Australian Office of Financial Management

Annual Report 2009-10

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Australian Government

Australian Office of Financial Management

5 October 2010

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 2010 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

Neil Hyden
Chief Executive Officer

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AOFM ITS ROLE

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

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Review by the Chief Executive Officer

Global financial markets remained volatile in 2009-10 in the wake of the global financial crisis and the volume of sovereign debt on issue by overseas governments soared to fund growing budget deficits. Sovereign gross debt to GDP ratios exceeded 65 per cent in Canada, France, Germany, the United Kingdom and the United States, 110 per cent in Greece and Italy and 180 per cent in Japan. Investors became more wary in distinguishing between the credits of different sovereign issuers, including between issuers that shared the same rating from credit rating agencies.[1] In some countries bond issuance was helped by monetary policies that allowed large scale purchases of bonds by central banks, but this support weakened when the policies began to be wound down.

Some emerging countries experienced more favourable conditions than many developed countries, with relatively vigorous economic growth driven by resource industries (Brazil, Chile, Russia) or domestic demand (China, India). Nevertheless, few if any countries were untouched by the global financial crisis and its consequences.

The Australian economy rebounded during the year, sustained by policy stimulus and demand for minerals and energy from our Asian trading partners. Most, but not all, domestic financial markets recovered their dynamism, and the access of Australian borrowers to overseas credit was maintained by Commonwealth guarantees for borrowing by financial institutions and State governments.

For the AOFM, the year held many challenges. The Budget funding task grew substantially due to the impact of the crisis. The underlying cash deficit increased to $54.8 billion from $27.1 billion the previous year. Gross bond issuance in 2009-10 amounted to $58.4 billion, compared to $34.1 billion in 2008-09 and $5.1 billion in 2007-08. The funding task was accomplished relatively smoothly, supported by active liaison with investors including the provision of information to overseas investors. During the year, the AOFM conducted 81 tenders for Treasury Bonds, resumed the issuance of Treasury Indexed Bonds and held 68 tenders for Treasury Notes.

1 Australia was ranked favourably in such comparisons among AAA rated sovereigns.

Bond issuance

Treasury Bond issuance occurred steadily over the course of the year and was spread across existing bond lines with the aim of enhancing their liquidity. Three new lines were launched, including two with short maturities to help manage refinancing risk.

The resumption of issuance of Treasury Indexed Bonds was launched in September 2009 with the syndicated issue of a new bond line maturing in 2025. There was excellent demand for the new bond and the size of the issue – $4 billion – immediately established it as a liquid line and helped to re-invigorate the Australian market for inflation-indexed securities. Following the syndicated issue, monthly tenders were conducted for further issuance of indexed bonds across the existing bond lines. This helped to maintain activity in the market and foster on-going investor interest.

Secondary market turnover increased for both Treasury Bonds and Treasury Indexed Bonds, broadly in line with the increased volumes on issue. The vitality and competitiveness of these markets has improved markedly, helped by an increase in the number of price-makers.

Maintaining a liquid sovereign bond market

Successive governments have committed to maintaining a liquid and efficient market in Australian Government Securities.[2]

The experience of the past two years during the global financial crisis has demonstrated the benefits of this approach. Government bonds are one of the foundations of the Australian financial system, as they are risk-free assets that provide both liquidity and reference points for pricing. A well-functioning government bond market strengthens the resilience of the system to shocks, and it enables governments to fund changes in their Budget position quickly and efficiently, whether due to changes in the economy or to implement fiscal objectives.

Management of the portfolio

The funding position in the early part of the year was relatively strong due to a better than projected Budget outcome for 2008-09, an unanticipated receipt of Special Drawing Rights from the International Monetary Fund and additional issuance of Treasury Notes in June 2009 as a precaution against increased uncertainty about bond issuance in June and July 2009. The volume of Treasury Notes on issue was gradually reduced from August 2009.

2 This commitment was reiterated in the 2010-11 Budget papers.

The planned bond issuance program was reviewed following the release of the Government's Mid-Year Economic and Fiscal Outlook statement in November 2009. It was decided to maintain the planned program in 2009-10 in order to reduce the issuance that would be required in 2010-11 when heavy redemptions are due. The proceeds from this pre-funding were invested in short-dated State government bonds.

As in previous years, the Government's cash flows were highly variable over the course of the year, with the swing between peak and trough in the within-year funding requirement being $28.7 billion. The AOFM's task in managing the daily cash balances is a demanding one, using both short-term assets and borrowing instruments. During the year, it issued a total of $31.9 billion in Treasury Notes, placed 457 term deposits with the Reserve Bank of Australia and made 89 investments in bank accepted bills and certificates of deposit issued by highly-rated Authorised Deposit-taking Institutions. In future it also plans to use repurchase transactions as an additional cash management instrument; work on agreements with counterparties for this commenced during the year.

Like other financial institutions, the AOFM manages its portfolio of debt and financial assets to maintain a balance between risk and return. In the AOFM's case, the debt exceeds the financial assets, so the net return represents a cost to the Budget. Balancing risk and return includes managing the composition of the portfolio between different instruments and different maturities. The volume and tenor of assets held as term deposits and bank paper are largely determined by the Government's daily and weekly cash flows, but the volume and maturity structure of the debt on issue are managed through issuance decisions, including the selection of bond lines and the size of tenders.

Since the onset of the global financial crisis and the resultant increase in bond issuance, the AOFM has issued across the yield curve, sensitive to fluctuations in the demand for bonds of different maturities and the need to limit refinancing risk.

The AOFM no longer targets duration, nor does it use interest rate swaps to manage its portfolio; all remaining swaps were allowed to mature during the year. The program was terminated in 2008 when yield curves had been flat for several years and the AOFM concluded that it no longer provided a firm basis for achieving future savings. During the life of the program, interest rate swaps generated total direct and indirect savings of $4.165 billion for the Commonwealth over a 17 year period.

Portfolio outcomes

The debt servicing cost of the gross debt managed by the AOFM in 2009-10 was $6.3 billion. This represented a cost of funds of 5.05 per cent, compared with 4.39 per cent the previous year. The increase in yield is more than fully accounted for by reduced savings from interest rate swaps: in 2008-09 these swaps contributed $969 million in interest revenue, mainly from the proceeds from the termination of swaps, whereas in 2009-10 there were no terminations and swaps contributed only $41 million in interest revenue. The yield on gross debt before swaps fell from 5.82 per cent to 5.08 per cent between the two years.

The interest revenue on assets in the portfolio was $1.3 billion, which represented a yield of 4.16 per cent compared with 5.36 per cent the previous year. The fall was due mainly to lower short-term market interest rates on average over the course of the two years.

As a result, the net cost of funds on the combined portfolio was 5.36 per cent in 2009-10, compared with 3.64 per cent the previous year. This apparent deterioration is more than fully attributable to the one-off effects of the termination of interest rate swaps and the realisation of accumulated savings that they released. If the savings from interest rate swaps are excluded in both years, the yield on the net portfolio fell from a cost of 6.17 per cent in 2008-09 to 5.40 per cent in 2009-10.

Lower interest rates also had the effect of increasing the market value of net liabilities by $2.77 billion.[3]

Residential mortgage-backed securities

The residential mortgage-backed securities (RMBS) market provides an important source of funding for smaller mortgage lenders to compete with the major banks in lending for housing. In October 2008 the Government decided to invest in Australian RMBS as a temporary measure to support competition in lending for housing while the market was disrupted by the impact of the global financial crisis. To this end, the Treasurer has directed the AOFM to invest up to $16 billion in eligible RMBS. Since November 2009, the program has had the additional objective of providing support for lending to small business, which is to be achieved through participating lenders using some of the proceeds of the AOFM's investment for lending to small business.

Building on the experience it has gained from the operation of the program, in December 2009 the AOFM introduced new procedures to provide greater flexibility. This allowed for proposals to be submitted to it either on a reverse enquiry basis (without the need to go through a tender procedure) or under pipeline arrangements (which provide greater funding certainty for issuers by allowing them to submit proposals for a series of separate RMBS issues). By the end of the financial year, the AOFM had invested $1.0 billion in six reverse enquiry transactions and approved pipeline arrangements for the investment of up to a total of $3.4 billion by December 2010.

3 Re-measurement effects are not realised unless the debt or assets involved are bought or sold. Re-measurements on debt that is not redeemed ahead of maturity sum to zero over the life of the debt.

The pricing of the AOFM's investments in RMBS is determined in consultation with issuers after mandates have been awarded. In this, the AOFM aims to balance the objective of maintaining a competitive flow of funds for new lending to housing and to small business with the objective of attracting other investors. Where other investors participate in a transaction, the AOFM participates at the same price. In May 2010 the AOFM adjusted its approach to pricing with the aim of making RMBS a more competitive source of funding. It indicated that it was prepared to invest at tighter levels than previously.

Investor sentiment towards RMBS improved over the course of 2009-10 and brought an overall increase in the level of private sector participation in primary issuance. However, there was a sharp contraction in deal flow in the second quarter of 2010 due to weakness in global credit markets and reduced offshore interest in Australian RMBS. The contraction was exacerbated by a slowing of housing loan originations and prepayments.

By 30 June 2010, the AOFM had completed 28 investments in RMBS, totalling $9.0 billion, sponsored by 14 issuers. Together with investments by other parties, the total volume of RMBS issued with the support of the program since its inception was $17.2 billion. This represents a significant component of total lending for housing and small business. Without it, new lending by lenders other than the major banks would have been lower and the ability of these lenders to compete with the major banks, now and in the future, would have been curtailed.

Office operations

In the 2009-10 Budget the AOFM received additional funding of $19.2 million over four years to expand its investor relations and bond promotion activities and support its increased workload and transactional costs arising from greater debt issuance and debt levels.

Investor relations

An Investor Relations Unit was established in July 2009 with three staff. It has undertaken an active program, with over 100 bilateral meetings with investors and conference presentations to audiences totalling around 650 investors. Promotional material was provided to specialised journals serving institutional investors. This included the annual Australian Supplement published by *Finance Asia*, which has a readership of over 20,000.

Operating deficit

The AOFM recorded an operating deficit on agency activities of $1.55 million in 2009-10. The deficit was due to fees and other costs associated with the syndicated issuance of Treasury Indexed Bonds being met from the agency's operating funds. The use of syndication brought cost savings by allowing a new liquid bond line to be established quickly and competitively.

These savings accrue as lower debt servicing costs under administered appropriations, not operating funds.

Treasury system upgrade

The AOFM partially upgraded its Quantum/QRisk treasury system during 2009-10. The upgrade provided no additional benefits to the AOFM but was necessary in order to ensure continued servicing by the vendor, Sunguard Asia Pacific Inc. A second phase of the upgrade will be undertaken in 2010-11.

The AOFM also commenced work during the year for the selection of a treasury system to operate when the current contract expires.

Enterprise agreement

The AOFM negotiated an enterprise agreement with its staff in 2009-10, in accordance with the *Fair Work Act 2009* and Government policy requirements. Previously, employment conditions for all AOFM staff had been set under Australian Workplace Agreements and common law agreements. The Agreement meets the Government's requirement that improved remuneration and conditions for Australian government employees be underpinned by improved productivity and performance. The parties recognised that to meet this objective the AOFM needs to recruit and retain high quality professional staff and to motivate and reward individual performance. The pay rates agreed took account of market rates for conservative financial services organisations using survey data provided by the Financial Institutions Remuneration Group. This data covers a wide range of public and private sector financial institutions, including banks, corporate treasuries and State debt management agencies. Consideration was also given to comparisons with rates in central APS agencies, taking account of differences in classification standards and employment conditions.

Classification of senior positions

A review undertaken by Mercer Human Resource Consulting concluded that four Group Head positions in the agency currently with formal APS classifications of Executive Level 2 should properly be classified as Senior Executive Service Band 1. One position was advertised at this level in April 2010, at its existing pay scale, but action on filling the position was suspended when the Government imposed a cap on SES numbers pending a review of the size, capability and work level standards of the SES. Further action will depend on the outcome of the Government's review. If the review results in greater constraints on the size and coverage of the SES, it would be desirable for it also to provide for appropriate status to be given to senior professional positions that are not included in the SES.

Cooperation with other debt managers

The AOFM supports the debt management activities of the Papua New Guinea and Solomon Islands governments under the Strongim Gavman Program and the Regional Assistance Mission to the Solomon Islands. It seconds a staff member to each of these countries to help them develop their cash and debt management capabilities, systems and procedures. Officials of the three debt management agencies met this year in Honiara to discuss progress and experiences.

During the year the AOFM also hosted visits by debt management officials from Indonesia, Papua New Guinea, the Solomon Islands, Sri Lanka and Vietnam. It participated in activities of the Working Party on Debt Management of the Organisation for Economic Development and cooperated with the central financing authorities of the Australian States and Territories.

Retirement

This is my final annual report as Chief Executive Officer of the AOFM as I plan to retire in November 2010. I have had a varied career since I joined the Australian Public Service in January 1965, including work in the Office of the Public Service Board, the Prime Minister's Department and the Treasury, as well as the AOFM. I also worked for four years as Executive Director on the board of the World Bank.

It has been a particular joy to work in the AOFM. It has a fine body of staff, with excellent skills and experience, who have provided great support in the challenges we have faced together over the past seven years. I thank them all for the roles they have played and the contributions they have made, and wish them well in their future careers.

I also thank Dr Ken Henry, the Secretary to the Treasury, the members of the AOFM Advisory Board and the AOFM Audit Committee, and other officials in Treasury, the Australian Government Solicitor's Office, ANAO and other government departments and agencies for the invaluable support they have provided. It has been greatly appreciated.

Neil Hyden
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 2009-10 year, the AOFM also invested in residential mortgage-backed securities under a Government program to support competition in lending for housing. It also invested in bonds issued by State and Territory governments.

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. Its staff are employed under the *Public Service Act 1999*.

For budgetary purposes, the AOFM's activities comprise of one program directed to one 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.

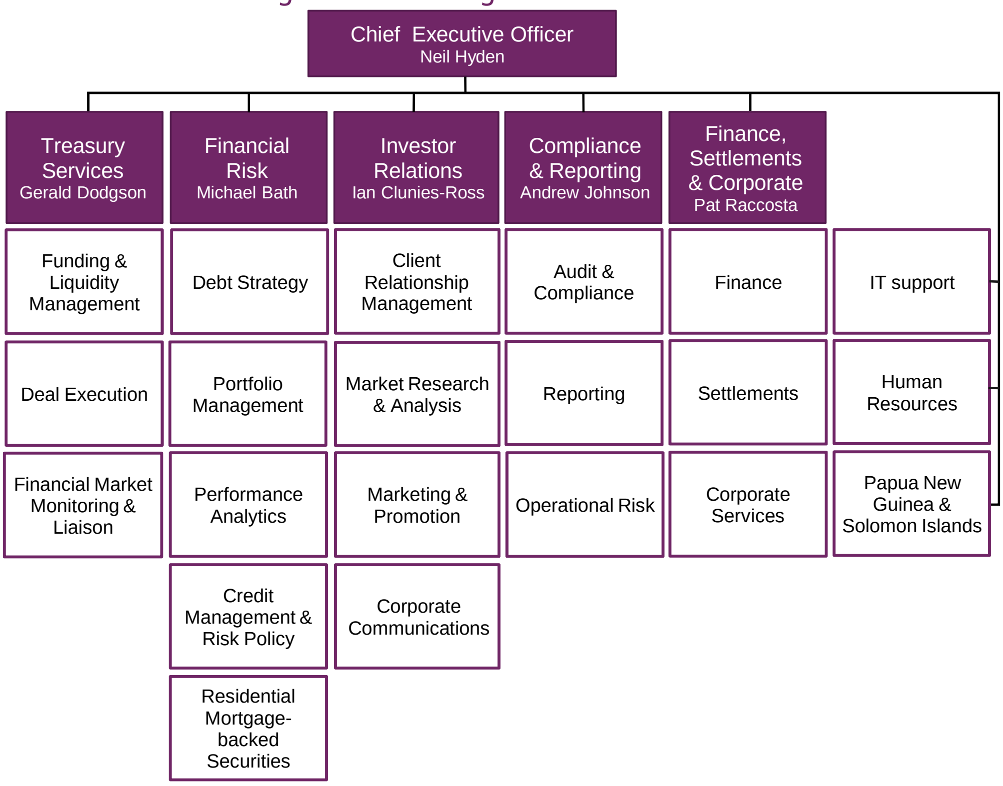
Organisational structure

During 2009-10, the AOFM operated using five groups:

- Treasury operations;
- Financial risk management;
- Investor relations;
- Compliance and reporting; and
- Finance, settlements and corporate.

They were supported by an information technology support unit and a human resources unit. In addition, two staff members were seconded to the Papua New Guinea and Solomon Islands governments to support their debt management activities. Roles and responsibilities within the Office were structured to ensure an appropriate segregation of duties and reporting lines.

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 2009-10 and reports on their performance.

Treasury Bond and Treasury Indexed Bond issuance

Objective

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

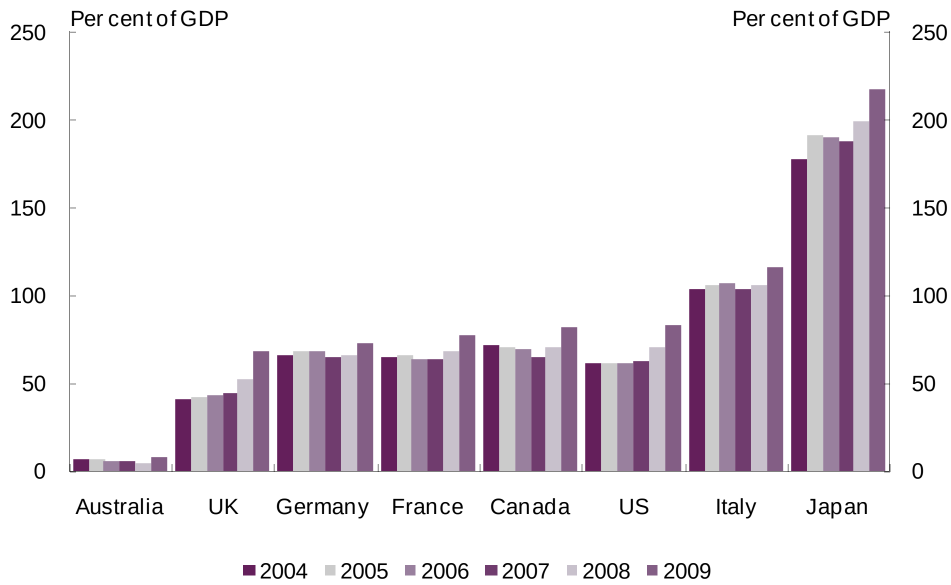
A secondary objective is to support the efficient operation of Australia's financial system. This objective is achieved in the following ways:

- 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.
- The existence of active and efficient physical and futures markets for sovereign debt also strengthens the robustness of the financial system and reduces its vulnerability to shocks.

Achieving the objective

This year's debt issuance task occurred against the backdrop of considerable uncertainty about the health of the global economy and financial system in the wake of the global financial crisis. Many OECD economies undertook large borrowing programs to fund growing budget deficits and support weakened financial institutions. Chart 1 shows the stock of gross government debt on issue as a proportion of GDP in Australia and several other OECD countries over recent years.

Chart 1: Gross Government debt as a per cent of GDP

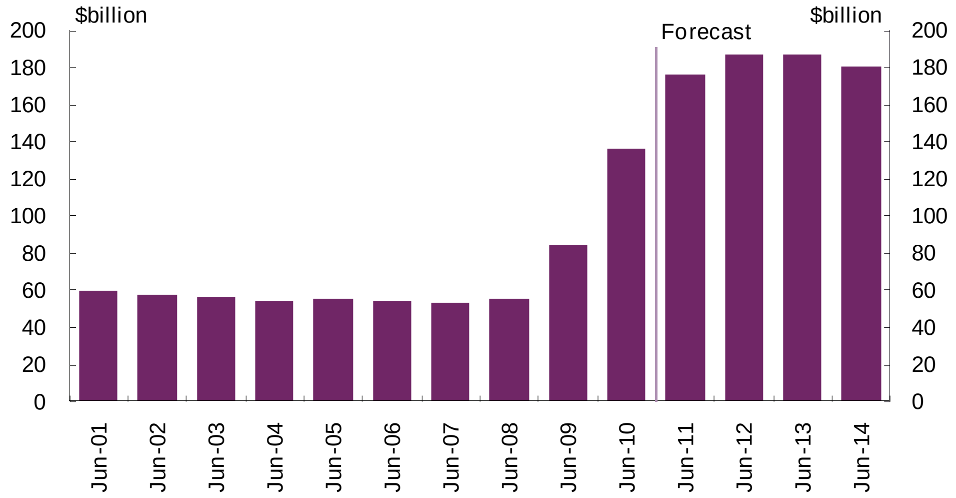


Source: IMF World Economic Outlook April 2010, Treasury

It can be seen that Australia started from a much lower level of government debt relative to GDP and has maintained this position throughout the global crisis. We therefore faced a much less formidable issuance challenge than the comparator countries. Nevertheless the task was still a substantial one as indicated in Chart 2.[1]

1 Bonds include Treasury Bonds and Treasury Indexed Bonds, with forecast amounts consistent with the 2010 Pre-Election Economic and Fiscal Outlook.

Chart 2: Australian Government bonds outstanding (face value)



The AOFM's debt issuance task was assisted by investors' perceptions of Australia's high credit quality, the relative strength of the Australian economy and fiscal outlook, and the attractive yields on the debt. These factors resulted in the relatively large volume of issuance being absorbed smoothly by financial markets.

In addition, legislation came into effect in December 2009 making Commonwealth Government Securities exempt from non-resident interest withholding tax. The exemption removed a barrier to investment for many offshore investors who had been unwilling or unable to invest in assets subject to interest withholding tax. Non-resident holdings of Commonwealth Government Securities were around sixty per cent of the total outstanding during 2009-10.

Treasury Bonds

Gross Treasury Bond issuance for the year totalled $52 billion. The bulk of issuance was in existing bond lines in order to enhance their liquidity and improve their attractiveness, particularly to large global investors. By the end of June 2010, the average face value of these lines was over $11 billion, compared with an average around $7 billion for the same lines a year earlier.

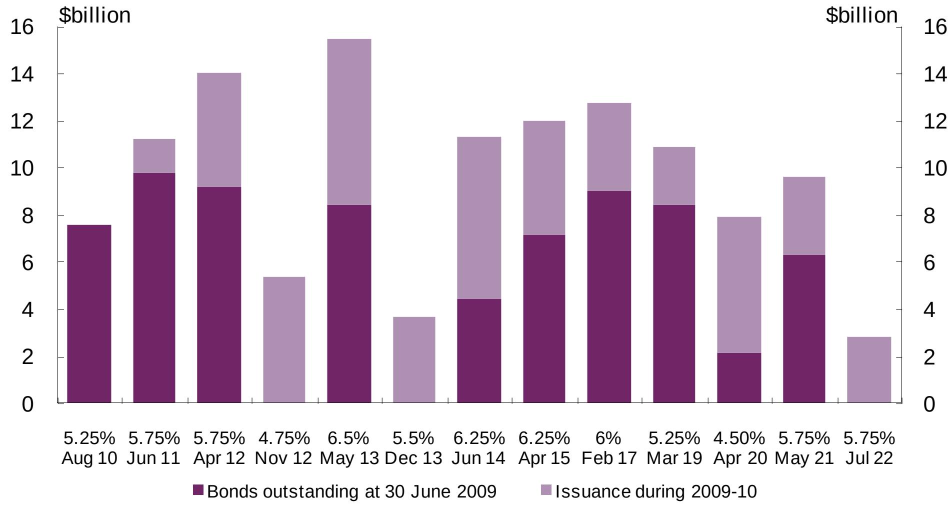
Issuing over a range of bond lines with differing maturities was also designed to help the management of the debt portfolio by ensuring that the maturity of the debt was not unduly concentrated but spread over a period of years. To further assist this objective, two new short-dated bond lines maturing in November 2012 and December 2013 were introduced to allow issuance to be spread across a larger number of lines and help limit the growth of the largest lines. A new bond line with a maturity date of July 2022 was also launched in order to maintain the length of the yield curve and support the operation of the 10-year Treasury Bond futures contract.

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. Most weeks two tenders were held: typically 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 2010 and issued over the financial year.

During the year the total volume of Treasury Bonds on issue increased by around $46 billion, to $125 billion. At the end of the year there seven Treasury Bond lines with over $10 billion on issue.

Chart 3: Treasury Bonds outstanding as at 30 June 2010 and issuance in 2009-10



Treasury Indexed Bonds

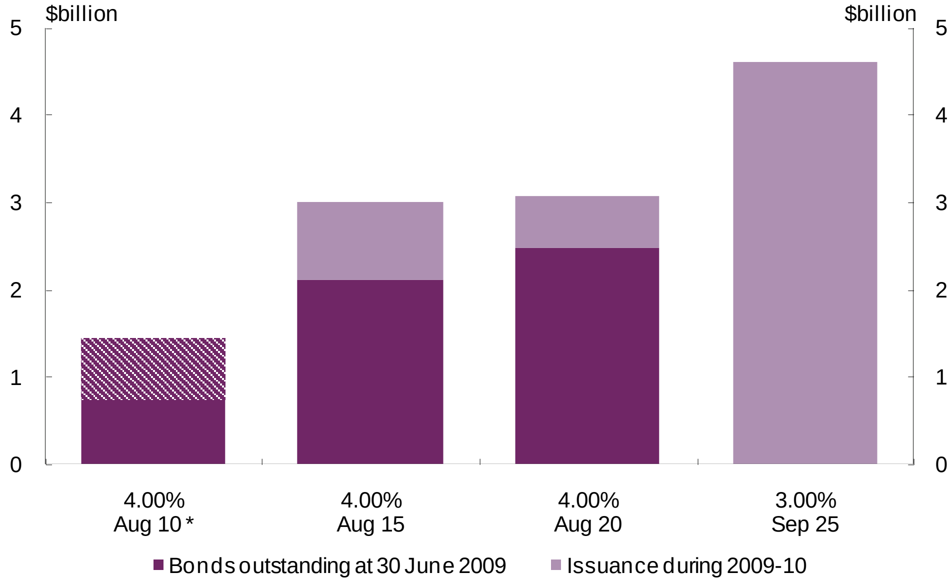
Treasury Indexed Bond issuance was recommenced in September 2009 to assist the management of Australian Government debt by widening the range of available debt instruments, diversifying risk and tapping additional sources of investor demand. Treasury Indexed Bonds were last issued in 2003. The decision to recommence issuance followed consultations with a wide range of financial market participants.

Issuance recommenced with the syndicated offer of a new Treasury Indexed Bond maturing in September 2025. A panel of six financial institutions was appointed to manage the $4 billion issue. The offer generated considerable interest both domestically and from offshore. As part of the issue, holders of the Treasury Indexed Bond maturing in August 2010 were given the opportunity to convert their holdings of that bond to stock of the new bond. Approximately $716 million face value of the 2010 Treasury Indexed Bond was repurchased in this manner.

Following the syndicated offer, Treasury Indexed Bonds were offered at monthly tenders of $300 million face value each. The volume of each line outstanding, relative yields and other prevailing market conditions were considered in the selection of which line to offer each month.

Chart 4 shows the Treasury Indexed Bonds outstanding as at 30 June 2010 and issued over the financial year.

Chart 4: Treasury Indexed Bonds outstanding as at 30 June 2010 and issuance in 2009-10



* $716 million of the $1,452 million face value of the 2010 Treasury Indexed Bond was repurchased during 2009-10.

In September 2009 the securities lending facility was expanded to enable borrowing of Treasury Indexed Bonds. During the year the facility was used twice to borrow such bonds.

Infrastructure Bonds

In April 2009 the Government announced that its investment in the National Broadband Network would be partly funded by the issuance of Aussie Infrastructure Bonds to household and institutional investors.

The 2010-11 Budget papers indicated that the component of this funding to be provided by institutional and other wholesale investors will be through the issue of CGS as part of the

Government's overall debt issuance. These bonds will not be identified separately from other CGS at the time of issue, but will be reported in the annual Budget Statements.

Performance

Funding the Budget

The Government's budget financing requirement in 2009-10 was fully met, together with $5 billion of pre-funding for 2010-11.

The Treasury Bond market was affected in the first part of the year by increased issuance by State governments following the passage of Commonwealth guarantee legislation in June 2009. Some investors sold holdings of Treasury Bonds to purchase higher yielding semi-government bonds of a similar maturity. This resulted in a large volume of Treasury Bonds coming onto the secondary market, making primary issuance of bonds with long maturities more difficult for a period. In view of the increased uncertainty about bond issuance at this time the AOFM increased its issuance of Treasury Notes in June 2009 and held an increased volume of short-term assets. Nevertheless, Treasury Bond issuance was maintained throughout this period, although only one long maturity bond line was issued at tender in the first six weeks of the financial year.

The funding position in the early part of the year was stronger than expected because the performance during the 2008-09 financial year exceeded the forecast in the 2008-09 Budget and the receipt for $4.8 billion from allocations of Special Drawing Rights by the International Monetary Fund that had not been anticipated at the time of the 2010-11 Budget. From August 2009 the volume of Treasury Notes on issue was reduced gradually, offsetting the build up that had occurred in June 2009.

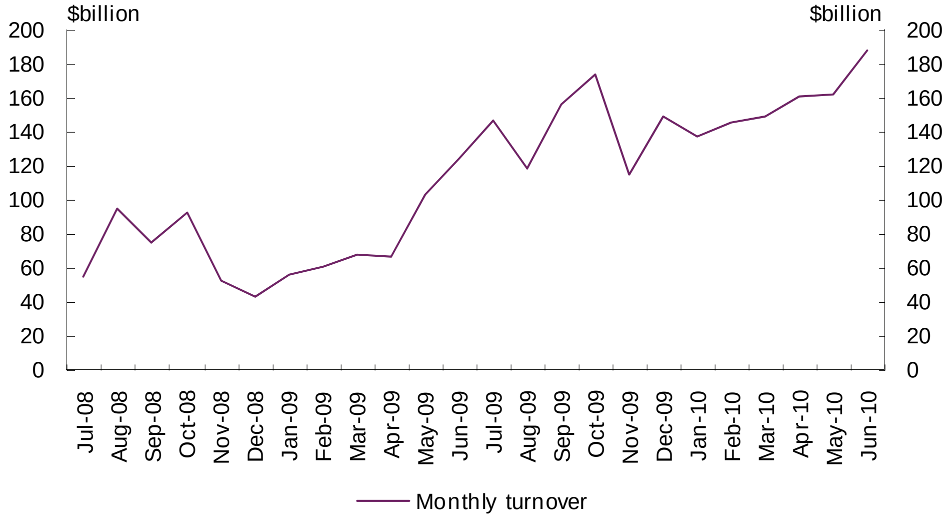
The AOFM reviewed the planned bond issuance program for 2009-10 following the release of the Government's Mid-Year Economic and Fiscal Outlook statement on 2 November 2009. It decided to maintain the planned program so as to reduce the bond issuance that would be required in 2010-11. Proceeds from this pre-funding were invested in short-dated semi-government bonds. The assets purchased were those with maturities on or before the maturity dates of Commonwealth debt maturing in 2010-11. During 2009-10, holdings of semi-government bonds peaked at over $4 billion.

Market liquidity and efficiency

The Treasury Bond market operated relatively smoothly throughout 2009-10. This was helped by the enhanced liquidity of the market due to increased issuance, and by more settled financial markets conditions than in 2008-09. The liquidity and efficiency of the Treasury Indexed Bond market also improved dramatically with the resumption of issuance.

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 2010.

Chart 5: Treasury Bond secondary market turnover



The Australian Government bond market displayed improved liquidity[3] in 2009-10 with:

- Treasury Bond turnover increased by 45 per cent in 2009-10 compared to 2008-09.
- Treasury Indexed Bond turnover increased by 209 per cent in 2009-10 compared to 2008-09.
- The turnover of 3-year Treasury Bond futures contracts increased by 36 per cent in 2009-10 compared to 2008-09, and turnover of the 10-year contracts increased by 4 per cent.

The liquidity and efficiency of the Treasury Bond and Treasury Indexed Bond markets were helped by an increase in the number of price-makers. During the year four new institutions registered to become bidders in tenders for the issue of Commonwealth Government Securities and also began making secondary market prices in these securities.

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

2 Total turnover includes repurchase transactions with data sourced from Austraclear.
3 Treasury Bond and Treasury Indexed Bond turnover data sourced from the 2010 Australian Financial Markets Report published by the Australian Financial Markets Association.

two-way prices. The more settled market conditions resulted in significantly less use of the securities lending facility in 2009-10 than in the previous year. The facility was used 60 times for overnight borrowing in 2009-10 compared with 374 instances of use in 2008-09. The face value amount lent was around $2.4 billion compared to $12.8 billion in 2008-09.

All Treasury Bond futures contract close-outs in 2009-10 occurred smoothly.

Efficiency of issuance

All issuance of Commonwealth Government Securities in 2009-10 was by competitive tender apart from the syndicated offering of the new 2025 Treasury Indexed Bond.

Tenders held during 2009-10 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 2009	Up to 2015	18,103	5.0751	-0.01	3.74
	2016 - 2022	6,298	5.4122	-0.20	3.33
January - June 2010	Up to 2015	16,600	5.0694	-0.03	3.59
	2016 - 2022	11,300	5.6190	0.08	3.33

The average ratio of the volume of bids received to the amount of stock on offer was 3.54 for Treasury Bonds in 2009-10, broadly in line with the averages for previous years, despite the much larger volume of total issuance in 2009-10. Only one tender had a cover ratio less than two.[4] In general, bids at tender were stronger for short-dated bonds compared to long-dated.

The strength of bidding at tenders was also reflected in the yield spreads to the secondary market. At many Treasury Bond tenders, and all Treasury Indexed Bond tenders, the weighted average 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 syndicated offering of the new 2025 Treasury Indexed Bond allowed the new bond to achieve a benchmark size immediately and ensured the issue attracted the attention of both domestic and foreign investors. Feedback from investors regarding the syndication process was

4 This occurred on 27 January 2010 and may have been affected by the preceding public holiday.

positive. Following the syndicated offering, there were seven competitive tenders for Treasury Indexed Bonds during the year. The average ratio of the volume of bids received to the amount of stock on offer was 3.91, with an average spread to the secondary market yield of -2.57 basis points.

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

Cash management

Objective

The AOFM manages the daily cash balances of the Australian Government in the Official Public Account (OPA).[5] 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.[6]

Achieving the objective

Achieving the objective in relation to cash management involves undertaking appropriate short-term investment and debt issuance.

Cash balances not required immediately are invested outside the OPA for nominated periods of time, with the maturity dates set primarily to finance large future outlays. The types, magnitudes and tenors of the short-term investments are determined by the AOFM. Investments are made in term deposits at the RBA, bank accepted bills and 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 bank accepted bills, certificates of deposit and semi-government bonds reflect prevailing market rates for those instruments.

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

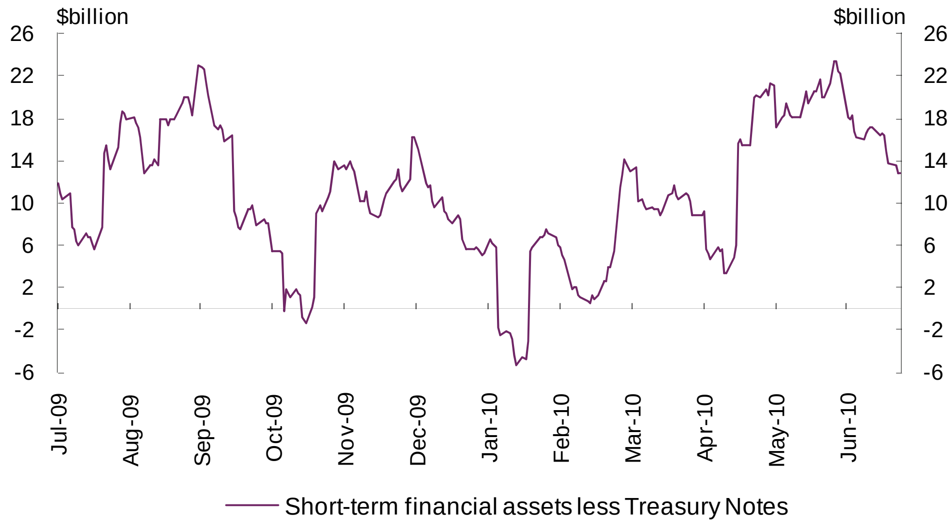
6 The overdraft facility is more costly than equivalent short-term borrowing (for example, issuance of Treasury Notes). The terms of the facility provide that it is to cover only temporary shortfalls of cash and is to be used infrequently and, in general, only to cover unexpected events.

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 2009-10 to maintain a liquid market.

The AOFM also plans to undertake repurchase transactions in the future to borrow for cash management purposes using semi-government bonds as collateral. It began negotiating repurchase agreement documentation with members of its Investment Panel towards the end of the year.

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 2009-10.

Chart 6: Within-year funding requirement 2009-10



Performance

The objective of meeting the Government's financial obligations as and when they fall due was met in 2009-10 without any use of the overdraft facility.

During 2009-10 the AOFM placed 457 term deposits with the RBA. The stock of term deposits fluctuated from a maximum of $33.4 billion in September 2009 to a minimum of $3.0 billion in January 2010.

- The average yield obtained on term deposits during 2009-10 was 3.60 per cent, compared with 4.97 per cent in 2008-09. The decrease in average yield reflects the lower average level of interest rates that prevailed in 2009-10.

Investment in bank accepted bills and certificates of deposit was undertaken when excess funds were available for investment and there was an acceptable higher return from investing in such instruments compared with placing funds on deposit at the RBA.

The face value amount invested in bank accepted bills and certificates of deposit peaked at $4.8 billion in April 2010. The average additional return in 2009-10 from investing in bank accepted bills and certificates of deposit compared with investing funds on deposit at the RBA was approximately 26 basis points per annum. This is estimated to have generated additional investment earnings in 2009-10 totalling around $8 million. The additional earnings generated on short-term bank debt were lower than earned in 2008-09 due to a contraction in the spread between Overnight Indexed Swap rates and bank bill yields.

Forty tenders for Treasury Notes were conducted during the year, for the issue of $31.9 billion (in face value terms). The tenders were well supported with an average cover ratio of 4.75. Yields averaged around 23 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 2009-10 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 2009-10 these limits were the same as applied in 2008-09, 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 2009-10

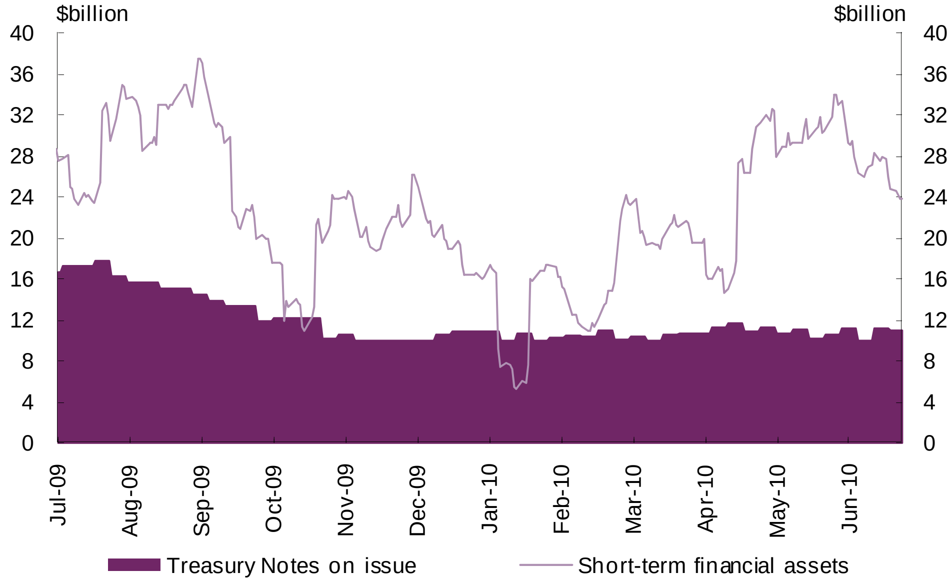
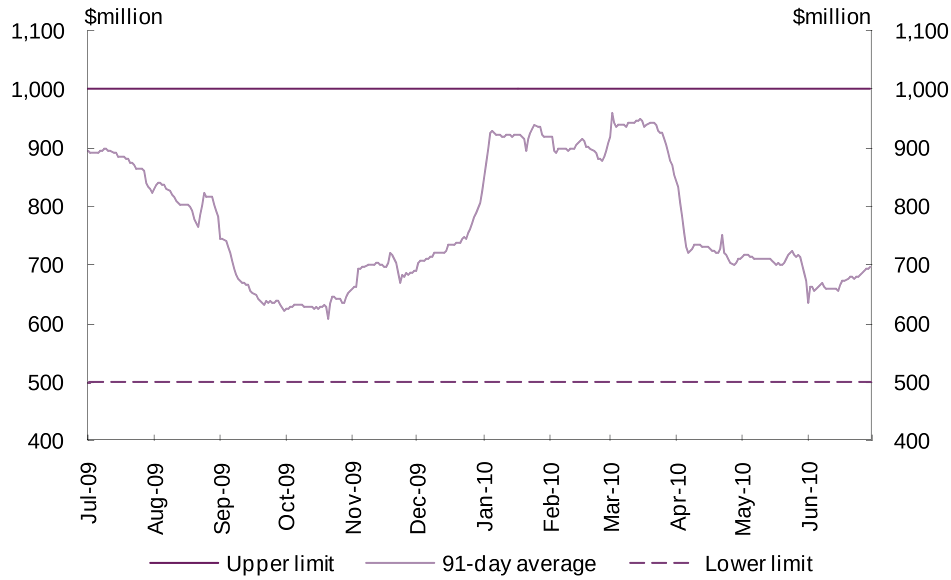


Chart 8: 91-day moving average cash balance



Minimising debt servicing costs subject to acceptable risk

Objective

In managing its debt portfolio, the AOFM generally 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.

The primary measure of cost used in balancing cost and risk is historic accrual debt servicing cost. This includes interest on physical debt and derivatives, 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 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 includes 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.

Achieving the objective

The AOFM's portfolio management strategy seeks to maintain balance in its portfolio of debt and investment instruments. The volume and tenor of assets held as term deposits and bank paper are largely determined by cash management requirements. However the volume and maturity structure of the debt on issue are managed to meet cost, risk and liquidity objectives.

The selection of bond lines and the size of tenders have a direct impact on the cost and risk of the overall portfolio. Factors such as the overall maturity structure of the portfolio, market conditions and the relative demand and cost of different bond lines are considered when issuance decisions are made. The duration of the nominal debt portfolio is thus determined by the cumulative effect of issuance decisions.

For Treasury Bonds, issuance is spread across the yield curve. Typically (but not universally) two tenders are undertaken per week, with one in the short to mid part (for example 1 to 6 years) of the curve and the other in the long part (for example 7 to 15 years) of the curve. The tenders may be of different sizes, providing flexibility in the maturity profile of the portfolio as it changes in size over time.

It is usually found that debt issued for long periods at fixed rates of interest pays higher interest rates than shorter-term debt, because lenders 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 swap from longer to shorter-term debt (or from fixed-rate debt to floating-rate debt). However, over recent years market yield curves have flattened and reduced the savings available from this approach. As a result, in 2008 the AOFM concluded that duration targeting using swaps no longer provided a firm basis for achieving future savings in debt servicing cost. The last swap matured in May 2010.

Performance

Reducing debt servicing cost

The debt servicing cost[7] of the gross debt managed by the AOFM in 2009-10 was $6.3 billion (after swaps). This represented a cost of funds of 5.05 per cent.

The cost increased by $3.31 billion over the previous year. In large part, this reflected the increase in the average book volume of debt, from $67.8 billion in 2008-09 to $124.5 billion in 2009-10. In addition, there was a large fall in savings from interest rate swaps. Interest rate swaps contributed $969 million in interest revenue in 2008-09, mainly as proceeds from the termination of swaps, but only $41 million in 2009-10.

The return on gross assets in 2009-10 was $1.3 billion, on an average book value of $31.8 billion. Interest revenue on gross assets fell by $253 million between the two years while the average book volume increased by $2.4 billion. The average yield earned on assets fell by 1.20 per cent from 5.36 per cent in 2008-09 to 4.16 per cent in 2009-10.

Taken together, the net servicing cost of the combined portfolio of debt and assets was $5.0 billion, with an effective yield of 5.36 per cent. The corresponding figures for 2008-09 were $1.4 billion and 3.64 per cent, respectively.

Table 2 provides further details of the cost outcomes for the combined portfolio by instrument and portfolio for 2008-09 and 2009-10.

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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.

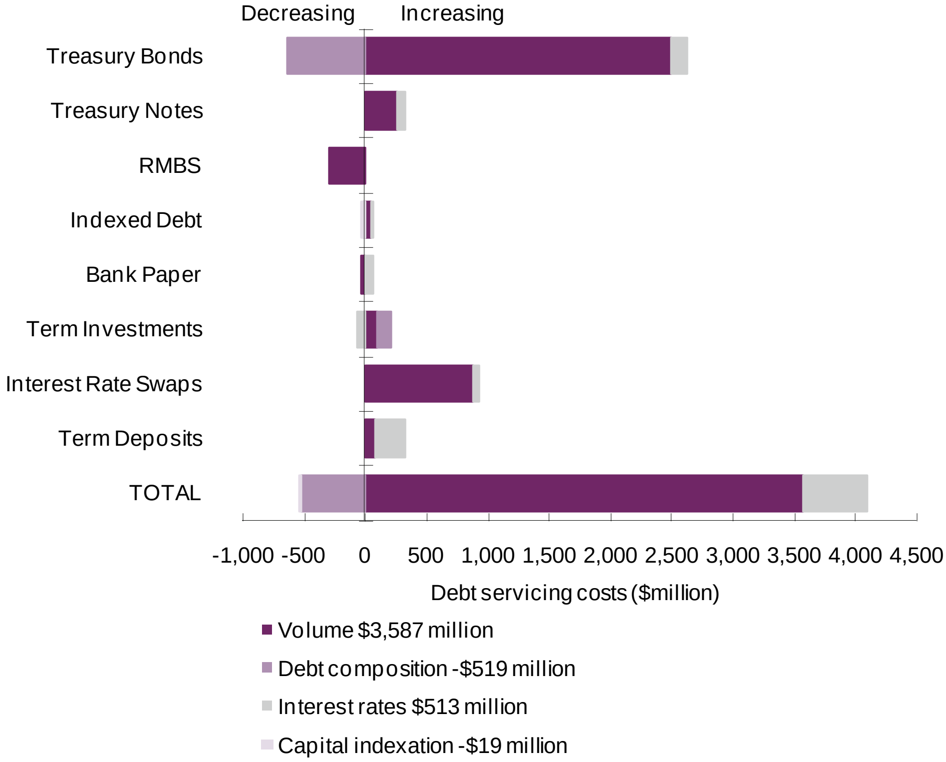
Table 2: Australian Government debt and assets administered by the AOFM

	Interest expense		Book volume		Effective yield	
	2008-09	2009-10	2008-09	2009-10	2008-09	2009-10
	$ million		$ million		per cent per annum	
Contribution by instrument						
Treasury fixed coupon bonds	(3,182)	(5,186)	(56,514)	(100,956)	5.63	5.14
Treasury inflation indexed bonds	(687)	(731)	(8,677)	(11,826)	7.92	6.18
Treasury notes	(75)	(411)	(2,641)	(11,691)	2.85	3.51
Other miscellaneous domestic debt	(0)	-	(0)	-	7.20	
Foreign loans (a)	(2)	(0)	(7)	(6)	23.27	2.98
Gross physical CGS debt	(3,946)	(6,328)	(67,840)	(124,479)	5.82	5.08
Interest rate swaps	969	41	-	-		
Gross CGS debt (after swaps)	(2,977)	(6,287)	(67,840)	(124,479)	4.39	5.05
Term deposits with the RBA	981	647	19,759	17,996	4.97	3.60
Investments in bank paper	140	102	2,108	2,579	6.64	3.97
Term investments (b)	199	37	2,864	1,326	6.96	2.80
RMBS investments	89	374	1,859	7,190	4.80	5.20
State Housing Advances	166	162	2,826	2,757	5.89	5.89
Gross assets	1,576	1,323	29,416	31,848	5.36	4.16
Net CGS debt	(1,400)	(4,964)	(38,423)	(92,631)	3.64	5.36
Contribution by portfolio						
Long-Term Debt Portfolio (c)	(2,690)	(5,900)	(62,070)	(112,707)	4.33	5.24
Cash Management Portfolio	1,034	400	18,961	10,129	5.45	3.95
RMBS Portfolio	89	374	1,859	7,190	4.80	5.20
State Housing Portfolio	166	162	2,826	2,757	5.89	5.89
Total debt and assets	(1,400)	(4,964)	(38,423)	(92,631)	3.64	5.36
Re-measurements (d)	(232)	(2,773)				
Total after re-measurements	(1,632)	(7,737)	(38,423)	(92,631)		

Note: Sub totals and totals are actual sum results, rounded to the nearest $ million. Effective yields are based on actual results before rounding, rounded to two decimal places.
(a) Interest expense and effective yield on foreign loans incorporates foreign exchange revaluations effects.
(b) Investments in State and Territory government bonds (2008-09 and 2009-10) and Kangaroo bonds (2008-09 only).
(c) Includes the Debt Hedge Portfolio which operated separately for part of the year (refers only to 2008-09).
(d) Re-measurements refer to unrealised changes in the market valuation of financial assets and liabilities.

Chart 9 sets out the components by instrument of the change in the debt servicing cost of the total 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 9: Changes in debt servicing cost between 2008-09 and 2009-10[8]



The major part of the increase in total debt servicing costs was due to the increase in the volume of Treasury Bonds, Treasury Notes and Treasury Indexed Bonds on issue and reduced savings on interest rate swaps. In particular, the increase in the volume of Treasury Bonds contributed an extra $2.5 billion to total debt servicing cost in 2009-10 compared to the previous year. This was partially offset by relatively expensive debt maturing and being replaced with new debt issued at lower interest rates. It was further offset by a smaller capital indexation impact on indexed bonds due to smaller CPI increases.

The savings provided by interest rate swaps were $928 million less in 2009-10 than in 2008-09. When comparing the two years, it should be noted that the savings in 2008-09 were largely due to the one-off proceeds from the termination of swaps, while no terminations were undertaken in 2009-10.

8 The total increase in debt servicing cost between 2008-09 and 2009-10 shown in Chart 9 ($3,562 million) is $2 million less than what is shown in Table 2 ($3,564 million). Unlike Table 2, Chart 9 does not show the change in debt servicing cost attributed to foreign currency debt and State Housing advances. Foreign currency debt reduced debt servicing cost between the two years by $2 million as a result of foreign currency gains and State Housing advances added $4 million due to volume impacts.

Low short-term interest rates, particularly in the first half of the financial year, reduced the return obtained on term deposits and other assets. The interest revenue on term deposits in 2009-10 was $647 million on an average book volume of $18.0 billion. This represented a return on funds of 3.60 per cent, compared with 4.97 per cent in 2008-09. Overall, term deposits in 2009-10 contributed $334 million less in interest compared to 2008-09, on a similar book volume. A similar effect occurred for investments in bank paper.

Holding relatively high short-term asset balances for precautionary reasons added to the net cost of the portfolio in 2009-10. The average yield earned on term deposits with the RBA and investments in bank paper during the year was 3.67 per cent, while the average yield on Treasury Bonds issued was 5.19 per cent and on Treasury Notes was 3.85 per cent. If the short-term asset balances had been $5.0 billion lower on average over the year, and the issuance of Treasury Bonds and average stock of Treasury Notes had been lower by $3.3 billion and $1.7 billion respectively, the net servicing cost would have been around $53 million lower, or about 6 basis points on the yield on the total portfolio.[9]

The term investments in the portfolio in 2009-10 comprised two distinct sets of investments in semi-government bonds: (i) the first set were held in the Debt Hedge Portfolio against additional Treasury Bond issuance undertaken to support market liquidity in 2008-09 and disposed of between June 2009 and July 2009; and (ii) the second set comprised shorter-dated semi-government bonds purchased and held in the cash management portfolio after the release of the improved fiscal outlook in November 2009 in order to pre-fund stock maturing in 2010-11.

- As noted in last year's annual report, the assets held against the additional bond issuance in 2008-09 generated a positive return, including an overall capital gain on disposal. However, the subset of these assets that was sold in 2009-10 incurred a capital loss, as yields had risen since their purchase. The effect of this capital loss was to reduce the effective average return on term investment holdings overall to 2.80 per cent for the financial year.

- On the other hand, the shorter-dated semi-government bonds generated an average accrual return of 4.90 per cent in 2009-10, which was higher than the return available on bank paper and term deposits with the Reserve Bank.

Movements in market interest rates had an unfavourable impact on the market value of the portfolio in 2009-10, with unrealised losses from re-measurements amounting to $2.77 billion. They comprised unrealised losses of $2.30 billion on nominal debt, $518 million on indexed debt,

9 The estimated net cost depends on the assumptions made about the distribution of lower borrowing between the two debt instruments. If it is assumed that the lower borrowings were shared equally, the estimated net cost is $43 million, while if the lower borrowings were entirely through a lower stock of Treasury Notes, the estimated net cost is $9 million. Because of the policy of maintaining a minimum of $10 billion of Treasury Notes on issue at all times in order to maintain an active market in them, the assumption used in the text is perhaps the most realistic.

$13 million on Treasury Notes and $44 million on interest rate swaps, offset by unrealised gains of $36 million on term investments and $64 million on RMBS investments. The re-measurement loss was driven by a year on year fall in the level of market interest rates, which pushed both liability and asset valuations higher. The effect was more pronounced on the liabilities due to their greater volume and longer average durations (which determine the sensitivity of market value to movements in interest rates).

In summary, a significant increase in the volume of debt generated a larger net interest cost. However, in percentage terms the yield on the portfolio benefited from the relatively low level of interest rates experienced in 2009-10, and would have fallen but for the one-off impact of the ending of swaps. If the savings from interest rate swaps are excluded in both years, the yield on the net portfolio fell from a cost of 6.17 per cent in 2008-09 to 5.40 per cent in 2009-10. Lower interest rates also had the effect of increasing the market value of net liabilities, leading to an unrealised loss in market value.

Interest rate swaps

At 30 June 2009, the Long-Term Debt Portfolio included 21 interest rate swaps with a notional face value of $2.425 billion. All of these swaps were allowed to mature, with the final swap maturing on 18 May 2010. No new swaps were entered into. The AOFM now has no interest rate swaps and therefore has no credit risk exposure to swap counterparties.

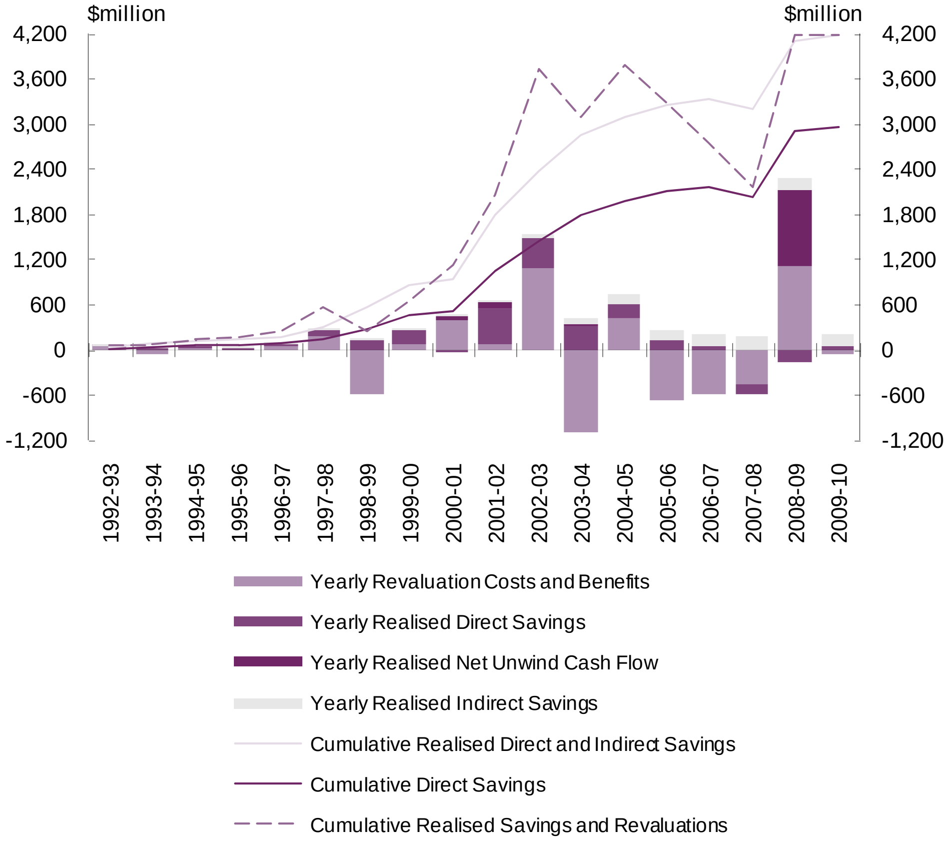
As at 18 May 2010, the AOFM swap program had generated $2.961 billion in cumulative realised direct savings for the Commonwealth since 1992 (when interest rate swaps were first executed). Of this amount, $63.6 million was generated post 30 June 2009.

These direct savings generated additional indirect savings from interest earned on the resulting higher asset balances and interest that did not need to be paid on lower liability balances.[10] As at 30 June 2010, the swap program had generated cumulative indirect savings amounting to $1.204 billion and a total cumulative benefit (that is direct and indirect savings) of $4.165 billion for the Commonwealth.

Chart 10 shows the total savings provided by swaps over the period since 1992-93. The chart shows the cumulative realised direct saving from swaps, cumulative realised savings (i.e. direct and indirect savings) and cumulative realised savings and revaluations (that is market value, direct and indirect savings). It also shows the yearly components of these aggregates.

10 Over most of the period when interest rate swaps were held, the Government held substantial short-term assets and issued debt solely to maintain the Treasury Bond market. The direct savings from the swaps therefore largely resulted in higher asset balances rather than lower debt issuance. As a result, the indirect savings came largely from the additional interest earned on these higher asset balances.

Chart 10: Total savings arising from interest rate swaps (inclusive of revaluations)



Residential mortgage-backed securities

Objective

The Australian residential mortgage-backed securities (RMBS) market provides an important source of funding for smaller mortgage lenders to compete with the major banks in lending for housing. The global financial crisis in 2007-08 reduced the liquidity of the Australian RMBS market, which in turn limited mortgage lenders' access to RMBS funding. In particular, margins on mortgage-backed bonds 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 RMBS in Australia. 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 current market dislocation. In

October 2008, the Treasurer directed the AOFM to invest up to a total of $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 $0.246 billion remaining from the initial program.

Under the Treasurer's Direction of November 2009, the aim of the RMBS Investment Program is to support competition in residential mortgage lending from a diverse range of lenders, with an additional objective of providing support for lending to small business. The latter objective is achieved through participating lenders using some of the proceeds of supported RMBS issues for lending to small business.

Achieving the objective

Developments in the Program

The allocation of the initial $8 billion was spread over three selection rounds. In each round the AOFM invited proposals from arrangers for it to participate as a cornerstone investor in primary RMBS transactions. Table 3 summarises investments under the three rounds. The third round was limited to non-ADI issuers to complete the $8 billion allocation provided for them by the Treasurer's direction.

Table 3: AOFM RMBS investment selection rounds

Selection round	Issue date	Completion date	No. of transactions	Funds invested ($m)
First round	13 October 2008	10 December 2008	4	1,996
Second round	18 December 2008	28 August 2009	13	5,386
Third round	31 August 2009	10 November 2009	3	372

Following the extension of the program in December 2009 the AOFM adjusted its approach to provide for the submission of investment proposals on a reverse enquiry basis and for serial investment, or 'pipeline', arrangements. The minimum requirements for proposals were altered to allow investments in transactions backed by a higher proportion of low documentation loans, subject to additional requirements designed to mitigate risks where low documentation loans exceed 10 per cent of the pool. This was done so as to support competition in mortgage lending through clearing warehouse facilities. The other minimum requirements[11] were not changed. These changes took account of changing market conditions and feedback from consultations with the industry.

The reverse enquiry approach was adopted to provide arrangers and issuers with more flexibility in the development of proposals and the timing of issues. Under this approach, proposals for individual deals could be submitted to the AOFM at any time rather than through

11 Detailed on pages 32 to 33 of the 2008-09 Annual Report.

a tender process. Reverse enquiry proposals are assessed against the two objectives of supporting competition in lending for housing and supporting lending to small business. This approach was expected to be most relevant to regional banks and mutuals, many of which undertake significant lending to small business. Applicants using the reverse enquiry channel are requested to indicate the extent of their support for small business lending. During 2009-10, a total of $1.01 billion was invested in six reverse enquiry transactions, each from different issuers.

The pipeline arrangement allows an issuer to undertake a series of separate RMBS issues that the AOFM will support. This approach was designed to provide lenders who are largely or wholly reliant on securitisation markets with greater funding certainty and so a greater capacity to compete in mortgage lending. A request for proposals for pipeline funding was issued on 8 December 2009 and five were accepted (from AMP Bank, FirstMac, Liberty Financial, Members Equity Bank and RESIMAC). The five arrangements provide for investment by the AOFM of up to a total of $3.4 billion. The AOFM needs to be satisfied on the proposed terms and pricing for each transaction. The arrangements are available until 15 December 2010 unless terminated earlier. By 30 June 2010, a total of $260 million had been invested in two transactions under pipeline funding arrangements.

The pricing of AOFM's investments in RMBS issues is determined in consultation with issuers after mandates have been awarded. In this, the AOFM aims to balance the objective of maintaining a competitive flow of funds for new lending to housing and small business with the objective of attracting other investors. Where the AOFM and other investors purchase the same RMBS tranche, they do so at the same price.

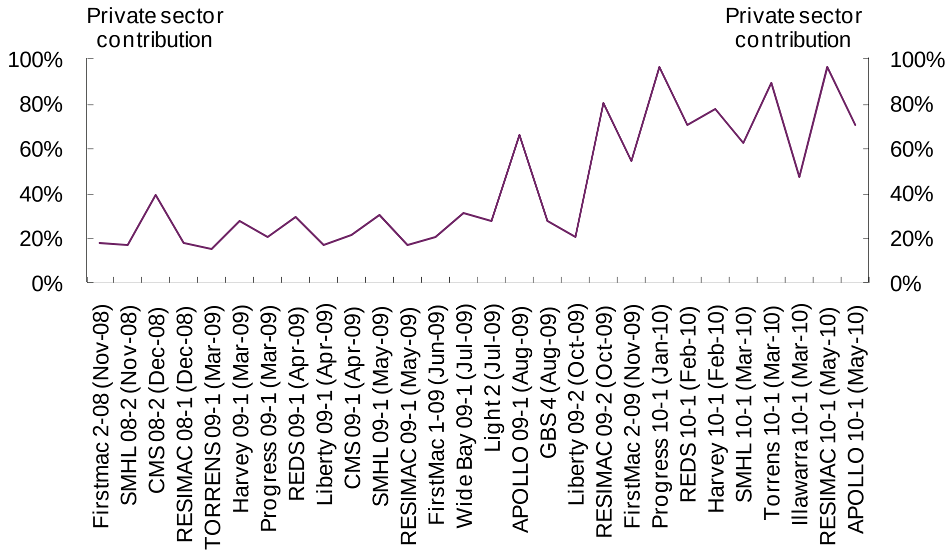
In May 2010 the AOFM adjusted its approach to investing with the aim of making RMBS a more competitive source of funding. At this time, the pricing of primary and secondary RMBS had stabilised at around 130 basis points above the one month bank bill rate for senior AAA-rated securities. The AOFM indicated it was prepared to invest at tighter levels but this was balanced with the desire to encourage continued private sector participation in AOFM supported issues. Additionally, the change in approach was designed to facilitate the creation of new structures whereby existing or potential demand from private sector investors for RMBS of a particular duration could be satisfied more effectively. One example of such a structure is the APOLLO 2010-1 transaction, where the AOFM invested in a long duration tranche so as to sponsor a shorter duration tranche in the transaction. This shorter duration tranche attracted strong demand from private sector investors and priced at the relatively tight margin of 100 basis points over the one month bank bill rate.

RMBS market conditions

Investor sentiment towards RMBS improved over the course of 2009-10 and brought an overall increase in the level of private sector participation in primary issuance.

Chart 11 shows the participation of other investors in RMBS issues supported by the AOFM since the inception of the program. Participation was around 20—30 per cent[12] until about July 2009; thereafter it trended upwards to around 70 per cent in the first half of 2010. In addition, five RMBS issues were undertaken in late 2009 without reliance on AOFM support.

Chart 11: Participation in AOFM supported RMBS issuance



The market continued to strengthen in the first quarter of 2010, when there was solid demand from other investors for six issues undertaken with AOFM support and one without. As a result of this investor demand, five of the transactions supported by the AOFM were increased in size; in two cases, the AOFM's contribution was able to be reduced significantly.

However, there was a sharp contraction in deal flow in the second quarter of 2010 due mainly to an easing in funding pressures for lenders and renewed weakness in global credit markets. The AOFM supported two RMBS transactions during the quarter. This included one backed by a pool of around 70 per cent low documentation mortgages; the AOFM was satisfied that the mortgage pool and the securities for this issue were of high credit quality. The other transaction supported by the AOFM had an innovative structure in which the AOFM supported a tranche with a longer weighted average life than for the issues it had previously supported. This was in accordance with its revised approach to pricing RMBS (as outlined above).

12 With a 20 per cent participation rate, other investors contribute 25 cents for every dollar invested by the AOFM.

Performance

By 30 June 2010, the AOFM had invested in 28 RMBS transactions, totalling $9.023 billion, sponsored by 14 issuers. Including investments from other parties, the total volume of RMBS issued with the support of the program since its inception was $17.188 billion.

The Australian RMBS market has significantly reduced in size since the beginning of the global financial crisis. Standard & Poor's data indicates that the stock of outstanding RMBS peaked at just under $170 billion in mid 2007, but fell to around $90 billion (excluding self-securitised transactions undertaken by ADIs) by June 2010. The AOFM program was crucial for the continued functioning of the primary market at this time.

The funds raised by the RMBS issues supported by the AOFM provided an important component of total lending for housing and small business over this period. Without them, 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. The broad based improvement in market conditions in RMBS markets over the past year, the substantial increase in participation by other investors and the maintenance of origination capacity of smaller financial institutions and mortgage originators reliant on securitisation suggest that the program has made a significant positive contribution towards maintaining competition in the domestic mortgage market.

The investments made under the program are also providing reasonable financial returns. Interest income in 2009-10 was $374 million, which represented an annualised return of 5.2 per cent. All the securities purchased under the program have been floating-rate notes, paying as at 30 June 2010 a weighted average margin of 131 basis points over the one month bank bill rate. In addition, capital repayments of $1.03 billion have been received.[13]

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. At the end of 2008-09 the RMBS portfolio showed an unrealised mark-to-market loss of $136 million; by the end of June 2010 this had fallen to a loss of $72 million, due to a narrowing in indicative secondary market margins over the course of the financial year.

Further information on the AOFM's investments in RMBS up to 30 June 2010 are given in Part 5 of this annual report.

13 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.

Investor relations

Objective

The AOFM has increased its investor relations activities to promote Australian Government Securities to support the increased issuance task. Additional funding for four years was provided for this purpose in the 2009-10 Budget.

Achieving the objective

An Investor Relations Unit was established in July 2009 to expand the AOFM's marketing and promotional activities. It aimed to engage with investors and financial intermediaries, including large overseas institutional investors that provide good prospects for rapid increases in investment.

Meetings held by the AOFM officials with investors during the year are summarised in Table 4. Over 100 bilateral meetings were held with overseas investors. In most cases, they were arranged with the assistance of financial intermediaries operating in the Australian market. The AOFM is grateful for their support. In addition, presentations were made to conferences with audiences totalling around 650 investors. The presentations were particularly useful in encouraging interest from a wide range of potential investors, many of whom may have had limited prior contact with and knowledge of Commonwealth Government Securities. The unit also assisted with meetings by the Treasurer in London and New York and one by the Assistant Treasurer in the Middle East.

Informational material was prepared and provided to specialised journals serving institutional investors. This included *Finance Asia*'s annual Australian Supplement where the AOFM contributed an article on Australian Government debt. The magazine has a readership of over 20,000 predominantly located in Asia.

Neil Hyden, CEO, keynote speaker at the Commonwealth Government Securities event in the Australian Pavilion, Shanghai Expo (2 June 2010).

Table 4: Investor relations activities in 2009-10

Date	Event/Activity
September 2009	Euromoney Conference (London): keynote presentation to 150 investors Kanga News Roundtable discussion (London): 20 participants Other European bilateral meetings: 25
October 2009	CBA Fixed Income Conference (Sydney): presentation
November 2009	South East Asian investor meetings: 14 Nomura Fixed Income Conference (Tokyo): presentation to 20-25 investor institutions (40 investors) Other Japanese meetings: 4
December 2009	Sydney investor meetings: 4
February 2010	Asset Allocation Conference (Sydney): roundtable discussion facilitated by CEO
March 2010	US investor meetings: 27 HSBC AAA Investor Conference (Paris): presentations to around 30 investors
May 2010	Sydney & Melbourne superannuation and investment consultant meetings: 6 institutions Presentation to the Australian Business Economist luncheon (Sydney) to 120 investors Euromoney Conference (Hong Kong): presentation to 150 investors North Asia investor meetings: 17
June 2010	Shanghai World Expo presentation: 21 potential investors, 10 bond salespersons/ financial institution executives UBS Reserve Managers Conference (Switzerland): presentation to 70 investors (mainly central banks and sovereign wealth funds) Asia Money Awards (Sydney): keynote speech to 100 financial market participants

In summary:	
Industry conferences/events in which AOFM presented	10 events
Total audience reach (approximately)	650 investors
Individual investor meetings conducted	107 meetings
Cities visited	Europe (11), North America (4), North Asia (6), South East Asia (3) and Australia (2)
AOFM staff in attendence	CEO, Head of Investor Relations, Director of Financial Risk, Head of Treasury Services
Banks used for investor meetings	ANZ, Citibank, Deutsche, HSBC, Nomura, RBC, RBS, Societe Generale,UBS, Westpac
Supporting the Minister	Treasurer 2 presentations (London, New York), Assistant Treasurer 2 bilaterals (Middle East)

Public Register of Government Borrowing

The *Guarantee of State and Territory Borrowing Appropriation Act 2009* requires the AOFM to maintain and publish a quarterly register that records the beneficial ownership by country of all securities on issue by the Commonwealth and any Commonwealth guaranteed issuance by the

States or Territories. The register was published on the AOFM's website on 24 May 2010. It shows monthly data commencing from December 2009 and will be updated quarterly.

The Act does not make any provision to require beneficial owners of securities or persons holding securities on their behalf to provide data on these holdings to the AOFM. The AOFM has therefore sought information on a voluntary basis. The New South Wales and Queensland Treasury Corporations, and the Australian Securities Exchange, have cooperated with the AOFM in the compilation of the register, subject to restrictions on the publication of data that would allow the identification of individual holdings. We are grateful for their assistance.

However the Australian Custodial Services Association advised the AOFM that, because of their fiduciary and contractual obligations to their clients, its members could not provide client information to the AOFM unless there was a clear legal or regulatory compulsion to do so. Accordingly the AOFM has not been able to obtain information from Australian nominee and custodial firms. These firms held around 62.3 per cent of CGS and Commonwealth guaranteed State securities as at 30 June 2010. The absence of this information limits the usefulness of the register.[14]

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. The current system, Avantgard Quantum/QRisk, was installed in 2002 with a five year licence, subsequently extended until April 2012. During the year the AOFM reviewed the options for a new contract.

A consultant was appointed to assist in identifying possible systems through an informal market scan. This confirmed that there are several systems that could potentially meet the AOFM's business needs, including some that could provide enhanced functionality, particularly in cost forecasting, limits management and portfolio reporting. The estimated capital and recurrent costs of ownership of most of these systems were concluded to be within the AOFM's budgetary constraints. However, significant further due diligence would be necessary to reach a definitive assessment on the merits of each system.

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14 The Australian Bureau of Statistics publishes quarterly data on non-resident portfolio investment in debt securities issued by the Australian Government and State and Territory governments. This does not include information on holdings by country of residence. The Bureau has power under the *Census and Statistics Act 1905* to require the provision of information.

In the light of these conclusions, the AOFM decided to conduct an open market testing procurement process and in June 2010 it sought expressions of interest via AusTender (the Government's online tendering system). It also wrote to 29 treasury system vendors, both domestically and overseas, informing them of the process. Over 10 responses were received and are currently being evaluated. It is expected that a short-list will be finalised by the end of September 2010. The vendors on the short-list will then be invited to participate in further selection processes, including a select tender, system demonstrations and proof-of-concept testing. These selection processes are expected to be completed in the first half of the 2011 calendar year. The implementation of a replacement system, if that were the outcome, would be a large task that could take up to three years. The AOFM has therefore negotiated an extension of its licence for the existing system to April 2014.

Virtual servers

The AOFM has an established technology platform that includes integrated services for the delivery of treasury management and market data. During the year server hardware was upgraded and virtualisation was implemented. The virtualised environment has improved the efficiency and availability of IT resources and is contributing towards the objectives of the Australian Government ICT Sustainability Plan.

Electronic recordkeeping

Over the past few years the AOFM has worked to improve its recordkeeping framework. This has included the development of recordkeeping policies and procedures, creation of a recordkeeping taxonomy, establishment of disposal authorities under the *Archives Act 1983*, staff training and the introduction of electronic recordkeeping.

Until recently the AOFM's recordkeeping was entirely paper-based. This required documents that originated electronically to be printed to paper. An increasing percentage of business documents are now being handled and stored electronically. This has improved efficiency, facilitated the collection of records and ensured that they are more readily accessible. Record handling practices are being monitored to maintain these gains and identify further improvements.

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 acceptable levels. It maintains a culture of prudence and 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 2009-10 included:

- internal audits of controls over settlements and the management of investments, and the methodology and documentation for fraud controls;
- completion of the Certificate of Compliance on the AOFM's compliance with the financial management framework under the *Financial Management and Accountability Act 1997*. No instances of non-compliance were identified in 2009-10; 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 arising from its management of its portfolio of debt and financial assets. In 2009-10, it settled around $51.3 billion of payments of interest, principal and redemptions on Commonwealth Government Securities and around $360.9 billion in financial asset acquisitions, including term deposits with the Reserve Bank of Australia, money market securities and fixed interest securities. The AOFM also ensures that administered receipts are settled promptly and correctly by its transaction counterparties.

In 2009-10, the AOFM was not late in settling any payment obligations. There were no instances where compensation was sought from a counterparty because it failed to settle a payment obligation in line with its contractual obligations.

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. It seconds a staff member 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 Port Moresby in November 2009 to discuss their experience with debt management over the year and the development of management capabilities.

During the year the AOFM also hosted visits by officials from Indonesia, Papua New Guinea, the Solomon Islands, Sri Lanka and Vietnam.

Agency financial performance

The AOFM recorded an operating deficit on agency activities of $1.55 million for 2009-10 financial year, comprising total revenue of $13.78 million and expenses of $15.33 million. The deficit in 2009-10 was due to the fees associated with the syndicated issuance of Treasury Indexed Bonds being met from the agency's operating funds. The AOFM obtained approval to budget for an operating loss of up to $5 million from the Finance Minister on 25 September 2009. On previous occasions when bonds have been issued by syndication, the fees have been met under standing appropriations in the relevant annual Loans Acts. However, when the *Commonwealth Inscribed Stock Act 1911* was amended in 2008 to provide ongoing borrowing authority, no provision was made for borrowing costs.

As at 30 June 2010, the AOFM was in a sound net worth and liquidity position, reporting net assets of $12.65 million, represented by assets of $14.70 million and liabilities of $2.05 million.

As at 30 June 2010, the AOFM had cash and unspent appropriations totalling $13.51 million. These funds are held to settle liabilities as and when they fall due and for future asset replacements and improvements.

During 2009-10, the AOFM returned $2.18 million to the Budget representing unspent depreciation funding. With the introduction of the 'net cash appropriation framework' from 1 July 2010 agencies were required to return unused depreciation funding as at 30 June 2010 that had accumulated since the introduction of accrual budgeting in 1999-2000.

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. The Secretary approves detailed debt management and investment policies, sets operational limits and addresses any breaches of 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 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 regularly to the Treasurer on its 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 2010 were:

- Dr Ken Henry AC, Secretary to the Treasury (Chair);
- Tony Cole AO, Executive Director of Mercer (Australia) Pty. Ltd., Director of the Northern Territory Treasury Corporation and Chairman of the Melbourne Institute Advisory Board;
- Neil Hyden, Chief Executive Officer, AOFM;
- David Martine, Deputy Secretary, Budget Group, Department of Finance and Deregulation;
- Greg Maughan, Consultant;
- Nigel Ray, Executive Director, Fiscal Group, Treasury; and
- Peter Warne, Non-Executive Director of Next Financial Limited and the Securities Industry Research Centre of Asia Pacific. Chairman of the Australian Leisure &

Entertainment Property Group and St Andrews Cathedral School Foundation Limited. He is also a Director of ASX Limited and subsidiary companies, Macquarie Group Limited, WHK Group Ltd, Capital Markets Cooperative Research Centre Limited and a number of other unlisted companies.

The Advisory Board met on three occasions in 2009-10.

Senior management committees

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

Executive Committee

The 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, the Head of Compliance and Reporting, the Chief Finance Officer, the Director of Financial Risk, the Head of Treasury Services and the Head of Investor Relations.

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 Compliance and Reporting, the Head of Investor Relations and the Head of Treasury Services, 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 members of the Executive Committee 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 Chief Finance Officer, the Head of Compliance and Reporting 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 Compliance and Reporting, the Director of Financial Risk, the Head of Investor Relations, the Chief Finance Officer and the Head of Treasury Services, together with other senior staff with relevant functional responsibilities.

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;
- 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 Chief Executive Officer 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; and
- a fraud risk assessment and Fraud Control Plan which comply with the Commonwealth Fraud Control Guidelines and include appropriate fraud prevention, detection, investigation and reporting procedures.

Audit

Audit Committee

The AOFM Audit Committee is a forum for the review of audit and related issues. It endorses the AOFM's internal audit plan, reviews audit reports and advises on action to be taken on matters raised in them, advises on the preparation and review of the AOFM's financial statements, reviews operational risks and oversees the development and implementation of fraud controls and awareness training.

The Audit Committee membership at 30 June 2010 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;

- Katrina Di Marco, Manager, Government Investment, Risk and Debt Policy Unit, the Treasury; and
- Andrew Johnson, the Head of Compliance and Reporting, AOFM.

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

The Committee met on four occasions during 2009-10.

Internal auditor

In addition to the regular annual audit review of internal operational controls and information technology controls, the internal auditor, PricewaterhouseCoopers, completed the following reviews in 2009-10:

- a review of the AOFM's settlements and investment management activities, which found that the AOFM has a robust control environment;
- a review of the Quantum upgrade project found that the AOFM has a robust project governance and management process in place over the Quantum upgrade project with no significant observations noted;
- a review of the methodology and documentation associated with the Fraud Control Plan, including the risk register, fraud risk assessment and fraud control plan found that the AOFM has a robust fraud control environment; and
- a review of the AOFM's yield curve methodology found the AOFM's curve methodology to be appropriate. Minor differences in valuations were noted, but were considered not material.

Australian National Audit Office reports

The ANAO's annual report on the *Interim Phase of the Audit of Financial Statements of General Government Sector Entities for the Year Ending 30 June 2010* identified no significant or moderate audit issues. Based on the audit work performed, it concluded that internal controls were operating satisfactorily to provide reasonable assurance that the Office could produce financial statements free of material misstatement.

During 2009-10, 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 staff are immobilised. 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, the range of AOFM IT applications and systems accessible at the business continuity site was extended. Business continuity plans were also updated and tested.

Judicial decisions

In 2009-10, 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 aims to meet its workforce needs primarily through the recruitment of recent graduates and their subsequent development through on-the-job experience, mentoring, assistance with further academic studies and in-house training. This approach is designed to maintain the core professional strength of the AOFM on a continuing basis. It allows people with strong academic achievements to develop specialised skills and experience related to the AOFM's work requirements and to expand their knowledge of financial markets and debt management, and also of public policy and administration.

Other staff are recruited to meet specific staffing needs, particularly for positions that require specialised skills and experience that are not currently available within the Office.

The Office provides challenging and interesting work in a professional work environment with opportunities for learning and career development. A broad-banded classification structure allows staff to advance between work levels within classification grades subject to work availability and performance without formal competitive selection processes. Promotions across grades are made via merit selection. This strategy has been successful in attracting and retaining highly qualified professional staff. The retention rate for 2009-10 was 89 per cent, with an average of 83 per cent over the previous five years.

Training and development

Eighty-three per cent of AOFM staff have degree qualifications, with 17 per cent holding higher degrees and 22 per cent double degrees. Thirty-one per cent have professional qualifications. Staff are encouraged to participate in training and development activities to develop their work skills and enhance their career prospects. Learning is fostered through on-the-job training, external courses, conferences, workshops and seminars.

Over the last five financial years, an average of 72 per cent of staff have participated in training or development supported by the Office. During this period, training averaged 4.3 days per full-time equivalent staff member (FTE) per year and the direct costs of training (paid to external parties) averaged $2,752 per FTE per year. In 2009-10, 61 per cent of employees participated in training, 5.6 days per FTE were invested in skill development and $3,250 per FTE was paid to external providers. Payments for training and development activity over the year amounted to 4.6 per cent of direct salary costs.

The AOFM workforce

As at 30 June 2010, the AOFM employed 34.2 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 2009 and 2010

	Ongoing				Non-ongoing				
	Full-time		Part-time		Full-time		Part-time		
Classification	**Male**	**Female**	**Male**	**Female**	**Male**	**Female**	**Male**	**Female**	**Total**
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**
2009									
AOFM1	0	2	0	0	0	0	0	0	**2**
AOFM2	16	6	0	2	1	0	0	0	**25**
AOFM3	4	1	0	0	0	0	0	0	**5**
AOFM4	1	0	0	0	0	0	0	0	**1**
CEO	1	0	0	0	0	0	0	0	**1**
Total	**22**	**9**	**0**	**2**	**1**	**0**	**0**	**0**	**34**

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

Two staff were located overseas during the year to support capacity building in sovereign debt management in Papua New Guinea and the Solomon Islands under the Strongim Gavman Program and the Regional Assistance Mission to the Solomon Islands respectively.

Changes to senior management

The AOFM employed Ian Clunies-Ross as Head of Investor Relations in July 2009.

Other staffing changes

Five ongoing employees were recruited during 2009-10. The new Investor Relations Unit took two of these, two were employed in the Compliance Unit and one in the Finance team. There were five staff departures during the year. For ongoing employees, departures represented 13.9 per cent of average staffing levels in 2009-10 (3.4 per cent in 2008-09).

Employment arrangements

During the year the AOFM negotiated an enterprise agreement with all non-SES staff which was approved by Fair Work Australia. The *AOFM Enterprise Agreement 2010-2011* came into effect on 2 June 2010. All Australian Workplace Agreements, common law contracts and Section 24(1) determinations under the *Public Service Act 1999* for non-SES staff ceased operating on that date. Employment terms and conditions are now based on the enterprise agreement, with remuneration outcomes based on job classification and performance.

The CEO is employed under an Australian Workplace Agreement with the Treasury.

Remuneration

Staff remuneration (Table 2) is now set under the *AOFM Enterprise Agreement*. In negotiating the Agreement, management follows the Government's policy requirements relating to the remuneration. It also takes account of market rates for conservative financial services organisations using data provided by the Financial Institutions Remuneration Group. This data covers 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 2010	
Classification	Base rate $	Grade rate $
AOFM1	39,602	65,134
AOFM2	61,712	126,491
AOFM3	145,736	182,170
AOFM4	196,010	245,012

Remuneration within the range for the classification depends on individual performance ratings. Performance appraisals assess outputs achieved and behaviours in producing those outputs. However, 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 posture and flexibility, yoga, Tai Chi, Pilates and aerobics classes. Flu vaccinations, health assessments, and health information were also provided in 2009-10. To prevent injuries in the workplace and to enhance the safety of staff, workplace assessments were conducted for all new starters. Counselling and other support is available under an Employee Assistance Program provided by Davidson Trahaire.

There were no compensable injury claims in 2009-10 and no accidents, injuries or dangerous occurrences were reported. 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.

Australian Government Disability Strategy

The AOFM follows *The Treasury Workplace Diversity Program 2009-2012* and *The Treasury Disability Action Plan 2009-2012* in line with the Australian Government Disability Strategy to help eliminate, as far as possible, discrimination on the grounds of disability.

Consultants

During 2009-10, the AOFM entered into four new consultancy contracts. In addition, two ongoing consultancy contracts were active during the year. New and ongoing consultancy contracts over the last three years, and expenditure on them, are summarised in Table 3. Details of consultancy contracts of $10,000 or more let during 2009-10 are provided in Table 4.

Table 3: Consultancy contracts

	2007-08	2008-09	2009-10
Number of consultancy contracts			
New contracts	8	5	4
Ongoing contracts	2	2	2
Expenditure (including GST)			
New contracts	$69,885	$20,994	$90,801
Ongoing contracts	$130,289	$131,336	$119,276

Table 4: Consultancy contracts of $10,000 or more let during 2009-10

Consultant name	Description	Price	Selection process(a)	Justification(b)
Australian Government Solictor	Legal Advice	$19,782	Direct sourcing	B
Infact Consulting	Advice on Treasury systems	$79,900	Direct sourcing	B

(a) Direct sourcing — one supplier (or a limited number of suppliers) is approached directly 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.

Assets management

The physical assets of the AOFM are managed in accordance with policies and procedures set out in the AOFM's Chief Executive Instructions. The assets are predominantly computers, office equipment and leasehold improvements.

Purchasing

The AOFM's policy and procedures on purchasing goods and services comply with legislative requirements and Government policy, in particular the requirements in the Commonwealth Procurement Guidelines (December 2008).

ANAO access clauses and exempt contracts

Six contracts were let during the reporting period that did not provide for the Auditor-General to have access to the contractor's premises. These contracts were for the syndicated issuance of $4 billion of Australian Government debt in September 2009. The AOFM appointed Deutsche Bank AG Sydney Branch, RBS Group (Australia) Pty Limited and UBS AG Australia Branch as Joint-Lead Managers for the issue. Citigroup Global Markets Australia Pty Limited, JP Morgan Australia Limited and Westpac Banking Corporation Limited were appointed as Co-Managers.

ANAO access clauses were not included in the contracts as the AOFM maintains all relevant information in relation to the issuance. Under these contracts, $6.6 million (including GST) was paid.

No contract in excess of $10,000 (including GST) 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*.

PART 4: FINANCIAL STATEMENTS

Australian National
Audit Office

INDEPENDENT AUDITOR'S REPORT

To the Treasurer

Scope

I have audited the accompanying financial statements of Australian Office of Financial Management for the year ended 30 June 2010, which comprise: the 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, including a Summary of significant accounting policies.

The Responsibility of the Chief Executive for the Financial Statements

The Australian Office of Financial Management's Chief Executive is responsible for the preparation and fair presentation of the financial statements in accordance with the Finance Minister's Orders made under the *Financial Management and Accountability Act 1997*, including the Australian Accounting Standards (which include the Australian Accounting Interpretations). This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

My responsibility is to express an opinion on the financial statements based on my audit. I have conducted my audit in accordance with the Australian National Audit Office Auditing Standards, which incorporate the Australian Auditing Standards. These auditing standards require that I comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance 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 and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for

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the purpose of expressing an opinion on the effectiveness of the Australian Office of Financial Management's internal control. An audit also includes evaluating the appropriateness of 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.

Auditor's 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 2010 and its financial performance and cash flows for the year then ended.

Australian National Audit Office

Warren J Cochrane
Group Executive Director
Assurance Audit Services Group

Delegate of the Auditor-General

Canberra
27 August 2010

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 2010 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
N Hyden	P Raccosta
Chief Executive Officer	Chief Finance Officer
27 August 2010	27 August 2010

Statement of comprehensive income

for the period ended 30 June 2010

	Notes	2010 $'000	2009 $'000
EXPENSES			
Employee benefits	4A	**5,243**	4,395
Supplier expenses	4B	**9,788**	3,199
Depreciation and amortisation	4C	**296**	281
Write-down and impairment of assets	4D	**1**	-
Total expenses		**15,328**	7,875
OWN-SOURCE INCOME			
Revenue:			
Sale of goods and rendering of services	5A	**532**	806
Other revenue	5B	**682**	514
		1,214	1,320
Gains:			
Reversal of previous write-downs	5C	**-**	59
		-	59
Total own-source income		**1,214**	1,379
Net cost of services		**14,114**	6,496
APPROPRIATION FUNDING			
Revenue from government	5D	**12,569**	8,467
Total appropriation funding		**12,569**	8,467
Comprehensive income (loss)		**(1,545)**	1,971

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

Balance sheet

as at 30 June 2010

	Notes	2010 $'000	2009 $'000
ASSETS			
Financial assets:			
Cash and cash equivalents		**90**	63
Receivables	6A	**13,591**	16,887
		13,681	16,950
Non-financial assets:			
Infrastructure, plant and equipment	7A,7C	**626**	555
Intangibles	7B,7C	**294**	377
Other non-financial assets	7D	**98**	90
		1,018	1,022
Total assets		**14,699**	17,972
LIABILITIES			
Payables:			
Supplier payables	8A	**311**	205
Other payables	8B	**109**	88
		420	293
Provisions:			
Employee provisions	9A	**1,499**	1,182
Other provisions	9B	**130**	125
		1,629	1,307
Total liabilities		**2,049**	1,600
Net assets		**12,650**	16,372
EQUITY(a)			
Retained surplus		**11,404**	12,949
Contributed equity		**1,246**	3,423
Total equity		**12,650**	16,372

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 2010

	2010 $'000	2009 $'000
RETAINED SURPLUS		
Opening balance	**12,949**	10,978
Changes for period:		
Comprehensive income (loss)	**(1,545)**	1,971
Total retained surplus	**11,404**	12,949
CONTRIBUTED EQUITY		
Opening balance	**3,423**	3,423
Changes for period:		
Distributions to owners:		
Return of capital - unused depreciation funding	**(2,177)**	-
Total contributed equity	**1,246**	3,423
Total equity	**12,650**	16,372

Statement of cash flows

for the period ended 30 June 2010

	Notes	2010 $'000	2009 $'000
OPERATING ACTIVITIES			
Cash received:			
Ordinary appropriations		**14,616**	5,790
GST received		**500**	51
Goods and services		**918**	1,326
		16,034	7,167
Cash used:			
Employees		**4,912**	4,218
Suppliers		**9,940**	2,889
GST paid		**7**	40
Transfers to Official Public Account(a)		**918**	-
		15,777	7,147
Net cash from (used by) operating activities	10	**257**	20
INVESTING ACTIVITIES			
Cash used:			
Purchase of property, plant and equipment		**230**	116
		230	116
Net cash from (used by) investing activities		**(230)**	(116)
Net increase (decrease) in cash held		**27**	(96)
Plus cash held at the beginning of the reporting period		**63**	159
Cash at the end of the reporting period		**90**	63

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

(a) Commencing in 2009-10 all non-appropriation receipts are required to be returned to the Official Public Account. When these receipts are subsequently drawn down by the AOFM, they are recorded as ordinary appropriations.

Schedule of commitments

as at 30 June 2010

	2010 $'000	2009 $'000
BY TYPE		
Commitments payable:		
Operating leases(a)	**1,924**	2,186
Other commitments(b)	**2,722**	2,184
	4,646	4,370
Commitments receivable:		
GST recoverable on commitments	**(46)**	(44)
	(46)	(44)
Net commitments by type	**4,600**	4,326
BY MATURITY		
Commitments payable:		
Operating leases:		
One year or less	**351**	333
From one to five years	**1,398**	1,334
Over five years	**175**	519
	1,924	2,186
Other commitments:		
One year or less	**1,791**	1,693
From one to five years	**930**	490
Over five years	**1**	1
	2,722	2,184
Commitments receivable:		
GST recoverable on commitments:		
One year or less	**(43)**	(40)
From one to five years	**(3)**	(4)
Over five years	**-**	-
	(46)	(44)
Net commitments by maturity	**4,600**	4,326

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 2010

	Notes	2010 $'000	2009 $'000
BY ASSET TYPE			
Leasehold improvements	7C	**17**	-
Computers, plant and equipment	7C	**218**	39
Computer software	7C	**50**	77
Total asset additions by asset type		**285**	116
BY FUNDING SOURCE			
Funded from ordinary appropriations:			
Leasehold improvements		**17**	-
Computers, plant and equipment		**218**	39
Computer software		**50**	77
		285	116
Funded from equity appropriations:			
Leasehold improvements		**-**	-
Computers, plant and equipment		**-**	-
Computer software		**-**	-
		-	-
Total asset additions by funding source		**285**	116

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 2010

	Notes	2010 $'000	2009 $'000
Income before re-measurements			
Interest revenue	16A	**1,436,315**	2,527,570
Other revenue	16B	**281**	3,328
Total income before re-measurements		**1,436,596**	2,530,898
Expenses before re-measurements			
Grants	17A	**28**	28
Interest expense	17B	**6,348,013**	4,962,327
Total expenses before re-measurements		**6,348,041**	4,962,355
Gains (losses) before re-measurements			
Net foreign exchange gains (losses)	18A	**334**	(1,049)
Net gains (losses) on sale of financial instruments	18B	**(52,587)**	1,034,245
Total gains (losses) before re-measurements		**(52,253)**	1,033,196
Operating result before re-measurements		**(4,963,698)**	(1,398,261)
Re-measurements			
Net market revaluation gains (losses)	19	**(2,772,676)**	(232,211)
Total re-measurements		**(2,772,676)**	(232,211)
Comprehensive income (loss)		**(7,736,374)**	(1,630,472)

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 2010

	Notes	2010 $'000	2009 $'000
ASSETS			
Financial assets:			
Cash and cash equivalents		**622**	622
Investments (under FMA section 39)(a)	20A	**30,710,034**	35,486,265
Receivables	20B	**2,694,170**	2,833,391
Accrued revenue	20C	**478**	490
Total administered assets		**33,405,304**	38,320,768
LIABILITIES			
Interest bearing liabilities:			
Commonwealth Government Securities	21A	**157,375,520**	107,313,801
		157,375,520	107,313,801
Payables:			
Accrued expenses	21B	**103**	104
		103	104
Total liabilities		**157,375,623**	107,313,905
Net assets	22	**(123,970,319)**	(68,993,137)

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 2010

	2010 $'000	2009 $'000
OPERATING ACTIVITIES		
Cash received:		
Interest receipts(a)	**1,385,924**	1,573,173
Other(b)	**281**	1,034,620
	1,386,205	2,607,793
Cash used:		
Interest payments(a)	**6,620,495**	3,755,241
	6,620,495	3,755,241
Net cash from (used by) operating activities	**(5,234,290)**	(1,147,448)
INVESTING ACTIVITIES		
Cash received:		
Capital proceeds from deposits	**353,350,000**	375,350,000
Capital proceeds from fixed interest securities	**2,812,038**	3,195,972
Capital proceeds from discount securities	**11,370,527**	11,507,500
Capital proceeds from residential mortgage-backed securities	**924,455**	179,281
Repayments from advances and loans	**93,516**	91,260
	368,550,536	390,324,013
Cash used:		
Acquisition of deposits	**341,800,000**	372,800,000
Acquisition of fixed interest securities	**4,372,381**	5,247,136
Acquisition of discount securities	**14,608,490**	12,503,360
Acquisition of residential mortgage-backed securities	**2,819,540**	6,203,420
	363,600,411	396,753,916
Net cash from (used by) investing activities	**4,950,125**	(6,429,903)
FINANCING ACTIVITIES		
Cash received:		
Capital proceeds from borrowings	**91,464,035**	54,520,821
Receipt of collateral	**-**	101,000
Other receipts	**85**	86
	91,464,120	54,621,907
Cash used:		
Repayment of borrowings(c)	**43,939,148**	7,085,282
Return of collateral	**-**	101,000
	43,939,148	7,186,282
Net cash from (used by) financing activities	**47,524,972**	47,435,625

(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 2009-10 were $63.590 million ($55.771 million for 2008-09), whilst aggregate swap interest receipts for 2009-10 were $127.541 million ($1,102.751 million for 2008-09). Net swap interest payments for 2009-10 were $ nil million ($219.230 million for 2008-09), whilst aggregate swap interest payments for 2009-10 were $63.951 million ($1,266.210 million for 2008-09).

(b) 2008-09 figure includes $1,031.292 million from termination of interest rate swaps.

(c) 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 2010

	2010 $'000	2009 $'000
Net increase (decrease) in cash held	**47,240,807**	39,858,274
Plus cash held at the beginning of the reporting period	**622**	622
Cash from Official Public Account:		
Appropriations	**414,967,129**	405,936,466
Special accounts	**183**	38
	414,967,312	405,936,504
Cash to Official Public Account:		
Receipts	**(462,208,034)**	(445,794,692)
Special accounts	**(85)**	(86)
	(462,208,119)	(445,794,778)
Cash at the end of the reporting period	**622**	622

Schedule of administered items (continued)
Administered commitments
as at 30 June 2010

	2010 $'000	2009 $'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 2010 the AOFM had open transactions under its securities lending facility. The repurchase price of Treasury Bonds sold by the Australian Government to other parties under the facility as at 30 June 2010 was $90,339,832 (face value of $83,460,000). The sale price of securities acquired by the Australian Government from other parties as collateral under the facility as at 30 June 2010 was $90,349,604 (face value of $89,645,000). 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 2010

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 2009 to 30 June 2010. 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) (being the *Financial Management and Accountability Orders (Financial Statements for Reporting Periods Ending on or after 1 July 2009)* 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 departmental 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.

On 6 August 2009 the Finance Minister approved a new outcome statement for the AOFM. The outcome statement was amended as part of Operation Sunlight (the government's reform agenda to improve openness and transparency of public sector financial management and governance).

The AOFM's new outcome statement is:

The advancement of macroeconomic growth and stability, and the effective operation of financial markets, through issuing debt, investing in financial assets and managing debt, investments and cash for the Australian Government.

The AOFM's previous outcome statement was:

To enhance the Commonwealth's capacity to manage its net debt portfolio, offering the prospect of savings in debt servicing costs and an improvement in the net worth of the Commonwealth over time.

The change was made to recognise the broad impact of government debt and financial assets on the operation of the Australian economy and financial markets, as well as in funding government activities.

1.2 Significant accounting estimates and judgments

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.

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

From 2009-10, AASB 7 *Financial Instruments: Disclosures* requires reporting entities to disclose the methods used to determine fair value for financial assets and financial liabilities by assigning a three-level hierarchy to those valuations. For those instruments at fair value, the hierarchy ranks the quality of significant inputs used to determine fair value. The AOFM has applied these new disclosure requirements at Note 24H.

Other amendments to Australian Accounting Standards that became effective in 2009-10 have not impacted on the AOFM.

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

The IASB is in the process of progressively replacing IAS 39 *Financial Instruments: Recognition and Measurement* (the Australian equivalent standard is AASB 139) over five phases. The first phase has been completed with the issuance of IFRS 9 *Financial Instruments* in November 2009. The Australian equivalent AASB 9 was issued in December 2009 and becomes operative for reporting periods beginning on or after 1 January 2013 (1 July 2013 for the AOFM). AASB 9 deals with the classification and measurement of financial assets. Under AASB 9 financial assets are to be classified and measured on the basis of the entity's business model for managing those assets. Where an asset is held to collect contractual cash flows, it shall be measured at amortised cost (after initial recognition at fair value). The sale of assets for portfolio management, credit or liquidity reasons would not jeopardise this classification. Where an asset is held for the purposes of trading to earn capital profits, it shall be measured at fair value through profit or loss. Derivatives remain at fair value through profit or loss.

The classification rules in AASB 9 are a simplification of the rules contained in AASB 139. There are fewer options for a reporting entity to designate its own classification and measurement to its financial assets. From an initial assessment the AOFM believes that, on the basis of its current business model, its non-derivative financial assets will need to be reclassified and measured at amortised cost under the new standard. However, a more definitive assessment will be made as further phases of the replacement project are completed. Currently all derivative and non-derivative financial assets of the AOFM are classified and measured at fair value through profit or loss, with the exception of loans to the States and the Northern Territory.

In accordance with section 11 of the FMOs, the AOFM is not permitted to adopt a new Australian Accounting Standard or AASB Interpretation earlier than its effective date of application without the approval of the Chief Executive of the Department of Finance and Deregulation. The AOFM has not adopted early a new Australian Accounting Standard or AASB Interpretation.

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 government, including:

- computers, plant and equipment;
- liabilities for employee entitlements;
- revenue deemed appropriated under the *Financial Management and Accountability Act 1997*; and
- employee expenses and other administrative expenses; including debt issuance costs such as registry fees, syndication fees and legal 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 support lending to small business.

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. On 29 June 2010 the Minister for Finance and Deregulation made a determination to reduce the AOFM's 2009-10 departmental appropriation under *Appropriation Act (No.1) 2009-10* by $69,000. This reduction stems from the government's decision to set savings targets for each portfolio.

Appropriation receivables are recognised (at their nominal amounts) for output appropriations that are undrawn by the AOFM and have not lapsed.

From 1 July 2010, the appropriation framework has changed. Under the new 'net cash appropriation framework' 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.

(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.

The AOFM was not appropriated any capital injections from government for 2009-10 (nil for 2008-09). From 1 July 2010, under the new 'net cash appropriation framework' the AOFM will be appropriated by capital injections to meet expenditures for the replacement of infrastructure, plant and equipment and intangibles.

(b) Distributions to owners

Distributions to owners are debited to Contributed Equity in the Balance Sheet unless the distributions are in the nature of a dividend. Dividends are debited to Retained Surplus in the Balance Sheet.

The AOFM made a distribution to owners of $2.177 million during 2009-10 (nil for 2008-09). With the introduction of the new 'net cash appropriation framework' from 1 July 2010 agencies were required to return to the budget unused depreciation funding as at 30 June 2010 that was accumulated since the introduction of accrual budgeting in 1999-2000. On 13 May 2010 the Minister for Finance and Deregulation made a determination to reduce the AOFM's departmental appropriations previously appropriated by the Parliament in relation to depreciation that had not been spent.

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 as at 30 June 2010 (30 June 2009) 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 2010 (1 July 2009).

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 liability is reported by the Department of Finance and Deregulation as an administered item.

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 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 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 three 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 then in progress.

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	**2010**	2009
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 (2008-09: 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.

AASB 101 encourages reporting entities to adopt a presentation for its 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 on sale, 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 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 currently 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, debt issued by foreign government and supranational institutions 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 what would otherwise be required and investing the proceeds in highly liquid assets until required), to support competition in the residential mortgage market and to support lending to small business.

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 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 Administered Re-measurements in the Schedule of the 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 2010 approximately $10 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* ($10 million as at 30 June 2009). 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 $3,068 million as at 30 June 2010 ($3,162 million as at 30 June 2009).

Loans and receivables assets 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. Commonwealth Government Securities 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 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 Administered 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.

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, the AOFM's domestic interest rate swaps must be classified at fair value through profit or loss. Refer to Note 2 for details on the AOFM's use of interest rate swaps.

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 Administered 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 and foreign government and supranational institutions debt investments are based on observable market quotes for each issue.

The fair value of term deposit investments with the RBA and Treasury Notes 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 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.

(b) Derivative financial instruments

The net fair value of domestic interest rate swaps is based on discounted cash flows using a zero coupon curve valuation methodology created from observable money market and swap rates as at the end of the financial year.

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 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 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. 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 (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 Treasury Bonds 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 Treasury Bonds loaned to bond market participants.

In 2009-10 the securities lending facility was widened to enable borrowing of Treasury Indexed Bonds.

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) 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 fixed interest 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. The AOFM also significantly increased debt issuance and intensified its promotional activities with investors (including overseas investors) and intermediaries.

As a means of diversifying its funding sources, in September 2009, the AOFM resumed issuance of Treasury Indexed Bonds.

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 state government bonds with maturities before 30 June 2011. 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 financial assets

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 (bringing the program to $16 billion) subject to market conditions. An additional objective of the extended program is 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 making these investments the AOFM has continually adjusted its approach to changing market conditions. In December 2009 the AOFM moved away from a request-for-proposals approach to one where issuers could move more flexibly and with greater funding certainty to arrange new issuance activity. Issuers can approach the AOFM at any time to participate in an investment proposal via a reverse enquiry process. In addition, after the conduct of an invitation and evaluation process the AOFM selected five issuers and subject to certain conditions, agreed to invest in a series of separate RMBS issues proposed by each issuer up to 15 December 2010. In more recent times the AOFM has accepted pricing tighter than secondary market levels where appropriate and consistent with program objectives.

During the financial year the AOFM sold $73.790 million (face value) of RMBS securities in subordinate tranches with a higher risk profile (although still rated 'AAA') and longer terms to maturity to rebalance the risk characteristics of the RMBS portfolio. These securities were sold at par plus accrued interest.

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;
- 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 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, 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 long-term debt portfolio and the cash management portfolio. In addition, the AOFM's investments in residential mortgage-backed securities, and housing 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.

Long-term debt portfolio

The AOFM manages the interest rate structure of the long-term debt portfolio through the choice of instruments and bond series in issuing debt. The cost and interest rate risk of the long-term 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) 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.

(c) 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 and by issuing Treasury Notes. The AOFM also has access to an overdraft facility with the RBA. The overdraft facility is not to be used in normal day-to-day operations but only to cover temporary, unexpected shortfalls of cash and it has a limit of $1 billion. Should circumstances arise for the overdraft to exceed this limit, Ministerial approval is required.

The AOFM seeks to control refinancing risk by issuing along the entire yield curve. This creates a range of short-dated and mid-to-long dated exposures that balance cost and refinancing patterns. In formulating its annual debt issuance strategy the AOFM considers the volume of debt in any one line and the structure (including number of bond lines and maturity gaps between lines) of the yield curve. The AOFM CEO approves the debt issuance program.

Senior management monitors the daily balances in the OPA, holdings of short-term assets and the 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 at 30 June 2010.

(d) Credit risk

Investments

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 may be set.
AAA rated or equivalent debt securities issued or guaranteed by the government of a foreign country in Australian dollars	Class and individual issuer limits may be set.
AAA rated or equivalent debt securities issued by a financial institution or supranational in Australian dollars	Class and individual issuer limits may be set.
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 may be set.
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 may be set.
Deposits with the Reserve Bank of Australia	No limits apply.
AAA rated or equivalent residential mortgage-backed securities issued in Australia	A limit of $16 billion invested in face value terms with no single issuer limits.

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 2010 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.

Interest rate swaps

Credit risk exposures arise when domestic interest rate swaps that the AOFM has executed with counterparties have a positive market value in favour of the AOFM. The AOFM ensures that these counterparty credit risk exposures remain acceptable by containing key measures of credit risk within approved limits. Its credit risk policy establishes credit risk management principles and controls, credit risk mitigation strategies, measures for assessing counterparty credit quality, exposure limits and reporting in relation to interest rate swaps.

All interest rate swap contracts were closed out as at 18 May 2010.

Other assets and credit exposures

The AOFM has a credit risk exposure on its housing 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.

(e) Prepayment risk

The residential mortgage-backed securities 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 loan principal repayments ahead of scheduled principal payments and the estimated weighted average remaining life of the RMBS.

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

Note 4: Expenses

	2010 $'000	2009 $'000
Note 4A: Employee benefits		
Wages and salaries	**3,926**	3,238
Superannuation	**728**	716
Leave and other entitlements	**342**	137
Other employee expenses	**247**	304
Total employee benefits	**5,243**	4,395
Note 4B: Supplier expenses		
Corporate support services	**417**	399
Market data services	**596**	469
Operating lease rentals(a)	**322**	309
Registry, depository and transaction services	**639**	625
Syndicated debt issuance and associated services	**6,194**	-
Workers compensation premium	**20**	13
Other(b)	**1,600**	1,384
Total supplier expenses	**9,788**	3,199
Supplier expenses are made up of:		
Provision of goods - related entities	**1**	1
Provision of goods - external entities	**37**	45
Provision of services - related entities	**1,693**	1,725
Provision of services - external entities	**8,057**	1,428
	9,788	3,199
Note 4C: Depreciation and amortisation		
Depreciation of infrastructure, plant and equipment:		
Computers, plant and equipment	**97**	99
Leasehold improvements	**66**	64
Amortisation of intangibles:		
Computer software	**133**	118
Total depreciation and amortisation	**296**	281
Note 4D: Write-down and impairment of assets		
Computers, plant and equipment - disposed	**1**	-
Total write-down and impairment of assets	**1**	-
Total expenses	**15,328**	7,875

(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 $0.295 million (2008-09: $0.286 million).

Note 5: Income

	2010 $'000	2009 $'000
Note 5A: Sale of goods and rendering of services		
With related entities:		
Fees for management of the Communications Fund	**-**	164
Staff secondments to other agencies	**532**	642
Total sale of goods and rendering of services	**532**	806
Note 5B: Other revenue		
Resources received free of charge - ANAO audit services	**295**	286
Other	**387**	228
Total other revenue	**682**	514
Note 5C: Reversal of previous write-downs		
Asset revaluation increment:		
Leasehold improvements	**-**	4
Computers, plant and equipment	**-**	55
Total reversal of previous write-downs	**-**	59
Note 5D: Revenue from government		
Appropriations - departmental output	**12,569**	8,467
Total revenue from government	**12,569**	8,467
Total income	**13,783**	9,846

Note 6: Financial assets

	2010 $'000	2009 $'000
Note 6A: Receivables		
With related parties:		
Goods and services	**167**	159
Appropriations receivable - for output and equity injections(a)	**13,415**	16,721
With external parties:		
Other	**9**	7
Total receivables	**13,591**	16,887
Receivables are expected to be recovered in:		
No more than 12 months	**176**	166
More than 12 months	**13,415**	16,721
	13,591	16,887
Receivables are aged as follows:		
Not overdue	**13,591**	16,887
Overdue	**-**	-
	13,591	16,887

(a) Appropriations receivable are appropriations controlled by the AOFM but held in the OPA under the government's 'just-in-time' drawdown arrangements. As at 30 June 2010, the balance comprised undrawn equity injections of $949,070 ($949,070 as at 30 June 2009) and undrawn output appropriations of $12,466,230 ($15,771,575 as at 30 June 2009). During 2009-10 the AOFM returned $2.177 million in unused output appropriations to government, representing unused depreciation funding as at 30 June 2010 that was accumulated since the introduction of accrual budgeting in 1999-2000.

Note 7: Non-financial assets

	2010 $'000	2009 $'000
Note 7A: Infrastructure, plant and equipment		
Computers, plant and equipment:		
Gross value - at cost	**224**	6
Accumulated depreciation	**(37)**	-
	187	6
Gross value - at 2009 valuation (fair value)	**167**	180
Accumulated depreciation	**(93)**	(45)
	74	135
	261	141
Leasehold improvements:		
Gross value - at 2009 valuation (fair value)	**972**	955
Accumulated depreciation	**(607)**	(541)
	365	414
Total infrastructure, plant and equipment	**626**	555

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 2010 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.

	2010 $'000	2009 $'000
Note 7B: Intangibles		
Computer software (purchased):		
Gross value - at cost	**3,033**	3,018
Accumulated amortisation	**(2,739)**	(2,641)
Total intangibles	**294**	377

No indicators of impairment were identified for intangible assets.

Note 7: Non-financial assets (continued)

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

	Leasehold improvements	Computers, plant and equipment	Computer software (purchased)	Total
	2010 $'000	2010 $'000	2010 $'000	2010 $'000
Note 7C: Reconciliation of opening and closing balances				
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
Disposals:				
Gross book value	-	(13)	(35)	(48)
Accumulated depreciation/ amortisation	-	12	35	47
Depreciation/amortisation charge	(66)	(97)	(133)	(296)
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

Note 7: Non-financial assets (continued)

	Leasehold improvements	Computers, plant and equipment	Computer software (purchased)	Total
	2009	2009	2009	2009
	$'000	$'000	$'000	$'000
Note 7C: Reconciliation of opening and closing balances (continued)				
As at 1 July 2008				
Gross book value	922	464	2,941	4,327
Accumulated depreciation/ amortisation	(448)	(318)	(2,523)	(3,289)
Net book value 1 July 2008	474	146	418	1,038
Additions:				
Purchases	-	39	77	116
Depreciation/amortisation charge	(64)	(99)	(118)	(281)
Revaluation:				
Gross book value	33	(317)	-	(284)
Accumulated depreciation/ amortisation	(29)	372	-	343
Net book value 30 June 2009	414	141	377	932
As at 30 June 2009				
Gross book value	955	186	3,018	4,159
Accumulated depreciation/ amortisation	(541)	(45)	(2,641)	(3,227)
	414	141	377	932

	2010	2009
	$'000	$'000
Note 7D: Other non-financial assets		
Prepayments	**98**	90
Total other non-financial assets	**98**	90
Other non-financial assets are expected to be recovered in:		
No more than 12 months	**98**	90
More than 12 months	**-**	-
	98	90

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

Note 8: Payables

	2010 $'000	2009 $'000
Note 8A: Supplier payables		
With related entities:		
Trade creditors and accruals(a)	**34**	39
With external parties:		
Trade creditors and accruals(a)	**277**	166
Total supplier payables	**311**	205
Supplier payables are expected to be settled in:		
No more than 12 months	**282**	205
More than 12 months	**29**	-
	311	205
Note 8B: Other payables(b)		
Salaries and wages	**75**	54
Superannuation	**13**	9
Tax and other	**21**	25
Total other payables	**109**	88
Other payables are expected to be settled in:		
No more than 12 months	**109**	88
More than 12 months	**-**	-
	109	88

(a) Settlement is usually made net 30 days.

(b) Outstanding salaries and superannuation contributions payable in relation to the final fortnight of the financial year were presented in the 2008-09 financial statements within employee provisions. This year these items are presented in other payables and comparatives have been re-cast.

Note 9: Provisions

	2010 $'000	2009 $'000
Note 9A: Employee provisions(a)		
Annual leave	**389**	330
Long service leave	**984**	701
Superannuation	**126**	151
Total employee provisions	**1,499**	1,182
Employee provisions are expected to be settled in:		
No more than 12 months	**613**	275
More than 12 months	**886**	907
	1,499	1,182
Note 9B: Other provisions		
Make-good on leasehold premises(b)	**130**	125
Total other provisions	**130**	125
Other provisions are expected to be settled in:		
No more than 12 months	**-**	-
More than 12 months	**130**	125
	130	125
Reconciliation of movements in other provisions:		
Opening	**125**	120
Re-measurement	**5**	5
Closing	**130**	125

(a) Outstanding salaries and superannuation contributions payable in relation to the final fortnight of the financial year were presented in the 2008-09 financial statements within employee provisions. This year these items are presented in other payables and comparatives have been re-cast.

(b) 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, the 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:

	2010	2009
	$'000	$'000
Net cost of services	**(14,114)**	(6,496)
Add revenue from Government	**12,569**	8,467
Adjustments for non-cash items:		
Depreciation and amortisation	**296**	281
Write-down and impairment of assets	**1**	-
Reversal of previous write-downs	**-**	(59)
Appropriations returned to government	**(2,177)**	-
Infrastructure, plant and equipment and intangibles accruals	**(55)**	-
Adjustments for changes in assets:		
(Increase) decrease in receivables	**3,296**	(2,433)
(Increase) decrease in other prepayments	**(8)**	(50)
Adjustments for changes in liabilities:		
Increase (decrease) in employee provisions	**317**	174
Increase (decrease) in other provisions	**5**	5
Increase (decrease) in other payables	**21**	5
Increase (decrease) in supplier payables	**106**	126
Net cash from (used by) operating activities	**257**	20

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 equivalent in the Balance Sheet. The table below represents the reconciliation.

	2010 $'000	2009 $'000
Items in Balance Sheet		
Financial assets - cash and cash equivalents	**90**	63
Total items in the Balance Sheet	**90**	63
Total as per Statement of Cash Flows	**90**	63

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.

The number of Senior Executive Service (SES) officers who received or were due to receive remuneration is as follows:

	2010	2009
Number of SES officers whose remuneration was between:		
$325,000 to $339,999	**1**	-
$355,000 to $369,999	**-**	1
Total	**1**	1

Note 12: Executive remuneration (continued)

The remuneration of SES officers comprised the following benefits(a):

	2010 $	2009 $
Salary (including annual leave taken)	**265,158**	256,495
Superannuation(b)	**53,653**	68,287
Changes in leave and other entitlements:		
Annual leave	**(1,207)**	7,219
Long service leave(c)	**14,309**	36,533
Total	**331,913**	368,534

(a) Salary and superannuation excludes accruals for amounts due but unpaid as at the end of the financial year.

(b) Superannuation contributions are paid into the Commonwealth Superannuation Scheme (CSS) at a rate determined by the Department of Finance and Deregulation. The contributions made by the AOFM do not necessarily correspond with the officer's benefit under the scheme which is governed by legislation.

(c) The value of the long service leave provision as at 30 June each year 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. In 2008-09 the discount rate moved from 91.3 per cent (30/6/08) to 96.9 per cent (30/6/09). As at 30 June 2010 the discount rate was 96.7 per cent.

During 2009-10 no separation or redundancy payments were made to SES officers (2008-09: nil).

The following table shows the annualised remuneration packages as at 30 June for SES officers employed on 30 June.

	No.	2010 Base salary (incl annual leave) $	2010 Total remuneration package(a) $
Annualised total remuneration:			
$325,000 to $339,999	**1**	**267,808**	**328,915**
Total		**267,808**	**328,915**

	No.	2009 Base salary (incl annual leave) $	2009 Total remuneration package(a) $
Annualised total remuneration:			
$325,000 to $339,999	1	260,008	337,029
Total		260,008	337,029

(a) Total remuneration includes long service leave calculated on a nominal basis and superannuation paid to the CSS based on the contribution rate determined by the Department of Finance and Deregulation. The CSS contribution rate used for 30 June 2010 annualised salary is 18.4 per cent and 25.2 per cent for 2009.

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:

	2010	2009
	$	$
Remuneration of auditors	**294,547**	285,623

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:

	2010	2009
Average staffing level	**36**	30

Note 15: Compensation and debt relief in special circumstances

Departmental
No 'Act of Grace' payments were made during the reporting period (nil for 2008-09).
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 2008-09).
No payments were made under the 'Defective Administration Scheme' during the reporting period (nil for 2008-09).
No payments were made under section 73 of the *Public Service Act 1999* during the reporting period (nil for 2008-09).
No payments were made under ex-gratia programs during the reporting period (nil for 2008-09).
Administered
No 'Act of Grace' payments were made during the reporting period (nil for 2008-09).
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 (1 waiver for $21 for 2008-09).
No payments were made under the 'Defective Administration Scheme' during the reporting period (nil for 2008-09).
No payments were made under section 73 of the *Public Service Act 1999* during the reporting period (nil for 2008-09).
No payments were made under ex-gratia programs during the reporting period (nil for 2008-09).

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

	2010 $'000	2009 $'000
Note 16A: Interest revenue(a)		
Loans to State and Territory governments:		
State and Territory debt	**309**	318
Housing advances	**162,248**	166,348
Deposits	**647,350**	981,342
Discount securities	**102,438**	138,521
Fixed interest securities	**63,942**	161,205
Residential mortgage-backed securities	**374,145**	89,230
Swaps interest	**85,883**	990,606
Total interest revenue	**1,436,315**	2,527,570
Note 16B: Other revenue		
Securities lending and other revenue	**281**	3,328
Total other revenue	**281**	3,328
Total income administered on behalf of government	**1,436,596**	2,530,898

(a) Recognised using the effective interest method.

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

	2010 $'000	2009 $'000
Note 17A: Grants		
Public Sector:		
State and Territory governments(a)	**28**	28
Total grants	**28**	28
Note 17B: Interest expense		
Commonwealth Government Securities interest:(b)		
Treasury Bonds	**5,186,144**	3,181,947
Treasury Indexed Bonds	**705,405**	686,999
Treasury Notes	**410,596**	75,155
Other debt	**803**	963
Swaps interest	**45,047**	1,016,186
Other costs	**18**	1,077
Total interest expense	**6,348,013**	4,962,327
Total expenses administered on behalf of government	**6,348,041**	4,962,355

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

(b) Recognised using the effective interest method.

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

	2010 $'000	2009 $'000
Note 18A: Net foreign exchange gains (losses)		
Foreign currency denominated loans and securities	**334**	(1,049)
Total net foreign exchange gains (losses)	**334**	(1,049)
Note 18B: Net gains (losses) on sale of financial instruments(a)		
Termination of interst rate swaps	**-**	994,675
Sale of discount securities	**-**	1,505
Sale of fixed interest assets	**(26,833)**	38,065
Repurchase of debt	**(25,754)**	-
Total net gains (losses) on sale of financial instruments	**(52,587)**	1,034,245
Total gains (losses) before re-measurement	**(52,253)**	1,033,196

(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

	2010 $'000	2009 $'000
Net market revaluation gains (losses)(a)		
Commonwealth Government Securities	**(2,829,175)**	(1,067,433)
Deposits and discount securities	**(131)**	21
Fixed interest securities	**36,377**	(34,762)
Residential mortgage-backed securities	**64,263**	(136,422)
Interest rate swaps	**(44,010)**	1,006,385
Total net market revaluation gains (losses)	**(2,772,676)**	(232,211)

(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)

	2010 $'000	2009 $'000
Note 20A: Investments (under FMA section 39)(b)		
Designated at fair value through profit and loss:		
Deposits	**14,960,696**	26,515,639
Discount securities	**4,259,203**	998,432
Fixed interest securities	**3,620,934**	2,071,660
Residential mortgage-backed securities	**7,869,201**	5,900,534
Total investments (under FMA section 39)	**30,710,034**	35,486,265
Investments maturing:(c)		
Within one year	**23,246,837**	27,807,147
In one to five years	**7,175,920**	6,088,231
In more than five years	**287,277**	1,590,887
	30,710,034	35,486,265
Note 20B: Receivables		
At amortised cost:		
Loans to State and Territory governments:		
Principal	**3,078,596**	3,172,488
Balance of special account(d)	**(494)**	(546)
Unamortised net discounts	**(383,932)**	(405,314)
	2,694,170	2,766,628
At fair value through profit and loss:		
Interest rate swaps	**-**	66,763
Total receivables	**2,694,170**	2,833,391
Receivables maturing:(c)		
Within one year	**1,930**	68,533
In one to five years	**26,219**	24,238
In more than five years	**2,666,021**	2,740,620
	2,694,170	2,833,391
Receivables are aged as follows:		
Not overdue	**2,694,170**	2,833,391
Overdue	**-**	-
	2,694,170	2,833,391

(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 re-pricing 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 20: Assets administered on behalf of government (continued)

	2010 $'000	2009 $'000
Note 20C: Accrued revenue		
Accrued interest on loans to State and Territory governments	**478**	490
Total accrued revenue	**478**	490
Accrued revenue maturing:		
Within one year	**478**	490
	478	490

Note 21: Liabilities administered on behalf of government(a)

	2010 $'000	2009 $'000
Note 21A: Commonwealth Government Securities		
Designated at fair value through profit and loss:		
Treasury Bonds	**130,252,730**	81,263,880
Treasury Indexed Bonds	**16,198,297**	9,468,515
Treasury Notes	**10,899,702**	16,555,417
Other debt	**8,703**	8,936
	157,359,432	107,296,748
At amortised cost:		
Other debt	**16,088**	17,053
Total Commonwealth Government Securities	**157,375,520**	107,313,801
Commonwealth Government Securities maturing:(b)		
Within one year	**31,201,906**	22,757,977
In one to five years	**65,227,210**	43,446,327
In more than five years	**60,946,404**	41,109,497
	157,375,520	107,313,801
Note 21B: Accrued expenses		
Interest payable on other debt (at amortised cost)	**103**	104
Total accrued expenses	**103**	104
Accrued expenses maturing:		
Within one year	**103**	104
	103	104

(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 re-pricing dates.

Note 22: Administered reconciliation table

	2010 $'000	2009 $'000
Opening administered assets less administered liabilities	**(68,993,137)**	(27,504,390)
Administered income and expenses:		
Administered income before re-measurements	**1,436,596**	2,530,898
Administered gains (losses) before re-measurements	**(52,253)**	1,033,196
Administered expenses before re-measurements	**(6,348,041)**	(4,962,355)
Re-measurements - net market revaluation gains (losses)	**(2,772,676)**	(232,211)
Administered transfers (to) / from Australian Government:		
Special appropriations (unlimited)	**414,967,174**	405,936,516
Transfers to OPA	**(462,208,034)**	(445,794,692)
Change in special account balance	**52**	(99)
Closing administered assets less administered liabilities	**(123,970,319)**	(68,993,137)

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 2010 there were two open transactions under the AOFM's securities lending facility (nil as at 30 June 2009).

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:

	2010 $'000	2009 $'000
Administered financial assets		
Cash	**622**	622
Loans and receivables (at amortised cost):		
Loans to State and Territory governments	**2,694,170**	2,766,628
Accrued interest on loans to State and Territory governments	**478**	490
	2,694,648	2,767,118
Fair value through profit or loss (required by AASB 139):		
Interest rate swaps	**-**	66,763
Fair value through profit or loss (designated by the AOFM):		
Investments	**30,710,034**	35,486,265
Carrying amount of financial assets	**33,405,304**	38,320,768
Administered financial liabilities		
Fair value through profit or loss (designated by the AOFM):		
Treasury Bonds	**130,252,730**	81,263,880
Treasury Indexed Bonds	**16,198,297**	9,468,515
Treasury Notes	**10,899,702**	16,555,417
Other debt	**8,703**	8,936
	157,359,432	107,296,748
Other financial liabilities (at amortised cost):		
Other debt	**16,088**	17,053
Interest payable on other debt	**103**	104
	16,191	17,157
Carrying amount of financial liabilities	**157,375,623**	107,313,905
Net assets	**(123,970,319)**	(68,993,137)

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 as at 30 June 2009 and 30 June 2010. The notional principal amounts are not exchanged and act as a reference upon which interest payments are calculated.

	2010	2009
	$'000	$'000
Notional principal		
Interest rate swaps:		
Pay — fixed swaps	**-**	-
Receive — fixed swaps	**-**	2,425,000
Total notional principal	**-**	2,425,000
Notional principal maturing:		
Within one year	**-**	2,425,000
	-	2,425,000

The following table contains details of swap terminations and maturities, together with net proceeds received by the AOFM on termination of agreements in 2008-09.

	2010	2009
	$'000	$'000
Notional principal - opening balance	**2,425,000**	23,150,000
New swap transactions	**-**	-
Matured	**(2,425,000)**	(5,375,000)
Terminated prior to maturity, maturing:		
In current year	**-**	(200,000)
Within one year	**-**	(300,000)
In one to five years	**-**	(10,750,000)
In more than five years	**-**	(4,100,000)
Closing balance	**-**	2,425,000
Net receipts from termination		
Proceeds from counterparties on termination	**-**	1,031,292
Payments to counterparties on termination	**-**	-
Total net receipts from termination	**-**	1,031,292

Note 24: Administered financial instruments (continued)

Note 24B: Interest rate swaps (continued)

During 2008-09 the AOFM made collateral calls on several interest rate swap counterparties when the value of the swaps moved in its favour beyond a specified level. Collateral was posted by the swap counterparties in the form of Australian dollars. The AOFM paid interest on these funds at the actual overnight cash rate. Total interest paid by the AOFM for 2008-09 on collateral held was $342,851. With the termination of swaps with the relevant counterparties, the exposures were subsequently restored to within acceptable limits and the funds were returned.

There were no collateral calls made in 2009-10.

	2010	2009
	$'000	$'000
Opening balance of collateral held	**-**	-
Collateral received by the AOFM	**-**	101,000
Collateral returned by the AOFM	**-**	(101,000)
Closing balance of collateral held	**-**	-

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 2010 for each class of financial assets and financial liabilities is set out below. The maturity profile is based on contractual re-pricing dates except for residential mortgage-backed securities in which the maturity profile is based on the weighted average life of each issue. 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 re-pricing 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.

2010	Fixed	Floating	Non	Maturing in				Weighted
	interest	interest	interest	1 year	1 to 5	5 years		average
By instrument	rate	rate	bearing	or less	years	or more	Total	interest(a)
As at 30 June 2010	$'000	$'000	$'000	$'000	$'000	$'000	$'000	%
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 government housing 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 long-term 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 24C: Interest rate risk (continued)

2009 By instrument As at 30 June 2009	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(b) %
Financial assets								
Cash	-	-	622	622	-	-	622	-
Interest rate swaps(a)	124,795	-	-	124,795	-	-	124,795	6.80
Loans to State and Territory governments	2,767,114	-	4	2,260	24,238	2,740,620	2,767,118	5.88
Deposits	26,515,639	-	-	26,515,639	-	-	26,515,639	3.00
Discount securities	998,432	-	-	998,432	-	-	998,432	3.21
Fixed interest securities	2,071,660	-	-	-	480,773	1,590,887	2,071,660	5.54
Residential mortgage-backed securities	-	5,900,534	-	293,076	5,607,458	-	5,900,534	4.60
Total financial assets	32,477,640	5,900,534	626	27,934,824	6,112,469	4,331,507	38,378,800	
Financial liabilities								
Interest rate swaps(a)	-	58,032	-	58,032	-	-	58,032	3.05
Treasury Bonds	81,263,880	-	-	6,195,999	41,141,393	33,926,488	81,263,880	5.21
Treasury Indexed Bonds	9,468,515	-	-	-	2,304,934	7,163,581	9,468,515	4.22
Treasury Notes	16,555,417	-	-	16,555,417	-	-	16,555,417	2.93
Other debt	19,532	-	6,561	6,665	-	19,428	26,093	3.66
Total financial liabilities	107,307,344	58,032	6,561	22,816,113	43,446,327	41,109,497	107,371,937	
Net assets	(74,829,704)	5,842,502	(5,935)	5,118,711	(37,333,858)	(36,777,990)	(68,993,137)	

(a) Amounts are represented on a gross basis. This differs from the presentation in the Schedules of Assets and Liabilities Administered on Behalf of Government, where amounts are on a net basis.

(b) 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)

2009 By portfolio As at 30 June 2009	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(b) %
Long term debt portfolio								
Financial assets	2,206,505	-	4	124,903	480,773	1,600,833	2,206,509	6.22
Financial liabilities	(90,751,926)	(58,032)	(6,561)	(6,260,695)	(43,446,327)	(41,109,497)	(90,816,519)	(a)
Net assets	(88,545,421)	(58,032)	(6,557)	(6,135,792)	(42,965,554)	(39,508,664)	(88,610,010)	
Cash management portfolio								
Financial assets	27,514,070	-	622	27,514,692	-	-	27,514,692	3.00
Financial liabilities	(16,555,417)	-	-	(16,555,417)	-	-	(16,555,417)	2.93
Net assets	10,958,653	-	622	10,959,275	-	-	10,959,275	
Residential mortgage-backed securities								
Financial assets	-	5,900,534	-	293,076	5,607,458	-	5,900,534	4.60
Financial liabilities	-	-	-	-	-	-	-	-
Net assets	-	5,900,534	-	293,076	5,607,458	-	5,900,534	
State and territory government government housing advances								
Financial assets	2,757,064	-	-	2,152	24,238	2,730,674	2,757,064	5.89
Financial liabilities	-	-	-	-	-	-	-	-
Net assets	2,757,064	-	-	2,152	24,238	2,730,674	2,757,064	
Total net assets	(74,829,704)	5,842,502	(5,935)	5,118,711	(37,333,858)	(36,777,990)	(68,993,137)	

(a) Financial liabilities in the long-term debt portfolio comprise debt instruments that incur a nominal interest rate and debt instruments that incur a real interest rate. As at 30 June 2009, the weighted average interest rate of debt instruments at nominal interest rates was 5.15 per cent and the weighted average interest rate of debt instruments at real interest rates was 4.22 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:

	2010 AUD $'000	2009 AUD $'000
FOREIGN CURRENCY DENOMINATED LIABILITIES		
Current:		
Pounds sterling	**93**	109
Japanese yen	**5**	5
Swiss francs	**55**	58
Euros	**8**	10
	161	182
Non-current:		
United States dollars	**6,243**	6,558
Pounds sterling	**731**	1,031
	6,974	7,589
Total foreign currency denominated liabilities	**7,135**	7,771
FOREIGN CURRENCY DENOMINATED ASSETS		
Current:		
Pounds sterling	**3**	4
	3	4
Non-current:		
Pounds sterling	**731**	1,031
	731	1,031
Total foreign currency denominated assets	**734**	1,035

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.

			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**

			2009		
Contractual maturities	**Within 1 year $'000**	**1 to 2 years $'000**	**2 to 5 years $'000**	**>5 years $'000**	**Total $'000**
Treasury Bonds	10,433,541	21,401,748	30,061,773	40,437,284	102,334,346
Treasury Indexed Bonds(a)	355,679	2,540,732	796,720	7,664,308	11,357,439
Treasury Notes	16,700,000	-	-	-	16,700,000
Other debt(b)	549	549	1,648	8,205	10,951
Total	27,489,769	23,943,029	30,860,141	48,109,797	130,402,736

(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 State 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 is zero.

The following tables set out the AOFM's credit risk by asset class and long-term credit rating as at 30 June 2009 and 30 June 2010.

	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 credit 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 housing 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 24F: Credit risk (continued)

	2009			
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	2,121,085	710,696	-	2,831,781
Deposits(b)	26,515,639	-	-	26,515,639
Discount securities	-	998,432		998,432
Fixed interest securities	1,243,132	828,528	-	2,071,660
Interest rate swaps	-	27,115	39,648	66,763
Residential mortgage-backed securities	5,900,534	-	-	5,900,534
Total	35,781,012	2,564,771	39,648	38,385,431

(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.

	2009			
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	1,253,732	855,643	39,648	2,149,023
Cash management	26,516,261	998,432	-	27,514,693
Residential mortgage-backed securities	5,900,534	-	-	5,900,534
State and Territory government housing advances	2,110,485	710,696	-	2,821,181
Total	35,781,012	2,564,771	39,648	38,385,431

(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 $9,022.960 million.

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, involving $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 (bringing the program to $16 billion) subject to market conditions. An additional objective of the extended program is to provide support for lending to small business through participating lenders agreeing to direct some of the proceeds received for lending to small business.

During the financial year the AOFM sold $73.790 million (face value) of RMBS securities in subordinate tranches to rebalance the risk characteristics of the RMBS portfolio. The securities were sold at par plus accrued interest. After sales and principal repayments the amount invested as at 30 June 2010 was $7,919.225 million ($6,024.139 million as at 30 June 2009) in face value terms.

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.

Note 24: Administered financial instruments (continued)

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

Original program:

Originator	Issue	Original amount invested	Principal repayments and sales	Invested as at 30-Jun-10	Acquisition date
		$'000	$'000	$'000	
Authorised deposit taking institutions					
AMP	Progress 2009-1 Trust	**425,000**	**83,602**	**341,398**	30-Mar-09
Australian Central Credit Union	Light Trust No.2	**190,000**	**20,942**	**169,058**	28-Jul-09
Bank of Queensland	Reds Trust Series 2009-1	**500,000**	**-**	**500,000**	21-Apr-09
Bendigo and Adelaide Bank	Torrens Series 2009-1	**475,000**	**120,311**	**354,689**	18-Mar-09
Credit Union Australia	Harvey Trust 2009-1	**350,000**	**-**	**350,000**	26-Mar-09
Greater Building Society	GBS Receivables Trust No.4	**190,000**	**-**	**190,000**	11-Sep-09
Members Equity Bank	SMHL Securitisation Fund 2008-2	**500,000**	**134,865**	**365,135**	09-Dec-08
Members Equity Bank	SMHL Securitisation Fund 2009-1	**500,000**	**15,601**	**484,399**	14-May-09
Suncorp-Metway	Apollo Series 2009-1 Trust	**499,200**	**-**	**499,200**	04-Sep-09
Wide Bay Australia	WB Trust 2009-1	**299,500**	**7,823**	**291,677**	16-Jul-09
		3,928,700	**383,144**	**3,545,556**	
Other institutions					
Challenger	Challenger Millennium Series 2008-2	**500,000**	**123,322**	**376,678**	12-Dec-08
Challenger	Challenger Millennium Series 2009-1	**500,000**	**49,398**	**450,602**	24-Apr-09
Firstmac	Firstmac RMBS Series 2-2008	**496,000**	**111,628**	**384,372**	21-Nov-08
Firstmac	Firstmac RMBS Series 1-2009	**498,620**	**5,162**	**493,458**	05-Jun-09
Firstmac	Firstmac RMBS Series 2-2009	**215,140**	**19,740**	**195,400**	24-Nov-09
Liberty Financial	Liberty Prime Series 2009-1	**500,000**	**150,924**	**349,076**	20-Apr-09
Liberty Financial	Liberty Prime Series 2009-2	**99,800**	**6,512**	**93,288**	21-Oct-09
Resimac	Resimac Premier Series 2008-1	**500,000**	**140,856**	**359,144**	15-Dec-08
Resimac	Resimac Premier Series 2009-1	**458,800**	**60,035**	**398,765**	28-May-09
Resimac	Resimac Premier Series 2009-2	**56,400**	**-**	**56,400**	28-Oct-09
		3,824,760	**667,577**	**3,157,183**	
Total		**7,753,460**	**1,050,721**	**6,702,739**	

Note 24: Administered financial instruments (continued)

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

Extended program:

Originator	Issue	Original amount invested	Principal repayments and sales	Invested as at 30-Jun-10	Acquisition date
		$'000	$'000	$'000	
AMP Bank	Progress 2010-1 Trust	**36,000**	-	**36,000**	29-Jan-10
Bank of Queensland	Reds Trust Series 2010-1	**250,000**	**14,498**	**235,502**	17-Feb-10
Bendigo and Adelaide Bank	Torrens Series 2010-1	**123,000**	**6,034**	**116,966**	24-Mar-10
Credit Union Australia	Harvey Trust 2010-1	**143,000**	**9,620**	**133,380**	10-Mar-10
IMB	Illawarra Series 2010-1 RMBS Trust	**157,500**	**5,628**	**151,872**	31-Mar-10
Members Equity Bank	SMHL Securitisation Fund 2010-1	**250,000**	**17,044**	**232,956**	15-Mar-10
Resimac	Resimac Premier Series 2010-1	**10,000**	**190**	**9,810**	17-May-10
Suncorp-Metway	Apollo Series 2010-1 Trust	**300,000**	-	**300,000**	09-Jun-10
Total		**1,269,500**	**53,014**	**1,216,486**	

By financial year	Opening balance	Amount invested	Principal repayments	Sales	Invested as at Year end
	$'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**
Total		**9,022,960**	**1,029,945**	**73,790**	

Note 24: Administered financial instruments (continued)

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

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 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)

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 housing 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)

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 30 June 2010, by assigning a 3 level hierarchy to those valuations. This requirement is first applicable in the 2009-10 financial year and comparatives are not provided.

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

2009 By instrument as at 30 June 2009	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)	3,171,942	2,767,118	2,831,235
Deposits	26,500,000	26,515,639	26,515,639
Discount securities	1,000,000	998,432	998,432
Fixed interest securities	2,024,000	2,071,660	2,071,660
Residential mortgage-backed securities	6,024,139	5,900,534	5,900,534
Interest rate swaps	-	66,763	66,763
Total financial assets (recognised)	38,720,703	38,320,768	38,384,885
Administered financial liabilities (recognised)			
Treasury Bonds	78,403,136	81,263,880	81,263,880
Treasury Indexed Bonds	8,891,967	9,468,515	9,468,515
Treasury Notes	16,700,000	16,555,417	16,555,417
Other debt	23,612	26,093	26,093
Total financial liabilities (recognised)	104,018,715	107,313,905	107,313,905
Net financial assets (recognised)	(65,298,012)	(68,993,137)	(68,929,020)

(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)

2009 By portfolio as at 30 June 2009	Principal value $'000	Total carrying amount $'000	Aggregate net fair value $'000
Long term debt			
Financial assets	2,033,950	2,148,477	2,148,477
Financial liabilities	(87,318,715)	(90,758,488)	(90,758,488)
Net assets	(85,284,765)	(88,610,011)	(88,610,011)
Cash management			
Financial assets	27,500,622	27,514,693	27,514,693
Financial liabilities	(16,700,000)	(16,555,417)	(16,555,417)
Net assets	10,800,622	10,959,276	10,959,276
Residential mortgage-backed securities			
Financial assets	6,024,139	5,900,534	5,900,534
Financial liabilities	-	-	-
Net assets	6,024,139	5,900,534	5,900,534
State and territory government housing advances			
Financial assets	3,161,992	2,757,064	2,821,181
Financial liabilities	-	-	-
Net assets	3,161,992	2,757,064	2,821,181
Net financial assets (recognised)	(65,298,012)	(68,993,137)	(68,929,020)

Note 24: Administered financial instruments (continued)

Note 24I: Movement in Commonwealth Government Securities on issue (face value)

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**

2009	Opening balance $'000	Issuance $'000	Maturities/ Redemptions $'000	Other $'000	Closing balance $'000
Treasury Bonds	49,395,141	34,102,000	(5,094,005)	-	78,403,136
Treasury Indexed Bonds(a)	6,020,000	-	-	-	6,020,000
Treasury Notes	-	18,700,000	(2,000,000)	-	16,700,000
Other debt(b)	26,968	-	(4,384)	1,028	23,612
Total	55,442,109	52,802,000	(7,098,389)	1,028	101,146,748

(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)

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**

2009	Opening balance $'000	Acquisitions $'000	Maturities/ Redemptions $'000	Other $'000	Closing balance $'000
Deposits	29,050,000	372,800,000	(375,350,000)	-	26,500,000
Discount securities	-	12,648,000	(11,648,000)	-	1,000,000
Fixed interest securities	-	5,174,000	(3,150,000)	-	2,024,000
Residential mortgage-backed securities	-	6,203,420	(179,281)	-	6,024,139
Total	29,050,000	396,825,420	(390,327,281)	-	35,548,139

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. For the AOFM, market risk is synonymous with interest rate risk.

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 the 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 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 the 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.

Under previous Commonwealth-State financing arrangements the Commonwealth 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.

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

At 1 July 2010, 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 2011, with all other variables held constant, the effect on AOFM's operating result before re-measurements (calculated on an accruals basis) and equity position for the year ended 30 June 2011 would be 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 2009 $'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
Residential mortgage-backed securities	7,869,201	(100,157)	(100,157)	100,157	100,157
Fixed interest securities	3,620,934	-	-	-	-
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.

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)

		2009			
Change in interest rates from 1 July 2009 for 12 months to 30 June 2010		**-1%**		**+1%**	
	Carrying amount as at 30 June 2009 $'000	**Impact in 2009-10 on profit $'000**	**Impact in 2009-10 on equity $'000**	**Impact in 2009-10 on profit $'000**	**Impact in 2009-10 on equity $'000**
Financial assets					
Cash	622	-	-	-	-
Loans to State and Territory governments	2,767,118	-	-	-	-
Deposits	26,515,639	(257,401)	(257,401)	257,401	257,401
Discount securities	998,432	-	-	-	-
Residential mortgage-backed securities	5,900,534	(68,986)	(68,986)	68,986	68,986
Fixed interest securities	2,071,660	-	-	-	-
Interest rate swaps	66,763	6,722	6,722	(6,722)	(6,722)
Financial liabilities					
Treasury Bonds	81,263,880	232,656	232,656	(211,137)	(211,137)
Treasury Indexed Bonds	9,468,515	-	-	-	-
Treasury Notes	16,555,417	121,459	121,459	(121,459)	(121,459)
Other debt	26,093	-	-	-	-
Total increase (decrease) in accrual result (before re-measurements)		34,450	34,450	(12,931)	(12,931)

(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 2010, 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 2011, 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 2011 would be 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 2009 $'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**	**-**	**-**	**-**	**-**
Residential mortgage-backed securities	**7,869,201**	**-**	**-**	**-**	**-**
Fixed interest securities	**3,620,934**	**-**	**-**	**-**	**-**
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)**

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)

	2009				
Change in CPI from 1 July 2009 for 12 months to 30 June 2010		**-1%**		**+1%**	
	Carrying amount as at 30 June 2009 $'000	**Impact in 2009-10 on profit $'000**	**Impact in 2009-10 on equity $'000**	**Impact in 2009-10 on profit $'000**	**Impact in 2009-10 on equity $'000**
Financial assets					
Cash	622	-	-	-	-
Loans to State and Territory governments	2,767,118	-	-	-	-
Deposits	26,515,639	-	-	-	-
Discount securities	998,432	-	-	-	-
Residential mortgage-backed securities	5,900,534	-	-	-	-
Fixed interest securities	2,071,660	-	-	-	-
Interest rate swaps	66,763	-	-	-	-
Financial liabilities					
Treasury Bonds	81,263,880	-	-	-	-
Treasury Indexed Bonds	9,468,515	92,306	92,306	(92,176)	(92,176)
Treasury Notes	16,555,417	-	-	-	-
Other debt	26,093	-	-	-	-
Total increase (decrease) in accrual result (before re-measurements)		92,306	92,306	(92,176)	(92,176)

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 interest rate swaps comprised the difference between:
  - the return on each floating rate leg at the relevant reference market interest rate (being either the 3-month or 6-month BBSW rate) as at year end; and
  - the return on each floating rate leg at a yield that is 100 basis points higher and lower than the relevant reference market interest rate as at year end. The 100 basis point shift is applied from the date of the first rate re-set for the next financial year for each floating rate leg 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 (being the 1-month BBSW rate plus specific fixed margin set for each deal 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 deal. The 100 basis point shift is applied from the date of the first rate re-set for the next 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:

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

- the return on term deposits held at 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
- 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 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 $56,000 million of Treasury Bonds and $4,000 million of Treasury Indexed Bonds during the 2010-11 financial year (2009-10: $59,000 million; 2009-10: nil). It is also assumed that the volume of Treasury Notes outstanding as at 30 June 2010 of $11,000 million remains unchanged throughout the 2010-11 financial year (2009-10: $16,700 million). In addition it is assumed that the volume of term deposit investments will remain at levels as at 30 June 2010 of $14,950 million for the full 12 months to 30 June 2011 (2009-10: $26,500 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 2010. During 2010-11 the AOFM will make further investments of $6,246 million in RMBS. These new issues have been modelled on a 25 per cent per annum principal repayment rate, with a deferred start. 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 2010 was $63.973 million per basis point ($35.966 million per basis point as at 30 June 2009). This means that a 1 basis point (or 0.01%) parallel increase (decrease) in interest rates across the yield curve would result in a favourable (unfavourable) change of $63.973 million in the fair value of the portfolio as at 30 June 2010 ($35.966 million as at 30 June 2009).

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:

	2010		
Bond series	**Number of transactions**	**Face value of Bonds 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	-

Note 26: Securities lending facility (continued)

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

	2009		
Bond series	**Number of transactions**	**Face value of Bonds 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:			
September 2009	56	1,570,000	280
August 2010	87	3,101,300	690
June 2011	57	1,229,200	347
May 2013	28	1,349,450	202
June 2014	26	636,300	176
April 2015	64	2,136,544	356
February 2017	28	1,255,870	284
May 2021	28	1,479,600	280
	374	12,758,264	2,615
(iii) Open transactions as at the end of the financial year			
Nil			

In 2008-09 the securities lending facility was widened to allow intra-day borrowing of Treasury Bonds. Interest is not payable under the facility for intra-day lending. Intra-day lending during 2009-10 was as follows:

	2010	
Bond series	**Number of transactions**	**Face value of Treasury Bonds 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**

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

	2009	
Bond series	**Number of transactions**	**Face value of Treasury Bonds loaned $'000**
Treasury Bonds:		
September 2009	8	1,433,200
June 2011	3	176,500
May 2013	1	250,000
April 2015	4	96,500
	16	1,956,200

Note 27: Disclosures of appropriations

Note 27A: Acquittal of authority to draw cash from the Consolidated Revenue Fund (Appropriations) for Ordinary Annual Services 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

	Administered expenses $'000	Departmental outputs $'000	Total $'000
Year ended 30 June 2010 (current year)			
Balance brought forward from previous period	10	15,836	15,846
Appropriation Act:			
Appropriation Act (No. 1) 2009-2010	10	12,638	12,648
Appropriation reduced (*Appropriation Act No. 1 2008-2009* section 11)	(10)	-	(10)
Appropriation reduced (*Appropriation Act No. 1 2009-2010* sections 10 & 11)	-	(69)	(69)
Appropriation reduced (*Appropriation Act No. 3 2009-2010* section 14)	-	(2,177)	(2,177)
Financial Management and Accountability Act:			
Appropriations to take account of recoverable GST (FMA Act s 30A)	-	500	500
Relevant agency receipts (*FMA Act* s 31)	-	918	918
Total appropriation available for payments	10	27,646	27,656
Cash payments made during the year (GST inclusive)	-	(15,089)	(15,089)
Balance of Authority to draw cash from the Consolidated Revenue Fund for Ordinary Annual Services Appropriations	10	12,557	12,567
Represented by:			
Cash at bank	-	90	90
Appropriations receivable	-	12,466	12,466
Net GST receivable from the ATO(a)	-	1	1
Undrawn, unlapsed administered appropriations(b)	10	-	10
Total as at 30 June	10	12,557	12,567

(a) Included as an offset to other payables at note 8B.

(b) Note 27B specifies the amount of administered annual appropriation required to be carried forward to meet expenditure commitments. Amounts not required are reduced in accordance with section 11 of *Appropriation Act (No. 1) 2009-10* when this report is tabled in Parliament.

Note 27: Disclosures of appropriations (continued)

Note 27A: Acquittal of authority to draw cash from the Consolidated Revenue Fund (Appropriations) for Ordinary Annual Services 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

	Administered expenses $'000	Departmental outputs $'000	Total $'000
Year ended 30 June 2009 (comparative year)			
Balance brought forward from previous period	10	13,255	13,265
Appropriation Act:			
Appropriation Act (No. 1) 2008-2009	10	8,467	8,477
Appropriations reduced (*Appropriation Act* sections 10, 11 & 12)	(10)	-	(10)
Financial Management and Accountability Act:			
Appropriations to take account of recoverable GST (FMA Act s 30A)	-	51	51
Relevant agency receipts (*FMA Act* s 31)	-	1,326	1,326
Total appropriation available for payments	10	23,099	23,109
Cash payments made during the year (GST inclusive)	-	(7,263)	(7,263)
Balance of Authority to draw cash from the Consolidated Revenue Fund for Ordinary Annual Services Appropriations	10	15,836	15,846
Represented by:			
Cash at bank	-	63	63
Departmental appropriations receivable	-	15,772	15,772
Net GST receivable from the ATO(a)	-	1	1
Undrawn, unlapsed administered appropriations(b)	10	-	10
Total as at 30 June	10	15,836	15,846

(a) Included in Other Receivables in Note 6A.

(b) The undrawn, unlapsed administered appropriation, of $10,000.00 was not required by the AOFM and was reduced when the AOFM's 2008-09 annual report was tabled in Parliament under section 11 of *Appropriation Act (No. 1) 2008-09*.

Note 27: Disclosures of appropriations (continued)

Note 27B: Acquittal of authority to draw cash from the Consolidated Revenue Fund (Appropriations) for Ordinary Annual Services Appropriations (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 2009-10 the AOFM received an appropriation authority of $10,000 in *Appropriation Act (No. 1) 2009-10* for this purpose. Section 11 of *Appropriation Act (No.1) 2009-2010* 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) 2009-2010* 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

	2010 $0.00
Reduction in administered items	
Total administered items appropriated 2009-10	**10,000.00**
Less administered items required by the agency as per Appropriation Act, section 11:	
Appropriation Act (No. 1) 2009-2010	**0.00**
Total administered items required by the agency	**0.00**
Total reduction in administered items - effective 2010-11	**10,000.00**

Note 27: Disclosures of appropriations (continued)

Note 27C: Acquittal of authority to draw cash from the Consolidated Revenue Fund (Appropriations) for Other than Ordinary Annual Services 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

	2010	2009
	$'000	$'000
Balance brought forward from previous period	**949**	949
Appropriation Act:		
Appropriation Act (No. 2) 2009-2010	**-**	-
Total appropriation available for payments	**949**	949
Cash payments made during the year (GST inclusive)	**-**	-
Balance of Authority to draw cash from the Consolidated Revenue Fund for Other than Ordinary Annual Services	**949**	949
Represented by:		
Departmental equity injection appropriation receivable	**949**	949
Total as at 30 June	**949**	949

Note 27: Disclosures of appropriations (continued)

Note 27D: Acquittal of authority to draw cash from the Consolidated Revenue Fund — Administered Special Appropriations (unlimited amount)

The following administered special appropriations were not drawn on in the current or previous financial year:

Act	Purpose
Airports (Transitional) Act 1996, section 78	Payment of principal and interest on former debts of the Federal Airports Corporation
Australian National Railways Commission Sale Act 1997, section 67AW	Payment of principal and interest on former debts of the National Railways Commission
Financial Management and Accountability Act 1997, section 30A	Payments of recoverable GST
Loans Redemption and Conversion Act 1921, section 5	Payment of principal, interest and costs of converting loans made in accordance with the Act
Loans Securities Act 1919, section 5BA	Payment of money to enter into securities lending arrangements
Moomba – Sydney Pipeline System Sale Act 1994, section 19	Payment of principal and interest on former debts of the Pipeline Authority
Qantas Sale Act 1992, section 18	Payment of principal and interest on former debts of Qantas
Treasury Bills Act 1914, section 6	Payment of principal and interest on money raised by issuance of Treasury Bills

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

	2010 $'000	2009 $'000
Commonwealth Inscribed Stock Act 1911, section 6		
Purpose: payment of principal and interest on money raised by Stock issued under the Act		
Cash payments made during year - principal (expenditure)	**43,201,994**	7,081,473
Cash payments made during year - interest (expenditure)	**6,944,331**	3,952,756
Appropriations credited to Special Accounts	**-**	-
Refunds credited (net) (FMA section 30)	**-**	-
Total charged to appropriation	**50,146,325**	11,034,229
Estimated actual - principal (expenditure)	**48,201,208**	7,142,610
Estimated actual - interest (expenditure)	**7,342,200**	4,181,200
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		
Cash payments made during year - (expenditure)	**329**	336
Appropriations credited to Special Accounts (included in above)	**46**	51
Refunds credited (net) (FMA section 30)	**-**	-
Total charged to appropriation	**329**	336
Estimated actual - (expenditure)	**-**	-

Note 27: Disclosures of appropriations (continued)

Note 27D: Acquittal of authority to draw cash from the Consolidated Revenue Fund — Administered Special Appropriations (unlimited amount) (continued)

	2010 $'000	2009 $'000
Financial Management and Accountability Act 1997, section 39(9)		
Purpose: to make investments in the name of the Commonwealth of Australia(a)		
Cash payments made during year - principal (expenditure)	**364,820,018**	396,819,404
Cash payments made during year - interest (expenditure)	**-**	-
Appropriations credited to Special Accounts	**-**	-
Refunds credited (net) (FMA section 30)	**-**	-
Total charged to appropriation	**364,820,018**	396,819,404
Estimated actual - principal (expenditure)	**315,388,600**	359,452,700
Estimated actual - interest (expenditure)	**-**	-
Loans Securities Act 1919, section 4		
Purpose: payment of principal and interest on money raised by stock issued under the Act		
Cash payments made during year - principal (expenditure)	**-**	-
Cash payments made during year - interest (expenditure)	**502**	621
Appropriations credited to Special Accounts	**-**	-
Refunds credited (net) (FMA section 30)	**-**	-
Total charged to appropriation	**502**	621
Estimated actual - principal (expenditure)	**-**	-
Estimated actual - interest (expenditure)	**800**	1,000
Loans Securities Act 1919, section 5B		
Purpose: payment of money under a swap agreement and any expenditure in connection with the negotiation, management or service of, or a repayment under any such agreement(b)		
Cash payments made during year - principal (expenditure)	**-**	101,000
Cash payments made during year - interest (expenditure)	**63,951**	1,266,553
Appropriations credited to Special Accounts	**-**	-
Refunds credited (net) (FMA section 30)	**-**	-
Total charged to appropriation	**63,951**	1,367,553
Estimated actual - principal (expenditure)	**-**	-
Estimated actual - interest (expenditure)	**64,000**	1,278,800

(a) 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 2009-10 includes $1,138.920 million for the repurchase and cancellation of $715.735 million of August 2010 Treasury Indexed Bonds in October 2009.

(b) 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 these transactions are disclosed in this note on an aggregate basis.

Note 27: Disclosures of appropriations (continued)

Note 27D: Acquittal of authority to draw cash from the Consolidated Revenue Fund — Administered Special Appropriations (unlimited amount) (continued)

	2010 $'000	2009 $'000
Snowy Hydro Corporatisation Act 1997, section 22		
Purpose: payment of principal and interest on former debts of the Snowy Mountains Hydro Electricity Authority		
Cash payments made during year - principal (expenditure)	**-**	4,000
Cash payments made during year - interest (expenditure)	**-**	165
Appropriations credited to Special Accounts	**-**	-
Refunds credited (net) (FMA section 30)	**-**	-
Total charged to appropriation	**-**	4,165
Estimated actual - principal (expenditure)	**-**	4,000
Estimated actual - interest (expenditure)	**-**	165
Total		
Total budget estimate (expenditure)	**370,996,808**	372,060,475
Total payments made (expenditure)	**415,031,125**	409,226,308
Appropriations credited to Special Accounts (included in above)	**46**	51
Refunds credited (section 30)	**-**	-

Note 27: Disclosures of appropriations (continued)

Note 27E: Acquittal of authority to draw cash from the Consolidated Revenue Fund — Special Appropriations (Refund Provisions)

In 2008-09 and 2009-10 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: Acquittal of authority to draw cash from the Consolidated Revenue Fund — Special Appropriations (FMA section 39)

Investment of Public money: **Special appropriations under section 39 of the FMA Act(a)**	**2010** **$'000**	2009 $'000
In face value terms		
Amount invested brought forward from previous period	**35,548,139**	29,050,000
Investments made during the year(b)	**363,667,010**	396,825,420
Redemptions of current year investments	**(368,498,454)**	(390,327,281)
Amount invested carried to the next period (at face value)	**30,716,695**	35,548,139

(a) See Note 24J for further details.

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

FMA = *Financial Management and Accountability Act 1997*.

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	**2010 $'000**	2009 $'000
Balance brought forward from previous period	**546**	447
Appropriation for reporting period	**28**	28
Interest amounts credited	**18**	23
Other receipts:		
State and Territory contributions	**85**	86
Available for payments	**677**	**584**
Total increase	**131**	**137**
Payments made:		
Debt repayments	**(183)**	(38)
Total decrease	**(183)**	(38)
Balance	**494**	546
Balance represented by:		
Cash - held in the Official Public Account	**494**	546
Total balance carried to the next period	**494**	546

Note 27H: Assets held in trust (Administered)

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

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

Note 28: Reporting of outcomes

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

	Outcome 1	Outcome 1
	2010	2009
	$'000	$'000
Expenses		
Administered	**6,348,041**	4,962,355
Departmental	**15,328**	7,875
Total expenses	**6,363,369**	4,970,230
Own-source income		
Administered		
Interest	**1,436,315**	2,527,570
Other	**281**	3,328
Gains (losses)	**(2,824,929)**	800,985
Total administered	**(1,388,333)**	3,331,883
Departmental		
Other	**919**	1,093
Total departmental	**919**	1,093
Total own-source income	**(1,387,414)**	3,332,976
Net cost/(contribution) of outcome	**7,750,783**	1,637,254

Note 29: Communications Fund

Until 1 January 2009, the AOFM acted as an agent for the Department of Broadband, Communications and the Digital Economy (DBCDE) in making investments on behalf of the Communications Fund.

The Communications Fund was established by Part 9C of the *Telecommunications (Consumer Protection and Service Standards) Act 1999*. The Communications Fund consists of a special account and investments.

Note 29: Communications Fund (continued)

Telecommunications (Consumer Protection and Service Standards) Act 1999 **(Part 9C)**	**DBCDE (Responsible Agency) 2009 $'000**
Opening Balance (at cost)	2,356,419
Investment earnings receipts	94,457
Expense payments	(158)
Transfers to Building Australia Fund (at cost)	(2,450,718)
Balance of investments (at cost) — 30 June	-

This table is prepared on a cash basis, showing net receipts and payments.

In the 2008-09 Budget it was announced that the Communications Fund would close during the year and its assets would be transferred to the Building Australia Fund (managed by the Future Fund Board of Guardians). On 1 January 2009 the Communications Fund was abolished and its investments were transferred to the Building Australia Fund. The market value of the investments transferred on 1 January 2009 was $2,468,395,373. Following the transfer, the Building Australia Fund paid investment management costs of $163,830 (excluding GST) incurred, but not paid, by the Communications Fund.

These investments and their earnings were reported by DBCDE and not the AOFM.

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 2009-10 in the context of the overall flow of funds for the Australian Government General Government Sector. Flows managed by the AOFM are shown in pink.

Table 1: General Government Sector funding requirement and funding sources

Source of funds	Actual 2009-10 ($billion)	Use of funds	Actual 2009-10 ($billion)
		Headline budget balance	56.5
Debt issuance [a]		**Debt redemption** [a]	
Treasury Bonds	53.7	Maturing CGS debt	6.0
Treasury Indexed Bonds	7.1	Early CGS debt repurchases	1.1
Total	**60.8**	Treasury Notes (net)	6.1
		Total	**13.2**
Other sources of funds			
IMF financing transactions	4.8	**Other applications of funds**	
Total	**4.8**	Other general government sector borrowings (net)	0.1
Financial assets		Other financing (net) [b]	1.4
Change in AOFM asset holdings	6.7	**Total**	**1.5**
Change in Official Public Account balance at the RBA	0.3	**Financial assets**	
Total	**7.0**	Change in other general government sector investments	1.5
		Total	**1.5**
Total	**72.6**	**Total**	**72.6**

(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.

Appropriations and other sources of funding

Table 2 summarises the gross resources applied by the AOFM in 2009-10 and budgeted for 2010-11, both from appropriations and other sources and for recurrent and capital purposes.

Agency recurrent funding is used to meet operating expenses such as employee remuneration and supplier payments.

Administered recurrent funding is used to meet operating expenses such as interest on Australian Government debt and swap interest payments.

Capital funding is used to meet the cost of maturing Australian Government debt and to make investments.

Table 2: AOFM gross appropriations and other funding

	Budget(b) 2009-10 ($'000)	Actual 2009-10 ($'000)	Budget 2010-11 ($'000)
FUNDING FOR CURRENT PURPOSES			
ADMINISTERED EXPENSES(a)			
Annual appropriations	10	-	10
Special appropriations	6,613,362	6,400,628	9,605,850
Total administered appropriations	**6,613,372**	**6,400,628**	**9,605,860**
DEPARTMENTAL			
Annual appropriations	12,569	12,569	15,896
Total revenue from government (appropriations) contributing to price of agency outputs	**12,569**	**12,569**	**15,896**
Percentage of total price of outputs	**92.5%**	**91.2%**	**93.6%**
Revenue from other sources			
Other sources	1,018	1,214	1,089
Total revenue from other sources	**1,018**	**1,214**	**1,089**
Total price of agency outputs	**13,587**	**13,783**	**16,985**
Total resourcing - recurrent purposes	**6,626,959**	**6,414,411**	**9,622,845**
FUNDING FOR CAPITAL PURPOSES(c)			
ADMINISTERED			
Special appropriations	363,589,808	408,022,012	367,890,500
Total administered appropriations	**363,589,808**	**408,022,012**	**367,890,500**
AGENCY			
Agency equity injections(d)	**-**	**-**	**250**
Total resourcing - capital purposes	**363,589,808**	**408,022,012**	**367,890,750**
Total resourcing for AOFM Outcome(e)	**370,216,767**	**414,436,423**	**377,513,595**
Administered	370,203,180	414,422,640	377,496,360
Departmental	13,587	13,783	17,235
	Budget(a) 2009-10	**Actual 2009-10**	**Budget 2010-11**
Average staffing level (number)	**37**	**36**	**42**

(a) Excludes unrealised fair value revaluations.
(b) The Budget figure for 2009-10 is the 'estimated actual 2009-10 balance' reported in the *Portfolio Budget Statements 2010-11*.
(c) Excludes repayments of debt made on behalf of the State and Territory governments through the Debt Retirement Reserve Trust Account, a special account governed by the *Financial Agreement Act 1994*.
(d) During 2009-10 the AOFM did not use any agency equity injections.
(e) Part 1: AOFM overview specifies the AOFM outcome.

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.

Advertising and market research

During 2009-10 the AOFM did not make payments to advertising agencies, market research organisations, polling organisations, direct mail organisations or media advertising organisations for campaign advertising or market research services.

Non-campaign advertising conducted during 2009-10 comprised an article in Finance Asia magazine to promote Australian Government debt, and recruitment advertising.

Freedom of information

Section 8 of the *Freedom of Information Act 1982* requires agencies to publish information about:

- their organisation and decision making powers;
- what arrangements they make for public involvement in their work;
- what types of documents they hold; and
- how the public can access these documents.

Freedom of information matters in respect of the AOFM are handled by the Treasury and the statement required under section 8 of the *Freedom of Information Act 1982* appears in the Treasury Annual Report. In this material, references to 'Department' encompass the AOFM. Additional details that relate specifically to the AOFM are provided below.

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 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 members 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 should apply in writing to:

The Secretary
The Treasury
Langton Crescent
PARKES ACT 2600
Attention: Freedom of Information Coordinator

If a member of the public requests a document and the Treasury approves access, the Treasury will provide copies of documents after the applicant pays any charges. Alternatively, applicants may arrange to inspect documents at the Treasury, Langton Crescent, Parkes, ACT between 9.00 am and 5.00 pm, Monday to Friday (except public and public service holidays).

An application fee of $30 or a written request, pursuant to subsection 30A(1) of the *Freedom of Information Act 1982*, that the application fee be waived should accompany requests. Telephone enquiries should be directed to the Freedom of Information Coordinator, telephone +61 2 6263 2976 or facsimile +61 2 6263 2992, between 9.00 am and 5.00 pm Monday to Friday (except public or public service holidays).

Officers of the SES in Treasury can grant or refuse requests for access to documents under section 23 of the *Freedom of Information Act 1982*. In accordance with section 54 of the Act, an applicant may, within 30 days of receiving notification of a decision under the Act, apply to the Secretary to the Treasury, seeking an internal review of a decision to refuse a request. The prescribed fee of $40 should accompany the application. Treasury Executive Directors are authorised under section 23 to consider and make decisions on applications for internal review.

Freedom of information activity

The AOFM received no requests for access to documents under the *Freedom of Information Act* in 2009-10.

Ecologically sustainable development

The AOFM's operations have an impact on the environment through the use of energy, water and other materials, and the generation of waste. 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 as at the end of June 2010 were Commonwealth Government Securities (Treasury Bonds, Treasury Indexed Bonds, Treasury Notes and other securities), short-term money market investments, term deposits placed with the Reserve Bank of Australia, short-dated bonds issued by Australian States and Territories, residential-mortgage backed securities (RMBS) and housing advances to the States under the 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. At the beginning of 2009-10 it also included assets purchased with the proceeds of 'additional' Treasury Bond issuance during 2008-09. These assets were subsequently sold.

As no borrowings have been undertaken in foreign currencies since 1987 the Portfolio holds only a 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 the within-year variability in the Australian Government's financing requirement due to within-year mismatches 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 2010 are shown in Table 3.

On 31 March 2010, AOFM holdings of certain mezzanine AAA rated RMBS notes were sold at par to a domestic investor for portfolio rebalancing purposes. Details may be found on the AOFM's website. Credit concerns were not a consideration in deciding to execute the sale.

Table 3: AOFM's RMBS investments up to 30 June 2010

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

* Weighted average life

Table 3: AOFM's RMBS investments up to 30 June 2010 (continued)

Pricing date	Settlement date	Issuer	Issue name	Tranche	Expected WAL* at closing (years)	Coupon (per cent)	Original face value ($m)
9-Jul-09	16-Jul-09	Wide Bay Australia	WB Trust 2009-1	Class A2	3.5	1M BBSW + 1.40%	282.50
9-Jul-09	16-Jul-09	Wide Bay Australia	WB Trust 2009-1	Class AB	5.4	1M BBSW + 1.60%	1.00
14-Jul-09	28-Jul-09	Australian Central Credit Union	Light Trust No. 2	Class A1	4.0	1M BBSW + 1.30%	190.00
20-Aug-09	4-Sep-09	Suncorp Metway	APOLLO Series 2009-1 Trust	Class A3	3.6	1M BBSW + 1.30%	499.20
28-Aug-09	11-Sep-09	Greater Building Society	GBS Receivables Trust No. 4	Class A1	4.3	1M BBSW + 1.35%	190.00
14-Oct-09	21-Oct-09	Liberty Financial	Liberty Prime Series 2009-2	Class A2	1.0	1M BBSW + 0.90%	35.00
14-Oct-09	21-Oct-09	Liberty Financial	Liberty Prime Series 2009-2	Class A3	3.3	1M BBSW + 1.40%	58.50
14-Oct-09	21-Oct-09	Liberty Financial	Liberty Prime Series 2009-2	Class AB	4.0	1M BBSW + 1.65%	6.30
21-Oct-09	28-Oct-09	RESIMAC	RESIMAC Premier Series 2009-2	Class A2	3.3	1M BBSW + 1.40%	38.10
21-Oct-09	28-Oct-09	RESIMAC	RESIMAC Premier Series 2009-2	Class AB	3.5	1M BBSW + 1.95%	18.30
10-Nov-09	24-Nov-09	FirstMac	FirstMac Mortgage Funding Trust Series 2-2009	Class A2	3.5	1M BBSW + 1.40%	195.40
10-Nov-09	24-Nov-09	FirstMac	FirstMac Mortgage Funding Trust Series 2-2009	Class AB	5.0	1M BBSW + 1.95%	19.74
22-Jan-10	29-Jan-10	AMP Bank	Progress 2010-1 Trust	Class AB	5.2	1M BBSW + 1.80%	36.00
9-Feb-10	17-Feb-10	Bank of Queensland	Series 2010-1 REDS Trust	Class A	3.1	1M BBSW + 1.30%	250.00
25-Feb-10	10-Mar-10	CUA	Series 2010-1 Harvey Trust	Class A1	2.9	1M BBSW + 1.35%	143.00
5-Mar-10	15-Mar-10	Members' Equity Bank	SMHL Securitisation Fund 2010-1	Class A	2.6	1M BBSW + 1.35%	250.00
17-Mar-10	24-Mar-10	Bendigo and Adelaide Bank	TORRENS Series 2010-1 Trust	Class A	2.8	1M BBSW + 1.35%	123.00
26-Mar-10	31-Mar-10	IMB	Illawarra Series 2010-1 RMBS Trust	Class A	3.0	1M BBSW + 1.35%	157.50
12-May-10	17-May-10	RESIMAC	RESIMAC Premier Series 2010-1	Class A	2.4	1M BBSW + 1.65%	10.00
28-May-10	9-Jun-10	Suncorp Metway	APOLLO Series 2010-1 Trust	Class A2	6.0	1M BBSW + 1.10%	300.00
							9022.96

*Weighted average life

Tender results for debt issuance

Table 4: Treasury Bond tender results — 2009-10

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
8 Jul 09	6.25% 15 May 2013	700	4.7435	0.35	2.00	3.78
10 Jul 09	5.75% 15 Jun 2011	700	3.7208	0.08	2.00	4.02
15 Jul 09	6.25% 15 Jun 2014	700	5.1288	-0.12	2.00	2.80
17 Jul 09	6.50% 15 Apr 2012	700	4.4722	-0.28	1.00	3.21
22 Jul 09	6.25% 15 May 2013	799	5.0174	1.24	1.50	2.78
24 Jul 09	5.75% 15 May 2021	499	5.7918	1.18	2.00	2.40
29 Jul 09	6.25% 15 Jun 2014	699	5.5313	-0.37	2.00	3.42
31 Jul 09	6.50% 15 Apr 2012	700	4.8116	0.16	0.50	4.94
5 Aug 09	6.25% 15 Apr 2015	500	5.5732	-0.18	2.00	4.11
7 Aug 09	6.25% 15 May 2013	802	5.3709	0.09	1.50	3.93
12 Aug 09	4.50% 15 Apr 2020	499	5.6782	-0.18	1.50	2.57
14 Aug 09	6.25% 15 Jun 2014	800	5.4804	-0.71	2.50	3.32
19 Aug 09	6.00% 15 Feb 2017	499	5.4658	-0.42	0.50	3.88
21 Aug 09	6.25% 15 Apr 2015	501	5.3022	-0.53	1.00	4.39
26 Aug 09	5.75% 15 May 2021	500	5.4542	-0.33	1.00	2.52
28 Aug 09	6.25% 15 May 2013	699	5.2095	0.70	1.50	2.69
4 Sep 09	6.25% 15 Jun 2014	700	5.2284	-0.16	1.50	2.91
9 Sep 09	6.25% 15 Apr 2015	500	5.3067	0.17	1.50	2.57
16 Sep 09	6.00% 15 Feb 2017	500	5.2283	0.08	1.50	2.88
18 Sep 09	6.50% 15 Apr 2012	701	4.6713	0.13	1.00	3.47
23 Sep 09	4.50% 15 Apr 2020	502	5.4334	-0.41	1.00	3.44
25 Sep 09	6.25% 15 May 2013	699	4.9075	-0.25	0.50	4.14
7 Oct 09	6.25% 15 Jun 2014	698	5.1630	0.05	1.00	3.25
14 Oct 09	6.00% 15 Feb 2017	700	5.3299	-0.76	1.00	2.43
21 Oct 09	6.25% 15 Apr 2015	500	5.6575	0.25	1.00	3.95
23 Oct 09	6.50% 15 Apr 2012	702	5.2544	0.44	0.50	4.16
28 Oct 09	6.25% 15 Jun 2014	500	5.5304	0.04	1.00	3.80
30 Oct 09	6.25% 15 Apr 2015	700	5.4534	0.09	1.50	2.93
4 Nov 09	4.50% 15 Apr 2020	499	5.6450	0.00	1.00	4.43
6 Nov 09	6.50% 15 Apr 2012	700	5.0221	-1.04	0.50	5.54
11 Nov 09	5.75% 15 May 2021	499	5.7793	-0.57	1.00	3.95
13 Nov 09	6.25% 15 Jun 2014	701	5.3847	-0.03	1.00	5.51
18 Nov 09	4.50% 15 Apr 2020	599	5.5540	0.15	1.00	3.54
20 Nov 09	6.25% 15 May 2013	601	4.9827	0.27	0.50	3.72
25 Nov 09	5.75% 15 May 2021	501	4.4250	-0.50	1.00	3.36
27 Nov 09	6.50% 15 Apr 2012	701	4.5967	-0.08	1.00	4.16
2 Dec 09	6.00% 15 Feb 2017	501	5.1715	-0.60	0.50	4.52
4 Dec 09	6.25% 15 Jun 2014	700	5.0536	-0.14	1.00	4.27
9 Dec 09	6.25% 15 May 2013	700	4.9179	-0.46	1.50	3.28
13 Jan 10	5.25% 15 Mar 2019	500	5.4984	0.09	1.50	2.62
15 Jan 10	6.25% 15 Apr 2015	700	5.3820	-0.05	1.00	4.54

Table 4: Treasury Bond tender results — 2009-10 (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
20 Jan 10	4.50% 15 Apr 2020	500	5.6316	-0.09	1.00	2.54
22 Jan 10	6.50% 15 Apr 2012	700	4.6600	-1.00	0.00	4.85
27 Jan 10	6.25% 15 May 2013	700	4.9214	0.89	2.00	1.45
29 Jan 10	5.25% 15 Mar 2019	500	5.4115	0.15	1.00	2.85
3 Feb 10	4.50% 15 Apr 2020	500	5.5163	0.89	1.00	2.88
5 Feb 10	6.25% 15 Apr 2015	700	5.0439	0.39	1.00	2.81
10 Feb 10	5.75% 15 May 2021	500	5.5744	0.19	0.50	3.79
12 Feb 10	6.25% 15 May 2013	700	4.9100	0.00	0.00	5.37
17 Feb 10	4.50% 15 Apr 2020	500	5.5952	0.02	1.00	4.31
19 Feb 10	4.75% 15 Nov 2012	1,250	4.8552	0.00	3.50	3.74
24 Feb 10	5.75% 15 May 2021	300	5.6272	-0.28	0.50	4.66
26 Feb 10	4.75% 15 Nov 2012	1,000	5.7470	-0.30	1.00	2.69
3 Mar 10	4.50% 15 Apr 2020	500	5.4550	0.00	1.00	3.79
5 Mar 10	6.25% 15 May 2013	700	4.8499	0.24	0.50	3.66
10 Mar 10	6.25% 15 Jun 2014	700	5.2093	-0.07	0.50	3.44
17 Mar 10	6.25% 15 Apr 2015	500	5.3522	-0.28	1.00	3.78
19 Mar 10	4.75% 15 Nov 2012	1,000	5.0646	-0.29	2.50	3.20
24 Mar 10	5.25% 15 Mar 2019	500	5.6565	-0.45	0.50	3.87
26 Mar 10	6.25% 15 Jun 2014	700	5.4008	0.33	2.00	2.89
31 Mar 10	5.75% 15 May 2021	500	5.8291	0.41	0.50	4.29
7 Apr 10	5.75% 15 Jul 2022	1,000	5.9642	N/A	4.50	3.25
9 Apr 10	6.00% 15 Feb 2017	500	5.7008	0.08	0.50	3.41
14 Apr 10	5.75% 15 Jul 2022	800	5.9428	0.28	0.50	3.78
16 Apr 10	4.75% 15 Nov 2012	750	5.2141	-0.34	1.00	4.67
21 Apr 10	4.50% 15 Apr 2020	700	5.8501	0.26	1.50	2.69
23 Apr 10	5.25% 15 Mar 2019	500	5.7754	0.04	1.00	2.91
30 Apr 10	5.50% 15 Dec 2013	1,250	5.3931	N/A	3.00	4.00
5 May 10	5.75% 15 Jul 2022	500	5.7568	0.68	1.00	3.18
7 May 10	4.75% 15 Nov 2012	700	4.9063	0.88	2.00	3.21
12 May 10	5.75% 15 Jun 2011	700	4.4144	-2.36	5.00	3.07
14 May 10	5.50% 15 Dec 2013	1,000	5.1953	0.78	0.50	3.84
19 May 10	6.00% 15 Feb 2017	500	5.2710	-0.40	0.50	3.58
21 May 10	4.75% 15 Nov 2012	700	4.6532	0.57	1.00	3.14
26 May 10	4.50% 15 Apr 2020	500	5.3332	-0.18	0.50	3.38
28 May 10	5.50% 15 Dec 2013	750	4.9550	-1.00	1.00	4.47
2 Jun 10	6.00% 15 Feb 2017	500	5.1600	-0.25	1.00	2.73
4 Jun 10	6.25% 15 Apr 2015	700	5.0932	0.32	0.50	2.75
9 Jun 10	5.75% 15 Jul 2022	500	5.4302	0.27	1.00	3.34
16 Jun 10	5.25% 15 Mar 2019	500	5.3912	-0.13	1.00	2.18
18 Jun 10	5.50% 15 Dec 2013	700	4.8874	0.74	1.00	3.84
Average over year to June 2010				-0.02	1.22	3.54
Average over 3 years to June 2010				0.19	1.40	3.60
Average over 10 years to June 2010				0.24	1.30	3.70

Table 5: Treasury Indexed Bond tender results — 2009-10

Tender date	Coupon and maturity	Face value amount allocated ($m)	Weighted average issue yield (%)	Spread to secondary market yield (basis points)	Times covered
16 Nov 09	4.00% 20 Aug 2020	301	2.9800	-2.50	3.12
19 Jan 10	3.00% 20 Sep 2025	300	2.7050	-1.00	3.36
23 Feb 10	4.00% 20 Aug 2015	300	3.6400	-6.00	4.19
23 Mar 10	3.00% 20 Sep 2025	300	2.7350	-0.50	3.75
13 Apr 10	4.00% 20 Aug 2015	300	2.6700	-4.00	4.25
25 May 10	4.00% 20 Aug 2020	300	2.5450	-0.50	3.90
22 Jun 10	4.00% 20 Aug 2015	300	2.4000	-3.50	4.77
Average over year to June 2010				-2.57	3.91

Table 6: Treasury Note tender results — 2009-10

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)
2 Jul 09	23 Oct 09	600	3.0100	6.0	2.94	11.05	-10.95
2 Jul 09	22 Jan 10	300	3.1000	7.0	2.92	23.67	-10.13
16 Jul 09	23 Oct 09	500	3.0400	5.0	2.97	11.26	-6.04
16 Jul 09	22 Jan 10	300	3.1500	4.0	2.98	20.07	-8.93
23 Jul 09	23 Oct 09	600	3.0500	2.0	2.97	8.91	-7.59
23 Jul 09	22 Jan 10	300	3.1900	0.0	2.98	21.00	-11.00
6 Aug 09	27 Nov 09	300	3.1600	8.0	3.08	10.10	-13.00
6 Aug 09	22 Jan 10	300	3.3300	4.0	3.17	18.27	-8.63
20 Aug 09	27 Nov 09	300	3.1400	0.0	3.09	5.40	-14.80
20 Aug 09	22 Jan 10	300	3.3300	6.0	3.19	18.05	-9.15
3 Sep 09	23 Oct 09	300	3.0700	0.0	3.02	4.60	-14.90
17 Sep 09	23 Oct 09	299	3.0300	2.0	3.02	1.26	-15.04
1 Oct 09	8 Jan 10	300	3.2200	5.0	3.29	-5.37	-13.37
1 Oct 09	9 Apr 10	300	3.6200	4.0	3.57	7.20	-15.80
15 Oct 09	22 Jan 10	300	3.5200	6.0	3.61	-5.75	-30.25
22 Oct 09	8 Jan 10	600	3.5100	6.0	3.66	-11.46	-25.36
22 Oct 09	23 Apr 10	300	4.0500	5.0	4.05	3.13	-23.57
29 Oct 09	18 Dec 09	600	3.4700	17.0	3.54	0.19	-10.41
29 Oct 09	12 Feb 10	400	3.7200	17.0	3.72	8.52	-15.68
12 Nov 09	26 Feb 10	600	3.7300	4.0	3.73	2.73	-29.87
19 Nov 09	26 Feb 10	600	3.6600	7.0	3.72	-3.33	-27.13
26 Nov 09	26 Feb 10	600	3.7500	6.0	3.76	3.75	-22.25
26 Nov 09	21 May 10	600	4.0900	5.0	3.99	14.02	-26.28
3 Dec 09	12 Mar 10	600	3.7800	3.0	3.82	-1.60	-25.20
10 Dec 09	12 Feb 10	300	3.7900	0.0	3.78	1.20	-25.10
10 Dec 09	23 Apr 10	300	3.8600	9.0	3.91	2.60	-34.90
17 Dec 09	12 Mar 10	300	3.7300	25.0	3.83	4.44	-19.68
17 Dec 09	21 May 10	600	3.9700	4.0	3.97	2.86	-28.77
14 Jan 10	12 Mar 10	400	3.8000	9.0	3.88	-4.81	-30.63
14 Jan 10	23 Apr 10	600	3.8800	17.0	3.98	-2.55	-29.63
21 Jan 10	26 Feb 10	300	3.7800	11.0	3.87	-0.74	-16.93
21 Jan 10	26 Mar 10	800	3.8500	7.0	3.95	-7.09	-29.71
21 Jan 10	21 May 10	600	3.8800	17.0	4.08	-13.20	-34.53
28 Jan 10	7 May 10	600	3.8800	12.0	4.07	-14.95	-40.77
4 Feb 10	23 Apr 10	500	3.7800	4.0	3.83	-3.64	-29.32
11 Feb 10	7 May 10	600	3.7500	11.0	3.84	-4.67	-37.96
11 Feb 10	11 Jun 10	300	3.7900	11.0	3.90	-8.03	-41.53
18 Feb 10	7 May 10	600	3.7800	10.0	3.89	-5.11	-26.15
18 Feb 10	11 Jun 10	300	3.8600	9.0	3.96	-5.35	-28.04
25 Feb 10	23 Apr 10	600	3.8000	10.0	3.89	-3.60	-23.23
25 Feb 10	21 May 10	600	3.8300	12.0	3.93	-3.47	-25.93
25 Feb 10	23 Jul 10	300	3.9700	9.0	4.05	-2.09	-29.89
4 Mar 10	11 Jun 10	600	3.9400	12.0	4.10	-12.24	-24.98
11 Mar 10	11 Jun 10	600	4.0500	11.0	4.14	-3.56	-26.23

Table 6: Treasury Note tender results — 2009-10 (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)
11 Mar 10	23 Jul 10	300	4.0100	22.0	4.23	-1.95	-24.05
18 Mar 10	11 Jun 10	600	4.0400	15.0	4.15	2.35	-5.76
25 Mar 10	25 Jun 10	600	4.1700	7.0	4.23	-1.92	-16.92
25 Mar 10	13 Aug 10	300	4.2000	17.0	4.32	3.12	-18.45
8 Apr 10	23 Jul 10	600	4.3500	9.0	4.40	1.90	-13.60
8 Apr 10	13 Aug 10	300	4.4400	0.0	4.44	0.33	-17.13
15 Apr 10	23 Jul 10	400	4.4000	6.0	4.37	7.30	-17.10
22 Apr 10	23 Jun 10	600	4.3700	4.0	4.42	-2.22	-8.72
22 Apr 10	13 Aug 10	600	4.4500	7.0	4.45	3.35	-7.45
22 Apr 10	10 Sep 10	600	4.3500	23.0	4.50	6.65	-8.85
29 Apr 10	13 Aug 10	400	4.5500	3.0	4.52	5.07	-10.27
6 May 10	13 Aug 10	600	4.5700	5.0	4.58	1.22	-23.86
6 May 10	26 Nov 10	600	4.7300	10.0	4.73	6.67	-18.52
13 May 10	24 Sep 10	400	4.5600	7.0	4.60	-2.06	-34.03
20 May 10	13 Aug 10	600	4.5000	5.0	4.52	0.06	-14.76
20 May 10	24 Sep 10	600	4.5400	1.0	4.53	1.51	-36.82
20 May 10	26 Nov 10	300	4.6200	6.0	4.57	9.20	-31.38
25 May 10	24 Sep 10	400	4.4000	0.0	4.47	-6.71	-46.74
3 Jun 10	10 Sep 10	300	4.5500	10.0	4.52	0.75	-30.93
10 Jun 10	24 Sep 10	600	4.5000	5.0	4.54	-2.25	-42.61
10 Jun 10	17 Dec 10	600	4.6000	11.0	4.57	9.31	-30.13
17 Jun 10	24 Sep 10	600	4.5000	9.0	4.56	0.85	-33.62
17 Jun 10	26 Nov 10	600	4.6000	15.0	4.61	9.96	-29.02
24 Jun 10	22 Oct 10	400	4.5400	10.0	4.55	1.93	-41.28
Average over year to June 2010				8.03	4.75	2.00	-22.67

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 transaction was conducted that gave rise to the asset or liability. 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 the Government's 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 includes small residual amounts of Australian Savings Bonds, Peace Saving Certificates and War Saving Certificates.

Coupon rate

The rate of fixed interest payable on a bond over a particular period. 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 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 investment transactions.

Credit spread

The difference in yield between different securities due to different credit quality. The credit spread reflects the additional net yield an investor can earn from a security with more credit risk relative to one with less credit risk.

Derivative

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

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 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 BBSW (Bank Bill Swap Reference Rates). 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 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 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 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.

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 paid (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 issue premium or discount 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 interest cost.

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

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 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 of a debt instrument to be sold readily 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 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 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 tend to have more stable interest costs through time but have 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', 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 the other party a fixed interest rate in exchange for receiving the average overnight cash rate recorded over the term of the swap. The terms to maturity of such swaps are typically between one week to one year. Financial market participants enter into overnight indexed swaps to manage their exposures to movement in the overnight cash rate.

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

Physical debt

Securities that evidence debt, in contrast to derivatives. Treasury Bonds, Treasury Indexed Bonds and Treasury Notes are physical debt.

Present value

The amount that represents the value today 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 $\$100 \times [1/(1 + 0.10)^2] = \$82.64$.

Primary market

The market where securities 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 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 pool of loans secured by residential mortgages. A description of the principal features of a typical RMBS transaction is 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.

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 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 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 by giving a predetermined number of days notice.

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 security issued by the Australian Government whose capital value is adjusted periodically according to movements in the Consumer Price Index. Interest on the bonds 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 that cannot be funded by other means, such as changes in the AOFM's holdings of term deposits with the Reserve Bank of Australia.

Two-way price

The provision by a market-maker of the prices (or yields) at which they are prepared to buy and sell a particular financial product or instrument. That is, the quoting of both a bid and an offer.

UBS Australian Bank Bill Index

A performance benchmark designed to represent the performance of a passively managed short-term money market portfolio. This index has an average term to maturity of approximately 45 days which is commensurate with the average term to maturity of assets comprising major cash management trusts.

Yield

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

Yield curve

The graphical representation of the relationship between the yield on debt securities of the same credit quality but different terms to maturity 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
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

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