

GLOSSARY

Australian dollar Long-Term Debt Portfolio

The majority of the Long-Term Debt Portfolio consists of the domestic debt component known as the Australian dollar Long-Term Debt Portfolio. It consists of the Australian dollar denominated component of the estimated trend volume of net debt which comprises both ongoing liabilities and persistent asset balances. Within this portfolio, the excess of gross over net ongoing debt is matched by the persistent asset balances and allocated to the Debt Hedge Book, while the balance is allocated to the Core Book.

Australian savings bond

A retail debt instrument which was issued from 1976 until 1987. The bonds were sold 'on tap' and had a maximum maturity of around 7.5 years. The security could be redeemed early at the request of the holder on a month's notice and without penalty after a minimum holding period.

Basis risk

The risk that two instruments with an identical sensitivity to interest rates do not behave in an identical manner. For example, the AOFM's debt defeasance strategy consisted of overlaying the trend term deposit balance with interest rate swaps to receive fixed rates, matches against the excess of gross over net nominal debt. When swap rates and bond yields of similar terms did not move in unison the strategy was exposed to basis risk.

Bearer securities

A negotiable instrument, akin to cash, which evidences a payment obligation to be met, on presentation, at designated dates.

Cash Management Portfolio

The AOFM's portfolio framework allocates the Commonwealth net debt portfolio between a Long-Term Debt Portfolio and a Cash Management Portfolio. The Cash Management Portfolio contains short-term assets and liabilities necessary to manage the within-year variability in net debt and accommodates deviations from the trend volume of net debt held in the Long-Term Debt Portfolio caused by within-year variability in the net financing requirement.

Commonwealth Government securities (CGS)

Refers to debt obligations of the Commonwealth evidenced by the issue of securities. The vast bulk of the CGS on issue is represented by Treasury bonds and Treasury Indexed bonds.

Core Book

Houses the domestic component of the trend level of net long-term CGS debt. It is part of the Australian dollar Long-Term Debt Portfolio.

Credit risk

The risk of financial loss arising from a counterparty to a transaction defaulting on its financial obligations under that transaction. Credit risk is contingent on both a default taking place and there being pecuniary loss as a result. The Commonwealth faces credit risk as a part of its debt management activities in relation to its swap derivative transactions.

Debt Hedge Book

Holds the continuing assets that have accumulated in the net debt portfolio as a result of debt issuance in excess of funding requirements, together with a matched set of liabilities, in the form of a representative cross-section of the Treasury bonds on issue. It is part of the Australian dollar Long-Term Debt Portfolio.

Defeasance

Arrangements whereby a set of debt liabilities are held against a set of assets with closely matching and offsetting cost and risk characteristics.

Discount

The amount by which the value of a security is less than its face, or par, value.

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.

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 small

residual volume of physical foreign currency loans issued in the 1980s. The AOFM is exploring means of repurchasing this debt cost-effectively.

Forward foreign exchange contract

A financial transaction in which two counterparties agree to trade foreign exchange at a specified price at a specified future date. The AOFM undertook forward foreign exchange contracts with the Reserve Bank of Australia to alter the level of foreign currency exposure in the Commonwealth debt portfolio.

Funding risk

The risk that an issuer is unable to raise funds, as required, in an orderly manner and without financial penalty. The Commonwealth faces funding risk in respect of the primary issuance, typically in tender processes, of its full range of debt instruments. Funding risk encompasses both long-term fund raising to cover budget deficits and the short-term funding or cash management implications of mismatches in the timing of government outlays and receipts.

Futures baskets

A collection of like financial products or commodities, grouped together to underpin a particular futures contract. For example, 3- and 10-year Treasury bond futures baskets consist of a collection of Treasury bond lines that have an average term to maturity of approximately 3 and 10 years respectively.

Futures contract

An agreement between two parties that commits one party to buy an underlying financial instrument or commodity and one 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 offset prior to the expiration date. This type of agreement is traded on a futures exchange, with bond futures contracts being traded via the Sydney Futures Exchange.

General government net debt

The sum of selected financial liabilities less the sum of selected financial assets in the Australian Government general government sector balance sheet. It is the sum of deposits held, advances received, government securities, loans and other borrowings less the sum of cash and deposits, advances paid and investments, loans and placements.

Grade rate

The salary rate by reference to which salaries at each classification level are set according to an employee's performance. The grade rate applies to superior performance at the classification level to which it refers.

Liquidity risk

The risk of financial loss that could occur should the debt portfolio require restructuring. Liquidity is the ease with which one financial claim can be exchanged for another as a result of the willingness of third parties to transact in this debt. The Commonwealth faces liquidity risk with respect to transactions in existing debt such as debt repurchases prior to maturity.

Long-Term Debt Portfolio

The AOFM's portfolio framework allocates the Commonwealth net debt portfolio between a Long-Term Debt Portfolio and a Cash Management Portfolio. The Long-Term Debt Portfolio contains ongoing domestic and foreign currency liabilities and assets and is designed to represent the trend volume of net CGS debt. The Cash Management Portfolio accommodates deviations from this trend volume of net debt caused by within-year variability in the net financing requirement.

Market risk

The risk, from an issuer's perspective, that once debt has been issued, financial market prices may move such that either debt service costs increase directly or the opportunity to reduce debt service costs is missed. The Commonwealth faces two main sources of market risk – interest rate risk and exchange rate risk.

Market value

The amount of money for which a security trades in the market at a particular point of 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. Modified duration is also closely related to the weighted average term to repricing and is the primary risk parameter used by the AOFM. Portfolios with higher modified durations have more stable interest costs through time but have a more volatile market value through time.

Net debt portfolio

The net debt portfolio comprises CGS on issue (net of Commonwealth holdings), term deposits at the Reserve Bank of Australia, swaps and forward foreign exchange contracts administered by the AOFM.

Novate

A novate is an arrangement where a third party agrees to take the place of a party to a transaction and honour the commitments of the original party to the transaction.

Operational risk

The risk of financial loss arising from the transaction, settlement and resource management processes associated with debt management. This broad definition includes risks such as fraud risk, settlement risk, legal risk, accounting risk, personnel risk and reputational risk. Operational risk is contingent on both an operational failure occurring and there being a resultant financial loss.

Overdues

Securities which have passed their maturity date but remain unrepresented by stockholders. These are predominantly Treasury bonds, Australian Savings bonds and War Savings Certificates. The Commonwealth repays the stock when presented. No interest accrues on the stock following its maturity date.

Repo

A bond repurchase agreement.

Risk premium

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

Short-dated exposure

A measure of the proportion of the portfolio subject to immediate repricing. After allocating each cash flow within the net debt portfolio proportionally to the nearest two annual pricing points, the share of the portfolio's market value allocated to the zero-year pricing point is the short-dated exposure. For example, a liability due to mature in one day would be allocated almost entirely to the zero-year pricing point, while 50 per cent of a bond with six months to maturity would be allocated to the zero-year pricing point. The net interest cost of debt

portfolios with higher short-dated exposures responds more quickly to movements in market interest rates, all else being equal.

Stock lending

An activity whereby securities are lent to the financial market for a fee. This activity may be conducted to alleviate temporary market shortages of specific lines of stock.

Swap

A financial transaction in which two counterparties agree to exchange streams of payments occurring over time according to predetermined rules. Swaps are used, for liability management purposes, to change the cost and currency and/or interest rate exposure associated with existing loans.

Treasury bond

This is a medium to long-term security issued by the Commonwealth that carries an annual rate of interest fixed over the life of the security, payable in six monthly instalments on the face, or par, value of the security. The bonds are repayable at face value on maturity.

Treasury Indexed bond (TIB)

This is a medium to long-term security issued by the Commonwealth in the form of a capital indexed bond. The nominal value of the security, on which a fixed rate of interest applies, varies over time according to movements in the Consumer Price Index. At maturity, the adjusted capital value of the bonds is paid. In the past, Treasury Indexed bonds were also issued in the form of Interest Indexed Bonds, some of which are yet to mature. These bonds carry a nominal rate of interest, which varies over time according to movements in the Consumer Price Index, and are repayable at face value on maturity. Interest on TIBs is paid quarterly.

Treasury note (TN)

An instrument issued 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 mismatches between the Commonwealth's outlay and revenue streams within the course of a year that cannot be met by changes in the AOFM's holdings of term deposits with the Reserve Bank of Australia.

ACRONYMS

AASB	Australian Accounting Standard
ANAO	Australian National Audit Office
AOFM	Australian Office of Financial Management
APS	Australian Public Service
ATO	Australian Taxation Office
AUD	Australian dollar
AWA	Australian Workplace Agreement
CGS	Commonwealth Government securities
CPI	Consumer Price Index
CRF	Consolidated Revenue Fund
EEO	Equal Employment Opportunity
EL	Executive Level (APS Classification)
FBT	Fringe Benefit Tax
FMA	<i>Financial Management and Accountability Act 1997</i>
FMO	Finance Minister's Orders
FOI	Freedom of Information
GDP	Gross Domestic Product
GST	Goods and Service Tax
IT	Information technology
OECD	Organisation for Economic Co-operation and Development
OPA	Official Public Account
RBA	Reserve Bank of Australia
SES	Senior Executive Service
USD	United States dollar

INDEX OF COMPLIANCE WITH REQUIREMENTS

Requirement	Page
Letter of transmission	iii
Aids to Access	
Table of contents	vii
Glossary	139
Acronyms	145
Compliance index	147
Contact details	149
Internet address	149
Alphabetical index	151
Review by Chief Executive Officer	xi
Part 1: Departmental Overview	1
Role and functions	3
Outcome and output information	3
AOFM organisational structure	8
AOFM financial and staffing resources summary	6-9
Part 2: Operations and performance	11
Report on performance	13-39

Requirement (continued)	Page
Part 3: Management and accountability	51
Corporate governance	53-57
External scrutiny	57-60
Management of human resources	60-63
Occupational health and safety	62-63
Consultants	64
Competitive tendering and contracting	63
Purchasing	63
Assets management	64
Advertising and market research	65
Discretionary grants	65
Ecologically sustainable development and environmental performance	65-66
Freedom of information	67-69
Part 4: Financial Statements	71

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