GLOSSARY

Accrual cost

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

Basis point

One hundredth of one per cent.

Benchmark

An index or notional portfolio used as a point of reference for the management of an actual portfolio or the measurement of its performance.

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 transaction giving rise to the asset or liability was conducted. The AOFM's assets and liabilities are measured at fair value, except for Australian Government loans to the States for housing, which are measured at historic cost.

Cash Management Portfolio

The AOFM allocates its net debt between a Long-Term Debt Portfolio and a Cash Management Portfolio. The Cash Management Portfolio contains short-term assets and liabilities and is used to manage the within-year variability in the Government's cash flows.

Commonwealth Government securities (CGS)

Debt obligations of the Commonwealth evidenced by the issue of securities or, increasingly, issued as inscribed stock. CGS on issue are predominantly Treasury Bonds and Treasury Indexed Bonds but also include small residual volumes of Australian Savings Bonds, Peace Saving Certificates and War Saving Certificates.

Coupon rate

The rate of fixed interest payment on a bond. In the case of Treasury Bonds coupon interest is payable semi-annually and the coupon rate is set on the date of announcement of first issuance of the bond line.

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 AOFM faces credit risk in relation to its interest rate swap and investment transactions.

Discount

The amount by which the value of a security 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 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 leg

The component of an interest rate swap that provides interest at a fixed rate.

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 leg

The component of an interest rate swap that provides for the payment of interest at a floating rate.

Floating rate

An interest rate that varies according to a particular indicator such as BBSW (Bank Bill Swap Reference Rate). For example, the floating leg of an interest rate swap may provide for the interest paid to be reset each 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 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 budget deficits 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 a futures contract. For example, 3- 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 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. 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.

General Government Sector debt

The sum of deposits held, advances received, government securities, loans and other borrowings in the Australian Government General Government Sector balance sheet less the sum of cash and deposits, advances paid and investments, loans and placements on the balance sheet.

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 giving rise to the asset or liability was conducted.

Interest rate risk

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

Issuance

The sale of debt securities in the primary market.

Liquidity

The capacity of a debt instrument to be easily sold and converted into cash. A liquid market allows the 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 purchased or sold readily.

Long-Term Debt Portfolio

The AOFM allocates its net debt 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.

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 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 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. Portfolios with higher modified durations have more stable interest costs through time but have a more volatile market value through time. Modified duration is related to duration by the equation:

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

However, at times, 'modified duration' is abbreviated to 'duration', preferably only in context, when this will not lead to confusion.

Net debt portfolio

The AOFM's net debt portfolio comprises CGS on issue (excluding Australian Government holdings), term deposits at the Reserve Bank of Australia, and interest rate swaps administered by the AOFM. This portfolio represents a subset of General Government Sector net debt.

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 has not been adjusted for 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.

Present value

The amount that corresponds to today's value of a payment to be received 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 x $[1/(1 + 0.10)^2]$ = $82.64.

Primary market

The market where bonds are issued for the first time and 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

Interest rate that has been adjusted for 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.

Repo

A repurchase 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 have increased when maturing debt needs to be refinanced. Whenever the AOFM enters the market to borrow funds, it is exposed to repricing risk. Similarly, the use of interest rate swaps to reduce the duration of the portfolio, by receiving a fixed rate and paying a floating rate, increases the level of repricing risk.

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.

Securities lending

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

Securities Lending Facility

A facility established by the AOFM in 2004 that uses repurchase agreements to lend Treasury Bonds to market participants for short periods when they are not readily available from other sources. The facility is operated by the Reserve Bank of Australia on behalf of the AOFM.

Short-dated exposure

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

Spread

The difference between two prices or rates.

Swap

A financial transaction in which two counterparties agree to exchange streams of payments occurring over time according to predetermined rules. The AOFM transacts interest rate swaps to reduce the debt service cost of its debt portfolio.

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 another name for its term to maturity.

Term premium

The margin over the expected path of cash rates that investors require to compensate them for investing 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) fixed over the life of the security, payable in six monthly instalments (semi-annually) on the face, or par, value of the security. The bonds are repayable at face value on maturity.

Treasury Indexed Bond

A medium- to long-term debt security which was issued by the Australian Government in two forms (Capital Indexed and Interest Indexed) from 1985 until 2003. With Capital Indexed Bonds, the capital value of the security, on which a fixed rate of interest applies, varies over time according to movements in the Consumer Price Index (CPI). At maturity, the adjusted capital value of the bonds is paid. Interest Indexed Bonds have all matured. Interest on these bonds varied over time according to movements in the CPI. The bonds were repayable at face value on maturity.

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 that cannot be funded by other means, such as changes in the AOFM's holdings of term deposits with the Reserve Bank of Australia.

Yield curve

The graphical representation of the relationship between the yield on debt securities of the same credit quality but different term to maturities on a specific date. 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
ANAO	Australian National Audit Office
AOFM	Australian Office of Financial Management
APEC	Asia-Pacific Economic Cooperation
APS	Australian Public Service
AUD	Australian dollar
CEO	Chief Executive Officer
CGS	Commonwealth Government securities
CPI	Consumer Price Index
EL	Executive Level (APS Classification)
FBT	Fringe Benefit Tax
FMA	*Financial Management and Accountability Act 1997*
FMO	Finance Minister's Orders
GDP	Gross Domestic Product
GST	Goods and Service Tax
IT	Information technology
LTDP	Long-term Debt Portfolio
OECD	Organisation for Economic Co-operation and Development
OPA	Official Public Account
RBA	Reserve Bank of Australia
RITS	Reserve Bank Information and Transfer System
SES	Senior Executive Service
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

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

A

B

C

D

E

F

G

H

I

L

M

N

O

P

R

S

T

U

Y