Australian Office of Financial Management

Annual Report 2008-09

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Australian Government

Australian Office of Financial Management

1 October 2009

The Hon Wayne Swan MP
Treasurer
Parliament House
CANBERRA ACT 2600

Dear Treasurer

I have pleasure in presenting the Annual Report of the Australian Office of Financial Management for the year ending 30 June 2009 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 aims to advance economic 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.

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Treasury Bond market

Last year's annual report included an article which reviewed the role of the Treasury Bond market in the Australian financial system in the light of developments over the preceding five years. In 2003 the then Government had announced that it would continue to issue Treasury Bonds in periods when borrowing was not needed for Budget funding in order to maintain a liquid and efficient bond market. This policy was continued by the present Government when it took office in 2007.

The decision to continue issuance was based on the benefits that the economy derives from having an active and efficient Treasury Bond market, together with the related market in Treasury Bond futures. These markets help financial institutions manage their interest rate risk and thereby contribute to a lower cost of capital in Australia. They also strengthen the financial system against the potential impact of financial shocks.

Taking account of developments over subsequent years, the article in last year's annual report concluded that these benefits remained important for the Australian economy. In particular, the experience of financial market turbulence in 2007-08, as the global financial crisis began to have its impact, had highlighted the roles of the Treasury Bond market and the futures market as anchors for the financial system.

During 2008-09, the global financial crisis intensified, generating further turbulence in Australian financial markets, particularly in the period between the failure of Lehman Brothers in mid-September 2008 and the announcement by the Government in mid-October that it would guarantee the deposits and wholesale funding of Authorised Deposit-taking Institutions. Over this period, the Treasury Bond market came under considerable buying pressure as investors sought safe haven assets. In addition, existing investors tended to hold the bonds more tightly, while some with large holdings reportedly stopped lending their securities to market makers. The AOFM increased its issuance to relieve these strains, and the Treasury Bond market and the Treasury Bond futures market continued to function in a broadly satisfactory manner.

Many other segments of financial markets were more severely affected by the turmoil and some effectively ceased operating through this period. The interest rate swaps market continued, but at a reduced level. The operation of the swaps market was helped by the continued functioning of the Treasury Bond futures market, as it allowed parties to undertake swaps to hedge their positions if needed.

In short, the experience of the past year further confirmed the value of the Treasury Bond and bond futures markets for the resilience of the financial system, while the global financial crisis has itself underscored the importance of financial system stability for economic prosperity.

The past year also highlighted one other benefit of maintaining an active and efficient Treasury Bond market that was not considered in the article in last year's report. This was that the existence of an active market, with its supporting networks of investors, dealers and other market intermediaries, tender arrangements and established procedures, enabled the AOFM to increase the volume of issuance very quickly when the need arose. It thus allowed the Government to act proactively and decisively in responding to the financial crisis and providing stimulus to the economy.

The AOFM was able to launch an increased issuance program in the same week that the Government announced the revised Budget outlook. In the subsequent five months, over $25 billion of Treasury Bonds were issued. This speedy response would not have been practicable if the sovereign bond market had no longer existed.

The increased issuance was readily taken up by investors, prompted by the energetic promotional efforts of our bond dealers and intermediaries. The AOFM also engaged actively with major investors, both domestically and overseas. The Treasurer gave presentations to investors in Tokyo, London and New York, and I visited investors in Hong Kong, Beijing, Tokyo, London, Paris and Dubai (the latter at a forum for investors in AAA bonds that included many central banks and reserve asset managers from around the globe). Meetings were also held in Sydney and Melbourne. Several financial institutions assisted in arranging meetings, including the Commonwealth Bank of Australia, Deutsche Bank, HSBC Bank, Nomura Securities, UBS and Westpac, and also the Australian Business Economists. I thank them for their support.

Additional funding was provided in the 2009-10 Budget for the Office to expand its investor relations and bond promotion activities. The main selling points for our bonds are the very strong position of the Australian economy and the Budget, the Australian Government's high credit status within the ranks of AAA-rated sovereigns, Australia's close links with strongly growing Asian economies, and the liquidity of our bond lines.

Additional Treasury Bond issuance and investment of the proceeds

During the first part of 2008-09 (prior to the change in the Budget outlook announced on 3 February 2009), the AOFM undertook additional issuance of Treasury Bonds over the program originally announced in the 2008-09 Budget. This was to maintain the liquidity and efficient operation of the market in the face of increased demand for the bonds. The proceeds of this additional issuance were invested to offset the cost and risk of the additional issuance.

The additional issuance program ended with the change in Budget estimates published on 3 February 2009. The additional issuance and investment undertaken up to that date amounted to $4.6 billion. The investments were predominantly in semi-government and Kangaroo bonds with risk characteristics closely matched to those of the additional Treasury Bonds. On 3 February 2009 the program had provided a positive net return of $21.5 million on an historic accruals basis, but a negative net return of $12.1 million on a mark-to-market basis.

Management of the portfolio

Since its establishment in 1999, the AOFM has sought to manage its debt portfolio to reduce debt servicing costs over the medium term at acceptable risk. For much of this period it used interest rate swaps to achieve this aim. However over recent years, market yield curves flattened and, at times, became inverted. This reduced the potential savings available from adjusting the portfolio's cost and risk characteristics through interest rate swaps. In the 2008 regular review of its portfolio management strategy, the AOFM concluded that this approach no longer provided a firm basis for achieving future savings. It therefore decided to end the strategy from the end of 2007-08.

Under the new approach followed in 2008-09, interest rate swaps are no longer used; the cost and risk characteristics of the portfolio are determined by issuance decisions, including the selection of the bond maturities to be issued.

Initially, issuance was planned to continue in accordance with the model set out in the 2003-04 Budget papers, which was designed to maintain a stable Treasury Bond market while also supporting the 3 and 10-year Treasury Bond futures contracts. In the absence of interest rate swaps, this approach would have caused the duration of the portfolio to rise gradually towards 4 over a period of years.

In the first half of 2008-09, the global financial crisis generated increased demand for Treasury Bonds in view of their high credit quality. This reduced the liquidity of the market and, to offset this, the Government directed the Office to undertake additional issuance as a temporary measure. The cost and risk of this additional issuance were offset by investing the proceeds in matched assets.

However, with the revised Budget outlook announced on 3 February 2009, investments in matched assets ceased and the selection of bond lines and the size of tenders now directly affected the risk characteristics of the portfolio. Henceforth issuance decisions needed to have regard to their impact on the overall maturity structure of the portfolio.

The revised approach to issuance adopted by the AOFM was designed to provide short-term flexibility within a framework directed to medium-term objectives. Decisions on the bond lines to be offered at tender were made weekly, taking account of market conditions, but a balance was maintained between issuing shorter and longer bonds. Issuance was spread over almost all the existing bond lines to increase their liquidity. Refinancing risk was managed by limiting the volume of debt maturing in the early years. The cumulative effect of these decision processes was that the average maturity and duration of the bonds issued between February and June 2009 was longer than if the selection of the bond lines to be issued had been guided simply by relative market demand.

Interest rate swap terminations

Although interest rate swaps are no longer used in the management of the AOFM's portfolio, at the start of the year it held a substantial volume of swaps as a legacy from their past use. During the year, the AOFM unwound 131 swaps with a notional face value of $15.35 billion. Of these, 130 were undertaken as part of an unwind program that commenced in November 2008. The program generated a net realised value of $1.029 billion in favour of the Commonwealth.

At end-June 2009 the portfolio contained 21 remaining swaps with a total notional face value of $2.425 billion. These are all due to mature by mid-May 2010; the AOFM expects to allow them to mature without early termination.

Residential mortgage-backed securities

In October 2008 the Treasurer directed the AOFM to invest up to $8 billion in residential mortgage-backed securities (RMBS) to support competition in lending for housing in Australia. The AOFM adopted a cornerstone investor approach to these investments with the aim of encouraging other investors to return to the RMBS market. The selection criteria used in assessing proposals was directed towards the objective of supporting competition in lending for housing and in ensuring that the funds provided would be used to originate new residential mortgages.

Consistent with the purpose of the program, the pricing of RMBS issues was determined by balancing the objective of providing a flow of funds that would allow competitive lending for new housing with the objective of attracting other investors. Where third party investors participated in transactions, the AOFM participated at the same price. This approach resulted in spreads over BBSW rates which were lower than the spreads available in the secondary market on previously issued RMBS, but which were still attractive in historic terms (relative to past primary issuance).

By end-June 2009, a total of 13 issues had been completed, in which the AOFM invested $6.2 billion and other investors $1.8 billion.

RMBS are complex financial and legal instruments and the AOFM has needed to expand its skills base to manage them. A new position of RMBS Portfolio Manager was established and filled by the recruitment of a person with extensive market experience of securitisation in Australia and overseas.

Other changes

Other substantial changes made during the year included:

- The resumption of issuance of Treasury Notes. These will be used primarily for within-year cash management, although in 2008-09 the volume of notes on issue was built up to allow a continuing market to be established;

- The use in cash management of short-term money market investments in highly-rated bank accepted bills and certificates of deposit. This provides the AOFM with a broader range of investment options and allows higher yields than on term deposits with the Reserve Bank of Australia; and

- The closure of the Communications Fund on 1 January 2009. The AOFM managed the investments of this Fund on behalf of the Department of Broadband, Communications and the Digital Economy. It was not part of the AOFM's own balance sheet.

Portfolio outcomes

The debt servicing cost of the gross debt managed by the AOFM in 2008-09 was $3.0 billion (after swaps). This represented a cost of funds of 4.39 per cent, compared with 6.55 per cent the previous year. The yield on physical debt fell as new debt was issued at lower interest rates than the debt issued in previous years. However, the major part of the change was due to increased revenues from interest rate swaps, as market interest rate movements during the year brought the value of the swap portfolio strongly into-the-money in the AOFM's favour and swap terminations allowed these gains to be realised.

The yield on assets in the portfolio was 5.36 per cent in 2008-09, compared with 6.75 per cent the previous year. This reflected lower yields on term deposits with the Reserve Bank of Australia, partially offset by higher yields from term investments (made with the proceeds of the additional issuance undertaken in the first part of the year). The returns from investments in residential mortgage-backed securities also lowered the average yield on gross assets.

The net cost of funds on the combined portfolio of debt and assets in 2008-09 was 3.64 per cent, compared with 6.44 per cent the previous year.

Public Register of Government Borrowings

The *Guarantee of State and Territory Borrowing Appropriation Act 2009* (the Guarantee Act), which was enacted in June 2009, includes provisions which require the AOFM to establish, and publish on its website each quarter, a register recording the beneficial ownership, by country, of all securities issued by the Commonwealth. The register must also record the beneficial ownership of any issuance by Australian States or Territories that is guaranteed by the Commonwealth. The AOFM must include in the register a statement of the Office's opinion as to the domicile of the beneficial owner of securities if nominal ownership is registered in a country other than the actual domicile.

These provisions were introduced as an amendment to the legislation in the Senate. The Government did not support the amendment there on the grounds that it was impractical and would not create greater transparency. However, the Government ultimately accepted the amendment in order to achieve passage of the Act.

The AOFM is consulting with the Treasury and the Australian Bureau of Statistics to establish whether there is a practicable way of providing better information on bond holdings. However this would need to take into account the following concerns:

- Many non-resident investors with large holdings of fixed securities are unwilling to disclose details of their investments for commercial reasons. Some public sector investors, such as central banks and foreign reserve managers, also have policy reasons for maintaining confidentiality about their activities.

- Such investors are likely to withdraw from securities where their holdings are required to be revealed. This would make it more difficult, and more costly, for the Commonwealth to issue securities and for States and Territories to issue guaranteed debt.

- The Guarantee Act contains no provisions to ensure participation by State and Territory governments that would be disadvantaged by its operation.

- The AOFM is unlikely to be able to form an opinion on the domicile of beneficial owners of securities where the nominal owners do not cooperate in identifying them.

- The Act contains no provisions to compel the provision of information by beneficial or notional bond holders.

- No provision has been made for additional resources for the AOFM to undertake this new function.

- No other country has similar requirements.

The Guarantee Act provides that the proposed public register must be in a form to be prescribed by regulations. No regulations have yet been made. The AOFM considers that this should not be done until a practicable set of arrangements has been devised that meets these concerns.

Operational risk

The AOFM has continued its efforts to strengthen its management of operational risk. Activities undertaken during the year included an update of the AOFM's Fraud Control Plan, completion of processes to support the provision of an annual Certificate of Compliance under the *Financial Management and Accountability Act 1997* and a comprehensive review of the AOFM's Chief Executive Officer's Instructions.

Cooperation with other debt managers

The AOFM actively supports sovereign debt management in other countries. It has seconded one staff member to assist in capacity development in debt management in Papua New Guinea under the Strongim Gavman program and one in the Solomon Islands as part of the Regional Assistance Mission Solomon Islands. These deployments aim to develop cash and debt management capabilities through training and mentoring, as well as the development of systems and procedures. This year a forum was conducted by the AOFM in Canberra attended by officials responsible for sovereign debt management of the two countries, together with seconded AOFM staff, to improve the assistance provided. The AOFM also hosted two visits from debt management officials from Indonesia.

Staff

Since its establishment in 1999, all AOFM staff have been engaged under Australian Workplace Agreements. With the change in government policy on 13 February 2008, the AOFM is working towards the establishment of a collective agreement. Since that date, no new Australian Workplace Agreements have been made. As an interim arrangement, new recruits are engaged under common law contracts.

There were no changes in the senior staff of the Agency during 2008-09.

The AOFM faced considerable challenges during the year in implementing policy initiatives and dealing with turbulent market conditions. Staff met these challenges with skill and determination. I thank them all for the contributions they have made.

Sovereign Risk Manager of the Year award

In January 2009 the AOFM was presented with the Sovereign Risk Manager of the Year award by Risk Magazine in London. The commendation referred to a range of activities undertaken by the AOFM in 2008, including issuance to maintain an active sovereign debt market, execution of interest rate swap terminations, investments in residential mortgage-backed securities and risk management initiatives aimed at reviewing, prioritising and mitigating the operational risks faced by the Agency.

It was pleasing to receive this award in the tenth year of the Office's operations as a separate agency. The Office has come a long way over this period in developing its expertise and systems and in responding to changing policy and market needs.

Nevertheless, it faces a challenging period ahead. Now is not the time to rest on our laurels.

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 a specialised agency 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 Commonwealth Government Securities (CGS) in the form of Treasury Bonds, and the operation of a securities lending facility that allows financial market participants to borrow Treasury Bonds from the Reserve Bank of Australia. The AOFM's cash management activities include the issuance of Treasury Notes for short-term funding, with surplus funds being invested in term deposits with the Reserve Bank of Australia (RBA) and in short-term money market instruments such as bank accepted bills and negotiable certificates of deposit. During the 2008-09 year, the AOFM also invested in residential mortgage-backed securities under a Government program to support competition in lending for housing. It also invested the proceeds of additional bond issuance undertaken during the year in semi-government and Kangaroo bonds.

During the year, the AOFM managed the investment of monies for the Communications Fund on behalf of the Department of Broadband, Communications and the Digital Economy. The Communications Fund was closed on 1 January 2009, with the assets being transferred into the Building Australia Fund, which is managed by the Future Fund Management Agency.

The AOFM forms 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, its finances are separate from those of the Treasury as it is a prescribed agency under the *Financial Management and Accountability Act 1997* and maintains its own accounts. Its staff are employed under the *Public Service Act 1999*.

For budgetary purposes, the AOFM's activities comprise a single output — debt management — directed to one outcome. This has been to enhance the Australian Government'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 Australian Government over time.

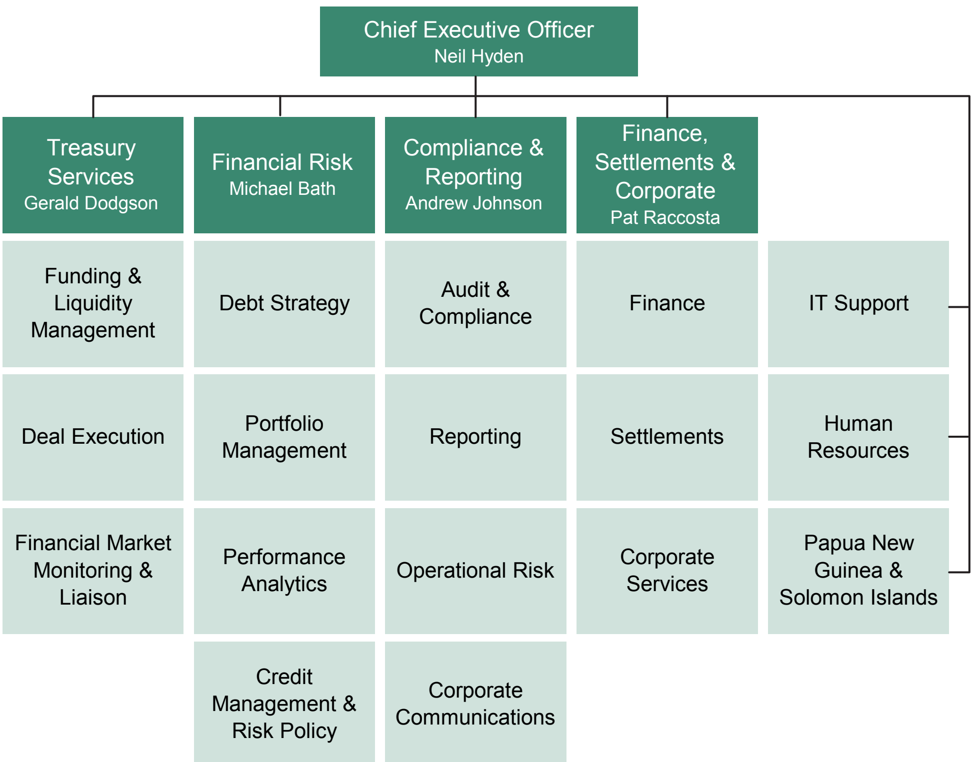
Organisational structure

During 2008-09, the AOFM was organised into four groups as set out in Figure 1:

- Treasury operations;
- Financial risk management;
- Compliance and reporting; and
- Finance, settlement and corporate functions.

These four groups are supported by an information technology support unit and a human resources unit. Additionally, two staff members are seconded to the Papua New Guinea and Solomon Islands governments to support their debt management activities. Roles and responsibilities within the office are 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 cost effectively, subject to acceptable risk; and
- supporting the efficient operation of Australia's financial system.

This section outlines the activities undertaken in 2008-09 and reports on their performance.

Treasury Bond issuance

Objectives

Between 1 July 2008 and 3 February 2009 the Budget was forecast to have a positive Underlying Cash Balance in 2009-10 so that there was no need to borrow for Budget funding. Treasury Bond issuance during this period was undertaken simply to support the efficient operation of the Treasury Bond and Treasury Bond futures markets. These markets play an important role in the operation of the Australian financial system, as they are used in the pricing and hedging of a wide range of financial instruments and in the management of interest rate risk. The existence of active and efficient Treasury Bond and Treasury Bond futures markets also strengthens the robustness of the financial system and reduces its vulnerability to shocks.

The forecast Budget outcome changed in the *Updated Economic and Fiscal Outlook* (UEFO) published on 3 February 2009. From that date, the primary objective of Treasury Bond issuance became raising monies to fund the Budget.

Achieving the objective

Supporting the Treasury Bond market

One consequence of the global financial crisis was an increase in the demand for Treasury Bonds, as investors sought high quality fixed interest investments. As a result, conditions in the Treasury Bond market tightened.

On 20 May 2008, following consultations with market participants about the adequacy of the supply of Treasury Bonds, the Treasurer announced that the Government would increase the issuance in order to ensure the continued efficient operation of the Treasury Bond and Treasury Bond futures markets. To this end, the Government legislated to allow an increase in Treasury Bonds on issue of up to $25 billion. Legislation providing for this received Royal Assent in July 2008.

On 13 July 2008, the Treasurer directed the AOFM to issue up to an additional $5 billion of Treasury Bonds beyond the $5.3 billion program announced in the Budget. The amount of additional issuance was to depend on market conditions. Towards the end of 2008 it appeared that the $5 billion limit might not be sufficient, and on 15 December 2008 the Treasurer increased the limit by a further $5 billion.

Between 1 July 2008 and 3 February 2009, the AOFM issued a total of $8.8 billion of Treasury Bonds (in face value terms). Of this amount, $4.2 billion represented issuance under the core program announced in the 2008-09 Budget and $4.6 billion represented additional issuance.

Issuance under the core program was in a new June 2014 bond line and the existing May 2021 bond line.

In order to best support the market, additional issuance was directed to bond lines that were in the shortest supply. Bonds were issued both on an outright tender basis (that is in exchange for cash) and through switch tenders where bonds were issued in exchange for State government bonds of a similar maturity. A total of 19 additional tenders were held, seven on an outright basis and 12 as switch tenders.

Funding the Budget

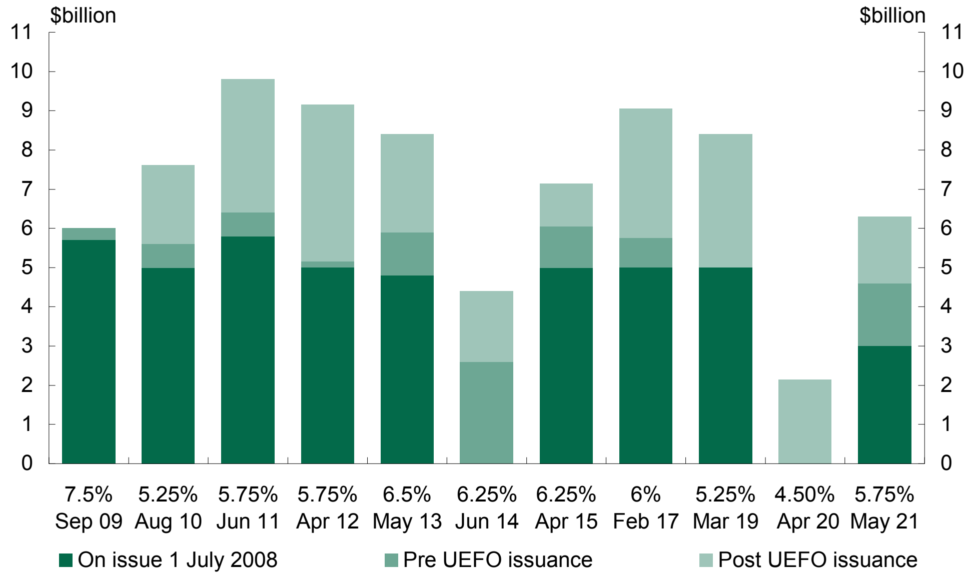
Following the change in fiscal forecasts in February 2009, Treasury Bond issuance was redirected towards raising monies to fund the Budget. The volume of issuance also increased; over $25 billion of bonds were issued between February 2009 and June 2009.

Generally two bond tenders were held per week, each in the range $500 million to $700 million. The bulk of issuance was into existing bond lines in order to enhance their liquidity and improve their attractiveness to investors. A new bond line with a maturity date of April 2020 was also launched in order to establish a line that can act as the benchmark ten-year bond in 2010.

The selection of bond lines for issue took account of current market conditions, relative value considerations, the aim of increasing the liquidity of all outstanding bond lines and the need to manage the maturity structure of the debt to limit refinancing risk.

Chart 1 shows the Treasury Bonds outstanding as at 30 June 2009 and issued over the financial year.

Chart 1: Treasury Bonds outstanding as at 30 June 2009 and issuance in 2008-09



Whereas in June 2008 most bond lines had a volume on issue of around $5 billion, by June 2009 five lines had volumes on issue of over $8 billion. During the year the total volume of Treasury Bonds on issue (net of Australian Government holdings) increased by around $29.0 billion, to $78.4 billion.

Following the 2009-10 Budget, consideration was given to issuing longer-dated Treasury Bonds and resuming the issuance of Treasury Indexed Bonds. Issuance of such bonds could assist portfolio management by widening the range of available debt instruments, diversifying risk and tapping additional sources of investor demand. However no decisions had been announced by the end of the year.

Securities lending facility

The AOFM's securities lending facility allows bond market participants to borrow Treasury Bonds for short periods when they are not otherwise available. This enhances the efficiency of the market by improving the capacity of intermediaries to make two-way prices.

In August 2008 changes were made to the securities lending facility in order to enhance its effectiveness.

- The range of collateral accepted in lending Treasury Bonds through the facility was widened to include all securities accepted by the Reserve Bank of Australia as general collateral in repurchase agreements. Prior to this, acceptable collateral was limited to Commonwealth Government Securities. This limitation on the range of acceptable collateral made it potentially more difficult to access the facility when these securities were in general short supply.
- The facility was also extended to permit the borrowing of Treasury Bonds on an intra-day basis. This change was made because it would facilitate the settlement of financial transactions involving the bonds in some situations (for example where a closed chain of lending transactions has inadvertently developed between market participants).

Consultation with financial market participants

The AOFM continued to maintain an active dialogue with financial market participants, the RBA and the Australian Securities Exchange. The AOFM also participated as an observer in meetings of the Debt Securities Committee, Repo Committee and Negotiable Trading Instruments Committee of the Australian Financial Markets Association.

Following the increase in issuance from February 2009, liaison with both domestic and overseas investors was substantially expanded to promote issuance and the Office's awareness of investor needs and preferences.

Performance

Market efficiency

The Treasury Bond market experienced considerable volatility in 2008-09. In particular, in the period between the failure of Lehman Brothers in mid-September 2008 and the announcement of the Commonwealth guarantee of deposits and wholesale funding of authorised deposit-taking institutions in mid-October 2008, the Treasury Bond market came under considerable buying pressure as investors sought safe haven assets. In addition, existing investors tended to hold the bonds more tightly, while some with large holdings reportedly stopped lending their securities to market-makers.

Despite these strains, the Treasury Bond market continued to function in a broadly satisfactory manner. Many other segments of financial markets were more severely affected by the turmoil through this period and at times some effectively ceased operating.

Tightness in the Treasury Bond market was eased by the increased issuance and its targeting into the most sought after bond lines. The timing and volume of issuance was closely aligned to market conditions. For example, in early October, when market strains were at their height, $1.45 billion of bonds were issued in four tenders over consecutive business days.

The changes to securities lending arrangements also helped minimise pressures in the Treasury Bond market and kept the repurchase (repo) market operating reasonably smoothly. Reflecting the strong demand for Treasury Bonds, there was considerable usage of the securities lending facility in 2008-09:

- The facility was used for overnight borrowing 374 times in 2008-09 compared with 88 times in 2007-08. The face value amount lent was around $12.8 billion compared to $2.5 billion in 2007-08.

- Peak usage of the facility occurred in September and October, when the facility was accessed 161 times for term lending and the amount lent was $6.7 billion.

The financial market turbulence impacted upon turnover in both the Treasury Bond and Treasury Bond futures markets.

- The turnover of Treasury Bonds decreased by around 10.4 per cent in 2008-09 compared to 2007-08.

- The turnover of 3-year Treasury Bond futures contracts decreased by around 30 per cent in 2008-09 compared to 2007-08, and turnover of the 10-year contracts decreased by around 38 per cent.

All Treasury Bond futures contract close-outs in 2008-09 occurred smoothly.

Efficiency of issuance

Treasury Bonds are issued by competitive tender using an electronic tender system. In March 2009 the AOFM adopted a new electronic tender system supplied by Yieldbroker Pty Ltd. The Yieldbroker DEBTS system is an online platform which operates in Australia for the trading of fixed income securities. The change to the new tender system occurred very smoothly and was well received by bidders. The system is easy to use and tender results are now available almost immediately after the close of bidding. Each bidder is also given details of the stock allotted to them almost immediately after the close of the tender.

Despite the large increase in issuance, tender performance measures in 2008-09 were broadly in line with those in recent years. Table 1 shows the results of the tenders conducted during the year.

Table 1: Treasury Bond tender results — 2008-09

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
21-Jul-08	6.25% 15-Jun-2014	750	6.4774	na	1.50	2.68
30-Jul-08	6.25% 15-May-2013	150	6.2167	-0.33	1.00	5.69
6-Aug-08	6.50% 15-Apr-2012	149	5.8899	-0.51	1.00	6.05
11-Aug-08	6.25% 15-Jun-2014	600	5.8867	0.67	3.00	2.43
13-Aug-08	5.75% 15-Jun-2011	151	5.6800	na	na	8.47
18-Aug-08	6.25% 15-May-2013	149	5.7150	na	na	6.70
20-Aug-08	5.75% 15-Jun-2011	151	5.6700	na	na	8.19
27-Aug-08	6.00% 15-Feb-2017	152	5.7000	na	na	8.55
3-Sep-08	6.25% 15-Apr-2015	300	5.6500	na	na	4.44
8-Sep-08	6.25% 15-Apr-2015	401	5.7991	-0.09	1.50	4.48
17-Sep-08	6.25% 15-May-2013	300	5.4850	na	na	5.15
22-Sep-08	5.75% 15-May-2021	400	5.7866	-0.59	1.50	2.94
1-Oct-08	6.00% 15-Feb-2017	301	5.485	na	na	3.26
8-Oct-08	5.75% 15-May-2021	399	5.1204	1.29	1.00	3.05
9-Oct-08	6.25% 15-Jun-2014	450	4.7310	1.10	2.50	1.50
10-Oct-08	5.25% 15-Aug-2010	301	4.0300	na	na	2.55
13-Oct-08	7.50% 15-Sep-2009	300	4.0983	9.83	5.00	3.43
24-Oct-08	5.25% 15-Aug-2010	300	4.1900	na	na	2.98
5-Nov-08	6.00% 15-Feb-2017	299	5.2000	na	na	4.08
12-Nov-08	6.25% 15-Apr-2015	299	4.5500	na	na	4.59
19-Nov-08	6.25% 15-May-2013	200	4.1100	na	na	3.15
5-Dec-08	6.25% 15-Apr-2015	300	3.8856	-0.44	2.00	3.00
8-Dec-08	6.25% 15-May-2013	299	3.8411	-0.64	0.50	3.25
10-Dec-08	6.25% 15-Jun-2014	400	3.9244	1.44	3.00	2.03
7-Jan-09	5.75% 15-Jun-2011	300	3.2950	-1.00	0.00	3.70
12-Jan-09	6.25% 15-Apr-2015	150	3.6850	-1.00	0.00	5.90
16-Jan-09	6.25% 15-Jun-2014	401	3.4413	0.83	2.00	2.51
21-Jan-09	5.75% 15-May-2021	399	4.0692	2.92	4.00	1.44
6-Feb-09	6.25% 15-Apr-2015	601	3.9113	0.38	1.50	2.62
11-Feb-09	6.25% 15-May-2013	601	3.4608	1.08	1.50	2.58
13-Feb-09	6.25% 15-Jun-2014	601	3.6905	0.75	3.00	2.87
18-Feb-09	6.50% 15-Apr-2012	600	2.9851	-0.99	1.50	4.78
20-Feb-09	5.75% 15-Jun-2011	599	2.9321	-2.29	0.50	4.45
25-Feb-09	6.25% 15-May-2013	600	3.4804	0.54	1.50	4.08
27-Feb-09	5.75% 15-May-2021	501	4.5176	-2.24	1.50	3.91
3-Mar-09	6.50% 15-Apr-2012	600	3.3029	0.29	1.50	3.88
6-Mar-09	6.25% 15-Jun-2014	598	3.7168	0.18	2.00	3.14
11-Mar-09	6.00% 15-Feb-2017	601	4.1811	-0.61	2.50	2.97
13-Mar-09	5.25% 15-Aug-2010	600	2.5880	0.30	2.00	2.55
18-Mar-09	5.75% 15-Jun-2011	701	2.9546	1.46	2.00	4.48
20-Mar-09	5.75% 15-May-2021	500	4.4176	1.26	3.50	2.46
25-Mar-09	6.25% 15-Jun-2014	601	3.9811	1.61	4.00	2.71
27-Mar-09	5.25% 15-Mar-2019	600	4.5506	1.06	2.00	2.98
1-Apr-09	6.00% 15-Feb-2017	600	4.2867	1.17	2.00	3.66
3-Apr-09	6.25% 15-May-2013	599	3.8374	2.24	2.00	3.40
8-Apr-09	5.75% 15-May-2021	700	4.8736	0.61	1.50	3.36
15-Apr-09	5.25% 15-Mar-2019	700	4.6351	1.01	1.50	3.16
17-Apr-09	5.75% 15-Jun-2011	701	3.3248	-0.02	2.00	4.94

Continued over page.

Table 1: Treasury Bond tender results — 2008-09 (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
22-Apr-09	6.50% 15-Apr-2012	700	3.5375	-1.25	2.50	5.46
24-Apr-09	6.00% 15-Feb-2017	700	4.3763	0.13	1.00	3.56
29-Apr-09	4.50% 15-Apr-2020	750	4.6844	na	10.50	2.89
1-May-09	5.25% 15-Aug-2010	700	2.6779	-2.21	2.00	5.46
6-May-09	4.50% 15-Apr-2020	699	5.0042	0.92	3.00	3.19
8-May-09	5.25% 15-Mar-2019	702	4.9563	0.13	1.00	3.80
13-May-09	6.50% 15-Apr-2012	701	3.8646	-0.29	1.00	4.36
15-May-09	6.00% 15-Feb-2017	700	4.7633	0.58	1.00	2.59
20-May-09	4.50% 15-Apr-2020	699	5.2237	1.07	1.50	3.04
22-May-09	5.75% 15-Jun-2011	700	3.7275	-1.00	0.50	5.66
27-May-09	5.25% 15-Mar-2019	699	5.3471	1.21	1.50	2.76
29-May-09	6.50% 15-Apr-2012	698	3.9845	-0.30	1.50	4.58
3-Jun-09	6.00% 15-Feb-2017	700	5.3252	1.02	1.50	3.27
5-Jun-09	6.25% 15-May-2013	700	4.5704	0.04	1.00	3.46
10-Jun-09	6.25% 15-Apr-2015	499	5.2852	0.00	2.00	2.11
12-Jun-09	5.75% 15-Jun-2011	699	4.0056	0.06	3.00	3.39
17-Jun-09	5.25% 15-Mar-2019	700	5.4372	1.72	3.00	1.78
19-Jun-09	6.50% 15-Apr-2012	700	4.5279	1.29	3.00	1.87
24-Jun-09	5.25% 15-Aug-2010	701	3.4161	0.86	4.00	3.85
Average over year to June 2009				0.48	2.06	3.76
Average over 3 years to June 2009				0.33	1.66	3.76
Average over 10 years to June 2009				0.41	1.42	3.83

Denotes switch tender

Investment of the proceeds of additional Treasury Bond issuance

Objective

Additional Treasury Bond issuance totalling around $4.6 billion (in face value terms) was undertaken between 1 July 2008 and on 3 February 2009 to support the operation of the Treasury Bond and Treasury Bond futures markets. The proceeds were invested with the aim of providing returns commensurate with the debt serving costs of the additional issuance, while adopting a prudent approach to credit and interest rate risk.

With the change in fiscal outlook published on 3 February 2009, the objective of issuance changed to funding the Budget. The distinction between core and additional issuance was removed and the AOFM began selling the investments acquired with the proceeds of additional issuance.

Achieving the objective

To facilitate performance monitoring, the assets and liabilities arising from the additional Treasury Bond issuance were allocated to a separate portfolio, called the Debt Hedge Portfolio. The portfolio was managed to minimise maturity gaps and to have an overall net interest rate exposure approaching zero.

The investment mandate approved by the Secretary to the Treasury provided for the proceeds of the additional issuance to be invested in a range of highly-rated Australian dollar denominated debt securities. It also allowed funds to be invested in short-term money market investments such as negotiable certificates of deposit issued by Authorised Deposit-taking Institutions and term deposits at the RBA.

The bulk of the proceeds were invested in semi-government bonds and Kangaroo bonds,[1] as these Australian dollar denominated securities matched relatively closely the characteristics of Treasury Bonds. Purchases of securities were transacted by the following means:

- on an outright basis in the secondary market, where the AOFM contacted at least three market-makers for either two-way prices or offers;
- on a switch basis, where the AOFM contacted at least three market-makers for prices to switch from an existing investment to another;
- as part of a placement of new securities (as either a new primary issue or tap of existing securities) on an outright or switch basis; and
- tenders for the issue of additional Treasury Bonds conducted on a switch basis for semi-government bonds.

An advantage of the switch tenders was that the issuance of the Treasury Bonds and the investment of their proceeds occurred simultaneously. This removed the risk of losses due to unfavourable movements in market rates between issuance and investment.

When the investment of the proceeds of the additional issuance ceased in February 2009, the Debt Hedge Portfolio was closed and its assets and liabilities transferred to the Long-Term Debt Portfolio.

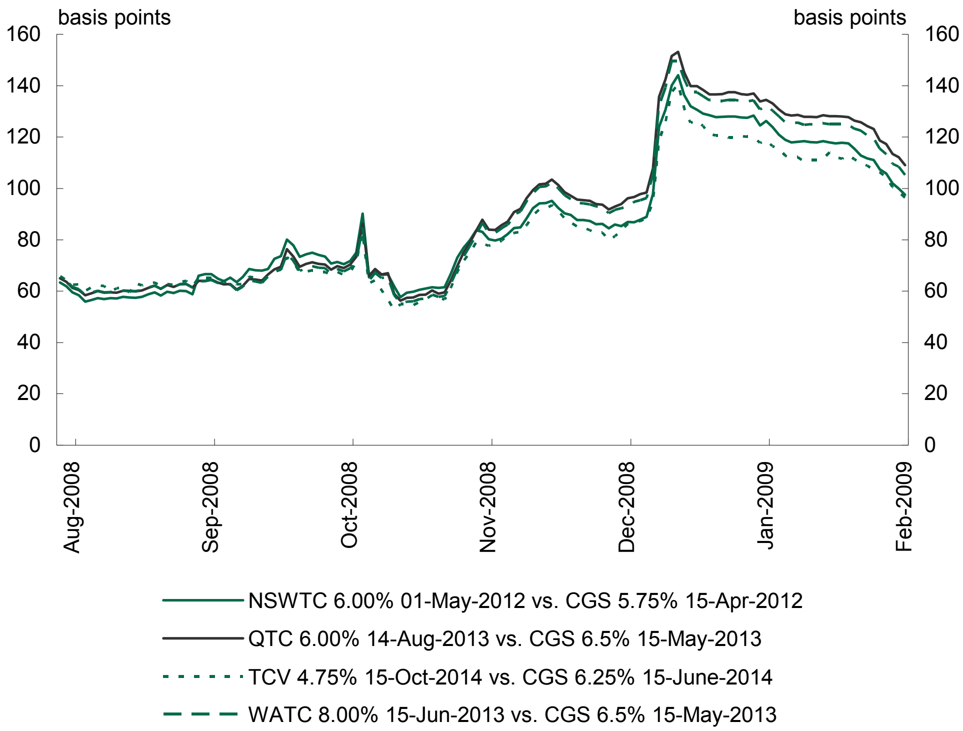
Performance

On an accruals (historic cost) basis, the Debt Hedge Portfolio had provided a net return of $21.5 million when it was closed on 4 February 2009.

1 A Kangaroo bond is an Australian dollar denominated bond issued into the Australian market by a foreign issuer.

Up until early December 2008, the mark-to-market performance of the Portfolio experienced only relatively small deviations around zero. In mid-December 2008, in line with a general widening of credit spreads coinciding with the first usage of the wholesale funding guarantee by domestic banks, there was a significant widening in the spread of semi-government bond yields to Australian Government bond yields. This led to a deterioration in the mark-to-market performance of the Portfolio. By early February 2009, semi-government bond spreads had narrowed from their peaks, but still remained much wider than over most of 2008. Chart 2 shows semi-government bond spreads for select semi-government bond lines.

Chart 2: Semi-government bond spreads for select semi-government bond lines



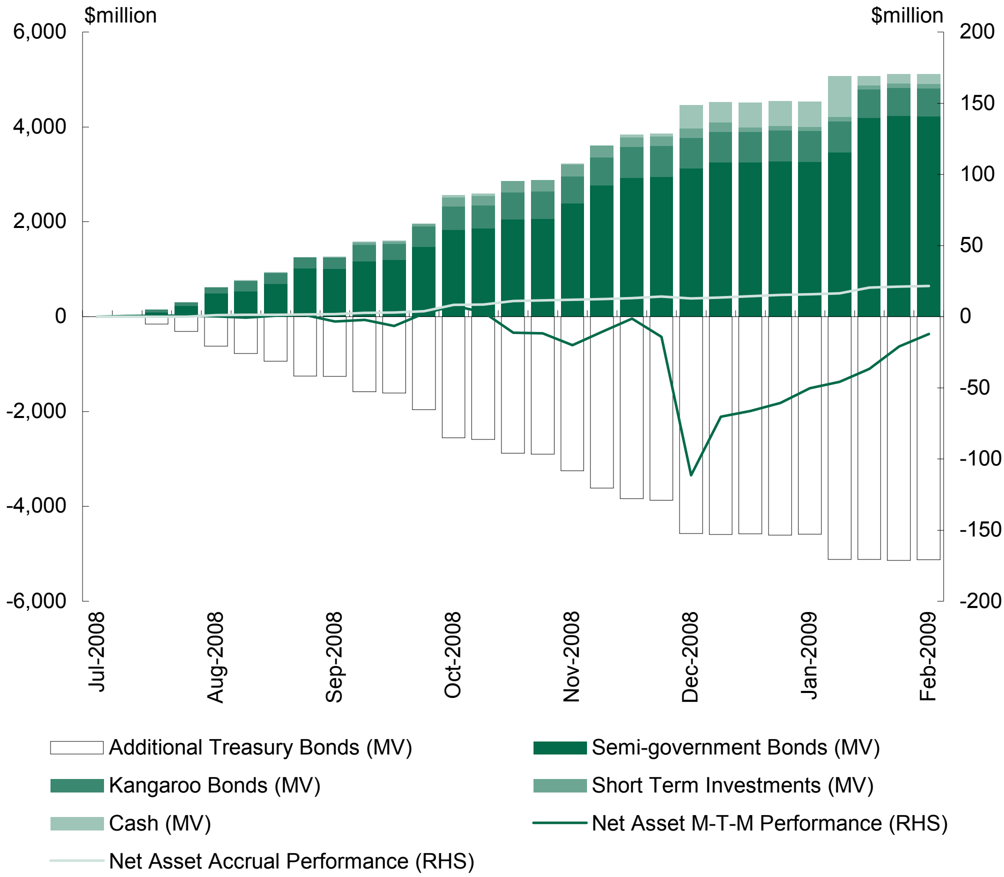
Source: Bloomberg

Mid-curve semi-government bonds experienced the greatest widening in spreads. While the additional Treasury Bond issuance was allocated across virtually all bond lines, it centred on mid-curve lines that were most in demand in the market. The investment strategies followed to reduce the interest rate risk exposure of the Portfolio produced a similar maturity structure for investments, with a concentration of mid-curve semi-government bonds. This exacerbated the impact of the movements in spreads on the market value of the Portfolio.

At 3 February 2009, the Portfolio had a mark-to-market return of negative $12.1 million.

The net accrual and mark-to-market performance of the Debt Hedge Portfolio through time is shown in Chart 3. The chart also displays the volume and make-up of investment holdings and the corresponding volume of additional Treasury Bond issuance through time.

Chart 3: Net mark-to-market and accrual performance of Debt Hedge Portfolio



The assets and liabilities in the Debt Hedge Portfolio were transferred to the Long-Term Debt Portfolio on 4 February 2009. The investments were no longer required and were completely divested by end-July 2009.

Yields for both Kangaroo and semi-government bonds began to rise in the first quarter of 2009 and continued rising over the remainder of the financial year. This was a consequence of the general steepening in yield curves that occurred at this time.

Over their entire holding period, Kangaroo and semi-government bonds generated a positive return of $175.4 million, comprising $165.5 million in interest revenue and $9.9 million in realised capital gains.

Cash management

Objective

The AOFM manages the daily cash balances of the Australian Government in the Official Public Account (OPA).[2] The AOFM's primary objective in managing these 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.[3]

Achieving the objective

Achieving the objectives 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 magnitudes and tenors of the short-term investments are determined by the AOFM.

In August 2008, the AOFM began investing excess cash in a broader range of short-term investment assets, namely highly-rated bank accepted bills and certificates of deposit issued by Authorised Deposit-taking Institutions. Prior to this, excess cash was invested only in term deposits at the RBA. The broader range of investment options should help enhance investment returns on surplus cash balances.

- Interest rates for term deposits at the RBA are based on Overnight Indexed Swap rates.
- Interest rates for bank accepted bills and certificates of deposit reflect prevailing market rates for those instruments.

Treasury Notes are short-term debt securities that can be issued to provide short-term funding. In recent years their issuance has not been needed because the AOFM's holdings of short-term assets have been sufficient to cover fluctuations in OPA balances. However, with the Budget balance moving into deficit and the transfer of monies to funds managed by the Future Fund, it was evident that the AOFM's short-term asset holdings would soon become insufficient to meet all within-year funding needs and that short-term borrowings would also be required.

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

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

To this end, the issuance of Treasury Notes recommenced in March 2009. The notes on issue were built up over the remaining months of the financial year. The AOFM plans to keep at least $10 billion of notes on issue at all times so as to maintain a liquid market in them.

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 4 shows the movement in the funding requirement in 2008-09.

Chart 4: Within-year funding requirement 2008-09

Performance

The objective of meeting the Government's financial obligations when they fall due was met, with the overdraft facility provided by the RBA accessed only once in 2008-09.

During 2008-09 the AOFM placed 473 term deposits with the RBA. The stock of term deposits fluctuated from a minimum of $3.1 billion in January 2009 to a maximum of $39.0 billion in June 2009.

- The average yield obtained on term deposits during 2008-09 was 4.97 per cent, compared with 6.89 per cent in 2007-08.

Short-term 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 paper compared with placing funds on deposit at the RBA. (While investment in highly-rated bank issued paper carries low credit risk, it is not completely risk free, unlike a deposit at the RBA, and requires an appropriately higher return.)

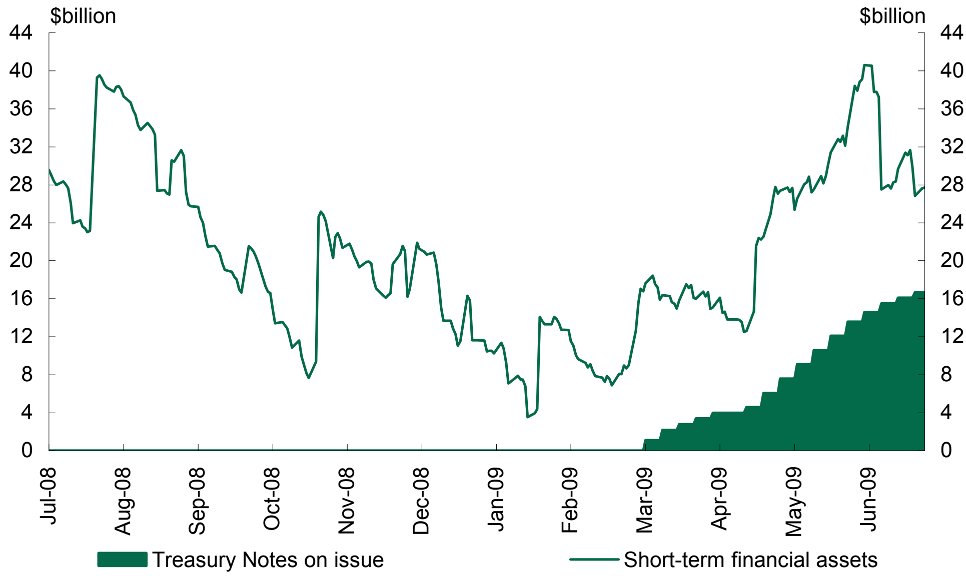
The face value amount invested in bank accepted bills and certificates of deposit peaked at $8.25 billion in November 2008. The average additional return in 2008-09 from investing in bank accepted bills and certificates of deposit compared with investing funds on deposit at the RBA was approximately 47 basis points per annum. This is estimated to have generated additional investment earnings in 2008-09 totalling around $10 million.

Re-establishment of the Treasury Note market occurred relatively smoothly and tenders for the issue of Treasury Notes were well supported. Sixteen tenders were conducted in 2008-09 for the issue of $18.7 billion (in face value terms) of Treasury Notes.

- The notes were issued at tender at yields that averaged around 20 basis points less than bank bill yields of the corresponding maturity. This is broadly similar to the spread to bank bill yields that Treasury Notes were issued at in the past.

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 2008-09 are shown in Chart 5.

Chart 5: Short-term financial asset holdings and Treasury Notes on Issue 2008-09



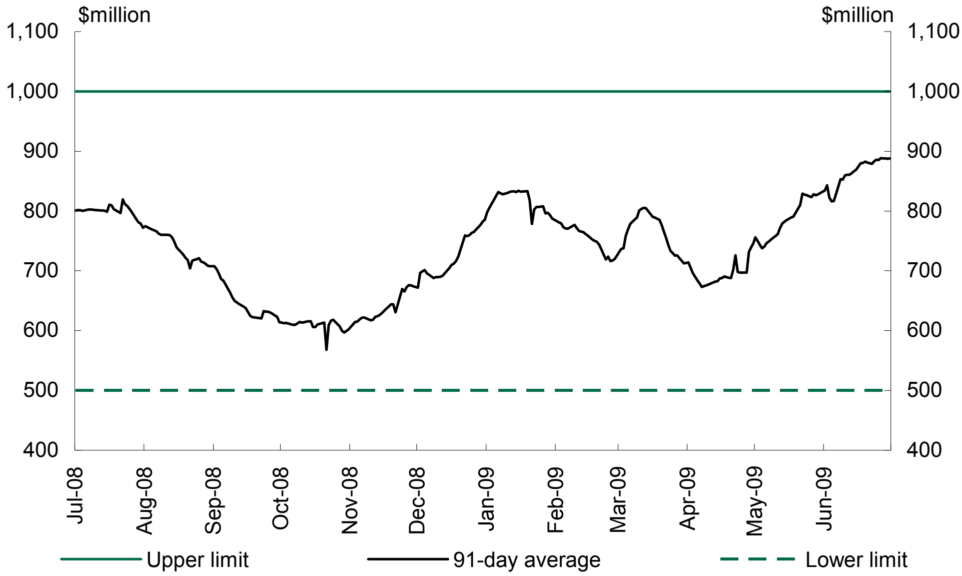
In undertaking its cash management activities, the AOFM is required to maintain the 91-day rolling average of the daily OPA cash balance within operational limits around a target level. In

2008-09 these limits were the same as applied in 2007-08, 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 6.

Chart 6: 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.

The primary measure of cost used in this context 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

For several years prior to 2008-09, the composition of the physical debt in the AOFM's portfolio provided little opportunity for reducing debt servicing costs, because the volume and maturity structure of the debt was determined by the policy of issuing to support the Treasury Bond and Treasury Bond futures markets. Furthermore, the volume and tenor of assets held as term deposits were largely determined by cash management requirements. However, the AOFM was able to reduce debt servicing costs by using derivative instruments to adjust the portfolio's cost and risk characteristics, such as modified duration and short-dated exposure. It used interest rate swaps[4] to achieve this objective.

Historically, debt issued for long periods at fixed rates of interest has required higher interest rates than shorter-term debt, because lenders demand a higher return for having their funds locked away for longer periods. Interest rate swaps provided savings in debt service costs by swapping from longer to shorter-term debt (or from fixed-rate debt to floating-rate debt). However, increasing the amount of short-term or floating-rate debt in the portfolio increased the potential variability of debt service costs, as interest rate movements were able to flow through to the overall cost of funds more quickly.

Over recent years, market yield curves flattened and, at times, became inverted. This reduced the potential savings available from adjusting the portfolio's cost and risk characteristics through interest rate swaps. In its 2008 review of its portfolio management strategy, the AOFM concluded that this strategy no longer provided a firm basis for achieving future savings in debt servicing costs. While the strategy had produced substantial savings over many years, in the changed circumstances it was considered better to accept the maturity structure of the debt portfolio that resulted from debt issuance.

As a result, the previous portfolio management framework was terminated from the end of 2007-08. Existing swaps were regarded as a legacy component of the portfolio to be managed in light of market conditions. Initially the legacy swaps were allowed to remain and mature, but when swap rates fell significantly in late 2008, the AOFM began terminating them, a process that was largely completed by May 2009.

4 An interest rate swap is a financial contract where one party agrees to pay another a stream of fixed interest payments on an agreed notional principal amount, in return for a stream of floating interest rate payments on the same notional principal.

Under the new strategy, the duration of the nominal debt portfolio was determined by the cumulative effect of issuance decisions. It was recognised that the policy of issuing into bond lines that supported the baskets for the 3 and 10-year bond futures contracts would cause the duration of the nominal debt portfolio to tend towards a value of four over a period of years as the legacy swaps matured.[5] This governed the interest rate risk of the portfolio. The portfolio management strategy was thus to allow duration to move to four; the decision to actively unwind swaps accelerated this transition.

The Treasurer's direction in May 2008 for the AOFM to undertake additional Treasury Bond issuance to support the market did not affect the strategy, as the cost and risk of the additional issuance was offset by the investment of the proceeds in matched assets comprising semi-government and Kangaroo bonds. The Office was thus able to be flexible in responding to shortages in particular bond lines without disturbing the cost and risk characteristics of the core portfolio.

The reorientation of the AOFM's borrowing task to funding the Budget had a bigger impact on portfolio management. The distinction between core and additional issuance was removed, investments in matched assets ceased and the selection of bond lines and the size of tenders now had a direct impact on the cost and risk of the overall portfolio. Henceforth issuance decisions needed to have regard to the overall maturity structure of the portfolio — including its exposure to market risk and refinancing risk over the medium term — as well as to short-term market conditions and the relative demand and cost of different bond lines.

The approach adopted to issuance after 3 February 2009 was designed to provide short-term flexibility within a framework directed to medium-term objectives. Decisions on the bond lines to be offered at tender were made weekly, taking account of market conditions, but a balance was maintained between issuing shorter and longer bonds. Issuance was spread over almost all the existing bond lines to increase their liquidity. Refinancing risk was managed by limiting the volume of debt maturing in the early years. The cumulative effect was that the average maturity and duration of the bonds issued between February 2009 and June 2009 was longer than if the selection of the bond lines to be issued had been guided simply by relative market demand.

5 The modified duration of the nominal physical debt before swaps has generally been a little over 4.0 over recent years.

Performance

Reducing debt servicing cost

The debt servicing cost[6] of the gross debt managed by the AOFM in 2008-09 was $3.0 billion (after swaps), on an average book value of $67.8 billion. This represented a cost of funds of 4.39 per cent.

The return on gross assets was $1.6 billion, on an average book value of $29.4 billion, over the same period. This represented an average yield of 5.36 per cent.

These aggregates were affected by the inclusion of a number of new instruments in 2008-09. On the debt side, the issue of Treasury Notes resumed during the year, while new assets included bank paper (money market instruments), term investments in semi-government and Kangaroo bonds, and residential mortgage-backed securities. The AOFM's holdings of Commonwealth advances to State and Territory governments for public housing are also included for the first time.[7]

Taken together, the combined portfolio of debt and assets managed by the AOFM had a net interest expense (before re-measurements) of $1.4 billion, at an effective yield of 3.64 per cent. The corresponding figure for 2007-08 was 6.44 per cent.

The large decrease in net interest expense for 2008-09 compared to 2007-08 was driven by a number of factors, the largest of which was the substantial revenue from swaps over the year. Interest rate swaps reduced the effective yield of gross CGS debt by 1.43 per cent through realising $969 million from swap terminations and net interest receipts. Also contributing to the reduced net interest expense of the AOFM portfolio was the return obtained from investments in short-term bank paper and term investments in semi-government and Kangaroo Bonds.

Table 2 provides further details of the cost outcomes for the combined portfolio by instrument and portfolio for 2007-08 and 2008-09. In this table, the Debt Hedge Portfolio (which operated separately for only part of the year) has been grouped with the Long-Term Debt Portfolio (in which its assets and liabilities were subsumed on 4 February 2009). Information on the separate performance of the Debt Hedge Portfolio is provided on page 14 above.

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

7 These advances were made under Commonwealth-State Housing Agreements and have been administered by the AOFM for many years, but were not previously reported in the debt portfolio cost outcomes.

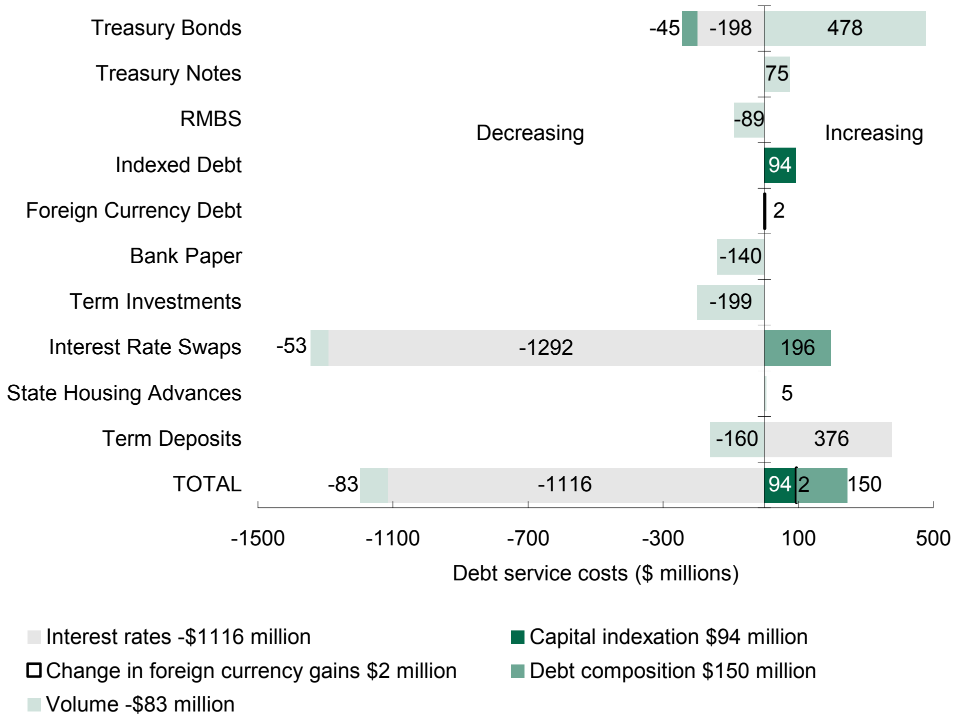
Table 2: Australian Government debt and assets administered by the AOFM

	Interest expense		Book volume		Effective yield	
	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09
	$ million		$ million		per cent per annum	
Contribution by instrument						
Treasury fixed coupon bonds	(2,947)	(3,182)	(48,476)	(56,514)	6.08	5.63
Treasury inflation indexed bonds	(593)	(687)	(8,317)	(8,677)	7.13	7.92
Treasury notes	-	(75)	-	(2,641)		2.85
Other miscellaneous domestic debt	(0)	(0)	(4)	(0)	8.22	7.20
Foreign loans (a)	0	(2)	(6)	(7)	-3.42	23.27
Gross physical CGS debt	(3,540)	(3,946)	(56,804)	(67,840)	6.23	5.82
Interest rate swaps	(180)	969	-	-		
Gross CGS debt (after swaps)	(3,721)	(2,977)	(56,804)	(67,840)	6.55	4.39
Term deposits with the RBA	1,197	981	17,378	19,759	6.89	4.97
Investments in bank paper	-	140	-	2,108		6.64
Term investments (b)	-	199	-	2,864		6.96
RMBS investments	-	89	-	1,859		4.80
State Housing Advances	171	166	2,899	2,826	5.89	5.89
Gross assets	1,368	1,576	20,277	29,416	6.75	5.36
Total debt and assets	**(2,353)**	**(1,400)**	**(36,527)**	**(38,423)**	**6.44**	**3.64**
Contribution by portfolio						
Long Term Debt Portfolio (c)	(3,727)	(2,690)	(56,892)	(62,070)	6.55	4.33
Cash Management Portfolio	1,204	1,034	17,466	18,961	6.89	5.45
RMBS Portfolio	-	89	-	1,859		4.80
State Housing Portfolio	171	166	2,899	2,826	5.89	5.89
Total debt and assets	**(2,353)**	**(1,400)**	**(36,527)**	**(38,423)**	**6.44**	**3.64**
Re-measurements (d)	(118)	(232)				
Total after re-measurements	**(2,471)**	**(1,632)**	**(36,527)**	**(38,423)**		

(a) Interest expense and effective yield on foreign loans incorporates foreign exchange revaluation effects. The reported interest expense for Foreign Loans in 2007-08 has been corrected from that reported in the AOFM's 2007-08 annual report.
(b) Investments in State and Territory government bonds and Kangaroo bonds.
(c) Includes the Debt Hedge Portfolio which operated separately for part of the year.
(d) Re-measurements refer to unrealised changes in the market valuation of financial assets and liabilities.

Despite the volume of debt increasing in 2008-09 over 2007-08, the debt servicing cost of the total portfolio fell by $953 million. Chart 7 sets out the components of this change by instrument, 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 7: Changes in debt servicing cost between 2007-08 and 2008-09



The reduction in total debt servicing costs was dominated by increased savings from interest rate swaps. Returns on swaps increased by $1.15 billion compared to 2007-08. A driving factor for this was the proceeds from the termination of swaps, which crystallised significant gains in market value. Also contributing to the increased returns from swaps were falls in market interest rates and a reversal in the shape of yield curves. In particular, lower short-term interest rates reduced the cost of the floating legs of swaps and brought a large increase in interest receipts from swaps in the second half of the financial year. Overall, swaps reduced the interest costs of the portfolio (before re-measurements) by $969 million during 2008-09.

The debt servicing cost of physical debt increased by $406 million compared to 2007-08, as a result of the increased Treasury Bond issuance and the resumption of issuance of Treasury Notes. Also contributing were higher capital accretion costs on indexed bonds due to larger CPI increases. This was partially offset by relatively expensive debt maturing and being replaced with new debt issued at significantly lower interest rates.

However, the lower short-term interest rates had a negative impact on the return obtained on term deposits. The interest revenue on term deposits in 2008-09 was $981 million, on an average book volume of $19.8 billion. This represented a return on funds of 4.97 per cent, compared with 6.89 per cent in 2007-08. Overall, term deposits in 2008-09 contributed $216 million less in interest compared to 2007-08, despite there being a slightly higher average volume. Unlike in

2007-08, term deposits in 2008-09 did not have a favourable effect on the net cost of funds in percentage terms, as the yield on term deposits was lower than the average cost of servicing gross debt.

Movements in market interest rates had an unfavourable impact on the market value of the portfolio in 2008-09, with unrealised losses from re-measurements amounting to $232 million. They comprised a gain of $1.01 billion on interest rate swaps, offset by losses of $1.07 billion on nominal debt, $35 million on term investments and $136 million on RMBS investments. The increase in unrealised losses from re-measurements in 2008-09 compared to 2007-08 was largely driven by falling interest rates inflating the market value of debt on issue. Conversely, lower market interest rates in 2008-09 had a positive impact on swap revaluations.

Interest rate swap terminations

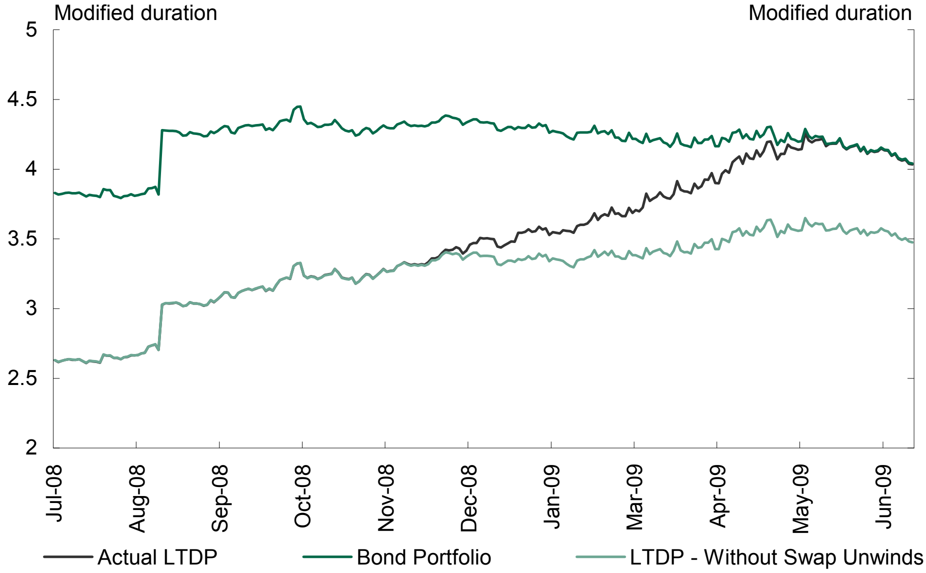
In November 2008, the AOFM commenced a program to unwind its remaining domestic interest rate swaps. At that time, the portfolio comprised 177 swaps with a notional face value of $20.65 billion. The program was largely completed by May 2009, when the AOFM stopped actively seeking terminations. In total, 130 swaps were unwound representing a notional face value of $15.25 billion. This included 12 swaps that were unwound in response to adjustments to credit ratings or other credit-related events.[8] The unwind program generated a net realised value of $1.029 billion in favour of the Commonwealth. The estimated price of unwinding the swaps was around 2.5 basis points from mid-market, equating to around $13.5 million.

As at 30 June 2009, the AOFM's swap portfolio consisted of 21 swaps with a total notional face value of $2.425 billion. These swaps all mature by mid-May 2010 and thus carry very little interest rate risk. The AOFM expects to allow them to mature without early termination.

With the unwind of the swaps, the modified duration of the nominal Long-Term Debt Portfolio will in future be determined by ongoing issuance and maturing debt. Chart 8 illustrates this transition over the course of the unwind program.

8 In 2008-09, there were a total of 13 credit-related swap terminations. The first occurred in October 2008, prior to the commencement of the unwind program. Over the course of 2008-09, therefore, a total of 131 interest rate swap terminations were undertaken.

Chart 8: Modified Duration — nominal component of Australian dollar Long-Term Debt Portfolio 2008-09



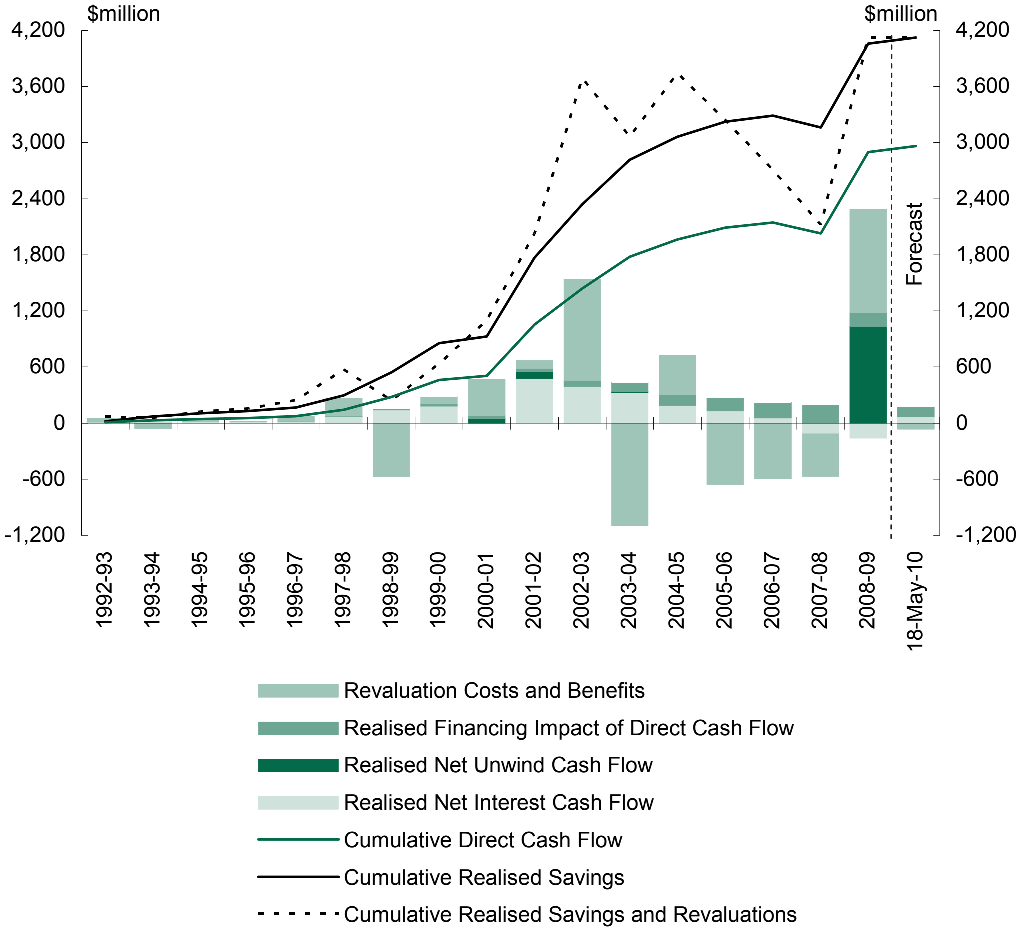
The AOFM's annual report for 2006-07 included a review article on the management of the domestic debt portfolio over recent years and the use of interest rate swaps. It concluded that the direct costs savings from interest rate payments and receipts on swaps had amounted to $2.1 billion between 1992 (when interest rate swaps were first executed) and the end of 2006-07. It estimated that these direct savings had generated additional indirect savings through higher asset balances, and that the cumulative realised benefit to the Commonwealth from direct and indirect savings combined over this period amounted to $2.8 billion. Against this, at 30 June 2007 the interest rate swaps portfolio had an unrealised market value of negative $581 million.

These figures can now be updated. Realised direct savings from interest rate swaps have grown to a total of $2.898 billion as at 30 June 2009, while the cumulative realised benefit from direct and indirect savings combined have been $3.952 billion. At 30 June 2009 the remaining interest rate swaps had a positive unrealised market value of $66.8 million. Thus, at 30 June 2009 swaps had generated a total benefit of $4.019 billion.

Chart 9 shows the total savings provided by swaps over the period since 1992-93 and projected to 18 May 2010 when the final remaining swap matures. While final performance figures will not be available until then, the outcome is unlikely to differ greatly from the projections as only 21 swaps remained in the portfolio at 30 June 2009, of which 11 were subject to only one further repricing. The chart shows the cumulative direct cash flows from the swaps, cumulative realised (direct and indirect) savings and cumulative realised savings and (market value) revaluations. It also shows the yearly components of these aggregates.

Total direct savings are projected to be $2.964 billion on 18 May 2010. Including indirect savings, the total benefit is projected to be $4.126 billion.

Chart 9: Total Savings arising from interest rate swaps (inclusive of revaluations)



Credit management of interest rate swaps

The use of interest rate swaps brings an exposure to counterparty credit risk. In 2008-09 the AOFM continued to use collateral agreements to manage this risk. These collateral agreements require counterparties to post collateral when the AOFM's credit exposure rises above a predefined threshold. Swap terminations were also undertaken to reduce the level of credit exposure during the year.

The AOFM has Credit Support Annexes with 17 of its swap counterparties. On 30 June 2009, 84.7 per cent of the total nominal face value of the interest rate swap portfolio was covered by collateral agreements. Table 3 indicates the average credit quality across the counterparties to which the AOFM has an exposure.

Table 3: Derivative counterparties by credit rating as at 30 June 2008 and 30 June 2009

Credit rating: Moody's/ Standard & Poors (a)	Number of AOFM counterparties by credit rating as at 30 June 2008	Number of AOFM counterparties by credit rating as at 30 June 2009
Aaa/AAA	0	0
Aa1/AA+	1	0
Aa2/AA	10	2
Aa3/AA-	7	2
A1/A+	2	2
A2/A	2	3
Total number of counterparties	22	9

(a) Where a counterparty has a split rating between the two ratings agencies it is allocated to the lower of the two ratings levels.
(b) The number of counterparties listed as at 30 June 2008 has been corrected from that of the AOFM's 2007-08 report which had listed a total 24.

As a result of credit downgrades and movements in interest rates, the AOFM made five collateral calls from two counterparties totalling $106.3 million, and executed 13 credit-related swap terminations across five different counterparties, recouping $125.4 million in order to reduce its credit exposures to these counterparties.

The AOFM's exposure to counterparty credit risk on swaps was $66.8 million at 30 June 2009. All remaining swaps will mature in 2009-10.

Residential mortgage-backed securities

Objective

Since the late 1980s, the securitisation of mortgages into residential mortgage-backed securities (RMBS) has provided an important source of funding for new and small mortgage lenders to compete with the major banks in lending for housing. Commencing in 2007-08, developments in global financial markets reduced liquidity in the Australian RMBS market and constrained the ability of lenders to access funding from the source. In particular, margins on existing mortgage-backed bonds widened to a point that rendered securitisation uncompetitive as a source of finance for mortgage providers. 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 residential mortgage-backed security in Australia.

In view of these developments, the Government decided to invest in Australian RMBS to support competition in Australia's mortgage market 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, including $4 billion to be invested in securities by issuers that were not Authorised Deposit-taking Institutions (non-ADIs). The allocation to the non-ADI sector was made in conjunction with the Government's decision to guarantee the deposits and wholesale funding of ADIs.

Securitisation and RMBS

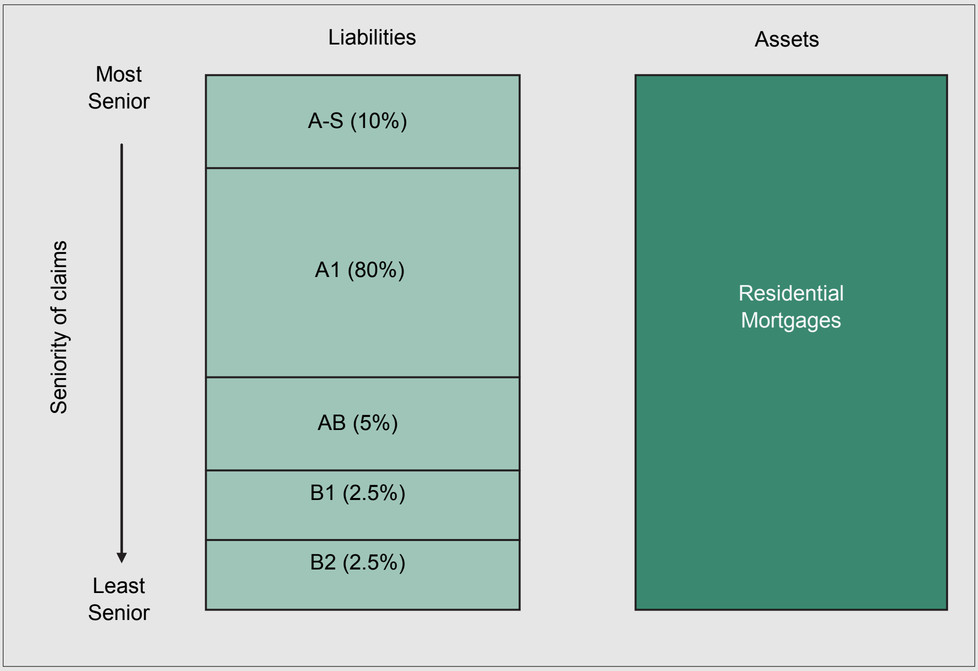
Securitisation is the process whereby income producing assets are pooled together to produce bond-like securities. Cash flows from the assets are directed to bondholders through a special purpose vehicle. The special purpose vehicle is legally separate to the originator of the assets, and is structured to remain unaffected in the event that the originator becomes bankrupt.

The first RMBS transaction was undertaken in 1977 by Bank of America, and consisted of a simple 'pass-through' structure. The asset class has evolved, however, and now investors can benefit from credit enhancement techniques such as subordination and over-collateralisation.

Subordination is the name given to the structure whereby the securities that are supported by the pool of mortgages are structured into 'tranches' that allow 'senior' notes to be repaid before the other 'mezzanine' and 'junior' or 'subordinated' notes. As the underlying pool of mortgages repays both principal and interest through time, the most senior tranches will be repaid before the mezzanine and subordinated notes, and the mezzanine notes will in turn be repaid before the subordinated notes. Based on historic mortgage prepayment experience, the cash flows associated with each tranche can be modelled with some degree of accuracy.

In Figure 1 below, the senior notes are shown as classes A-S and A1, class AB is a mezzanine note and classes B1 and B2 are the subordinated notes. The senior tranches typically comprise the major part of an RMBS issue; in Figure 1, the senior notes make up 90 per cent of the total, whereas the mezzanine notes and subordinated notes together represent 10 per cent. With this deal structure, the senior notes and mezzanine note respectively have 10 and 5 per cent credit enhancement through subordination. While there is some variation from deal to deal, depending on pool characteristics, the senior and mezzanine notes typically obtain AAA credit ratings and subordinated notes are typically assigned lower ratings.

Figure 1: Typical RMBS Structure



The 'Weighted Average Life' (WAL) of an RMBS tranche represents the duration of the tranche. It is calculated as the sum of its cash flows weighted by the periods in which they are paid, divided by the initial face value of the tranche. While repayments can stretch out for much longer than the WAL, this is a useful measure in making comparisons with equivalent standard bonds, or 'bullet' securities.

In the event that the mortgage pool suffers losses, for example through defaults on underlying mortgages, the subordinated tranches suffer the first losses. In so doing, the senior notes enjoy a buffer, making them less risky. Under the AOFM's investment program, only AAA-rated pieces have been purchased. Occasionally, the AOFM has purchased small amounts of the most senior, fastest paying tranches (see class A-S in Figure 1 above), but these tranches have typically been purchased solely by other investors. The amount of subordination in the tranches below the AOFM's lowest-ranked investments has varied from 2.7 per cent to 9.4 per cent of the pool.

Lenders mortgage insurance (LMI) is another common form of credit enhancement. LMI providers insure bondholders against defaults by mortgage borrowers. A less common form of credit enhancement has been the use of over-collateralisation, whereby the issuer injects an equity piece or 'seller note' into the structure as the lowest tranche (see class B2 in Figure 1 above).

Achieving the objective

After consulting with market participants, the AOFM concluded that the most effective means of arranging these investments would be to act as a cornerstone investor in AAA-rated tranches of eligible RMBS transactions. This recognised that a key to re-invigorating the RMBS market lay in encouraging investors to return to it. The AOFM also aimed to ensure, as far as practicable, that the proceeds on the investments would be used for further lending for housing and to promote market competition. An alternative approach that was considered, of simply purchasing existing RMBS in the secondary market, may have resulted in issuers withdrawing from housing lending and investing the proceeds in other activities.

Investment Guidelines were developed that were consistent with the Treasurer's Directions and the first Request for Proposals (RFP) was issued on 13 October 2008. The RFP specified the selection criteria and minimum requirements that would be used in selecting proposals.

The selection criteria were directed to the objective of supporting competition in the residential mortgage market, and comprised:

(i) the extent to which the funds raised would be used to originate new residential mortgages in the near term;

(ii) the extent to which the mortgage originators have relied on RMBS to finance their residential housing lending in the past;

(iii) the expected participation of other investors in the transaction;

(iv) the experience and capability of the deal arrangers and lead managers;

(v) the extent to which the transaction would avoid congestion with other proposed transactions; and

(vi) the capability and quality of the asset servicer.

The minimum requirements were as follows:

(i) securities must have a AAA-rating, from two major ratings agencies;

(ii) the transactions are to settle via Austraclear;

(iii) the issuers are to commit to monthly reporting on the composition of the underlying mortgage pool; and

(iv) the underlying mortgage pool must meet the following minimum standards:

   a. mortgage insurable, Australian dollar denominated mortgages;
   b. a closed pool, with no substitution or pre-funding of mortgages;
   c. a maximum of 10 per cent of the pool in low-doc loans;
   d. a maximum loan size of $750,000;
   e. a maximum loan term of 30 years;
   f. a weighted average loan to value ratio of not more than 70 per cent;
   g. a maximum individual loan to value ratio of 95 per cent;

h. a maximum of 50 per cent of the pool in interest only loans;
i. a maximum interest only period of 10 years; and
j. a maximum time in arrears of 30 days of any loan.

Twelve proposals that met these requirements were received, from which a panel comprising the Chief Executive Officer, the Director of Financial Risk and the Head of Treasury Services selected the four highest ranking transactions. These deals, totalling $1.996 billion, were transacted and settled by 15 December 2008.

A second RFP was issued on 18 December 2008, with minor changes based on experience and feedback from the first RFP. Specifically, the cap on the weighted average loan to value ratio was removed, the requirement for mortgage insurability was clarified and the requirement for a pool audit was specified in greater detail. An additional selection criterion, namely the overall quality of the mortgage pool and securities on offer, was also included. The main purpose of these changes was to allow greater flexibility in the composition of mortgage pools, while maintaining a level of assurance regarding the overall quality of the AOFM's investments.

Seventeen conforming proposals were received under the second RFP, including four from non-ADIs. A further nine investments were made under this RFP over the remainder of the 2008-09 financial year.

Price was not a criterion used to rank proposals in the selection process. Instead, pricing was determined in consultation with issuers after mandates had been awarded. In this, the AOFM aimed to balance the objective of maintaining a competitive flow of funds for new lending for housing with the objective of attracting other investors. Where third party investors participated in transactions, the AOFM participated at the same price.

Since mid-December 2008 when the wholesale bank guarantee was first used, the AOFM has typically been the sole investor in the longer-dated AAA-rated tranches of RMBS issues. At the same time, distressed selling in the secondary market increased, at price levels that were uneconomic for new mortgage lending. The AOFM sought to obtain margins that allowed the competitive origination of new mortgages, while maintaining consistency, on a risk-adjusted basis, in the pricing between transactions. The outcome was that the majority of investments in the longer tranches were undertaken at margins to the bank bill rate of between 1.2 per cent per annum and 1.4 per cent per annum, while smaller AAA-rated mezzanine tranches were priced at a wider margin to compensate for their subordination to the senior AAA tranches and longer WALs.

Outcome and performance

By 30 June 2009, the AOFM had completed 13 RMBS transactions, totalling $6.203 billion, comprising $2.75 billion in six transactions sponsored by five ADIs and $3.453 billion invested in seven transactions sponsored by four non-ADIs. Including investments from other parties, the total volume of RMBS that was able to be issued over this period as part of the program was $8.042 billion. This represented approximately 6.6 per cent of residential mortgages originated in Australia over the period November 2008 to June 2009.

Interest accrued in 2008-09 was $89 million, which represented an annualised return of 4.80 per cent. The securities purchased in 2008-09 were all floating-rate notes, paying a weighted average margin of around 1.3 per cent per annum over the one month bank bill rate.

The average credit margin of around 1.3 per cent per annum on the RMBS portfolio is above the AOFM's cost of short-term funding, which has historically been below the bank bill rate. However this average margin is narrower than margins currently available in the secondary market, and the RMBS held by the AOFM showed an unrealised mark-to-market loss of $136 million in 2008-09. The market value of the AOFM's RMBS is determined by an independent service provider. The difference corresponds to a margin of about 80 basis points across the RMBS portfolio. This remeasurement effect can be considered to be the opportunity cost associated with purchasing these assets at prices that promote competition in housing lending, rather than at secondary market prices. If the RMBS investments had been priced at yields 80 basis points wider, they would not have provided a viable source of funding for housing.

Table 4 provides details of RMBS investments at 30 June 2009. A total of $6.203 billion had been invested and had generated capital repayments of $179 million.

Table 4: RMBS Investments as at 30 June 2009

Pricing Date	Issuer	ADI/ Non-ADI	Instrument Name	Expected WAL* at closing (years)	Coupon 1m BBSW + (%)	Original Face Value ($m)	Current Face Value ($m)
14-Nov-08	FirstMac	Non-ADI	FirstMac 2008-2 Class A1	0.7	1.25%	132.0	96.9
			FirstMac 2008-2 Class A2	3.5	1.50%	325.0	325.0
			FirstMac 2008-2 Class AB	5.0	1.80%	39.0	39.0
17-Nov-08	Members Equity Bank	ADI	SMHL 2008-2 Class A1	2.8	1.30%	500.0	454.6
4-Dec-08	Challenger	Non-ADI	Challenger 2008-2 Class A	2.8	1.35%	481.0	442.4
			Challenger 2008-2 ClassAB	4.5	1.75%	19.0	19.0
10-Dec-08	RESIMAC	Non-ADI	RESIMAC 2008-1 Class A2	1.5	1.20%	280.0	250.6
			RESIMAC 2008-1 Class A3	4.5	1.40%	204.8	204.8
			RESIMAC 2008-1 Class AB	4.5	1.70%	15.3	15.3
6-Mar-09	Credit Union Australia	ADI	HarvTrust 2009-1 Class A1	3.6	1.40%	350.0	350.0
13-Mar-09	Bendigo and Adelaide Bank	ADI	TORRENS 2009-1 Class A2	4.2	1.35%	475.0	475.0
23-Mar-09	AMP Bank	ADI	PROGRESS 2009-1 Class A2	4.0	1.30%	425.0	425.0
3-Apr-09	Bank of Queensland	ADI	REDS 2009-1 Class A1	4.2	1.30%	500.0	500.0
9-Apr-09	Liberty Financial	Non-ADI	LIBERTY 2009-1 Class A1	0.1	0.90%	14.5	0.0
			LIBERTY 2009-1 Class A2	0.9	1.20%	164.7	148.4
			LIBERTY 2009-1 Class A3	3.2	1.40%	283.0	283.0
			LIBERTY 2009-1 Class AB	4.0	1.65%	37.8	37.8
15-Apr-09	Challenger	Non-ADI	CHALLENGER 2009-1 Class A2	0.5	1.00%	38.2	38.2
			CHALLENGER 2009-1 Class A3	1.5	1.30%	152.5	152.5
			CHALLENGER 2009-1 Class A4	4.3	1.45%	289.0	289.0
			CHALLENGER 2009-1 Class AB	4.4	1.70%	20.3	20.3
11-May-09	Members Equity Bank	ADI	SMHL 2009-1 Class A2	3.7	1.35%	500.0	500.0
21-May-09	RESIMAC	Non-ADI	RESIMAC 2009-1 Class A2	0.5	1.00%	10.0	10.0
			RESIMAC 2009-1 Class A3	2.9	1.40%	435.0	435.0
			RESIMAC 2009-1 Class AB	4.1	1.70%	13.8	13.8
1-Jun-09	FirstMac	Non-ADI	FirstMac 2009-1 Class A3	2.9	1.40%	458.0	458.0
			FirstMac 2009-1 Class AB	5.0	2.20%	40.6	40.6
						6,203.4	6,024.1

* Weighted average life

Communications Fund

The Communications Fund was established in September 2005 to provide an income stream to fund the Government's response to any recommendations proposed by the Regional Telecommunications Independent Review Committee in reports reviewing the adequacy of telecommunication services in regional, rural and remote parts of Australia. The Fund was closed on 1 January 2009 and its assets transferred to the Building Australia Fund (which is managed by the Future Fund Board of Guardians). Prior to its closure the AOFM managed the investments of the Communications Fund on behalf of the Department of Broadband, Communications and the Digital Economy.

The investments of the Communications Fund comprised short-term Australian denominated dollar money market instruments and deposits, including bank accepted bills, negotiable certificates of deposit and commercial paper. When the fund was closed the value of the Fund's investments totalled approximately $2,468 million.

The before-fees investment portfolio performance benchmark for the Fund was the UBS Australian Bank Bill Index. The after-fees performance benchmark was the UBS Australian Bank Bill Index less 2 to 3 basis points. Performance against the benchmarks for the period the fund operated in 2008-09 is as follows:

- The before-fees return of the Communications Fund underperformed against the benchmark by 0.3 basis points.
- The after-fees return of the Communications Fund exceeded the benchmark by 0.4 basis points.

Over the life of the Fund, it obtained an average return on its assets of 7.17 per cent per annum, which was 3.3 basis points higher than the before-fees Fund benchmark, and 4.2 basis points higher on an after-fees basis.

Financial information concerning the operation of the Communications Fund is reported in the financial statements of the Department of Broadband, Communications and the Digital Economy.

Operational risk

Objective

Operational risk is the risk of loss due to operational failures resulting from internal processes, people, or 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.

Achieving the objective

The AOFM 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. This foundation is accompanied by detailed controls and procedures overseen by the Operational Risk Committee and the Audit Committee. The Compliance Unit also monitors compliance with financial risk management policies and procedures on a daily basis.

In 2008-09, the AOFM undertook a number of activities to enhance the operational risk framework including:

- an update of the AOFM's Fraud Control Plan (FCP), including a reassessment of the risks of fraud from within the Agency and externally. The review considered potential fraud risks and found that the Agency's controls were appropriate for preventing and detecting fraud. No instances of fraud were detected in the Agency in 2008-09;

- completion of the Certificate of Compliance, an annual requirement for Chief Executives of agencies governed by the *Financial Management and Accountability Act 1997* (FMA Act), to report on compliance with the financial management framework. As a part of this process the Agency reviewed the requirements of the FMA Act, FMA Regulations, FMA Orders and FMA (Finance Minister to Chief Executives) Delegation and associated government financial policies. A risk assessment of the Agency's compliance with these requirements found that the Agency's controls and processes provide reasonable confidence of compliance. Further testing of the higher risk areas detected no instances of non-compliance;

- a comprehensive review of the AOFM's Chief Executive Instructions (CEIs) and internal financial delegations issued under the *Financial Management and Accountability Act 1997*. The CEIs provide a detailed framework of financial and management controls and delegations which limit discretion, approval and spending of public monies to minor amounts or alternatively require senior executive approval; and

- internal audits covering activities such as general controls, IT general controls and compliance.

Settlement operations

The AOFM handles very large volumes of payments on its administered portfolio of debt and assets. In 2008-09, it settled around $11.0 billion of payments of CGS interest and principal payments, $1.3 billion of swap payments and $372.8 billion in purchases of term deposits with the Reserve Bank of Australia. The AOFM also ensures that administered receipts are settled promptly and correctly by its transaction counterparties.

Settlement risk is a key risk managed by the AOFM. In 2008-09, the AOFM was not late in settling any payment obligations. There was one instance where compensation was sought from a counterparty because it failed to settle a payment obligation in line with its contractual obligations. No other compensation was sought throughout the year.

Information Technology operations

The AOFM has an established technology platform that includes integrated services for the delivery of treasury management and market data. The services provided by AvantGard Quantum, Bloomberg and Reuters continue to meet the requirements of the AOFM by providing a reliable environment that supports the Agency's debt management and investment activities.

Cooperation with other debt managers

Over the 2008-09 financial year, the AOFM continued to provide support for debt management activities in Papua New Guinea and the Solomon Islands. One position was staffed in each of these countries under the auspices of the Strongim Gavman Program and the Regional Assistance Mission to the Solomon Islands respectively. These deployments aim to develop cash and debt management capabilities through training and mentoring as well as the development of systems and procedures. This year a forum was conducted by the AOFM in Canberra attended by officials responsible for sovereign debt management of the two countries, together with seconded AOFM staff, to improve the assistance provided.

During the year the AOFM also hosted two visits from debt management officials from Indonesia.

Agency financial performance

Agency activities recorded an operating surplus of $1.97 million for 2008-09 financial year, comprising total revenue of $9.85 million and expenses of $7.88 million. As at 30 June 2009, the AOFM was in a sound net worth and liquidity position, reporting net assets of $16.37 million, represented by assets of $17.97 million (including current assets of $0.32 million) and liabilities of $1.60 million.

As at 30 June 2009, the AOFM maintained cash and unspent appropriations totalling $16.78 million. These funds are held to settle liabilities as and when they fall due and for future asset replacements and improvements.

During 2008-09, the AOFM did not return or establish a provision for return, by the way of dividend, of unspent appropriation monies to Government.

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 2009 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;
- Dr Paul Grimes, General Manager, Budget Group, Department of Finance and Deregulation;
- Neil Hyden, Chief Executive Officer, AOFM;
- 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 Ltd and a number of other unlisted companies.

The Advisory Board met on four occasions in 2008-09.

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

Asset & 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 the CEO, the Director of Financial Risk, the Head of Compliance and Reporting 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 and the IT Manager.

Operational Risk 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 the CEO, the Head of Compliance and Reporting, the Director of Financial Risk, 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, that are approved by the Secretary to the Treasury;

- Chief Executive Instructions and internal financial delegations, which establish an administrative framework for the delegation of the Chief Executive's powers under the *Financial Management and Accountability Act 1997*;

- a Contract Management Policy, which establishes 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 review of audit and related issues. It approves the AOFM's internal audit plan, reviews audit reports and advises on action to be taken on matters raised 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 2009 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;

- Michelle Stone, 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 Committee met on four occasions during 2008-09.

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 2008-09:

- a review of the AOFM's Anti-Money Laundering and Counter-Terrorism Financing program found that the AOFM's Part A Program is consistent with the overall requirements of the AML/CTF Act and Rules;

- a review of the processes, content and format of AOFM risk reporting and the associated governance framework found that the control environment is robust due to appropriate levels of segregation, system controls and oversight controls. It recommended some improvements in tailoring the reporting to AOFM objectives; and

- a follow-up review of Business Continuity & Disaster Recovery (IT) found that AOFM has a comprehensive Business Continuity and Disaster Recovery Plan, which is supported by satisfactory business continuity and disaster recovery training and education documentation.

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 2009* identified no risk issues in relation to the AOFM and concluded, based on the audit work performed, that internal controls were operating satisfactorily to provide a reasonable assurance that the Office could produce financial statements free of material misstatement.

During 2008-09, the ANAO did not conduct any other cross-agency audits which involved the AOFM.

Operations

During 2008-09, the AOFM expanded its range of activities as the Government introduced a number of initiatives designed to address issues in Australian financial markets. The year began with the AOFM continuing issuance of Government debt in order to support the Treasury Bond and Treasury Bond futures markets. During the year, the AOFM embarked on a program of additional Treasury Bond issuance in response to investor demand, the proceeds of which were used to purchase semi-government and Kangaroo bonds. The AOFM also began using additional cash balances in the Official Public Account to invest in short-term money market instruments. In November of 2008, the AOFM acted as a cornerstone investor in AAA-rated residential mortgage-backed securities for the first time. With the shift in the Government's budgetary position in late 2008-09, the AOFM scaled back its investment activities in order focus on debt issuance. Systems and procedures for the Compliance, Reporting and Settlements Units evolved to incorporate the new functions and the increased level of activities. AOFM staff in the aforementioned units received training relating to the new systems and procedures.

In the 2009-10 Federal Budget, the AOFM received an increased level of funding. This will enable to the Office to employ extra resources to assist in the new and increased functions of the Agency. The funding will also allow the AOFM to ensure that the risk framework around the activities remains robust.

Business continuity arrangements

The AOFM has business continuity and pandemic plans which are aimed at ensuring the Agency's critical activities are able to continue to be performed in the event of a major disruption to the Office 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, business continuity plans were updated and tested.

In response to the initial stages of the outbreak of Pandemic (H1N1) 2009, action was taken in accordance with the Office's pandemic plan to strengthen back-up arrangements for essential functions and additional training for staff to undertake them. Arrangements for staff working from home were also reviewed. Key staff have been provided with the capability to dial-in to the IT network, giving them the capacity to work from home if necessary. The pandemic plan provides for a range of other measures, depending of the severity of the pandemic. These measures were not needed in 2008-09.

Judicial decisions

In 2008-09, 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, expanding 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. During the year, a new position of Manager, Residential Mortgage-backed Securities and a vacancy for the Compliance Manager role were filled by the recruitment of staff with extensive relevant work experience.

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 2008-09 was 91 per cent, with an average of 74 per cent over the previous five years.

Training and development

Eighty-three per cent of AOFM staff have degree qualifications, with 14 per cent holding higher degrees and 28 per cent double degrees. Twenty-five percent 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 75.1 per cent of staff have participated in training or development supported by the Office. During this period, training averaged 3.8 days per full-time equivalent staff member (FTE) per year and the direct costs of training (paid to external parties) averaged $2,377 per FTE per year. In 2008-09, 75 per cent of employees participated in training, 3.5 days per FTE were invested in skill development and $1,949 per FTE was paid to external providers. Payments for training and development activity over the year amounted to 2.6 per cent of direct salary costs.

The AOFM workforce

As at 30 June 2009, the AOFM employed 32.8 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 2008 and 2009

	Ongoing				Non-ongoing				
	Full-time		Part-time		Full-time		Part-time		
Classification	**Male**	**Female**	**Male**	**Female**	**Male**	**Female**	**Male**	**Female**	**Total**
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**
2008									
AOFM1	0	2	0	0	0	0	0	0	**2**
AOFM2	12	7	1	3	1	0	0	0	**24**
AOFM3	4	0	0	0	2	0	0	0	**6**
AOFM4	1	0	0	0	0	0	0	0	**1**
CEO	1	0	0	0	0	0	0	0	**1**
Total	**18**	**9**	**1**	**3**	**3**	**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

There were no changes to senior management during the period.

Other staffing changes

Five ongoing employees and one non-ongoing employee were recruited during 2008-09 to the AOFM2 level. They included four graduates who joined in the middle of the financial year. There were three staff departures during the year, two of whom were non-ongoing employees. For ongoing employees, departures represented 3.4 per cent of average staffing levels in 2008-09 (20.5 per cent in 2007-08).

Employment arrangements

Most staff are employed under Australian Workplace Agreements with the AOFM that were executed prior to the change in Government policy in February 2008. The Office is working towards establishing a collective agreement to cover all staff other than the CEO. As an interim arrangement new staff recruited during the year were employed under common law contracts. Section 24(1) determinations under the *Public Service Act 1999* have been used to supplement terms and conditions for staff deployed overseas.

Individual workplace agreements and contracts specify employment terms and conditions, 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 reviewed annually, taking 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 2009	
	Base Rate	Grade Rate
Classification	**$**	**$**
AOFM1	38,825	63,857
AOFM2	60,502	123,046
AOFM3	141,766	177,208
AOFM4	190,671	238,339

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 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, health information, and dietary assistance were also provided in 2008-09. 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 2008-09 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's Workplace Diversity Program and Disability Action Plan in line with the Australian Government Disability Strategy to help eliminate, as far as possible, discrimination on the grounds of disability.

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, 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).

Consultants

During 2008-09, 5 new consultancy contracts were entered into involving total actual expenditure of $20,994. In addition, 2 ongoing consultancy contracts were active during the 2008-09 year, involving total actual expenditure of $131,336.

The numbers for 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 2008-09 are provided in Table 4.

Table 3: Consultancy contracts

	2006-07	2007-08	2008-09
Number of consultancy contracts			
New Contracts	7	8	5
Ongoing contracts	2	2	2
Expenditure (including GST)			
New Contracts	$59,483	$69,885	$20,994
Ongoing contracts	$154,184	$130,289	$131,336

Table 4: Consultancy contracts of $10,000 or more let during 2008-09

Consultant name	Description	Price
Nil to report		
Total		**$0**

ANAO access clauses and exempt contracts

Only one contract for $100,000 or more was let during the reporting period that did not provide for the Auditor-General to have to access the contractor's premises. This was an agreement to allow the AOFM to participate in the Austraclear System, which is an electronic depository and settlement system for Commonwealth Government Securities, semi-government securities and private-sector debt securities, including residential mortgage-backed securities. It is a licensed clearing and settlement facility under the *Corporations Act 2001* and each participant must comply with the Austraclear System Regulations, which represent a legally binding contract between each participant and Austraclear Limited (the owner of the Austraclear System and a subsidiary of the Australian Securities Exchange). The Austraclear System Regulations represent formal 'Operating Rules' under the *Corporation Act 2001*. The contract let during the year provides for AOFM participation for the period 2009-12 at a cost of $492,810.

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 the Australian Office of Financial Management for the year ended 30 June 2009, which comprise: a Statement by the Chief Executive and Chief Finance Officer; Income Statement; Balance Sheet; Statement of Changes in Equity; Cash Flow Statement; Schedule of Commitments; Schedule of Contingencies; Schedule of Administered Items and Notes to and forming part of the Financial Statements, including a Summary of 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 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

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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 2009 and its financial performance and cash flows for the year then ended.

Australian National Audit Office

Warren J Cochrane

Group Executive Director

Delegate of the Auditor-General

Canberra

21 August 2009

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 2009 are based on properly maintained 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 Chief Executive Officer 21 August 2009	P Raccosta Chief Finance Officer 21 August 2009

Income statement
for the year ended 30 June 2009

	Notes	**2009 $'000**	2008 $'000
REVENUE			
Revenue from government	4A	**8,467**	8,489
Other revenue	4B	**1,034**	1,464
Resources received free of charge	4C	**286**	269
Reversals of previous asset write-downs and impairments	4D	**59**	-
Total revenue		**9,846**	10,222
EXPENSES			
Employee benefits	5A	**4,395**	4,319
Suppliers	5B	**3,199**	2,786
Depreciation and amortisation	5C	**281**	317
Write-down and impairment of assets	5D	**-**	90
Total expenses		**7,875**	7,512
Surplus		**1,971**	2,710

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

Balance sheet
as at 30 June 2009

	Notes	2009 $'000	2008 $'000
ASSETS			
Financial assets			
Cash and cash equivalents		**63**	159
Trade and other receivables	6A	**16,887**	14,454
Total financial assets		**16,950**	14,613
Non-financial assets			
Infrastructure, plant and equipment	7A,7C	**555**	620
Intangibles	7B,7C	**377**	418
Other non-financial assets	7D	**90**	40
Total non-financial assets		**1,022**	1,078
Total assets		**17,972**	15,691
LIABILITIES			
Payables			
Suppliers	8A	**223**	97
Other payables	8B	**7**	2
Total payables		**230**	99
Provisions			
Employee provisions	9A	**1,245**	1,071
Other provisions	9B	**125**	120
Total provisions		**1,370**	1,191
Total liabilities		**1,600**	1,290
Net assets		**16,372**	14,401
EQUITY(a)			
Retained surplus		**12,949**	10,978
Contributed equity		**3,423**	3,423
Total equity		**16,372**	14,401
Current assets		**319**	609
Non-current assets		**17,653**	15,082
Current liabilities		**1,229**	971
Non-current liabilities		**371**	319

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 year ended 30 June 2009

	Notes	2009 $'000	2008 $'000
RETAINED SURPLUS			
Opening balance		**10,978**	8,268
Changes for the period:			
Surplus		**1,971**	2,710
Closing balance as at 30 June		**12,949**	10,978
CONTRIBUTED EQUITY			
Opening balance		**3,423**	3,423
Changes for the period:			
Capital injections		**-**	-
Closing balance as at 30 June		**3,423**	3,423
Total equity		**16,372**	14,401

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

Cash flow statement

for the year ended 30 June 2009

	Notes	2009 $'000	2008 $'000
OPERATING ACTIVITIES			
Cash received			
Appropriations		**5,790**	5,525
GST received		**51**	50
Goods and services		**1,326**	1,254
Total cash received		**7,167**	6,829
Cash used			
Employees		**4,218**	4,326
Suppliers		**2,889**	2,553
GST paid		**40**	50
Total cash used		**7,147**	6,929
Net cash from (used by) operating activities	10	**20**	(100)
INVESTING ACTIVITIES			
Cash used			
Purchase of property, plant and equipment and intangibles		**116**	53
Total cash used		**116**	53
Net cash from (used by) investing activities		**(116)**	(53)
FINANCING ACTIVITIES			
Appropriations - contributed equity		**-**	-
Net cash from (used by) financing activities		**-**	-
Net increase (decrease) in cash held		**(96)**	(153)
Cash at the beginning of the reporting period		**159**	312
Cash at the end of the reporting period		**63**	159

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

Schedule of commitments
as at 30 June 2009

	Notes	2009 $'000	2008 $'000
BY TYPE			
Other commitments			
Operating leases(a)		**2,186**	2,424
Other commitments(b)		**2,184**	3,501
Total other commitments		**4,370**	5,925
Commitments receivable - GST recoverable on commitments		**44**	85
Net commitments by type		**4,326**	5,840
BY MATURITY			
Operating lease commitments			
One year or less		**333**	323
From one to five years		**1,334**	1,279
Over five years		**519**	822
Total operating lease commitments by maturity		**2,186**	2,424
Other commitments			
One year or less		**1,693**	1,808
From one to five years		**490**	1,692
Over five years		**1**	1
Total other commitments by maturity		**2,184**	3,501
Commitments receivable			
One year or less		**40**	41
From one to five years		**4**	44
Total commitments receivable by maturity		**44**	85
Net commitments by maturity		**4,326**	5,840

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

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 included 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 internal audit services, payroll services, market data and news services, fiscal agency agreements and service agreements with other parties, including Commonwealth bodies.

Schedule of administered items

	Notes	2009 $'000	2008 $'000
Income and expenses administered on behalf of government			
for the year ended 30 June 2009			
Income before re-measurements			
Non-taxation revenue			
Interest	16A	**2,527,570**	2,995,083
Other revenue	16B	**3,328**	2,266
Total revenue before re-measurements		**2,530,898**	2,997,349
Expenses before re-measurements			
Grants	17A	**28**	30
Interest	17B	**4,962,327**	5,350,972
Total expenses before re-measurements		**4,962,355**	5,351,002
Administered gains before re-measurements			
Net foreign exchange gains (losses)	18A	**(1,049)**	754
Net gains (losses) on sale of financial instruments	18B	**1,034,245**	-
Total administered gains before re-measurements		**1,033,196**	754
Administered operating result before re-measurements		**(1,398,261)**	(2,352,899)
Administered re-measurements			
Net market revaluation gains (losses)	19	**(232,211)**	(117,648)
Total administered re-measurements		**(232,211)**	(117,648)
Net administered result		**(1,630,472)**	(2,470,547)

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

Schedule of administered items (continued)

	Notes	**2009 $'000**	2008 $'000
Assets and liabilities administered on behalf of government			
as at 30 June 2009			
ASSETS			
Financial assets			
Cash and cash equivalents	20A	**622**	622
Receivables	20B	**2,833,391**	2,836,521
Investments (under FMA section 39)(a)	20C	**35,486,265**	29,098,675
Accrued revenue	20D	**490**	502
Total financial assets		**38,320,768**	31,936,320
Total assets		**38,320,768**	31,936,320
LIABILITIES			
Interest bearing liabilities			
Commonwealth Government Securities	21A	**107,313,801**	58,399,722
Total interest bearing liabilities		**107,313,801**	58,399,722
Payables			
Other payables	21B	**104**	1,040,988
Total payables		**104**	1,040,988
Total liabilities		**107,313,905**	59,440,710
Net assets administered on behalf of government	22	**(68,993,137)**	(27,504,390)
Current assets		**27,876,792**	29,101,411
Non-current assets		**10,443,976**	2,834,909
Current liabilities		**22,758,081**	5,328,765
Non-current liabilities		**84,555,824**	54,111,945

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)

	Notes	2009 $'000	2008 $'000
Administered cash flows			
for the year ended 30 June 2009			
OPERATING ACTIVITIES			
Cash received			
Interest(a)		**1,573,173**	1,362,492
Other(b)		**1,034,620**	2,266
Total cash received		**2,607,793**	1,364,758
Cash used			
Interest(a)		**3,755,241**	3,589,697
Total cash used		**3,755,241**	3,589,697
Net cash from (used by) operating activities		**(1,147,448)**	(2,224,939)
INVESTING ACTIVITIES			
Cash received			
Capital proceeds from term deposits		**375,350,000**	310,050,000
Capital proceeds from fixed interest securities		**3,195,972**	-
Capital proceeds from discount securities		**11,507,500**	-
Repayments from residential mortgage-backed securities		**179,281**	-
Repayments from advances and loans		**91,260**	88,650
Total cash received		**390,324,013**	310,138,650
Cash used			
Acquisition of term deposits		**372,800,000**	318,750,000
Acquisition of fixed interest securities		**5,247,136**	-
Acquisition of discount securities		**12,503,360**	-
Acquisition of residential mortgage-backed securities		**6,203,420**	-
Total cash used		**396,753,916**	318,750,000
Net cash from (used by) investing activities		**(6,429,903)**	(8,611,350)
FINANCING ACTIVITIES			
Cash received			
Capital proceeds from borrowings		**54,520,821**	4,937,916
Receipt of collateral		**101,000**	-
Other receipts		**86**	361
Total cash received		**54,621,907**	4,938,277
Cash used			
Repayment of borrowings(c)		**7,085,282**	2,922,910
Return of collateral		**101,000**	-
Total cash used		**7,186,282**	2,922,910
Net cash from (used by) financing activities		**47,435,625**	2,015,367

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

(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 2008-09 were $55.771 million ($36.479 million for 2007-08), whilst aggregate swap interest receipts for 2008-09 were $1,102.751 million ($1,698.469 million for 2007-08). Net swap interest payments for 2008-09 were $219.230 million ($150.478 million for 2007-08), whilst aggregate swap interest payments for 2008-09 were $1,266.210 million ($1,812.468 million for 2007-08).

(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)

	Notes	2009 $'000	2008 $'000
Administered cash flows			
for the year ended 30 June 2009 (continued)			
Net increase (decrease) in cash held		**39,858,274**	(8,820,922)
Cash at the beginning of the reporting period		**622**	867
Cash from Official Public Account:			
Appropriations		**405,936,466**	325,333,975
Special accounts		**38**	394
		405,936,504	325,334,369
Cash to Official Public Account:			
Receipts		**(445,794,692)**	(316,513,331)
Special accounts		**(86)**	(361)
		(445,794,778)	(316,513,692)
Cash at the end of the reporting period		**622**	622

Notes to and forming part of the financial statements
for the year ended 30 June 2009

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 2008 to 30 June 2009. They are required by section 49 of the *Financial Management and Accountability Act 1997*, and are a general purpose financial report 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 2008));
- 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 of the International Accounting Standards Board for the purposes of setting Australian Accounting Standards, but not in their entirety and with some modification 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 property, 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 program, is dependent on government policy and on continuing appropriations by Parliament for the AOFM's administration and program.

Administered revenue, expenses, assets, liabilities and cash flows reported in the Schedule of Administered Items and related notes are accounted for on the same basis and using the same policies as for departmental items, except where otherwise stated.

1.2 Communications Fund

In 2005-06 the Communications Fund was established under the *Telecommunications (Consumer Protection and Service Standards) Act 1999* to fund improvements in telecommunication services in regional, rural and remote parts of Australia. The AOFM was authorised by the responsible Ministers (the Minister for Broadband, Communications and the Digital Economy and the Minister for Finance and Deregulation) to make investments on behalf of the Department of Broadband, Communications and the Digital Economy (DBCDE). These investments and their earnings are reported by DBCDE and not the AOFM. See Note 31 for additional information.

On 1 January 2009, the Communications Fund was closed and its balance transferred to the Building Australia Fund. The investments of the Building Australia Fund are managed by the Future Fund Board of Guardians.

1.3 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.

1.4 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 14 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

During 2008-09 an amendment was made to AASB 139 *Financial Instruments: Recognition and Measurement* to allow reporting entities to reclassify, in limited circumstances, financial assets out of the category fair value through profit and loss. The AOFM did not utilise this amendment to reclassify financial assets.

Other amendments to Australian Accounting Standards that became effective in 2008-09 have not impacted on the AOFM.

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

The AOFM is not aware of any new Australian Accounting Standard that has been issued but is not yet effective whose application will have an impact on the AOFM's financial results or financial position in future reporting periods.

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 Department of Finance and Deregulation Chief Executive. The AOFM has not early adopted a new Australian Accounting Standard or AASB Interpretation.

1.5 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.

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 investment in residential mortgage-backed securities to support competition in the residential mortgage market.

The purpose of the separation of administered and departmental items is to enable assessment of the administrative efficiency of the AOFM in providing goods and services to the government.

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

1.6 Revenue (Departmental)

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

(a) Revenue from government — output appropriations

The full amount of the appropriation for departmental outputs for the year (less any formal reductions) is recognised as revenue.

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

(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.

Contributions of assets at no cost of acquisition are recognised as revenue at their fair value when the assets qualify for recognition.

(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.

1.7 Transactions with the government as owner (Departmental)

(a) Capital injections

Appropriations designated as ‘capital injections’ (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 capital injections that are undrawn by the AOFM and have not lapsed.

The AOFM was not appropriated any capital injections from government for 2008-09 (nil for 2007-08).

(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 did not make a distribution to owners during 2008-09 (nil for 2007-08).

1.8 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) Leave

The liability for employee benefits includes provisions 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 leave liabilities are calculated on the basis of employees' remuneration at the end of the financial year adjusted for expected increases in remuneration effective from 1 July 2009.

Liabilities for short-term employee benefits (such as wages and salaries and annual leave expected to be settled within 12 months from the end of the financial year) are measured at their nominal amounts.

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 has commissioned an 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.

(b) Superannuation

Staff and contractors of the AOFM contribute to the Commonwealth Superannuation Scheme (Defined Benefit), Public Sector Superannuation Scheme (Defined Benefit), Public Sector Superannuation Scheme (Accumulation Plan) and other nominated schemes. Employer contributions (including productivity contributions and salary sacrificed superannuation contributions) of $719,393 were made to these schemes during the financial year (2007-08: $715,371).

The AOFM makes employer contributions to the Australian Government at rates determined by an actuary to be sufficient to meet the cost to the government of the superannuation entitlements of its employees. The liability for defined superannuation benefits payable to an employee upon termination of employment with the Australian Government is recognised in the financial statements of the Department of Finance and Deregulation and is settled by the Australian Government in due course.

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.

1.9 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 to the Income Statement on a straight-line basis which is representative of the pattern of benefits derived from the leased assets.

1.10 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.

1.11 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.

1.12 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 the 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 Income Statement 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. An impairment provision was not required.

(d) Depreciation and amortisation

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 amortised 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 and amortisation rates (useful lives) are reviewed regularly and necessary adjustments are recognised in the current, or current and future reporting periods as appropriate. During the year the AOFM revised the useful lives of the majority of its assets to reflect latest estimated replacement dates. The financial effect of this revision to useful lives was a reduction in depreciation and amortisation expenses for 2008-09 of $9,257.

Depreciation and amortisation expenses have been determined by applying rates to new depreciable assets based on the following useful lives:

Sub-class of depreciable asset	**2009**	2008
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 and amortisation allocated to each class of asset during the reporting period is disclosed at Note 5C.

1.13 Computer software (Departmental)

Purchases of computer software are recognised at cost in the Balance Sheet except for purchases costing less than $10,000, which are expensed at the time of acquisition.

An item of software represents:

- a software licence granted for greater than 12 months; or
- a developed software application.

Developed software is recognised by capitalising all directly attributable internal and external costs that enhance the software's functionality and therefore service potential.

Software assets are amortised on a straight-line basis over their anticipated useful lives, being three to five years (2007-08: three to five years). Software assets are not subject to revaluation.

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

1.14 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 Cash Flow Statement are recorded in gross terms (that is, 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, services arising from the management of the Communications Fund 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.

1.15 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 in the administered financial statements. 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.

1.16 Exemption from FMOs

Section 17.5 of the FMOs provides an exemption to the AOFM from presenting the Schedule of Income and Expenses Administered on Behalf of Government, and associated notes, as set out in the Annexure to the FMOs. Instead, the AOFM is required to comply with AASB 101 *Presentation of Financial Statements* for presenting its administered revenue and expenses.

Paragraph 83 of AASB 101 encourages reporting entities to adopt an Income Statement presentation 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 a rarity). 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 the value of transactions managed from year to year. The revaluation effect will net to zero over the life of a financial instrument.

1.17 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 entered into. Depending on the transaction type this may be several days prior to settlement.

1.18 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 longer term Australian dollar denominated semi-government debt, 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, for supporting competition in the residential mortgage market and, for a period during 2008-09, for investing the proceeds from the issuance of Treasury Bonds over and above what was required to meet maturing debt and financing requirements in fixed interest debt securities to offset cost and risk of the additional issuance.

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. That is, 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 managed in mark-to-market terms.

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

Until July 1990, the Australian Government borrowed on behalf of the State and 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 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 Territories 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 2009 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* ($11 million as at 30 June 2008). 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*, the Australian Government, from 1945 to 1989, made advances to the State and 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 $3,162 million as at 30 June 2009 ($3,253 million as at 30 June 2008).

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 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 Territory governments and overdues.

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

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 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 Payables in the Schedule of 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 and Note 3 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 of the swaps 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.

No swap debtors have been assessed as being unable to meet contractual obligations due to the Australian Government as at 30 June 2009 (nil for 30 June 2008). Consequently, the AOFM has not included an allowance for uncollectability of amounts due on interest rate swap contracts.

1.19 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 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. 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.

(a) Non-derivative financial instruments at fair value

The fair value of domestic CGS 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 components of the domestic CGS debt portfolio as at the end of the financial year.

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 is based on a zero coupon curve using the overnight cash rate and overnight indexed swap rates. These yields reflect the default free credit risk status of the RBA. 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 market swap rates as at the end of the financial year.

1.20 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 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 are reported as revenue when received.

(b) Grants

Under the *Financial Agreement Act 1994*, the Australian Government assists the State and Territory governments to redeem maturing debt on allocation to them. Payments made to the State and Territory governments under these arrangements are recognised as grants expenses as and when they fall due and payable.

(c) Borrowing costs

In accordance with section 20.1 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.

In 2008-09 the range of securities accepted as collateral was widened to include all securities accepted by the RBA as general collateral in repurchase agreements that the RBA undertakes with the market. The securities lending facility was also widened to include intra-day (as well as overnight) borrowing of Treasury 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 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. The interest rate payable by the other party is the RBA target cash rate. The interest rate payable by the Australian Government is the target cash rate less a margin determined by the AOFM. 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 of the AOFM

The AOFM manages a portfolio of debt and financial assets on behalf of the Australian Government. It issues Treasury Bonds to finance projected budget deficits and support interest rate markets and Treasury Notes to manage the within-year financing task. It also manages the government's cash in the Official Public Account (OPA) which is surplus to immediate requirements by making investments in short term deposits with the RBA and debt securities. It undertakes the administration, financial and operational risk management, and financial reporting of its portfolio of debt and assets.

From 2003 until recently, debt issuance by the AOFM had been undertaken solely with the objective of maintaining the Treasury Bond and Treasury Bond futures markets rather than for budget funding purposes. Successive budget surpluses removed the need to borrow to fund the budget. Issuance was maintained at levels that matched maturing debt obligations to support the continued operation of these markets, as they allow market participants to better manage their interest rate risk and thereby contribute to a lower cost of capital in Australia. They also help strengthen the financial system against the potential impacts of financial shocks. For a period (between August 2008 and February 2009) additional debt was issued over and above what was required to meet maturing debt obligations in order to further support the liquidity of the Treasury Bond market. The proceeds of this additional issuance were invested in fixed interest assets to offset the cost and risk of the additional issuance.

Since the release of the *Updated Economic and Fiscal Outlook* on 3 February 2009, the proceeds of issuance have been used for budget funding. The *Outlook* presented revised fiscal forecasts for budget deficits in 2008-09 and subsequent years. This required the AOFM to increase its financing program and resume Treasury Note issuance. The Treasury Bond market has moved from a relatively steady state to one where the debt on issue is increasing and where new issuance is competing with other AAA rated issues (including other sovereigns, semi-governments and institutions issuing government guaranteed debt). To assist with the efficient placement of debt, the AOFM will initiate a promotional program to intensify its market liaison with investors and intermediaries.

Until 2008 the AOFM used interest rate swaps to reduce the cost of its borrowing. However, due to changing yield curves and reductions in the term premium, the potential to make savings in debt servicing costs has declined. No new swaps have been executed since late in 2007 and in 2008-09 the AOFM was running down its portfolio of interest rate swaps.

The AOFM manages the overall level of cash in the OPA by making short term deposits with the RBA and buying short-dated discount securities to offset fluctuations in the daily flows in and out of the OPA. It may also make short term borrowings from the public by issuing Treasury Notes. The OPA is part of the Balance Sheet of the Department of Finance and Deregulation and not part of the AOFM's Balance Sheet. The AOFM holds continuing balances of short term assets and debt to allow it to respond flexibly and quickly to swings in cash requirements.

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, of which a maximum of $4 billion may be in RMBS securities issued by authorised deposit taking institutions. The AOFM acquired a total of $6,203.420 million of AAA (or equivalent) rated RMBS up to year end.

AOFM's borrowing and portfolio management activities comply with applicable accounting standards and legislative requirements. The key legislative mechanisms that governed these activities during the reporting period were as follows:

- the *Commonwealth Inscribed Stock Act 1911* and associated regulations represent the Australian Government's primary vehicle for the creation and issuance of domestic stock prescribed under the Act, including Treasury Bonds and Treasury Notes;
  - in July 2008, the Act was amended to provide the Treasurer with an authority to borrow up to a limit of $75 billion. The limit excludes stock and securities on issue on the commencement of the amendment, other than Treasury Bonds. A further amendment was made in February 2009 to allow the Treasurer to increase the limit by an additional $125 billion in special circumstances by making a declaration. The Act provides for the Treasurer to delegate his borrowing power to certain officials, which must be accompanied by a direction made in writing and which specifies the maximum face value of stock and securities that may be issued under the Act and the *Loans Securities Act 1919*. In March 2009 the Treasurer made a declaration that special circumstances existed and increased the limit to the maximum provided by the Act.
- 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 provision relating to overseas borrowings and provides authority to enter into swaps and other financial agreements;
  - in July 2008, the Act was amended to provide the Treasurer with an explicit authority to enter into securities lending arrangements of up to a maximum of $5 billion at any time and for the collection of collateral.
- the *Loans (Temporary Revenue Deficits) Act 1953* gives the Treasurer the power to borrow to meet 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;
  - in July 2008, the Act was amended to broaden the Treasurer's investment powers to allow investment for any purpose and not only for managing debt. The amendment also widened the range of eligible investments.

Note 3: Financial risk management

The AOFM is exposed to risks arising from financial instruments on its administered Balance Sheet comprising interest rate risk, exchange rate risk, liquidity risk, credit risk and prepayment risk. These risks are managed within a financial risk management framework that includes directions from the Treasurer, 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 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. The AOFM's investments in residential mortgage-backed securities are managed in a separate portfolio. Housing Advances to State and Territory governments (which were not evidenced by the issue of securities) made under previous Commonwealth-State financing arrangements are also held in a separate portfolio.

(a) Interest rate risk

Interest rate risk represents the risk to debt servicing costs and investment returns 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 is the accruals basis of accounting under the historic cost accounting convention. Market value cost 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

Prior to 30 June 2008, the AOFM managed the cost and interest rate risk of its long term debt portfolio in accordance with an interest rate risk management policy using domestic interest rate swaps. This was guided by reference to a benchmark portfolio that reflected the desired trade-off between expected cost and potential variability around the expected cost. In 2007-08, a review of the benchmark portfolio and the assumptions supporting it concluded that the interest rate risk management policy should be changed in 2008-09 and that interest rate swaps were no longer to be undertaken. Given that they no longer served a policy objective, the AOFM commenced a program in 2008-09 to run-down its portfolio of interest rate swaps by terminating its agreements with counterparties. See Note 24B for details of the AOFM's interest rate swap portfolio.

With the increased issuance of debt in 2008-09 and subsequent years, the AOFM is able to manage 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.

For a period during the financial year (and when the AOFM issued additional debt to maintain market liquidity), the proceeds of debt issuance over and above what was required to meet maturing debt obligations were invested in fixed interest assets to offset the cost and risk of the additional issuance. This additional issuance and associated assets were managed within a separate portfolio. With the deterioration in the budget position and the need to finance projected budget deficits the portfolio was rolled into the long term debt portfolio. The assets are gradually being liquidated as opportunities arise as an additional source of funding.

Cash management portfolio

The primary objective of the cash management portfolio is liquidity management but other objectives are to minimise the net cost of funding and the cash balance and to invest excess balances efficiently.

Residential mortgage-backed securities

The objective set by the government for the AOFM's investment in the residential mortgage-backed securities market is to enhance competition in the residential mortgage market in Australia. Interest earned on residential mortgage-backed securities comprises a floating interest rate (set against 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 risk

The AOFM manages the government's 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. In 2008-09 the AOFM resumed issuance of Treasury Notes to assist in the management of the within-year financing task. The AOFM maintains the daily volume of cash in the OPA, within limits set by the Treasurer and the Minister for Finance and Deregulation, by monitoring the projected daily transactions of major spending and revenue agencies and by undertaking investment of funds that are surplus to cash requirements and the issuing of Treasury Notes to the wholesale market to meet short-falls in cash requirements. 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.

Senior management monitors the daily balances in the OPA, holdings of short term assets and the need for the issuance of Treasury Notes.

(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.

Eligible investments are as follows:

- Securities issued or guaranteed by the Commonwealth, a State or Territory;
  - individual issuer limits apply;
- AAA rated securities issued or guaranteed by the government of a foreign country in Australian dollars;
  - individual issuer limits apply;
- AAA rated securities issued by a financial institution or supranational in Australian dollars;
  - individual issuer limits apply;
- 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 and individual issuer limits apply;
- 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 apply;
- deposits with the Reserve Bank of Australia; and
  - no limits exist for this class;
- AAA rated or equivalent residential mortgage-backed securities;

  - a program limit of $8 billion, of which a maximum of $4 billion may be in securities issued by authorised deposit taking institutions, with no single issuer limits.

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.

Residential mortgage-backed securities (RMBS)

The credit quality of the 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. See Note 24E for details of the AOFM's portfolio of RMBS.

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.

Under the credit risk policy:

- interest rate swaps may only be executed with those counterparties who have a Master Agreement with the AOFM which includes netting arrangements, right-to-break clauses and early termination clauses for credit rating downgrades;
  - the credit risk associated with favourable contractual positions is reduced by netting arrangements to the extent that if a default event occurs, all amounts with the counterparty are terminated and settled on a net basis;
- swap counterparties must have a long term senior credit rating of at least A (by Standard and Poor's) and A2 (by Moody's) where a Collateral Support Annexe is in place, and AA- (by Standard and Poor's) and Aa3 (by Moody's) where a Collateral Support Annexe is not in place;

  - a Collateral Support Annexe requires a counterparty to post collateral in the form of Australian dollars with the AOFM to offset some of the AOFM's credit exposure to it, where the current exposure reaches a specified level;
- credit risk limits apply to the current exposure and potential exposure for each counterparty;
  - current exposure is the current mark-to-market value of all swaps with a counterparty;
  - potential exposure is a conservative estimate of the extent to which the current exposure could vary over time with changes in interest rates; and
- regular reporting is provided to senior management of the current and potential exposures by counterparty, and together with the results of stress testing current exposure for credit downgrades and changes in market interest rates.

Other assets and credit exposures

The AOFM has a credit risk exposure on its advances (not evidenced by the issue of securities) 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 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 of the RMBS 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 on the RMBS varies over time and the actual date that the securities will be repaid in full cannot be precisely determined (this is referred to a prepayment risk). The AOFM monitors the performance of each RMBS issue through a monthly report made available by the issuer. The report provides details of cash received from payments on the underlying mortgages, payments made under the cash flow waterfall, the rate of loan principal repayments ahead of scheduled principal payments and the estimated weighted average remaining life of the RMBS.

Note 4: Revenue

	2009	2008
	$'000	$'000
Note 4A: Revenue from government		
Appropriations:		
Departmental outputs	**8,467**	8,489
Total revenue from government	**8,467**	8,489
Note 4B: Other revenue		
Staff secondments to other agencies	**642**	802
Fees for management of the Communications Fund	**164**	316
Other	**228**	346
Total other revenue	**1,034**	1,464
Note 4C: Resources received free of charge		
ANAO audit services	**286**	261
Other	**-**	8
Total resources received free of charge	**286**	269
Note 4D: Reversals of previous asset write-downs and impairments		
Asset revaluation increment - leasehold improvements	**4**	-
Asset revaluation increment - computers, plant and equipment	**55**	-
Total reversals of previous asset write-downs and impairments	**59**	-
Total revenue	**9,846**	10,222

Note 5: Expenses

	2009 $'000	2008 $'000
Note 5A: Employee benefits		
Wages and salaries	**3,238**	3,272
Superannuation	**716**	693
Leave and other entitlements	**137**	(27)
Other employee expenses	**304**	381
Total employee benefits	**4,395**	4,319
Note 5B: Suppliers		
Provision of goods:		
external entities	**45**	51
related entities	**1**	1
Rendering of services:		
external entities	**1,428**	1,194
related entities	**1,403**	1,208
Operating lease rentals(a)	**309**	321
Workers compensation premium (related entity)	**13**	11
Total suppliers	**3,199**	2,786
Note 5C: Depreciation and amortisation		
Depreciation of infrastructure, plant and equipment:		
Computers, plant and equipment	**99**	142
Leasehold improvements	**64**	58
Amortisation of intangibles:		
Computer software	**118**	117
Total depreciation and amortisation	**281**	317
Note 5D: Write-down and impairment of assets		
Computers, plant and equipment - disposed	**-**	90
Total write-down and impairment of assets	**-**	90
Total expenses	**7,875**	7,512

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

Note 6: Financial assets

	2009	2008
	$'000	$'000
Note 6A: Trade and other receivables		
Appropriations receivable - undrawn(a)	**16,721**	14,044
Other	**166**	410
Total receivables	**16,887**	14,454
Current receivables	**166**	410
Non-current receivables	**16,721**	14,044
Receivables are aged as follows:		
Not past due	**16,887**	14,454
Overdue	**-**	-
Total receivables (gross)	**16,887**	14,454

(a) Appropriations receivable-undrawn are appropriations controlled by the AOFM but held in the OPA under the government's 'just-in-time' drawdown arrangements. As at 30 June 2009, the balance comprised undrawn equity injections of $949,070 ($949,070 as at 30 June 2008) and undrawn output appropriations of $15,771,575 ($13,094,575 as at 30 June 2008).

Note 7: Non-financial assets

	2009 $'000	2008 $'000
Note 7A: Infrastructure, plant and equipment		
Computers, plant and equipment - at cost	**6**	94
Accumulated depreciation	**-**	(26)
	6	68
Computers, plant and equipment - at 2006 valuation (fair value)	**-**	370
Accumulated depreciation	**-**	(292)
	-	78
Computers, plant and equipment - at 2009 valuation (fair value)	**180**	-
Accumulated depreciation	**(45)**	-
	135	-
Total computers, plant and equipment	**141**	146
Leasehold improvements - at 2006 valuation (fair value)	**-**	922
Accumulated amortisation	**-**	(448)
	-	474
Leasehold improvements - at 2009 valuation (fair value)	**955**	-
Accumulated amortisation	**(541)**	-
	414	-
Total leasehold improvements	**414**	474
Total infrastructure, plant and equipment	**555**	620
Current infrastructure, plant and equipment	**-**	-
Non-current infrastructure, plant and equipment	**555**	620
Note 7B: Intangibles		
Computer software purchased - at cost	**3,018**	2,941
Accumulated amortisation	**(2,641)**	(2,523)
Total intangibles	**377**	418
Current intangibles	**-**	-
Non-current intangibles	**377**	418

All revaluations are independent and are conducted in accordance with the revaluation policy stated at Note 1.12. 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.

Note 7: Non-financial assets (continued)

	Leasehold improvements $'000	Computers, plant and equipment $'000	Computer software (purchased) $'000	Total $'000
		30 June 2009		
Note 7C: Reconciliation of the opening and closing balances of property, plant and equipment and intangibles				
Opening values 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 as at 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**
As at 30 June 2009				
Gross book value	**955**	**186**	**3,018**	**4,159**
Accumulated depreciation/ amortisation	**(541)**	**(45)**	**(2,641)**	**(3,227)**
Net book value as at 30 June 2009	**414**	**141**	**377**	**932**

Note 7: Non-financial assets (continued)

	Leasehold improvements $'000	Computers, plant and equipment $'000	Computer software (purchased) $'000	Total $'000
		30 June 2008		
Note 7C: Reconciliation of the opening and closing balances of property, plant and equipment and intangibles (continued)				
Opening values as at 1 July 2007				
Gross book value	1,110	433	2,931	4,474
Accumulated depreciation/ amortisation	(499)	(185)	(2,406)	(3,090)
Net book value as at 1 July 2007	611	248	525	1,384
Additions:				
Purchases	-	43	10	53
Resources received free of charge	8	-	-	8
Disposals:				
Gross book value	(196)	(12)	-	(208)
Accumulated depreciation/ amortisation	109	9	-	118
Depreciation/amortisation charge	(58)	(142)	(117)	(317)
As at 30 June 2008				
Gross book value	922	464	2,941	4,327
Accumulated depreciation/ amortisation	(448)	(318)	(2,523)	(3,289)
Net book value as at 30 June 2008	474	146	418	1,038

Note 7: Non-financial assets (continued)

	2009 $'000	2008 $'000
Note 7D: Other non-financial assets		
Prepayments	**90**	40
Total other non-financial assets	**90**	40
Current prepayments	**90**	40
Non-current prepayments	**-**	-

Note 8: Payables

	2009 $'000	2008 $'000
Note 8A: Suppliers		
Trade creditors(a)	**223**	97
Total suppliers	**223**	97
Current suppliers	**223**	97
Non-current suppliers	**-**	-
Note 8B: Other payables		
Tax payable	**7**	2
Total other payables	**7**	2
Current other payables	**7**	2
Non-current other payables	**-**	-

(a) Settlement is usually made net 30 days.

Note 9: Provisions

	2009 $'000	2008 $'000
Note 9A: Employee provisions		
Salaries and wages	**54**	35
Annual leave	**330**	316
Long service leave	**701**	578
Superannuation	**160**	142
Total employee provisions	**1,245**	1,071
Current employee provisions(a)	**999**	872
Non-current employee provisions	**246**	199
Note 9B: Other provisions		
Make-good on leasehold premises:(b)		
Opening balance	**120**	135
Additional provision made	**5**	(15)
Total other provisions	**125**	120
Current other provisions	**-**	-
Non-current other provisions	**125**	120

(a) Under AASB 101 *Presentation of Financial Statements,* liabilities are to be classified as current where the creditor has a legal right to payment within 12 months, even where payment is not expected.
The value of employee entitlement provisions expected to be settled over the next 12 months is $0.338 million ($0.312 million as at 30 June 2008).

(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. The AOFM has made a provision to recognise this obligation.

Note 10: Cash flow reconciliation

	2009 $'000	2008 $'000
Reconciliation of cash and cash equivalents as per Balance Sheet to Cash Flow Statement		
Reported cash and cash equivalents as per:		
Cash Flow Statement	**63**	159
Balance Sheet	**63**	159
Reconciliation of surplus to net cash from (used by) operating activities:		
Surplus	**1,971**	2,710
Adjustments to surplus:		
Depreciation and amortisation	**281**	317
Write-down of non-financial assets	**-**	90
Capitalised resources received free of charge	**-**	(8)
Revaluation increments	**(59)**	-
Changes in assets:		
(Increase) decrease in receivables	**(2,433)**	(3,174)
(Increase) decrease in other assets	**(50)**	31
Changes in liabilities:		
Increase (decrease) in employee provisions	**174**	1
Increase (decrease) in other provisions	**5**	(15)
Increase (decrease) in other payables	**5**	(17)
Increase (decrease) in supplier payables	**126**	(35)
Net cash from (used by) operating activities	**20**	(100)

Note 11: Contingent liabilities and assets

Unquantifiable contingencies

The AOFM is not aware of any unquantifiable contingencies as of the signing date that require disclosure in the financial statements.

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

The number of Senior Executive Service employees who received or were due to receive total remuneration of $130,000 or more is as follows:

	2009	2008
$310,000 to $324,999	**-**	1
$355,000 to $369,999	**1**	-
The aggregate amount of total remuneration of executives shown above	**$368,534**	$317,060
The aggregate amount of separation and redundancy payments during the year to executives shown above	**-**	-

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.

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:

	2009	2008
	$	**$**
Remuneration of auditors	**285,623**	261,000

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 for the AOFM during the year was:

	2009	2008
Average staffing level (ASL)(a)	**30**	29

(a) Paid ASL only.

Note 15: Compensation and debt relief in special circumstances

Departmental

No 'Act of Grace' payments were made during the reporting period (nil for 2007-08).

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 2007-08).

No payments were made under the 'Defective Administration Scheme' during the reporting period (nil for 2007-08).

No payments were made under section 73 of the *Public Service Act 1999* during the reporting period (nil for 2007-08).

No payments were made under ex-gratia programs during the reporting period (nil for 2007-08).

Administered

No 'Act of Grace' payments were made during the reporting period (nil for 2007-08).

One waiver of amounts owing to the government was made pursuant to subsection 34(1) of the *Financial Management and Accountability Act 1997* during the reporting period for $21 (nil for 2007-08).

No payments were made under the 'Defective Administration Scheme' during the reporting period (nil for 2007-08).

No payments were made under section 73 of the *Public Service Act 1999* during the reporting period (nil for 2007-08).

No payments were made under ex-gratia programs during the reporting period (nil for 2007-08).

Note 16: Revenue before re-measurements administered on behalf of government [(a)]

	2009 $'000	2008 $'000
Note 16A: Interest		
Loans to State and Territory governments:		
State and Territory debt	**318**	325
Housing advances	**166,348**	170,635
Deposits	**981,342**	1,197,227
Discount securities	**138,521**	-
Fixed interest securities	**161,205**	-
Residential mortgage-backed securities	**89,230**	-
Swaps interest	**990,606**	1,626,896
Total interest	**2,527,570**	2,995,083
Note 16B: Other revenue		
Securities lending and other revenue	**3,328**	2,266
Total other revenue	**3,328**	2,266
Total revenue administered on behalf of government	**2,530,898**	2,997,349

(a) All revenue is recognised using the effective interest method.

Note 17: Expenses before re-measurements administered on behalf of government [(a)]

	2009 $'000	2008 $'000
Note 17A: Grants		
Public Sector:		
State and Territory governments	**28**	30
Total grants	**28**	30
Note 17B: Interest		
Commonwealth Government Securities interest	**3,945,064**	3,541,938
Swaps interest	**1,016,186**	1,807,023
Other costs	**1,077**	2,011
Total interest	**4,962,327**	5,350,972
Total expenses administered on behalf of government	**4,962,355**	5,351,002

(a) All expenses are recognised using the effective interest method.

Note 18: Administered gains before re-measurements

	2009 $'000	2008 $'000
Note 18A: Net foreign exchange gains (losses)		
Foreign exchange gains (losses) on foreign currency denominated loans and securities	**(1,049)**	754
Total net foreign exchange gains (losses)	**(1,049)**	754
Note 18B: Net gains (losses) on sale of financial instruments		
Net gains on termination of interest rate swaps	**994,675**	-
Net gains on sale of fixed interest assets	**38,065**	-
Net gains on sale of discount securities	**1,505**	-
Total net gains (losses) on sale of financial instruments(a)	**1,034,245**	-
Total administered gains before re-measurements	**1,033,196**	754

(a) Total net gains (losses) on sale of financial instruments represents the total proceeds received or receivable from the 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

	2009 $'000	2008 $'000
Commonwealth Government Securities	**(1,067,433)**	276,100
Deposits and discount securities	**21**	(61)
Fixed interest securities	**(34,762)**	-
Residential mortgage-backed securities	**(136,422)**	-
Interest rate swaps	**1,006,385**	(393,687)
Total net market revaluation gains (losses)(a)	**(232,211)**	(117,648)

(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]

	2009 $'000	2008 $'000
Note 20A: Cash and cash equivalents		
Cash at bank	**622**	622
Total Cash	**622**	622
Current cash	**622**	622
Non-current cash	**-**	-
Note 20B: Receivables		
Loans to State and Territory governments at amortised cost - principal value	**3,172,488**	3,263,802
Less:		
Balance of special account(b)	**(546)**	(447)
Unamortised net discounts	**(405,314)**	(426,834)
Total loans to State and Territory governments at amortised cost	**2,766,628**	2,836,521
Interest rate swaps at fair value through profit or loss	**66,763**	-
Total receivables	**2,833,391**	2,836,521
Current receivables	**68,533**	1,612
Non-current receivables	**2,764,858**	2,834,909
Receivables maturing:(c)		
Within one year	**68,533**	1,612
In one to five years	**24,238**	24,374
In more than five years	**2,740,620**	2,810,535
	2,833,391	2,836,521
Receivables are aged as follows:		
Not past due	**2,833,391**	2,836,521
Overdue	**-**	-
	2,833,391	2,836,521

(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) Refer to Note 27F for special account balances.
(c) The maturity profile is based on contractual re-pricing dates.

Note 20: Assets administered on behalf of government (continued)

	2009 $'000	2008 $'000
Note 20C: Investments (under FMA section 39)		
Deposits at fair value through profit or loss	**26,515,639**	29,098,675
Discount securities at fair value through profit or loss	**998,432**	-
Residential mortgage-backed securities at fair value through profit or loss	**5,900,534**	-
Fixed interest securities at fair value through profit or loss	**2,071,660**	-
Total investments (under FMA section 39)(a)	**35,486,265**	29,098,675
Current investments	**27,807,147**	29,098,675
Non-current investments	**7,679,118**	-
Investments maturing:(b)		
Within one year	**27,807,147**	29,098,675
In one to five years	**6,088,231**	-
In more than five years	**1,590,887**	-
	35,486,265	29,098,675
Note 20D: Accrued revenue		
Accrued interest on loans to State and Territory governments	**490**	502
Total accrued revenue	**490**	502
Current accrued revenue	**490**	502
Non-current accrued revenue	**-**	-
Total assets administered on behalf of government	**38,320,768**	31,936,320

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

(b) 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.

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

	2009 $'000	2008 $'000
Note 21A: Commonwealth Government Securities		
Treasury Bonds at fair value through profit or loss	**81,263,880**	48,909,581
Treasury Capital Indexed Bonds at fair value through profit or loss	**9,468,515**	9,461,376
Treasury Notes at fair value through profit or loss	**16,555,417**	-
Other debt securities at fair value through profit or loss	**8,936**	11,326
Other debt securities at amortised cost	**17,053**	17,439
Total Commonwealth Government Securities	**107,313,801**	58,399,722
Current Commonwealth Government Securities	**22,757,977**	5,280,569
Non-current Commonwealth Government Securities	**84,555,824**	53,119,153
Commonwealth Government Securities maturing:(b)		
Within one year	**22,757,977**	5,280,569
In one to five years	**43,446,327**	28,454,996
In more than five years	**41,109,497**	24,664,157
	107,313,801	58,399,722
Note 21B: Other payables		
Interest rate swaps at fair value through profit or loss	-	1,040,883
Interest coupons payable on debt at amortised cost	**104**	105
Total other payables	**104**	1,040,988
Current other payables	**104**	48,196
Non-current other payables	-	992,792
Other payables maturing:(b)		
Within one year	**104**	48,196
In one to five years	-	456,599
In more than five years	-	536,193
	104	1,040,988
Total liabilities administered on behalf of government	**107,313,905**	59,440,710

(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

	2009 $'000	2008 $'000
Administered reconciliation table		
Opening administered assets less administered liabilities as at 1 July	**(27,504,390)**	(33,854,520)
Plus: Administered revenue (before re-measurements)	**2,530,898**	2,997,349
Administered gains (before re-measurements)	**1,033,196**	754
Less: Administered expenses (before re-measurements)	**(4,962,355)**	(5,351,002)
Administered transfers (to) from Australian Government:		
Special appropriations (unlimited)	**405,936,516**	325,334,033
Transfers to OPA	**(445,794,692)**	(316,513,331)
Net market revaluation gains (losses)	**(232,211)**	(117,648)
Change in special account balance	**(99)**	(25)
Closing administered assets less administered liabilities as at 30 June	**(68,993,137)**	(27,504,390)

Note 23: Administered contingent liabilities and assets

Unquantifiable contingencies

The AOFM is not aware of any unquantifiable contingencies as of the signing date that require disclosure in the financial statements.

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 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 2009 there were no open transactions under the AOFM's securities lending facility (nil as at 30 June 2008).

Note 24: Administered financial instruments

Note 24A: Categories of administered financial assets and liabilities

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

	2009 **$'000**	2008 $'000
Administered financial assets		
Cash	**622**	622
Loans and receivables (at amortised cost)		
Loans to State and Territory governments	**2,767,118**	2,837,023
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	**35,486,265**	29,098,675
Carrying amount of financial assets	**38,320,768**	31,936,320
Administered financial liabilities		
Other financial liabilties (at amortised cost)		
Debt on allocation to States and Northern Territory and overdues	**17,157**	17,544
Fair value through profit or loss (required by AASB 139)		
Interest rate swaps	**-**	1,040,883
Fair value through profit or loss (designated by the AOFM)		
Commonwealth Government Securities, excluding debt on allocation to the States and Northern Territory and overdues	**107,296,748**	58,382,283
Carrying amount of financial liabilities	**107,313,905**	59,440,710
Net assets	**(68,993,137)**	(27,504,390)

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 is obliged to receive and pay interest at fixed and/or floating interest rates. These swaps are not held for trading purposes, nor are they designated for hedge accounting. No new swaps have been executed since November 2007 and the AOFM is running down its portfolio.

The following table outlines the notional principal amount of swaps outstanding as at 30 June 2009. The notional principal amounts are not exchanged and act as a reference upon which interest payments can be calculated.

	2009	2008
	$'000	$'000
INTEREST RATE SWAPS		
Notional principal amounts		
Pay — fixed swaps	**-**	1,300,000
Receive — fixed swaps	**2,425,000**	21,850,000
	2,425,000	23,150,000
Notional principal maturing:		
Within one year	**2,425,000**	5,575,000
In one to five years	**-**	11,225,000
In more than five years	**-**	6,350,000
	2,425,000	23,150,000

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

	2009	2008
	$'000	$'000
INTEREST RATE SWAPS		
Notional principal amounts		
Opening balance	**23,150,000**	29,260,000
New swap transactions	**-**	300,000
Matured	**(5,375,000)**	(6,410,000)
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**	23,150,000
Net receipts from termination		
Proceeds from counterparties on termination	**1,031,292**	-
Payments to counterparties on termination	**-**	-
	1,031,292	-

Note 24: Administered financial instruments (continued)

Note 24B: Interest rate swaps (continued)

During the year 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 (2007-08: nil). With the termination of swaps with the relevant counterparties, the exposures were subsequently restored to within acceptable limits and the funds were returned.

Collateral transactions undertaken with interest rate swap counterparties	**2009 $'000**	2008 $'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 2009 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 physical assets with those of its physical liabilities is limited by the differences in the volumes and the need for assets to be available for cash management or other purposes.

2009	Fixed	Floating	Non	Maturing in				Weighted
By instrument	interest rate	interest rate	interest bearing	1 year or less	1 to 5 years	5 years or more	Total	average interest(b)
As at 30 June 2009	$'000	$'000	$'000	$'000	$'000	$'000	$'000	%
Financial assets								
Cash at bank	**-**	**-**	**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 Capital 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	**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 Capital Indexed Bonds (which are real interest rates).

Note 24: Administered financial instruments (continued)

Note 24C: Interest rate risk (continued)

2009	Fixed	Floating	Non	Maturing in				Weighted
	interest	interest	interest	1 year	1 to 5	5 years		average
By portfolio	rate	rate	bearing	or less	years	or more	Total	interest
As at 30 June 2009	$'000	$'000	$'000	$'000	$'000	$'000	$'000	%
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 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 is 5.15 per cent and the weighted average interest rate of debt instruments at real interest rates is 4.22 per cent.

Note 24: Administered financial instruments (continued)

Note 24C: Interest rate risk (continued)

2008 By instrument	Fixed interest rate	Floating interest rate	Non interest bearing	Maturing in 1 year or less	1 to 5 years	5 years or more	Total	Weighted average interest(b)
As at 30 June 2008	$'000	$'000	$'000	$'000	$'000	$'000	$'000	%
Financial assets								
Cash at bank	-	-	622	622	-	-	622	-
Interest rate swaps(a)	4,222,801	58,701	-	245,763	1,992,664	2,043,075	4,281,502	6.33
Loans to state and territory governments	2,837,019	-	4	2,114	24,374	2,810,535	2,837,023	5.88
Deposits	29,098,675	-	-	29,098,675	-	-	29,098,675	7.26
Total financial assets	36,158,495	58,701	626	29,347,174	2,017,038	4,853,610	36,217,822	
Financial liabilities								
Interest rate swaps (a)	41,417	5,280,968	-	293,854	2,449,263	2,579,268	5,322,385	7.75
Treasury Bonds	48,909,581	-	-	5,269,521	26,222,924	17,417,136	48,909,581	6.04
Treasury Capital Indexed Bonds	9,461,376	-	-	-	2,232,072	7,229,304	9,461,376	4.22
Treasury Notes	-	-	-	-	-	-	-	-
Other	21,976	-	6,894	11,153	-	17,717	28,870	4.00
Total financial liabilities	58,434,350	5,280,968	6,894	5,574,528	30,904,259	27,243,425	63,722,212	
Net assets	(22,275,855)	(5,222,267)	(6,268)	23,772,646	(28,887,221)	(22,389,815)	(27,504,390)	

(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 Capital Indexed Bonds (which are real interest rates).

Note 24: Administered financial instruments (continued)

Note 24C: Interest rate risk (continued)

2008	Fixed	Floating	Non	Maturing in				Weighted
	interest	interest	interest	1 year	1 to 5	5 years		average
By portfolio	rate	rate	bearing	or less	years	or more	Total	interest
As at 30 June 2008	$'000	$'000	$'000	$'000	$'000	$'000	$'000	%
Long term debt								
Financial assets	4,233,005	58,701	4	245,872	1,992,664	2,053,174	4,291,710	6.33
Financial liabilities	(58,434,350)	(5,280,968)	(6,894)	(5,574,528)	(30,904,259)	(27,243,425)	(63,722,212)	(a)
Net assets	(54,201,345)	(5,222,267)	(6,890)	(5,328,656)	(28,911,595)	(25,190,251)	(59,430,502)	
Cash management								
Financial assets	29,098,675	-	622	29,099,297	-	-	29,099,297	7.26
Financial liabilities	-	-	-	-	-	-	-	-
Net assets	29,098,675	-	622	29,099,297	-	-	29,099,297	
State and territory government housing advances								
Financial assets	2,826,815	-	-	2,005	24,374	2,800,436	2,826,815	5.89
Financial liabilities	-	-	-	-	-	-	-	-
Net assets	2,826,815	-	-	2,005	24,374	2,800,436	2,826,815	
Net assets	(22,275,855)	(5,222,267)	(6,268)	23,772,646	(28,887,221)	(22,389,815)	(27,504,390)	

(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 2008, the weighted average interest rate of debt instruments at nominal interest rates is 6.58 per cent and the weighted average interest rate of debt instruments at real interest rates is 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:

	2009 AUD $'000	2008 AUD $'000
FOREIGN CURRENCY DENOMINATED LIABILITIES		
Current		
Pounds sterling	**109**	110
Japanese yen	**5**	4
Swiss francs	**58**	52
Deutsche marks	**10**	9
	182	175
Non-current		
United States dollars	**6,558**	5,528
Pounds sterling	**1,031**	1,040
	7,589	6,568
Total foreign currency denominated liabilities	**7,771**	6,743
FOREIGN CURRENCY DENOMINATED ASSETS		
Current		
Pounds sterling	**4**	4
	4	4
Non-current		
Pounds sterling	**1,031**	1,040
	1,031	1,040
Total foreign currency denominated assets	**1,035**	1,044

Note 24: Administered financial instruments (continued)

Note 24E: Residential mortgage-backed securities

The AOFM has acquired a portfolio of AAA rated (or equivalent) residential mortgage-backed securities with a face value of $6,203.420 million (under a total program limit of $8,000 million). As at the end of the financial year the principal outstanding was $6,024.139 million. Details of residential mortgage-backed securities acquired by the AOFM since the government announced this initiative in September 2008 are contained in the following table:

Originator	Issue	Original amount invested	Principal repayments	Amount invested as at 30-Jun-09	Acquisition date	Legal maturity date
		$'000	$'000	$'000		
Authorised deposit taking institutions						
AMP	Progress 2009-1 Trust	**425,000**	**-**	**425,000**	30 March 2009	28 July 2039
Bank of Queensland	Reds Trust Series 2009-1	**500,000**	**-**	**500,000**	21 April 2009	21 April 2040
Bendigo and Adelaide Bank	Torrens Series 2009-1	**475,000**	**-**	**475,000**	18 March 2009	17 April 2040
Credit Union Australia	Harvey Trust 2009-1	**350,000**	**-**	**350,000**	26 March 2009	12 May 2040
Members Equity Bank	SMHL Securitisation Fund 2008-2	**500,000**	**45,438**	**454,562**	9 December 2008	9 November 2041
Members Equity Bank	SMHL Securitisation Fund 2009-1	**500,000**	**-**	**500,000**	14 May 2009	28 September 2041
		2,750,000	**45,438**	**2,704,562**		
Other institutions						
Challenger	Challenger Millenium Series 2008-2	**500,000**	**38,564**	**461,436**	12 December 2008	7 November 2039
Challenger	Challenger Millenium Series 2009-1	**500,000**	**-**	**500,000**	24 April 2009	20 April 2040
Firstmac	Firstmac Series 2-2008	**496,000**	**35,080**	**460,920**	21 November 2008	12 November 2039
Firstmac	Firstmac Series 1-2009	**498,620**	**-**	**498,620**	5 June 2009	16 June 2040
Liberty Financial	Liberty Prime Series 2009-1	**500,000**	**30,807**	**469,193**	20 April 2009	15 April 2040
Resimac	Resimac Premier Series 2008-1	**500,000**	**29,392**	**470,608**	15 December 2008	15 December 2039
Resimac	Resimac Premier Series 2009-1	**458,800**	**-**	**458,800**	28 May 2009	8 June 2040
		3,453,420	**133,843**	**3,319,577**		
Total		**6,203,420**	**179,281**	**6,024,139**		

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 and investment grade money market securities. In addition, its loans comprise advances and debt on allocation to the State and Territory governments.

The AOFM has an exposure to financial institutions in relation to its swap contracts. This risk is mitigated by the swap counterparties being reputable financial institutions and the ability for the AOFM to obtain collateral against its main counterparties.

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 2008 and 30 June 2009.

	2009							
S&P or Fitch long-term rating(a)	AAA	AA+	AA	AA-	A+	A	A-	**Total**
Moody's long-term rating(a)	Aaa	Aa1	Aa2	Aa3	A1	A2	A3	
	$'000	$'000	$'000	$'000	$'000	$'000	$'000	**$'000**
By instrument								
Cash held with the RBA(b)	**622**	**-**	**-**	**-**	**-**	**-**	**-**	**622**
Loans to State and Territory governments	**2,121,085**	**710,696**	**-**	**-**	**-**	**-**	**-**	**2,831,781**
Deposits with the RBA(b)	**26,515,639**	**-**	**-**	**-**	**-**	**-**	**-**	**26,515,639**
Discount securities	**-**	**-**	**628,894**	**369,538**	**-**	**-**	**-**	**998,432**
Residential mortgage-backed securities securities	**5,900,534**	**-**	**-**	**-**	**-**	**-**	**-**	**5,900,534**
Fixed interest securities	**1,243,132**	**828,528**	**-**	**-**	**-**	**-**	**-**	**2,071,660**
Interest rate swaps	**-**	**-**	**11,232**	**15,883**	**27,474**	**7,826**	**4,348**	**66,763**
	35,781,012	**1,539,224**	**640,126**	**385,421**	**27,474**	**7,826**	**4,348**	**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) The RBA does not issue debt in the wholesale market and accordingly does not have a credit rating. However, as Australia's central bank it is deemed to have the same credit rating as the Australian Government.

Note 24: Administered financial instruments (continued)

Note 24F: Credit risk (continued)

	2009							
S&P or Fitch long-term rating(a)	AAA	AA+	AA	AA-	A+	A	A-	**Total**
Moody's long-term rating(a)	Aaa	Aa1	Aa2	Aa3	A1	A2	A3	
	$'000	$'000	$'000	$'000	$'000	$'000	$'000	**$'000**
By portfolio								
Long term debt	**1,253,732**	**828,528**	**11,232**	**15,883**	**27,474**	**7,826**	**4,348**	**2,149,023**
Cash management	**26,516,261**	**-**	**628,894**	**369,538**	**-**	**-**	**-**	**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**	**1,539,224**	**640,126**	**385,421**	**27,474**	**7,826**	**4,348**	**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 24F: Credit risk (continued)

	2008							
S&P or Fitch long-term rating(a)	AAA	AA+	AA	AA-	A+	A	A-	**Total**
Moody's long-term rating(a)	Aaa	Aa1	Aa2	Aa3	A1	A2	A3	
	$'000	$'000	$'000	$'000	$'000	$'000	$'000	**$'000**
By instrument								
Cash held with the RBA(b)	622	-	-	-	-	-	-	**622**
Loans to State and Territory governments	2,326,621	339,172	-	-	-	-	-	**2,665,793**
Investments with the RBA(b)	29,098,675	-	-	-	-	-	-	**29,098,675**
Interest rate swaps	-	-	-	-	-	-	-	**-**
	31,425,918	339,172	-	-	-	-	-	**31,765,090**

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

	2008							
S&P or Fitch long-term rating(a)	AAA	AA+	AA	AA-	A+	A	A-	**Total**
Moody's long-term rating(a)	Aaa	Aa1	Aa2	Aa3	A1	A2	A3	
	$'000	$'000	$'000	$'000	$'000	$'000	$'000	**$'000**
By portfolio								
Long term debt	10,655	-	-	-	-	-	-	**10,655**
Cash management	29,099,297	-	-	-	-	-	-	**29,099,297**
Residential mortgage-backed securities	-	-	-	-	-	-	-	**-**
State and Territory government housing advances	2,315,966	339,172	-	-	-	-	-	**2,655,138**
Total	31,425,918	339,172	-	-	-	-	-	**31,765,090**

(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: Net fair values of administered financial assets and liabilities

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 Capital Indexed Bonds	**8,891,967**	**9,468,515**	**9,468,515**
Treasury Notes	**16,700,000**	**16,555,417**	**16,555,417**
Other	**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 Capital 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 Capital 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 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 24G: 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 24G: Net fair values of administered financial assets and liabilities (continued)

2008 By instrument as at 30 June 2008	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)	3,263,355	2,837,023	2,665,346
Deposits	29,050,000	29,098,675	29,098,675
Total financial assets (recognised)	32,313,977	31,936,320	31,764,643
Administered financial liabilities (recognised)			
Treasury Bonds	49,395,141	48,909,581	48,909,581
Treasury Capital Indexed Bonds	8,624,263	9,461,376	9,461,376
Other	26,968	28,870	28,870
Interest rate swaps	-	1,040,883	1,040,883
Total financial liabilities (recognised)	58,046,372	59,440,710	59,440,710
Net financial assets (recognised)	(25,732,395)	(27,504,390)	(27,676,067)

(a) Comprises the face value of financial instruments, with the exception of Treasury Capital 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 Capital 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 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.

2008 By portfolio as at 30 June 2008	Principal value $'000	Total carrying amount $'000	Aggregate net fair value $'000
Long term debt			
Financial assets	10,103	10,208	10,208
Financial liabilities	(58,046,372)	(59,440,710)	(59,440,710)
Net assets	(58,036,269)	(59,430,502)	(59,430,502)
Cash management			
Financial assets	29,050,622	29,099,297	29,099,297
Financial liabilities	-	-	-
Net assets	29,050,622	29,099,297	29,099,297
Residential mortgage-backed securities			
Financial assets	-	-	-
Financial liabilities	-	-	-
Net assets	-	-	-
State and territory government housing advances			
Financial assets	3,253,252	2,826,815	2,655,138
Financial liabilities	-	-	-
Net assets	3,253,252	2,826,815	2,655,138
Net financial assets (recognised)	(25,732,395)	(27,504,390)	(27,676,067)

Note 24: Administered financial instruments (continued)

Note 24H: 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.

			2009		
Contractual maturities	**1 year or less $'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 Capital 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 securities(b)	**549**	**549**	**1,648**	**8,205**	**10,951**
	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.

			2008		
Contractual maturities	**1 year or less $'000**	**1 to 2 years $'000**	**2 to 5 years $'000**	**>5 years $'000**	**Total $'000**
Treasury Bonds	7,987,582	8,165,674	25,718,455	22,768,407	64,640,118
Treasury Capital Indexed Bonds(a)	344,971	344,971	2,979,405	7,691,130	11,360,477
Other debt securities(b)	4,628	463	1,389	7,380	13,860
Interest rate swaps(c)	298,564	264,264	606,104	230,486	1,399,418
	8,635,745	8,775,372	29,305,353	30,697,403	77,413,873

(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.
(c) Interest flows on swaps are disclosed on a net basis and floating interest rates are projected at the relevant reference rate as at the end of the financial year from the first reset in 2008-09 and held constant thereafter.

Note 24: Administered financial instruments (continued)

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

2009 Reconciliation of the opening and closing balance of CGS	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 Capital Indexed Bonds(a)	**6,020,000**	**-**	**-**	**-**	**6,020,000**
Treasury Notes	**-**	**18,700,000**	**(2,000,000)**	**-**	**16,700,000**
Other(b)	**26,968**	**-**	**(4,384)**	**1,028**	**23,612**
Total Commonwealth Government Securities	**55,442,109**	**52,802,000**	**(7,098,389)**	**1,028**	**101,146,748**

(a) The inflation adjusted capital accretion for Treasury Capital 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.

2008 Reconciliation of the opening and closing balance of CGS	Opening balance $'000	Issuance $'000	Maturities/ Redemptions $'000	Other $'000	Closing balance $'000
Treasury Bonds	47,199,443	5,102,000	(2,906,302)	-	49,395,141
Treasury Capital Indexed Bonds(a)	6,020,000	-	-	-	6,020,000
Treasury Notes	-	-	-	-	-
Other(b)	44,533	-	(16,666)	(899)	26,968
Total Commonwealth Government Securities	53,263,976	5,102,000	(2,922,968)	(899)	55,442,109

(a) The inflation adjusted capital accretion for Treasury Capital 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)

2009 Reconciliation of the opening and closing balance of investments	Opening balance $'000	Acquisitions $'000	Maturities/ Redemptions $'000	Closing balance $'000
Term deposits with the RBA	**29,050,000**	**372,800,000**	**(375,350,000)**	**26,500,000**
Fixed interest securities	**-**	**5,174,000**	**(3,150,000)**	**2,024,000**
Discount securities	**-**	**12,648,000**	**(11,648,000)**	**1,000,000**
Residential mortgage-backed securities	**-**	**6,203,420**	**(179,281)**	**6,024,139**
Total investments	**29,050,000**	**396,825,420**	**(390,327,281)**	**35,548,139**

2008 Reconciliation of the opening and closing balance of investments	Opening balance $'000	Acquisitions $'000	Maturities/ Redemptions $'000	Closing balance $'000
Term deposits with the RBA	20,350,000	318,750,000	(310,050,000)	29,050,000
Fixed interest securities	-	-	-	-
Discount securities	-	-	-	-
Residential mortgage-backed securities	-	-	-	-
Total investments	20,350,000	318,750,000	(310,050,000)	29,050,000

Note 25: Market risk sensitivity of administered financial instruments

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

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

Changes in domestic interest rates will impact on debt servicing costs of AOFM's Treasury Bonds and Treasury Notes 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. In a rising (falling) interest rate market, debt servicing costs will rise (fall) each time the primary market is accessed to raise borrowings. Changes in interest rates have no impact on future cash flows on principal amounts.

Australian dollar interest rate swaps, which comprise the AOFM receiving a fixed interest rate and paying a floating interest rate (or vice-versa), subject the portfolio to fluctuations in future net cash flows at the time each floating rate leg is reset against the relevant reference market interest rate. When interest rates rise (fall), net swap interest revenue will fall (rise).

For a period during the 2008-09 financial year the proceeds of debt issuance over and above what was required to meet maturing debt obligations were invested in fixed interest assets to offset the cost and risk of the additional issuance. Since the release of the *Updated Economic and Fiscal Outlook* in February 2009, and the need to finance projected budget deficits, the assets are being liquidated as opportunities arise. When these investments mature or are sold they will not be re-invested, and accordingly there is no reinvestment risk. However, changes in interest rates will have an impact on the value of proceeds realised on their sale, and as a result the yield earned on them.

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

Australian dollar denominated residential mortgage-backed security investments held by the AOFM comprise the AOFM receiving 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 short term 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 are re-invested at the prevailing market interest rate, the return may change due to re-investment at a higher or lower interest rates. Changes in interest rates have no impact on future cash flows on principal amounts.

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 will not cause a fluctuation on future cash flows of interest or principal.

At 1 July 2009, 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 2010, 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 2010 would be as follows:

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

Operating result sensitivity to changes in domestic interest rates (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**	**-**	**-**	**-**	**-**
Term deposit investments	**26,515,639**	**(257,401)**	**(257,401)**	**257,401**	**257,401**
Discount security investments	**998,432**	**-**	**-**	**-**	**-**
Residential mortgage-backed security investments	**5,900,534**	**(68,986)**	**(68,986)**	**68,986**	**68,986**
Fixed interest security investments	**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 Capital 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)**

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 (calculated on an accruals basis)

	2008				
Change in interest rates from 1 July 2008 for 12 months to 30 June 2009		**-1%**		**+1%**	
	Carrying amount as at 30 June 2008 $'000	**Impact in 2008-09 on profit $'000**	**Impact in 2008-09 on equity $'000**	**Impact in 2008-09 on profit $'000**	**Impact in 2008-09 on equity $'000**
Financial assets					
Cash	622	-	-	-	-
Loans to State and Territory governments	2,837,023	-	-	-	-
Term deposit investments	29,098,675	(281,562)	(281,562)	281,562	281,562
Financial liabilities					
Treasury Bonds	48,909,581	15,188	15,188	(12,835)	(12,835)
Treasury Capital Indexed Bonds	9,461,376	-	-	-	-
Other debt	28,870	-	-	-	-
Interest rate swaps	1,040,883	146,551	146,551	(146,551)	(146,551)
Total increase (decrease) in accrual result (before re-measurements)		(119,823)	(119,823)	122,176	122,176

(b) Inflation risk sensitivity analysis

The AOFM currently has three series of Treasury Capital 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 rate of interest payable on the accreted principal value. Accordingly they expose the AOFM to cash flow risk on interest payments and 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 will also rise.

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

At 1 July 2009, 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 2010, 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 2010 would be as follows:

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

	2009				
Change in consumer price index 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**	**-**	**-**	**-**	**-**
Term deposit investments	**26,515,639**	**-**	**-**	**-**	**-**
Discount security investments	**998,432**	**-**	**-**	**-**	**-**
Residential mortgage-backed security investments	**5,900,534**	**-**	**-**	**-**	**-**
Fixed interest security investments	**2,071,660**	**-**	**-**	**-**	**-**
Interest rate swaps	**66,763**	**-**	**-**	**-**	**-**
Financial liabilities					
Treasury Bonds	**81,263,880**	**-**	**-**	**-**	**-**
Treasury Capital 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)**

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

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

Sensitivity to changes in the consumer price index (calculated on an accruals basis)

	2008				
Change in consumer price index from 1 July 2008 for 12 months to 30 June 2009		**-1%**		**+1%**	
	Carrying amount as at 30 June 2008 $'000	**Impact in 2008-09 on profit $'000**	**Impact in 2008-09 on equity $'000**	**Impact in 2008-09 on profit $'000**	**Impact in 2008-09 on equity $'000**
Financial assets					
Cash	622	-	-	-	-
Loans to State and Territory governments	2,837,023	-	-	-	-
Term deposit investments	29,098,675	-	-	-	-
Financial liabilities					
Treasury Bonds	48,909,581	-	-	-	-
Treasury Capital Indexed Bonds	9,461,376	90,067	90,067	(91,869)	(91,869)
Other debt	28,870	-	-	-	-
Interest rate swaps	1,040,883	-	-	-	-
Total increase (decrease) in accrual result (before re-measurements)		90,067	90,067	(91,869)	(91,869)

(c) 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 a comparison of:
  - 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
  - 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 a comparison of:

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

  - debt servicing costs on Treasury Notes held at the end of the financial year for the full 12 months at the observed 3-month Treasury Note 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 3-month Treasury Note rate as at year end. The 100 basis point shift is applied from the date the positions held as at 30 June 2009 mature and is held constant at that level thereafter;

- the sensitivity of returns for the next 12 months on interest rate swaps comprised a comparison of:
  - 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 a comparison of:
  - 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 a comparison of:
  - 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 1-month 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 1-month OIS 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.

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

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 Capital Indexed Bonds comprised a comparison of:
  - 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 $59,000 million of Treasury Bonds during the 2009-10 financial year (2008-09: $5,300 million). It is also assumed that the volume of Treasury Notes outstanding as at 30 June 2009 of $16,700 million remains unchanged throughout the 2009-10 financial year (2008-09: nil). In addition it is assumed that the volume of term deposit investments will remain at levels as at 30 June 2009 of $26,500 million for the full 12 months to 30 June 2010 (2008-09: $29,050 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 2009. During 2009-10 the AOFM will make further investments of $1,750 million in RMBS. These new issues have been modelled on a 24 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. It is further assumed for the purposes of the sensitivity analysis that the AOFM will not run down its remaining interest rate swaps or fixed interest investments, nor will it undertake issuance of Treasury Capital Indexed Bonds during 2009-10 (2008-09: nil).

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.

(d) 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 2009 was $35.966 million per basis point ($19.5 million per basis point as at 30 June 2008). A 1 basis point parallel increase (decrease) in interest rates across the yield curve would result in a favourable (unfavourable) change of $35.966 million in the fair value of the portfolio as at 30 June 2009 ($19.5 million as at 30 June 2008).

The risk of fluctuations in the fair value of the AOFM's net debt portfolio is of a secondary order.

Note 26: Securities lending facility

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

2009			
Bond series	**Number of transactions**	**Face value of Treasury 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			
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			

2008			
Bond series	**Number of transactions**	**Face value of Treasury 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			
August 2008	3	68,200	7
September 2009	20	481,500	48
August 2010	6	75,900	6
June 2011	20	700,072	76
April 2012	3	94,000	8
May 2013	10	382,300	58
April 2015	15	308,700	45
February 2017	9	370,000	32
May 2021	2	34,100	3
	88	**2,514,772**	**283**
(iii) Open transactions as at the end of the financial year			
Nil			

Note 26: Securities lending facility (continued)

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 2008-09 was as follows:

	2009	
Bond series	**Number of transactions**	**Face value of Treasury Bonds loaned $'000**
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 — Enhance the Commonwealth's capacity to manage its net debt portfolio

Particulars	Administered expenses $'000	Departmental outputs $'000	Total $'000
Year ended 30 June 2009 (current year)			
Balance carried from previous year	**10**	**13,255**	**13,265**
Appropriation Act:			
Appropriation Act (No. 1) 2008-2009	**10**	**8,467**	**8,477**
Reduction	**(10)**	**-**	**(10)**
Financial Management and Accountability Act:			
Appropriation for recoverable GST (section 30A)	**-**	**51**	**51**
Annotations to net appropriations (section 31)	**-**	**1,326**	**1,326**
Total appropriations available for payment	**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**
Balance carried forward to next year represented by:			
Cash at bank	**-**	**63**	**63**
Departmental appropriation receivable	**-**	**15,772**	**15,772**
Net GST receivable from the ATO(a)	**-**	**1**	**1**
Undrawn, unlapsed administered appropriation(b)	**10**	**-**	**10**
Total	**10**	**15,836**	**15,846**

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

(b) The undrawn, unlapsed administered appropriation of $10,000.00 is not required by AOFM and under section 11 of *Appropriation Act (No. 1) 2008-09* is formally relinquished when the AOFM's 2008-09 annual report is tabled in Parliament. The reduction is effective in 2009-10 and will be shown in next year's financial statements as a reduction.

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 — Enhance the Commonwealth's capacity to manage its net debt portfolio

Particulars	Administered expenses $'000	Departmental outputs $'000	Total $'000
Year ended 30 June 2008 (comparative year)			
Balance carried from previous year	10	10,447	10,457
Appropriation Act:			
Appropriation Act (No. 1) 2007-2008	10	8,528	8,538
Reduction	(10)	(39)	(49)
Financial Management and Accountability Act:			
Appropriation for recoverable GST (section 30A)	-	47	47
Annotations to net appropriations (section 31)	-	1,254	1,254
Total appropriations available for payment	10	20,237	20,247
Cash payments made during the year (GST inclusive)	-	(6,982)	(6,982)
Balance of Authority to draw cash from the Consolidated Revenue Fund for Ordinary Annual Services Appropriations	10	13,255	13,265
Balance carried to next year represented by:			
Cash at bank	-	159	159
Departmental appropriation receivable	-	13,095	13,095
Net GST receivable from the ATO	-	1	1
Undrawn, unlapsed administered appropriation(a)	10	-	10
Total	10	13,255	13,265

(a) The undrawn, unlapsed administered appropriation was formally lapsed by the Minister for Finance and Deregulation in 2008-09.

Note 27: Disclosures of appropriations (continued)

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

Outcome 1 — Enhance the Commonwealth's capacity to manage its net debt portfolio

	Departmental equity injection	
	2009	2008
Particulars	**$'000**	$'000
Balance carried from previous year	**949**	949
Appropriations	**-**	-
Total appropriations available for payment	**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
Balance carried to next year represented by:		
Departmental capital injection appropriation receivable	**949**	949
Total	**949**	949

Note 27: Disclosures of appropriations (continued)

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

	2009 $'000	2008 $'000
***Airports (Transitional) Act 1996*, section 78**		
Purpose: payment of principal and interest on former debts of the Federal Airports Corporation		
Cash payments made during year - principal (expenditure)	-	-
Cash payments made during year - interest (expenditure)	-	-
Appropriations credited to Special Accounts	-	-
Refunds credited (net) (FMA section 30)	-	-
Total charged to appropriation	**-**	-
Estimated actual - principal (expenditure)	-	-
Estimated actual - interest (expenditure)	-	-
***Australian National Railways Sale Act 1997*, section 67AW**		
Purpose: payment of principal and interest on former debts of the National Railways Commission		
Cash payments made during year - principal (expenditure)	-	-
Cash payments made during year - interest (expenditure)	-	-
Appropriations credited to Special Accounts	-	-
Refunds credited (net) (FMA section 30)	-	-
Total charged to appropriation	**-**	-
Estimated actual - principal (expenditure)	-	-
Estimated actual - interest (expenditure)	-	-
***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)	**7,081,473**	2,906,516
Cash payments made during year - interest (expenditure)	**3,952,756**	3,508,605
Appropriations credited to Special Accounts	-	-
Refunds credited (net) (FMA section 30)	-	-
Total charged to appropriation	**11,034,229**	6,415,121
Estimated actual - principal (expenditure)	**7,142,610**	2,913,978
Estimated actual - interest (expenditure)	**4,181,200**	3,507,000
***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)	**336**	350
Appropriations credited to Special Accounts (included in above)	**51**	58
Refunds credited (net) (FMA section 30)	-	-
Total charged to appropriation	**336**	350
Estimated actual - (expenditure)	-	-

Note 27: Disclosures of appropriations (continued)

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

	2009 **$'000**	2008 $'000
***Financial Management and Accountability Act 1997*, section 30A**		
Purpose: payments of recoverable GST		
Cash payments made during year - (expenditure)	**-**	-
Appropriations credited to Special Accounts	**-**	-
Refunds credited (net) (FMA section 30)	**-**	-
Total charged to appropriation	**-**	-
Estimated actual - (expenditure)	**-**	-
***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)	**396,819,404**	318,750,000
Cash payments made during year - interest (expenditure)	**-**	-
Appropriations credited to Special Accounts	**-**	-
Refunds credited (net) (FMA section 30)	**-**	-
Total charged to appropriation	**396,819,404**	318,750,000
Estimated actual - principal (expenditure)	**359,452,700**	292,166,000
Estimated actual - interest (expenditure)	**-**	-
***Loans Redemption and Conversion Act 1921*, section 5**		
Purpose: payment of principal, interest and the costs of converting loans made in accordance with the Act		
Cash payments made during year - principal (expenditure)	**-**	-
Cash payments made during year - interest (expenditure)	**-**	-
Appropriations credited to Special Accounts	**-**	-
Refunds credited (net) (FMA section 30)	**-**	-
Total charged to appropriation	**-**	-
Estimated actual - principal (expenditure)	**-**	-
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)	**621**	503
Appropriations credited to Special Accounts	**-**	-
Refunds credited (net) (FMA section 30)	**-**	-
Total charged to appropriation	**621**	503
Estimated actual - principal (expenditure)	**-**	-
Estimated actual - interest (expenditure)	**1,000**	1,000

(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.

Note 27: Disclosures of appropriations (continued)

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

	2009 $'000	2008 $'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)	**1,266,553**	1,812,468
Appropriations credited to Special Accounts	**-**	-
Refunds credited (net) (FMA section 30)	**-**	-
Total charged to appropriation	**1,367,553**	1,812,468
Estimated actual - principal (expenditure)	**-**	-
Estimated actual - interest (expenditure)	**1,278,800**	1,812,390
***Moomba - Sydney Pipeline System Sale Act 1994*, section 19**		
Purpose: payment of principal and interest on former debts of the Pipeline Authority		
Cash payments made during year - principal (expenditure)	**-**	-
Cash payments made during year - interest (expenditure)	**-**	-
Appropriations credited to Special Accounts	**-**	-
Refunds credited (net) (FMA section 30)	**-**	-
Total charged to appropriation	**-**	-
Estimated actual - principal (expenditure)	**-**	-
Estimated actual - interest (expenditure)	**-**	-
***Qantas Sale Act 1992*, section 18**		
Purpose: payment of principal and interest on former debts of Qantas		
Cash payments made during year - principal (expenditure)	**-**	-
Cash payments made during year - interest (expenditure)	**-**	-
Appropriations credited to Special Accounts	**-**	-
Refunds credited (net) (FMA section 30)	**-**	-
Total charged to appropriation	**-**	-
Estimated actual - principal (expenditure)	**-**	-
Estimated actual - interest (expenditure)	**-**	-
***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**	16,000
Cash payments made during year - interest (expenditure)	**165**	1,146
Appropriations credited to Special Accounts	**-**	-
Refunds credited (net) (FMA section 30)	**-**	-
Total charged to appropriation	**4,165**	17,146
Estimated actual - principal (expenditure)	**4,000**	16,000
Estimated actual - interest (expenditure)	**165**	1,146

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

	2009 $'000	2008 $'000
***Treasury Bills Act 1914*, section 6**		
Purpose: payment of principal and interest on money raised by issuance of Treasury Bills		
Cash payments made during year - principal (expenditure)	**-**	-
Cash payments made during year - interest (expenditure)	**-**	-
Appropriations credited to Special Accounts	**-**	-
Refunds credited (net) (FMA section 30)	**-**	-
Total charged to appropriation	**-**	-
Estimated actual - principal (expenditure)	**-**	-
Estimated actual - interest (expenditure)	**-**	-
Total		
Total budget estimate (expenditure)	**372,060,475**	300,417,514
Total payments made (expenditure)	**409,226,308**	326,995,588
Appropriations credited to Special Accounts (included in above)	**51**	58
Refunds credited (section 30)	**-**	-

Note 27: Disclosures of appropriations (continued)

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

In 2008-09 the AOFM did not utilise section 28 of the *Financial Management and Accountability Act 1997*. In 2007-08 the AOFM drew down $50,000 under section 28 of the *Financial Management and Accountability Act 1997* to repay monies received from a counterparty in error.

Note 27E: Acquittal of authority to draw cash from the Consolidated Revenue Fund — Special Appropriations (FMA section 39)

Administered investment of Public Money: Special Appropriations under FMA section 39(a)	**2009 $'000**	2008 $'000
Balance carried from previous period (at face value)	**29,050,000**	20,350,000
Prior year investments redeemed in current year	**(29,050,000)**	(20,350,000)
Investments made	**396,825,420**	318,750,000
Redemptions of current year investments	**(361,277,281)**	(289,700,000)
Total balance carried to next year (at face value)	**35,548,139**	29,050,000

FMA = *Financial Management and Accountability Act 1997*.
(a) See Note 24J for further details.

Note 27: Disclosures of appropriations (continued)

Note 27F: Special accounts (Administered)

Debt Retirement Reserve Trust Account (DRRTA)

- Legal Authority — *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	**2009 $'000**	2008 $'000
Balance carried from previous period	**447**	422
Interest amounts credited	**23**	28
Appropriations for reporting period	**28**	30
Other receipts:		
State and Territory contributions	**86**	361
Available for payment	**584**	841
Payments made:		
Debt repayments	**(38)**	(394)
Balance carried to next year	**546**	447
Balance carried represented by:		
Cash on call held in the Official Public Account	**546**	447
Total balance carried to next year	**546**	447

Note 27G: 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 27F: Special accounts (Administered).

Note 28: Reporting of outcomes

Note 28A: Net cost of outcome delivery

	Outcome 1	Outcome 1
	2009	2008
	$'000	$'000
Expenses		
Administered expenses	**4,962,355**	5,351,002
Departmental expenses	**7,875**	7,512
Total expenses	**4,970,230**	5,358,514
Costs recovered from provision of goods and services to the non-government sector		
Administered	**-**	-
Departmental	**-**	-
Total costs recovered	**-**	-
Other external revenue		
Administered		
Interest	**2,527,570**	2,995,083
Other	**3,328**	2,266
Gains (losses)	**800,985**	(116,894)
Total administered	**3,331,883**	2,880,455
Departmental		
Other	**1,093**	1,464
Total departmental	**1,093**	1,464
Total other external revenue	**3,332,976**	2,881,919
Net cost of outcome	**1,637,254**	2,476,595

Note 29: Major departmental revenue and expenses by output group and output

The AOFM delivers a single output — debt management. The Income Statement provides the major classes of departmental revenue earned and expenses incurred to support this output.

Note 30: Major classes of administered revenue and expenses by outcome

The AOFM delivers a single outcome — 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 Schedule of Income and Expenses Administered on Behalf of Government provides the major classes of administered revenue and expenses attributable to this outcome.

Note 31: 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. These investments and their earnings are reported by DBCDE and not the AOFM.

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.

***Telecommunications (Consumer Protection and Service Standards) Act 1999* (Part 9C)**	**DBCDE (Responsible Agency) 2009 $'000**	**DBCDE (Responsible Agency) 2008 $'000**
Opening Balance (at cost)	**2,356,419**	2,215,986
Investment earnings receipts	**94,457**	140,592
Expense payments	**(158)**	(159)
Transfers to Building Australia Fund (at cost)	**(2,450,718)**	-
Balance of investments (at cost) — 30 June	**-**	2,356,419

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.

Note 32: 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

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 2009 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, residential-mortgage backed securities (RMBS), housing advances to the States under the Commonwealth-State Housing Agreements and interest rate swaps.[1]

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), and residual interest rate swaps that were previously used to manage the cost and risk of the Portfolio. For part of 2008-09 it also included assets purchased with the proceeds of 'additional' Treasury Bond issuance. These assets have subsequently been sold.

As no borrowings have been undertaken in foreign currencies since 1987 the Portfolio holds only a residual amount of foreign currency debt.

The volume of the Long-Term Debt Portfolio was adjusted over the course of the financial year to smooth the impact of discontinuities that would otherwise be produced by large transactions in the issuance of Treasury Bonds and maturities. This was achieved through short-term internal transfers between the Portfolio and the Cash Management Portfolio.

The **RMBS Portfolio** contains residential mortgage-backed securities purchased by the AOFM under the Government's policy to maintain competition in lending for housing.

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

1 Until 1 January 2009 the AOFM also invested monies for the Communications Fund on behalf of the Department of Broadband, Communications and the Digital Economy.

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.

Funding

Table 1 places the AOFM's asset and liability management activities in 2008-09 in the context of the overall flow of funds for the Australian Government General Government Sector. Flows managed by the AOFM are shown in green.

Table 1: General Government Sector funding requirement and funding sources

Source of funds	Actual 2008-09 ($billion)	Use of funds	Actual 2008-09 ($billion)
		Headline budget balance	31.3
Debt issuance[a]		**Debt redemption**[a]	
Treasury Bonds	36.4	Maturing CGS debt	5.1
Treasury Indexed Bonds	0.0	Early CGS debt repurchases	..
Treasury Notes (net)	16.5	Other general government sector redemptions (net)	0.2
Total	**52.9**	**Total**	**5.3**
Financial assets		**Other applications of funds**	
Change in short-term asset holdings	1.6	Swap interest (net)	0.2
		Other (net)[b]	0.3
Total	**1.6**	**Total**	**0.5**
		Financial assets	
		Change in Official Public Account balance at the RBA	..
		Change in other general government sector investments	17.4
		Total	**17.4**
Total	**54.4**	**Total**	**54.4**

(a) Cash flows rather than face value of securities.
(b) Includes other general government sector flows not elsewhere classified.
(c) Not all totals may sum exactly due to rounding.
(d) .. not zero but less than $0.05 billion.

Appropriations and other sources of funding

Table 2 summarises the gross resources applied by the AOFM in 2008-09 and budgeted for 2009-10, 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) 2008-09 ($'000)	Actual 2008-09 ($'000)	Budget 2009-10 ($'000)
FUNDING FOR CURRENT PURPOSES			
ADMINISTERED EXPENSES(a)			
Annual appropriations	10	-	10
Special appropriations	4,828,134	4,963,376	6,425,400
Total administered appropriations	**4,828,144**	**4,963,376**	**6,425,410**
DEPARTMENTAL			
Annual appropriations	8,467	8,467	12,638
Total revenue from government (appropriations) contibuting to price of agency outputs	**8,467**	**8,467**	**12,638**
Percentage of total price of outputs	**87.1%**	**86.0%**	**92.1%**
Revenue from other sources			
Other sources	1,256	1,379	1,089
Total revenue from other sources	**1,256**	**1,379**	**1,089**
Total price of agency outputs	**9,723**	**9,846**	**13,727**
Total resourcing - recurrent purposes	**4,837,867**	**4,973,222**	**6,439,137**
FUNDING FOR CAPITAL PURPOSES(c)			
ADMINISTERED			
Special appropriations	366,599,310	404,005,877	373,654,000
Total administered appropriations	**366,599,310**	**404,005,877**	**373,654,000**
AGENCY			
Agency equity injections(d)	**-**	**-**	**-**
Total resourcing - capital purposes	**366,599,310**	**404,005,877**	**373,654,000**
Total resourcing for AOFM Outcome(e)	**371,437,177**	**408,979,099**	**380,093,137**
Administered	371,427,454	408,969,253	380,079,410
Departmental	9,723	9,846	13,727
	Budget(a) 2008-09	**Actual 2008-09**	**Budget 2009-10**
Average staffing level (number)	31	30	43

(a) Excludes unrealised fair value revaluations.
(b) The Budget figure for 2008-09 is the 'estimated actual 2008-09 balance' reported in the *Portfolio Budget Statements 2009-10*.
(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 2008-09 the AOFM did not use any agency equity injections.
(e) Part 1: AOFM overview specifies the AOFM outcome.

Advertising and market research

During the 2008-09 financial year, the AOFM made no payments to advertising agencies for campaign advertising. The AOFM had a total expenditure of $63,430 to advertising agencies for non-campaign advertising (recruitment) in the 2008-2009 financial year. The following table lists individual expenditures of $10,900 or more in that category.

Table 3: 2008-09 non-campaign advertising expenditure $10,900 or more

Entity	Cost
HMA Blaze	$11,010

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.

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, functions, 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*.

The Minister for Broadband, Communications and the Digital Economy and the Minister for Finance and Deregulation have authorised the Chief Executive Officer of the AOFM to make investments for the Communications Fund under the *Telecommunications (Consumer Protection and Service Standards) Act 1999*. This authorisation operated until 1 January 2009 when the Communications Fund was closed.

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*, that the application fee be waived should accompany requests. Telephone enquiries should be directed to the Freedom of Information Coordinator, telephone 02 6263 2111, 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*. 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 2008-09.

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.

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 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.

Benchmark

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

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 giving rise to the asset or liability was conducted. The AOFM's assets and liabilities are measured at fair value, except for Australian Government advances to State and Territory governments for public housing, which are measured at historic cost.

Cash Management Portfolio

The Cash Management Portfolio is a part of the overall portfolio of assets and liabilities managed by the AOFM. It contains short-term assets and liabilities and is used to manage the within-year variability in 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 include small residual volumes of Australian Savings Bonds, Peace Saving Certificates and War Saving Certificates.

Coupon rate

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

Credit risk

The risk of financial loss arising from a counterparty to a transaction defaulting on its financial obligations under that transaction. Credit risk is contingent on both a default taking place and there being pecuniary loss as a result. The AOFM faces credit risk in relation to its interest rate swap and investment transactions.

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.

Discount

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

Discounting

Calculating the present value of a future amount.

Duration

Duration (expressed in years) represents the 'effective term' of a bond. It is the weighted average life of a bond or a portfolio of bonds. The weights are the relative cash flows associated with the bond or portfolio (the coupon payments and principal), discounted to their present value. See modified duration.

Exposure

The amount of money at risk in a portfolio. Exposure to a risk is calculated by measuring the current mark-to-market value that is exposed to that risk.

Face value

The amount of money indicated on a security, or inscribed in relation to a security, as being due to be paid on maturity.

Fixed leg

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

Fixed rate

An interest rate calculated as a constant percentage of the face value or notional principal and generally payable quarterly semi-annually or annually. Treasury Bonds pay a fixed coupon rate semi-annually.

Floating leg

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

Floating rate

An interest rate that varies according to a particular indicator such as BBSW (Bank Bill Swap Reference Rate). For example, the floating leg of an interest rate swap may provide for the interest paid to be reset each six months in accordance with the BBSW.

Foreign Debt Portfolio

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

Funding risk

The risk that an issuer is unable to raise funds, as required, in an orderly manner and without financial penalty. For the Australian Government, funding risk encompasses both long-term fund raising to cover 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- 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 giving rise to the asset or liability was conducted.

Interest rate risk

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

Present value

The amount that corresponds to today's value of a payment to be received in the future. If the opportunity cost of funds, or discount rate is 10 per cent, the present value of $100 to be received in two years is $\$100 \times [1/(1 + 0.10)^2] = \$82.64$.

Primary market

The market where bonds are issued for the first time and the sale proceeds go to the issuer. For example, the primary market for Treasury Bonds is when the bonds are sold at tender by the AOFM on behalf of the Australian Government.

Real interest rate

Interest rate that has been adjusted 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. Whenever the AOFM enters the market to borrow funds, it is exposed to repricing risk.

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.

Risk premium

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

Secondary market

The market where securities are bought and sold subsequent to original issuance.

Securities lending

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

Securities Lending Facility

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

Securitisation

The process of converting a pool of assets into marketable financial instruments by turning them into securities. 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

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

Short-dated exposure

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

Special purpose vehicle (SPV)

In the context of an Australian RMBS transaction, this vehicle 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 rates.

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 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 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 bonds — that is, the initial face value as adjusted for inflation over the life of the bonds. 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 curve

The graphical representation of the relationship between the yield on debt securities of the same credit quality but different term to maturities on a specific date. When securities with longer terms to maturity have a higher yield than securities with shorter terms to maturity, the curve is said to have a positive slope. In the opposite case, the slope is said to be negative or inverse.

ACRONYMS

AASB	Australian Accounting Standards Board
ANAO	Australian National Audit Office
AOFM	Australian Office of Financial Management
APEC	Asia-Pacific Economic Cooperation
APS	Australian Public Service
AUD	Australian dollar
BBSW	Bank Bill Swap Rate
CEO	Chief Executive Officer
CGS	Commonwealth Government securities
CPI	Consumer Price Index
EL	Executive Level (APS Classification)
FBT	Fringe Benefit Tax
FMA	*Financial Management and Accountability Act 1997*
FMO	Finance Minister's Orders
GDP	Gross Domestic Product
GST	Goods and Service Tax
IT	Information technology
LTDP	Long-term Debt Portfolio
OECD	Organisation for Economic Co-operation and Development
OPA	Official Public Account
RBA	Reserve Bank of Australia
RITS	Reserve Bank Information and Transfer System
RMBS	Residential mortgage-backed security
SES	Senior Executive Service
USD	United States dollar

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CONTACT DETAILS

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Internet address

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

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