $'000**	**Total $'000**
Treasury Bonds	25,781,813	20,191,110	60,161,762	54,118,310	160,252,995
Treasury Indexed Bonds(a)	1,686,974	504,383	1,513,149	16,217,552	19,922,058
Treasury Notes	11,000,000	-	-	-	11,000,000
Other debt(b)	523	523	1,568	7,289	9,903
Total	38,469,310	20,696,016	61,676,479	70,343,151	191,184,956

(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 24F: Credit risk

The AOFM's assets are of strong credit quality. Over the reporting period the AOFM limited its financial investments to term deposits with the RBA, investment grade money market securities and semi-government bonds. In addition, its loans comprise advances and debt on allocation to the State and Territory Governments. The AOFM's exposure to credit risk under the securities lending facility and its repurchase agreements as at year end is zero.

The following tables set out the AOFM's credit risk by asset class and credit rating as at 30 June 2011 and 30 June 2010.

	2011			
S&P or Fitch long-term rating(a)	**AAA**	**AA+ to AA-**	**A+ to A-**	**Total**
Moody's long-term rating(a)	**Aaa**	**Aa1 to Aa3**	**A1 to A3**	
	$'000	**$'000**	**$'000**	**$'000**
By instrument				
Cash(b)	**622**	**-**	**-**	**622**
Loans to State and Territory Governments	**2,058,576**	**697,552**	**-**	**2,756,128**
Deposits(b)	**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) Where a counterparty has a split rating, the AOFM's exposure to the counterparty is allocated to the lower credit rating.

(b) 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.

	2011			
S&P or Fitch long-term rating(a)	**AAA**	**AA+ to AA-**	**A+ to A-**	**Total**
Moody's long-term rating(a)	**Aaa**	**Aa1 to Aa3**	**A1 to A3**	
	$'000	**$'000**	**$'000**	**$'000**
By portfolio				
Long term debt	**8,796**	**-**	**-**	**8,796**
Cash management	**10,666,136**	**3,339,127**	**247,992**	**14,253,255**
Residential mortgage-backed securities	**10,778,744**	**-**	**-**	**10,778,744**
State and Territory Government advances	**2,049,780**	**697,552**	**-**	**2,747,332**
Total	**23,503,456**	**4,036,679**	**247,992**	**27,788,127**

(a) Where a counterparty has a split rating, the AOFM's exposure to the counterparty is allocated to the lower credit rating.

Note 24: Administered financial instruments (continued)

Note 24F: Credit risk (continued)

	2010			
S&P or Fitch long-term rating(a)	**AAA**	**AA+ to AA-**	**A+ to A-**	**Total**
Moody's long-term rating(a)	**Aaa**	**Aa1 to Aa3**	**A1 to A3**	
	$'000	**$'000**	**$'000**	**$'000**
By instrument				
Cash(b)	622	-	-	622
Loans to State and Territory Governments	2,144,787	723,478	-	2,868,265
Deposits(b)	14,960,696	-	-	14,960,696
Discount securities	-	3,619,277	639,926	4,259,203
Fixed interest securities	2,911,492	709,442	-	3,620,934
Residential mortgage-backed securities	7,869,201	-	-	7,869,201
Total	27,886,798	5,052,197	639,926	33,578,921

(a) Where a counterparty has a split rating, the AOFM's exposure to the counterparty is allocated to the lower credit rating.

(b) 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 rating as the Australian Government.

	2010			
S&P or Fitch long-term rating(a)	**AAA**	**AA+ to AA-**	**A+ to A-**	**Total**
Moody's long-term rating(a)	**Aaa**	**Aa1 to Aa3**	**A1 to A3**	
	$'000	**$'000**	**$'000**	**$'000**
By portfolio				
Long term debt	10,224	-	-	10,224
Cash management	17,872,810	4,328,719	639,926	22,841,455
Residential mortgage-backed securities	7,869,201	-	-	7,869,201
State and Territory Government advances	2,134,563	723,478	-	2,858,041
Total	27,886,798	5,052,197	639,926	33,578,921

(a) Where a counterparty has a split rating, the AOFM's exposure to the counterparty is allocated to the lower credit rating.

Note 24: Administered financial instruments (continued)

Note 24G: Residential mortgage-backed securities

The AOFM has acquired a portfolio of AAA rated (or equivalent) residential mortgage-backed securities with a face value of $13,372.180 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
By financial year	**$'000**	**$'000**	**$'000**	**$'000**	
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**
Total		**13,372,180**	**2,468,585**	**73,790**	

Note 24: Administered financial instruments (continued)

Note 24G: Residential mortgage-backed securities (continued)

Originator & Issue	Acquisition date	Original amount invested	Principal repayments and sales	Principal invested as 30-Jun-11	Principal invested as 30-Jun-10
		$'000	$'000	$'000	$'000
AMP:					
Progress 2009-1 Trust	30-Mar-09	**425,000**	**170,607**	**254,393**	341,398
Progress 2010-1 Trust	29-Jan-10	**36,000**	-	**36,000**	36,000
Progress 2011-1 Trust	27-May-11	**138,000**	-	**138,000**	-
Australian Central Credit Union:					
Light Trust No.2	28-Jul-09	**190,000**	**69,591**	**120,409**	169,058
Light Trust No.3	18-Nov-10	**243,500**	**-**	**243,500**	-
Bank of Queensland:					
Reds Trust Series 2009-1	21-Apr-09	**500,000**	**66,607**	**433,393**	500,000
Reds Trust Series 2010-1	17-Feb-10	**250,000**	**60,782**	**189,218**	235,502
Reds Trust Series 2010-2	27-Aug-10	**497,600**	**-**	**497,600**	-
Bendigo and Adelaide Bank:					
Torrens Series 2009-1	18-Mar-09	**475,000**	**197,536**	**277,464**	354,689
Torrens Series 2010-1	24-Mar-10	**123,000**	**35,568**	**87,432**	116,966
Torrens Series 2010-2	20-Jul-10	**496,000**	**-**	**496,000**	-
Torrens Series 2010-3	16-Dec-10	**415,000**	**80,339**	**334,661**	-
Challenger:					
Challenger Millennium 2008-2	12-Dec-08	**500,000**	**179,362**	**320,638**	376,678
Challenger Millennium 2009-1	24-Apr-09	**500,000**	**112,937**	**387,063**	450,602
Community CPS:					
Barton 2011-1	14-Apr-11	**90,900**	**-**	**90,900**	-
Credit Union Australia:					
Harvey Trust 2009-1	26-Mar-09	**350,000**	**55,560**	**294,440**	350,000
Harvey Trust 2010-1	10-Mar-10	**143,000**	**35,611**	**107,389**	133,380
Firstmac:					
Firstmac RMBS 2-2008	21-Nov-08	**496,000**	**155,573**	**340,427**	384,372
Firstmac RMBS 1-2009	05-Jun-09	**498,620**	**92,658**	**405,962**	493,458
Firstmac RMBS 2-2009	24-Nov-09	**215,140**	**19,740**	**195,400**	195,400
Firstmac RMBS 1-2010	09-Sep-10	**190,770**	**-**	**190,770**	-
Greater Building Society:					
GBS Receivables Trust No.4	11-Sep-09	**190,000**	**28,680**	**161,320**	190,000
IMB:					
Illawarra Series 2010-1	31-Mar-10	**157,500**	**33,507**	**123,993**	151,872
ING Bank:					
IDOL 2010-1	20-Oct-10	**250,000**	**-**	**250,000**	-
IDOL 2011-1	17-Jun-11	**206,000**	**-**	**206,000**	-
Liberty Financial:					
Liberty Prime Series 2009-1	20-Apr-09	**500,000**	**236,878**	**263,122**	349,076
Liberty Prime Series 2009-2	21-Oct-09	**99,800**	**25,739**	**74,061**	93,288
Liberty Prime Series 2010-1	18-Aug-10	**100,400**	**-**	**100,400**	-
Liberty Prime Series 2011-1	13-Apr-11	**50,750**	**-**	**50,750**	-
Macquarie Bank:					
Puma P-16	02-Sep-10	**247,500**	**-**	**247,500**	-
Puma P-17	20-Apr-11	**157,500**	**-**	**157,500**	-

Note 24: Administered financial instruments (continued)

Note 24G: Residential mortgage-backed securities (continued)

Originator & Issue	Acquisition date	Original amount invested	Principal repayments and sales	Principal invested as 30-Jun-11	Principal invested as 30-Jun-10
		$'000	$'000	$'000	$'000
Members Equity Bank:					
SMHL 2008-2	09-Dec-08	**500,000**	**225,841**	**274,159**	365,135
SMHL 2009-1	14-May-09	**500,000**	**157,915**	**342,085**	484,399
SMHL 2010-1	15-Mar-10	**250,000**	**82,568**	**167,432**	232,956
SMHL 2010-2E	14-Jul-10	**250,000**	**-**	**250,000**	-
SMHL 2010-3	28-Sep-10	**290,000**	**-**	**290,000**	-
MyState Financial:					
ConQuest 2010-2	04-Aug-10	**170,000**	**-**	**170,000**	-
Police and Nurse Credit Society:					
Pinnacle 2010-T1	03-Dec-10	**111,100**	**-**	**111,100**	-
Resimac:					
Resimac 2008-1	15-Dec-08	**500,000**	**219,493**	**280,507**	359,144
Resimac 2009-1	28-May-09	**458,800**	**136,863**	**321,937**	398,765
Resimac 2009-2	28-Oct-09	**56,400**	**-**	**56,400**	56,400
Resimac 2010-1	17-May-10	**10,000**	**2,114**	**7,886**	9,810
Resimac 2010-2	25-Nov-10	**148,000**	**-**	**148,000**	-
Resimac 2011-1	19-May-11	**192,000**	**1,967**	**190,033**	-
Suncorp-Metway:					
Apollo Series 2009-1 Trust	04-Sep-09	**499,200**	**16,879**	**482,321**	499,200
Apollo Series 2010-1 Trust	09-Jun-10	**300,000**	-	**300,000**	300,000
Wide Bay Australia:					
WB Trust 2009-1	16-Jul-09	**299,500**	**41,460**	**258,040**	291,677
WB Trust 2010-1	21-Dec-10	**104,200**	**-**	**104,200**	-
		13,372,180	**2,542,375**	**10,829,805**	**7,919,225**

Note 24: Administered financial instruments (continued)

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

2011 By instrument as at 30 June 2011	Principal value(a) $'000	Total carrying amount $'000	Aggregate net fair value $'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. An estimate of the redemption value on maturity is not provided for Treasury Indexed Bonds. For all other financial liabilities the principal value represents the amount due on maturity.

(b) Loans to State and Territory Governments are recognised at amortised cost in the Schedule of Assets and Liabilities Administered on Behalf of Government. 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 24H: Net fair values of administered financial assets and liabilities (continued)

2011 By portfolio as at 30 June 2011	Principal value $'000	Total carrying amount $'000	Aggregate net fair value $'000
Long term debt			
Financial assets	8,137	8,230	8,230
Financial liabilities	(179,406,500)	(185,749,285)	(185,749,285)
Net assets	(179,398,363)	(185,741,055)	(185,741,055)
Cash management			
Financial assets	14,250,622	14,253,255	14,253,255
Financial liabilities	(16,100,000)	(16,021,226)	(16,021,226)
Net assets	(1,849,378)	(1,767,971)	(1,767,971)
Residential mortgage-backed securities			
Financial assets	10,829,805	10,778,744	10,778,744
Financial liabilities	-	-	-
Net assets	10,829,805	10,778,744	10,778,744
State and Territory Government advances			
Financial assets	2,972,749	2,610,400	2,747,332
Financial liabilities	-	-	-
Net assets	2,972,749	2,610,400	2,747,332
Net financial assets (recognised)	(167,445,187)	(174,119,882)	(173,982,950)

Note 24: Administered financial instruments (continued)

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

Under Australian Accounting Standards the AOFM is required to disclose 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.

2011 By valuation hierarchy as at 30 June 2011	Level 1(a) $'000	Level 2(b) $'000	Level 3(c) $'000	Total $'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: Net fair values of administered financial assets and liabilities (continued)

2010 By instrument as at 30 June 2010	Principal value(a) $'000	Total carrying amount $'000	Aggregate net fair value $'000
Administered financial assets (recognised)			
Cash	622	622	622
Loans to State and Territory Governments(b)	3,078,103	2,694,648	2,867,772
Deposits	14,950,000	14,960,696	14,960,696
Discount securities	4,295,000	4,259,203	4,259,203
Fixed interest securities	3,552,470	3,620,934	3,620,934
Residential mortgage-backed securities	7,919,225	7,869,201	7,869,201
Total financial assets (recognised)	33,795,420	33,405,304	33,578,428
Administered financial liabilities (recognised)			
Treasury Bonds	124,695,087	130,252,730	130,252,730
Treasury Indexed Bonds	14,961,771	16,198,297	16,198,297
Treasury Notes	11,000,000	10,899,702	10,899,702
Other debt	22,331	24,894	24,894
Total financial liabilities (recognised)	150,679,189	157,375,623	157,375,623
Net financial assets (recognised)	(116,883,769)	(123,970,319)	(123,797,195)

(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. An estimate of the redemption value on maturity is not provided for Treasury Indexed Bonds. For all other financial liabilities the principal value represents the amount due on maturity.

(b) Loans to State and Territory Governments are recognised at amortised cost in the Schedule of Assets and Liabilities Administered on Behalf of Government. These transactions are not traded and, especially for those with the longest term 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 24H: Net fair values of administered financial assets and liabilities (continued)

2010 By portfolio as at 30 June 2010	Principal value $'000	Total carrying amount $'000	Aggregate net fair value $'000
Long term debt			
Financial assets	9,627	9,731	9,731
Financial liabilities	(139,679,189)	(146,475,921)	(146,475,921)
Net assets	(139,669,562)	(146,466,190)	(146,466,190)
Cash management			
Financial assets	22,798,092	22,841,455	22,841,455
Financial liabilities	(11,000,000)	(10,899,702)	(10,899,702)
Net assets	11,798,092	11,941,753	11,941,753
Residential mortgage-backed securities			
Financial assets	7,919,225	7,869,201	7,869,201
Financial liabilities	-	-	-
Net assets	7,919,225	7,869,201	7,869,201
State and Territory Government advances			
Financial assets	3,068,476	2,684,917	2,858,041
Financial liabilities	-	-	-
Net assets	3,068,476	2,684,917	2,858,041
Net financial assets (recognised)	(116,883,769)	(123,970,319)	(123,797,195)

2010 By valuation hierarchy as at 30 June 2010	Level 1(a) $'000	Level 2(b) $'000	Level 3(c) $'000	Total $'000
Administered financial assets (measured at fair value only)				
Deposits	-	14,960,696	-	14,960,696
Discount securities	-	4,259,203	-	4,259,203
Fixed interest securities	3,620,934	-	-	3,620,934
Residential mortgage-backed securities	-	7,869,201	-	7,869,201
	3,620,934	27,089,100	-	30,710,034
Administered financial liabilities (measured at fair value only)				
Treasury Bonds	130,252,730	-	-	130,252,730
Treasury Indexed Bonds	16,198,297	-	-	16,198,297
Treasury Notes	-	10,899,702	-	10,899,702
Other debt	-	8,703	-	8,703
	146,451,027	10,908,405	-	157,359,432

(a) The fair value 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 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 24I: Movement in commonwealth government securities on issue (face value)

2011	Opening balance $'000	Issuance $'000	Maturities/ Redemptions $'000	Other $'000	Closing balance $'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.

2010	Opening balance $'000	Issuance $'000	Maturities/ Redemptions $'000	Other $'000	Closing balance $'000
Treasury Bonds	78,403,136	52,301,000	(6,009,049)	-	124,695,087
Treasury Indexed Bonds(a)	6,020,000	6,111,000	(715,735)	-	11,415,265
Treasury Notes	16,700,000	31,899,000	(37,599,000)	-	11,000,000
Other debt(b)	23,612	-	(771)	(510)	22,331
Total	101,146,748	90,311,000	(44,324,555)	(510)	147,132,683

(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 24: Administered financial instruments (continued)

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

2011	Opening balance $'000	Acquisitions $'000	Maturities/ Redemptions $'000	Other $'000	Closing balance $'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**

2010	Opening balance $'000	Acquisitions $'000	Maturities/ Redemptions $'000	Other $'000	Closing balance $'000
Deposits	26,500,000	341,800,000	(353,350,000)	-	14,950,000
Discount securities	1,000,000	14,745,000	(11,450,000)	-	4,295,000
Fixed interest securities	2,024,000	4,302,470	(2,774,000)	-	3,552,470
Residential mortgage-backed securities	6,024,139	2,819,540	(924,454)	-	7,919,225
Total	35,548,139	363,667,010	(368,498,454)	-	30,716,695

Note 24: Administered financial instruments (continued)

Note 24K: Repurchase agreements

In 2010-11 the AOFM entered 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.

The following repurchase transactions were executed in 2010-11:

	2011		
Semi-government bond series	**Number of transactions**	**Interest paid $'000**	**Face value of bonds sold $'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 2011, 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 2012, 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 2012 would be as follows:

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

2011					
Change in interest rates from 1 July 2011 for 12 months to 30 June 2012		**-1%**		**+1%**	
	Carrying amount as at 30 June 2011 $'000	**Impact in 2011-12 on profit $'000**	**Impact in 2011-12 on equity $'000**	**Impact in 2011-12 on profit $'000**	**Impact in 2011-12 on equity $'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.

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)

2010					
Change in interest rates from 1 July 2010 for 12 months to 30 June 2011		**-1%**		**+1%**	
	Carrying amount as at 30 June 2010 $'000	**Impact in 2010-11 on profit $'000**	**Impact in 2010-11 on equity $'000**	**Impact in 2010-11 on profit $'000**	**Impact in 2010-11 on equity $'000**
Financial assets					
Cash	622	-	-	-	-
Loans to State and Territory Governments	2,694,648	-	-	-	-
Deposits	14,960,696	(147,452)	(147,452)	147,452	147,452
Discount securities	4,259,203	(35,536)	(35,536)	35,536	35,536
Fixed interest securities	3,620,934	-	-	-	-
Residential mortgage-backed securities	7,869,201	(100,157)	(100,157)	100,157	100,157
Financial liabilities					
Treasury Bonds	130,252,730	244,851	244,851	(231,129)	(231,129)
Treasury Indexed Bonds	16,198,297	-	-	-	-
Treasury Notes	10,899,702	87,471	87,471	(87,471)	(87,471)
Other debt	24,894	-	-	-	-
Total increase (decrease) in accrual result (before re-measurements)		49,177	49,177	(35,455)	(35,455)

(a) Changes in nominal interest rates only.

(b) Inflation risk sensitivity analysis

The AOFM currently has four 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 2011, 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 2012, 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 2012 would be as follows:

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

	2011				
Change in CPI from 1 July 2011 for 12 months to 30 June 2012		**-1%**		**+1%**	
	Carrying amount as at 30 June 2011 $'000	**Impact in 2011-12 on profit $'000**	**Impact in 2011-12 on equity $'000**	**Impact in 2011-12 on profit $'000**	**Impact in 2011-12 on equity $'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)**

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)

2010					
Change in CPI from 1 July 2010 for 12 months to 30 June 2011		-1%		+1%	
	Carrying amount as at 30 June 2010 $'000	Impact in 2010-11 on profit $'000	Impact in 2010-11 on equity $'000	Impact in 2010-11 on profit $'000	Impact in 2010-11 on equity $'000
Financial assets					
Cash	622	-	-	-	-
Loans to State and Territory Governments	2,694,648	-	-	-	-
Deposits	14,960,696	-	-	-	-
Discount securities	4,259,203	-	-	-	-
Fixed interest securities	3,620,934	-	-	-	-
Residential mortgage-backed securities	7,869,201	-	-	-	-
Financial liabilities					
Treasury Bonds	130,252,730	-	-	-	-
Treasury Indexed Bonds	16,198,297	170,750	170,750	(170,059)	(170,059)
Treasury Notes	10,899,702	-	-	-	-
Other debt	24,894	-	-	-	-
Total increase (decrease) in accrual result (before re-measurements)		170,750	170,750	(170,059)	(170,059)

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 1-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 swap 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 $51,000 million of Treasury Bonds and $2,000 million of Treasury Indexed Bonds during the 2011-12 financial year (2010-11: $56,000 million and $4,000 million respectively). It is also assumed that the volume of Treasury Notes outstanding as at 30 June 2011 of $16,100 million will remain at these levels for the full 12 months to 30 June 2012 (2010-11: $11,000 million). It is assumed that the volume of term deposit investments will remain at levels as at 30 June 2011 of $10,650 million for the full 12 months to 30 June 2011 (2010-11: $14,950 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 2011. During 2011-12 the AOFM will make further investments of $6,628 million in RMBS. These new issues have been modelled to have no principal repayments in 2011-12. 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 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 2011 was $81.314 million per basis point (30 June 2010: $63.973 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 $81.314 million in the fair value of the portfolio as at 30 June 2011 ($63.973 million as at 30 June 2010).

Note 26: Securities lending facility

Details of Treasury Bonds and Treasury Indexed Bonds loaned to bond market participants on an overnight basis under the securities lending facility are as follows:

	2011		
Bond series	**Number of transactions**	**Face value loaned**	**Net income earned**
		$'000	**$'000**
(i) Open transactions as at the beginning of the financial year			
February 2017	**2**	**83,460**	**7**
	2	**83,460**	**7**
(ii) New transactions completed during the financial year			
Treasury Bonds:			
April 2012	**6**	**219,600**	**19**
May 2013	**8**	**134,000**	**20**
December 2013	**1**	**141,000**	**12**
October 2014	**2**	**25,000**	**2**
April 2015	**15**	**375,309**	**62**
June 2016	**1**	**5,500**	**1**
February 2017	**8**	**185,710**	**20**
January 2018	**1**	**10,200**	**3**
	42	**1,096,319**	**139**
Treasury Indexed Bonds:			
August 2020	**4**	**146,500**	**57**
September 2025	**1**	**8,000**	**1**
	5	**154,500**	**58**
Total	**49**	**1,334,279**	**204**
(iii) Open transactions as at the end of the financial year			
Nil			

Note 26: Securities lending facility (continued)

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

2010			
Bond series	**Number of transactions**	**Face value loaned $'000**	**Net income earned $'000**
(i) Open transactions as at the beginning of the financial year			
Nil			
(ii) New transactions completed during the financial year			
Treasury Bonds:			
June 2011	3	230,850	49
April 2012	23	967,610	120
May 2013	1	13,000	1
June 2014	7	270,115	23
April 2015	20	754,200	80
February 2017	2	38,500	6
	56	2,274,275	279
Treasury Indexed Bonds:			
August 2015	2	12,500	2
	2	12,500	2
Total	58	2,286,775	281
(iii) Open transactions as at the end of the financial year			
Treasury Bonds:			
February 2017	2	83,460	-

Intra-day lending during 2010-11 was as follows:

2011		
Bond series	**Number of transactions**	**Face value loaned $'000**
Treasury Bonds:		
April 2012	**2**	**110,000**
May 2013	**1**	**17,000**
April 2015	**1**	**109,000**
June 2016	**1**	**65,000**
March 2019	**1**	**5,000**
May 2021	**1**	**58,000**
	7	**364,000**

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

2010		
Bond series	**Number of transactions**	**Face value loaned $'000**
Treasury Bonds:		
June 2011	9	543,000
June 2014	1	49,000
April 2015	2	600,000
May 2021	1	105,000
	13	1,297,000

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

	Appropriation Act		FMA Act				
	Annual appropriation	Appropriation reduced(b)	Section 30	Section 31 (GST ex)	Total appropriation	Appropriation applied	Variance(d)
	2011	2011	2011	2011	2011	2011	2011
	$'000	$'000	$'000	$'000	$'000	$'000	$'000
Departmental							
Ordinary annual services(a)	16,146	-	-	797	16,943	(11,396)	5,547
Other services							
Equity(c)	-	-	-	-	-	(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) 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.

(c) During 2010-11 the AOFM drew against its equity injection to extend its software licence for its debt management system.

(d) 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

	Appropriation Act		FMA Act				
	Annual appropriation	Appropriation reduced(b)(c)	Section 30	Section 31 (GST ex)	Total appropriation	Appropriation applied	Variance(d)
	2010	2010	2010	2010	2010	2010	2010
	$'000	$'000	$'000	$'000	$'000	$'000	$'000
Departmental							
Ordinary annual services(a)	12,638	(69)	-	915	13,484	(14,586)	(1,102)
Other services							
Equity	-	-	-	-	-	-	-
Total departmental	12,638	(69)	-	915	13,484	(14,586)	(1,102)
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) Departmental appropriations were reduced by determinations made by the Finance Minister:
- on 29 June 2010 to reduce the AOFM's 2009-10 departmental appropriations under *Appropriation Act (No. 1) 2009-10* by $69,000.
(c) Administered reductions are effected when the AOFM's annual report is tabled in Parliament. The reduction of $10,000.00 was made under *Appropriation Act (No.1) 2009-10* and occurred on the tabling of the AOFM's annual report for 2009-10.
(d) The departmental ordinary annual services variance is due to an operating loss for 2009-10. On 28 September 2009 the Finance Minister approved the AOFM to operate at a loss to enable it to conduct a syndicated issue of Treasury Indexed Bonds.

Note 27: Disclosures of appropriations (continued)

Note 27B: Unspent departmental 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

	2011	2010
	$'000	$'000
Unspent departmental annual appropriation		
Appropriation Act 2 2000-01	**662**	949
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**	-
Total	**18,765**	13,505
Represented by:		
Cash at bank	**100**	90
Appropriation receivable - output	**17,897**	12,466
Appropriation receivable - equity injection	**662**	949
Appropriation receivable - departmental capital budget	**106**	-
	18,765	13,505

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 2010-11 the AOFM received an appropriation authority of $10,000 in *Appropriation Act (No. 1) 2010-11* for this purpose. Section 11 of *Appropriation Act (No.1) 2010-2011* 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) 2010-2011* 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

	2011 $0.00
Reduction in administered items	
Total administered items appropriated 2010-11	**10,000.00**
Less administered items required by the agency as per Appropriation Act, section 11:	
Appropriation Act (No. 1) 2010-2011	**0.00**
Total administered items required by the agency	**0.00**
Total reduction in administered items - effective 2011-12	**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:

	2011 $'000	2010 $'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	**84,433,082**	50,146,325
Commonwealth Inscribed Stock Act 1911, section 13A		
Purpose: payment of costs and expenses incurred in relation to issuing debt and managing debt(a)	**-**	-
Commonwealth Inscribed Stock Act 1911, section 13B		
Purpose: payment of costs and expenses incurred in repurchasing debt prior to maturity(a)	**-**	-
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	**312**	329
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)	**296,180,266**	364,820,018

(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 2010-11 includes $102.189 million for the repurchase of Treasury Bonds prior to maturity. The 2009-10 reported amount includes $1,138.920 million for the repurchase of Treasury Indexed Bonds prior to maturity.

Note 27: Disclosures of appropriations (continued)

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

	2011 $'000	2010 $'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	**463**	502
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**	63,951
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	**386,835,785**	415,031,125

(c) Master Agreements executed between the Commonwealth and swap counterparties provide for settlement of interest rate swaps on a net basis per transaction. All amounts in relation to swap transactions are disclosed in this note on an aggregate basis. 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 2009-10 and 2010-11 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(a)** **In face value terms**	**2011** **$'000**	2010 $'000
Amount invested brought forward from previous period	**30,716,695**	35,548,139
Investments made during the year(b)(c)	**296,232,220**	364,382,745
Investments redeemed during the year(b)	**(301,869,110)**	(369,214,189)
Amount invested carried to the next period (at face value)(d)	**25,079,805**	30,716,695

FMA = *Financial Management and Accountability Act 1997*.

(a) Amounts include repurchase of debt prior to maturity.

(b) The AOFM has recast the 2009-10 comparative for 'investments made during the year' and 'investments redeemed during the year' by $715.7 million to reflect the repurchase and subsequent cancellation of Treasury Indexed Bonds in October 2009.

(c) 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.

(d) See Note 24J for details of investments held.

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.

Debt Retirement Reserve Trust Account	**2011 $'000**	2010 $'000
Balance brought forward from previous period	**494**	546
Appropriation for reporting period	**26**	28
Interest amounts credited	**22**	18
Other receipts:		
State and Territory contributions	**1,331**	85
Available for payments	**1,873**	677
Total increase	**1,379**	131
Payments made:		
Debt repayments	**(1,307)**	(183)
Total decrease	**(1,307)**	(183)
Balance	**566**	494
Balance represented by:		
Cash - held in the Official Public Account	**566**	494
Total balance carried to the next period	**566**	494

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 2011 $'000	Outcome 1 2010 $'000
Expenses		
Administered	**9,272,883**	6,348,041
Departmental	**11,786**	15,328
Total expenses	**9,284,669**	6,363,369
Own-source income		
Administered		
Interest	**1,375,603**	1,436,315
Other	**243**	281
Gains (losses)	**327,364**	(2,824,929)
Total administered	**1,703,210**	(1,388,333)
Departmental		
Other	**772**	919
Total departmental	**772**	919
Total own-source income	**1,703,982**	(1,387,414)
Net cost/(contribution) of outcome	**7,580,687**	7,750,783

Note 29: Comprehensive income (loss) attributable to the AOFM

	2011 $'000	2010 $'000
Comprehensive income (loss)	**5,176**	(1,545)
Plus non-appropriated expenses:		
Depreciation and amortisation	**315**	-
Comprehensive income (loss) attributable to the AOFM	**5,491**	(1,545)

Note 30: 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 2010-11 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 orange.

Table 1: General Government Sector funding requirement and funding sources

Source of funds	Actual 2010-11 ($billion)	Use of funds	Actual 2010-11 ($billion)
		Headline budget balance	51.1
Debt issuance[a]		**Debt redemption**[a]	
Treasury Bonds	56.0	Maturing Treasury Bonds	18.7
Treasury Indexed Bonds	4.1	Maturing Treasury Indexed Bonds	1.2
Treasury Notes (net)	4.4	Early CGS debt repurchases	0.1
Total	**64.5**	**Total**	**20.0**
Financial assets		**Other applications of funds**	
Change in AOFM asset holdings	8.6	Other general government sector borrowings (net)	0.1
Total	**8.6**	Other financing (net) [b]	0.3
		Total	**0.4**
		Financial assets	
		Change in Official Public Account balance at the RBA	0.2
		Change in other general government sector investments	1.4
		Total	**1.6**
Total	**73.1**	**Total**	**73.1**

(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 — cash

		Actual available appropriation 2010-11 $'000	-	Payments made (a) 2010-11 $'000	=	Balance Remaining $'000
Ordinary annual services						
Departmental appropriation(b)		28,702		10,599		18,103
Receipts from other sources (s31)(c)		797		797		-
Total departmental		29,499		11,396		18,103
Administered expenses						
Outcome 1		10		-		10
Total administered		10		-		10
Total ordinary annual services	**A**	29,509		11,396		18,113
Other services						
Departmental non-operating		949		287		662
Total other services	**B**	949		287		662
Total available annual appropriations (A + B)		30,458		11,683		18,775
Special appropriations non-capital						
Commonwealth Inscribed Stock Act 1911		10,171,017		10,171,017		-
Financial Agreement Act 1994		312		312		-
Financial Management and Accountability Act 1997		2,146		2,146		-
Loans Securities Act 1919		12,666		12,666		-
Subtotal		10,186,141		10,186,141		-
Special appropriations capital						
Commonwealth Inscribed Stock Act 1911		74,262,065		74,262,065		-
Financial Management and Accountability Act 1997		296,178,120		296,178,120		-
Loans Securities Act 1919		6,209,459		6,209,459		-
Subtotal		376,649,644		376,649,644		-
Total special appropriations	**C**	386,835,785		386,835,785		-
Total appropriations excluding special accounts (A + B + C)		386,866,243		386,847,468		18,775
Special Accounts						
Debt Retirement Reserve Trust Account						
Opening balance		494		-		-
Appropriation receipts		26		-		-
Non-appropriation receipts to special account						-
Interest amount credited		22		-		-
State and Territory contributions		1,331		-		-
Payments made		-		1,307		-
Total Special account	**D**	1,873		1,307		566
Total net resourcing for AOFM (A + B + C + D)		386,868,116		386,848,775		19,341

(a) Amounts presented in this table exclude GST where the GST is recoverable from the ATO.
(b) *Appropriation Bill (No. 1) 2010-11* plus carried forward cash balances as at 1 July 2010.
(c) 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) 2010-11 $'000**	**Actual Expenses 2010-11 $'000**	**Variation $'000**
Program 1.1: Australian Office of Financial Management			
Departmental expenses			
Ordinary annual services (Appropriation Bill No.1)	13,724	11,177	2,547
Expenses not requiring appropriation in the Budget year	711	609	102
Administered expenses			
Ordinary annual services (Appropriation Bill No.1)	10	-	10
Special appropriations expenses			
Commonwealth Inscribed Stock Act 1911	9,285,582	9,259,930	25,652
Loans Securities Act 1919	800	12,634	(11,834)
Financial Agreement Act 1994	50	319	(269)
Total for Program 1.1	9,300,877	9,284,669	16,208
	2009-10	**2010-11**	
Average staffing level (number)	**36**	**37**	

(a) The Budget figure for 2010-11 is the estimated actual 2010-11 expenses, reported in table 2.1 of the *Portfolio Budget Statements 2011-12*.

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 2010-11, the AOFM made no payments to market research organisations, polling organisations or direct mail organisations. No campaign advertising was conducted during 2010-11.

The AOFM incurred expenditure of $8,000 during 2010-11 for the development of advertisements to promote CGS to international investors. In addition, the AOFM incurred expenditure of $12,996 during 2010-11 to media advertising organisations for staff recruitment.

The following table lists individual expenditures of $11,500 or more on advertising.

Table 4: 2010-11 non-campaign advertising expenditure $11,500 or more

Entity	Purpose	Cost
Adcorp	Graduate recruitment	$11,549

These figures are inclusive of GST.

Freedom of information

Freedom of Information matters in respect to the AOFM are handled by the Treasury. Before 1 May 2011, section 8 of the *Freedom of Information Act 1982* (the Act) required an agency to report on its organisational structure, functions and decision making powers, the arrangements for public involvement in its work, the categories of documents it holds and how the public can obtain access to these documents.

From the 1 May 2011 agencies subject to the Act are required to publish information on a website as part of the Information Publication Scheme (IPS) provisions in Part 11 of the Act. This requirement has replaced the former requirement to publish a section 8 statement in an annual report.

The section 8 statement in the Treasury Annual Report for the period from 1 July 2010 to 30 April 2011 includes the AOFM. Additional details that relate specifically to the AOFM are provided below.

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.

Section 8 statement

Organisation and decision-making

Details of the AOFM's organisational structure are provided in Figure 1 in Part 1 of this report. Its functions and decision-making processes are outlined in the section on AOFM's role, function, outcome and output structure in Part 1 of this report and the section on senior management committees in Part 3.

The Treasurer has delegated powers to AOFM officials under the following legislation:

- *Commonwealth Inscribed Stock Act 1911* and the *Commonwealth Inscribed Stock Regulations*;

- *Loans Securities Act 1919*;
- *Financial Management and Accountability Act 1997*; and
- other Acts with regard to appropriations as set out in Note 27 of the financial statements included in this report.

The Minister for Finance and Deregulation has delegated powers to the Chief Executive Officer of the AOFM under the *Financial Management and Accountability Act 1997* and the *Financial Management and Accountability Regulations*.

Arrangements for public involvement

The AOFM consults informally with financial market participants and investors affected by its activities. It also obtains advice from the AOFM Advisory Board, described in Part 3 of this report, which includes three external members appointed from the financial sector. Information on the Agency can be found on its website www.aofm.gov.au and enquiries can be sent via post or email.

The AOFM does not issue Commonwealth Government Securities directly to the public, but small parcels of these securities may be purchased or sold through the Reserve Bank of Australia. Larger volumes may be traded through professional financial institutions.

Documents held by the AOFM

The AOFM holds correspondence, contracts and agreements, records of transactions, analysis and advice, financial and statistical data, and drafts and internal working documents prepared by its staff and relating to its functions of issuing and managing debt, investment and cash management. It also holds personnel records, organisation and staffing records, financial and expenditure records, and office procedures and instructions.

The AOFM places an indexed list of its policy file titles on the AOFM website every six months.

Access to documents

Applicants seeking access under the *Freedom of Information Act 1982* to AOFM documents can contact:

Freedom of information
The Treasury
Langton Crescent
PARKES ACT 2600
Email: FOI@treasury.gov.au
Telephone: + 61 2 6263 2800

Freedom of information activity

The AOFM received no requests for access to documents under the *Freedom of Information Act* in 2010-11.

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 the AOFM's portfolio

The assets and liabilities managed by the AOFM and held on its administered balance sheet in 2010-11 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, short-dated bonds issued by Australian States and Territories, 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 RMBS Portfolio, the Housing Advances Portfolio and the Cash Management Portfolio. This allocation recognises the different objectives, risks and management approach required in each area.

The **Long-Term Debt Portfolio** contains debt denominated in Australian dollars and in foreign currencies. It includes Commonwealth Government Securities other than Treasury Notes 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 **RMBS Portfolio** contains residential mortgage-backed securities purchased by the AOFM under the Government's policy to maintain competition in lending for housing and to support lending to small business.

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 maturity is due on 30 June 2042.

The **Cash Management Portfolio** manages 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.

Residential mortgage-backed securities portfolio

The AOFM's investments in residential mortgage-backed securities up to 30 June 2011 are shown in Table 3.

Table 5: AOFM's RMBS investments up to 30 June 2011

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

Table 5: AOFM's RMBS investments up to 30 June 2011 (continued)

Pricing date	Settlement date	Issuer	Issue name	Tranche	Expected WAL* at closing (years)	Coupon (per cent)	Original face value ($m)
09-Jul-09	16-Jul-09	Wide Bay Australia	WB Trust 2009-1	Class A2	3.5	1M BBSW + 1.40%	282.50
09-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	04-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
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
09-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
05-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	09-Jun-10	Suncorp Metway	APOLLO Series 2010-1 Trust	Class A2	6.0	1M BBSW + 1.10%	300.00
02-Jul-10	14-Jul-10	Members' Equity Bank	SMHL Securitisation Fund 2010-2E	Class A3	5.7	1M BBSW + 1.10%	250.00
08-Jul-10	20-Jul-10	Bendigo and Adelaide Bank	TORRENS Series 2010-2 Trust	Class A3	3.0	1M BBSW + 1.10%	19.50
08-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	04-Aug-10	MyState Financial	ConQuest 2010-2 Trust	Class A2	1.5	1M BBSW + 1.40%	20.00
23-Jul-10	04-Aug-10	MyState Financial	ConQuest 2010-2 Trust	Class A3	5.0	1M BBSW + 1.30%	139.25
23-Jul-10	04-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

Table 5: AOFM's RMBS investments up to 30 June 2011 (continued)

Pricing date	Settlement date	Issuer	Issue name	Tranche	Expected WAL* at closing (years)	Coupon (per cent)	Original face value ($m)
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	02-Sep-10	Macquarie Bank	PUMA Masterfund P-16	Class A3	6.3	1M BBSW + 1.15%	247.50
06-Sep-10	09-Sep-10	FirstMac	FirstMac Mortgage Funding Trust Series 1-2010	Class A3	4.7	1M BBSW + 1.30%	164.00
06-Sep-10	09-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	03-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	03-Dec-10	Police and Nurses Credit Socie	Pinnacle Series Trust 2010-T1	Class AB	6.7	1M BBSW + 2.00%	14.60
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
07-Apr-11	14-Apr-11	Community CPS	Barton Series 2011-1 Trust	Class A2	6.5	1M BBSW + 1.25%	90.90
08-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
							13372.18

*Weighted average life.

^The AOFM final allocation was zero.

Tender results for debt issuance

Table 6: Treasury Bond tender results — 2010-11

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
02-Jul-10	4.75% 15-Nov-2012	700	4.4499	0.49	1.00	2.76
07-Jul-10	4.75% 15-Jun-2016	1,000	4.8608	N/A	3.50	1.89
14-Jul-10	4.50% 15-Apr-2020	500	5.1754	0.29	1.00	2.70
16-Jul-10	6.25% 15-Apr-2015	700	4.7811	-0.64	1.00	3.40
21-Jul-10	5.75% 15-May-2021	500	5.2800	0.00	0.00	3.06
23-Jul-10	4.75% 15-Jun-2016	800	5.0188	-1.12	1.50	2.98
30-Jul-10	5.25% 15-Mar-2019	500	5.1315	0.40	1.00	2.78
04-Aug-10	4.50% 15-Apr-2020	500	5.1319	0.19	1.00	4.24
06-Aug-10	4.75% 15-Jun-2016	700	4.9250	0.25	1.50	2.80
11-Aug-10	6.00% 15-Feb-2017	500	4.8732	-0.18	0.50	4.26
13-Aug-10	5.50% 15-Dec-2013	700	4.6190	-0.10	1.00	6.31
18-Aug-10	5.75% 15-Jul-2022	500	5.0654	-0.46	1.50	4.54
20-Aug-10	4.75% 15-Jun-2016	700	4.6858	0.33	1.00	3.11
25-Aug-10	4.50% 15-Apr-2020	500	4.8150	0.00	0.00	4.42
27-Aug-10	5.50% 15-Dec-2013	700	4.3862	-0.38	0.50	3.79
01-Sep-10	5.75% 15-Jul-2022	500	4.8672	0.97	1.00	2.34
03-Sep-10	4.75% 15-Jun-2016	700	4.6266	-0.59	1.50	3.70
08-Sep-10	4.50% 15-Apr-2020	500	4.8810	-0.40	0.50	3.26
10-Sep-10	4.50% 21-Oct-2014	1,250	4.7561	0.00	2.00	2.74
17-Sep-10	6.25% 15-Apr-2015	700	4.8593	-0.57	0.50	3.71
22-Sep-10	5.75% 15-Jul-2022	500	5.1800	-0.75	0.00	4.29
24-Sep-10	4.75% 15-Jun-2016	700	4.9754	0.79	1.00	3.11
29-Sep-10	5.25% 15-Mar-2019	500	5.0374	0.24	0.50	3.07
01-Oct-10	4.50% 21-Oct-2014	850	4.9279	-0.96	0.50	2.76
06-Oct-10	4.50% 15-Apr-2020	500	5.0151	-0.49	1.00	3.61
08-Oct-10	6.50% 15-May-2013	700	4.9183	0.33	1.00	3.53
13-Oct-10	5.75% 15-Jul-2022	500	5.0982	0.32	0.50	3.36
15-Oct-10	4.75% 15-Jun-2016	700	4.9784	0.59	1.50	2.01
20-Oct-10	6.00% 15-Feb-2017	700	5.0431	-0.44	0.50	3.64
22-Oct-10	4.75% 15-Nov-2012	700	4.9013	-0.87	1.00	3.86
29-Oct-10	5.50% 15-Dec-2013	700	4.9319	-0.31	1.00	5.53
03-Nov-10	4.50% 15-Apr-2020	500	5.2521	-0.29	0.50	4.45
05-Nov-10	4.50% 21-Oct-2014	700	5.1412	-0.63	1.00	4.21
10-Nov-10	5.75% 15-Jul-2022	500	5.4348	0.48	0.50	4.55
12-Nov-10	4.75% 15-Jun-2016	700	5.2675	0.25	0.50	4.01
17-Nov-10	4.50% 15-Apr-2020	500	5.4021	-0.04	0.50	5.29
19-Nov-10	4.50% 21-Oct-2014	700	5.2847	0.22	1.50	3.78
24-Nov-10	5.50% 21-Jan-2018	850	5.4123	N/A	2.00	3.74
26-Nov-10	5.50% 15-Dec-2013	700	5.1650	-0.25	0.00	4.38
01-Dec-10	4.50% 15-Apr-2020	500	5.4110	0.10	0.50	4.10
03-Dec-10	4.75% 15-Nov-2012	700	4.9429	-0.71	1.50	5.01
08-Dec-10	5.50% 21-Jan-2018	650	5.4727	0.02	0.50	3.65

Table 6: Treasury Bond tender results — 2010-11 (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
12-Jan-11	5.50% 15-Dec-2013	700	4.9564	-0.86	1.00	3.63
14-Jan-11	4.75% 15-Nov-2012	700	4.9771	-1.04	0.50	4.20
19-Jan-11	4.75% 15-Jun-2016	700	5.3654	-0.21	1.00	4.14
21-Jan-11	4.50% 21-Oct-2014	700	5.2881	-0.19	0.50	4.56
28-Jan-11	5.50% 15-Dec-2013	700	5.0348	-0.02	0.50	5.79
02-Feb-11	4.50% 15-Apr-2020	500	5.5480	0.05	0.50	4.70
04-Feb-11	4.75% 15-Nov-2012	700	4.9964	-0.11	0.50	5.11
09-Feb-11	5.50% 21-Jan-2018	500	5.6994	-0.06	0.50	3.94
11-Feb-11	4.50% 21-Oct-2014	700	5.3727	0.02	0.50	3.91
16-Feb-11	5.75% 15-Jul-2022	500	5.7452	-0.48	0.50	4.63
18-Feb-11	5.50% 15-Dec-2013	700	5.1941	-0.84	0.50	5.52
23-Feb-11	5.50% 21-Jan-2018	500	5.4784	0.09	0.50	4.51
25-Feb-11	4.75% 15-Jun-2016	700	5.3867	0.42	1.00	3.70
02-Mar-11	5.75% 15-Jul-2022	500	5.5396	-0.04	0.50	4.31
04-Mar-11	4.50% 21-Oct-2014	700	5.2699	-0.51	0.50	5.23
09-Mar-11	6.50% 15-May-2013	500	4.9904	-0.71	0.50	6.07
16-Mar-11	5.50% 21-Jan-2018	500	5.3126	0.26	0.50	3.50
18-Mar-11	4.50% 21-Oct-2014	700	4.9782	-0.93	1.00	3.23
23-Mar-11	5.75% 15-May-2021	500	5.4445	-0.05	0.50	4.46
25-Mar-11	5.50% 15-Dec-2013	700	4.9482	-0.43	1.00	2.83
30-Mar-11	4.50% 15-Apr-2020	500	5.4686	-0.14	0.50	4.76
01-Apr-11	4.50% 21-Oct-2014	700	5.1381	-0.44	0.50	6.76
06-Apr-11	5.50% 21-Jan-2018	500	5.4298	-0.27	0.50	5.39
08-Apr-11	4.75% 15-Jun-2016	700	5.3620	-0.55	0.50	3.73
13-Apr-11	5.75% 15-Jul-2022	500	5.6588	-0.37	0.50	5.14
15-Apr-11	4.50% 21-Oct-2014	700	5.2375	-1.00	0.50	3.96
20-Apr-11	5.75% 15-May-2021	700	5.5157	0.32	0.50	2.94
29-Apr-11	4.75% 15-Jun-2016	700	5.2350	0.75	0.00	5.80
04-May-11	5.25% 15-Mar-2019	600	5.3544	-0.06	0.50	3.42
06-May-11	5.75% 15-Jul-2022	600	5.4001	0.01	1.00	3.49
11-May-11	4.50% 15-Apr-2020	600	5.4329	0.29	1.00	3.59
13-May-11	6.25% 15-Jun-2014	600	5.0743	0.68	1.50	3.21
18-May-11	5.50% 21-Apr-2023	1,000	5.4820	N/A	3.00	3.54
20-May-11	4.50% 21-Oct-2014	750	5.0482	0.57	2.50	3.36
25-May-11	5.75% 15-May-2021	750	5.2847	0.22	0.50	3.04
27-May-11	4.75% 15-Jun-2016	750	5.0583	-0.17	0.50	3.19
01-Jun-11	4.50% 15-Apr-2020	750	5.2469	0.69	1.00	2.04
03-Jun-11	5.25% 15-Mar-2019	750	5.2091	1.13	2.00	2.16
08-Jun-11	5.50% 21-Apr-2023	800	5.3883	1.33	2.50	2.67
10-Jun-11	6.00% 15-Feb-2017	750	5.0608	-0.92	1.00	5.58
17-Jun-11	4.75% 15-Jun-2016	750	4.8437	-0.38	1.50	4.37
22-Jun-11	5.75% 15-May-2021	750	5.1346	0.21	1.00	3.25
24-Jun-11	6.25% 15-Apr-2015	750	4.6722	-0.53	0.50	4.09
Average over year to June 2011				-0.11	0.88	3.91
Average over 3 years to June 2011				0.08	1.23	3.73
Average over 10 years to June 2011				0.11	1.16	3.77

Table 6: Treasury Indexed Bond tender results — 2010-11

Tender date	Coupon and maturity	Face value amount allocated ($m)	Weighted average issue yield (%)	Spread to secondary market yield (basis points)	Times covered
13-Jul-10	4.00% 20-Aug-2020	200	2.5600	-4.00	5.85
24-Aug-10	4.00% 20-Aug-2020	200	2.3500	-3.00	4.88
12-Oct-10	4.00% 20-Aug-2020	250	2.3005	0.50	3.57
23-Nov-10	3.00% 20-Sep-2025	200	2.6500	-1.00	4.58
18-Jan-11	2.50% 20-Sep-2030	200	2.7565	0.50	3.78
22-Feb-11	2.50% 20-Sep-2030	200	2.7750	-1.50	4.62
22-Mar-11	4.00% 20-Aug-2020	200	2.4550	-2.00	4.35
12-Apr-11	2.50% 20-Sep-2030	140	2.7350	-1.50	4.07
24-May-11	4.00% 20-Aug-2020	200	2.2350	0.50	3.01
21-Jun-11	4.00% 20-Aug-2015	200	1.9950	1.50	2.60
Average over year to June 2011				-1.00	4.13

Table 7: Treasury Note tender results — 2010-11

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)
8-Jul-10	22-Oct-10	300	4.5999	8.0	4.99	7.40	-27.72
15-Jul-10	22-Oct-10	500	4.6164	15.0	2.48	3.74	-29.36
22-Jul-10	22-Oct-10	500	4.5985	3.0	4.54	0.85	-18.48
29-Jul-10	22-Oct-10	500	4.5462	3.0	5.57	1.85	-22.25
5-Aug-10	12-Nov-10	500	4.5440	2.0	7.64	-0.05	-20.97
12-Aug-10	22-Oct-10	1,000	4.5005	8.0	3.70	-1.53	-29.69
12-Aug-10	12-Nov-10	600	4.5000	2.0	6.69	-2.80	-29.33
12-Aug-10	21-Jan-11	300	4.6230	8.0	6.54	5.75	-30.53
19-Aug-10	22-Oct-10	1,000	4.5159	5.0	3.84	1.69	-19.46
19-Aug-10	26-Nov-10	800	4.4864	2.0	6.20	-2.66	-24.52
26-Aug-10	12-Nov-10	1,000	4.4950	3.0	4.14	1.05	-24.12
26-Aug-10	17-Dec-10	800	4.5184	6.0	3.81	3.84	-24.91
2-Sep-10	22-Oct-10	1,000	4.5923	7.0	1.68	9.23	-6.23
2-Sep-10	26-Nov-10	600	4.5656	13.0	2.12	5.76	-8.56
2-Sep-10	21-Jan-11	300	4.5660	7.0	3.98	3.94	-3.60
9-Sep-10	22-Oct-10	300	4.5833	5.0	5.00	6.46	-7.17
9-Sep-10	17-Dec-10	600	4.6292	6.0	5.34	7.12	-21.20
9-Sep-10	11-Feb-11	600	4.6546	7.0	5.41	7.32	-25.98
16-Sep-10	12-Nov-10	600	4.6499	8.0	3.47	8.49	-4.22
16-Sep-10	3-Dec-10	600	4.6600	12.0	3.73	6.73	-9.35
23-Sep-10	3-Dec-10	600	4.7405	12.0	4.00	6.38	-3.39
23-Sep-10	21-Jan-11	1,000	4.8150	15.0	3.32	5.27	-15.04
23-Sep-10	11-Feb-11	600	4.9354	19.0	3.02	16.18	-6.68
30-Sep-10	3-Dec-10	300	4.7940	2.0	6.52	8.90	-7.22
30-Sep-10	21-Jan-11	600	4.9027	8.0	4.37	13.89	-14.10

Table 7: Treasury Note tender results — 2010-11 (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)
7-Oct-10	21-Jan-11	600	4.6707	5.0	7.92	3.72	-18.49
14-Oct-10	21-Jan-11	1,000	4.6796	5.0	6.00	6.28	-13.62
21-Oct-10	25-Feb-11	1,000	4.6867	4.0	6.81	1.24	-16.67
28-Oct-10	21-Jan-11	1,000	4.6400	5.0	6.48	4.45	-13.44
28-Oct-10	25-Feb-11	600	4.6750	2.0	6.63	4.79	-16.78
4-Nov-10	21-Jan-11	1,000	4.8300	6.0	5.71	3.90	-10.27
4-Nov-10	25-Feb-11	600	4.8593	6.0	7.02	3.68	-13.44
11-Nov-10	21-Jan-11	1,000	4.8590	7.0	3.30	6.25	-10.22
11-Nov-10	11-Feb-11	600	4.8572	6.0	5.11	4.72	-20.78
11-Nov-10	29-Apr-11	600	4.9633	6.0	5.12	9.13	-21.27
18-Nov-10	25-Feb-11	1,000	4.8644	4.0	5.08	6.58	-15.89
18-Nov-10	25-Mar-11	600	4.9191	3.0	6.21	9.46	-15.66
25-Nov-10	21-Jan-11	300	4.8260	5.0	5.50	5.34	-13.76
25-Nov-10	25-Feb-11	1,000	4.8643	4.0	4.42	6.78	-21.57
25-Nov-10	29-Apr-11	600	4.9216	6.0	5.76	6.89	-28.00
2-Dec-10	11-Feb-11	1,000	4.8252	6.0	4.47	5.72	-14.60
2-Dec-10	25-Mar-11	300	4.8317	1.0	8.84	3.88	-20.96
9-Dec-10	11-Feb-11	600	4.8263	3.0	4.70	5.57	-14.39
9-Dec-10	29-Apr-11	600	4.8702	5.0	4.86	5.73	-28.96
16-Dec-10	11-Feb-11	500	4.8200	3.0	6.87	5.17	-11.14
13-Jan-11	11-Mar-11	800	4.8036	6.0	4.32	4.71	-12.17
13-Jan-11	29-Apr-11	1,000	4.8370	7.0	4.71	5.15	-18.62
20-Jan-11	25-Mar-11	1,000	4.7922	3.0	6.06	3.57	-13.31
20-Jan-11	27-May-11	1,000	4.8075	4.0	6.49	2.20	-21.57
27-Jan-11	25-Mar-11	800	4.7756	5.0	6.29	1.67	-13.21
27-Jan-11	29-Apr-11	1,200	4.8162	4.0	4.60	3.49	-14.17
3-Feb-11	25-Mar-11	1,000	4.8169	3.0	4.64	6.00	-4.32
3-Feb-11	29-Apr-11	1,000	4.8222	5.0	5.21	5.36	-7.48
3-Feb-11	27-May-11	1,000	4.8171	5.0	5.34	3.16	-13.45
10-Feb-11	29-Apr-11	1,000	4.8116	3.0	6.57	3.69	-9.79
10-Feb-11	13-May-11	800	4.8072	3.0	7.81	2.56	-13.01
17-Feb-11	13-May-11	600	4.8088	2.0	8.77	3.64	-8.50
24-Feb-11	29-Apr-11	1,000	4.7807	3.0	6.69	1.79	-8.68
24-Feb-11	22-Jul-11	600	4.8326	2.0	11.77	1.45	-18.44
3-Mar-11	27-May-11	500	4.7534	3.0	10.64	-3.21	-17.23
10-Mar-11	9-Sep-11	300	4.7483	1.0	11.74	-9.99	-36.70
17-Mar-11	27-May-11	600	4.6701	6.0	9.18	-1.67	-15.53
24-Mar-11	10-Jun-11	900	4.7037	6.0	5.45	-3.27	-15.46
24-Mar-11	9-Sep-11	600	4.7466	6.0	6.24	-2.82	-23.37
31-Mar-11	22-Jul-11	800	4.7447	7.0	5.70	-1.05	-20.28
7-Apr-11	10-Jun-11	300	4.7553	3.0	9.97	0.00	-10.97
14-Apr-11	22-Jul-11	500	4.7807	2.0	8.23	0.57	-15.26
28-Apr-11	22-Jul-11	1,000	4.7345	5.0	4.71	-6.15	-17.35
28-Apr-11	12-Aug-11	1,000	4.7501	6.0	4.88	-6.40	-19.64

Table 7: Treasury Note tender results — 2010-11 (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)
5-May-11	22-Jul-11	1,000	4.7296	4.0	6.23	-8.23	-18.43
12-May-11	22-Jul-11	600	4.7441	3.0	7.85	-8.88	-20.64
12-May-11	12-Aug-11	600	4.8096	8.0	7.30	-5.04	-25.04
19-May-11	22-Jul-11	1,000	4.7510	3.0	6.20	-5.25	-18.74
19-May-11	12-Aug-11	600	4.7797	5.0	7.52	-4.86	-21.74
26-May-11	22-Jul-11	1,000	4.7510	9.0	5.09	-3.51	-17.11
26-May-11	12-Aug-11	1,000	4.7650	4.0	5.69	-4.15	-21.58
2-Jun-11	9-Sep-11	500	4.8011	10.0	5.90	-5.34	-21.35
9-Jun-11	22-Jul-11	500	4.7472	2.0	5.87	-2.42	-10.20
9-Jun-11	12-Aug-11	500	4.7485	5.0	6.28	-4.44	-17.46
16-Jun-11	22-Jul-11	500	4.7060	0.0	8.21	-5.67	-13.31
16-Jun-11	12-Aug-11	1,000	4.7064	1.0	7.36	-7.03	-18.05
23-Jun-11	12-Aug-11	1,000	4.7137	7.0	5.04	-3.25	-18.49
23-Jun-11	9-Sep-11	1,000	4.7308	7.0	5.66	-1.92	-24.45
23-Jun-11	21-Oct-11	500	4.7315	5.0	6.07	-2.75	-30.29
Average over year to June 2011				5.29	5.88	6.45	-22.33

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.

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 three month OIS rate is the interest rate for the fixed leg of an overnight indexed swap with a term to maturity of three 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)
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

CONTACT DETAILS

Enquiries

Enquiries regarding this report may be directed to:

Liaison Officer
Australian Office of Financial Management
Treasury Building
Langton Crescent
PARKES ACT 2600

Telephone: (61-2) 6263 1111
Fax: (61-2) 6263 1222
Email: enquiries@aofm.gov.au
Web site: www.aofm.gov.au

Internet address

A copy of this document can be located on the AOFM web site at:
(http://www.aofm.gov.au/content/publications/reports.asp).

INDEX

E

F

H

I

J

L

M

O

P

R

S

T

Y