Australian Office of Financial Management

Annual Report 2018-19

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Australian Government

Australian Office of Financial Management

27 September 2019

The Hon Joshua Frydenberg 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 2019 for presentation to the Parliament.

The Report has been prepared in accordance with section 46 of the *Public Governance, Performance and Accountability Act 2013*.

Part 2 *Performance* of this Annual Report includes the Australian Office of Financial Management Annual Performance Statement, which is prepared in accordance with section 39 of the *Public Governance, Performance and Accountability Act 2013*. In my opinion this Annual Performance Statement accurately reflects the Australian Office of Financial Management's performance for 2018-19.

Yours sincerely

Rob Nicholl
Chief Executive Officer

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ITS ROLE

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

CONTENTS

LIST OF TABLES

LIST OF CHARTS

REVIEW BY THE CHIEF EXECUTIVE OFFICER

REVIEW BY THE CHIEF EXECUTIVE OFFICER

Context

During 2018-19 the AOFM ensured that the government's expenditure obligations were met at all times and its Budget financing needs were delivered in full and cost effectively without undue risk. The AOFM also managed the Australian Government Securities (AGS) portfolio with a view to promoting market integrity while balancing a range of medium-long term debt portfolio considerations.

Term issuance for 2018-19 was $61 billion; considerably lower than for the previous year ($81 billion) and a direct reflection of improving fiscal outcomes. Issuance was smoothly absorbed into global financial markets during the year, although this was helped by the AOFM retaining sufficient flexibility to make issuance decisions conducive to market conditions at the time.

Much of the AOFM's engagement with AGS investors focused on explaining the implications of reduced issuance programs, including how this would result in some changes in the issuance pattern without adversely impacting liquidity or support for the futures contracts. In terms of cash portfolio management, the AOFM maintained a strategy similar to past years to ensure that a reasonable contingency was in place at all times to cover forecast payment obligations even if the ability to issue bonds were to have been temporarily impeded.

Elevated US Treasury bonds yields relative to AGS yields carried over from the previous year and this created some pressure on the AGS market because US Treasuries are a key investment alternative to AGS for many investors. Around November, global financial markets began to exhibit heightened levels of volatility, one result of which was a rally in bond markets that started a decline in yields most notably in the US but also throughout Europe, with AGS yields being 'dragged down' by other markets.

The backdrop for this market activity derived from a number of factors, monetary policies in the major economic zones again being significant. During the year the US Federal Reserve raised the cash target rate twice (to a mid-point high of 2.375 per cent), with the Bank of Canada (BoC) also moving twice. The European Central Bank (ECB) and Bank of Japan (BoJ) held rates steady throughout, while maintaining respective quantitative easing programs. The Bank of England (BoE) implemented one increase, which at the time looked to be in line with the outlook for the major EU economies.

The difference in economic performance and outlook between most notably the US and other countries had a marked effect on global capital flows during the year with fixed income and equities markets in the US attracting what looks to at times to have been some substantial global reallocations. AGS yields tended to perform relatively well although it became apparent to AOFM via feedback from the banks that the more active offshore investors that had been part of the AGS investor base in previous years had acted on the prospect of higher returns in other markets. These patterns are often difficult to discern because offshore investor decisions are based on a wide range of factors, some of which are not possible to observe, but are dominated by changes to foreign exchange levels, cross currency hedging costs, and movements in bond yields. One thing notable to the AOFM was a gradually increasing concentration of demand over the year around the futures baskets, and the 10-year futures basket in particular. This meant that opportunities to issue bonds of 15-year maturity or longer became more restricted compared with previous years. While not a problem for the AOFM in achieving its issuance strategy for the year, it was yet another reminder that issuance conditions are heavily influenced by global market factors.

Bond yields during the first half of 2018-19 remained relatively stable with market expectations signalling higher monetary policy rates (which as noted above were only delivered by the US Fed, the BoC and the BoE). One dynamic that did appreciably impact markets, particularly in the first half of the year, was the elevated funding rates for investors looking to fund their positions in repo markets (including the Australian repo market). This had the effect of limiting the ability of some investors to hold large positions in AGS. These conditions began to ease toward the end of the year but the AOFM is aware that this is likely to have resulted in a notable constraint to demand for AGS at times throughout the year.

As the second half of 2018-19 unfolded there were several substantial shifts to global financial market sentiment. Ongoing trade tensions between the US and China led to revisions to the economic outlook to both of those economies, with flow-on revisions to other regions. This resulted in a reversal in market views of monetary policy rates (largely from either increase or neutral to a ‘cut’), initiating a strong, consistent rally in bond markets generally. By the end of the financial year, AGS yields had reached historic lows. The spread between yields on ten-year Australian Treasury Bonds and US Treasuries remained negative, with the 30-year spread also turning negative during the year. The tightness of the funding pressures experienced during 2018 eased somewhat during the second half of 2018-19. Whilst lower relative yields and periods of elevated funding costs will have affected demand for AGS, investor diversity across the market tended to support aggregate demand.

During 2018-19, the level of offshore ownership of AGS remained at around 60 per cent. An apparent trend of onshore investor buying being dominated by domestic bank balance sheets that abated toward the end of 2017-18 did not noticeably return during 2018-19. All other things being equal, offshore investors are attracted to the AGS market by strong underlying liquidity relative to other markets (except the US Treasuries market of course, which is the largest and most liquid market). The credit quality of the Australian Government and the transparency and regularity of issuance are also important factors. The AOFM remains aware that should these features persist, the AGS market will continue to exhibit efficiency and resilience, providing the government with good access to financial markets as the need arises. However, 2018-19 was a timely reminder that AGS relies on the support of a large cohort of offshore investors and relative value between AGS and other investment alternatives can weigh on market demand, especially during periods where prices are adjusting to reflect changes in market conditions.

Issuance, market maintenance and portfolio management

The 2018-19 issuance program was undertaken through the familiar combination of regular weekly competitive tenders and several syndications where new bond lines were being established. The program was complemented by regular bond buyback tenders that have also become accepted by the market as a normal part of the AOFM's operations.

Treasury Bond issuance of $55 billion focused on achieving the AOFM's portfolio strategy, while supporting the bond futures contracts and market liquidity. The AOFM achieved its strategy of maintaining the duration of the portfolio, which had been incrementally lengthened over the previous six years, in the face of historically low term-premium assessments and during a period of declining yields. This leaves the AOFM with the enhanced range of issuance options it had achieved by lengthening the yield curve to 30 years (and in doing so broadening the diversity of the investor base). The AGS market internationally remains fully comparable to many other sovereign markets that would be considered as 'peer' markets. This leaves Australia well-placed in terms of access to global financial markets as and when this becomes necessary.

Treasury Indexed Bond issuance for the year totalled $5.9 billion, of which $2.2 billion was conducted via tender and $3.75 billion was by syndication for a new 30-year line. In conjunction with the syndication, around $2.1 billion of the August 2020 Treasury Indexed Bond line was repurchased to improve the efficiency of this market. A further $1 billion of the August 2020 line was repurchased in a separate later operation.

In addition to the repurchase of Treasury Indexed Bonds the AOFM also repurchased $23.1 billion of Treasury Bonds ahead of maturity (almost the same as the previous year), of which $14.7 billion were acquired through buyback tenders, $2.0 billion were bought back in conjunction with syndication and $6.3 billion were purchased from the RBA.

Looking ahead

The financial market outlook has been described by some market participants as amongst the most uncertain since shortly after the GFC. It continues to be dominated by speculation about the potential for further appreciable slowing in global economic growth and inflation prospects, not the least being the risks to trade flows arising from tension between the US and China and for the possibility of trade tensions extending to other major trading bloc relationships (including Europe). The recent monetary policy easing with rate cuts by the US Federal Reserve and the recommencement of QE by the ECB will impact the relative performance between sovereign bond markets and has the additional potential to create more uncertainty in foreign exchange markets. This will be at a time when policy rates are already at historically low levels and central bank balance sheets are at elevated levels as a result of various quantitative easing programs.

Add to this the continued risk of market disruption arising from geopolitical disputes and uncertainty as to when and how the UK will disengage from current arrangements with the EU, the global outlook is confused at best. These, amongst other factors, remain relevant to the AOFM's deliberations although the risk outlook for issuance remains appreciably lower given the forecast for programs around half of what they were just three years ago. Depending on the cause, a sudden and steep deterioration in global market conditions could become challenging for AOFM issuance although there is considerable operational flexibility, including the holding of substantial cash reserves, to deal with a wide range of global market circumstances.

The AOFM remains focused on portfolio management objectives that will support a diversified investor base and a continuing outlook for declining issuance (in line with improving fiscal forecasts), but little expected change in the overall size of the debt portfolio. A continuing need to communicate clearly regarding carefully considered issuance plans that will meet the test of the changing fiscal and global market circumstances remains at the forefront of AOFM awareness in how to deal with financial markets.

During the year the AOFM was given the responsibility to implement the government's new Australian Business Securitisation Fund. This will involve careful investment of a growing pool of funds (up to $2 billion over three years) in wholesale market operations in support of lenders to small and medium sized business, many of which find access to unsecured business lending a challenging proposition. Considerable work had begun by the start of 2019-20 to implement this program. However, a lot remains to be done to ensure appropriate arrangements are in place to assess the proposals for support from lenders that will form a key part of the program, together with devising meaningful ways for the AOFM to promote development of this sector of the domestic financial market.

Rob Nicholl
Chief Executive Officer

PART 1: AOFM OVERVIEW

AOFM OVERVIEW

Role, function, outcome and program structure

The AOFM is responsible for the management of Australian Government debt. The AOFM also manages the government's cash balances and invests in very low risk financial assets, which in recent years has been in the form of term deposits with the Reserve Bank of Australia (RBA).

The objectives of the AOFM are to:

1) meet the budget financing task in a cost-effective manner subject to acceptable risk;

2) facilitate the government's ability to meet its cash outlay requirements as and when they fall due; and

3) be a credible custodian of the AGS market and other portfolio responsibilities.

The AOFM's debt management activities include the issuance of Treasury Bonds and Treasury Indexed Bonds. To support the efficient operation of the markets for these debt instruments, a securities lending facility that allows financial market participants to borrow bonds is maintained on behalf of the AOFM by the RBA.

The AOFM's cash management activities include the issuance of Treasury Notes to meet short-term funding needs.

The AOFM is part of the Treasury portfolio. It is accountable to the Secretary to the Treasury and to the Treasurer, and through the Treasurer to the Parliament. The AOFM is a listed entity under the *Public Governance, Performance and Accountability Act 2013* (PGPA Act) which requires it to maintain its own accounts. It is responsible for compliance with the PGPA Act separately to the Treasury. AOFM staff are employed under the *Public Service Act 1999*.

For budgetary purposes, the AOFM's activities comprise one program directed to achieve the following outcome on behalf of the Australian Government: — *the advancement of macroeconomic growth and stability*. This outcome is pursued through the effective operation by issuing debt securities into financial markets, investing in financial assets; and managing debt, investment and cash portfolios. The AOFM aims to manage government debt for which it is responsible at least cost, subject to an acceptable level of risk. The government's policy objectives at a point in time, and over time of supporting the AGS market in order to maintain ready access to global financial markets, underpin the AOFM's planned activities from year-to-year.

Accountable authority

Mr Rob Nicholl, CEO, has been the accountable authority of AOFM for the entire reporting period.

Organisational structure

AOFM's business structure remains unchanged from the previous reporting period Portfolio and global market research (including monitoring and anticipating regulatory impacts on financial markets), issuance transaction design and execution, and investor engagement, together form what is viewed as 'front office' related (Funding, Markets and Strategy).

Business Operations comprise transaction settlements, together with all associated payment obligations and the monitoring and meeting financial reporting requirements in relation to the AOFM's transactions (and balance sheet activity) on behalf of the Australian Government. These activities form what is typically viewed in the financial sector as the 'back office' (Accounting Services).

A 'middle office' (Enterprise Assurance and Performance) oversights separation of the back and front office functions through maintaining complementary frameworks for enterprise risk and assurance (including the internal audit function) and the coordination of outsourced legal services, and compliance with the AOFM's obligations under relevant legal, regulatory and delegated powers. It also undertakes performance monitoring of the various portfolio and transaction activities.

AOFM governance, corporate related functions and support to the Chief Executive sit within a Corporate Development business unit. Advice on issues regarding the AOFM's staff development objectives and APS specific issues are provided directly to the Chief Executive through a dedicated role.

This overall structure provides for an appropriate segregation of duties — consistent with high standard financial industry protocols.

PART 2: PERFORMANCE AND OUTCOMES

PERFORMANCE AND OUTCOMES

Introduction

This part of the annual report is presented in three sections: Section 1 provides an Annual Performance Statement as required by the PGPA Act; Section 2 details the AOFM's issuance operations, debt and cash portfolio management task and its engagement with the market (namely investors); and Section 3 presents the main considerations for how the AOFM approaches strategy development to underpin its operational objectives.

Section 1: Annual Performance Statement

As the accountable authority of the Australian Office of Financial Management, I present the 2018-19 Annual Performance Statement of the Australian Office of Financial Management, as required under paragraph 39(1)(a) of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act).

In my opinion this annual performance statement accurately reflects the performance of the Australian Office of Financial Management, is based on properly maintained records and complies with subsection 39(2) of the PGPA Act.

Rob Nicholl

Chief Executive Officer

27 September 2019

Purpose

The AOFM's purpose is to ensure the government's debt financing needs are met each year while managing the cash, debt and other portfolios over the medium-long term at low cost subject to acceptable risk. The AOFM takes into account the potential for its operations to impact domestic financial markets.

The AOFM has adopted three key objectives to achieve its purpose:

1) meet the budget financing task in a cost-effective manner subject to acceptable risk;

2) facilitate the government's cash outlay requirements as and when they fall due; and

3) be a credible custodian of the AGS market, and meet other portfolio responsibilities as directed by government.

The AOFM balances cost and risk considerations but its overriding aim is to ensure that the financing requirements of government are able to be met in full and on time. The AOFM has minimal appetite for failure in any function associated with issuance, settlement and cash management. The design and conduct of its core business processes (including its business continuity arrangements) reflect this risk appetite.

The AOFM monitors its performance against the performance indicators presented in Table 1, sourced from the AOFM's Corporate Plan 2018-19 and Portfolio Budget Statements 2018-19. Sections 2 and 3 of this part of the Annual Report provide detail on a range of outcomes important to achievement by the AOFM of its annual and longer-term aims. This detail is provided separately to the Performance Statement because it is aimed at financial market participants as the relevant audience.

Table 1: Performance Information 2018–19

Performance Indicator[a]	Measure [b]
Objective 1: Meet the budget financing task in a cost effective manner subject to acceptable risk	
1. Term issuance	Shortfall in volume ($) between actual Treasury Bond issuance and planned issuance announced at the Budget and subsequent releases.
2.1 Financing cost (portfolio)	The cost of the long-term debt portfolio compared to the 10 year average of the 10-year bond rate.
2.2 Financing cost (issuance)	The cost of Treasury Bond issuance over the past 12 months compared to the average 10-year bond rate over the same period.
3. New issuance yields	Weighted average issue yield at Treasury Bond and Treasury Indexed Bond tenders less prevailing mid-market secondary yields.
Objective 2: Facilitate the government's cash outlay requirements as and when they fall due	
4. Use of the overdraft facility	Number of instances the RBA overdraft facility was utilised to the extent that it required Ministerial approval during the assessment period.

Objective 3: AOFM is a credible custodian of the AGS market and other portfolio responsibilities	
5. A liquid and efficient secondary market	Annual turnover in the secondary market for Treasury Bonds and Treasury Indexed Bonds.
6. Market commitments	Number of times the AOFM failed to undertake actions consistent with public announcements.

(a) Source: AOFM Corporate Plan 2018-19; Portfolio Budget Statements 2018-19 Budget Related Paper No. 1.16 — Treasury Portfolio, p. 108
(b) Source: AOFM measures performance against indicators using data captured from its market transactions; its financial systems recording portfolio composition; official notices to the market; and secondary financial market turnover data requested from intermediaries.

Performance Results 2018–19

Objective 1: Meet the budget financing task in a cost effective manner subject to acceptable risk

Indicator 1	**Term Issuance:** Shortfall in volume ($) between actual Treasury Bond issuance and planned issuance announced at the Budget and subsequent releases
Target	Zero
Result	Target met

The shortfall between actual and planned issuance was zero, with the financing task for 2018-19 fully met through the issuance of $60.9 billion of term securities. The financing task in any year comprises: funding for maturing AGS; any Budget deficit; and off-Budget funding requirements. If the AOFM undertakes higher bond issuance than planned it will adjust issuance in the following financial year accordingly and carry the additional cash as assets in the cash management portfolio. In the event bond issuance is lower than planned AOFM will have the choice of covering the difference with short-term funding (through the use of Treasury Notes) or running a lower asset balance in the cash management portfolio until increased bond issuance to compensate for this position has been executed.

Indicator 2.1	**<u>Financing cost (portfolio)</u>:** The cost of the long-term debt portfolio compared to the 10 year average of the 10-year bond rate
Target	Lower
Result	Target met

The effective yield of the long term debt portfolio for 2018–19 was 3.26 per cent (2017–18: 3.30 per cent). This is an expected outcome and is below the 10 year average of the 10 year bond rate of 3.52 per cent.

The trajectory and level of financing costs is an important consideration for the AOFM although in the short-term financing costs will lag movements in market yields due to the size of the debt portfolio. In an environment of declining interest rates (which characterises most of the period since the GFC), the financing cost of the long term debt portfolio will, all other things equal, decline as the AOFM replaces maturing debt issued (when rates were higher) with new debt issued at lower rates. The maturity profile of the portfolio is also relevant. If mainly longer term AGS are being issued for instance, the average term to maturity of the portfolio will be increasing while over time there will be fewer debt maturities to refinance each year. In a declining interest rate environment, this will result in a generally slower rate of decline in financing costs compared to issuing shorter term debt. The AOFM monitors the cost of the portfolio against the average 10-year bond rate because this is a globally relevant benchmark indicator. It is also closely associated with AOFM's task of supporting the 10-year futures contract and it represents a highly liquid part of the AGS yield curve.

Indicator 2.2	**<u>Financing cost (issuance)</u>:** The cost of Treasury Bond issuance over the past 12 months compared to the average 10-year bond rate over the same period
Target	Lower
Result	Target not met

The average yield of Treasury Bond issuance (accounting for the bulk of long term issuance) for 2018–19 was 2.29 per cent (2017–18: 2.70 per cent). This compares to the 2018–19 average of the 10 year bond rate of 2.26 per cent (2017–18: 2.71 per cent). The AOFM monitors issuance cost outcomes against the 10-year bond rate because it is a market relevant benchmark indicator and represents a highly liquid part of the AGS yield curve (making it a useful cost indicator of market conditions for the year overall). The 3 basis point outcome deviation from the indicator is within the AOFM's expectation of a range of around plus/minus 10 basis points.

The average term to maturity of the Treasury Bond portfolio was 7.44 years as at 30 June 2019 (30 June 2018: 7.38 years). The average term of new issuance in 2018–19 was 11.27 years, which was longer than planned issuance of 11 years average term to maturity (2017-18 actual: 11.08 years).

The average yield on Treasury Bonds issued during 2018–19 was higher than the average 10 year bond rate during the year. This outcome reflected the longer average tenor of issuance of 11.27 years (compared with the 10 year cost performance indicator) and the 'front-loading' of the issuance program in the first half of the year in advance of what was a significant rally in bond yields through the second half of the year. It should be noted that the AOFM typically aims to achieve more than half of the issuance task prior to mid-year in order to mitigate funding risk for the remainder of the fiscal year.

Overall, debt issuance in 2018–19 was consistent with the AOFM strategy of lengthening the average term to maturity of the nominal portfolio to reduce refinancing risk and variability in interest costs.

Indicator 3	**New issuance yields:** Weighted average issue yield at Treasury Bond and Treasury Indexed Bond tenders less prevailing mid-market secondary yields
Target	Issuance yields at or below the market rate
Result	Target met

The weekly selection of bond maturities and issuance volumes for tenders facilitated continual efficient functioning of the primary market. This is reflected by average tender yields being below secondary market yields for Treasury Bonds (0.23 basis points), and Treasury Indexed Bonds (1.37 basis points).

How AOFM achieves this objective

Each year the AOFM's financing task is determined by the forecast Budget balance, the need to refinance maturing debt, and funding to be undertaken by government that is additional to Budget requirements. The financing task can be adjusted in response to changes in management of the cash portfolio and the AOFM makes this operational judgement as appropriate from year to year.

The financing task is achieved through issuance of AGS, the mix of which is determined through an annual issuance strategy that balances debt portfolio risks (such as future interest rate volatility and funding risks) against differences in short and long-term borrowing costs.

The method of issuance is determined by balancing considerations of supporting AGS market liquidity and managing execution risk against the anticipated transaction costs associated with different issuance approaches (all of which contribute to overall portfolio costs). The majority of issuance occurs via competitive tender, which achieves the 'best cost' outcome for the government in most circumstances. The syndication method is reserved for situations in which execution risk (due to large issuance volume) and/or the trading liquidity of the security being issued are of primary consideration.

The criteria above show that the financing task was fully met while meeting expected costs associated with how this was achieved. Of the $60.9 billion in gross term issuance for the year, $53.55 billion was issued via competitive tender, with new issuance yields consistently lower than secondary market yields. The remainder was issued via syndication. Financing costs on the overall portfolio also compared favourably against market indicator rates. More detail on each of these aspects is provided in Section 2 below.

Objective 2: Facilitate the government's cash outlay requirements as and when they fall due

Indicator 4	**Use of overdraft facility:** Number of instances the RBA overdraft facility was utilised to the extent that it required Ministerial approval during the assessment period
Target	Zero
Result	Target met

Sufficient cash was available at all times to meet the government's outlays. The overdraft facility was not utilised in 2018–19.

How AOFM achieves this objective

This objective is achieved through management of the cash portfolio with the AOFM forecasting daily revenue collections and expenditure. At times there are significant mismatches between expenditure needs and revenue collected, which the AOFM accommodates through managing cash reserves and the use of short-term borrowing. There were no instances during the year where there was a need for the RBA overdraft facility to be used. The facility is used when the overnight cash balance in the official public account is not sufficient to cover expenditures.

Objective 3: AOFM is a credible custodian of the AGS market and other portfolio responsibilities

Indicator 5	**<u>A liquid and efficient secondary market</u>:** Annual turnover in the secondary market for Treasury Bonds and Treasury Indexed Bonds
Target	Greater than previous year
Result	Target met

AGS liquidity remained strong in 2018-19. Turnover of Treasury Bonds totalled $1.3 trillion (a 2 per cent increase from the previous year). Annual Treasury Indexed Bond turnover increased by 3 per cent, to $52 billion. Strong secondary market liquidity is a reflection of a range of factors but importantly includes regular AGS issuance by the AOFM that, amongst other factors, takes account of prevailing market conditions and the objective of supporting the futures contracts, active market making by intermediaries, and diversity of the AGS investor base.

Indicator 6	**<u>Market commitments</u>:** Number of times the AOFM failed to undertake actions consistent with public announcements
Target	Zero
Result	Target not met

The AOFM did not proceed with a previously planned and publicly announced operation on one occasion. The AOFM announced in both its annual speech to the Australian Business Economists Forum (Sydney, May 2018) and the Budget Operational Notice (May 2018), that it was planning to establish four new bond lines for 2018-19; these were to be: September 2023; May 2030; December 2030 and May 2041. The May 2030 and May 2041 new bond lines were introduced as planned and announced.

However, due to a reduction in the Budget financing task reported at MYEFO 2018-19, the AOFM decided it prudent, for reasons of supporting AGS market liquidity, to cancel establishment of the September 2023 and the December 2030 bond lines because there would not have been sufficient issuance in the reduced program to adequately support the introduction of these two bond lines at 'liquid' levels. The post-MYEFO Operational Notice made the statement that: "These lines are no longer planned to be issued", which while sufficient notice to the market of the change in plan, was nonetheless inconsistent with the original Budget notice. The AOFM does not consider this type of change to be a material underachievement given the change in plan was appropriately timed and publicly transparent.

How AOFM achieves this objective

That the AOFM is judged by financial markets to be a credible custodian of the AGS market can be assessed from a number of perspectives. It is important to note, however, that the AOFM does not have any regulatory or statutory authority and any influence it has in the market is only by virtue of its operations (although it recognises the potential for this influence to be appreciable at times).

Good market liquidity is a key consideration for most investors because it reflects an ability to transact in the market (either through buying or selling AGS) in a timely manner and in volumes to meet their needs, without market prices being materially moved as a result of those transactions. Liquidity is a product of having a wide range of active ‘price makers’ in AGS and a large, diverse and active investor base. The AOFM supports liquidity through: restricting the number of individual bond lines so that each can have greater volume outstanding, regular and consistent issuance into maturities that are chosen to reflect investor demand, clear communication and transparency regarding the AOFM’s operations and issuance strategy, and a long standing focus on the development of a functional and resilient AGS market. High levels of secondary market turnover and regular feedback from investors attesting to their capacity to buy and sell large parcels of AGS at acceptable prices are strong indicators of liquidity for 2018–19. They also reflect favourably on the AOFM’s credibility as a sovereign issuer and custodian of the AGS market.

Section 2: Outcomes

This section gives context to the outcomes achieved through the AOFM’s operations in supporting its principal functions, and discusses relevant market aspects of the environment in which the AOFM operates.

Bond issuance

Aims

The AOFM currently has two different term debt instrument choices — nominal Treasury Bonds and Treasury Indexed Bonds, the latter for which the capital value is adjusted over time according to inflation outcomes. During times of Australian Government budget deficits the main aim of issuance is to meet the budget financing task; however, the issuance program is also determined such that it will assist with meeting overall debt portfolio aims (such as increasing the average term to maturity of the portfolio while supporting market liquidity). The AOFM plans its programs each year to undertake issuance in a cost effective manner.

The AOFM also aims to support the efficient operation of Australia's financial markets by being a credible custodian of the AGS market. This takes account of the following financial market activities:

- Treasury Bonds, Treasury Indexed Bonds and Treasury Bond futures are used by financial market participants as benchmarks for the pricing of other capital market instruments and to manage interest rate risk; and
- the existence of active and efficient physical and futures markets for sovereign debt strengthens the robustness of the financial system and reduces its vulnerability to shocks.

A key element of market efficiency that is important to issuers, intermediaries and investors is market liquidity. Bond market liquidity is broadly accepted to mean the ability to trade bonds at short notice and at low cost without materially moving prices. Strong liquidity is attractive to investors and reflects favourably on a sovereign bond market. There is no single measure of liquidity, it is an assessment by individuals (and institutions) based on a number of considerations. These considerations include, but are not restricted to, turnover in secondary markets, the frequency of primary market activity, bid-offer spreads, and the time it takes to execute 'large' transactions.

Bond buybacks

The AOFM repurchases Treasury Bonds before their maturity with several aims in mind: to increase the duration of the debt portfolio, reduce refinancing risk, to assist in the cash management task around the time of bond maturities, enhancing the operation of the secondary market, and to offer broad assistance to the RBA in its liquidity management task when bond lines mature.

Treasury Indexed Bonds may be repurchased ahead of maturity from time to time. This may be to assist in the issue of a new line, or to enhance the operation of the secondary market.

Approach to achieving these aims and market influences

The AOFM uses competitive tenders and syndications to conduct bond issuance. Competitive tenders are the mainstay of AOFM's issuance operations. 62 Treasury Bond tenders and 15 Treasury Indexed Bond tenders were conducted during the year. One new Treasury Bond line was launched by syndication and one new Treasury Bond line was launched by tender. One new Treasury Indexed Bond line was launched by syndication in 2018-19 extending the linker curve by ten years (to 2050).

Buybacks of short-dated Treasury Bonds were conducted via tenders, in conjunction with syndicated issues, and via bilateral transactions with the RBA.

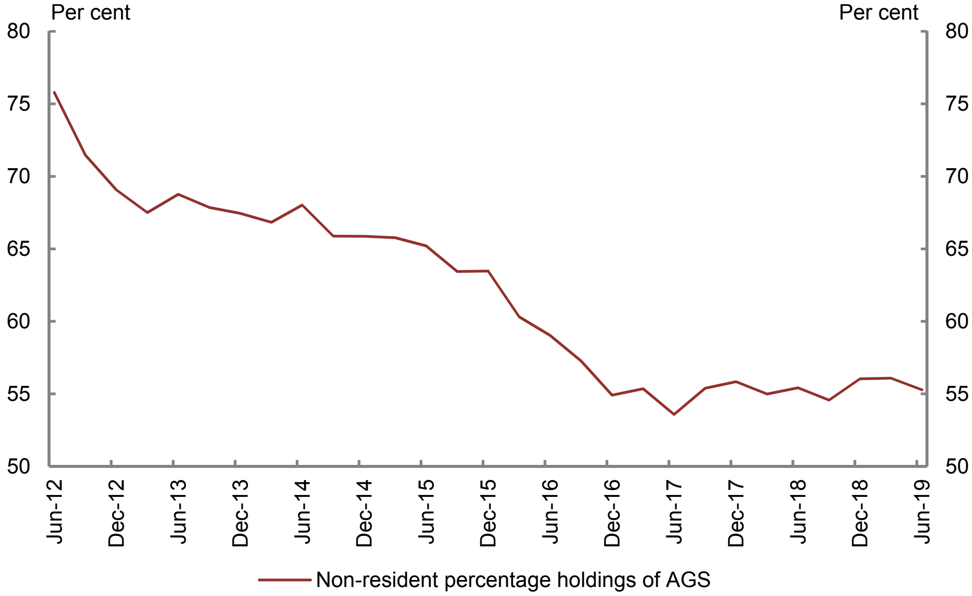
Issuance volumes were lower than last year.

Bond yields during the first half of 2018-19 remained relatively stable with the market expecting higher policy rates. Over the same period the elevated funding rates experienced by some investors since late 2017 (including Australian repo markets) persisted, with heightened stress around quarter ends, continuing to limit some investors and market-makers ability to hold large positions in AGS.

The second half of 2018-19 saw a rapid reversal in market views of the next policy rate movement from a hike to a cut, driving a strong, consistent rally in the AGS market in concert with the strong rally across the major sovereign bond markets generally. By the end of the financial year, AGS yields had hit historic lows with the three-year bond yield below 1% and the entire curve trading below 2%. The lower yield environment resulted in the spread between yields on ten-year Australian Treasury Bonds and US Treasuries remaining negative, with the 30-year spread also turning negative during the year. The tightness of the funding pressures experienced during 2018 eased somewhat during the second half of 2018-19. Whilst lower relative AGS yields and periods of elevated funding can affect demand, investor diversity across the AGS market means there has been little aggregate change in demand.

The proportion of outstanding AGS held by offshore investors remained relatively stable throughout 2018–19, as illustrated in Chart 1. This followed a period of declining relative holdings of non-residents from 2012. Strong offshore demand from across a diverse investor base remains with interest spread across the curve. Ongoing interest for the futures basket bonds reflect their continued strong liquidity.

Chart 1: Proportion of AGS held by non-resident investors — 2012-2019



Source: Australian Bureau of Statistics and the AOFM

Bond buybacks

The AOFM conducts regular competitive buyback tenders for the repurchase of short-dated Treasury Bonds. These operations are funded by separate tenders for issuance of longer-dated Treasury Bonds. Buyback tenders add to the AOFM's operational flexibility and have become accepted as a standard feature of the AOFM's operations.

There are two other ways in which the AOFM can repurchase bonds prior to maturity. Switches or buybacks can be accommodated in conjunction with syndicated issues; and via transactions with the RBA, which purchases short-dated Treasury Bonds in its liquidity operations.

During the year the AOFM repurchased Treasury Indexed Bonds several times. Holders of the 2018 Treasury Indexed Bond line were invited to submit offers of this line to the AOFM, in conjunction with the syndicated issue of the new 2041 bond line. The AOFM twice offered to repurchase the 2020 Treasury Indexed Bond: once in conjunction with the syndicated issue of the new 2050 line; and once via a special single price, unconstrained volume buyback auction.

Outcomes

Meeting the Budget financing task

The financing task for 2018–19 was fully met. A total of $60.90 billion of term debt was issued during the year.

At the time of the 2018–19 Budget, Treasury Bond and Treasury Indexed Bond issuance for the year was expected to total around $77 billion in face value terms. This volume was revised at the time of MYEFO in accordance with a revised improvement in the government's fiscal position compared to Budget forecasts.

Treasury Bond issuance

Gross Treasury Bond issuance for the year totalled $55.0 billion. This was a significant reduction from the $75.5 billion of Treasury Bonds issued in 2017–18. The bulk of this issuance was into existing bond lines in order to enhance market liquidity. In addition, two new Treasury Bond lines were launched in 2018–19:

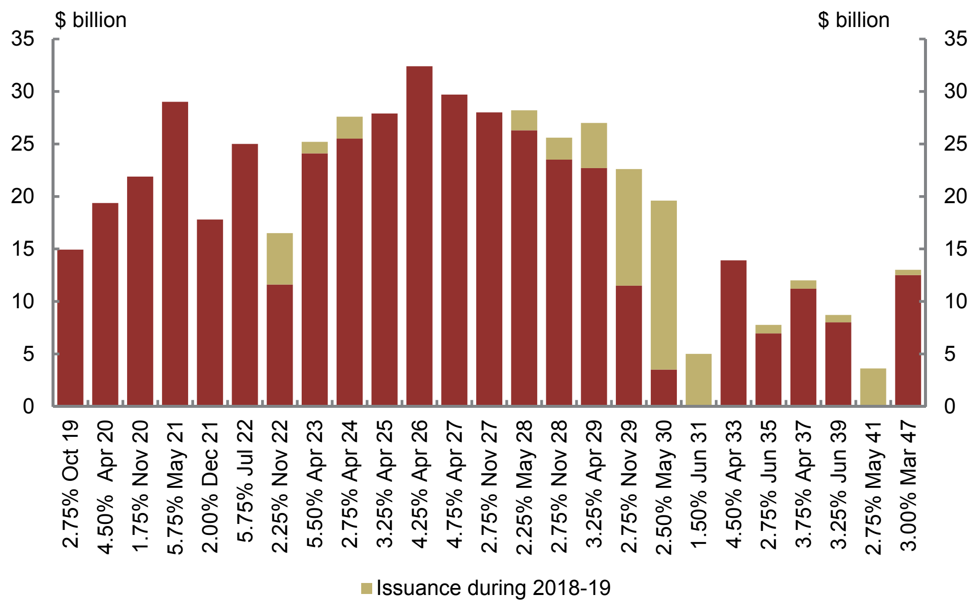
- a new bond line maturing in June 2031 was issued to support the operation of the 10-year Treasury Bond futures contract and to reduce growth in the amount outstanding in surrounding bond lines, which will make it easier to manage maturity of those bonds lines; and
- a new bond line maturing in May 2041 was issued to support the operation of the 20-year Treasury Bond futures contract.

In selecting the bond lines to issue each week, the AOFM continued to follow its standard practice of taking into account the debt issuance strategy, prevailing market conditions, information from financial market contacts about investor demand, relative value considerations, the liquidity of outstanding bond lines, and managing the maturity structure to limit funding risk. One or two tenders were held during most weeks.

Large transaction volumes were achieved at issues of new Treasury Bonds. The May 2041 ($3.6 billion) was issued by syndication, while a tender was held for the initial issue of the June 2031 ($3.0 billion) bond line.

At the end of the year, there were 25 Treasury Bond lines, with 13 of these lines having over $20 billion on issue and 21 having over $10 billion on issue. Chart 2 shows Treasury Bonds outstanding as at 30 June 2019 and the allocation of issuance across bond lines during 2018–19.

Chart 2: Treasury Bonds outstanding as at 30 June 2019 and issuance in 2018–19



Treasury Bond buybacks

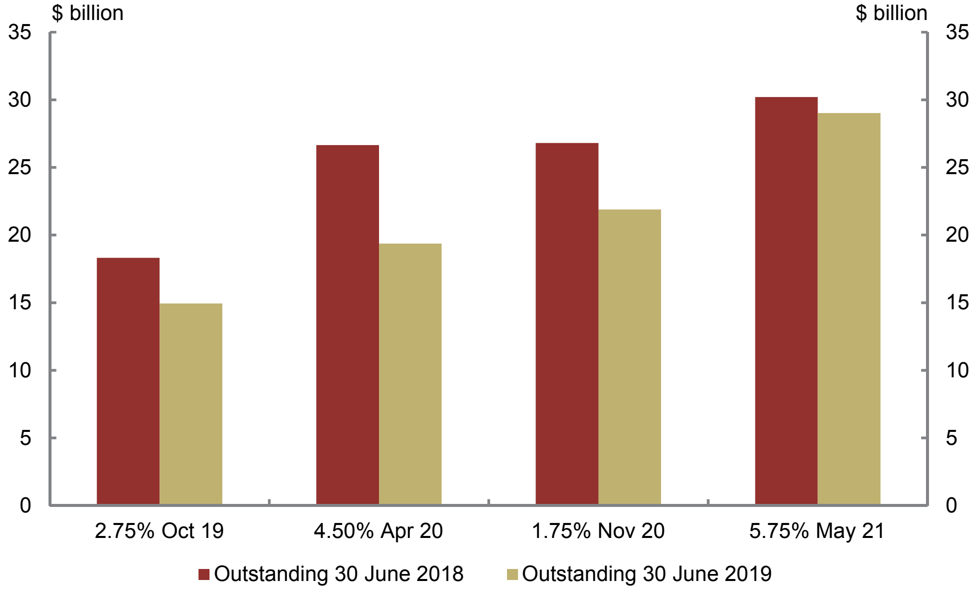
A total of $23.1 billion of Treasury Bonds were repurchased ahead of maturity in 2018-19, of which $16.7 billion were bonds maturing after 30 June 2019:

- 25 Treasury Bond buyback tenders were conducted, at which $14.7 billion of bonds were repurchased;
- the AOFM repurchased $2.05 billion of bonds in conjunction with the syndicated issue of the new 21 May 2041 Treasury Bond;
- $6.3 billion of bonds were repurchased from the RBA; and
- a small amount of bonds were repurchased from retail investors who sold their holdings via the Australian Government Securities Buyback Facility.

Buyback tenders are effectively a reverse of normal competitive issuance tenders. The AOFM sets the total volume of bonds it is prepared to buy back and offers from intermediaries are accepted from the highest yield (lowest price) in descending order until the total volume is reached. All Treasury Bond buybacks other than those from retail investors were of lines shorter than the three-year futures basket.

The volume outstanding in short-dated Treasury Bonds was reduced as illustrated in Chart 3.

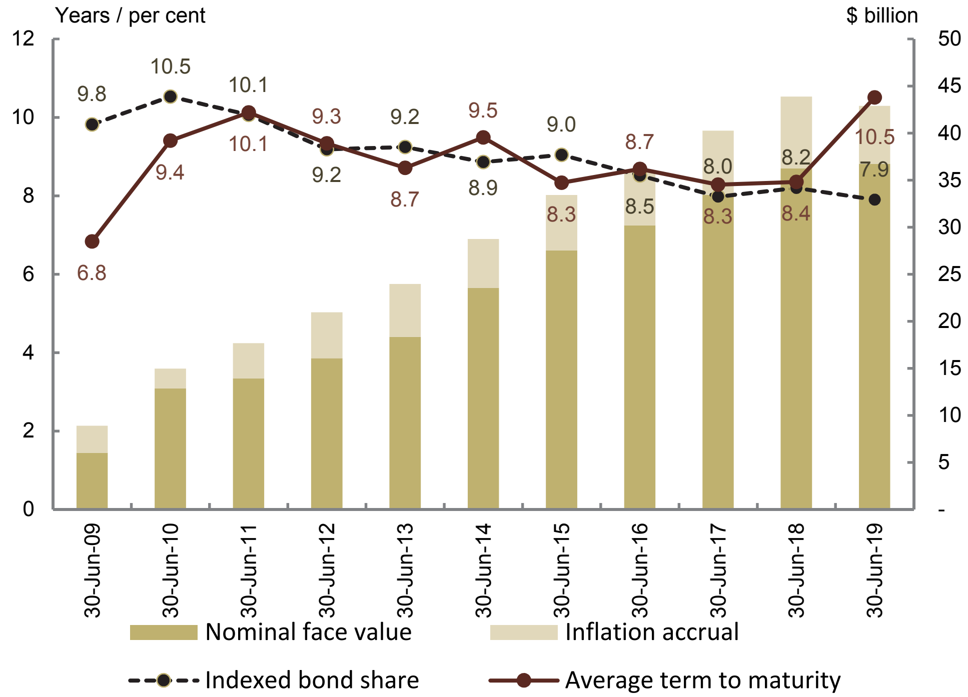
Chart 3: Volume outstanding in short-dated Treasury Bonds as at 30 June 2018 and 30 June 2019



Treasury Indexed Bond issuance

The AOFM maintains less than 10 per cent of the long-term debt portfolio in the form of Treasury Indexed Bonds, the capital values of which are adjusted with changes in the CPI. The issuance of these bonds typically attracts a different (and predominantly domestic) class of investor compared to Treasury Bonds, providing a source of diversification in the funding base. While the indexed bond portfolio has declined marginally as a share of the long term funding, the total stock of indexed bonds has continued to grow steadily (as shown in Chart 4).

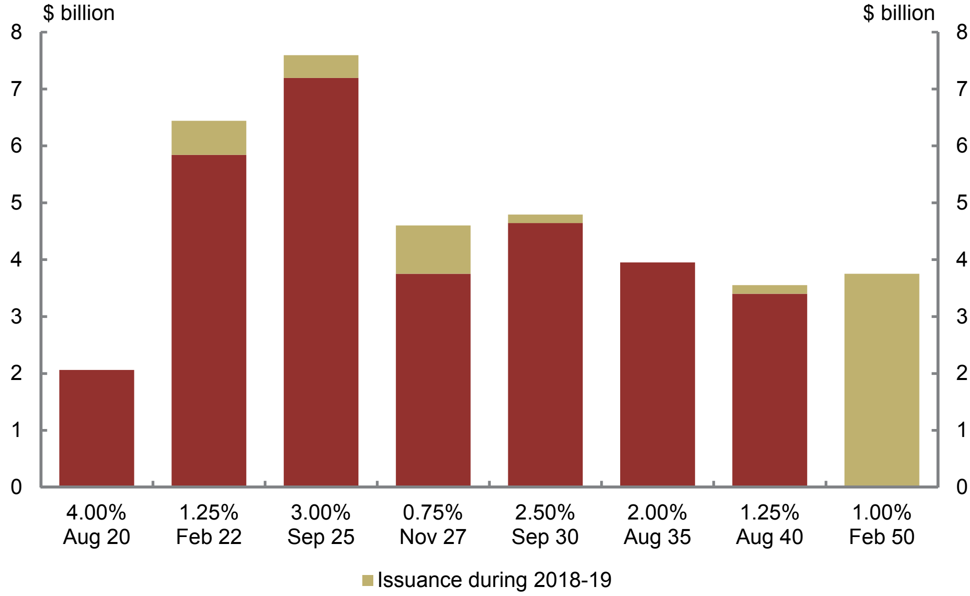
Chart 4: Treasury Indexed Bonds — average term to maturity and share of the long-term funding base



Treasury Indexed Bond issuance for the year totalled $5.9 billion, of which $2.2 billion was conducted via tender. Two tenders for the issue of Treasury Indexed Bonds were conducted in most months. The volume of each line outstanding, relative yields and other prevailing market conditions were considered in the selection of which line to offer. A syndicated offer for $3.8 billion of a new February 2050 Treasury Indexed Bond line was conducted in September 2018. In conjunction with the syndication, around $2.1 billion of the August 2020 Treasury Indexed Bond line was repurchased.

Chart 5 shows the amount outstanding in each of the eight Treasury Indexed Bond lines as at 30 June 2019, and the allocation of issuance during the 2018–19 year.

Chart 5: Treasury Indexed Bonds outstanding as at 30 June 2019 and issuance in 2018–19



Efficiency of issuance

Table 2 summarises the results of Treasury Bond tenders conducted during the year. The results are shown as averages for each half-year and grouped by the maturity dates of the bonds offered.

Table 2: Summary of Treasury Bond tender results

Period	Maturity	Face value amount allocated ($m)	Weighted average issue yield (%)	Average spread to secondary market yield (basis points)	Average times covered
July - December 2018	Up to 2026	4,900	2.1670	-0.51	5.44
	2027 - 2031	20,900	2.6644	-0.30	3.39
	2032 - 2047	900	3.0703	-0.15	2.38
January - June 2019	Up to 2026	3,200	1.5485	-0.39	4.45
	2027 - 2031	19,600	1.8815	-0.10	3.25
	2032 - 2047	1,900	2.3736	0.08	2.64

The average coverage ratio for all Treasury Bond tenders in 2018–19 was 3.57, a decrease from 4.44 in 2017–18. The average tender size of $829 million was higher than in 2017-18, reflecting a move to less frequent tenders. Shorter-dated bond tenders generally received a greater volume of bids (higher than average coverage ratios), which reflected both core investor base interest and a lower supply of short-dated bonds.

The strength of bidding at tenders was also reflected in competitive issue yield spreads to secondary market yields. At most Treasury Bond tenders the weighted average issue yields were below prevailing secondary market yields.

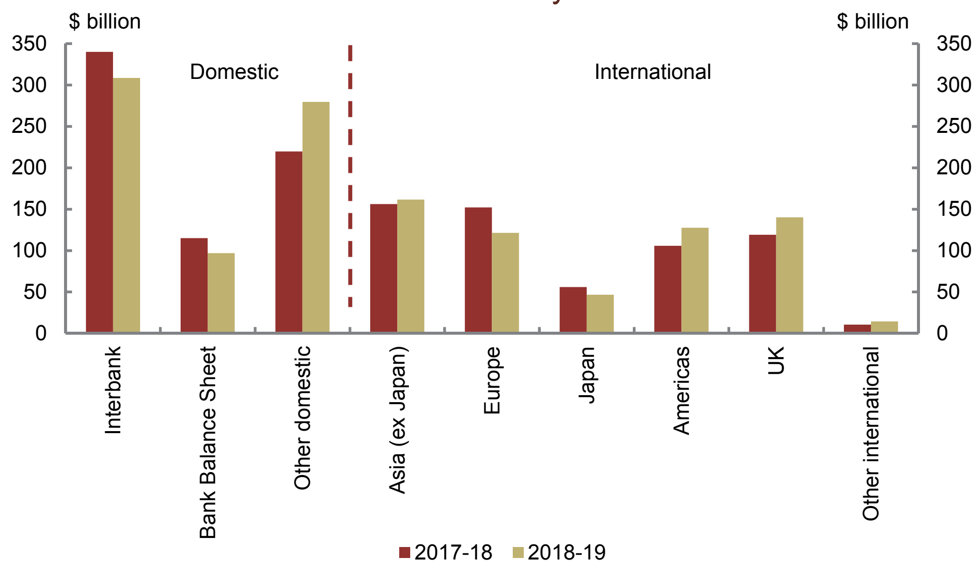
The average coverage ratio was 4.40 for Treasury Indexed Bond tenders, an increase from 3.53 in 2017–18. At most tenders, the weighted average issue yields were below prevailing secondary market yields.

Full tender details are available in Part 5 of this annual report.

Market liquidity and efficiency

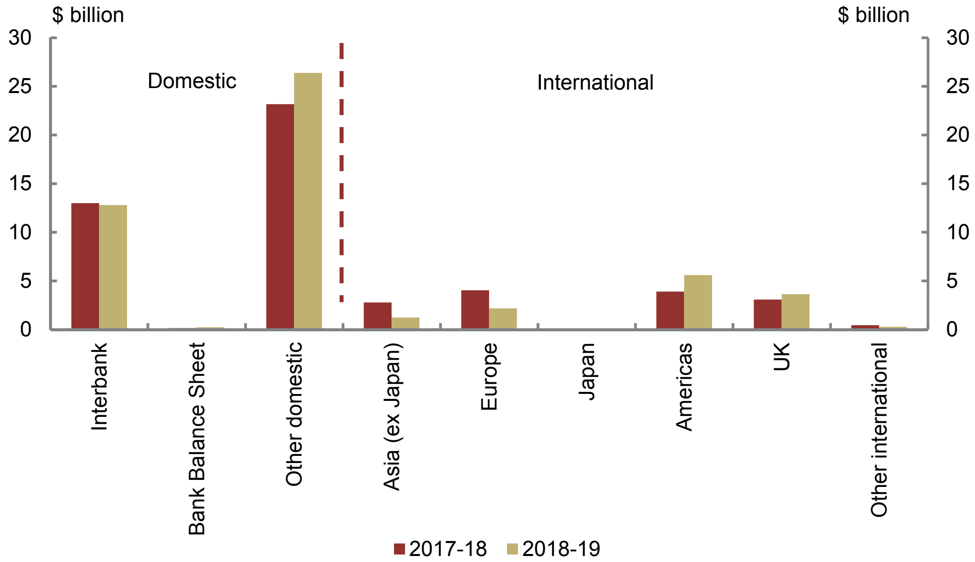
The Treasury Bond market operated smoothly during 2018-19 with liquidity and efficient price discovery being maintained throughout the year. Repo rates during the first half of the year remained high compared to long term averages with continued pressure around quarter ends, raising the costs to some investors and market makers of holding AGS. The elevated rates experienced during 2018 eased somewhat during the second half of the year.

Chart 6: Annual Treasury Bond Turnover



AOFM monitoring of the market indicates that liquidity in Treasury Indexed Bonds has continued to prove noticeably more challenging than for Treasury Bonds. This is consistent with the relative liquidity of nominal and inflation-linked securities in other sovereign debt markets. Treasury Indexed Bond turnover in 2018-19 was around $52 billion, an increase of 3 per cent from 2017-18. This was driven by a decrease of Interbank turnover Australian investors and in Asia (ex Japan). Intermediaries are responsible for the bulk of trades.

Chart 7: Annual Treasury Indexed Bond Turnover



There was tightness in several indexed bond lines at times during the year, requiring some market participants to borrow these from the securities lending facility.

Turnover in the Treasury Bond futures market is significantly higher than in the underlying Treasury Bonds. The three and 10-year Treasury Bond futures contracts are highly liquid: over 60 million three-year contracts (representing $6.0 trillion face value of bonds) and over 52 million 10-year contracts ($5.2 trillion face value of bonds) were traded in 2018–19. Turnover in the 20-year contract is considerably lower: 259,000 contracts ($15.8 billion face value of bonds) were traded. All contract close-outs in 2018–19 occurred smoothly.

The AOFM's securities lending facility allows market participants to borrow Treasury Bonds and Treasury Indexed Bonds for short periods when they are not otherwise available in the secondary market. This enhances the efficiency of the market by improving the capacity of intermediaries to continuously make two-way prices, reduces the risk of settlement failures, and supports market liquidity. The facility was used 21 times for overnight borrowing in 2018–19 compared with 52 times during 2017-18. The volumes borrowed were lower than in 2017–18, with the total face value amount lent in 2018–19 being $393 million, a decrease from $1,667 million in the previous year.

Debt portfolio management

Aims

This section details the outcomes of the AOFM's portfolio management activities. In managing the debt portfolio and meeting the government's financing requirements, the AOFM aims for low and stable debt servicing costs over the medium-long term. It also seeks to maintain liquid bond lines to facilitate cost-effective issuance of debt through time and to effectively manage future funding and refinancing risks.

Approach to achieving the aims

To meet these aims the AOFM endeavours to execute a debt issuance strategy that appropriately accounts for the trade-offs between cost and risk while providing consistent and transparent stewardship of the AGS market in order to underpin confidence and promote market liquidity. Through its operations the AOFM contributes to an efficient and resilient market while seeking to maintain continuity of access to financial markets for the Australian Government.

The AOFM uses cost and risk measures that reflect the considerations faced by sovereign debt managers generally. The primary cost measure used is historic accrual debt service cost. This includes interest payments made on AGS, realised market value gains and losses on repurchases, capital indexation of indexed debt, and the amortisation of any issuance premiums and discounts. Total accrual debt service cost can be expressed as a percentage of the stock of debt outstanding to provide the effective yield of the portfolio. The use of an historic accrual debt service cost measure excludes unrealised market value gains and losses.

An alternative measure of cost is 'fair value', which takes account of unrealised gains and losses resulting from movements in the market value of physical debt and assets. Debt service cost outcomes are presented in the AOFM's financial statements on this basis. 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. Fair value facilitates an assessment of financial risk exposures and changes in those exposures from year to year, the value of transactions managed and the economic consequences of alternative strategies. It is most useful in the context of trading for profit making purposes.

The AOFM calculates and compares several metrics to assess risk. In general, an acceptable level of risk can be characterised as an acceptable level of variation in interest cost outcomes over time. Debt issuance decisions made today impact the variability of future interest cost outcomes because of their influence on the maturity profile of the portfolio and hence the amount of debt that needs to be refinanced (and 're-priced') through time.

Outcomes

Portfolio cost

The debt servicing cost[1] of the net AGS portfolio managed by the AOFM in 2018–19 was $17.42 billion on an average book volume of $527.01 billion, representing a net cost of funds of 3.31 per cent for the financial year. The largest component of net AGS debt is the Long Term Debt Portfolio (LTDP), comprised primarily of Treasury Bonds and Treasury Indexed Bonds, which incurred debt servicing costs of $17.92 billion on an average book volume of $550.16 billion, implying a cost of funds of 3.26 per cent. The difference between net AGS debt and the LTDP is attributable to the short term assets and liabilities the AOFM uses for liquidity management purposes (term deposits and Treasury Notes) and other residual assets (such as state housing advances).

Table 3 provides further details of the cost outcomes for the portfolio of debt and assets administered by the AOFM broken down by instrument and portfolio for 2018-19 as well as 2017–18.

1 Debt servicing cost includes net interest expense (measured on an accruals basis and includes realised gains and losses on the disposal of assets or liabilities) plus foreign exchange revaluation gains and losses (now minimal). Unrealised changes in the market valuation of domestic debt and assets are not part of this measure.

Table 3: Commonwealth debt and assets administered by the AOFM

	Debt servicing cost		Book volume		Effective yield	
	2017-18	2018-19	2017-18	2018-19	2017-18	2018-19
	$ million		$ million		per cent per annum	
Contribution by instrument						
Treasury Bonds	(15,854)	(16,136)	(485,291)	(505,825)	3.27	3.19
Treasury Indexed Bonds	(1,598)	(1,785)	(43,207)	(44,337)	3.70	4.03
Treasury Notes	(67)	(63)	(3,950)	(3,398)	1.70	1.85
Gross physical AGS debt	(17,519)	(17,984)	(532,448)	(553,560)	3.29	3.25
Term deposits with the RBA	650	459	37,095	24,748	1.75	1.85
RMBS investments	37		915		4.04	0.00
State Housing Advances	110	106	1,880	1,801	5.86	5.89
Gross assets	797	565	39,890	26,548	2.00	2.13
Net AGS debt	**(16,722)**	**(17,419)**	**(492,558)**	**(527,011)**	**3.39**	**3.31**
Contribution by portfolio						
Long Term Debt Portfolio	(17,452)	(17,921)	(528,498)	(550,162)	3.30	3.26
Cash Management Portfolio	583	396	33,145	21,350	1.76	1.85
RMBS Portfolio	37		915		4.04	0.00
State Housing Portfolio	110	106	1,880	1,801	5.86	5.89
Total debt and assets	**(16,722)**	**(17,419)**	**(492,558)**	**(527,011)**	**3.39**	**3.31**
Re-measurements (a)	581	(43,550)				
Total after re-measurements	**(16,141)**	**(60,969)**	**(492,558)**	**(527,011)**		

Note: Sub totals and totals are actual sum results, rounded to the nearest million dollars. Effective yields are based on actual results before rounding, rounded to two decimal places. Book volume is a through the year average.
(a) Interest expense and effective yield on foreign loans incorporates foreign exchange revaluation effects.
(b) Re-measurements refer to unrealised gains and losses from changes in the market valuation of financial assets and liabilities.

The cost of gross debt increased in dollar terms by $0.47 billion compared to the previous year. This was primarily due to an increase in the average volume of debt on issue by $21.11 billion to $553.65 billion. However, in percentage terms the funding cost of gross debt declined by 4 basis points to 3.25 per cent. This improvement was driven by the issuance of new bonds at yields that were below the average of pre-existing (and maturing) debt.

The return on gross assets in dollar terms for the period was $565 million, a decrease of $232 million compared to 2017–18. This was driven by a $191 million decrease in income from term deposits (resulting from smaller holdings) as well as a $37 million reduction in income following the completion of the RMBS divestment process in February 2018. However, in percentage terms the return of gross assets increased by 13 basis points to 2.13 per cent.

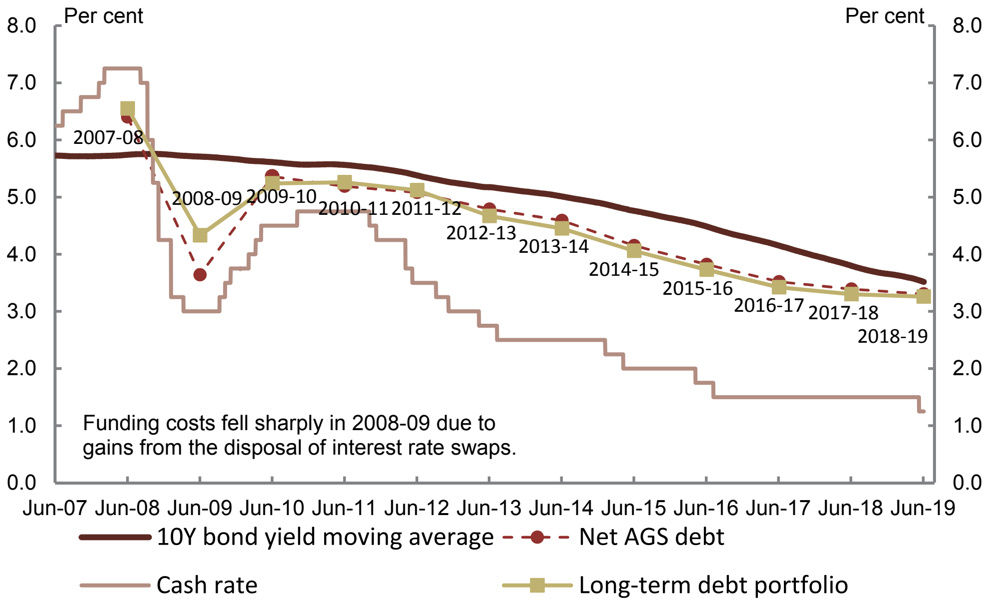
The net servicing cost of the combined portfolio of debt and assets was $17.42 billion. This was higher in dollar terms compared to 2017–18, primarily due to the higher volume of debt on issue. In percentage terms, net debt servicing costs fell from 3.39 per cent to 3.31 per cent, slightly larger than the fall in gross debt servicing costs.

Movements in market interest rates had an unfavourable impact on the market value of the portfolio in 2018–19. Unrealised losses from re-measurements amounted to $43.55 billion. This compares to an unrealised gain of $0.58 billion in the previous year. Most of the re-measurement losses are attributable to changes in the market value of Treasury Bonds. Re-measurement items are highly volatile from one year to the next and have no bearing on the AOFM's debt issuance strategy. Indeed, were the AOFM to adopt a strategy designed to minimise the 'noise' from re-measurements, issuance would be limited to only very short-term debt securities, for example Treasury Notes and near maturity bonds. However, this would create a portfolio structure that would maximise expected variability in debt servicing costs when measured in cash, accrual and public debt interest terms, while also maximising exposure to refinancing and funding risk. In practice the AOFM has been seeking to reduce these risks through allocating a greater proportion of issuance to long dated bond lines.

Portfolio risk management

Chart 8 shows the funding cost profile of the net AGS debt portfolio and the LTDP back to 2007-08. These profiles are contrasted with the cash rate and the 10-year moving average of the 10-year bond yield. With interest rates trending down, funding costs on net debt and the LTDP have declined by 188 and 200 basis points respectively since 2010-11. This compares to declines of 350 basis points in the cash rate and 205 basis points in the 10 year average of the 10-year bond rate over the same period. Given the largely fixed cost structure of net debt and the LTDP, changes in funding cost will always lag changes in the overnight cash rate (changing only when existing debt securities or assets mature or new securities are issued/investments placed).

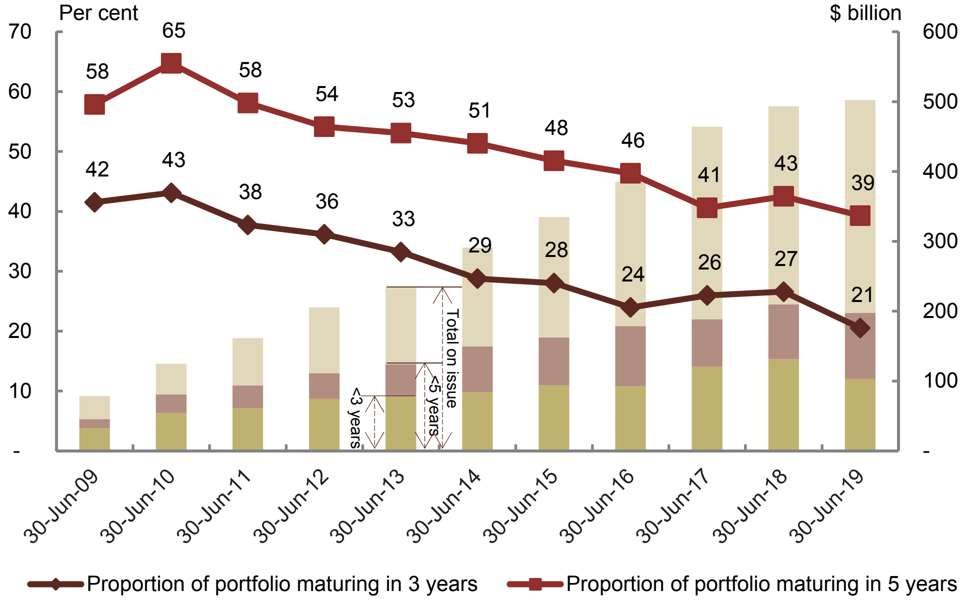
Chart 8: Net AGS debt and LTDP cost of funds analysis (per cent)



The reduced risk levels of the portfolio in terms of funding, refinancing and interest rate risk are demonstrated in Chart 9 below. The chart shows a steady decline in the short to medium term Treasury Bond refinancing task, measured as the proportion of the stock of Treasury Bonds on issue through time[2]. At 30 June 2010 the structure of the portfolio was such that 43 per cent and 65 per cent of bonds required refinancing over the next three and five year periods respectively; these have continued to decline and have now fallen to 21 per cent and 39 per cent.

2 In absolute dollar terms, the quantum of three and five year maturities in the portfolio has still grown although this has occurred at a considerably slower pace compared to growth in the overall stock of Treasury Bonds.

Chart 9: Treasury Bond portfolio — maturity profile



Cash management

Aims

The AOFM manages the daily cash balances of the Australian Government in the OPA.[3] This is undertaken in a manner that ensures the government is able to meet its financial obligations as and when they fall due. Other objectives are to minimise the cost of funding and the carrying cost of holding cash balances (which centres on holding only balances assessed as prudent to cover forecast needs and contingencies, while investing excess balances at low or minimal risk). In minimising cost, the AOFM seeks to avoid use of the overdraft facility provided by the RBA.[4]

3 The OPA is the collective term for the core bank accounts maintained at the RBA for Australian Government cash balance management.

4 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.

Approach to achieving the aims

Achieving the cash management objective involves formulating forecasts of government cash flows, and developing and implementing appropriate strategies for short-term investments and debt issuance.

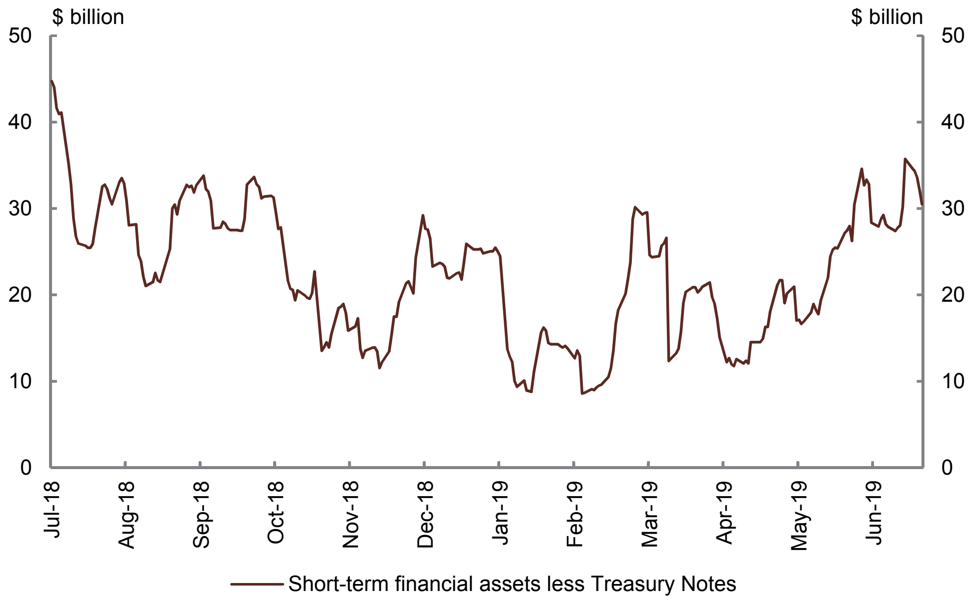
A precautionary asset balance is maintained to manage the forecasting risk associated with potentially large unexpected cash requirements (or shortfalls in revenue collections) and the funding risk associated with market constraints.

Cash balances not required immediately were invested in term deposits at the RBA, with the magnitudes and tenors of the term deposits determined by the AOFM. Maturity dates of term deposits were selected to most efficiently finance net outflows. Interest rates for term deposits at the RBA reflect the rates earned by the RBA in its open market operations.

Treasury Notes are issued to assist with management of the within-year funding requirement. The volume of Treasury Notes on issue ranged from \$2.5 billion to \$5.0 billion during 2018–19.

The size and volatility of the within-year funding requirement are reflected in changes in the short-term financial asset holdings managed by the AOFM, after deducting Treasury Notes on issue. Chart 10 shows movement in the funding requirement over the year.

Chart 10: Within-year funding requirement 2018–19



Outcomes

The task of meeting the government's financial obligations as and when they fall due was fully met. The overdraft facility was not utilised in 2018–19.

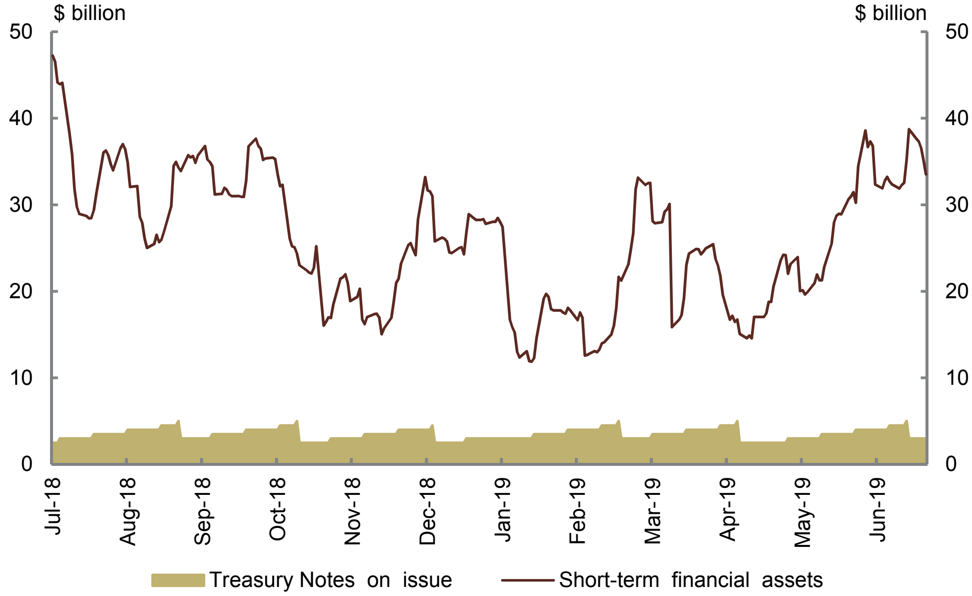
During 2018–19, the AOFM placed 390 term deposits with the RBA. The stock of term deposits fluctuated according to a range of factors influencing the AOFM's cash portfolio management needs. The balance of term deposits ranged from a maximum of $46.0 billion in July 2018 to a minimum of $11.3 billion in January 2019.

The average yield obtained on term deposits during 2018–19 was 1.85 per cent, compared with 1.75 per cent in 2017–18. The increase in average yield reflects the higher average level of short-dated interest rates that prevailed during 2018–19.

A total of $13.5 billion of Treasury Notes were issued in 2018–19 (in face value terms). The average coverage ratio at tenders was 4.61, an increase from 4.07 in 2017–18. Yields were on average around 35 basis points higher than Overnight Indexed Swap (OIS) rates for corresponding tenors (compared to around 25 basis points higher than OIS rates in 2017–18), reflecting higher spreads across Australian short-dated funding rates. Details are available in Part 5 of this report.

The movement in total short-term financial asset holdings managed by the AOFM (OPA cash balance plus term deposits with the RBA), together with the volume of Treasury Notes on issue during 2018–19 are shown in Chart 11.

Chart 11: Short-term financial asset holdings and Treasury Notes on issue 2018–19



In undertaking its cash management activities, the AOFM was required to adhere to a set of cash management principles which required that balances in the OPA be sufficient to meet the Commonwealth's operational needs without being excessive, with use of the overdraft facility expected to be infrequent and in general only to cover unexpected events (due to timing or quantum or both). The AOFM has developed an operational framework to adhere to the principles. The average OPA balance for the year was $1.240 billion.

Market engagement

Aims

Consistent and regular market engagement assists the AOFM to maintain a comprehensive understanding of market related issues including major announcements and events, impacts on the global flow of capital, changing investor preferences, and the performance of banks that play the role of intermediaries — particularly in the AGS market. While this latter aim can in part be served by assessing announced regulatory changes, there remains the need for ongoing direct engagement with market participants. The AOFM also understands the importance of regular engagement with investors to ensure that they understand the key considerations underpinning the AOFM's issuance and market maintenance/development strategies and appreciable changes in operation should these arise from time to time.

Market engagement by the AOFM continues to place a heavy emphasis on maintaining lines of communication with investors and bank intermediaries. This is done directly with both, and indirectly, with investors through feedback from the banks. Ongoing engagement assists greatly in understanding how investors view financial markets generally and in turn their view on the outlook for AGS and how intermediaries interact with and service the end investor.

Approach to achieving the Aims

Market engagement is based on an investor relations program underpinned by an investor relations strategy that is reviewed annually. This review takes account of changes in market conditions, investor activity, known changes in the key investor base, and the AOFM's planned issuance strategy.

The Investor Relations strategy has three themes:

- collecting and analysing market intelligence from investors;
- managing and maintaining updates to key investors about the AOFM's program of activities and its intended operations; and

- a deepening of the investor base through engagement with new or potentially new investors.

Diversification of the AGS investor base is expected to change with appreciable shifts in financial market conditions. Given the complexity of influences on the attractiveness of AGS relative to alternative investment options it is difficult to predict with a high degree of confidence full detail of the AGS investor composition at any point in time. However, the AOFM is highly active in looking to understand changes as they occur. It does this through high frequency and comprehensive communication with market participants. In this regard the major focus of investor engagement continues to be, engaging with our key investors and collecting and analysing the information on their portfolio activities as we receive it from them.

Outcomes

For the last two years the AOFM's market engagement has been heavily guided by the shift in its operations away from active market development through yield curve extensions and the introduction of a high number of new Treasury Bond and Treasury Indexed Bond maturities, to more of a market maintenance role. There were effectively two key drivers for this change; one was achieving the market and portfolio objectives of establishing 30-year benchmark yield curves for both the nominal and indexed yield curves (with no strong incentive to extend beyond 30-years), and the ongoing reduction in the budget deficit with consequent smaller funding tasks. Together these factors have made the AOFM's discussion with market participants appreciably more straightforward and this has allowed for an easier task of updating investors via teleconference and videoconferencing as substitutes for the regular face-to-face engagement that had previously been more appropriate. Due to the April Budget followed by the federal election, direct engagement over the months of March through to June was not conducted.

For the year overall, discussions were held with 95 investors directly (compared with 128 in 2017–18). This comprised of 65 face to face meetings and 30 video/teleconferencing calls. Although direct investor meetings were down from the year before, the AOFM was still able to cover a larger number of geographically diverse key AGS investors from differing sectors of the market. Key investors engaged via teleconference and videoconference were from 19 cities outside of Australia.

The AOFM intends to continue these methods where appropriate as a supplement to direct face-to-face meetings. However for some areas or regions the AOFM did not feel that conference calls were an appropriate method to use due to the lack of familiarity with certain investors and other practical considerations.

Face-to-face meetings with investors were held with the domestic investor base; around 30 meetings with large fund managers, bank balance sheets and superannuation funds.

Domestic investors continue to hold around 40 per cent of total AGS outstanding. There was one overseas series of meetings conducted in London, Paris and Madrid.

To also supplement communication with investors, the AOFM launched a quarterly investor note (Investor Insights) on the 1st of June this year via the AOFM website. 'Investor Insights' will provide AOFM views and background thinking on a range of AGS related matters.

The AOFM continued its past practice of using appropriate opportunities offered through conferences and speaking events. These events offer AOFM the opportunity to engage briefly but directly with investors and to reiterate key messages and themes, regarding AGS issuance and its market impacts. Each year the Australian Business Economists hosts a post-Budget speech by the CEO. It remains an important platform to provide information to the market for the upcoming year by giving the market some detail around the AOFM's intentions for forthcoming issuance and operations; (June) 2019 was the ninth consecutive year for this event.

The conference and investor missions hosted by the financial intermediaries in which the AOFM participated included a CBA Fixed Income Conference, ANZ Hunter Valley Debt Conference, the Deutsche Bank Investor Mission and an ANZ Investor Tour. The AOFM also spoke at the annual KangaNews roundtable and again participated in its annual year book publication. While these events do not substitute for the benefits derived from face-to-face meetings, they remain useful in their own right and typically offer opportunity for short face-to-face meetings with selected attendees.

The current approach to maintaining investor engagement is considered appropriate during lower and stable issuance programs and with the current operational approach to achieving these programs having been comprehensively explained to and understood by AGS investors. In the event that the AOFM foreshadowed a significant change in issuance or the nature of its approach to the market, a return to more intensive and widespread face-to-face investor engagement would be considered as appropriate.

Table 4: Summary of investor relations activities in 2018-19

Activity	**Details**
Conferences, speaking engagements and investor roadshows	9 events
Presentations: large engagements/ roundtables	5 presentations
Approximate total audience size: large presentations	220 attendees
Individual investor meetings Individual investor Tele/ Video Calls	65 investor meetings 30
Individual cities visited	7 cities
AOFM staff participating in investor relation activities	CEO, Head of Investor Relations, Head Portfolio Strategy & Research, Head Funding & Liquidity. Head of Market Intelligence, Senior Analyst, Investor Relations, Analyst Funding and Liquidity
Hosting banks: Investor roadshows, conferences, roundtable discussions	ANZ, Citi Commonwealth Bank of Australia, Deutsche Bank UBS, Westpac

Section 3: Portfolio and Operational Strategy

Debt Portfolio Management

Aims

The AOFM is a price-taker in global capital markets but influences the cost and risk profile of the AGS portfolio through the maturity structure of the securities it issues (and to a lesser extent, the mix between nominal and inflation-linked securities). Issuing longer-term securities will typically involve paying higher debt service costs (in the presence of a positive term premium)[5] although this is compensated by reduced variability in future interest cost outcomes and lower exposure to refinancing risk.[6] Issuing shorter term debt securities by contrast will typically incur less interest cost (avoiding a term premium), but result in higher variability in cost outcomes through time and a greater debt refinancing task. Striking the right balance between these cost and risk considerations is the debt manager's ongoing challenge.

Developing a medium to long-term view on appropriate portfolio management and then translating that into annual decision making on a strategy to implement that portfolio management objective is informed by an ongoing research program. This program is focussed on exploring the cost and risk characteristics of alternative portfolio structures and issuance strategies under a wide range of scenarios. This is done in light of prevailing fiscal and economic conditions, as well as an assessment of broader market trends. Drawing on this research, the AOFM formulated a strategy for the structure and composition of issuance for 2018-19 that was approved by the Treasurer at the time of the Budget. Separately, a range of complementary limits, thresholds, guidelines and targets governing the AOFM's operations were submitted to the Secretary to the Treasury for approval through an Annual Remit. These governance arrangements provide appropriate oversight for the impact of AOFM's gross issuance decisions each year on overall debt policy.

Implementing the annual issuance strategy involves weekly decisions such as determining how much and which lines to issue, or when a new maturity should be established. These operational decisions are influenced by several factors including prevailing market conditions, relative value considerations and feedback from intermediaries and investors. The ongoing suitability of the annual debt issuance and portfolio strategies is under constant review, but the strategies would only be changed

5 The term premium is the additional yield demanded by investors in order to hold a long-term bond instead of a series of shorter-term bonds.

6 Refinancing risk, also referred to as rollover risk or re-pricing risk, is the risk that renewed borrowings to replace maturing debt occurs on unfavourable terms (or perhaps not at all).

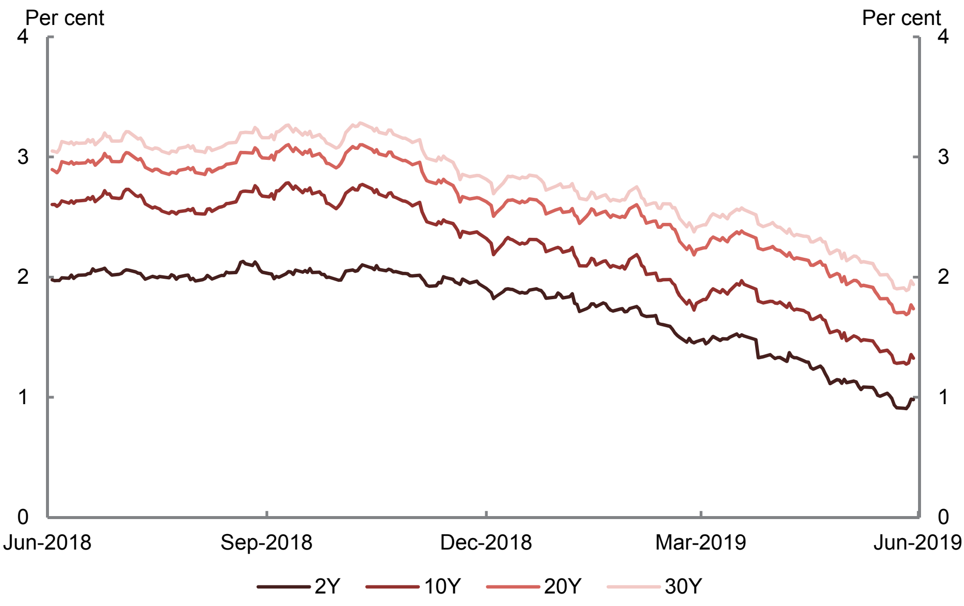
during the year in the face of substantive changes to market conditions or the fiscal outlook.

Debt Issuance Strategy

The AOFM's strategy for 2018-19 was formulated amid a strengthening global economic environment, and was in large part influenced by a continuation of low outright bond yields (from a historical perspective), and a low term premium (which increases the cost-effectiveness of longer term issuance).

In the first half of 2018-19 the synchronised strengthening of global economic data continued and expectations of higher policy rates tended to result in higher government bond yields. However, there was an abrupt change in the outlook in mid-2018-19 as expectations for global growth and monetary policy were revised to reflect a weakening outlook, leading to a significant rally in government bond yields (Chart 12).

Chart 12: Evolution of Treasury Bond benchmark yields



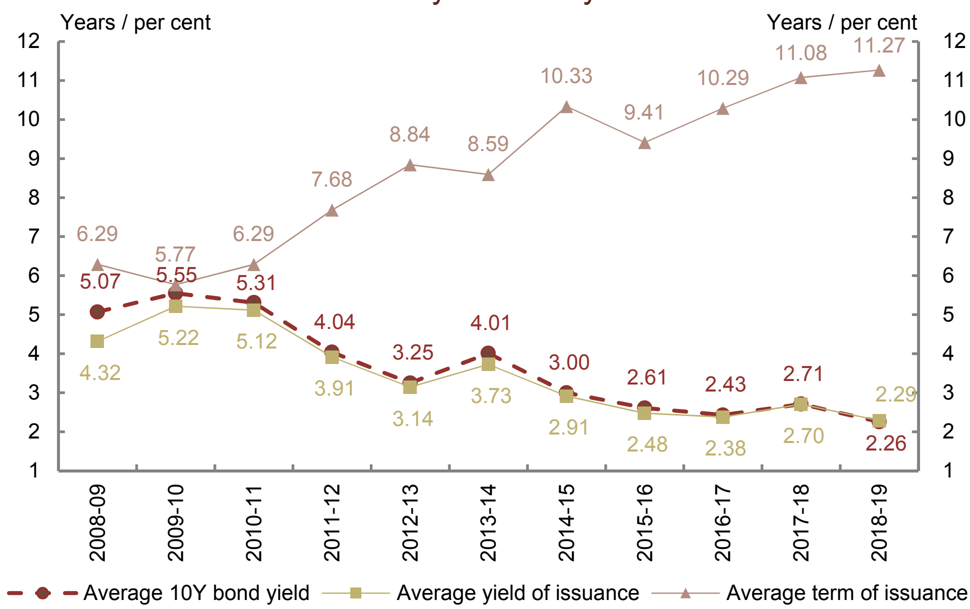
The yield curve flattened through the first half of 2018-19 before re-steepening in the second half of the year. Most of this change in longer bond yields reflected changes in other markets more than appreciable changes in the demand for AGS. Short-term AGS yields decreased in 2018-19 reflecting market expectations for a lower RBA monetary policy rate. The cash rate was subsequently lowered in June 2019 to 1.25 per cent to a new historic low. The 10-year and 30-year benchmark yield ended the financial year at 1.32 and 1.94 per cent respectively (also near historic lows).

In light of prevailing market conditions and funding requirements, the AOFM's strategy in 2018–19 followed a broadly similar theme to recent years, with a bias toward longer term issuance and further lengthening of the average term to maturity of the debt portfolio. Low outright rates and a very low (or zero) term premium reinforced this strategy from a cost effectiveness perspective. At its core, the 2018–19 portfolio strategy was designed to preserve the AOFM's operational flexibility under a wide variety of circumstances, while continuing to benefit from the relatively low interest rates on offer. The strategy was complemented by a regular program of bond buyback tenders. The strategy also aimed to support diversity in the AGS investor base.

Debt Portfolio and Issuance Metrics

Chart 13 demonstrates the lengthening bias implicit in the AOFM's issuance strategy with the average Treasury Bond issued in 2018–19 having a term to maturity of 11.27 years[7]. The issuance program continued to benefit from low interest rates, with an average yield on new issuance of 2.29 per cent. [8]

Chart 13: Treasury Bond issuance — average yield, term to maturity and 10-year bond yield

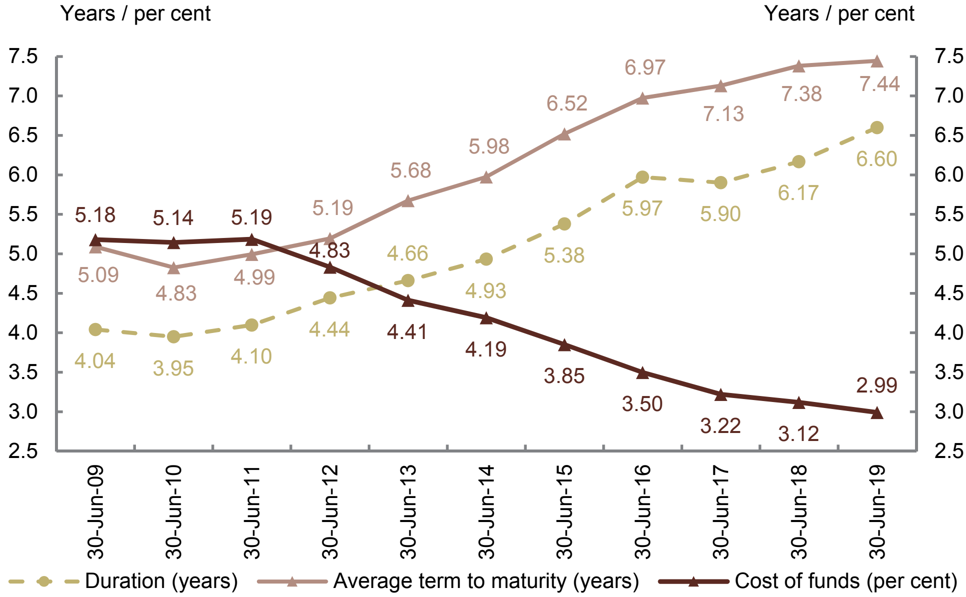


7 Calculation is based on the term to maturity of each bond issued during the year, weighted by book value.

8 Calculation is based on issue yields during the year weighted by book value.

Chart 14 shows that the average term to maturity of the Treasury Bond portfolio as a whole lengthened by 0.06 years to 7.44 years over 2018-2019. Duration was also higher by 0.43 years finishing the year at 6.60 years. The effective cost of funds (or yield) on the Treasury Bond portfolio fell from 3.12 to 2.99 over the same period.[9]

Chart 14: Treasury Bond portfolio — modified duration, average term to maturity and cost of funds



9 These are point in time measures as at 30 June each year, in contrast to the debt servicing cost incurred throughout the year captured in Table 3. Figures are calculated by weighting Treasury Bond issuance yields by book volume.

The structure and effective yield on the Treasury Bond portfolio as at 30 June 2019 is a product of issuance undertaken since the 2007-08 fiscal year. Around two thirds of the current portfolio for instance was issued in the last four financial years at average yields below the portfolio average of 2.99 percent as depicted in Chart 15.

Chart 15: Treasury Bond portfolio — composition and average yield by issuance year, as at 30 June 2019

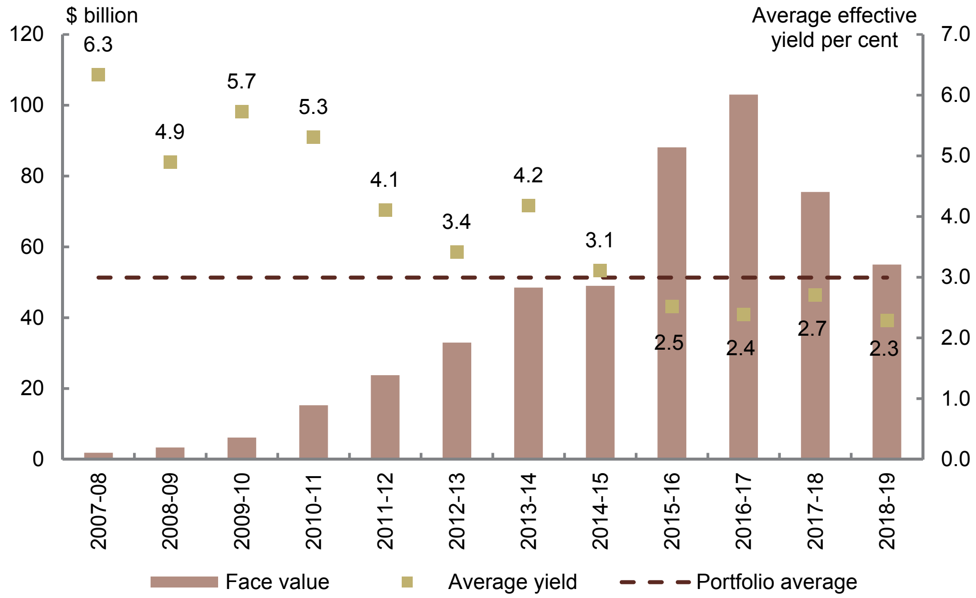
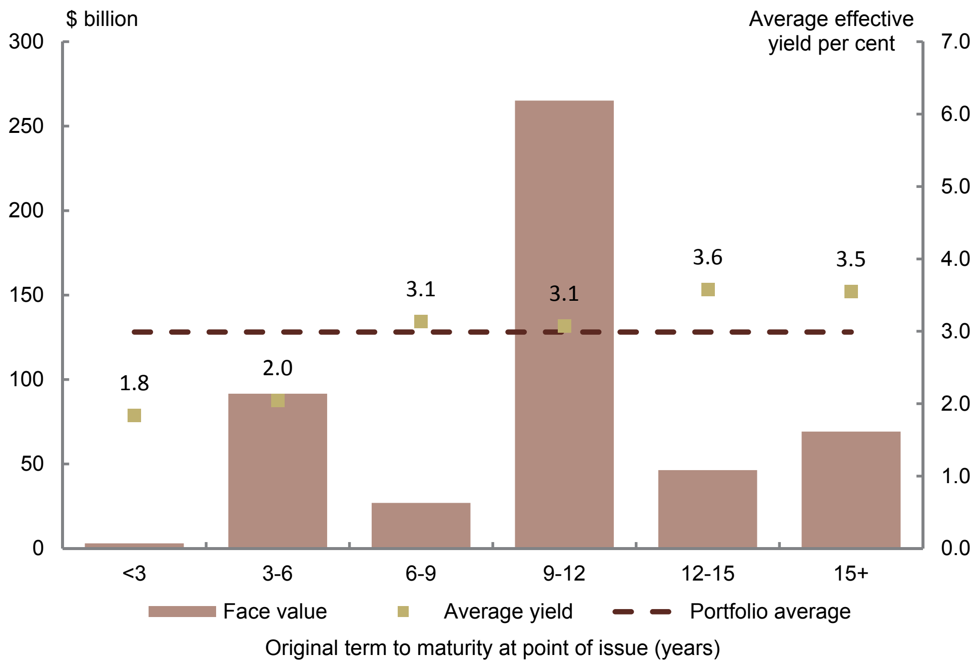


Chart 16 shows that more than half of current Treasury Bonds were issued with an original term to maturity of between 9 and 12 years. When issuance beyond 12 years is included, around three quarters of the portfolio has been issued with an original term to maturity of 9 years or longer. The predominance of longer term bonds in the portfolio is reflective of the AOFM lengthening bias since the start of the decade. This has contributed considerably to aim of reducing funding risk and the potential for high volatility in future interest rate outcomes.

Chart 16: Treasury Bond portfolio — composition and average yield by original term to maturity, as at 30 June 2019



The AOFM's strategy for the indexed bond proportion of the portfolio has been to provide sufficient supply to meet investor requirements while supporting liquidity and the continuing development of the market over time. Over 2018-19, Treasury Indexed Bonds comprised on average around 8 per cent of total term debt (nominal and indexed bonds) on issue. This share has been stable for several years now although the overall size of the market has continued to grow in dollar terms. Issuance of Treasury Indexed Bonds in 2018-19 was $5.9 billion gross and $0.5 billion in net terms after buybacks and maturities. The real yield curve was extended to 30 years through the successful launch of the 2050 line in September 2018.

In 2018–19, the AOFM continued to favour a relatively defensive liquidity strategy by maintaining an asset buffer (in the form of term deposits with the RBA) to act as a precaution against a possible deterioration in funding conditions. The AOFM anticipated that it would have sufficient cash and liquid assets available, each business day of the fiscal year, to fund the next four or more weeks of projected net government outlays and AGS maturities.

PART 3: MANAGEMENT AND ACCOUNTABILITY

MANAGEMENT AND ACCOUNTABILITY

Governance of the AOFM

The AOFM's governance arrangements facilitate an efficient and effective delivery of business objectives. Key elements of the governance arrangements include:

- corporate and tactical business planning processes;
- enterprise-wide risk management, assurance and compliance activities with oversight by an independently chaired Audit Committee;
- performance frameworks for on-going monitoring and review; and
- delegations, instructions and internal guidance regarding powers and duties to ensure adherence with relevant legislation, regulations, and policies.

Overview of accountabilities

The AOFM is part of the Treasury portfolio. It is accountable to the Secretary to the Treasury and to the Treasurer. As a listed entity under the PGPA Act the AOFM's CEO is accountable for the management and performance of the AOFM, namely with respect to the implementation of debt management and investment policies. This also extends to matters such as the maintenance of accounts and records, the management of risks, and compliance with legislation and government policy.

The Secretary to the Treasury is responsible for advising the Treasurer on government policy relating to debt management and investment. For the purposes of operational efficiency the AOFM CEO is delegated powers and authorisations by the Treasurer and the Secretary to the Treasury for debt creation and issuance, investment, and portfolio management.

The AOFM's corporate plan, policies, and codes of conduct reflect AOFM values and the high standards of integrity and accountability expected of staff. Activities are designed to meet the requirements of legislative and regulatory frameworks, as well as the codes and practices generally expected of financial market participants.

The AOFM meets an important part of its accountability to the Secretary of the Treasury through the (pre-Budget) provision of a comprehensive debt portfolio management strategy that focuses on the outlook for issuance (in the context of the financing task), appropriate AGS market development aspirations (such as yield curve extensions), planned cash portfolio management parameters, and planned bond buybacks. This strategy is reviewed annually and then formalised after the release of the Budget through an annual remit, with the Treasurer approving the scope of planned borrowing on behalf of the government for the Budget year ahead.

Committees

Executive Group

The AOFM Executive Group (comprising the CEO and business unit heads) leads the agency in accordance with its purpose and objectives. The Executive Group assists and supports the CEO in fulfilling his responsibilities to manage the AOFM (in particular, as the accountable authority under the PGPA Act, and pursuant to other Commonwealth legislation). The Group's activities include: setting and tracking strategic plans and performance targets, reviewing the AOFM's risk profile and setting risk appetite, monitoring financial and compliance performance, and building the capability and capacity to support high levels of performance.

Audit Committee

The Audit Committee monitors and reviews the AOFM's governance, enterprise risk management, internal control, and financial and performance reporting arrangements. It receives periodic internal briefings on changes to the business and risk profiles, oversees the AOFM's assurance program, and receives reports, indicator dashboards and briefings from AOFM business units and internal auditors. This information, together with relevant observations from the external auditor, assists the Audit Committee to form a view on the appropriateness of the AOFM's financial and performance reporting, compliance with its obligations, and the on-going effectiveness of AOFM risk and control frameworks.

Key activities of the Committee during 2018–19 included:

- advice on the preparation and review of the AOFM's financial statements;
- considering developments in the AOFM's risk profile and compliance performance, as reported through quarterly risk and assurance (including audit) reports;
- reviewing the adequacy of fraud control strategies and monitoring activities;
- monitoring the progress of: major corporate projects, initiatives to achieve the AOFM's workforce planning outcomes, and the implementation of audit recommendations; and
- reviewing AOFM reporting on performance obligations in line with the PGPA Act requirement, and monitoring AOFM key performance indicators and how these will be incorporated into its Annual Performance Statement.

The Committee met four times during 2018–19 at the AOFM's office in Canberra. Member attendance at 2018–19 meetings is provided in Table 5. The Audit Committee also conducted closed sessions with the internal auditors and external auditors during the year.

Table 5: Audit Committee meetings for 2018–19

Audit Committee members	Eligible meetings	Attendance
Will Laurie, Independent Member, Chair	4	4
Stephen Knight, Independent Member	4	4
Jan Harris, Independent Member	4	4
Samantha Montenegro, Chief Risk and Compliance Officer, AOFM (a)	2	1
Erin Martin, A/g Chief Risk and Compliance Officer, AOFM (b)	2	1

(a) Ms Samantha Montenegro commenced a secondment from 7 March 2019 and was replaced as a committee member by Ms Erin Martin.
(b) Ms Erin Martin's first eligible meeting was on 14 March 2019.

External observers at Audit Committee meetings included the ANAO and its outsourced provider (KPMG), and the AOFM's internal auditor (PricewaterhouseCoopers). The AOFM CEO regularly attends meetings as an observer.

Other management committees

Cash Management Meeting

The Cash Management Meeting is held each week to review the government's cash portfolio position and short to medium term cash flow projections, including expected funding needs and emerging risks to the cash portfolio profile. Prevailing financial market conditions are also discussed during periods of high volatility or recent abrupt change. In periods of high issuance programs the forward projected call on financial markets through debt issuance may also be a factor of close interest. The meeting is chaired by the CEO, and attended by the Head of Funding and Liquidity and other front office staff.

Security Committee

The Security Committee meets periodically and oversights security management within the AOFM. Its membership comprises the CEO (as Chair), Chief Risk and Compliance Officer, Agency Security Advisor, and IT Security Advisor. The head of the Department of the Treasury Security Team is also invited to attend ex officio to assist in security harmonisation.

Portfolio Strategy Meeting

Portfolio Strategy Meetings (PSM) advise the CEO on operational debt portfolio and financial risk management issues, evaluate financial market conditions, review deal execution and consider other matters of related interest via presentations or research papers. Membership during 2018–19 included the CEO, Head of Portfolio Strategy and Research, Head of Global Markets and Business Strategy, Head of Funding and Liquidity and Head of Investor Relations, with other senior staff holding relevant functional responsibilities invited as contributors and observers. Meetings are generally convened on a quarterly basis.

Management of fraud risk

The AOFM has a **minimal** appetite for fraud, and has taken comprehensive steps to prevent the occurrence of fraud. These include the application of a fraud control plan and processes and systems to ensure the regular identification, assessment and treatment of fraud risk vulnerabilities. Mandatory annual fraud awareness training is provided to all staff and is also provided when on boarding new staff. The AOFM's approach to fraud risk management complies with the PGPA Act and Rule and the Commonwealth Fraud Control Framework.

The AOFM reports fraud information annually to the responsible minister and the Australian Institute of Criminology. For 2018–19 the AOFM did not identify any instances of fraud or suspected fraud.

Enterprise risk

Risk management is integral to the AOFM's activities and is viewed internally as the responsibility of all staff. The Executive Group, in a leadership capacity, fosters a strong risk aware culture and supports staff in making appropriate risk-informed decisions. The risk and assurance functions guide staff on the design, implementation and effective operation of appropriate risk treatments and controls.

The enterprise risk management framework provides for the active and transparent management of uncertainty (threats and opportunities). Key reflection points are provided quarterly (at Executive Group meetings), and these are an established feature of annual corporate planning activities. Risk assessments are used as key inputs to strategy development and decisions on operational activities. The enterprise risk management framework captures information that is used to identify emerging matters of note and key risks to be managed and monitored. This approach is used at both enterprise ('top-down', outward focussed) and business unit ('bottom-up', inward focussed) levels. Staff understand that risks are to be managed in line with the AOFM's risk appetite and tolerance statements.

The AOFM's enterprise risk management framework is consistent with the Commonwealth Risk Management Policy. For the 2018 calendar year, the framework was assessed at an 'advanced' rating of maturity under the Comcover Benchmarking Program; this is consistent with the AOFM's target level of maturity.

The AOFM's enterprise risks are classified into three broad categories:

- Strategic risks — opportunities and exposures that impact the AOFM's medium to long term objectives. These are monitored and reviewed by the Executive Group on a semi-annual basis, with a comprehensive review of the context in which the AOFM operates undertaken as part of the annual corporate planning process;
- Portfolio risks — impact on portfolio management, investment and debt issuance activities. These risks are managed pursuant to the AOFM's financial risk management framework and reviewed at least on a quarterly basis; and
- Operational risks — relate to business processes and corporate activities of the AOFM. They generally deal with matters of compliance, the availability, integrity and/or actions of staff, providers, systems, and internal processes. These risks are reviewed at least quarterly.

The AOFM's most significant risks typically arise from uncertainty relating to external factors (most notably the potential for sudden changes in economic or financial market conditions), or major changes to business activities. Key entity risks under management include the:

- potential negative impact of market trends or disruptive technologies on the successful issuance of AGS necessary to meet funding requirements;
- ongoing management of actions and messaging by the AOFM to maintain AGS investor confidence, as well as a positive view of the AGS market; and
- potential disruptions to third party suppliers or failure of internal systems and controls, which may negatively impact the AOFM's ability to deliver outcomes in accordance with its objectives.

Business continuity arrangements

The AOFM has a comprehensive business continuity plan to ensure that its critical functions can continue in the event of a major disruption. These arrangements include multiple levels of redundancy that can be employed when the AOFM's day-to-day business systems or office accommodation are not accessible, or when AOFM staff are not available to perform key tasks. The most time critical functions covered by the plan are tenders, settlements and AGS payment obligations (coupon payments and maturity redemptions).

Business continuity plans were updated and tested in 2018–19 to ensure staff familiarity with processes and procedures in the event of a business disruption. Business continuity arrangements are supplemented by a crisis management framework to enhance business resiliency.

Assurance

The AOFM’s enterprise risk framework is complemented by an assurance framework that is used to monitor the operation and effectiveness of key controls. The framework is designed to meet the needs of the AOFM and is modelled on better practice industry standards.

The AOFM’s compliance with external obligations, internal controls, and its business procedures is monitored through a co-sourced arrangement, with in-house assurance and compliance activities supplemented by the use of independent internal audit services.

In 2018-19, assurance and compliance activities provided structured assurance on the effectiveness and efficiency of the AOFM’s governance arrangements, risk management, and internal control environment. Key activities undertaken in 2018-19 included:

- completion of the annual assurance testing program on key controls and compliance with key legislative and policy requirements;
- maintenance and performance of the AOFM’s approach to obligations under the *Anti-Money Laundering and Counter Terrorism Financing Act 2006*; and
- completion of an annual fraud control testing program.

Information and output derived from the enterprise risk and assurance frameworks support the CEO in meeting the obligation to maintain a system of risk management and internal control pursuant to section 16 of the PGPA Act.

Internal audit

The AOFM’s internal audit service provider is PricewaterhouseCoopers. Internal audit coverage is determined using a methodology aligned with professional internal audit standards, with due regard to the AOFM’s business and risk contexts. The Audit Committee endorses the internal audit strategy, for CEO approval.

The internal auditor completed five reviews in 2018–19:

- a health check review to assess the compliance of the AOFM’s Privacy Framework against relevant legislative requirements;

- an in-flight health check review of the AOFM's draft Workforce Plan to ensure planned activities reflected priorities of the AOFM and that it included ongoing monitoring and evaluation activities;
- a review of the AOFM's Assurance Framework;
- project assurance for the AOFM's website redevelopments [final report issued after 30 June 2019]; and
- a review of the AOFM's risk culture to assess maturity and changes relative to benchmark results established from the risk culture survey completed in 2016-17 [final report issued after 30 June 3019].

The internal auditor also completed a management initiated review to assess the design and integrity of the AOFM's Syndication Allocation spreadsheet tools.

In its annual report on internal controls, the internal auditor concluded that AOFM continues to have a mature control environment (demonstrated by the nature and type of findings reported). Audit recommendations were aimed at enhancing the efficiency of the current control environment or clarifying current settings. At 30 June 2019, four internal audit recommendations remained outstanding (out of 32 for the year) and are being addressed in accordance with agreed timelines.

Judicial decisions

In 2018–19, no matters relating to the AOFM were the subject of judicial proceedings, administrative tribunal hearings or consideration by the Commonwealth Ombudsman.

External reports on agency operations

There were no reports in 2018–19 on the operations of the AOFM by the Auditor-General (other than the report on financial statements), a Parliamentary committee, or the Commonwealth Ombudsman.

Management of human resources

Workforce planning

The AOFM Workforce Plan 2019-23 was finalised during the reporting period. The Plan is a context fit-for-purpose management tool (used mostly by the Executive Group) and aims to maintain organisational resilience and promote the development of staff.

The external labour environment has remained largely beneficial to AOFM operations during the period of the previous workforce plan. Reduced headcount in the financial sector has widened the pool of relevantly skilled people available for recruitment at the experienced and graduate level. AOFM investment in staff through development experiences including secondments and third party provider training has further increased the value of our human capital.

The Workforce Plan 2019-23 identifies five emerging issues and establishes actions to position AOFM to meet the challenges if they arise. The emerging issues the AOFM may need to address in the coming five years are:

1) responding quickly and seamlessly to any additional mandate, including the Australian Business Securitisation Fund (the ABSF);

2) adapting business processes to meet with developments in IT and changing regulatory standards;

3) maintaining investor confidence in the AOFM, specifically and the AGS market more broadly through AOFM's custodial role;

4) building on AOFM's ability (and comparative advantage) to provide technical advice within government on a range of matters related to market dynamics, debt pricing, and balance sheet risk; and

5) extending the capability of the agency to reinforce a 'high-performing' culture.

The Plan establishes a range of actions to position the AOFM workforce to meet these challenges over the life of the Plan.

Enterprise Agreement

The *AOFM Enterprise Agreement 2015–2018* was approved by the Fair Work Commission and came into effect on 17 July 2015; and it continues to apply. The CEO has authorised adjustments to AOFM pay rates via two determinations under subsection 24(1) of the *Public Service Act 1999;* one in November 2015 and the other in July 2018.

Training and development

In 2018–19, all staff participated in some form of training. This included presentation skills workshops, compliance training, leadership programmes, and financial markets related courses. The AOFM also supported further individual professional development activities and an internal seminar series. Payments to external providers for training and development during the period averaged $4,373 per full-time equivalent employee (FTE).

Eighty-eight per cent of AOFM staff have degree qualifications, with 25 per cent holding higher degrees and 28 per cent holding double degrees. Thirty-eight per cent have professional qualifications related to the technical aspects of their role with the AOFM.

The AOFM workforce

As at 30 June 2019, AOFM employed 37.3 FTE. Table 6 shows the paid head count of the workforce by broadband classification as at the beginning and end of 2018–19.

Table 6: Operative and paid inoperative staff as at 30 June 2019 and 2018

	Ongoing				Non-ongoing				
	Full-time		Part-time		Full-time		Part-time		
Classification	**Male**	**Female**	**Male**	**Female**	**Male**	**Female**	**Male**	**Female**	**Total**
2019									
AOFM1	-	1	-	1	-	-	-	-	**2**
AOFM2	17	6	1	4	-	-	-	1	**29**
AOFM3	5	2	-	-	-	-	-	-	**7**
AOFM4	1	-	-	-	-	-	-	-	**1**
CEO	1	-	-	-	-	-	-	-	**1**
Total	**24**	**9**	**1**	**5**	**-**	**-**	**-**	**1**	**40**
2018									
AOFM1	-	2	-	-	-	-	-	-	**2**
AOFM2	19	5	-	3	-	-	-	-	**27**
AOFM3	5	2	-	-	-	-	-	-	**7**
AOFM4	1	-	-	-	-	-	-	-	**1**
CEO	1	-	-	-	-	-	-	-	**1**
Total	**26**	**9**	**-**	**3**	**-**	**-**	**-**	**-**	**38**

Note: AOFM broadband classifications are 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.

During 2018-19 some employees were seconded to other agencies with these arrangements extending outside this reporting period. The secondment dates in the 2018-19 period are reported here. From July 2018 to early April 2019 one employee was seconded to the Infrastructure and Project Financing Agency. From July 2018 to late October 2018 another employee was seconded to the Department of the Treasury as the manager of the Risk, Governance and Appointments section. From early March 2019 to the end of the reporting period an employee was seconded to the North Queensland Livestock Industry Recovery Agency.

All staff are based in Canberra including those on the secondments noted above.

AOFM seconded four people to work in various parts of the office. Two people were seconded from the Department of the Treasury to staff a position in the Funding and Liquidity group. A senior advisor was seconded from the European Bank for Reconstruction and Development for three weeks in March 2019. Another person was seconded from the Department of Finance to AOFM's Finance Unit from early December 2018 through to the end of the reporting period.

Employees who identify as indigenous

The AOFM does not have any staff who identify as indigenous.

Changes to senior management

There were no permanent changes to senior management during 2018–19.

Other staffing changes

One ongoing employee and one non-ongoing employee were recruited during 2018-19.

There was one ongoing staff departure during the year.

Staff departures represented 2.7 per cent of average staffing levels in 2018–19 (2.7 per cent in 2017–18).

The retention rate for 2018–19 was 97.4 per cent, with an average annual retention rate of 90.5 per cent over the last five years.

Employment arrangements

All non-SES staff had terms and conditions set during 2017–18 by the *AOFM Enterprise Agreement 2015–2018* and determinations made under subsection 24(1) of the *Public Service Act 1999* by the CEO.

The CEO has his terms and conditions set by the Secretary through a determination made under subsection 24(1) of the *Public Service Act 1999*.

Remuneration

Pay rates as at 30 June 2019 are shown in Table 7. These rates were set in accordance with the *AOFM Enterprise Agreement 2015-2018* and determinations made under subsection 24(1) of the *Public Service Act 1999*.

Table 7: AOFM salary ranges

	30 June 2019	
	Band low	**Band high**
Classification	**$**	**$**
AOFM1	43,204	78,955
AOFM2	76,839	156,619
AOFM3	182,575	228,219
AOFM4	245,555	306,944

Remuneration within the range for the classification depends on individual performance ratings. Performance appraisals balance what is achieved (outputs) with how those results are obtained (behaviours). Performance-linked bonuses are not available.

Non-salary benefits provided to employees principally comprise superannuation and support for professional development through study assistance, short courses and payment of job-relevant professional society membership fees. A mobile phone, laptop, or other mobile device may be provided where there is a business need. Remuneration for key management personnel is reported in Note A of Part 4: Financial Statements.

Disability reporting mechanism

Since 1994, non-corporate Commonwealth entities have reported on their performance as policy adviser, purchaser, employer, regulator, and provider under the Commonwealth Disability Strategy. In 2007-08, reporting on the employer role was transferred to the Australian Public Service Commission's State of the Service reports and the *APS Statistical Bulletin*. These reports are available at www.apsc.gov.au. From 2010-11, entities have no longer been required to report on these functions.

The Commonwealth Disability Strategy has been overtaken by the National Disability Strategy 2010–2020, which sets out a 10-year national policy framework to improve the lives of people with disability, promote participation and create a more inclusive society. A high level two-yearly report will track progress against each of the six outcome areas of the Strategy and present a picture of how people with disability are faring. The first of these reports was published in 2014, and can be found at www.dss.gov.au.

Work health and safety

Health, wellbeing and safety services are provided by the Treasury under a Memorandum of Understanding. The AOFM has one Health and Safety Representative who assists staff in accordance with the *Work Health and Safety Act 2011*.

Monitoring the emergence of notable work health and safety issues is a standing agenda item at Executive Group meetings.

Flu vaccinations were made available to staff in 2018–19. Counselling and related support is available under an Employee Assistance Programme provided by Benestar Group. Additional online resources are provided to all staff to assist with safety, health and wellbeing promotion.

There were no compensable injury claims or notifiable incidents in 2018–19.

There have been no notices or investigations under Part 10 of the *Work Health and Safety Act 2011.*

Consultants

During 2018–19, one new consultancy contract was entered into with total actual expenditure of $24,200. In addition, two ongoing consultancy contracts were active during 2018–19, involving total actual expenditure of $188,814. This is summarised in Table 8.

Annual reports contain information about actual expenditure on contracts for consultancies. Information on the value of contracts and consultancies is available on the AusTender website at: www.tenders.gov.au.

The AOFM engages consultants where it requires specialist expertise or when independent research, review or assessment is required.

Prior to engaging consultants, the AOFM takes into account the skills, experience and resources required for the task, the skills available internally, and the cost-effectiveness of engaging external expertise. The decision to engage a consultant is made in accordance with the PGPA Act and related rules, including the *Commonwealth Procurement Rules* (CPRs), and relevant internal policies.

Table 8: Consultancy contracts

	2015–16	2016–17	2017–18	2018–19
Number of consultancy contracts				
New contracts	9	1	2	1
Ongoing contracts	5	3	2	2
Expenditure (including GST)				
New contracts	$211,337	$14,614	$13,200	$24,200
Ongoing contracts	$222,974	$221,822	$261,715	$188,814

Purchasing

The AOFM's purchasing activities are consistent with, and reflect the principles of, the Commonwealth Procurement Rules (CPRs). These rules are applied to the AOFM's activities through the *Accountable Authority Instructions* and supporting internal policies and procedures.

The AOFM's Procurement Plan is published annually and available from the AusTender website: www.tenders.gov.au. The plan is updated when circumstances change.

ANAO access clauses and exempt contracts

Two contracts in excess of $100,000 were entered into during the reporting period that did not provide for the Auditor-General to have access to the contractor's premises.

The first contract was for the syndicated issuance of $3.60 billion of Treasury Bonds (a May 2041 maturity) in July 2018. The AOFM appointed Commonwealth Bank of Australia, Toronto Dominion Australia Limited, UBS AG (Australia Branch) and Westpac Banking Corporation to act as managers for the issue.

The second contract was for the syndicated issuance of $3.75 billion of Treasury Indexed Bonds (a February 2050 maturity) in September 2018. The AOFM appointed Citigroup Global Markets Australia, Deutsche Bank AG, Merrill Lynch (Australia) Futures Limited, UBS AG (Australia Branch) and Westpac Banking Corporation to act as managers for the issue.

ANAO access clauses were not included in the contracts as the AOFM maintains all relevant information in relation to the contracted services. Under these contracts, $12.13 million (including GST) was paid.

No contract or standing offer has been exempted from being published in the Purchasing and Disposals Gazette on the basis that it would disclose exempt matters under the *Freedom of Information Act 1982*.

Procurement initiatives to support small business

The AOFM supports small business participation in the Commonwealth Government procurement market. Small and Medium Enterprises (SME) and Small Enterprise participation statistics are available on the Department of Finance's website.

www.finance.gov.au/procurement/statistics-on-commonwealth-purchasing-contracts.

Consistent with paragraph 5.5 of the CPRs, the AOFM's procurement practices provide appropriate opportunities for SMEs to compete and ensure that SMEs are not unfairly discriminated against.

The AOFM recognises the importance of ensuring that small businesses are paid on time. The results of the Survey of Australian Government Payments to Small Business are available on the Treasury's website: www.treasury.gov.au.

PART 4: FINANCIAL STATEMENTS

Australian Office of Financial Management

Statement by the Chief Executive Officer and Chief Financial Officer

In our opinion, the attached financial statements for the year ended 30 June 2019 comply with subsection 42 (2) of the *Public Governance, Performance and Accountability Act 2013*, and are prepared from properly maintained financial records as required by subsection 41 (2) of the *Public Governance, Performance and Accountability Act 2013*.

In our opinion, and on the condition of receiving continuing appropriations from Parliament, there are reasonable grounds to believe that the Australian Office of Financial Management will be able to pay its debts as and when they fall due.

No matter, transaction or event of a material or unusual nature has arisen in the interval between the end of the reporting period (30 June 2019) and the date of signing this report that has significantly affected or may significantly affect the AOFM's operations.

Signed

R Nicholl
Chief Executive Officer
23 August 2019

Signed

P Raccosta
Chief Financial Officer
23 August 2019

Objectives and activities of the AOFM

The AOFM's activities are focused on delivering to the following policy outcome:

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

The AOFM aims to achieve the outcome through the following objectives:

- meeting the budget financing task in a cost-effective manner subject to acceptable risk;
- facilitating the government's cash outlay requirements as and when they fall due; and
- being a credible custodian of the Australian Government Securities market and other portfolio responsibilities.

The AOFM manages a portfolio of debt and financial assets on behalf of the Australian Government. It issues Treasury Bonds and Treasury Indexed Bonds to finance budget deficits. It also manages the government's cash in the Official Public Account (OPA) which is surplus to immediate requirements to manage the within-year financing task. It undertakes the administration, financial and operational risk management, and financial reporting of its portfolio of debt and assets.

Financing the budget

In the absence of budget deficits debt issuance by the AOFM has been used to maintain the Treasury Bond and Treasury Bond futures markets. Since the onset of the Global Financial Crisis in 2008-09 the AOFM has had to significantly increase debt issuance and intensify its engagement with investors (including overseas investors) and intermediaries.

Portfolio management

The cost and risk of the debt portfolio is managed through debt issuance and (where appropriate) investment activities. Since early 2009, budget deficits have required debt issuance volumes that have exceeded those necessary to maintain liquidity in Treasury Bond and Treasury Bond futures markets, affording the AOFM with a greater level of flexibility in setting its issuance program against an overarching objective of minimising cost subject to acceptable risk. In recent years the AOFM has lengthened the duration of its Treasury Bond portfolio through longer term issuance as a means of reducing refinancing risk and the variability of debt servicing costs over time. The Treasury Bond yield curve extends to 28 years currently (an extension of 16 years since 2011).

Cash management

The AOFM manages the overall level of cash in the OPA to ensure that the government is able to meet its financial obligations as and when they fall due. To this end, it makes short term borrowings by issuing Treasury Notes and invests OPA cash surplus to immediate requirements in term deposits with the RBA. The AOFM holds continuing balances of highly liquid assets to allow it to respond flexibly and quickly to meet unexpected expenditure requirements and disruptions in the markets.

The OPA is recorded in the Department of Finance's financial statements and is not reported by the AOFM.

Australian Business Securitisation Fund (ABSF)

In November 2018 the government announced the establishment of the Australian Business Securitisation Fund (ABSF) to foster competition in the small and medium enterprise (SME) lending market with the aim of improving access to, and over time the cost of finance to SMEs.

In February 2019, the government introduced the *Australian Business Securitisation Fund Bill 2019* into Parliament to establish the ABSF and to credit it over a period of 5 years with $2 billion to meet the purposes set out in the Bill. The Bill received royal assent on 5 April 2019. The ABSF received its first credit of funding on 1 July 2019 for an amount of $250 million. On 1 July 2020 the ABSF will receive a further funding credit of $250 million.

The AOFM is responsible for administering the ABSF.

Legislation

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

- the *Commonwealth Inscribed Stock Act 1911* represents the Australian Government's primary vehicle for the creation and issuance of stock, including Treasury Bonds, Treasury Indexed Bonds and Treasury Notes. It also provides a standing authority to the Treasurer to borrow in Australian currency;
  - On 9 May 2017 the Treasurer issued a direction under section 51JA of the Act permitting the AOFM to borrow up to $600 billion.
- the *Loans Securities Act 1919* includes provisions relating to overseas borrowings, securities lending, repurchase agreements and other financial arrangements;

- the *Financial Agreement Act 1994* formalises debt consolidation and redemption arrangements applying since 1 July 1990 between the Australian Government and the State and Northern Territory Governments;
- section 58 of *Public Governance, Performance and Accountability Act 2013* allows the Treasurer to invest public money in authorised investments; and
- the *Australian Business Securitisation Fund Act 2019*.

ADMINISTERED ACCOUNTS

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

Administered assets, liabilities, revenue and expenses are those items that an entity does not control but over which it has management responsibility on behalf of the government and which are subject to prescriptive rules or conditions established by legislation, or Australian Government policy, in order to achieve Australian Government outcomes. These items include debt issued to finance the government's fiscal requirements and investments of funds surplus to the government's immediate financing needs.

Administered schedule of comprehensive income ($ millions)

for the period ended 30 June 2019

	Notes	2019	2018
EXPENSES			
Interest expense:			
Treasury Bonds	2	**15,560**	15,363
Treasury Indexed Bonds	3	**1,465**	1,566
Treasury Notes		**63**	67
Interest expense		**17,088**	16,996
Supplier expenses		**12**	29
Total expenses		**17,100**	17,025
INCOME			
Interest revenue:			
Loans to State and Territory Governments		**106**	110
Deposits		**459**	650
Residential mortgage-backed securities		**-**	26
Total income		**565**	786
GAINS (LOSSES)			
Residential mortgage-backed securities sales		**-**	11
Debt repurchased		**(896)**	(523)
Total gains (losses)		**(896)**	(512)
Surplus (deficit) before re-measurements		**(17,431)**	(16,751)
RE-MEASUREMENTS (net market revaluation)			
Treasury Bonds		**(41,160)**	823
Treasury Indexed Bonds		**(2,390)**	(238)
Treasury Notes		**-**	1
Other		**-**	(5)
Total re-measurements		**(43,550)**	581
Surplus (deficit)		**(60,981)**	(16,170)

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

Interest expense and interest revenue are determined using the effective interest method.

The category 'gains (losses)' represents the total proceeds paid or received from repurchasing debt prior to maturity or from selling a financial asset prior to maturity, less the amortised cost carrying value of the debt or financial asset using the effective interest method at the time of repurchase or sale. The AOFM conducts these transactions at market rates.

The category 'surplus (deficit) 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. This is most relevant to the AOFM's role in managing the debt portfolio, which is predominately issued and held to maturity, and where portfolio restructuring is performed primarily for debt market management purposes, rather than for profit making purposes. With the growth in the volume of debt outstanding in individual bond lines, the role of the buyback program will increase in significance.

The category 're-measurements' provides information on the unrealised changes in the market revaluation of the portfolio of administered financial assets and financial liabilities (which are carried at fair value through profit or loss) during the financial year. This is relevant for assessing changes in financial risk exposures and changes to the value of transactions managed from year to year. The revaluation effect will net to zero over the life of a financial instrument.

Administered schedule of assets and liabilities ($ millions)

as at 30 June 2019

	Notes	2019	2018
LIABILITIES			
Interest bearing liabilities at fair value:			
Treasury Bonds	**2**	**573,557**	524,403
Treasury Indexed Bonds	**3**	**49,813**	48,548
Treasury Notes	**4**	**2,993**	2,492
Interest bearing liabilities at amortised cost:			
Other debt		**6**	6
Interest bearing liabilities		**626,369**	575,449
Total liabilities		**626,369**	575,449
FINANCIAL ASSETS			
Cash at bank		**1**	1
Assets at fair value:			
Term deposits with the RBA	**5**	**-**	45,140
Assets at amortised cost:			
Term deposits with the RBA	**5**	**31,112**	-
Loans to State and Territory Governments	**6**	**1,711**	1,792
Total assets		**32,824**	46,933
Net assets (liabilities)		**(593,545)**	(528,516)

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

The Treasurer has issued a direction under the *Commonwealth Inscribed Stock Act 1911* permitting the AOFM to borrow up to a limit of $600 billion in face value terms. As at 30 June 2019 the face value on issue was $542 billion. The schedule above reports the carrying value of debt in fair value terms.

Current/non-current balances reported ($ millions)

	2019	2018
Current assets	**31,197**	45,222
Non-current assets	**1,627**	1,711
Current liabilities	**38,162**	35,016
Non-current liabilities	**588,207**	540,433

Financial assets and financial liabilities denoted as being measured at amortised cost, 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 in Interest Revenue (for assets) and Interest Expense (for liabilities).

Financial assets and financial liabilities denoted as being measured at fair value, are measured at fair value on initial recognition and at fair value through profit or loss on subsequent measurement. Changes in carrying value are attributed between changes in amortised cost and other changes. Changes in carrying value attributable to amortised cost, including amortisation of premiums or discounts, are recognised in Interest Revenue (for assets) and Interest Expense (for liabilities). Other changes in carrying value (including unrealised changes in valuation due to a change in interest rates) are recognised in Re-measurements.

The AOFM is not aware of any quantifiable or unquantifiable administered contingencies as of the signing date that may have an impact on its operations.

Administered reconciliation schedule ($ millions)

for the period ended 30 June 2019

	Notes	2019	2018
NET ASSETS			
Opening value		**(528,516)**	(486,594)
Adjustment due to the implementation of AASB 9		**(4)**	-
Revised opening value		**(528,520)**	(486,594)
Administered schedule of comprehensive income:			
Surplus (deficit)		**(60,981)**	(16,170)
Administered transfers (to) from Australian Government:			
Special appropriations (unlimited)	**8**	**548,336**	557,571
Transfers to OPA		**(552,380)**	(583,323)
Change in special account balance		**-**	-
Net assets		**(593,545)**	(528,516)

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

Administered schedule of cash flows ($ millions)

for the period ended 30 June 2019

	Notes	2019	2018
OPERATING ACTIVITIES			
Cash received (used):			
Interest receipts		**581**	801
GST refunds from ATO		**1**	2
Interest paid on Treasury Bonds	**2**	**(18,042)**	(18,295)
Interest paid on Treasury Indexed Bonds	**3**	**(2,966)**	(1,142)
Interest paid on Treasury Notes		**(62)**	(70)
Interest paid on other debt instruments		**(9)**	(7)
Other payments		**(13)**	(31)
Net cash from operating activities	**7**	**(20,510)**	(18,742)
INVESTING ACTIVITIES			
Cash received (used):			
Capital proceeds from deposits		**475,350**	485,150
Capital proceeds from RMBS		**-**	1,929
State and Territory loan repayments		**98**	96
Acquisition of deposits		**(461,350)**	(473,450)
Net cash from investing activities		**14,098**	13,725
FINANCING ACTIVITIES			
Cash received (used):			
Capital proceeds from borrowings		**75,892**	94,820
Other receipts		**87**	43
Repayment of borrowings		**(65,436)**	(64,051)
Other payments		**(87)**	(43)
Net cash from financing activities		**10,456**	30,769
TRANSACTIONS WITH OPA			
Cash from (to):			
Appropriations		**548,336**	557,571
Receipts sent to OPA		**(552,380)**	(583,323)
Net cash from OPA		**(4,044)**	(25,752)
Net change in cash held		-	-
+ cash held at the beginning of period		**1**	1
Cash held at the end of the period		**1**	1

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

Note 1: Financial risk management

The government is exposed to financial risks arising from its portfolio of financial assets and liabilities — interest rate risk, inflation risk, credit risk, liquidity risk and refinancing risk. These risks are managed by the AOFM within a financial risk management framework that includes directions from the Treasurer and policies and limits approved by the Secretary to the Treasury and overseen by the CEO and senior management of the AOFM.

Timing mismatches between the Australian Government's receipts and expenditures cause large fluctuations in the volume of short term assets and liabilities managed 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 debt, long term financing and short term financing are managed through separate portfolios, the debt portfolio and the cash management portfolio. In addition, loans to State and Territory Governments are held in a separate portfolio.

Debt portfolio

The debt portfolio is used to meet the Australian Government's budget financing needs, to support efficient Treasury Bond and Treasury Bond futures markets, and to promote depth and breadth in the investor base. Issuance is the primary mechanism for managing interest rate risk of the debt portfolio. That is, the AOFM manages the cost structure of the debt portfolio through the choice of instruments and bond series in issuing debt. The annual debt issuance strategy is informed by qualitative and quantitative factors to achieve an interest rate profile that appropriately balances cost and cost variability, investor demand and diversification, the refinancing task and financial market efficiency.

Cash management portfolio

The cash management portfolio is used to manage within year timing mismatches between Australian Government receipts and expenditures. The cash management portfolio holds a fluctuating portfolio of short term investments and short term liabilities. The portfolio is managed to achieve an appropriate balance between refinancing risk, liquidity risk and interest rate risk.

Interest rate risk

Interest rate risk represents the risk to debt servicing cost outcomes and investment return outcomes, and to the value of debt and financial assets caused by changes in interest rates.

In its ordinary course of business the primary measure used by the AOFM to assess interest rate risk is the accruals basis of accounting under the historic cost accounting convention. Fair value measures of interest rate risk are considered to be secondary.

Financial instruments with a fixed interest rate expose the portfolio to changes in fair value with changes in interest rates, whilst those financial instruments at floating interest rates expose the portfolio to changes in debt servicing costs with changes in interest rates. The extent to which the AOFM can match the repricing profile of financial liabilities with financial assets is limited due to the significant differences in the volumes and the need for assets to be available for cash management or other purposes. The interest rate exposure is predominately to fixed interest instruments.

Interest exposure of assets and liabilities ($m)

	2019	2018
Fixed rate exposures		
Assets	**32,823**	46,932
Liabilities	**(626,363)**	(575,443)
Floating rate or non-interest bearing exposures		
Assets	**1**	1
Liabilities	**(6)**	(6)

The following sensitivity analysis illustrates the interest rate risk sensitivity of administered financial instruments and the financial impact on profit or loss and equity to financial positions held as at period end.

Sensitivity of 30 June balances to a +20 basis points change (2018: +20) ($m)

	2019	2018
Changes in fair value:		
Treasury Bonds	**7,485**	6,396
Treasury Indexed Bonds	**963**	728
Other	**1**	(1)

Sensitivity of 30 June balances to a -20 basis points change (2018: -20) ($m)

	2019	2018
Changes in fair value:		
Treasury Bonds	**(7,651)**	(6,532)
Treasury Indexed Bonds	**(995)**	(747)
Other	**(1)**	1

In undertaking the sensitivity analysis a parallel shift in interest rates (real and nominal) is applied to instruments.

For fixed rate instruments, a shift in market interest rates on 30 June balances only has an effect on those instruments carried at fair value, by altering their fair value carrying amount as at 30 June. Fixed rate instruments carried at fair value include Treasury Bonds and Treasury Indexed Bonds.

A sensitivity of 20 basis points has been used for domestic interest rates as per standard parameters set by the Department of Finance.

Inflation risk

Treasury Indexed Bonds have their principal value indexed against the all Groups Australian Consumer Price Index (CPI). Interest is paid at a fixed rate on the accreted principal value. Accordingly these debt instruments expose the government to inflation risk on interest payments and on the value of principal payable on maturity. There is a six month lag between the calculation period for the CPI and its impact on the value of interest and principal.

Treasury Indexed Bonds lines index value for next interest payment as at 30 June

	First issued	2016	2017	2018	2019
21 Nov 18 - 1.00%	Apr-14	104.74	106.61	108.65	
20 Aug 20 - 4.00%	Oct-96	164.25	167.19	170.40	**173.05**
21 Feb 22 - 1.25%	Feb-12	108.80	110.75	112.87	**114.63**
20 Sep 25 - 3.00%	Sep-09	117.19	119.29	121.57	**123.47**
21 Nov 27 - 0.75%	Aug-17			101.91	**103.50**
20 Sep 30 - 2.50%	Sep-10	114.32	116.37	118.60	**120.45**
21 Aug 35 - 2.00%	Sep-13	105.96	107.86	109.92	**111.63**
21 Aug 40 - 1.25%	Aug-15	101.68	103.49	105.48	**107.12**
21 Feb 50 - 1.00%	Sep-18				**101.55**

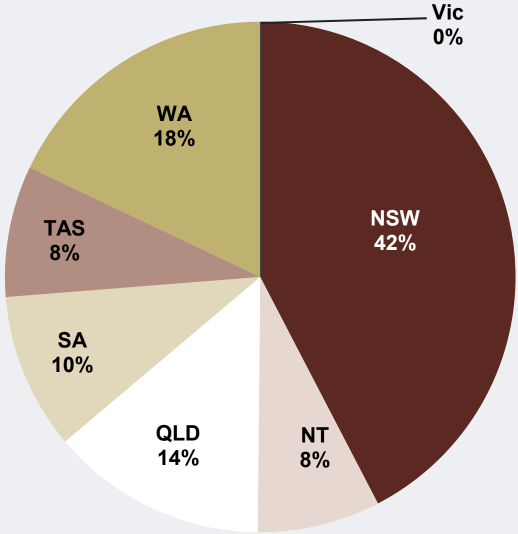
Credit risk

Credit risk is the risk of non-performance (including partial performance) by a counterparty to a financial contract, leading to a financial loss for the creditor.

The AOFM’s investment activity is made in accordance with legislative requirements, delegations and directions from the Treasurer and policies and limits established by the Secretary to the Treasury. For 2018–19 and 2017–18, investments in term deposits with the RBA were the only eligible investments the AOFM was permitted to acquire. Investments with the RBA are considered to carry zero credit risk.

Under Commonwealth-State financing arrangements between 1945 and 1989, the Australian Government made concessional loans (not evidenced by the issuance of debt securities) to State and Northern Territory Governments for specific purposes. As at 30 June 2019, the principal outstanding on these loans was $1,895 million.

Composition of loans to state and territory governments as at 30 June 2019:



Value of loans to state and territory governments by credit rating ($m)

	Principal value		Estimated fair value	
	2019	2018	**2019**	2018
Aaa / AAA	**803**	851	**1,014**	975
Aa1 / AA+	**787**	273	**1,012**	313
Aa2 / AA	**305**	869	**397**	1,009
Total	**1,895**	1,993	**2,423**	2,297

Where a counterparty has a split rating between the rating agencies (Standard and Poor's and Moody's), the AOFM's exposure is allocated to the lower credit rating.

To protect the Australian Government's financial position with respect to securities lending arrangements (which allows market participants to borrow Treasury Bonds and Treasury Indexed Bonds not readily available from other sources), the market value of the collateral securities taken from counterparties is greater than the market value of the securities lent. There is a right to seek additional collateral if there is a decline in the relative value of these securities.

Liquidity risk and refinancing risk

Refinancing risk is the risk that when maturing debt needs to be funded by debt issuance, it may have to be refinanced at a higher cost or market conditions may prevent sufficient funds from being raised in an orderly manner. The AOFM seeks to control refinancing risk by issuing along the entire yield curve. This creates a range of short-dated and mid-to-long dated exposures that balance cost and refinancing patterns. In formulating its debt issuance strategy the AOFM considers the volume of debt in any one line and the maturity structure of its debt (including the number of bond lines and the maturity gaps between lines).

The AOFM monitors market conditions in order to form a view on refinancing risk due to issuance at a particular point in time. In addition, as a means of reducing refinancing risk in future years and to improve market efficiency, the AOFM conducts regular buy backs of Treasury Bonds that no longer form part of the ASX three-year futures contract.

The AOFM manages liquidity risk by maintaining sufficient cash and short-term investments to ensure that the government can meet its financial obligations as and when they fall due. The AOFM manages the daily volume of cash in the OPA by monitoring the projected daily transactions of major spending and revenue agencies, undertaking investment of funds that are surplus to immediate cash requirements, and by issuing Treasury Notes. The cash flows into and out of the OPA are highly variable and difficult to forecast from day to day, and so in consequence are the size and timing of cash management activities. 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 (in the absence of Ministerial approval). The AOFM monitors the daily balance in the OPA, holdings of short-term assets, and short-term and long-term debt issuance activities.

The following table discloses the undiscounted value of the contractual maturities of financial liabilities as at the reporting date, including estimated future interest payments. Interest payments and the principal value on redemption of Treasury Indexed Bonds are based on capital values as at period end.

Future undiscounted cash outflows of liabilities as at 30 June 2019 ($m)

	Treasury Bonds	Treasury Indexed Bonds	Other	Total
Principal payments:				
within 1 year	34,294	-	2,994	37,288
1 to 5 years	163,006	10,949	-	173,955
5 to 10 years	198,799	14,136	-	212,935
10 to 15 years	61,100	5,773	-	66,873
15 years+	45,050	12,020	-	57,070
Total Principal	502,249	42,878	2,994	548,121
Interest payments:				
within 1 year	17,365	870	12	18,247
1 to 5 years	53,819	2,737	-	56,556
5 to 10 years	36,916	2,067	-	38,983
10 to 15 years	10,627	1,049	-	11,676
15 years+	8,740	1,007	-	9,747
Total Interest	127,467	7,730	12	135,209

Future undiscounted cash outflows of liabilities as at 30 June 2018 ($m)

	Treasury Bonds	Treasury Indexed Bonds	Other	Total
Principal payments:				
within 1 year	29,185	2,561	2,493	34,239
1 to 5 years	180,449	15,306	-	195,755
5 to 10 years	169,800	12,566	-	182,366
10 to 15 years	75,100	5,506	-	80,606
15 years+	38,650	7,928	-	46,578
Total Principal	493,184	43,867	2,493	539,544
Interest payments:				
within 1 year	17,767	1,004	13	18,784
1 to 5 years	55,431	2,904	-	58,335
5 to 10 years	37,009	2,066	-	39,075
10 to 15 years	11,068	968	-	12,036
15 years+	8,872	520	-	9,392
Total Interest	130,147	7,462	13	137,622

Fair value reported

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at measurement date. This is the quoted market price if one is available.

AASB 13 requires assets and liabilities measured at fair value to be disclosed according to their position in a fair value hierarchy. This hierarchy has three levels: Level 1 which is valuation based on quoted prices in active markets for identical instruments; Level 2 which is valuation based on quoted prices or other observable market data not included in Level 1; Level 3 which is valuation based on significant inputs to valuation other than observable market data.

Fair value hierarchy 2019 ($m)

	Carried at fair value			**Carried at amortised cost**
	Level 1	**Level 2**	**Level 3**	
Liabilities	(626,363)	-	-	(6)
Assets	-	-	-	32,823

In 2019, the carrying value of term deposits was changed to amortised cost from fair value due to the introduction of AASB 9.

Fair value hierarchy 2018 ($m)

	Carried at fair value			**Carried at amortised cost**
	Level 1	**Level 2**	**Level 3**	
Liabilities	(575,443)	-	-	(6)
Assets	-	45,140	-	1,792

Note 2: Treasury Bonds

Treasury Bonds are denominated in Australian dollars and pay a fixed coupon semi-annually in arrears. Treasury Bonds are redeemable at face value on maturity. There are no options available to either the Australian Government or the holder of the securities to exchange or convert Treasury Bonds. There are also no options to either party for early redemption. The AOFM issues Treasury Bonds primarily through a competitive auction process to registered bidders. In certain circumstances syndicated issuance is undertaken.

Accounting policy

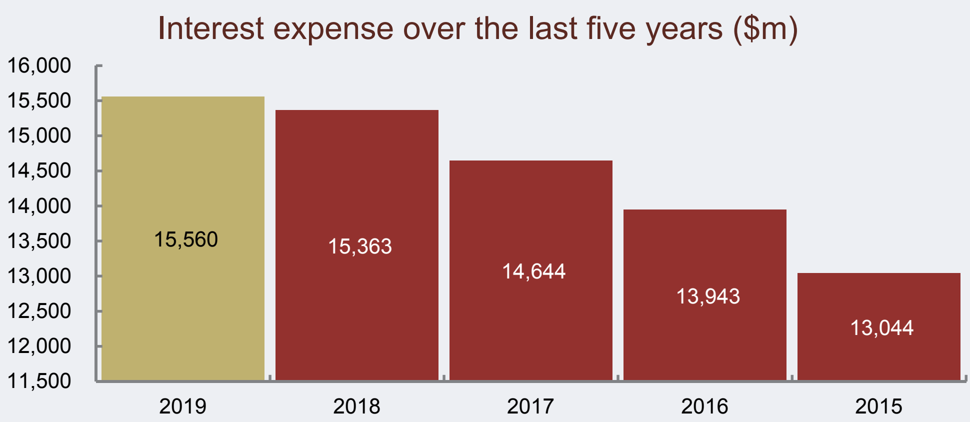
The AOFM monitors the cost and risk on Treasury Bonds primarily on an accruals basis, but also on a fair value basis. The AOFM has designated Treasury Bonds to be carried at fair value through profit or loss under AASB 9. The accounting treatment for Treasury Bonds remained unchanged with the transition from AASB 139 to AASB 9.

The fair value of Treasury Bonds is determined by reference to observable market rates for identical instruments.

Key aggregates

Interest expense ($m)

	2019	2018
Interest paid / payable	**17,781**	17,751
Amortisation of net premiums	**(2,221)**	(2,388)
Interest expense	**15,560**	15,363

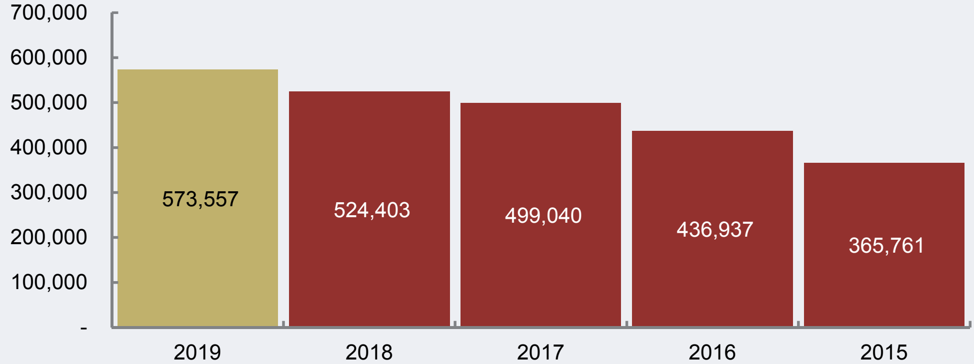


Whilst the interest expense on the Treasury Bond portfolio has risen over time due to higher borrowing levels, the accrual cost in yield terms has fallen as a consequence of the lower interest rate environment.

Carrying values — administered liabilities ($m)

	2019	2018
Face value	**502,249**	493,184
Accrued interest	**3,237**	3,498
Unamortised net premiums	**9,252**	10,062
Market value adjustment	**58,819**	17,659
Carrying value	**573,557**	524,403

Carrying values over the last 5 years ($m)



As at 30 June 2019 the weighted average market yield on Treasury Bonds was 1.19 per cent (30 June 2018: 2.39 per cent). As at 30 June 2019 the weighted average (nominal) issuance yield on Treasury Bonds was 3.01 per cent (30 June 2018: 3.14 per cent).

Changes in principal value (face value) for the period ($m)

	2019	2018
Issuance via tender	**51,400**	59,800
Issuance via syndication	**3,600**	15,700
Debt repurchased	**(23,099)**	(22,892)
Matured	**(22,836)**	(23,468)
Change in principal value	**9,065**	29,140

Of the debt repurchased in 2018-19, $6.3 billion was for Treasury Bonds otherwise maturing in 2018-19 (2017-18: $7.7 billion).

Interest paid — schedule of cash flows ($m)

	2019	2018
Coupons paid	**18,176**	18,529
Interest received on issuance	**(365)**	(478)
Interest paid on repurchase	**231**	244
Interest paid	**18,042**	18,295

Note 3: Treasury Indexed Bonds

Treasury Indexed Bonds are denominated in Australian dollars and are capital indexed with the principal value of the bond adjusted by reference to movements in the CPI (based on a six month lag).

Interest payments are made quarterly in arrears, at a fixed rate, on the adjusted capital value. At maturity, investors receive the adjusted capital value of the security.

The AOFM issues Treasury Indexed Bonds primarily through a competitive auction process to registered bidders. In certain circumstances syndicated issuance is undertaken.

Accounting policy

The AOFM monitors the cost and risk on Treasury Indexed Bonds primarily on an accruals basis, but also on a fair value basis. The AOFM has designated Treasury Indexed Bonds to be carried at fair value through profit or loss under AASB 9. The accounting treatment for Treasury Indexed Bonds remained unchanged with the transition from AASB 139 to AASB 9.

The fair value of Treasury Indexed Bonds is determined by reference to observable market rates for identical instruments.

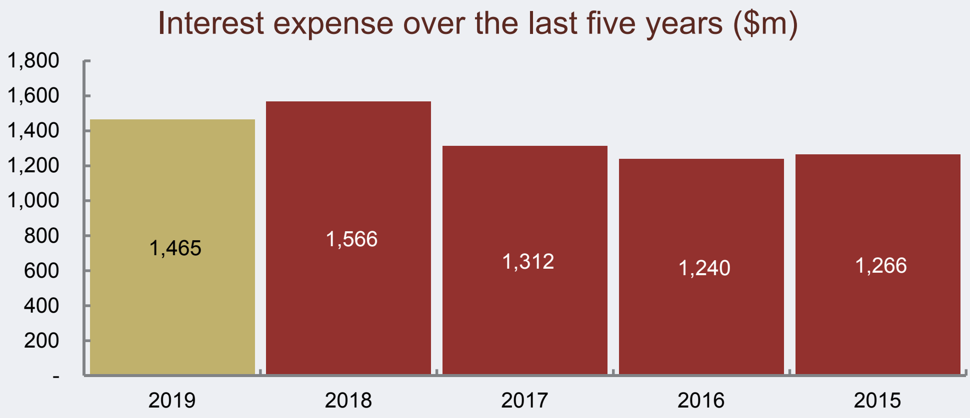
Capital accretion is recognised in Interest Expense over time with each quarterly release of the CPI.

As future inflation rates are uncertain and it is not appropriate for the AOFM to express a view on the inflation outlook, an estimate of the adjusted capital value on maturity of each series of Treasury Indexed Bonds is not disclosed in the financial statements.

Key aggregates

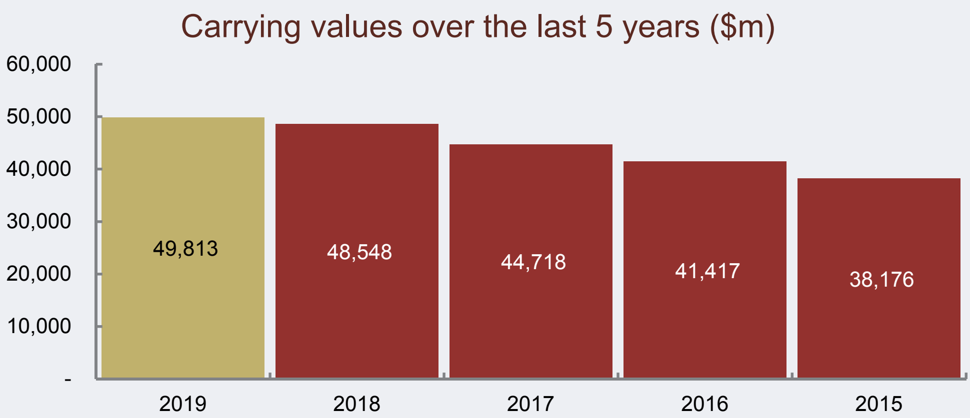
Interest expense ($m)

	2019	2018
Interest paid / payable	**930**	984
Capital accretion and amortisation of net premiums	**535**	582
Interest expense	**1,465**	1,566



Carrying values — administered liabilities ($m)

	2019	2018
Principal (adjusted capital value):		
Face value	**36,737**	36,247
Capital accretion (to next coupon)	**6,141**	7,620
Adjusted capital value	**42,878**	43,867
Accrued interest	**63**	82
Unamortised net premiums	**1,191**	1,308
Market value adjustment	**5,681**	3,291
Carrying value	**49,813**	48,548



As at 30 June 2019, the weighted average market (real) yield on Treasury Indexed Bonds was 0.00 per cent (30 June 2018: 0.51 per cent).

As at 30 June 2019, the weighted average (real) issuance yield on Treasury Indexed Bonds was 1.42 per cent (30 June 2018: 1.63 per cent).

Changes in principal value for the period ($m)

	Principal (face value)		Adjusted Capital Value	
	2019	2018	**2019**	2018
Issuance via tender	**2,150**	2,550	**2,387**	2,739
Issuance via syndication	**3,750**	3,000	**3,765**	3,010
Debt repurchased	**(4,548)**	(2,732)	**(6,866)**	(2,922)
Matured	**(862)**	-	**(940)**	-
Accretion	**-**	-	**665**	798
Change in principal value	**490**	2,818	**(989)**	3,625

Of the debt repurchased in 2018-19, $1.5 billion was for Treasury Indexed Bonds otherwise maturing in 2018-19 (2017-18: nil).

Interest paid — schedule of cash flows ($m)

	2019	2018
Coupons paid	**935**	983
Interest received on issuance	**(6)**	(4)
Interest paid on repurchase	**20**	1
Accretion since issuance (on redemption)	**2,017**	162
Interest paid	**2,966**	1,142

Note 4: Treasury Notes

Treasury Notes are short term discount instruments, denominated in Australian dollars and repayable at face value on maturity.

Accounting policy

The AOFM monitors the cost and risk on Treasury Notes primarily on an accruals basis, but also on a fair value basis. The AOFM has designated Treasury Notes to be carried at fair value through profit or loss under AASB 9.

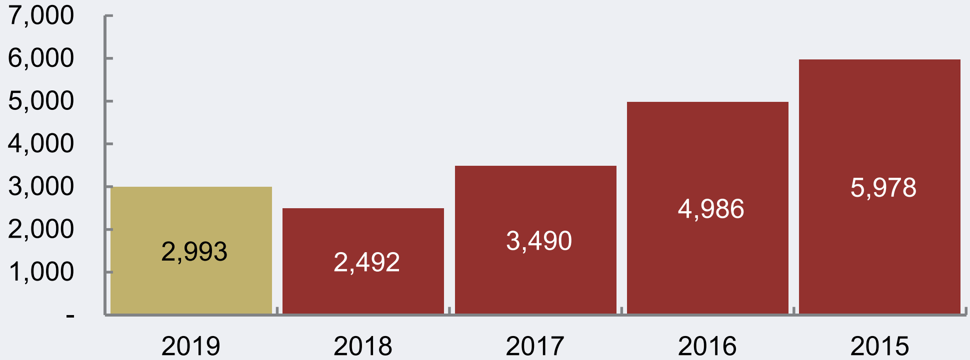
The fair value of Treasury Notes is determined by reference to observable market rates for identical instruments.

Key aggregates

Carrying values — administered liabilities ($m)

	2019	2018
Face value	**3,000**	2,500
Unexpired interest discount	**(7)**	(8)
Market value adjustment	**-**	-
Carrying value	**2,993**	2,492

Carrying values over the last 5 years ($m)



Changes in principal value (face value) for the period ($m)

	2019	2018
Issuance via tender	**13,500**	13,500
Matured	**(13,000)**	(14,500)
Change in principal value	**500**	(1,000)

The average tenor of issuance was around three months (2017-18: three months).

Note 5: Term deposits with the RBA

Term deposits with the RBA are Australian dollar denominated investments placed for a fixed term of less than six months at an agreed fixed interest rate, with interest calculated on a simple interest basis. Term deposit investments are made under the authority of section 58 of the *Public Governance, Performance and Accountability Act 2013*.

Accounting policy

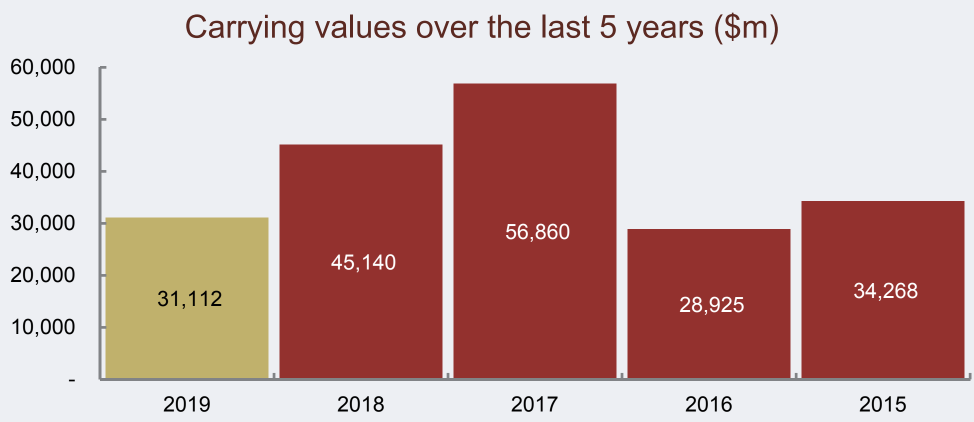
The AOFM's business model is to hold term deposits primarily to collect the contractual cash flows, as such term deposits are carried at amortised cost from 1 July 2018 under AASB 9. Previously, under AASB 139 term deposits were carried at fair value. The 2018 comparatives have not been restated.

Key aggregates

Carrying values — administered assets ($m)

	2019	2018
Face value	**31,100**	45,100
Accrued interest	**12**	36
Market value adjustment (a)	**-**	4
Carrying value	**31,112**	45,140

(a) Not applicable for 2018-19.



Changes in principal value (face value) for the period ($m)

	2019	2018
New term deposits	**461,350**	473,450
Matured term deposits	**(475,350)**	(485,150)
Change in principal value	**(14,000)**	(11,700)

Note 6: Loans to State and Territory Governments

Loans to State and Territory Governments predominantly comprise concessional housing advances and specific purpose capital advances made between 1945 and 1989 under Commonwealth — State financing arrangements. These loans are structured with annual repayments which incorporate principal and interest.

Accounting policy

Loans to State and Territory Governments are measured at fair value on initial recognition and at amortised cost on subsequent measurement using the effective interest method. An expected credit loss provision is not made on these loans.

Key aggregates

Carrying values — administered assets ($m)

	2019	2018
Face value	**1,895**	**1,993**
Unamortised net discounts	**(184)**	**(201)**
Accrued interest	-	-
Carrying value	**1,711**	**1,792**
Expected to be received:		
Within one year	**84**	**82**
In one to five years	**351**	**345**
In more than five years	**1,276**	**1,365**
Carrying value by expected recovery	**1,711**	**1,792**
Ageing:		
Not overdue	**1,711**	**1,792**
Overdue	-	-
Carrying value by ageing	**1,711**	**1,792**

The fair value of these loans is $2,423 million (2017-18: $2,297 million). In estimating fair value data from Treasury Bonds is used.

Note 7: Cash flow reconciliation

The following table reconciles the surplus (deficit) reported in the Schedule of Comprehensive Income to net cash flows from operating activities reported in the Schedule of Cash Flows.

Reconciliation of net cash from operating activities ($m)

	2019	2018
Surplus (deficit)	**(60,981)**	(16,170)
Adjustments for non-cash items:		
Amortisation and capital accretion of debt instruments	**(1,686)**	(1,806)
Amortisation of concessional loans	**(17)**	(16)
Net (gains) losses	**896**	512
Re-measurements	**43,550**	(581)
Adjustments for cash items:		
Capital accretion costs on redemption of debt	**(2,017)**	(162)
Accrual adjustments:		
Interest accruals on debt	**(279)**	(543)
Interest accruals on assets	**24**	24
Net cash from operating activities	**(20,510)**	(18,742)

Note 8: Appropriations

Administered special appropriations — unlimited ($'000)

	2019	2018
Commonwealth Inscribed Stock Act 1911		
s13AA - payment of principal and interest on money raised by Stock issued under the Act and payments on depository interests in Stock issued under the Act	**55,983,173**	57,529,106
s13A - payment of costs and expenses incurred in relation to issuing and managing debt and depository interests	**12,742**	31,305
s13B - payment of costs and expenses incurred in repurchasing debt prior to maturity	**30,989,895**	26,560,649
Financial Agreement Act 1994		
s5 - debt redemption assistance and payment of interest to bond holders on behalf of the State and Northern Territory Governments on public debt under the Act (a)	**8**	8
Public Governance, Performance and Accountability Act 2013		
s58(7) - investments made in the name of the Commonwealth of Australia	**461,350,000**	473,450,000
Total	**548,335,818**	557,571,068

(a) The 2018-19 amount includes $1,156 paid into the Debt Retirement Reserve Trust Account (2017-18: $1,131).

The following details administered special appropriations that are available but were not used by the AOFM during 2018-19 and 2017-18 (where relevant):

- *Australian National Railways Commission Sale Act 1997, sec 67AW* — Purpose: payment of principal and interest on former debts of the National Railways Commission.
- *Loans Redemption and Conversion Act 1921, sec 5* — Purpose: payment of principal, interest and costs of converting loans made in accordance with the Act.
- *Loans Securities Act 1919, sec 4* — Purpose: payment of principal and interest on money raised by stock issued under the Act.
- *Loans Securities Act 1919, sec 5B* — Purpose: payment of money under a swap or other financial arrangement and any expenditure in connection with the negotiation, management or service of, or a repayment under, any such agreement.
- *Loans Securities Act 1919, sec 5BA* — Purpose: payment of money to enter into securities lending arrangements.

- *Moomba-Sydney Pipeline System Sale Act 1994, sec 19* — Purpose: payment of principal and interest on former debts of the Pipeline Authority.
- *Public Governance, Performance and Accountability Act 2013, sec 74A* — Purpose: payments of recoverable GST.
- *Treasury Bills Act 1914, sec 6* — Purpose: payment of principal and interest on money raised by issuance of Treasury Bills.

The following table details the investments (in face value terms) made in the name of the Commonwealth under the authority of section 58 of the *Public Governance, Performance and Accountability Act 2013*.

PGPA Act investments — in face value ($'000)

	2019	2018
Opening value	**45,100,000**	58,718,811
Acquisitions	**461,350,000**	473,450,000
Redemptions and sales	**(475,350,000)**	(487,068,811)
Closing value	**31,100,000**	45,100,000

Administered annual appropriations ($'000)

	2019	2018
Annual appropriations	**-**	10
Total available for payment	**-**	10
Appropriation applied	**-**	-
Variance	**-**	10

Unspent administered annual appropriation ($'000)

	2019	2018
Appropriation Act 1 2017-18	**-**	10

Special account — Debt Retirement Reserve Trust Account (DRRTA) ($'000)

	2019	2018
Opening balance	**40**	44
Appropriation for reporting period:		
Commonwealth contributions	**1**	1
Interest amounts credited	**-**	1
State contributions	**1**	1
Available for payments	**42**	47
Debt repayments made	**-**	(7)
Balance	**42**	40
Balance represented by:		
Cash - held in the Official Public Account	**42**	40

Establishing Instrument — *Public Governance, Performance and Accountability Act 2013*, section 80.

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.

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

Special account — Australian Business Securitisation Fund (ABSF)

Establishing Instrument — *Australian Business Securitisation Fund Act 2019*, section 11.

Purpose — to establish the $2 billion ABSF to increase access to and over time reduce the cost of finance to small and medium enterprises (SME) by making targeted interventions in the SME securitisation market.

The ABSF received its first funding credit of $250 million on 1 July 2019.

Note 9: Budgetary report to outcome comparison

The AOFM produces budget estimates of Australian Government Securities (AGS) and certain financial assets for the Australian Government Budget which is released in April/May each year for the Budget year (the financial year commencing on the following 1 July) and three forward years.

The projections of debt issuance and asset holdings are a consequence of the expenditure, investment and revenue decisions and assumptions made by the government in producing its Budget. As part of the Budget process, the AOFM receives an estimate of the aggregated annual financing task for the Budget year and forward years from the Treasury. The Headline Cash Surplus/Deficit (which represents net cash flows after operating activities and investing activities for policy purposes; and before investments for liquidity purposes and financing activities) is the closest published aggregate to this financing task. The financing task plus the volume of maturing AGS debt and planned early repurchases of AGS debt (that would otherwise mature in a future year) determines the size of the planned debt issuance program in each year.

The volume of AGS debt that needs to be issued in face value terms to generate the required level of financing will depend on the future level of AGS yields (or interest rates) and the mix and tenor of debt to be issued. The mix and tenor of debt to be issued is based on the debt management strategy for the period ahead, which in turn takes into account longer-term portfolio considerations.

A technical assumption is made about future AGS yields. It is assumed that the AGS yields for different tenors of debt will be the same as the prevailing observed market rates at the time the budget estimates are prepared.

2018-19 Budget

In the 2018-19 Budget (released in May 2018) the government estimated a Headline Cash Deficit of $27.6 billion for 2018-19. After AGS maturities and redemptions of $48.4 billion, operational considerations (such as market conditions, the uncertainty and timing associated with future year funding requirements, the strength of revenue collections relative to forecast and the level of cash holdings to maintain) and financing transactions of other government agencies; the long term debt issuance program for 2018-19 was set at $77 billion.

At the time of the Mid-Year Economic and Fiscal Outlook (released in December 2018) the Headline Cash Deficit for 2018-19 was forecast to improve (by $9.3 billion) to $18.3 billion. The long term debt issuance program was reduced (by $19 billion) to $58 billion after adjustment for a reduction in the level of cash holdings to maintain.

At the time of 2019-20 Budget (released in April 2019) the Headline Cash Deficit was forecasted to improve further (by $5.6 billion) to $12.7 billion. The long term issuance program was increased (by $1.9 billion) to $59.9 billion after operational considerations.

Administered schedule of comprehensive income ($m)

	Outcome	Budget (a)	Variance
	2019	**2019**	**2019**
EXPENSES			
Interest expense	**17,088**	17,781	(693)
Supplier expenses	**12**	30	(18)
Total expenses	**17,100**	17,811	(711)
INCOME			
Interest revenue	**565**	597	(32)
Total income	**565**	597	(32)
GAINS (LOSSES)			
Debt repurchased	**(896)**	(641)	(255)
Total gains (losses)	**(896)**	(641)	(255)
Surplus (deficit) before re-measurements	**(17,431)**	(17,855)	424
RE-MEASUREMENTS			
Net market revaluation	**(43,550)**	1,315	(44,865)
Total re-measurements	**(43,550)**	1,315	(44,865)
Surplus (deficit)	**(60,981)**	(16,540)	(44,441)

(a) Original Budget released in May 2018. The Budget figures are not audited.

Significant variances in expenses before re-measurements

Interest expense for 2018-19 was $0.7 billion lower than forecast at Budget, primarily due to lower interest costs on Treasury Bonds ($0.5 billion) and Treasury Indexed Bonds ($0.2 billion).

The lower interest expense is attributable to lower levels of issuance than forecast (due to an improvement in the fiscal position), lower issuance rates than forecast (due to lower bond yields) and higher debt repurchases than forecast.

Significant variances in gains (losses)

Repurchases of future year maturities of $15 billion for Treasury Bonds and $2 billion for Treasury Indexed Bonds was forecast at Budget. Such repurchases mitigate future funding and refinancing risks. Over the course of 2018-19, the AOFM conducted buybacks of future year maturities of $16.7 billion for Treasury Bonds and $3.1 billion for Treasury Indexed Bonds. This was due to greater than expected investor demand.

In addition, as part of its cash management operations the AOFM repurchases debt maturing in the current financial year from time-to-time. In 2018-19 the AOFM repurchased $6.3 billion of near maturity Treasury Bonds and $1.5 billion of near maturity Treasury Indexed Bonds. The early redemption of within year maturities are not forecast in the Budget. The additional repurchases of debt prior to maturity realised additional accounting losses.

Significant variances in re-measurements

It is assumed in the Budget that AGS yields for different tenors of debt will be the same as the prevailing observed market rates (at the time when the budget estimates are prepared). Due to this technical assumption, re-measurements of the portfolio for changes in market interest rates are not significant. However, actual market yields as at 30 June 2019 were significantly lower across the nominal yield curve by around 120 basis points than as at 30 June 2018. This has resulted in an increase in the market value of the AGS portfolio compared to Budget. There is an inverse relationship between yield and price for bonds.

Administered schedule of assets and liabilities ($m)

	Outcome	Budget (a)	Variance
	2019	**2019**	**2019**
LIABILITIES			
Interest bearing liabilities	**626,369**	594,437	31,932
Total liabilities	**626,369**	594,437	31,932
ASSETS			
Cash at bank	**1**	1	-
Investments	**31,112**	35,660	(4,548)
Loans to State and Territory Governments	**1,711**	1,712	(1)
Total assets	**32,824**	37,373	(4,549)
Net assets	**(593,545)**	(557,064)	(36,481)

(a) Original Budget released in May 2018. The Budget figures are not audited.

Significant variances in interest bearing liabilities

The value of the AGS portfolio outstanding was $31.9 billion higher than Budget. This is primarily attributable to differences in the market revaluation for 2018-19 of $44.9 billion (due to significant reductions in market yields as compared to Budget) and offset by lower face value of debt outstanding of $19.2 billion (due to lower issuance arising from an improved fiscal position).

Significant variances in investments

The AOFM had $31.1 billion (in face value terms) of term deposit investments as at 30 June 2019, which was $4.5 billion less than forecast in Budget. Term deposits are highly variable in nature as they are influenced by the government's payments and receipts, and due to AOFM operational considerations.

Note 10: Securities lending facility

The AOFM has a securities lending facility for Treasury Bonds and Treasury Indexed Bonds, operated by the RBA. The purpose of the facility is to enhance the efficiency of the bond markets by allowing bond market participants to borrow Treasury Bonds and Treasury Indexed Bonds when they are not readily available in those markets. Bonds are lent on an intra-day or overnight basis.

Transactions undertaken during the period

	Number		Face value ($m)	
	2019	2018	**2019**	2018
Overnight:				
Treasury Bonds	**8**	28	**236**	1,220
Treasury Indexed Bonds	**13**	26	**157**	458
Intra-day:				
Treasury Bonds	**9**	8	**636**	738
Treasury Indexed Bonds	**1**	-	**30**	-
Total	**31**	62	**1,059**	2,416

No transactions were open at the beginning or end of the year.

DEPARTMENTAL ACCOUNTS

Departmental assets, liabilities, revenue and expenses are those items that an entity has control over and include ordinary operating costs and associated funding, salaries, employee entitlements and operational expenses.

Statement of comprehensive income ($'000)

for the period ended 30 June 2019

	Notes	2019	2018
NET COST OF SERVICES			
EXPENSES			
Employee benefits	A	**7,017**	6,822
Supplier expenses	A	**3,379**	3,460
Depreciation and amortisation		**434**	433
Total expenses		**10,830**	10,715
OWN-SOURCE INCOME			
Staff secondments		**310**	447
Resources received free of charge		**298**	290
Total own-source income		**608**	737
Net cost of services		**10,222**	9,978
APPROPRIATION FUNDING			
Revenue from government		**11,723**	10,834
Total appropriation funding		**11,723**	10,834
Surplus (deficit)		**1,501**	856

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

Statement of financial position ($'000)

as at 30 June 2019

	Notes	2019	2018
ASSETS			
Financial assets:			
Cash and cash equivalents		**73**	73
Receivables	B	**24,946**	24,586
Non-financial assets:			
Property, plant and equipment	C	**1,786**	2,047
Computer software	D	**780**	942
Supplier prepayments		**60**	223
Total assets		**27,645**	27,871
LIABILITIES			
Payables:			
Supplier payables		**237**	136
Salary and superannuation		**48**	47
Provisions:			
Employee provisions	E	**2,853**	2,354
Other provisions	F	**418**	418
Total liabilities		**3,556**	2,955
Net assets		**24,089**	24,916
EQUITY			
Retained surplus		**31,968**	30,467
Contributed equity		**(7,879)**	(5,551)
Total equity		**24,089**	24,916

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

Current/non-current balances reported ($'000)

	2019	2018
Current assets	**14,316**	12,866
Non-current assets	**13,329**	15,005
Current liabilities	**802**	672
Non-current liabilities	**2,754**	2,283

Statement of changes in equity ($'000)

for the period ended 30 June 2019

	Notes	2019	2018
RETAINED SURPLUS			
Changes for period:			
Surplus (deficit)		**1,501**	856
Change for period		**1,501**	856
+ opening value		**30,467**	29,611
Closing balance		**31,968**	30,467
CONTRIBUTED EQUITY			
Changes for period:			
Capital injection - capital budget		**710**	713
Return of capital - appropriations extinguished		**(3,038)**	(1,631)
Change for period		**(2,328)**	(918)
+ opening value		**(5,551)**	(4,633)
Closing balance		**(7,879)**	(5,551)
Total equity		**24,089**	24,916

The AOFM is not aware of any quantifiable or unquantifiable departmental contingencies as of the signing date that may have an impact on its operations.

Statement of cash flows ($'000)

for the period ended 30 June 2019

	Notes	2019	2018
OPERATING ACTIVITIES			
Cash received (used):			
Appropriations		**9,400**	10,256
GST received from ATO		**6**	5
Services and other		**475**	537
Employees		**(6,556)**	(6,732)
Suppliers		**(2,844)**	(3,543)
GST paid to ATO		**-**	(8)
Transfers to Official Public Account (a)		**(481)**	(542)
Net cash from operating activities	**G**	**-**	(27)
INVESTING ACTIVITIES			
Cash received (used):			
Purchase of leasehold improvements		**-**	(204)
Purchase of plant and equipment		**(11)**	(9)
Purchase of prepayment		**(8)**	-
Net cash from investing activities		**(19)**	(213)
FINANCING ACTIVITIES			
Cash received (used):			
Appropriations		**19**	213
Net cash from financing activities		**19**	213
Net change in cash held		**-**	(27)
+ cash held at the beginning of period		**73**	100
Cash held at the end of the period		**73**	73

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

(a) Non appropriation receipts are required to be returned to the Official Public Account (OPA). They increase the AOFM's available appropriation under section 74 of the *Public Governance, Performance and Accountability Act 2013* and when subsequently drawn down for use by the AOFM they are recorded as appropriations.

Note A: Expenses

Employee benefits ($'000)

	2019	2018
Wages and salaries	**5,555**	5,384
Superannuation	**1,049**	943
Leave entitlements	**398**	197
Other employee expenses	**15**	298
Total	**7,017**	6,822

The below table sets out the CEO's actual remuneration (on an accruals basis).

Key Management Personnel ($'000)

	2019	2018
Short-term employee benefits:		
Salary and other short-term benefits	**365**	354
Annual leave accrued	**29**	29
Long service leave accrued	**10**	9
Post employment benefits (superannuation)	**51**	51
Total	**455**	443
Number of key management personnel	**1**	1

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly. The Chief Executive Officer (CEO), the Secretary to the Treasury and the Treasurer have been determined to be key management personnel for the AOFM. The CEO only is remunerated by the AOFM.

Supplier expenses ($'000)

	2019	2018
ANAO - notional audit fee	**298**	290
Corporate support services	**828**	829
Depository and transaction services	**20**	168
Market data services	**522**	555
Operating lease payments - premises	**264**	277
Travel	**233**	316
Treasury management system	**240**	289
Workers compensation premium	**24**	21
Other	**950**	715
Total	**3,379**	3,460

The AOFM's operating lease is for its office premises within the Treasury Building and is a sub-lease from the Department of the Treasury. The sub-lease is largely a back-to-back arrangement of the Department of the Treasury's lease with the building owner, the Department of Finance.

The lease term ends on 21 December 2025, and there are two 5-year extension options.

Rental payments, with the exception of years where there is a market review (2021, 2024 and upon extension) increase by 3 per cent per annum.

Future estimated lease payments ($'000)

	2019
Within 1 year	**281**
1 to 5 years	**1,187**
Over 5 years	**3,971**
Total	**5,439**

Note B: Receivables

Accounting policy

Receivables are measured at fair value on initial recognition and at amortised cost on subsequent measurement.

Appropriations receivable are recognised at their nominal amounts. Appropriations receivable are appropriations controlled by the AOFM but held in the OPA under the government's 'just in time' drawdown arrangements.

Receivables ($'000)

	2019	2018
Goods and services (related)	**16**	112
Appropriations receivable	**24,930**	24,474
GST	**-**	-
Total	**24,946**	24,586

No receivable is overdue.

Recovery of receivables expected in ($'000)

	2019	2018
No more than 12 months	**14,183**	12,570
More than 12 months	**10,763**	12,016
Total	**24,946**	24,586

Note C: Property, plant and equipment

Accounting policy

Asset recognition threshold on acquisition

Purchases of leasehold improvements are recognised initially at cost except for purchases costing less than $10,000 which are expensed at the time of acquisition. For leasehold improvements the estimated cost of removal and restoring the leased premises to their original condition is included in the initial cost of leasehold improvements.

Purchases of plant and equipment are recognised initially at cost except for purchases costing less than $1,000 which are expensed at the time of acquisition.

Revaluations

Following initial recognition at cost, valuations are conducted with sufficient frequency to ensure that the carrying amounts of assets do not materially differ from fair value as at the reporting date. Fair value is determined by depreciated replacement cost for leasehold improvements and by secondary market information for plant and equipment.

Property, plant and equipment ($'000)

	2019	2018
Gross value:		
Leasehold improvements	**1,924**	1,924
Plant and equipment	**441**	430
Accumulated depreciation:		
Leasehold improvements	**(472)**	(247)
Plant and equipment	**(107)**	(60)
Total	**1,786**	2,047

No indicators of impairment were identified for property, plant and equipment.

Reconciliation of changes in gross value ($'000)

	2019	2018
Opening value	**2,354**	2,335
Purchases	**11**	19
Disposals	**-**	-
Closing value	**2,365**	2,354

Reconciliation of changes in accumulated depreciation ($'000)

	2019	2018
Opening value	**(307)**	(36)
Depreciation charge for period	**(272)**	(271)
Disposals	**-**	-
Closing value	**(579)**	(307)

Depreciation

Leasehold improvements are depreciated on a straight line basis over the unexpired period of the lease.

Plant and equipment is depreciated on a straight line basis, on the basis of the following useful lives.

Useful life

	2019	2018
Artwork	**100 years**	100 years
Furniture and fittings	**Lease term**	Lease term
ICT equipment	**3-5 years**	3-5 years

Useful lives are assessed annually and revised if necessary to reflect current estimates of an asset's useful life to the AOFM. Revisions in useful life affect the rate of depreciation applied for the current period and future periods.

No useful lives were revised in 2018-19 (2017-18: nil).

Note D: Computer software

Accounting policy

Asset recognition threshold on acquisition

Purchases of computer software are recognised initially at cost 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.

Computer software ($'000)

	2019	2018
Gross value	**1,521**	1,521
Accumulated amortisation	**(741)**	(579)
Total	**780**	942

No indicators of impairment were identified for computer software.

Amortisation

Software assets are amortised on a straight line basis over their anticipated useful lives, being three to ten years (2017-18: three to ten years).

Software assets are carried at cost and are not subject to revaluation.

Reconciliation of changes in accumulated amortisation ($'000)

	2019	2018
Opening value	**(579)**	(417)
Amortisation charge for period	**(162)**	(162)
Closing value	**(741)**	(579)

Note E: Employee provisions

Accounting policy

Leave

The liability for employee benefits includes provisions for annual leave and long service leave. No provision has been made for sick leave as 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.

Long service leave and annual leave are measured at the present value of the estimated future payments to be made. In determining the present value, the AOFM commissions a periodic actuarial assessment.

Superannuation

The AOFM contributes to defined benefit superannuation schemes (the Commonwealth Superannuation Scheme and the Public Sector Superannuation Scheme) and accumulation plans (defined contribution schemes) on behalf of staff.

The AOFM accounts for its superannuation contributions as if they were defined contribution plans i.e. it has no ongoing liability to report. The superannuation benefits payable to an employee upon termination of employment with the Australian Government from defined benefit schemes is recognised in the financial statements of the Department of Finance and is settled by the Australian Government in due course.

An on cost liability is recognised for superannuation contributions payable on accrued annual leave and long service leave as at the end of the financial year.

Employee provisions ($'000)

	2019	2018
Annual leave	**557**	524
Long service leave	**1,948**	1,583
Superannuation	**348**	247
Total	**2,853**	2,354

Payment of employee provisions expected in ($'000)

	2019	2018
No more than 12 months	**517**	489
More than 12 months	**2,336**	1,865
Total	**2,853**	2,354

Note F: Other provisions

Other provisions are for the restoration of the AOFM's leasehold premises on expiry of its lease.

The AOFM lease for its office premises ends on 21 December 2025, there are two 5 year extension options.

Other provisions ($'000)

	2019	2018
Make good on leasehold premises	**418**	418
Total	**418**	418
Other provisions are expected to be settled in:		
No more than 12 months	**-**	-
More than 12 months	**418**	418
Total	**418**	418

Reconciliation of movements in other provisions ($'000)

	2019	2018
Opening balance	**418**	418
New / re-measurements	**-**	-
Total	**418**	418

Note G: Cash flow reconciliation

The following table reconciles the AOFM's operating cash flows as presented in the Statement of Cash Flows to its net cost of services presented in the Statement of Comprehensive Income.

Reconciliation of net cost of services to net operating cash flows ($'000)

	2019	2018
Net cost of services	**(10,222)**	(9,978)
Add revenue from Government	**11,723**	10,834
Adjustments for non-cash items:		
Depreciation and amortisation	**434**	433
Appropriations extinguished	**(3,038)**	(1,631)
Asset accruals	**-**	194
Change in receivables for capital budget items	**699**	500
Adjustments for changes in assets:		
(Increase) decrease in receivables	**(360)**	87
(Increase) decrease in supplier prepayments	**163**	(165)
Adjustments for changes in liabilities:		
Increase (decrease) in supplier payables	**101**	(374)
Increase (decrease) in salary and superannuation	**1**	(2)
Increase (decrease) in employee provisions	**499**	75
Increase (decrease) in other provisions	**-**	-
Net cash from operating activities	**-**	(27)

Note H: Appropriations

The following table outlines appropriations for the period and the amount of appropriations utilised for the period.

Annual appropriations ($'000)

	2019	2018
Annual appropriations:		
Outputs	**11,723**	10,867
Departmental capital budget	**710**	713
Appropriation withheld (a)	**-**	(33)
Public Governance, Performance and Accountability Act 2013:		
Section 74 - retained receipts	**481**	542
Total available for payment	**12,914**	12,089
Appropriation applied (current and prior years)	**(9,419)**	(10,496)
Variance	**3,495**	1,593

(a) On 29 June 2018, $33,000 relating to savings measures announced at MYEFO 2017-2018 was withheld via section 51 of the *Public Governance, Performance and Accountability Act 2013*.

The variance in departmental appropriations available to appropriations applied (spent) is explained by lower administrative costs than expected.

The following table outlines the unspent balance of appropriations available to the AOFM as at the end of the reporting period.

Unspent departmental annual appropriations ($'000)

	2019	2018
Appropriation Act (No. 1) 2015-16 (a)	**-**	1,631
Supply Act (No. 1) 2016-17 (b)	**2,687**	4,966
Appropriation Act (No. 1) 2016-17 (b)	**201**	7,342
Appropriation Act (No. 2) 2016-17 (b)	**150**	150
Appropriation Act (No. 1) 2017-18	**12,089**	12,089
Appropriation Act (No. 1) 2018-19	**11,980**	-
Appropriation Act (No. 3) 2018-19	**934**	-
Total	**28,041**	26,178
Represented By:		
Cash at bank	**73**	73
Appropriations receivable	**24,930**	24,474
Appropriations extinguished - 1 July	**3,038**	1,631
Total	**28,041**	26,178

(a) The Appropriation Act was repealed on 1 July 2018 and unspent funds were no longer available for use at this time. Unspent funds were accounted for as a return of capital on 30 June 2018 (refer to Statement of Changes in Equity).

(b) These Acts were repealed on 1 July 2019 and unspent funds were no longer available for use at this time. Unspent funds were accounted for as a return of capital on 30 June 2019 (refer to Statement of Changes in Equity).

Note I: Budgetary report to outcome comparison

The Budgetary comparison is to the original Budget released in May 2018. The Budget figures are not audited.

Statement of comprehensive income ($'000)

	Outcome	Budget (a)	Variance
NET COST OF SERVICES			
EXPENSES			
Employee benefits	**7,017**	6,669	348
Supplier expenses	**3,379**	4,811	(1,432)
Depreciation and amortisation	**434**	500	(66)
Total	**10,830**	11,980	(1,150)
OWN-SOURCE INCOME			
Revenue	**608**	691	(83)
Total	**608**	691	(83)
Net cost of services	**10,222**	11,289	(1,067)
APPROPRIATION FUNDING			
Revenue from government	**11,723**	10,789	934
Total	**11,723**	10,789	934
Surplus (deficit)	**1,501**	(500)	2,001

(a) Original Budget released in May 2018. The Budget figures are not audited.

Statement of financial position ($'000)

	Outcome	Budget (a)	Variance
ASSETS			
Financial assets:			
Cash and cash equivalents	**73**	100	(27)
Receivables	**24,946**	25,660	(714)
Non-financial assets:			
Property, plant and equipment	**1,786**	2,322	(536)
Computer software	**780**	1,604	(824)
Supplier prepayments	**60**	58	2
Total	**27,645**	29,744	(2,099)
LIABILITIES			
Payables	**285**	559	(274)
Employee provisions	**2,853**	2,366	487
Other provisions	**418**	418	-
Total	**3,556**	3,343	213
Net assets	**24,089**	26,401	(2,312)
EQUITY			
Retained surplus	**31,968**	29,611	2,357
Contributed equity	**(7,879)**	(3,210)	(4,669)
Total	**24,089**	26,401	(2,312)

(a) Original Budget released in May 2018. The Budget figures are not audited.

Statement of changes in equity ($'000)

	Outcome	Budget (a)	Variance
EQUITY			
RETAINED SURPLUS			
Opening balance	**30,467**	30,111	356
Surplus (deficit)	**1,501**	(500)	2,001
Total	**31,968**	29,611	2,357
CONTRIBUTED EQUITY			
Opening balance	**(5,551)**	(3,920)	(1,631)
Capital injections	**710**	710	-
Appropriations extinguished	**(3,038)**	-	(3,038)
Total	**(7,879)**	(3,210)	(4,669)

(a) Original Budget released in May 2018. The Budget figures are not audited.

Statement of cash flows ($'000)

	Outcome	Budget (a)	Variance
OPERATING ACTIVITIES			
Cash received	**9,881**	11,487	(1,606)
Cash used	**(9,881)**	(11,487)	1,606
Net cash from operating activities	**-**	-	-
INVESTING ACTIVITIES			
Cash received	**-**	-	-
Cash used	**(19)**	(710)	691
Net cash from investing activities	**(19)**	(710)	691
FINANCING ACTIVITIES			
Cash received - appropriations	**19**	710	(691)
Net cash from financing activities	**19**	710	(691)
Net change in cash held	**-**	-	-
+ cash held at the beginning of period	**73**	100	(27)
Cash held at the end of the period	**73**	100	(27)

(a) Original Budget released in May 2018. The Budget figures are not audited.

Significant variances in the Departmental financial statements

Employee expenses were higher than forecast at Budget primarily due to the valuation of employee leave entitlements, the present value of which increased due to an increase in the factor applied to the nominal value of future cash flows, and due to an increase in the rates applied for superannuation oncosts. These revisions were based on independent advice received for the valuation of the AOFM's leave provisions.

During 2018-19 the AOFM incurred lower than forecast supplier expenses for undertaking its issuance program and managing its portfolio of financial assets and liabilities. Reasons for this include the use of conservative assumptions in estimating certain expenditures and savings achieved on other expenditure classes.

Appropriation funding was greater than Budget by $0.9 million, due to additional funding provided to implement and manage the Australian Business Securitisation Fund (ABSF).

Receivables were lower than estimated at Budget by $0.7 million. This comprises lower than anticipated unbilled recoveries from secondments ($0.2 million) and a lower than anticipated appropriation receivable ($0.5 million).

Expenditure on infrastructure, plant and equipment and software was lower than forecast due to changes in the expected timing of capital expenditures on fit-out and debt management system assets. Subject to a few exceptions, the AOFM acquires managed services by way of outsourcing and cloud computing, which has reduced its call on capital expenditures particularly in relation to information and communication technology. In recognition of this change, from the 2019-20 Budget the AOFM has reduced its capital budget allocation.

The balance of contributed equity as at 30 June 2019 was lower than Budget due to the extinguishment of appropriations (which were not forecast).

Basis of preparation of the financial statements

The Australian Office of Financial Management is a listed entity under the *Public Governance, Performance and Accountability Act 2013*. The AOFM is a not-for-profit Australian Government entity.

These financial statements cover the AOFM as an administrative entity of the Commonwealth of Australia and are for the reporting period 1 July 2018 to 30 June 2019. They are required by section 42 of the *Public Governance, Performance and Accountability Act 2013*, and are general purpose financial statements prepared on a going concern basis.

The financial statements have been prepared in accordance with:

- the *Public Governance, Performance and Accountability (Financial Reporting) Rule 2015*; and
- Australian Accounting Standards that apply for the reporting period.

The financial statements have been prepared on an historical cost basis, except for certain assets and liabilities which are carried at fair value or on a discounted cash flow basis as required or allowable by relevant accounting standards.

The financial statements are presented in Australian dollars and values are rounded as indicated.

The continued existence of the AOFM in its present form, and with its present outcome and program, is dependent on government policy and on continuing appropriations by Parliament for the AOFM's administration and activities.

New Australian Accounting Standards applicable to the reporting period

During 2018-19 the AOFM adopted all applicable Australian Accounting Standards that became effective during the reporting period.

AASB 9 became operational on 1 July 2018 and at that time the AOFM made a change to the accounting treatment of its administered term deposit investments from being carried at fair value through profit or loss to amortised cost. The carrying value adjustment on 1 July 2018 (of $4 million) was recognised directly in opening equity. Comparatives were not adjusted.

In re-stating its term deposits to amortised cost from fair value through profit or loss as at 1 July 2018, the AOFM used the effective interest method applicable at the time of initial recognition of the investments. If the AOFM had not reclassified its term deposits it would have recognised an unrealised fair value loss of $3 million for 2018-19.

New Australian Accounting Standards applicable in future reporting periods

A number of revised or new Australian Accounting Standards have been issued that are effective for future reporting periods. With the exception of AASB 16 *Leases* (effective for the 2019-20 financial year), the revisions are not expected to materially affect the AOFM's assets, liabilities, revenue and expenses.

AASB 16 *Leases*

Currently, accounting standards distinguish between operating leases and finance leases. Lessees are required to recognise finance leases only on the balance sheet. Under AASB 16 the majority of leases will need to be recognised on the balance sheet by lessees.

On 1 July 2019 the AOFM will recognise a lease liability and an equivalent 'right of use' asset for $4.8 million pertaining to its property sub-lease with the Department of Treasury. Comparatives will not be adjusted.

ANAO Audit Opinion

Auditor-General for Australia

Australian National
Audit Office

INDEPENDENT AUDITOR'S REPORT

To the Treasurer

Opinion

In my opinion, the financial statements of the Australian Office of Financial Management ('the Entity') for the year ended 30 June 2019:

(a) comply with Australian Accounting Standards and the *Public Governance, Performance and Accountability (Financial Reporting) Rule 2015*; and

(b) present fairly the financial position of the Entity as at 30 June 2019 and its financial performance and cash flows for the year then ended.

The financial statements of the Entity, which I have audited, comprise the following statements as at 30 June 2019 and for the year then ended:

- Statement by the Chief Executive Officer and Chief Finance Officer;
- Statement of Comprehensive Income;
- Statement of Financial Position;
- Statement of Changes in Equity;
- Cash Flow Statement;
- Administered Schedule of Comprehensive Income;
- Administered Schedule of Assets and Liabilities;
- Administered Reconciliation Schedule;
- Administered Cash Flow Statement; and
- Notes to the financial statements, comprising a Summary of Significant Accounting Policies and other explanatory information.

Basis for Opinion

I conducted my audit in accordance with the Australian National Audit Office Auditing Standards, which incorporate the Australian Auditing Standards. My responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of my report. I am independent of the Entity in accordance with the relevant ethical requirements for financial statement audits I conduct. These include the relevant independence requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants* (the Code) to the extent that they are not in conflict with the *Auditor-General Act 1997* I have also fulfilled my other responsibilities in accordance with the Code. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Key Audit Matter

Key audit matters are those matters that, in my professional judgement, were of most significance in my audit of the financial statements of the current period. The matter set out below was addressed in the context of my audit of the financial statements as a whole, and in forming my opinion thereon, and I do not provide a separate opinion on this matter.

Key audit matter	How the audit addressed the matter
Valuation of Australian Government Securities *Refer to Administered Note 1 'Financial Risk Management', 2 'Treasury Bonds', 3 'Treasury*	The audit procedures that I applied to address the matter included testing: • the design and effectiveness of general key IT controls relevant to the treasury

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Indexed Bonds', and 4 'Treasury Notes'.

The Australian Office of Financial Management issues Australian Government Securities on behalf of the Commonwealth Government. The securities primarily comprise treasury bonds, treasury indexed bonds, and treasury notes.

The valuation of Australian Government Securities is a key audit matter due to:

- the significant value of Australian Government Securities relative to the Australian Office of Financial Management's balance sheet ($626,363 million at 30 June 2019) and the range of financial instruments held; and
- the valuation of financial instruments uses a variety of different fair value estimation methodologies which involve assumptions about the return on securities over a long period into the future.

management systems used to record and measure Australian Government Securities;

- the design and effectiveness of key controls relevant to the issuance of Australian Government Securities, including new tenders, debt coupon payments, coupon redemptions, and debt buybacks;
- the design and effectiveness of key controls relevant to the ongoing monitoring of market valuations of debt; and
- valuations of Australian Government Securities at 30 June 2019, using the following procedures:
    - agreed the face values and coupon rates of treasury bonds, treasury indexed bonds, and treasury notes to independent third party reports; and
    - performed a recalculation of the fair value of Australian Government Securities for issued treasury bonds, treasury indexed bonds, and treasury notes and assessed the assumptions about future returns on these securities against market yield data.

Accountable Authority's Responsibility for the Financial Statements

As the Accountable Authority of the Australian Office of Financial Management the Chief Executive Officer is responsible under the *Public Governance, Performance and Accountability Act 2013* for the preparation and fair presentation of annual financial statements that comply with Australian Accounting Standards and the rules made under that Act. The Chief Executive Officer is also responsible for such internal control as the Chief Executive Officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Chief Executive Officer is responsible for assessing the Entity's ability to continue as a going concern, taking into account whether the Entity's operations will cease as a result of an administrative restructure or for any other reason. The Chief Executive Officer is also responsible for disclosing matters related to going concern as applicable and using the going concern basis of accounting unless the assessment indicates that it is not appropriate.

Auditor's Responsibilities for the Audit of the Financial Statements

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Australian National Audit Office Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with the Australian National Audit Office Auditing Standards, I exercise professional judgement and maintain professional scepticism throughout the audit. I also:

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;

- obtain an understanding of internal control relevant to the audit 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 Entity's internal control;
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Chief Executive Officer;
- conclude on the appropriateness of the Chief Executive Officer's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Entity to cease to continue as a going concern; and
- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with the Chief Executive Officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

From the matters communicated with the Chief Executive Officer, I determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. I describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, I determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Australian National Audit Office

Grant Hehir

Grant Hehir

Auditor-General

Canberra

23 August 2019

PART 5: OTHER INFORMATION

OTHER INFORMATION

Agency financial performance

The AOFM recorded an operating surplus on agency activities of $1.50 million for the 2018–19 financial year, comprising total revenue of $12.33 million and expenses of $10.83 million. The surplus in 2018–19 was due to lower than anticipated operating costs.

As at 30 June 2019, the AOFM was in a sound net worth and liquidity position, with net assets of $24.09 million, represented by assets of $27.65 million and liabilities of $3.56 million.

As at 30 June 2019, the AOFM had unspent appropriations totalling $24.93 million. Unspent appropriations are available to settle liabilities as and when they fall due and for future asset replacements and improvements.

Agency resource statement and resources for outcomes

Table 9: Expenses and resources for Outcome 1

Outcome 1: The advancement of macroeconomic growth and stability and the effective operation of financial markets, through issuing debt, investing in financial assets and managing debt, investments and cash for the Australian Government	**Budget(a) 2018-19 $'000**	**Actual Expenses 2018-19 $'000**	**Variation $'000**
Program1.1: Australian Office of Financial Management			
Departmental expenses			
Departmental appropriation and other receipts	10,344	10,098	246
Expenses not requiring appropriation in the Budget year	820	732	88
Administered expenses before re-measurements			
Expenses not requiring appropriation	774,217	895,566	(121,349)
Special appropriations expenses			
Commonwealth Inscribed Stock Act 1911	17,153,897	17,099,879	54,018
Financial Agreement Act 1994	8	8	-
Total expenses for program1.1	**17,939,286**	**18,006,283**	**(66,997)**
	2018-19	**2018-19**	
Average staffing level (number)	**40**	**37**	**3**

(a) The Budget figure for 2018–19 is the estimated actual 2018–19 expenses, reported in Table 2.1 of the 2019–20 Portfolio Budget Statements.

Table 10: AOFM resource statement

		Actual available appropriation 2018-19 $'000	Payments made 2018-19 $'000	Appropriations extinguished 2018-19 $'000	= Balance 2018-19 $'000
Ordinary annual services					
Departmental appropriation(a)(b)		36,979	9,419	3,038	24,522
Receipts from other sources (s74)(c)		481		-	481
Total departmental		37,460	9,419	3,038	25,003
Administered expenses					
Total administered		-	-	-	-
Total ordinary annual services	**A**	37,460	9,419	3,038	25,003
Other services					
Departmental non-operating		-	-	-	-
Total other services	**B**	-	-	-	-
Total available annual appropriations (A+B)		37,460	9,419	3,038	25,003
Special appropriations - operating					
Commonwealth Inscribed Stock Act 1911		21,462,472	21,462,472	-	-
Financial Agreement Act 1994		8	8	-	-
Subtotal		21,462,480	21,462,480	-	-
Special appropriations - investing and financing					
Commonwealth Inscribed Stock Act 1911		65,565,094	65,565,094	-	-
Public Governance, Performance and Accountability Act 2013		461,350,000	461,350,000	-	-
Subtotal		526,915,094	526,915,094	-	-
Total special appropriations	**C**	548,377,574	548,377,574	-	-
Total appropriations excluding special accounts (A + B + C)		548,415,034	548,386,993	3,038	25,003
Special Accounts					
Debt Retirement Reserve Trust Account		42	-	-	42
Total Special Account	**D**	42	-	-	42
Total net resourcing and payments for AOFM (A + B + C + D)		548,415,076	548,386,993	3,038	25,045

(a) Actual available appropriation comprises *Appropriation Act (No.1) 2018–19* plus carried forward appropriation balances as at 1 July 2018.
(b) Includes capital budget appropriation for 2018–19 of $0.710 million.
(c) Receipts received under section 74 of the PGPA Act.

Grant programs

Under the *Financial Agreement Act 1994*, the Commonwealth is required to contribute to the Debt Retirement Reserve Trust Account to assist the Northern Territory and State governments to redeem maturing debt on allocation to them. Monies standing to the credit of this Account are held for the purposes prescribed by the *Financial Agreement Act 1994*.

The contributions made by the Commonwealth are accounted for as grants in the AOFM's financial statements.

Advertising and market research

The AOFM incurred expenditure of $5,247 in advertising to promote the Australian Government Securities market to investors.

The AOFM incurred expenditure of $14,832 during 2018–19 to media advertising organisations for staff recruitment.

Freedom of information

Agencies subject to the *Freedom of Information Act 1982* (FOI Act) are required to publish information to the public as part of the Information Publication Scheme (IPS). Freedom of information (FOI) matters in respect of the AOFM are handled by the Treasury and all documents disclosed in response to FOI requests (other than personal or business information that would be unreasonable to publish) are published on the FOI Disclosure Log of the Treasury website. The Treasury reports on AOFM's FOI requests in an annual submission to the Office of the Australian Information Commissioner (OAIC) for inclusion in the OAIC's annual report. In 2018–19, the AOFM received no FOI requests.

An agency plan showing what information is published in accordance with the IPS requirements, including material relevant to the AOFM, is accessible from the AOFM's website at https://www.aofm.gov.au/about/access-information/information-publication-scheme

Ecologically sustainable development

The AOFM's operations have an impact on the environment typical of office operations generally. Facilities management services are provided to the AOFM by the Treasury under a Memorandum of Understanding, and by Broadspectrum under a whole of Australian Government arrangement administered by the Department of Finance. Broadspectrum are obligated to comply with environmental laws and Commonwealth environmental policies and to report to the Department of Finance regarding their compliance. Information on the environmental impact of the services provided to AOFM by the Treasury is published in the Treasury's Annual Report.

Management structure of the AOFM's debt and assets

The assets and liabilities managed by the AOFM and held on its administered balance sheet in 2018–19 were AGS (Treasury Bonds, Treasury Indexed Bonds and Treasury Notes), term deposits placed with the RBA and loans to the States under the various Commonwealth-State Housing Agreements.

For financial and risk management purposes, these assets and liabilities are allocated into different financial portfolios: long-term debt; cash management; and housing advances. This allocation recognises the different objectives, risks and management approaches required in each area.

The **long-term debt portfolio** includes all AGS, other than Treasury Notes, which are issued for cash management purposes.

The **cash management portfolio** includes Treasury Notes and assets which are held to manage within-year variability in the Australian Government's financing requirements. This portfolio is used to fund differences in the timing of Government payments and receipts, as well as providing for contingency liquidity in the event of an unforeseen call on cash requirements separate to planned needs (such as reduced issuance capability during a major market dislocation event).

The **housing advances portfolio** comprises loans for public housing made to the states and territories. These loans, which were not evidenced by the issue of securities, were made under previous Commonwealth-state financing arrangements. The last of these loans is due to mature on 30 June 2042.

AGS issuance for 2018-19

Table 11: Treasury Bond tender results — 2018–19

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
2-Jul-18	2.25% 21-Nov-2022	300	2.2034	-0.80	0.25	7.68
4-Jul-18	2.75% 21-Nov-2029	800	2.6094	-0.43	0.25	3.46
1-Aug-18	2.75% 21-Nov-2029	1,000	2.7136	-0.39	0.50	2.88
10-Aug-18	2.25% 21-Nov-2022	1,000	2.1839	-0.48	0.50	4.67
13-Aug-18	3.75% 21-Apr-2037	400	2.8670	-0.40	0.50	2.15
15-Aug-18	2.50%21-May-2030	1,000	2.6348	-0.08	0.75	3.18
22-Aug-18	2.25% 21-Nov-2022	1,000	2.1415	-0.45	0.50	4.62
27-Aug-18	2.25% 21-May-2028	500	2.5482	-0.26	0.50	5.14
29-Aug-18	2.75% 21-Nov-2029	1,000	2.6052	-0.06	0.75	2.70
7-Sep-18	2.50%21-May-2030	1,000	2.5859	-0.33	0.50	3.30
10-Sep-18	2.25% 21-Nov-2022	600	2.1168	-0.41	0.50	4.68
12-Sep-18	2.25% 21-May-2028	1,000	2.5890	-0.43	0.50	3.20
24-Sep-18	2.75% 21-Nov-2029	800	2.7220	-0.42	0.75	2.84
26-Sep-18	2.50%21-May-2030	1,500	2.8035	-0.05	1.00	2.47
3-Oct-18	3.25% 21-Apr-2029	500	2.6465	-0.35	0.25	4.97
5-Oct-18	2.25% 21-Nov-2022	500	2.1725	-0.61	0.00	5.90
8-Oct-18	2.75% 21 Nov-2028	500	2.7698	-0.62	0.75	4.94
10-Oct-18	2.50%21-May-2030	1,000	2.7996	-0.41	0.25	3.24
17-Oct-18	2.75% 21-Nov-2029	1,000	2.7298	-0.29	0.25	3.10
22-Oct-18	2.25% 21-Nov-2022	500	2.1921	-0.39	0.25	6.45
24-Oct-18	2.50%21-May-2030	1,000	2.7190	-0.45	0.50	4.04
2-Nov-18	3.25% 21-Apr-2029	1,000	2.6631	-0.24	0.50	3.00
5-Nov-18	3.00% 21-Mar-2047	500	3.2330	0.10	1.25	2.62
7-Nov-18	2.75% 21 Nov-2028	1,000	2.7387	-0.38	0.50	2.99
14-Nov-18	2.75% 21-Nov-2029	1,000	2.7366	-0.34	0.50	3.91
19-Nov-18	3.25% 21-Apr-2029	1,000	2.6596	-0.17	0.50	2.57
21-Nov-18	2.50%21-May-2030	1,000	2.7486	-0.34	0.50	3.31
26-Nov-18	2.75% 21 Nov-2028	600	2.6418	-0.35	0.25	4.66
28-Nov-18	2.25% 21-Nov-2022	1,000	2.1794	-0.45	0.50	4.09
5-Dec-18	2.75% 21-Nov-2029	1,000	2.5399	-0.41	0.75	2.51
10-Dec-18	3.25% 21-Apr-2029	700	2.4121	-0.27	0.25	2.75
12-Dec-18	2.50%21-May-2030	1,000	2.4958	0.21	0.50	2.83
14-Jan-19	2.50%21-May-2030	1,000	2.3296	0.26	0.50	2.93
21-Jan-19	2.75% 21-Apr-2024	700	1.9831	-0.16	0.75	3.77
23-Jan-19	2.75% 21-Nov-2029	900	2.2988	-0.09	0.50	2.70
1-Feb-19	3.75% 21-Apr-2037	400	2.5517	0.79	0.75	2.60
4-Feb-19	2.25% 21-May-2028	400	2.2256	-0.27	0.50	3.16
6-Feb-19	2.50%21-May-2030	900	2.2814	-0.06	0.25	3.13
13-Feb-19	2.75% 21-Nov-2029	900	2.1564	-0.06	0.50	2.98
18-Feb-19	2.75% 21-Jun-2035	400	2.3978	-0.84	1.00	2.44
20-Feb-19	2.50%21-May-2030	900	2.1472	-0.20	0.50	3.39
25-Feb-19	3.25% 21-Jun-2039	400	2.5125	-0.37	0.50	2.66
27-Feb-19	3.25% 21-Apr-2029	500	2.0855	0.13	0.75	4.82
4-Mar-19	5.50% 21-Apr-2023	400	1.7167	-0.52	0.25	6.05

Table 11: Treasury Bond tender results — 2018–19 (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
8-Mar-19	2.50%21-May-2030	900	2.0677	-0.20	0.50	3.41
18-Mar-19	3.25% 21-Apr-2029	600	1.9692	-0.26	0.25	4.13
20-Mar-19	2.50%21-May-2030	900	1.9459	-0.16	0.50	3.03
25-Mar-19	2.75% 21-Apr-2024	500	1.4465	-0.52	0.25	5.61
27-Mar-19	2.75% 21-Nov-2029	900	1.8158	-0.04	0.50	2.81
1-Apr-19	5.50% 21-Apr-2023	700	1.4064	-0.27	0.25	3.99
5-Apr-19	2.50%21-May-2030	900	1.9247	-0.16	0.25	3.03
8-Apr-19	2.75% 21-Jun-2035	400	2.1445	-0.20	0.25	3.22
10-Apr-19	2.75% 21-Nov-2029	900	1.8864	-0.11	0.50	2.91
15-Apr-19	2.50%21-May-2030	800	1.9783	-0.02	0.50	3.42
29-Apr-19	3.25% 21-Jun-2039	300	2.2240	1.02	1.00	2.30
1-May-19	2.50%21-May-2030	900	1.8222	-0.18	0.25	3.17
8-May-19	2.75% 21-Nov-2029	900	1.7652	-0.10	0.50	3.52
13-May-19	2.50%21-May-2030	500	1.7478	-0.31	0.50	3.76
15-May-19	2.75% 21-Apr-2024	900	1.3028	-0.49	0.75	2.84
29-May-19	1.50% 21-Jun-2031	3,000	1.6073		1.25	3.59
5-Jun-19	2.50%21-May-2030	900	1.5477	-0.12	0.50	2.67
19-Jun-19	1.50% 21-Jun-2031	2,000	1.4307	0.02	0.75	2.43
Average over year to June 2019				-0.23	0.52	3.57
Average over 3 years to June 2019				-0.39	0.57	3.80
Average over 10 years to June 2019				-0.29	0.82	3.62

Table 12: Treasury Bond syndication results — 2018–19

Syndication date	Coupon and maturity	Face value amount allocated ($m)	Issue yield (%)	Joint Lead Managers
17-Jul-18	2.75% 21-May-2041	3,600	3.090	Commonwealth Bank of Australia, TD Securities, UBS AG Australia Branch and Westpac Institutional Bank

Table 13: Treasury Bond buyback tender results — 2018–19

Tender date	Coupon and maturity	Face value amount repurchased ($m)	Weighted average accepted yield (%)	Spread to secondary market yield (basis points)	Range of offers accepted (basis points)	Times covered
2-Jul-18	2.75% 21-Oct-2019	236	1.9528	0.75	1.25	4.55
	4.50% 15-Apr-2020	64	1.9806	0.43	0.50	
13-Aug-18	2.75% 21-Oct-2019	350	1.9624	0.99	0.50	4.83
	4.50% 15-Apr-2020	50	1.9675	0.87	0.00	
27-Aug-18	2.75% 21-Oct-2019	325	1.9671	0.71	0.50	3.15
	4.50% 15-Apr-2020	175	1.9731	0.93	0.50	
10-Sep-18	2.75% 21-Oct-2019	489	1.9834	0.34	0.75	3.50
	4.50% 15-Apr-2020	111	1.9936	0.28	0.25	
24-Sep-18	2.75% 21-Oct-2019	310	1.9857	0.69	1.00	2.46
	4.50% 15-Apr-2020	490	2.0344	1.31	2.00	
8-Oct-18	2.75% 21-Oct-2019	400	1.9050	1.34	0.00	4.16
	1.75% 21-Nov-2020	100	2.0108	0.33	0.25	
22-Oct-18	2.75% 21-Oct-2019	400	1.9038	0.38	0.25	5.02
	1.75% 21-Nov-2020	100	2.0281	0.43	0.50	
5-Nov-18	4.50% 15-Apr-2020	100	1.9954	-0.11	0.75	2.71
	1.75% 21-Nov-2020	400	2.0436	0.62	0.25	
19-Nov-18	4.50% 15-Apr-2020	301	2.0150	0.45	0.00	2.75
	1.75% 21-Nov-2020	699	2.0483	0.70	0.50	
26-Nov-18	4.50% 15-Apr-2020	550	2.0094	1.09	0.25	4.19
	1.75% 21-Nov-2020	50	2.0350	-0.05	0.00	
10-Dec-18	4.50% 15-Apr-2020	305	1.9197	0.74	0.25	4.92
	1.75% 21-Nov-2020	395	1.9072	0.77	0.50	
14-Jan-19	4.50% 15-Apr-2020	620	1.8990	2.10	2.00	3.71
	1.75% 21-Nov-2020	380	1.8750	0.75	0.25	
21-Jan-19	4.50% 15-Apr-2020	208	1.9134	0.84	0.25	3.64
	1.75% 21-Nov-2020	492	1.9050	0.75	0.00	
4-Feb-19	4.50% 15-Apr-2020	140	1.8889	0.02	0.25	3.62
	1.75% 21-Nov-2020	260	1.8575	0.00	0.00	
18-Feb-19	4.50% 15-Apr-2020	350	1.7884	1.09	0.50	5.41
	1.75% 21-Nov-2020	50	1.7813	0.51	0.25	
4-Mar-19	4.50% 15-Apr-2020	313	1.8012	0.62	1.50	5.52
	1.75% 21-Nov-2020	87	1.7894	0.70	0.75	
18-Mar-19	1.75% 21-Nov-2020	485	1.6066	1.21	1.00	3.78
	5.75% 15-May-2021	115	1.5900	0.55	0.00	
25-Mar-19	5.75% 15-May-2021	500	1.4617	0.42	0.50	4.31
1-Apr-19	4.50% 15-Apr-2020	650	1.5625	1.33	0.00	4.97
	5.75% 15-May-2021	50	1.4725	0.75	0.00	
8-Apr-19	4.50% 15-Apr-2020	850	1.5678	1.41	0.50	3.99
	5.75% 15-May-2021	50	1.4925	0.99	0.00	
15-Apr-19	4.50% 15-Apr-2020	334	1.5752	0.52	0.75	2.65
	5.75% 15-May-2021	466	1.5298	0.66	0.50	
29-Apr-19	4.50% 15-Apr-2020	50	1.4080	0.40	0.50	5.87
	1.75% 21-Nov-2020	250	1.3659	0.33	0.50	
13-May-19	4.50% 15-Apr-2020	50	1.3976	0.56	0.50	4.17
	1.75% 21-Nov-2020	450	1.3251	0.76	0.50	
29-May-19	4.50% 15-Apr-2020	50	1.1940	0.90	0.25	4.88
	1.75% 21-Nov-2020	450	1.1571	1.21	0.50	
19-Jun-19	4.50% 15-Apr-2020	337	1.1051	0.84	0.50	2.50
	1.75% 21-Nov-2020	263	1.0294	0.71	0.50	
Average over year to June 2019				0.71	0.48	4.05

Table 14: Treasury Indexed Bond tender results — 2018–19

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
10-Jul-18	1.25% 21-Aug-2040	150	0.9086	-1.75	2.75	3.45
14-Aug-18	0.75% 21-Nov-2027	150	0.7099	-3.01	1.75	4.38
28-Aug-18	1.25% 21-Feb-2022	150	0.3481	-4.11	1.25	5.00
9-Oct-18	0.75% 21-Nov-2027	150	0.8078	-0.49	1.25	4.97
13-Nov-18	1.25% 21-Feb-2022	150	0.4793	-2.08	0.50	4.53
27-Nov-18	0.75% 21-Nov-2027	150	0.8033	-1.04	3.00	3.45
12-Feb-19	1.25% 21-Feb-2022	150	0.2366	0.09	2.25	3.53
26-Feb-19	0.75% 21-Nov-2027	100	0.5083	-0.98	0.50	4.74
12-Mar-19	3.00% 20-Sep-2025	100	0.3898	-0.81	0.25	7.71
26-Mar-19	0.75% 21-Nov-2027	150	0.2700	-1.12	0.00	3.70
9-Apr-19	2.50% 20-Sep-2030	150	0.3300	-2.75	0.00	5.31
14-May-19	3.00% 20-Sep-2025	150	0.0924	-1.23	1.50	4.30
31-May-19	0.75% 21-Nov-2027	150	-0.0645	-1.20	1.25	4.53
11-Jun-19	1.25% 21-Feb-2022	150	-0.1899	-0.27	1.75	3.47
25-Jun-19	3.00% 20-Sep-2025	150	-0.2597	0.25	1.75	2.89
Average over year to June 2019				-1.37	1.32	4.40
Average over 3 years to June 2019				-1.15	1.57	3.66

Table 15: Treasury Indexed Bond syndication results — 2018–19

Syndication date	Coupon and maturity	Face value amount allocated ($m)	Issue yield (%)	Joint Lead Managers
18-Sep-18	1.00% 21-Feb-2050	3,750	1.1600	Bank of America Merrill Lynch, Citi, Deutsche Bank AG Sydney Branch, UBS AG Australia Branch and Westpac Institutional Bank

Table 16: Treasury Note tender results — 2018–19

Tender date	Maturity	Face value amount allocated ($m)	Weighted average issue yield (%)	Spread to OIS (basis points)	Range of bids accepted (basis points)	Times covered
5-Jul-18	12-Oct-18	500	1.8511	35.08	7.0	4.02
19-Jul-18	12-Oct-18	500	1.9708	47.08	4.0	4.88
2-Aug-18	12-Oct-18	500	1.9438	44.38	3.0	4.80
16-Aug-18	12-Oct-18	500	1.9073	40.73	2.0	4.26
23-Aug-18	7-Dec-18	500	1.9167	41.67	5.0	4.60
6-Sep-18	7-Dec-18	500	1.9140	41.40	5.0	6.00
20-Sep-18	7-Dec-18	500	1.9092	40.92	1.0	4.47
4-Oct-18	7-Dec-18	500	1.8620	36.20	1.0	5.72
11-Oct-18	22-Feb-19	500	1.8343	33.25	6.0	5.59
25-Oct-18	22-Feb-19	500	1.8129	31.29	5.0	5.00
8-Nov-18	22-Feb-19	500	1.8530	35.30	7.0	4.51
22-Nov-18	22-Feb-19	500	1.9299	42.99	8.0	2.82
6-Dec-18	12-Apr-19	500	1.8632	36.32	8.0	4.89
20-Dec-18	12-Apr-19	500	1.8600	36.06	15.0	4.10
17-Jan-19	12-Apr-19	500	1.9603	46.23	14.0	3.65
31-Jan-19	12-Apr-19	500	2.0115	51.46	7.0	3.78
14-Feb-19	12-Apr-19	500	1.9478	45.25	8.0	4.34
21-Feb-19	21-Jun-19	500	1.8983	41.74	7.0	5.32
7-Mar-19	21-Jun-19	500	1.8082	34.51	8.0	5.14
21-Mar-19	21-Jun-19	500	1.7291	26.96	8.0	4.42
4-Apr-19	21-Jun-19	500	1.7135	25.43	7.0	4.34
11-Apr-19	23-Aug-19	500	1.6865	26.93	7.0	5.10
2-May-19	23-Aug-19	500	1.5634	26.40	4.0	4.84
16-May-19	23-Aug-19	500	1.5549	20.08	10.0	3.92
30-May-19	23-Aug-19	500	1.4094	21.42	13.0	4.41
13-Jun-19	23-Aug-19	500	1.3498	15.34	1.0	4.63
20-Jun-19	25-Oct-19	500	1.1914	13.49	5.0	4.98
Average over year to June 2019				34.74	6.5	4.61
Average over 3 years to June 2019				23.45	6.1	4.06

Remuneration

Table 17: Remuneration

Key Management Personnel

		Short-term benefits			Post-employment	Other long-term benefits		Termination benefits	
Name	Position	Base salary and annual leave	Bonuses	Other benefits	Superannuation	Long service leave	Other	Termination benefits	Total
		$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000
Rob Nicholl	CEO	394,494			51,065	9,599			455,158

The CEO's remuneration conditions are established by the Secretary to the Treasury. AOFM does not have any SES staff other than Key Management Personell.

Table 17: Remuneration (continued)

Highly Paid Staff

		Short-term benefits			Post-employment	Other long-term benefits		Termination benefits	
Remuneration Band	Number	Average base salary and annual leave $'000	Average bonuses $'000	Average other benefits $'000	Average superannuation $'000	Average long service leave $'000	Average other $'000	Average termination benefits $'000	Average total $'000
220,000 — 245,000	1	185,698			26,157	13,574			225,429
245,000 -270,000	2	225,634			34,806	8,089			268,529
270,000 — 295,000	4	233,623			43,140	8,152			284,915
295,000 — 320,000	0								—
345,000 — 370,000	1	304,334			56,931	10,056			371,321

Remuneration for Other Highly Paid Staff is established by the AOFM's Enterprise Bargaining Agreement

Glossary

Accrual cost

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

Australian Government Securities (AGS)

Debt obligations of the Australian Government evidenced by the issue of securities or, nowadays, issued as inscribed stock. AGS on issue are predominantly Treasury Bonds, Treasury Indexed Bonds and Treasury Notes but also include small residual amounts of Australian Savings Bonds, Peace Saving Certificates and War Saving Certificates.

Bank Bill Swap (BBSW) rate

The mid-rate of the market for bank accepted bills and negotiable certificates of deposit issued by banks designated by the Australian Financial Markets Association as 'Prime Banks', that have a remaining maturity of between one and six months. BBSW is used as a reference rate for various financial products.

Basis point

One hundredth of one per cent.

Bid-ask spread

The difference between the price (or yield) at which a market maker is willing to buy and sell a particular financial product or instrument.

Book value (or carrying amount)

The amount at which an asset or liability is recognised in the balance sheet. Under a fair value methodology, measurement is by reference to current market rates. Under an historic cost methodology, measurement is by reference to market value rates at the time the original transaction was conducted. The AOFM's assets and liabilities are measured at fair value, except for advances to State and Territory governments for public housing, which are measured at historic cost.

Cash Management Portfolio

The Cash Management Portfolio is a part of the overall portfolio of assets and liabilities managed by the AOFM. It contains short-term assets and liabilities and is used to manage the within-year variability in government cash flows.

Coupon rate

A rate of interest paid on a bond, which is fixed for a specified period (usually the term of the bond). In the case of Treasury Bonds coupon interest is payable semi-annually, while for Treasury Indexed Bonds it is paid quarterly. In each case, the coupon rate is set on the date of announcement of first issuance of the bond line.

Credit risk

The risk of counterparty default creating financial loss. Credit risk is contingent on the combination of a default and there being pecuniary loss. The AOFM faces credit risk in relation to its settlement and investment activities (except in relation to its term deposits held with the RBA).

Credit spread

The difference in yields between securities of different credit qualities. The credit spread reflects the additional net yield required by an investor from a security with more credit risk relative to one with less credit risk.

Discount

An amount by which the value of a security on transfer is less than its face (or par) value.

Discounting

Calculating the present value of a future amount.

Duration

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

Exposure

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

Face value

The amount of money indicated on a security, or inscribed in relation to a security, payable to the holder on maturity and used to calculate interest payments. In the case of a Treasury Indexed Bond, the face value is the principal or par value, unadjusted for changes in the Consumer Price Index.

Fixed rate

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

Floating rate

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

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 the ability to raise term funding to cover future Budget needs (including the maturities of Treasury Bonds and Treasury Indexed Bonds). This is distinct from re-financing risk, which relates to the ability to 'roll-over' or pay down short-term funding obligations.

Futures basket

A collection of like financial products or commodities, grouped together, that are used to define the benchmark for pricing a futures contract. The Australian Securities Exchange three-year, 10-year and 20-year Treasury Bond futures baskets consist of collections of Treasury Bond lines that have an average term to maturity of approximately three, ten and twenty years respectively.

Futures contract

An agreement to buy or sell an asset at a specified date in the future at a price agreed today. The agreement is completed by physical delivery or cash settlement, or alternatively is offset prior to the expiration date. In Australia, standardised futures contracts are traded on the Australian Securities Exchange. Futures contracts traded on the Australian Securities Exchange include contracts for three-year, 10-year and 20-year Treasury Bonds.

Historic cost

The basis of measurement where an asset or liability is recorded at fair value on initial recognition and, after initial recognition, by amortisation of the initial value using market rates at the time the transaction was conducted that gave rise to the asset or liability.

Interest

The charge for borrowing money, usually expressed as an annual percentage rate. For the AOFM financial statements, interest cost is the coupon payment (where relevant) adjusted for the amortised cost carrying value of a debt security. Where a debt security is issued at a premium or discount to its principal value, the premium or discount at issuance is recognised in amortised cost carrying value and amortised over the life of the security using the effective interest method. This amortisation is recognised in the interest cost.

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

Interest rate risk

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

Issuance

The sale of debt securities in the primary market.

Liquidity

The capacity for a debt instrument to be readily purchased or sold. A liquid market allows the ready buying or selling of large quantities of an instrument at relatively short notice, in reasonable volume and without significant influencing its price.

Liquidity also refers to the ability to meet cash payment obligations.

Liquidity risk

The risk that a financial instrument will not be able to be readily purchased or sold.

Long-Term Debt Portfolio (LTDP)

The Long-Term Debt Portfolio is the substantive part of the portfolio managed by the AOFM. It contains ongoing domestic and foreign currency liabilities.

Market risk

The risk that the price (value) of a financial instrument or portfolio of financial instruments will vary as market conditions change. In the case of a debt issuer and investor such as the AOFM, the principal source of market risk is from changes in interest rates.

Market value

The amount of money for which a security is traded in the market at a particular point in time.

Modified duration

A measure of the sensitivity of the market value of a debt security to a change in interest rates. It is measured as the percentage change in the market value of a debt instrument in response to a one percentage point change in nominal interest rates. Portfolios with higher modified durations tend to have more stable interest costs through time, but more volatile market values. Modified duration is related to duration by the equation:

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

At times, 'modified duration' is abbreviated to 'duration', and desirably only in contexts where this will not lead to confusion.

Nominal debt

Debt that is not indexed to inflation. Treasury Notes and Treasury Bonds are examples of nominal debt.

Nominal interest rate

Interest rate that does not take account of the effects of inflation (in contrast to the 'real' interest rate).

Official Public Account (OPA)

The OPA is the collective term for the Core Bank Accounts maintained at the RBA for Australian Government cash balance management.

Operational risk

The risk of loss, whether direct or indirect, arising from inadequate or failed internal business processes or systems.

Overnight cash rate

The interest rate charged on overnight loans between financial intermediaries. The RBA manages the supply of funds available in the money market to keep the cash rate as close as possible to a target set by the Bank Board as an instrument of monetary policy.

Overnight Indexed Swap (OIS)

A fixed for floating interest rate swap in which one party agrees to pay another party a fixed interest rate in exchange for receiving the average overnight cash rate recorded over the term of the swap. The term to maturity of such swaps is typically between one week and one year. Financial market participants enter into overnight indexed swaps to manage their exposures to movement in the overnight cash rate.

Physical debt

Securities that give rise to debt, in contrast to derivatives (which give rise to a contingent liability). Treasury Bonds, Treasury Indexed Bonds and Treasury Notes represent physical debt.

Present value

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

Primary market

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

Real interest rate

An interest rate that has been adjusted to take account of the effects of inflation.

Repricing risk

The risk that interest rates will have increased when maturing debt needs to be refinanced.

Residential mortgage-backed security (RMBS)

A debt instrument issued by a special purpose vehicle to finance the securitisation of a pool of loans that is secured by residential mortgages.

Risk premium

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

Secondary market

The market where securities are bought and sold subsequent to original issuance. Investors trade securities between themselves (usually via intermediaries such as banks) in the secondary market.

Securities lending

An activity whereby securities are lent to a financial market participant for a fee.

Securities lending facility

A facility established by the AOFM in 2004 that uses repurchase agreements to lend Treasury Bonds and Treasury Indexed Bonds to market participants for short periods. The facility is operated by the RBA on behalf of the AOFM. It supports the efficient operation of these markets as it facilitates trading by enabling dealers to obtain specific lines of stock when they are not readily available from other sources.

Short-dated exposure

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

Spread

The difference between two prices or yields.

Syndication

Where an issuer arranges a primary market transaction through a panel of banks but the bonds that are issued are purchased as a result of direct orders from end-investors during the syndication process. The final price and volume of issuance are typically determined as part of the process, but either or both could be pre-set at specific levels prior to commencement of the process.

Tender

A method of issuance whereby debt is sold through auction. The amount, coupon and maturity date of the stock are announced by the issuer. Registered participants then bid for their desired amounts of stock at interest rates at which they are prepared to buy. Bids are accepted from lowest interest rate (yield) upward until the issue amount has been filled. Stock is therefore allocated in order of lowest yield (and highest price).

Tenor

The tenor of a financial instrument is its remaining term to maturity.

Term deposit

A deposit held at a financial institution that has a fixed (short) term. When a term deposit is purchased, the lender (the customer) understands that the money can only be withdrawn after the term has ended, or after having given a predetermined number of days' notice.

Term premium

The extra return investors demand for holding a longer-term bond as opposed to investing in a series of short-term bonds.

Treasury Bond

A medium to long term debt security issued by the Australian Government that carries an annual rate of interest (the coupon rate), which is fixed over the life of the security and payable in six-monthly instalments (semi-annually) on the face, or par, value of the security. The bonds are repayable in full at face value on maturity.

Treasury Indexed Bond

A security issued by the Australian Government for which the capital value is adjusted periodically according to movements in the Consumer Price Index. Interest is paid quarterly at a fixed rate on the adjusted capital value. At maturity, investors receive the adjusted capital value of the bond — that is, the initial face value as adjusted for inflation over the life of the bond. Interest Indexed Bonds, another form of indexed bond, were also issued by the Commonwealth Government in the past but these have all now matured.

Treasury Note

A short-term debt security issued by the Australian Government at a discount and redeemable at par on maturity. The interest payable on the notes is represented by the difference between their issue value and their par or face value.

Two-way price

A price (or yield) at which a market-maker is prepared to both buy and sell a particular financial product or instrument. That is, the simultaneous quoting of a bid and an offer.

Yield

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

Yield curve

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

ACRONYMS

AASB	Australian Accounting Standards Board
ADIs	Authorised Deposit-taking Institutions
AFMA	Australian Financial Markets Association
AGFIF	Australian Government Fixed Income Forum
AGS	Australian Government Securities
AML/CTF	Anti-Money Laundering and Counter-Terrorism Financing
ANAO	Australian National Audit Office
AOFM	Australian Office of Financial Management
APS	Australian Public Service
APSC	Australian Public Service Commission
AUD	Australian dollar
AUSTRAC	Australian Transaction Reports and Analysis Centre
BBSW	Bank Bill Swap Reference Rates
CEO	Chief Executive Officer
CPI	Consumer Price Index
CPRs	Commonwealth Procurement Rules
EL	Executive Level (APS Classification)
EU	European Union
FOI	Freedom of Information
FTE	Full-time equivalent
GST	Goods and Services Tax

IPS	Information Publication Scheme
IT	Information technology
LTDP	Long-Term Debt Portfolio
OAIC	Office of the Australian Information Commissioner
OIS	Overnight Indexed Swap
OPA	Official Public Account
PGPA	*Public Governance, Performance and Accountability Act 2013*
PSM	Portfolio Strategy Meeting
RBA	Reserve Bank of Australia
RMBS	Residential Mortgage-backed Security
SES	Senior Executive Service
SME	Small and Medium Enterprises
TIB	Treasury Indexed Bond
US	United States of America
USD	United States dollar

Index of compliance with requirements

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INDEX

R

S

T