The Auditor-General
Auditor-General Report No.18 2023–24
Performance Audit

# Australian Office of Financial Management's Management of the Australian Government's Debt

Australian Office of Financial Management

Department of the Treasury

Australian National Audit Office

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Chief Operating Officer
Corporate Management Group
Australian National Audit Office
GPO Box 707
Canberra ACT 2601

Or via email:
communication@anao.gov.au.

Canberra ACT

22 February 2024

Dear President
Dear Mr Speaker

In accordance with the authority contained in the *Auditor-General Act 1997*, the Auditor-General has undertaken an independent performance audit in the Australian Office of Financial Management and the Department of the Treasury. The report is titled *Australian Office of Financial Management's Management of the Australian Government's Debt.* Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit to the Parliament.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's website — http://www.anao.gov.au.

Yours sincerely

Rona Mellor PSM
Acting Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

**AUDITING FOR AUSTRALIA**

The Auditor-General is head of the Australian National Audit Office (ANAO). The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits, financial statement audits and assurance reviews of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Australian Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

For further information contact:
**Australian National Audit Office**
**GPO Box 707**
**Canberra ACT 2601**

**Phone: (02) 6203 7300**
**Email: ag1@anao.gov.au**

Auditor-General reports and information about the ANAO are available on our website:
http://www.anao.gov.au

### Audit team

Vijay Murik
Hoa Nguyen
Nancy Jin
David Willis
Alyssa McDonald
David Tellis

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# Audit snapshot

**Auditor-General Report No.18 2023–24**

*Australian Office of Financial Management's Management of the Australian Government's Debt*

## Why did we do this audit?

- Debt is the largest liability on the Australian Government's balance sheet.
- The level of public debt interest payments on Australian government debt is currently high, giving rise to risks and costs to the Budget.
- The audit provides assurance to Parliament on the effectiveness of the Australian Office of Financial Management's (AOFM) management of the Australian Government's debt.

## Key facts

- The AOFM manages the debt portfolio of the Australian Government and borrows on behalf of the Government. The Treasury oversees the AOFM's borrowing activities.
- The AOFM issued $848.7 billion of Australian Government Securities (AGS) between 1 January 2020 and 30 June 2023.
- At the 2023–24 Mid-year Economic and Fiscal Outlook, the Australian Government is expected to pay $20.0 billion in interest payments on AGS in 2023–24, which is expected to increase to $28.2 billion by 2026–27.

## What did we find?

- The AOFM is largely effective at managing Australian Government debt.
- The AOFM and Treasury have largely effective governance arrangements to support debt issuance and management activities but lacked clarity in relation to the accountabilities and responsibilities for oversight of debt management.
- The AOFM is largely effective at managing costs and risks associated with government debt. Financial risks relating to debt management were managed appropriately. The AOFM has policies and processes in place to support cost effective borrowing, but it does not assess whether the government debt portfolio was structured at least cost subject to acceptable risk.

## What did we recommend?

- The Auditor-General made five recommendations to the AOFM and three recommendations to Treasury relating to governance, probity and performance evaluation of debt management activities.
- The AOFM and Treasury agreed to all recommendations.

**$889.8b**

value of outstanding Australian Government Securities as at 30 June 2023.

**2.43%**

interest costs of the debt portfolio as a share of the value of the debt portfolio at 30 June 2023.

**40%**

proportion of outstanding Treasury Bonds as at 30 June 2023 that will mature and be repaid prior to 30 June 2028.

# Summary and recommendations

## Background

1. The Australian Office of Financial Management (AOFM) is responsible for the management of the Australian Government's debt and related financial assets, such as cash holdings.[1] The AOFM has been the sovereign debt manager for Australia since its establishment in 1999 and undertakes borrowing activities on behalf of the Australian Government.[2] Before the AOFM was established, the Department of the Treasury (Treasury) was responsible for sovereign debt management. Treasury is the 'lead economic adviser' for the Australian Government, and aims to 'provide advice to the Government and implement policies and programs to achieve strong and sustainable outcomes'.[3]

2. The Australian Government borrows money by issuing Australian Government Securities (AGS), previously named Commonwealth Government Securities. AGS issuance activities take place to meet the borrowing requirements of the Australian Government, especially when there is a Budget deficit[4], and to maintain the effective operation of the AGS market.[5]

### Rationale for undertaking the audit

3. AGS is the largest liability on the Australian Government's balance sheet. The value of AGS outstanding has risen from $561.8 billion as at 1 January 2020 to $889.8 billion as at 30 June 2023, primarily due to increased Australian Government borrowing during the COVID-19 pandemic and is expected to continue to increase with future borrowing activities. The amount of interest required to be paid increases with the amount of AGS on issue.[6] The amount and trajectory of AGS on issue is related to the fiscal sustainability of the Australian Government. Increased debt on issue incurs higher debt servicing[7] costs in the long term.[8] As noted by the International Monetary Fund, 'prudent debt management' can support government resilience to volatile market conditions and financial crises.[9]

1 AOFM, *Annual Report 2021–22,* AOFM, 2022, p. 7.

2 This was a role that was held within the Department of the Treasury prior to 1 July 1999.

3 Treasury, *Corporate Plan 2023–24* [Internet], Treasury, available from https://corporate-plan.treasury.gov.au/ [accessed 18 September 2023].

4 When the Government's expenditure is greater than its revenue from taxation and its revenue from non-taxation sources such as interest and dividends, this is referred to as a 'budget deficit'.

5 Australian Office of Financial Management, *AOFM Annual Report 2021–22* [Internet], available from https://www.aofm.gov.au/publications/annual-reports [accessed on 18 September 2023].

6 Australian Government Budget Paper No. 1: 2022–23, Commonwealth of Australia, Canberra, 2023, pp. 195–197.

7 The debt servicing costs refers to the cost of covering the payment of principal and interest of a debt instrument.

8 Treasury, *2023 Intergenerational Report,* Box 6.1 p.130 [Internet], Treasury, available from https://treasury.gov.au/publication/2023-intergenerational-report [accessed at 13 September 2023].

9 World Bank and International Monetary Fund, *Revised Guidelines for Public Debt Management* [Internet], IMF, Washington, D.C, 2014, available from https://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/Revised-Guidelines-for-Public-Debt-Management-PP4855 [accessed 4 August 2023].

4. The audit provides assurance to Parliament on the effectiveness of the AOFM's management of the Australian Government's debt.[10]

### Audit objective and criteria

5. The objective of this audit was to assess the effectiveness of the AOFM's management of the Australian Government's debt.

6. To form a conclusion against the objective, the following high-level criteria were adopted:

- Was there an effective governance framework to manage government debt?
- Was government debt appropriately managed?

## Conclusion

7. The AOFM is largely effective at managing the Australian Government's debt.

8. The AOFM and Treasury have largely effective governance arrangements to support operational activities to fund the Australian Government, including establishing, approving and executing a strategy for debt management. The roles, responsibilities and accountabilities amongst key stakeholders in relation to debt management oversight and decision-making under the legislative framework are not transparent. There is a lack of clear documentation of debt management policy and operational decisions and the rationale behind these decisions. The AOFM lacked processes for the documentation and management of gifts, benefits and hospitality. The AOFM and Treasury could improve adherence to legislative requirements and internal policies relating to conflict of interest.

9. The AOFM is largely effective at managing costs and risks associated with Australian Government debt. The AOFM has a framework for managing funding risk and interest rate risk relating to its borrowing activities. The AOFM met the Australian Government's borrowing requirements between 1 January 2020 and 30 June 2023. The AOFM did not define any targets, limits or benchmarks for the cost of the debt portfolio. The AOFM has policies and processes in place to support cost-effective borrowing, but it does not assess whether the debt portfolio was managed at least cost subject to acceptable risk. Debt management activities were supported by relevant information from internal and external sources in respect of economic and financial market conditions, and the fiscal conditions of the Australian Government. The AOFM's borrowing decisions were consistent with relevant aspects of guidelines on best practices for public debt management published by the World Bank and International Monetary Fund.

## Supporting findings

### Governance arrangements

10. The AOFM has appropriate policies and procedures in place to issue Australian Government debt and to provide advice to the Treasurer and Secretary of the Treasury (the secretary), relating to debt management. The internal bases for advice and recommendations on

10 Senator Katy Gallagher also wrote to the ANAO in May 2020 to examine the effectiveness of the Government's debt management given the significant and rapidly increasing debt levels as a result of the COVID-19 pandemic, available from https://www.anao.gov.au/work/request/effectiveness-the-commonwealth-governments-debt-management.

debt management to the Treasurer and the secretary are mostly not documented, therefore not clear or transparent. The Treasurer and the secretary have oversight of debt management through policies and procedures for the annual oversight of debt management, however, while these establish parameters for debt issuance, these parameters can be operationally varied. The Commonwealth Inscribed Stock (Maximum Total Face Value of Stock and Securities) Direction 2020, which sets a maximum legislative limit on the total face value of debt, is the primary control on Australian Government borrowing. (See paragraphs 2.3 to 2.27)

11. The AOFM has established frameworks to manage risk, compliance and assurance. The AOFM has separate frameworks for the management of enterprise risk and financial risk. The AOFM Middle Office does not assume responsibility for the management of financial risks. The AOFM’s processes for the acceptance of gifts, benefits and hospitality by the AOFM’s CEO and staff are not aligned with relevant public sector requirements. The AOFM’s conflict of interest processes are not aligned with the AOFM’s conflict of interest-policy. The Treasury’s conflict of interest processes do not incorporate the AOFM CEO and for this reason are not aligned with Treasury’s conflict of interest policy and legislative requirements. (See paragraphs 2.28 to 2.82)

12. The AOFM has appropriate internal monitoring arrangements which report on the AOFM’s stated targets, limits and guidelines as outlined in key debt management oversight documents, however, monitoring and reporting does not lead to clear actions if targets, limits and guidelines are operationally exceeded. There is transparency around the levels of government debt. The Treasurer is required to report on debt through the Debt Statement at each Budget and Mid-Year Economic and Fiscal Outlook; this is developed by the Department of the Treasury with the advice of the AOFM. The AOFM publishes a range of debt information publicly through its Annual Report and website. To support added transparency, there is scope for the AOFM to publish more information publicly on its debt management approach and strategy. (See paragraphs 2.83 to 2.101)

## Debt management

13. The AOFM has a framework for managing funding and interest rate risk relating to its borrowing activities. The AOFM met the Australian Government’s borrowing requirements between 1 January 2020 and 30 June 2023. There was no target, limit or guidelines for the cost of the debt portfolio. The AOFM has policies and processes in place to support cost-effective borrowing, but it does not assess whether the government debt portfolio was structured at least cost subject to acceptable risk. (See paragraphs 3.3 to 3.55)

14. The AOFM availed itself of relevant information in its debt management strategy and activities. The AOFM effectively sourced and analysed information that it received from market makers, AGS investors, the Department of the Treasury, the Reserve Bank of Australia, and from internal IT systems and analysis. The information was used by the AOFM to support and refine its debt management strategies, decisions and activities. (See paragraphs 3.56 to 3.77)

15. International best practices with respect to sovereign debt management have been described by the World Bank and International Monetary Fund’s Revised Guidelines for Public Debt Management (Guidelines). Aspects of the AOFM’s debt management decisions were assessed as consistent with the relevant provisions of the Guidelines. There are no Australian Government guidelines with respect to debt management. The AOFM’s syndicated borrowing

activities are exempt from Division 2 of the Commonwealth Procurement Rules (CPR). The AOFM's self-assessments of the compliance of its syndicated borrowing activities with the applicable provisions from Division 1 of the CPR were not fully documented. (See paragraphs 3.78 to 3.108)

## Recommendations

| | |
|---|---|
| **Recommendation no. 1**<br>**Paragraph 2.23** | The Australian Office of Financial Management and the Department of the Treasury should ensure that where governance arrangements are not defined by legislation, they are clearly documented, including clear roles and responsibilities.<br><br>**Australian Office of Financial Management response:** *Agreed.*<br><br>**Department of the Treasury response:** *Agreed.* |
| **Recommendation no. 2**<br>**Paragraph 2.25** | The Australian Office of Financial Management should document all governance meetings related to debt management; and ensure that there is clear and timely documentation of operational directives and limits relating to the execution of debt management.<br><br>**Australian Office of Financial Management response:** *Agreed.* |
| **Recommendation no. 3**<br>**Paragraph 2.78** | The Australian Office of Financial Management and the Department of the Treasury implement conflict of interest processes consistent with internal policies and legislative requirements.<br><br>**Australian Office of Financial Management response:** *Agreed.*<br><br>**Department of the Treasury response:** *Agreed.* |
| **Recommendation no. 4**<br>**Paragraph 2.80** | The Australian Office of Financial Management should:<br>(a) review whether a guiding principle, consistent with other Australian Public Service agencies, that officials are to generally avoid the acceptance of gifts, benefits and hospitality is appropriate for the organisation;<br>(b) document the basis for accepting offers of gifts, benefits and hospitality;<br>(c) document conflict of interest considerations for accepting offers of gifts, benefits and hospitality;<br>(d) document the disposal of gifts; and<br>(e) document considerations and benefits of providing official hospitality in line with the AOFM's Accountable Authority Instructions.<br><br>**Australian Office of Financial Management response:** *Agreed.* |

**Recommendation no. 5**
**Paragraph 3.54**

The Australian Office of Financial Management and the Department of the Treasury should:

(a) consider how transparency around the impacts of debt management decisions on cost and risk outcomes for the debt portfolio can be enhanced;

(b) review the Financial Risk Management Policy and debt management performance measurement framework with a focus on increasing transparency around the impacts of debt management decisions on cost and risk outcomes for the debt portfolio; and

(c) annually evaluate the Debt Management Strategy and the performance of the debt portfolio over various time horizons.

**Australian Office of Financial Management response:** *Agreed.*

**Department of the Treasury response:** *Agreed.*

## Summary of entity responses

16. The proposed audit report was provided to the Australian Office of Financial Management and the Department of the Treasury. The AOFM's and Treasury's summary responses to the report are provided below and the full response is at Appendix 1. The improvements observed by the ANAO during the course of this audit are at Appendix 2.

### Australian Office of Financial Management

The Australian Office of Financial Management (AOFM) welcomes the findings of the ANAO's report, including that AOFM's policies and processes support cost-effective borrowing and the appropriate management of financial risks; and that governance arrangements are largely effective in supporting debt issuance and management activities.

The AOFM agrees with the five recommendations, and notes that these primarily represent enhancements to established documentation and processes to achieve greater transparency. Implementation of the recommendations has already commenced.

The AOFM will work with the Treasury to increase transparency and strengthen existing documentation of governance arrangements and debt management decisions.

The AOFM will also review and enhance existing policies and procedures relating to gifts, benefits (including hospitality) and conflicts of interest. The AOFM notes the report's finding relating to coverage of conflict of interest declarations of the AOFM CEO. The Treasury has updated its processes for conflict of interest, including the declaration and capture of interests for CEOs within the portfolio.

### Department of the Treasury

Treasury welcomes the report and its recognition of the AOFM's key role in supporting the Government's response to the COVID-19 pandemic – raising the funding required to respond to the effects of the pandemic.

Since the establishment of the AOFM in 1999, fundamental responsibility for debt management has resided with the AOFM. The AOFM supports a well-functioning, competitive, liquid market in Australian Government Securities, underpinned by a transparent and consistent operational approach to debt management.

Treasury has a range of governance processes to provide assurance around the AOFM's debt management approach, consistent with relevant debt management legislation. These processes are set out in the AOFM's Financial Risk Management Policy (FRMP).

Treasury has updated its processes for conflict of interest, including the declaration and capture of interests for CEOs within the portfolio. As part of Treasury's ongoing efforts to mature and enhance its pro-integrity culture, opportunities for further improvement will be identified and implemented.

Treasury has agreed with recommendations 1, 3 and 5.

Treasury will work with the AOFM to increase transparency and strengthen documentation of governance processes, including reviewing the FRMP and making governance arrangements publicly accessible.

## Key messages from this audit for all Australian Government entities

17. Below is a summary of key messages which have been identified in this audit and may be relevant for the operations of other Australian Government entities.

**Governance and risk management**

- Where statutory responsibilities are conferred on an SES officer of a Department of State in respect of an entity within the Department's portfolio, and the SES officer is accountable to the Department's Accountable Authority (the secretary), it is important that there is a clear articulation of the SES officer's role and the role of the secretary together with appropriate governance arrangements to improve accountability and support the Department's and entity's progress towards shared objectives.
- Compliance and assurance arrangements should seek to provide assurance over business risks, not just operational risks.
- An understanding of the probity requirements and risks specific to an entity will assist the entity to manage probity most effectively, including through the development of fit-for-purpose policies and procedures.

**Performance and impact measurement**

- When establishing a performance measurement framework, it is important to clearly define performance benchmarks and develop relevant, reliable and complete indicators and targets in order to facilitate a meaningful assessment of progress and outcomes.

# Audit findings

# 1. Background

1.1 The Australian Office of Financial Management (AOFM) is responsible for the oversight and management of the government's debt and related financial assets, such as cash holdings.[11] The AOFM has been the sovereign debt manager for Australia since its establishment in 1999 and undertakes borrowing activities on behalf of the Australian Government.[12] Before the AOFM was established, the Department of the Treasury (Treasury) was responsible for sovereign debt management. Treasury is the 'lead economic adviser' for the Australian Government, and aims to 'provide advice to the Government and implement policies and programs to achieve strong and sustainable outcomes'.[13]

1.2 Australian Government Securities (AGS) are a form of debt instrument[14], which allow the Australian Government to borrow money from investors in the financial markets for an agreed period of time. During this time, the Australian Government will pay periodic interest on the AGS[15], then repay the principal amount, which is the 'face value', at an agreed future date, which is the 'maturity date'.[16]

1.3 The amount of debt that Australia has on issue is recorded as a liability within the general government sector in the Australian Government's Budget papers.[17] This is represented in the Australian Government's balance sheet, which records the value of the Australian Government's assets and liabilities, and its net worth. AGS are the largest liability on the Australian Government's balance sheet[18], and the trajectory of AGS on issue as a share of the economy is a key determinant of the sustainability of the Australian Government's fiscal condition and outlook.[19]

## The Australian Office of Financial Management

1.4 The Australian Office of Financial Management (AOFM) is responsible for the management of the Australian Government's debt and related financial assets, such as cash holdings.[20] The AOFM has been the sovereign debt manager for Australia since its establishment in 1999, and undertakes borrowing activities on behalf of the Australian Government.[21] The AOFM is a non-corporate

11 The Australian Office of Financial Management (AOFM), *Annual Report 2021–22,* AOFM, 2022, p. 7.

12 This was a role that was held within the Department of the Treasury prior to 1 July 1999.

13 Treasury, *Corporate Plan 2023–24* [Internet], Treasury, available from https://corporate-plan.treasury.gov.au/ [accessed 18 September 2023].

14 A debt instrument involves an obligation from one party (issuer) to repay principal and interest to another party (investor) at a future date, with associated conditions for the issuer and investor.

15 A debt security is an investment into a debt instrument. Bonds and notes are common debt securities traded in financial markets.

16 Technical information regarding the bond market is available from the Reserve Bank of Australia: Reserve Bank of Australia, *Explainer: Bonds and the Yield Curve* [Internet], available from https://www.rba.gov.au/education/resources/explainers/pdf/bonds-and-the-yield-curve.pdf [accessed 25 October 2023].

17 Historical data of the Australian Government's debt is found within Budget papers.

18 Australian Government Budget Paper No. 1: 2023–24, Commonwealth of Australia, Canberra, 2023, p. 353.

19 Parliamentary Budget Office, *Fiscal sustainability: Long-term budget scenarios* [Internet], 2021, PBO, available from https://www.pbo.gov.au/publications-and-data/publications/fiscal-projections-and-sustainability/fiscal-sustainability [accessed 20 September 2023].

20 AOFM, *Annual Report 2021–22,* AOFM, 2022, p. 7.

21 This was a role that was held within the Department of the Treasury prior to 1 July 1999.

commonwealth entity, is part of the Treasury portfolio and the AOFM Chief Executive Officer (CEO) is the Accountable Authority.

1.5 The AOFM was established in 1999 to 'enhance the Commonwealth's capacity to manage its net debt portfolio' and to 'assume responsibility for the Commonwealth's existing debt management activities'.[22]

1.6 The AOFM is classified by the Australian Public Service Commission (APSC) as an 'extra small agency' with a specialist function.[23] The AOFM had an average staffing level of 42 during 2022–23, and received departmental funding of $13.2 million in 2022-23.[24] The AOFM states publicly on its website that its organisational structure is based on financial industry practice and comprises of a:

- Front Office — includes funding activities, market liaison, debt management strategy, financial risk management, research, and cash management;
- Middle Office — includes enterprise risk management, assurance and performance; and
- Back Office — includes business operations (including settlements and financial reporting), and corporate development.

### *Department of the Treasury*

1.7 The Department of the Treasury (Treasury) is the 'lead economic adviser' for the Australian Government, which aims to 'provide advice to the Government and implement policies and programs to achieve strong and sustainable outcomes'.[25]

1.8 The AOFM is a prescribed agency[26] in the Treasury portfolio. The Accountable Authority of AOFM, the CEO, is employed by Treasury under section 22 of the *Public Service Act 1999* as a Senior Executive Service (SES) officer. The CEO is then delegated *Public Service Act 1999* powers by the Secretary to the Treasury (the secretary). The AOFM's relationship with Treasury is discussed further in Chapter 2.

## Debt issuance program

1.9 The AOFM is responsible for the issuance of AGS and for managing the Australian Government's debt portfolio. As noted in section 51JA of the *Commonwealth Inscribed Stock Act 1911*, the AOFM borrows money on the Treasurer's behalf through the issuance of AGS, which currently comprises three types of securities: Treasury Bonds, Treasury Indexed Bonds and Treasury Notes (see Box 1). In April 2023, the Australian Government announced that it would also begin issuing 'sovereign green bonds' — bonds to 'back public projects driving Australia's net zero transformation and boosting the scale and credibility of Australia's green finance market' — in

22 Australian Government Budget Paper No. 2: 1999–00, Commonwealth of Australia, Canberra, 1999, p. 154.

23 Australian Public Service Commission, 'APS Agencies – size and function', APSC, accessed from https://www.apsc.gov.au/aps-agencies-size-and-function [accessed 15 November 2023].

24 AOFM, *AOFM Annual Report 2022–23*, AOFM, p. 104.

25 Treasury, *Corporate Plan 2023–24* [Internet], Treasury, accessed from https://corporate-plan.treasury.gov.au/ [accessed 18 September 2023].

26 A prescribed agency is a listed entity that is prescribed by legislation to complete separate tasks, but is not part of another Commonwealth entity under the *Public Governance, Performance and Accountability Act 2013*.

mid-2024 following the development of a Green Bonds Framework and engagement with investors.[27]

| **Box 1: Description of Australian Government Securities (AGS)[a]** |
| --- |
| There are currently three types of debt securities that are issued by the Australian Government:<br><br>1. Treasury Bonds: medium to long-term securities (maturities ranging to around 30 years) with a fixed annual rate of interest payable every six months. Comprises 91.5 per cent of all AGS on issue.<br><br>2. Treasury Indexed Bonds (TIBs): medium to long-term securities for which the capital value of the security is adjusted for movements in the consumer price index.[b] Interest on TIBs is paid quarterly at a fixed rate on the adjusted capital value. Comprises 4.3 per cent of all AGS on issue.<br><br>3. Treasury Notes: short-term discount securities which mature within one year of issuance. Maturities typically range from one to six months. The volume of Treasury Notes on issue will vary over the course of the year, depending on the size and profile of the within-year funding requirements. Comprises 4.2 per cent of all AGS on issue. |

Note a: Based on the face value of AGS on issue as of 1 May 2023.

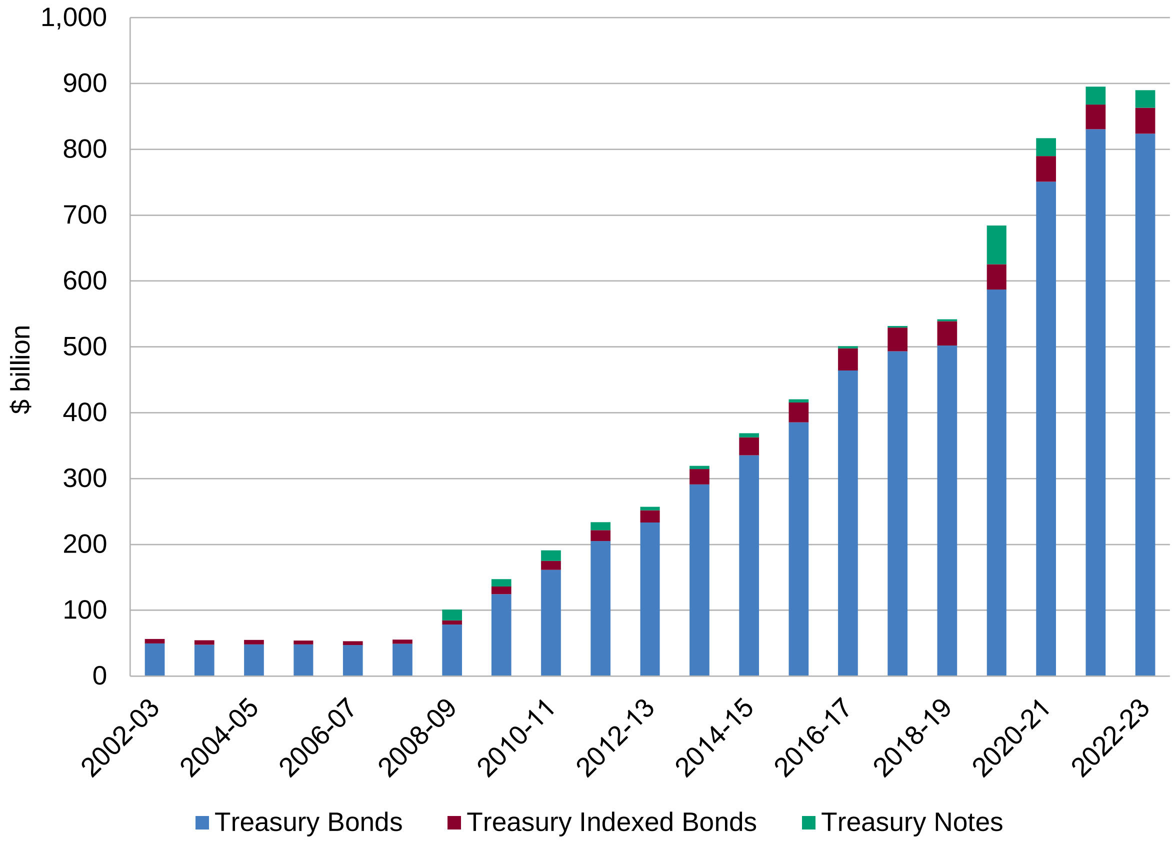
Note b: The consumer price index is a measure of overall change in the pricing of a representative basket of consumer goods and is used to understand household inflation.

Source: Australian Government, Budget Measures: Budget Paper No. 1: 2023–24, Commonwealth of Australia, Canberra, 2023, p. 253. Australian Office of Financial Management, *Annual Report 2021–22,* AOFM, 2022, p. 19. ANAO analysis of face value of AGS on issue as of 1 May 2023 subject to the Treasurer's Direction.

1.10 Figure 1.1 presents the face value of AGS on issue by type of debt security.

27 The Treasurer, The Minister for Climate Change and Energy, Assistant Minister for Climate Change and Energy, Investor Roundtable aligns efforts to deliver cleaner, cheaper energy, media release, Parliament House, Canberra, 21 April 2023.

**Figure 1.1: Face value of Australian Government Securities on issue[a]**




Note a: Does not include other bonds and securities that are not subject to the Treasurer's Direction as outlined in section 51JA(2A) of the *Commonwealth Inscribed Stock Act 1911*.

Source: AOFM Data Hub, 'End of Financial Year Positions, Executive Summary, Overview of AGS outstanding and investments held' [Internet], 2023, AOFM, available from https://www.aofm.gov.au/media/530 [accessed 6 February 2024].

1.11 The AOFM issues the securities into a limited number of maturities (or lines), to manage the debt portfolio. Limiting the number of maturities helps to ensure that each line is sufficiently liquid so that the securities can be readily traded in the secondary market[28]: the Australian fixed income market for institutional participants and the Australian Securities Exchange for retail investors.[29] Creating liquidity in the secondary market attracts investors, promotes demand for AGS and assists in lowering borrowing costs.[30] Having multiple, liquid lines also ensures there can be targeted investor demand for a given maturity, and reduces the risk of exhausting this demand.[31]

1.12 The AOFM's issuance program is determined with respect to refinancing requirements for maturing AGS, the Budget funding requirements, Australian Government policy objectives in

28 Liquidity describes how quickly an asset, such as a debt instrument, can be purchased or sold for cash without negatively impacting market price.

29 Australian Government Budget Paper No. 1: 2023–24, Commonwealth of Australia, Canberra, 2023, p. 253.

30 Australian Government Budget Paper No. 1: 2022–23, Commonwealth of Australia, Canberra, 2023, pp. 185–186.

31 Treasury, *Commonwealth Debt Management Review* [Internet], 2002, The Treasury, available from https://treasury.gov.au/review/cdmr [accessed 14 September 2023].

support of the AGS market, and operational considerations.[32] Operational considerations can involve the AOFM deciding to hold higher or lower cash balances or to smooth issuance across financial years. Since the AOFM exercises 'operational independence', it can decide the appropriate course of action, such as holding higher or lower cash balances, or smoothing issuance across several years.[33]

1.13 The AOFM aims to manage the debt portfolio by 'balancing costs and risks'.[34] That is, there is a trade-off between cost and risks in managing the debt portfolio. This is to be achieved through the AOFM's purposes as listed in its annual report. These include[35]:

- Purpose 1: Meet the Government's annual financing task while managing the trade-offs between costs and risks.
- Purpose 2: Ensure the Government can always meet its cash outlay requirements.
- Purpose 3: Conduct market facing activities in a manner that supports a well-functioning AGS market.

1.14 The AOFM has relationships with a variety of external stakeholders, including financial intermediaries. The AOFM has a list of 19 market makers, which are domestic and international financial intermediaries.[36] Market makers buy AGS from and sell AGS to investors both domestically and globally to ensure that their investment needs are met and to support liquidity in the AGS market.[37] The AOFM engages with market makers on a regular basis and receives information from these institutions on market conditions.

## Debt increase in response to the COVID-19 pandemic

1.15 In March 2020, the Australian Government began to implement a range of policies to suppress the spread of the COVID-19 pandemic and support the Australian people and businesses during times of economic uncertainty. The March 2022 Budget stated that total direct economic support since the onset of the COVID-19 pandemic was $314 billion, and total direct economic and health support since the onset of the COVID-19 pandemic was $343 billion.[38]

1.16 Measures to support Australians included three stimulus packages, totalling $213.6 billion.

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32 Australian Government Budget Paper No. 1: 2023–24, Commonwealth of Australia, Canberra, 2023, p. 253.

33 ibid.

34 AOFM, *Annual Report 2021–22,* AOFM, 2022, p. 7.

35 ibid., p. 23 (Table 1). Purpose 4, which involves the Australian Business Securitisation Fund, and the Structured Finance Support Fund, was not listed as this is out of scope for the audit.

36 As at October 2023, the 19 market makers for Treasury Bonds are: Australia and New Zealand Banking Group Limited, Barrenjoey, BofA Securities, BNP Paribas, Citi, Commonwealth Bank of Australia, Daiwa Capital Markets Europe Limited, Deutsche Bank AG, Goldman Sachs, HSBC Bank Australia Limited, J.P. Morgan, Mizuho Securities Asia Limited, Morgan Stanley, National Australia Bank Limited, Nomura, RBC Capital Markets, TD Securities, UBS AG and Westpac Banking Corporation. Subsets of these market makers deal actively in Treasury Notes and Treasury Indexed Bonds, respectively. See AOFM, *Treasury Bond Market Makers*, 2023, AOFM, available from https://www.aofm.gov.au/securities/treasury-bonds [accessed 9 October 2023].

37 AOFM, *Treasury Bonds* [Internet], AOFM, available from https://www.aofm.gov.au/securities/treasury-bonds [accessed on 20 August 2023].

38 Australian Government Budget 2022–23, *Australia's plan for a stronger future: Keeping Australians safe*, Commonwealth of Australia, Canberra, 2023, pp. 185–186 [Internet], available from https://archive.budget.gov.au/2022-23/download/glossy_safe.pdf [accessed 9 November 2023].

- A $17.6 billion economic stimulus package was announced on 12 March 2020, which aimed at keeping Australians employed, businesses open, and supporting households.[39]
- A $66 billion economic support package was announced on the 22 March 2020, which continued support for households, and businesses and employees, with the introduction of '[r]egulatory protection and financial support for businesses'.[40]
- A $130 billion economic support package was announced on 30 March 2020, which provided a 'historic wage subsidy' through the JobKeeper[41] scheme.[42]

1.17 With increased spending from the Australian Government, the AOFM was tasked with increasing the funds available to the Australian Government through significantly higher issuance of AGS. Initially, there was a rapid increase in AGS issuance — the Treasury Bond issuance program for 2019-20 was expected to be $55 billion as at the 2019-20 MYEFO prior to the onset of the COVID-19 pandemic, but total Treasury bond issuance during the year of 2019-20 amounted to $128.2 billion.

1.18 A total of $848.7 billion in AGS was issued between the period within audit scope of 1 January 2020 to 30 June 2023 through tender and syndication, comprising $355 billion in Treasury Notes, $483.1 billion in Treasury Bonds and $10.6 billion in Treasury Indexed Bonds. Subsection 51JA(2) of the *Commonwealth Inscribed Stock Act 1911* requires the Treasurer to give a 'direction' stipulating the maximum AGS that can be on issue. To reflect the Australian Government's economic response to the COVID-19 pandemic, effective from 7 October 2020, the Treasurer directed that the maximum 'face value'[43] of AGS that can be on issue is $1,200 billion.[44]

1.19 Figure 1.2 demonstrates how the face value of AGS has changed over time as a percentage of Gross Domestic Product[45], including the increase between 2018–19 and 2021–22.

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39 Prime Minister, Treasurer, Economic Stimulus Package, media release, Parliament House, Canberra, 12 March 2020.

40 Prime Minister, Treasurer, Supporting Australian workers and business, media release, Parliament House, Canberra, 22 March 2020.

41 Further information on the JobKeeper Scheme can be found in Auditor-General Report No.22 of 2021–22, *Administration of the JobKeeper Scheme.*

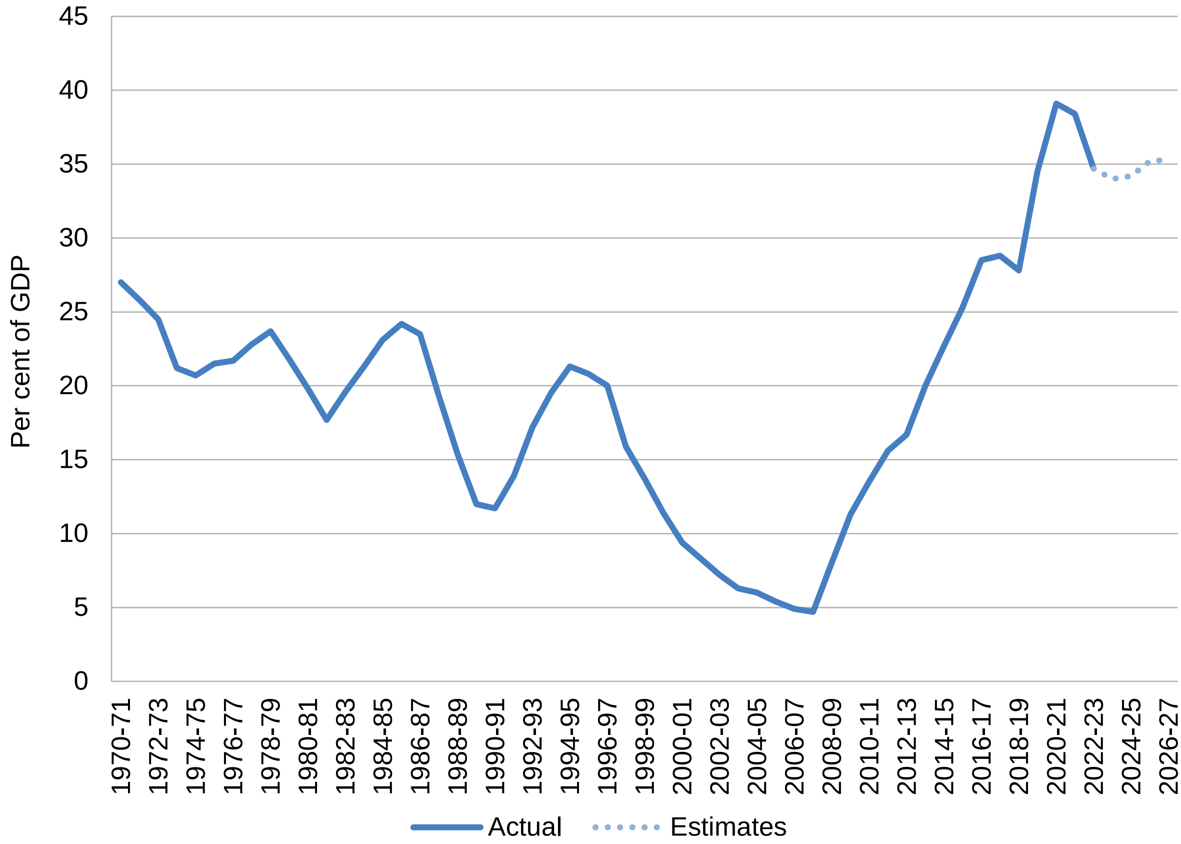
42 Prime Minister, Treasurer, $130 billion JobKeeper payment to keep Australians in a job, media release, Parliament House, Canberra, 30 March 2020.

43 The maximum face value represents the gross value of all AGS on issue at any given point in time. The face value of an AGS is the amount that is repaid to its holder upon maturity.

44 Commonwealth Inscribed Stock (Maximum Total Face Value of Stock and Securities) Direction 2020, pt 2.

45 The Gross Domestic Product is the standard measure of the market value of all goods and services produced within the economy in a given time period.

**Figure 1.2: Face value of Australian Government Securities as a percentage of Gross Domestic Product**




Source: Parliamentary Budget Office, *Historical data published in the Australian Government's latest Budget update* [Internet], PBO, available from https://www.pbo.gov.au/publications-and-data/data-and-tools/data-portal [accessed 6 February 2024]. Data is current as of the 2023-24 Mid-year Economic and Fiscal Outlook.

## Financial market conditions during the COVID-19 pandemic

1.20 Financial market conditions influence the interest rates applicable to AGS, and hence the interest payments made by the Australian Government to AGS investors. The onset of the COVID-19 pandemic caused volatility in global financial markets and prompted a significant fiscal and monetary policy response. To meet the Government's borrowing requirements, the AOFM adapted its issuance operations through these market conditions and coordinated its activities with Treasury and the Reserve Bank of Australia (RBA). Appendix 3 draws on the market commentary presented in AOFM annual reports to provide a description of the evolution of AGS market conditions through the period within audit scope of 1 January 2020 to 30 June 2023.

## Costs and risks of Australian Government debt

1.21 Interest payments on AGS, which are generally determined by prevailing AGS yields in financial markets as at the time of AGS issuance, impose ongoing costs on the Australian Government as debt is serviced and refinanced through time. As at the 2023–24 Mid-year Economic and Fiscal Outlook, the Australian Government is expected to pay $20.0 billion in interest payments on AGS in 2023–24, and this is expected to increase to $28.2 billion by 2026–27.[46]

1.22 There are risks associated with the Australian Government's debt portfolio (expanded on in Box 2). These risks may impact the financial performance of the debt portfolio.[47]

**Box 2: Types of risk associated with the Australian Government's debt portfolio[a]**

The three main financial risks related to the Australian Government's debt portfolio are as follows.

- **Interest rate risk:** 'The risk associated with changes to cash flows or the value of assets and liabilities in response to changes in interest rates.' All AGS in the Australian Government's debt portfolio are subject to interest rate risk, and their valuation in financial markets (known as 'market value') changes in accordance with prevailing interest rates in financial markets. Interest rate risk is a form of market risk, which is the risk associated with changes to cash flows or the value of assets and liabilities in response to changes in financial market variables.
- **Liquidity risk**: 'The risk of not having sufficient funds available to meet payment obligations'. Liquidity risk can occur from different sources, including: forecasting risk, where there is an error in the forecasts of the government's cash balance; and refinancing risk, where the Australian Government is unable to fund the principal repayment upon maturity of a given bond. The Reserve Bank of Australia's overdraft facility provides emergency liquidity when there is not enough to draw from within the cash balance as a countermeasure.
- **Funding risk**: Another aspect of liquidity risk, funding risk describes whether the Australian Government's funding requirements can be met. While the government's ability to meet its funding requirements depends on fiscal and economic conditions as well as refinancing requirements in respect of maturing bonds, by spreading issuance over different periods, funding risk can be reduced.

Other forms of risk related to debt management include the following.

- **Execution risk**: Execution risk is the risk that a transaction, such as the issuance or repurchase of AGS, will be executed poorly. For example, a bond tender would be subject to execution risk if it is expected to receive poor demand and raise insufficient funds.
- **Credit risk**: Credit risk refers to the risk of default, such as, where the issuer of a bond is unable to meet its obligations by failing to repay principal or interest on the bond.
- **Operational risk:** Operational risk refers to issues occurring during operational processes and activities, such as a system ceasing to function, or human error.

Note a: Exchange rate risk was not included, as AOFM holds no foreign currency debt.

46 Mid-year Economic and Fiscal Outlook 2023–24, Commonwealth of Australia, Canberra, 2023, p. 97.

47 Further technical information on government debt markets is available from the Reserve Bank of Australia: Reserve Bank of Australia, *Explainer: Bonds and the Yield Curve* [Internet], available from https://www.rba.gov.au/education/resources/explainers/pdf/bonds-and-the-yield-curve.pdf [accessed on 25 October 2023].

Source: AOFM documentation and Treasury, *Review of the Commonwealth Government Securities Market* [Internet], 2002, The Treasury, available from https://treasury.gov.au/review/cdmr/discussion-paper/appendix-2 [accessed 27 July 2023].

## Previous reviews and audits

1.23 Auditor-General Report No. 14 of 1999–2000, *Commonwealth Debt Management*, focussed on Treasury and the newly established AOFM, and their 'effectiveness of the raising, management and retirement of Commonwealth debt, consistent with an acceptable degree of risk exposure'. The audit found that the debt issuance programs conducted by Treasury and the AOFM were in accordance with the financing task and were being managed effectively. It also found that the borrowing program was being exposed to 'new complexities' due to uncertainty regarding market conditions, and an increase in risk management and accountability was necessary. The report also noted that there were several deficiencies when it came to financial derivatives, which could result in considerable financial losses. The report made six recommendations. AOFM and Treasury agreed to all six recommendations.[48]

1.24 Auditor-General Report No. 42 of 2004–05, *Commonwealth Debt Management Follow-up Audit* assessed the progress of implementation of the six recommendations from the initial audit, and to assess the impact of the changes made.[49] The report found that, of the 15 actions identified from the previous audit, 11 were completed, and two were being progressed satisfactorily. The other two required further work. The report made two recommendations, of which AOFM agreed to one, and 'agreed with qualification' to the other.[50]

1.25 The Capability Review undertaken by the APSC in November 2015 identified a lack of clarity around the role of the AOFM Advisory Board as both a provider of strategic advice to the secretary and advice to AOFM on governance and corporate matters. The APSC noted that the Advisory Board functioned as a 'board of directors' would for a private company. The APSC also noted that the AOFM could play a broader role in contributing financial markets intelligence to the Department of the Treasury and the Department of Finance.

## Rationale for undertaking the audit

1.26 AGS is the largest liability on the Australian Government's balance sheet. The value of AGS outstanding has risen from $561.8 billion as at 1 January 2020 to $889.8 billion as at 30 June 2023, primarily due to increased Australian Government borrowing during the COVID-19 pandemic and is expected to continue to increase with future borrowing activities. The amount of interest required to be paid increases with the amount of AGS on issue.[51] The amount and trajectory of AGS on issue is related to the fiscal sustainability of the Australian Government. Increased debt on issue incurs

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48 Auditor-General Report No. 14 1999–00 *Commonwealth Debt Management*, p. 10, available from https://www.anao.gov.au/work/performance-audit/commonwealth-debt-management [accessed 12 May 2023].

49 Auditor-General Report No. 42 2004-05 *Commonwealth Debt Management Follow-up Audit*, p. 13, available from https://www.anao.gov.au/work/performance-audit/commonwealth-debt-management-follow-up-audit [accessed 12 May 2023].

50 ibid., pp. 14–15.

51 Australian Government Budget Paper No. 1: 2022–23, Commonwealth of Australia, Canberra, 2023, pp. 195–197.

higher debt servicing[52] costs in the long term.[53] As noted by the International Monetary Fund, 'prudent debt management' can support government resilience to volatile market conditions and financial crises. [54]

1.27 The audit provides assurance to Parliament on the effectiveness of the AOFM's management of the Australian Government's debt.[55]

## Audit approach

### Audit objective, criteria and scope

1.28 The objective of this audit was to assess the effectiveness of the AOFM's management of the Australian Government's debt.

1.29 To form a conclusion against the objective, the following high-level criteria were adopted:

- Was there an effective governance framework to manage government debt?
- Was government debt appropriately managed?

1.30 The audit did not examine:

- the debts issued prior to 1 January 2020 and after 30 June 2023 (noting that earlier time periods have been referenced in the report where relevant to audit findings);
- how the proceeds from debt issuance have been used by the Australian Government;
- debt issuance by other Australian Government agencies such as Housing Australia[56] or the Australian Rail Track Corporation Limited;
- the Australian Government's fiscal strategy; and
- the AOFM's investment programs under the Australian Business Securitisation Fund (ABSF) or the Structured Finance Support Fund (SFSF).

### Audit methodology

1.31 The audit methodology involved:

- a review of documentation held by the AOFM relating to the management of the Australian Government's debt;

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52 The debt servicing costs refers to the cost of covering the payment of principal and interest of a debt instrument.

53 Treasury, *2023 Intergenerational Report,* Box 6.1 p.130 [Internet], Treasury, available from https://treasury.gov.au/publication/2023-intergenerational-report [accessed 13 September 2023].

54 World Bank and International Monetary Fund, *Revised Guidelines for Public Debt Management* [Internet], IMF, Washington, D.C, 2014, available from https://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/Revised-Guidelines-for-Public-Debt-Management-PP4855 [accessed 4 August 2023].

55 Senator Katy Gallagher also wrote to the ANAO in May 2020 to examine the effectiveness of the Government's debt management given the significant and rapidly increasing debt levels as a result of the COVID-19 pandemic, available from https://www.anao.gov.au/work/request/effectiveness-the-commonwealth-governments-debt-management.

56 On 12 October 2023, the National Housing Finance and Investment Corporation (NHFIC) became Housing Australia, with an expanded role to improve housing outcomes. [Internet] https://www.housingaustralia.gov.au/who-we-are

- analysis of AOFM’s transactional data;
- visits to the AOFM office in Canberra, which included demonstrations of business processes;
- meetings with AOFM staff and relevant stakeholders including AGS market makers and investors; and
- a review of AOFM’s governance arrangements, including its risk management system of controls and assurance activities, including those relating to its debt management.

1.32 The audit was conducted in accordance with ANAO Auditing Standards at a cost to the ANAO of approximately $601,254.

1.33 The team members for this audit were Vijay Murik, Hoa Nguyen, Nancy Jin, David Willis, Alyssa McDonald and David Tellis.

# 2. Governance

**Areas examined**

This chapter examines whether there is an appropriate governance framework for the management of Australian Government debt.

**Conclusion**

The Australian Office of Financial Management (AOFM) and Department of the Treasury (Treasury) have largely effective governance arrangements to support operational activities to fund the Australian Government, including establishing, approving and executing a strategy for debt management. The roles, responsibilities and accountabilities amongst key stakeholders in relation to debt management oversight and decision-making under the legislative framework are not transparent. There is a lack of clear documentation of debt management policy and operational decisions and the rationale behind these decisions. The AOFM lacked processes for the documentation and management of gifts, benefits and hospitality. The AOFM and Treasury could improve adherence to legislative requirements and internal policies relating to conflict of interest.

**Areas for improvement**

The ANAO made four recommendations: that the AOFM and Treasury ensure there are clear statements of debt management mandates, roles and responsibilities; that the AOFM document discussions and outcomes at all debt management governance meetings; that the AOFM and Treasury implement improved management of conflict of interest; and that the AOFM consider and document the basis for accepting offers of gifts, benefits and hospitality.

The ANAO also suggested: the AOFM consider aligning its financial risk management practices with the requirements for financial institutions; improve guidance in relation to market sensitive information; and consider improving transparency around its debt management strategy.

2.1 Public debt management is the process of establishing and executing a strategy for managing government debt and associated debt servicing costs, consistent with a prudent degree of risk. Effective public debt management should include clearly articulated governance arrangements that specify roles and responsibilities, a framework for managing risks that enables the identification and management of the trade-off between costs and risk in the government debt portfolio, as well as clear public reporting on performance against the measures of cost and risk adopted.[57]

2.2 Good public debt management includes that the allocation of responsibilities among financial agencies (such as the ministry of finance, the central bank and the debt management agency) for the purpose of debt management policy and undertaking primary debt issues[58], should

57 World Bank and International Monetary Fund, *Revised Guidelines for Public Debt Management* [Internet], IMF, Washington, D.C, 2014, available from https://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/Revised-Guidelines-for-Public-Debt-Management-PP4855 [accessed 4 August 2023].

58 ibid., p. 22. This also includes secondary market arrangements, depository facilities, and clearing and settlement arrangements for trading government securities.

be publicly disclosed. It also includes that the objectives should be clearly defined and publicly disclosed, and that the measures of cost and risk that are adopted should be explained.[59]

## Were appropriate policies and procedures in place to manage government debt?

The Australian Office of Financial Management (AOFM) has appropriate policies and procedures in place to issue Australian Government debt and to provide advice to the Treasurer and Secretary to the Treasury (the secretary), relating to debt management. The internal bases for advice and recommendations on debt management to the Treasurer and the secretary are mostly not documented, therefore not clear or transparent. The Treasurer and the secretary have oversight of debt management through policies and procedures for the annual oversight of debt management, however, while these establish parameters for debt issuance, these parameters can be operationally varied. The Commonwealth Inscribed Stock (Maximum Total Face Value of Stock and Securities) Direction 2020, which sets a maximum legislative limit on the total face value of debt, is the primary control on Australian Government borrowing.

### Legislative framework

2.3 The Australian Government (Treasurer), Department of the Treasury (Treasury) and the AOFM have responsibilities for the management of public debt. The *Charter of Budget Honesty Act 1998* sets out that the responsibility of the Government to manage financial risks faced by the Commonwealth prudently, having regard to economic circumstances, including by maintaining Commonwealth general government debt at prudent levels, and that relevant financial risks include risks arising from excessive net debt. Treasury, under the Administrative Arrangements Orders, deals with 'borrowing money on the public credit of the Commonwealth'. AOFM's purpose, under Schedule 1 of the Public Governance, Performance and Accountability Rule 2014 subparagraphs 2(e)(i) and 2(e)(ii) is:

- the advancement of macroeconomic growth and stability, and the effective operation of financial markets, through issuing debt, investing in financial assets and managing debt, investments and cash for the Australian Government; and
- any functions conferred on the entity by or under a law of the Commonwealth.

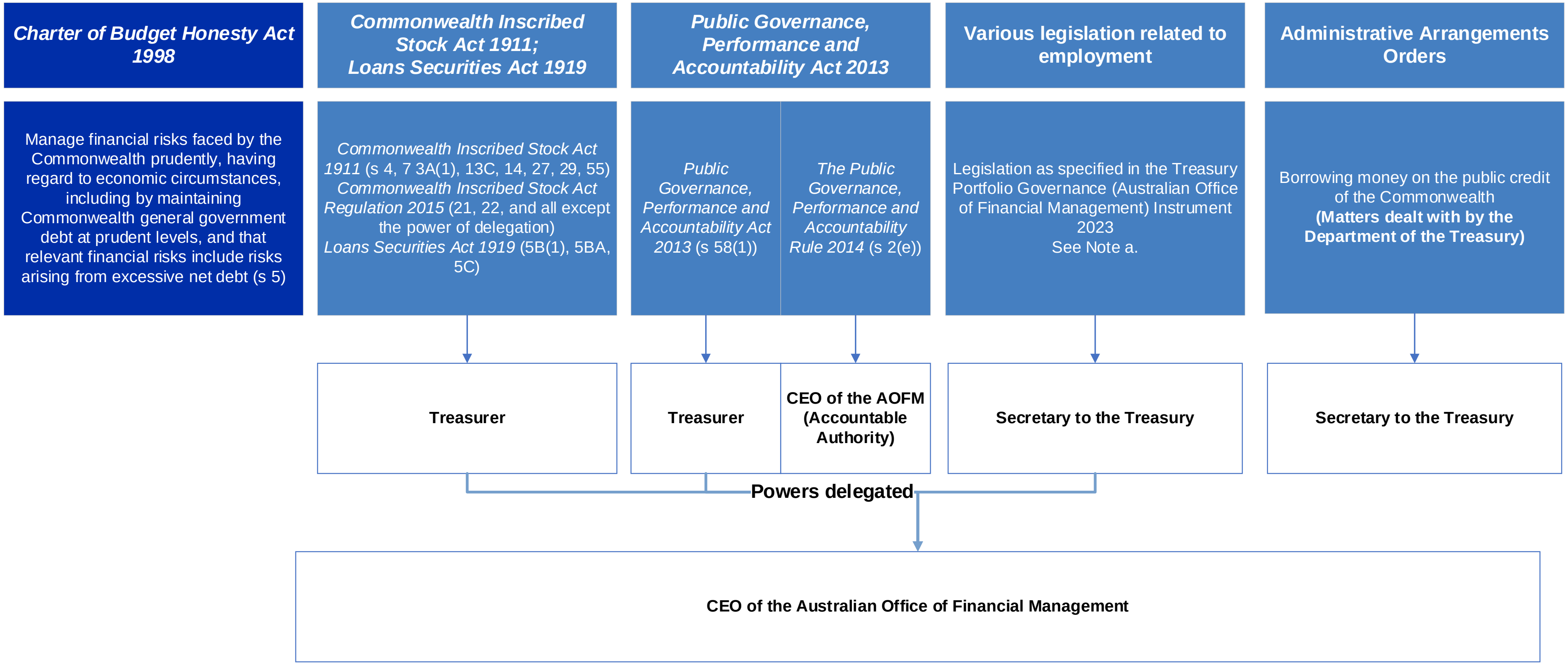
2.4 The powers delegated to the AOFM under legislation relate to the operational issuance of debt, the ability to enter into investments and related functions. The Treasurer delegates powers and functions under the *Commonwealth Inscribed Stock Act 1911* (CIS Act), *Loans Securities Act 1919* (LS Act) and *Public Governance, Performance and Accountability Act 2013* (PGPA Act) to officials within the AOFM, including the CEO, and heads of business areas.[60] The CIS Act and the LS Act do not specify requirements for debt management. The scope of these delegations mean that delegates can issue debt (for example, at weekly auction Tenders) without each transaction requiring additional approval. The total face value of Australian Government Securities (AGS) that can be on issue is limited by a legislative instrument made by the Treasurer: the Commonwealth Inscribed Stock (Maximum Total Face Value of Stock and Securities) Direction 2020 (the Direction)

59 ibid., p. 8.

60 The business unit names have changed since the delegation was signed 2 September 2021.

(see paragraph 1.18). Delegations for legislation relating to debt management are outlined at Figure 2.1.

**Figure 2.1: Delegations to Australian Office of Financial Management CEO**




Note a: Under the Treasury Portfolio Governance (Australian Office of Financial Management) Instrument 2023, powers are delegated to the CEO of the AOFM for various powers related to employment: *Australian Public Service Commissioner's Directions 2022*; *Fair Work Regulations 2009*; *Governance of Australian Government Superannuation Schemes Act 2011*; *Long Service Leave (Commonwealth Employees) Act 1976*; *Maternity Leave (Commonwealth Employees) Act 1973*; *Public Interest Disclosure Act 2013*; *Public Service Act 1999*; *Public Service Classification Rules 2000*; *Public Service Regulations 2023*; and *Safety, Rehabilitation and Compensation Act 1988*.

Source: ANAO analysis of relevant legislation and AOFM documentation.

## Governance framework

2.5 Until June 2008, the Commonwealth Debt Management Charter (the Charter) and the accompanying Commonwealth Debt Management Memorandum of Understanding between AOFM and Treasury (the Memorandum of Understanding) provided detailed descriptions of the roles, accountabilities and requirements for the Treasurer, the secretary and the CEO of AOFM. The AOFM Advisory Board advised to discontinue the Charter and Memorandum of Understanding on 6 June 2008, and this was agreed by the secretary in the 2008–09 Annual Remit. Not all aspects of the Charter and Memorandum of Understanding were carried across in later internal policy and governance documents; in particular, there is less detail on governance arrangements and responsibilities in later internal policy and governance documents. Treasury advised in January 2024 that the decision to discontinue the Charter 'coincided with a reduction in AOFM operational risk following decisions that AOFM would no longer use higher risk instruments such as derivatives and foreign exchange swaps'.

2.6 The Financial Risk Management Policy (FRMP) is an internal policy document that sets out the governance framework that the AOFM acts in accordance with, including governance forums, documents and roles for the management of Commonwealth debt. Governance roles are described at Table 2.1. The FRMP is to be reviewed annually by the AOFM[61], with substantive[62] changes agreed to by the secretary. The AOFM did not provide advice to the secretary on whether there had been any changes to the FRMP between 2019–20 and 2022–23. Treasury advised in January 2024 that 'between 2019–20 and 2022–23, the AOFM did not make any substantive changes to the FRMP [and therefore] [n]o advice was provided to the Secretary during this period.' Despite the role for the secretary outlined in the FRMP, Treasury's oversight role of the AOFM is not legislated, and Treasury advised its oversight role is implicitly determined by Treasury's role as the government's lead economic advisor and Department tasked with the provision of fiscal and economic policy advice[63], with high-level responsibility for 'borrowing money'. Treasury, through the secretary, also supports the Treasurer's role in debt management as set out in Table 2.1.

61 Changes to the FRMP were observed during the audit period. However, no changes were approved by the secretary. Treasury advised: 'No advice was provided to the Secretary on the Financial Risk Management Policy during the period of the audit.'

62 According to the Financial Risk Management Policy: 'A change to the Policy is regarded as substantive if its implementation will result in a change in either the activities undertaken by the AOFM or the extent of the AOFM's obligations or services provided to the government or Secretary.'

63 Department of the Treasury, *Corporate Plan 2023-24* [Internet], Treasury, accessed from https://corporate-plan.treasury.gov.au/ [accessed 27 November 2023].

**Table 2.1: Governance roles and responsibilities outlined by the Financial Risk Management Policy**

| Stakeholder | Role | Points of oversight |
| --- | --- | --- |
| Treasurer | To 'determine the scope and terms of the debt management mandate, acting on advice from Treasury and the AOFM'. | Debt Issuance Ministerial Submission |
| Secretary to the Treasury | Is 'responsible for oversight of the AOFM in executing its mandate' and 'provides advice to the Treasurer on debt management policy'.<br>Supported in this role by the AOFM Advisory Board (re-established in March 2023, and previously operational between December 2000 and November 2016). | Annual Remit, including Debt Management Strategy and Liquidity Management Strategy |
| CEO of AOFM | Is responsible for 'operational debt management issues and the administration of the AOFM and conduct of its operations'. | Provision of advice on cost and interest rate risk management to the secretary; recommending the Annual Remit to the secretary; Financial Risk Management Policy changes |

Source: ANAO analysis of AOFM's Financial Risk Management Policies up to October 2022.

## Governance structure

2.7 AOFM has established governance arrangements to support the CEO as the accountable authority for AOFM in providing advice on the management of the Australian Government's debt and operationalising debt issuance. While it does not have a legislated role to govern the AOFM, Treasury's implicit governance role in relation to debt management, is implemented primarily through the secretary's oversight of the Annual Remit.

2.8 The Executive Leadership Group (ELG) is chaired by the AOFM CEO and comprises the heads of the AOFM's business groups. It met monthly in the period January 2020 to December 2022. In 2023, the Executive Group has met weekly. Between January 2020 and May 2023 the ELG did not discuss issues related to the management of the Australian Government's debt, but members of the ELG attended other AOFM committees that discussed these issues during this period.[64] The ELG's terms of reference outline that the group's performance will be assessed by the CEO each year against three criteria: team culture, quality of advice and accountability.[65]

2.9 The role of the Portfolio Strategy Meetings is to review the key considerations of the AOFM's debt management responsibilities. The terms of reference for the AOFM Portfolio Strategy Meeting state that meetings are chaired by the AOFM CEO and include staff members from the AOFM's Front Office and are to be held 'on a regular basis'. The FRMP states that interest rate risk (assessed as a key financial risk arising from the AOFM's debt management activities)[66] should be a regular topic at Portfolio Strategy Meetings. Presentation packs were prepared for all quarterly meetings

64 The AOFM advised in January 2024 that 'enterprise risks (including portfolio risks) and performance measures (i.e. externally reported KPIs) are discussed at the ELG level on a quarterly basis'.

65 The AOFM advised in January 2024 that 'a performance assessment did not take place in 2020 and 2022; and that a performance assessment was conducted at the December 2021 ELG meeting, but this assessment was not documented'.

66 Interest rate risk is defined in Box 2 of Chapter 1: Background.

between February 2020 and May 2023. Some presentation packs refer to the current trends related to interest rates. Meetings are not minuted.

2.10 The FRMP states that Cash Management Meetings are focussed on monitoring liquidity risk[67] and are attended by the AOFM CEO and Front Office staff. The AOFM advised that this is 'not a decision-making committee with [a] terms of reference or [a] charter'. Presentation packs were developed for meetings on most weeks between January 2021 and May 2023. Meetings are not minuted.

### *AOFM Advisory Board*

2.11 The AOFM Advisory Board (Advisory Board) is convened by the secretary to assist the secretary to assess the AOFM's proposed strategies and to advise the secretary on debt and investment markets.

2.12 The Advisory Board was first established in December 2000 and was dissolved in November 2016 by the secretary. As the Advisory Board was set up at the discretion of the secretary, it could be dissolved in the same manner. Several reasons were provided at the time for the dissolution of the Advisory Board:

(a) potential conflict (or perception thereof) between the market experience required of the Advisory Board members and the advice they were expected to provide;

(b) advice could be sought on a more flexible basis from experts as required; and

(c) findings of the Capability Review undertaken by the Australian Public Service Commission (APSC) in November 2015 including a lack of clarity around the role of the Advisory Board as both a provider of strategic advice to the Secretary and advice to AOFM on governance and corporate matters and that the Advisory Board functioned as a 'board of directors' would for a private company.

2.13 The Advisory Board was re-established in March 2023 by the secretary. The appointees were recommended by the then CEO of the AOFM in 2022, and subsequently approved and appointed by the secretary. Of the four external members of the re-established Advisory Board, two had been part of the Advisory Board at the point it was previously disbanded. The membership of the AOFM Advisory Board is published in the 2022–23 Annual Report.[68]The scope of the re-established Advisory Board is consideration and advice relating to the Annual Remit and related Debt Management Strategy (DMS) and Liquidity Management Strategy (LMS), and excludes AOFM corporate governance, operational matters and fiscal policy. This is in contrast to the scope of the previous Advisory Board (2000–2016), which included corporate governance and business planning.

2.14 The Budget Policy Division in Treasury has responsibility for providing secretariat services to the AOFM Advisory Board. Treasury provides a briefing to the secretary ahead of the Advisory Board meetings. The briefings provide an overview of the discussion topics but do not provide in-depth advice, separate analysis regarding debt management practices, and public policy in relation to debt, or strategies for implementation as proposed by AOFM.

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67 Liquidity risk is defined in Box 2 of Chapter 1: Background.

68 Australian Office of Financial Management, *AOFM Annual Report 2022-23* [Internet], AOFM, accessed from https://www.aofm.gov.au/sites/default/files/2023-10-19/AOFM%202022-23%20Annual%20Report_WEB.pdf [accessed 13 November 2023], page 77-78.

## Oversight of debt management

2.15 Treasury, through the secretary, supports the Treasurer's role in debt management. The annual Debt Issuance Ministerial Submission (Debt Issuance Strategy) is provided by AOFM to the Treasurer to advise of the planned debt issuance before Budget each year. The Debt Issuance Strategy describes the financing task which is provided by Treasury to the AOFM when required. The Debt Issuance Ministerial Submission then formulates the total planned annual debt issuance by type of AGS required to meet the financing task. The FRMP states the Debt Issuance Strategy should be reviewed and updated when the government releases updated fiscal forecasts and projections.

2.16 The AOFM provided a ministerial submission to the Treasurer before the Budget for the years 2019–20, 2020–21, 2021–22, 2022–23 (March), 2022–23 (October) and 2023–24. These ministerial submissions outlined the AOFM's issuance strategy for that year in relation to the financing task at Budget. The ministerial submissions were approved by the Treasurer in 2019–20, 2020–21 and 2021–22, and not approved (not signed) by the Treasurer in 2022–23 (March), 2022–23 (October) and 2023–24.

2.17 Additional updates, via a ministerial submission, at the Mid-Year Economic and Fiscal Outlook (MYEFO) were provided in 2019–20, 2020–21, and 2021–22. An update was provided in December 2022 (there was no MYEFO in 2022–23 due to the October 2022 Budget).

2.18 In 2020, the AOFM provided updated issuance submissions to the Treasurer on 7 April 2020, 5 June 2020, 2 July 2020, and 10 August 2020. These updates addressed the effects of the COVID-19 pandemic and monetary and fiscal policy responses on debt management and AGS issuance at the time. Three of the additional submissions were not approved by the Treasurer.

2.19 The AOFM's Annual Remit facilitates the secretary's oversight of the AOFM. The FRMP states that the Annual Remit 'contains limits, targets and thresholds that the secretary to the Treasury seeks to have the AOFM operate within' and 'is the mechanism for the secretary to approve the targets, limits, and guidelines that comprise the strategies'. There is no legislative basis for the secretary's approval of the Annual Remit. The Annual Remit includes the AOFM's recommended annual strategies for debt management and liquidity management. The 'limits, targets and guidelines' in each Annual Remit includes Weighted Average Maturity (WAM), a measure of cost and risk for debt issuance in the year ahead (see paragraph 3.11); approach to issuance; and levels of cash held. AOFM advised that the approval of the Annual Remit is 'an internal governance requirement' per the FRMP and 'not linked to a legislative requirement.

2.20 Annual Remits for the years 2019–20, 2020–21, 2021–22 and 2022–23 were provided to the secretary. These were approved before the start of the corresponding financial year in 2019–20[69], 79 days after the beginning of the financial year in 2020–21, before the start of the financial year in

69 An update to the 2019–20 Annual Remit following the Mid-Year Economic and Fiscal Outlook was provided to the secretary on 23 December 2019.

2021–22, and one day after the beginning of the financial year in 2022–23.[70] The date of the approval of the Annual Remit did not affect ability of the AOFM to issue debt. AOFM advised that the ‘trigger for an annual remit is a financing task as part of the Budget process’. The absence of a signed remit prior to 1 July does not prevent AOFM from issuing AGS to meet Government financing needs’. The Annual Remit was not required to be updated when expected debt issuance changed.

2.21 Each Annual Remit informs the secretary of the AOFM’s adherence with the previous year’s Annual Remit. Treasury advised in January 2024 that ‘changes in issuance volumes from those advised in the annual remit reflect changes in the borrowing task [due to the evolving economic and fiscal outlook and the Government’s policy decisions]’. In 2019–20 and 2022–23, the AOFM reported that its operations were consistent with the previous Annual Remit. In 2020–21, the AOFM advised the secretary that the WAM issuance target was not met and the final volumes of Treasury Bonds and Treasury Notes in 2019–20 were considerably higher than set out in the 2019–20 Annual Remit. In 2021–22, AOFM advised the secretary that issuance in the first half of the year was lower than intended.

2.22 Treasury provided the secretary with advice prior to the approval of the Annual Remit from 2020–21 to 2023–24. In 2020–21 and 2021–22, this advice included recommendations to approve the Annual Remit or aspects thereof. Treasury advised the ANAO on 9 November 2023 that the Annual Remit is provided to the Treasurer ‘following agreement by the Treasury Secretary’ which ‘provides an opportunity for the Treasurer to express any concerns with the remit.’ A summary of the annual process for the establishment of the key debt management limits through the Debt Issuance Ministerial Submission and the Annual Remit is outlined at Figure 2.2.

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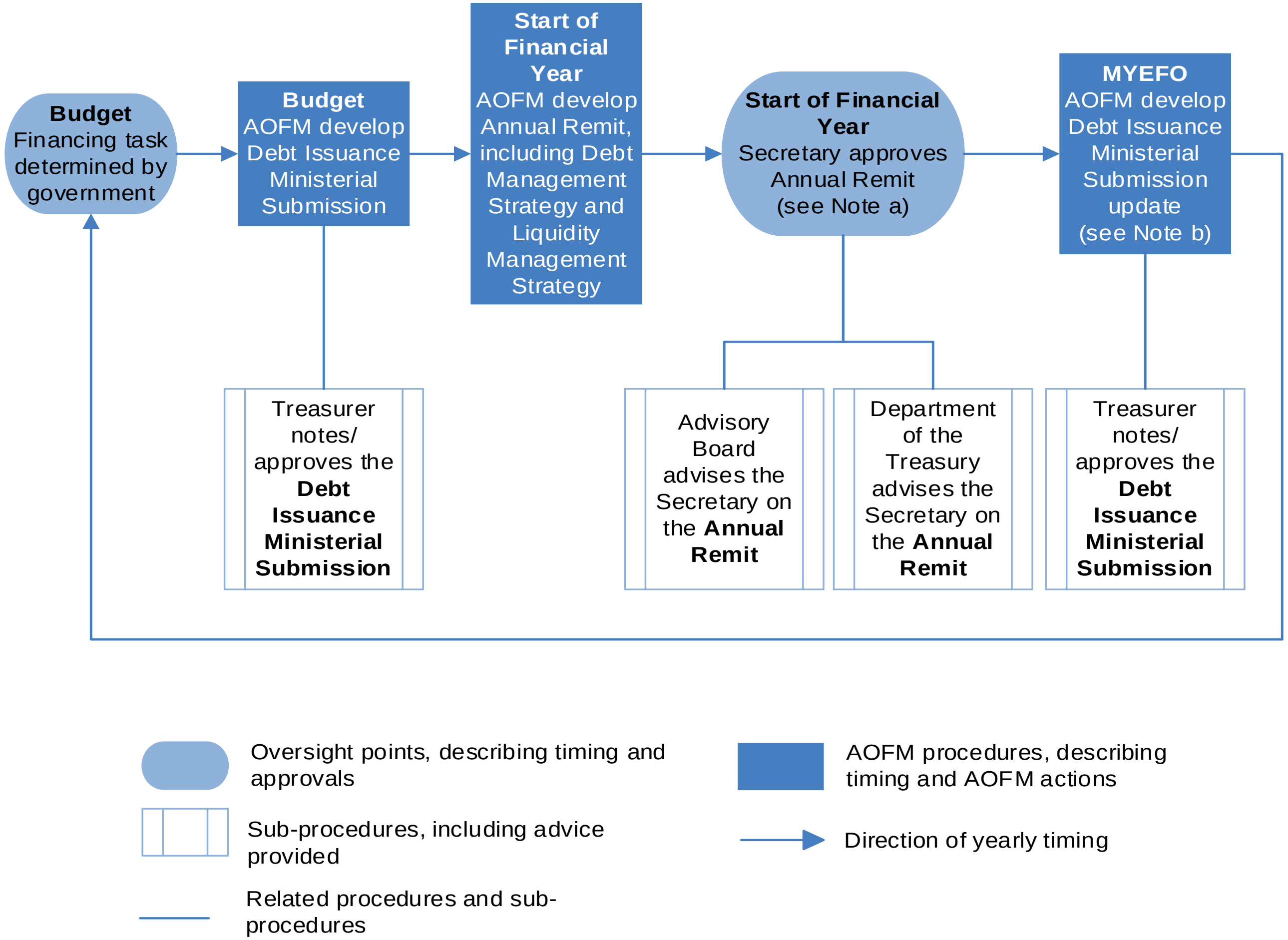
70 On 20 March 2020, the Government decided to defer the 2020-21 Budget until 6 October 2020 given the challenges raised by the global COVID-19 pandemic. Treasurer, ‘2020–21 Budget announcement’, media release, 20 March 2020, available from https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/2020-21-budget-announcement [accessed 16 August 2023]. The AOFM advised in January 2024 that ‘[t]hese [remits] were approved before the start of the corresponding financial year in 2019–20, 79 days after the beginning of the financial year in 2020–21 (due to the delay of the budget from May 2020 to October 2020), 68 days before the start of the financial year in 2021–22, and one day after the beginning of the financial year in 2022–23’.

**Figure 2.2: Process for Debt Issuance Ministerial Submission and Annual Remit as of 2023**




Note a: While the Annual Remit in practice is developed before the start of the Financial Year, AOFM advised that the timing is dependent on the provision of the financing task for the year, which could mean updates apart from the standard Budget and MYEFO timings.

Note b: While the Debt Issuance Ministerial Submission is also typically developed at Budget and MYEFO timings, their timings may change depending on changes to these financial updates.

Source: ANAO analysis of AOFM and Treasury documentation.

## Recommendation no. 1

2.23 The Australian Office of Financial Management and the Department of the Treasury should ensure that where governance arrangements are not defined by legislation, they are clearly documented, including clear roles and responsibilities.

**Australian Office of Financial Management response:** *Agreed.*

2.24 *The AOFM will work with the Department of the Treasury to enhance existing documentation of governance arrangements not defined by legislation, including clear roles and responsibilities for the Treasurer, the Secretary to the Treasury and the AOFM CEO.*

**Department of the Treasury response:** *Agreed.*

## Recommendation no. 2

2.25 The Australian Office of Financial Management should document all governance meetings related to debt management; and ensure that there is clear and timely documentation of operational directives and limits relating to the execution of debt management.

**Australian Office of Financial Management response:** *Agreed.*

2.26 *The AOFM will document all governance meetings related to debt management.*

2.27 *The AOFM will review existing arrangements to identify if there are any gaps or opportunities for improvement regarding the clear and timely documentation of operational directives and limits.*

## Were there effective risk management, compliance and assurance arrangements to manage government debt?

The AOFM has established frameworks to manage risk, compliance and assurance. The AOFM has separate frameworks for the management of enterprise risk and financial risk. The AOFM Middle Office does not assume responsibility for the management of financial risks. The AOFM's processes for the acceptance of gifts, benefits and hospitality by the AOFM's CEO and staff are not aligned with relevant public sector requirements. The AOFM's conflict of interest processes are not aligned with the AOFM's conflict of interest policy. The Treasury's conflict of interest processes do not incorporate the AOFM CEO and for this reason are not aligned with Treasury's conflict of interest policy and legislative requirements.

2.28 Section 16 of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act) requires the accountable authority of a Commonwealth entity to establish and maintain an appropriate system of risk oversight and management and internal control for the entity. The

Commonwealth Risk Management Policy requires that entities embed risk management into the decision-making activities of an entity, including implementation.[71]

2.29 The AOFM is a public sector and financial market entity which seeks to base its operational principles on financial industry best practice.[72] Therefore, the AOFM's financial risk management structures should take into consideration those of other financial market entities, especially with respect to establishing appropriate internal controls and the segregation of duties, in addition to meeting requirements of the Commonwealth Risk Management Policy.

2.30 The Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC) develop requirements and better practice guidance for financial risk management practices for regulated entities. While the AOFM is not regulated by APRA or ASIC, APRA's and ASIC's regulatory requirements and guidance represent best practice in the management of financial risks.

2.31 Prudential standards[73] for all APRA-regulated entities requires that:

- risk frameworks address material risks to the entity, including market and investment risks;
- material risks associated with the institution's strategic objectives and business plan must be explicitly managed through the risk management framework;
- the risk management function for the institution is operationally independent; has the necessary authority and reporting lines to conduct its activities effectively and independently; and has access to all aspects of the institution that have the potential to generate material risk; and
- the Chief Risk Officer must be independent from business lines, other revenue-generating responsibilities and the finance function.

2.32 Guidance from ASIC[74] to funds management companies regarding their risk management obligations states that:

- documented risk management systems should include:
  - policies and procedures for identifying, assessing and understanding each of the material risks of the fund operator's business and funds operated;
  - policies and procedures for ensuring there is adequate oversight of the risk management systems by both the party responsible for ownership of the risk and the compliance function, including appropriate reporting; and

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71 Department of Finance, *Commonwealth Risk Management Policy* [Internet], Department of Finance, accessed from https://www.finance.gov.au/government/comcover/risk-services/management/commonwealth-risk-management-policy [accessed 7 September 2023].

72 Australian Office of Financial Management, *AOFM Corporate Plan 2021–22* [Internet], AOFM, accessed from https://www.aofm.gov.au/publications/corporate-plan/corporate-plan-2021-22 [accessed 9 October 2023].

73 Banking, Insurance, Life Insurance and Health Insurance (prudential standard) determination No. 1 of 2019.

74 Australian Securities and Investments Commission, Regulatory Guide 259 Risk management systems of fund operators (ASIC) [Internet], ASIC, available from https://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-259-risk-management-systems-of-fund-operators/ [accessed November 2023], page 6.

– a policy or statement on the fund operator's risk appetite and the risk tolerance for each material risk identified.

2.33 Funds management companies may segregate functions to allow for independent checks and balances; establish a designated risk management function and/or risk management committee.[75]

## Management of risks

2.34 The AOFM has established a risk governance framework and an assurance framework to support its CEO to meet debt management obligations. The key elements of the AOFM's risk governance framework in relation to debt management consists of the Enterprise Risk Management framework and the FRMP, as well as the 'targets, limits, and guidelines' in the Annual Remit, DMS and LMS.[76] The AOFM advised the ANAO in June 2023 that '[no] additional compliance, assurance or oversight activities were stood up to support the increase in Government debt. The AOFM dialled up issuance and existing processes and tools on hand were scalable.'

### *Enterprise risk management framework*

2.35 The enterprise risk management framework outlines the AOFM's approach for identifying, managing and reporting on strategic, portfolio and operational risks.

2.36 The Chief Risk and Assurance Officer (CRAO) is responsible for the timely monitoring and reporting of risks, incidents and treatments to the AOFM CEO, Executive Leadership Group and the Audit and Risk Committee. Business units are responsible for assessing risks and reporting risks and changes to risks to the Middle Office, which maintains the risk register. The CRAO attested for each annual review of the Enterprise Risk Management Framework provided to the CEO that AOFM officials consistently applied the risk management process, using templates to report risks appropriately.

2.37 Table 2.2 outlines the four portfolio risk categories identified in the Enterprise Risk Management Strategy for 2022–23, and AOFM's appetite and management of these risks. As set out in Table 2.2, tolerances for the key financial risks outlined in the FRMP (interest rate risk and liquidity risk) are managed according to the provisions of the FRMP for measuring, mitigating and reporting on financial risks which is undertaken primarily by the Front Office as discussed at paragraph 1.6. The FRMP does not specify a risk oversight role for the Middle Office for these risks.

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75 Australian Securities and Investments Commission, Regulatory Guide 259 Risk management systems of fund operators [Internet], ASIC, available from https://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-259-risk-management-systems-of-fund-operators/ [accessed 27 November 2023], p 6.

76 The Debt Management Strategy, Liquidity Management Strategy and the Annual Remit are discussed in paragraph 2.13.

**Table 2.2: AOFM portfolio risk taxonomy, appetite, and tolerances for 2022–23**

| Risk category | Risk appetite and rationale | Tolerance and control documentation |
|---|---|---|
| **Liquidity risk**<br>AOFM will not have the funds available to meet the Government's payment obligations as they fall due. | **Minimal (low risk level)**<br>The ability to meet government cash flow requirements in a cost-effective manner goes to the core of AOFM obligations. Ready access to financial assets is taken to have primacy over other objectives.<br>It is essential that the AOFM take the necessary steps to meet day-to-day outlays of government and avoid market or operational disruptions caused by AOFM action or inaction. | Financial Risk Management Policy, supporting strategies, guidelines, and procedures. |
| **Market risk**<br>Exposure to the uncertainty in market parameters impacting the value of the asset and liability portfolios and/or public debt interest costs. | **Balanced (high risk level)**<br>Within the bounds of relevant legislation, the AOFM is well placed to assess and leverage appropriate market risks and opportunities to achieve overall portfolio optimisation. | Financial Risk Management Policy, supporting strategies, guidelines, and procedures. |
| **Credit risk**<br>AOFM or a counterparty may default on its obligations or be unable to perform under the terms of a contract, creating financial loss. | **Minimal to cautious (low to medium risk level)**<br>The AOFM has a cautious appetite in relation to structured finance activities, due to the nature of the underlying asset classes.<br>The AOFM has a minimal risk appetite for credit risk associated with debt management activities. Settlement failure arising from either the AOFM or a counterparty defaulting on its AGS obligations, would compromise AOFM's financing obligations and carry with it the potential for significant reputational impact. | • Information Memoranda (AGS)<br>• Trade tickets |
| **Portfolio strategy**<br>Inadequate risk decision-making processes that underpin portfolio decisions. | **Cautious (medium risk level)**<br>To ensure AOFM adequately considers its core portfolio obligations it is important that we maintain sound risk-based decision-making processes based on reliable and relevant information. | • Financial Risk Management Policy, supporting guidelines and procedures<br>• Annual Remit<br>• Market Notices<br>• Australian Financial Market Association market rules |

Source: AOFM documentation.

### *Enterprise assurance framework*

2.38 Both enterprise and financial risks are supported by the AOFM's assurance framework. The AOFM's assurance framework consists of a policy, updated and approved by the CEO every three years, and an annual program.

2.39 The assurance framework is based on a three line of defence model, where Business Units own and manage risks and are responsible for reporting these to the Middle Office as the first line of defence, the Middle Office has oversight of and monitors risks, and internal audit provides additional assurance.

2.40 The annual assurance program showed that controls were developed for identified risks. The Middle Office's assurance actions as a second line of oversight and control, is primarily through the Middle Office's Daily Report, which provides a compliance check against 'targets, limits, and guidelines' including those outlined in the Debt Issuance Ministerial Submission and Annual Remit. The AOFM advises that in practice, the relevant limit reported against is the weighted average maturity (WAM). Other activities undertaken by the Middle Office largely involves checking that annual limits and financial risk policies are developed and reported against.

2.41 The AOFM has an Audit and Risk Committee that provides independent advice to the CEO. Audit and Risk Committee papers and minutes show Enterprise Risk and Assurance updates are provided at each Audit and Risk Committee meeting.

### *Management of non-compliance*

2.42 The AOFM advised the ANAO in November 2023 that non-compliance is to be reported to the secretary and that this reporting takes place through the Annual Remit and Debt Issuance Strategy. The AOFM has not developed any process or procedures in the instance that non-compliance with financial risk tolerances is identified.

**Opportunity for improvement**

2.43 The Australian Office of Financial Management could:

(a) ensure that overarching risk frameworks and the risk management function engage with all material risks, and that risk management reflects financial markets better practice and

(b) develop clear processes and procedures which clarifies compliance actions when financial risk tolerances, or the targets, limits and guidelines contained in the Annual Remit, Debt Issuance Strategy and Financial Risk Management Policy, are not adhered to.

## Management of probity

### *Fraud*

2.44 The AOFM Fraud Control Plan was reviewed in 2019 and 2021, and outlines the AOFM's approach to managing fraud. The Plan states that 'the AOFM has a minimal risk appetite for fraud.' The AOFM's Fraud Manager is the CRAO who coordinates and manages the AOFM's fraud control policies and processes.

2.45 As at February 2023, the CRAO reported to the AOFM Executive Leadership Group no instances of non-compliance with the AOFM's fraud control policies have been identified. The AOFM advised the ANAO on 9 November 2023 that a register of instances of fraud has not been established as there have not been any identified instances of fraud.

### *Conflict of interest*

2.46 The main legislative requirements relating to conflict of interest for Australian Public Service (APS) employees are as follows:

- under sub-section 13(7) of the *Public Service Act 1999*, an APS employee must take reasonable steps to avoid any conflict of interest (real or apparent) in connection with the employee's APS employment; and must disclose details of any material personal interest of the employee in connection with the employee's APS employment;
- under sub-section 29(1) of the *Public Governance, Performance and Accountability Act 2013*, an official of a Commonwealth entity who has a material personal interest that relates to the affairs of the entity must disclose details of the interest; and
- under sub-section 13(1) of the Public Governance, Performance and Accountability Rule 2014, an official of a Commonwealth entity who is the accountable authority of the entity and has a material personal interest that relates to the affairs of the entity must disclose that interest, in writing, to the entity's responsible Minister.

2.47 The AOFM maintains internal policies to manage conflicts of interest and instances of fraud. The AOFM Conflict of Interest Policy is updated annually and includes guidance for all AOFM officials and consultants or contractors (including Audit and Risk Committee members).

2.48 The Policy provides guidance on the following:

- responsibilities of APS employees under the Australian Public Service Code of Conduct;
- *Corporations Act 2001* provisions (Part 7.10, Division 3) prohibiting insider trading and the definition of insider trading;
- definitions of real, and apparent, conflicts of interest;
- responsibilities of the CEO, CRAO, managers and officials in relation to the management of conflicts of interest;
- CEO's directions on the disclosure, and avoidance, of conflicts of interest, as well as guidance on determining the significance of any particular conflict; and
- templates for officials to declare any conflicts of interest, real or apparent.

2.49 The CEO provides additional guidance to AOFM officials on the disclosure of specific conflicts; determined to be a matter of priority:

- any dealings (including holding of equities) by AOFM officials in ASX [Australian Securities Exchange] Ltd;
- requirement for officials involved in selection of bids in investment transactions to disclose any interests they may have in firms that appear on the AOFM's Investment Facility panel member list and/or market participants submitting proposals for the securitisation facilities; and

- requirement for officials involved in settlements or the retail registry facility to disclose any private dealings (including holding of equities) they may have in Computershare Australia.

2.50 The AOFM Conflict of Interest Policy specifically states:

> All AOFM officials are prohibited from holding a direct interest in or trading Australian Government Securities (AGS) or AGS derivatives (e.g. Australian Government Bond futures and AGS depositary interests including Australian Government Bond Chess Depository Interests (CDIs)). Where the AGS or AGS derivatives form part of an investment portfolio such as a managed superannuation fund or investment scheme and individual trading decisions are not influenced by the official, this requirement does not apply.

2.51 All officials covered by the AOFM Conflict of Interest Policy are required to submit an acknowledgement each year that they are aware of the requirements of the PGPA Act — Duties of Officials; APS Code of Conduct; and AOFM's Employment Policies and Procedures. This is done through the submission of the Declaration of Interests form (Annexure 1 to the Conflict of Interest Policy) on commencement and once per year.

2.52 The AOFM Conflict of Interest Policy states that for the management of conflicts:

> Where a conflict of interest arises, the official and the manager share responsibility for its management. The conflict must be handled transparently and in a way that will stand up to scrutiny. A written record of actions taken to manage the conflict of interest must be made by the official and agreed by their manager, reviewed regularly, and updated when any circumstances change. Part B of Annexure A provides space for this conflict management plan to be recorded. Completed conflict management plans must be provided to the CRAO.

2.53 The CEO determines appropriate action in the event of a breach of the Conflict of Interest Policy.

2.54 The CRAO is responsible for the maintenance of a register of conflict of interest declarations and conflict management plans. However, the CRAO maintains individual declarations on their computer.

2.55 During the audit period of January 2020 and June 2023, there were two rounds of declaration of conflict of interest: August 2020 and March 2022. This demonstrates a gap of 20 months between declarations.[77] One staff declaration was absent in 2020 and three staff declarations were absent in 2022.[78]

2.56 Conflict management plans are self-reported by the staff member. ANAO analysis of declarations made during these two rounds showed no evidence of what actions are taken by staff and their managers to manage conflicts and whether the CRAO was satisfied that declared conflicts of interest had been appropriately addressed.

2.57 The Audit and Risk Committee Charter requires that all Audit and Risk Committee members submit an annual written declaration to the CEO of real or apparent conflicts of interest they may have in relation to their responsibilities to be completed on the final yearly meeting. A declaration

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77 The conflict of interest declaration process in 2019 occurred in July 2019; and in 2023 this occurred in July 2023.

78 AOFM advised in January 2024 that 'this was an administrative oversight and there was no evidence of impropriety'.

is also required at the beginning of each meeting, with the Chair, in consultation with the CEO, responsible for deciding if the committee member should excuse themselves from a discussion.

2.58 During the audit period, the Audit and Risk Committee members each signed the External Audit Committee Member Conflicts of Interest Declaration each year.

2.59 The AOFM Conflict of Interest Policy does not cover the CEO. SES employees are required to submit, at least annually, a written declaration of their own and immediate family's financial and other material personal interests.[79] The CEO, as an SES employed by Treasury, is covered by the Treasury Conflict of Interest Policy which states that new SES staff are required to 'complete an annual conflict of interest declaration, starting with a declaration on commencement of their appointment'.

2.60 During the audit period, the CEO of the AOFM did not submit any conflict of interest declaration (including annual declarations or declarations upon commencement) to the secretary.

2.61 As advisors to the secretary, the AOFM Advisory Board is subject to the Treasury Conflict of Interest policy. In appointing the members, Treasury determined that a current or past market role of the AOFM Advisory Board member was not of itself a conflict, but designed a test where advisory roles were 'not judged to have a conflict of interest'. AOFM Advisory Board members advised that they are requested to declare conflicts of interests ahead of each meeting. Any conflicts of interest are included as part of meeting minutes, and the Chair can excuse members from meetings at any point once this is made known. All AOFM Advisory Board members submitted conflict of interest declarations upon commencement.

2.62 Advisory board members do receive access to market sensitive information, but do not receive specific guidance from Treasury about confidentiality requirements for dealing with market sensitive information.

**Opportunity for improvement**

2.63 The Australian Office of Financial Management and the Department of the Treasury could:

- advise AOFM Advisory Board members of any information considered market sensitive; and
- ensure there is guidance to AOFM Advisory Board members about confidentiality requirements for dealing with market sensitive information.

### *Gifts, benefits and hospitality requirements*

2.64 Section 27 of the PGPA Act states that an official must not improperly use their position to gain, or seek to gain, a benefit to themselves or another person. The giving or receiving of gifts, benefits and hospitality can create the perception that an official is subject to inappropriate external influence.[80]

79 Australian Public Service Commission, *Declaration of interests* [Internet], https://www.apsc.gov.au/working-aps/integrity/integrity-resources/declaration-interests

80 Australian Public Service Commission, *Guidance for Agency Heads – Gifts and Benefits* [Internet], APSC, available from https://www.apsc.gov.au/working-aps/integrity/integrity-resources/guidance-agency-heads-gifts-and-benefits [accessed 11 September 2023].

2.65 A policy for giving and receiving gifts, benefits and hospitality is an important element of a robust control environment and supports ethical conduct. The effective implementation of such a policy, which generally requires accurate disclosures by entity personnel, benefits from strong cultural settings within the entity, including the example set by senior leadership ('tone at the top').

2.66 AOFM's requirements for managing the receipt of gifts, benefits and hospitality are contained in the Accountable Authority Instructions (AAIs), employment policies and procedures, and conflict of interest policies. The AOFM's guidance states:

> The AOFM's role will give rise to offers of hospitality (e.g. meals, in house functions, attendance at corporate functions and other events). Acceptance of hospitality can be normal business practice but has the potential to cause perceived or actual conflicts of interest – which need to be either avoided or managed.
>
> …
>
> Hospitality on an 'excessive' scale (judged by either value or frequency) should be declined, even where there is a reasonable expectation that it will contribute to the achievement of the AOFM's relationship management objectives.

2.67 There is no clear internal guidance or defined thresholds for cost or frequency on what is considered 'excessive' hospitality.

2.68 AOFM's AAIs define official hospitality as the 'use of public resources to provide hospitality to persons other than officials to facilitate the achievement of one or more entity objectives'. Under the AAIs, officials must not enter into an arrangement to provide official hospitality unless:

- delegated the authority under section 23 of the PGPA Act by the CEO; and
- the requirements of these instructions have been met.

2.69 Under the AAIs, decisions to approve official hospitality should be publicly defensible, and procured goods and services are subject to the Commonwealth Procurement Rules. The Chief Financial Officer (CFO) must ensure a permanent record is maintained of both approval and expenditure documentation on the provision of official hospitality for monitoring and reporting purposes.

2.70 AOFM records indicate that the majority of gifts, benefits and hospitality accepted by the AOFM comprises meals offered by market makers in AGS. The AOFM advised the ANAO that as a public sector entity with a 'market facing' role, there is a need to balance different expectations around the acceptance of gifts, benefits and hospitality, including that financial market stakeholders expect acceptance of hospitality in the course of business. Between the audit period of 1 January 2020 to 30 June 2023, there were 146 entries relating to offered gifts, benefits and hospitality in an internal register; 139 were recorded as accepted; four were recorded as declined; no action was recorded for three entries but these were reported in the external gift register. In accordance with APSC guidance, 118 entries over the $100 reporting threshold were published in the external register; three entries of less than the $100 value reporting threshold were published; and no gifts declined were reported.[81] The value of externally reported gifts, benefits and hospitality totalled

81 Australian Public Service Commission, *Guidance for Agency Heads – Gifts and Benefits* [Internet], APSC, available from https://www.apsc.gov.au/working-aps/integrity/integrity-resources/guidance-agency-heads-gifts-and-benefits [accessed 11 September 2023].

$37,063.40 during the audit period, of which $24,660 is the total value of gifts, benefits and hospitality provided by banks which make markets in AGS.

2.71 The internal register contained no record of perceived or actual conflict of interest considerations in relation to accepting the gift, benefit or hospitality. There was no record of the basis of acceptance or non-acceptance of hospitality. There was inconsistent reporting of how gifts accepted were disposed of, including if they were kept by the AOFM official, remained the property of the entity or otherwise disposed of. Regarding the acceptance of gifts, benefits and hospitality, the AOFM advised in January 2024 that 'as a public sector entity with a 'market facing' role there is a need to balance its public sector responsibilities with financial markets business practices particularly when meeting with investors, intermediaries and other financial markets participants'.

2.72 The AAIs require that gifts or benefits above $350 will require approval by the CEO prior to acceptance. There was self-reporting of whether the CEO approval for the acceptance of gifts, benefits or hospitality over $350 was received from August 2020 in the internal register, however, there was no consistent process regarding how offers of gifts, benefits and hospitality above the limit of $350 were approved. In some cases, approval was provided through email. The AOFM advised that in some circumstances, attendance of the CEO would be taken to be approval to the offer of hospitality.

2.73 While the AOFM's AAIs state that Official Hospitality is the 'use of public resources to provide hospitality to persons other than officials to facilitate the achievement of one or more entity objectives', during the audit period, there was a total of 26 instances of official hospitality provided by the AOFM. Of these, 10 instances (38 per cent) were provided only to AOFM staff (no non-AOFM officials in attendance). AOFM records indicated that of the 11 official gifts provided by the AOFM, the majority of gift recipients were AOFM staff members.[82]

2.74 There is scope for AOFM to improve its guidance in relation to gifts, benefits and hospitality. Where the AOFM has conflicts it needs to balance between its public sector responsibilities and financial markets business practices', it should be clear in its policies where it has allowed the adoption of financial market business or has a reduced focus on its public sector responsibilities. There should be clear justification of, if applicable, why the AOFM should not have a guiding

82 AOFM advised in January 2024 that 'the registers … have specific (and sometimes dual) purposes: [The] [h]ospitality register includes gifts, benefits and hospitality that has been provided to the AOFM by external parties. This supports the Accountable Authority Instructions (AAIs) requirement (AAI 6.6.7) to have a register of hospitality offered to employees and our compliance reporting on the public website. [The] [o]fficial entertainment register includes hospitality that has been provided by the AOFM to both officials and external parties. This supports the AAIs requirement (AAI 2.8.10) to have a record of all hospitality provided by the AOFM to external parties, and also records official entertainment provided to staff to facilitate the annual FBT return. This is a dual purpose register, hence the inclusion of employees. [The] [g]ift register includes details of any gifts provided by the AOFM and supports the AAI requirement to have a register of all gifts of public property (AAI 6.9.4), which does not distinguish between staff or external parties.'

principle, consistent with other APS agencies, that officials are to generally avoid the acceptance of gifts, benefits and hospitality.[83]

2.75 AOFM's declaration process does not require recipients to document in the gifts, benefits and hospitality register their assessment of whether accepting an offer represents a real or perceived conflict of interest. There is no record of the basis for the individual official's decision. AOFM can strengthen its arrangements for managing reputational risk by requiring the recipients of offers of gifts, benefits and hospitality to record in the internal register whether accepting the offer represents a real or perceived conflict of interest and document the basis for their decision. Documenting the basis of decisions is particularly important for managing perceptions of conflicts of interest related to the acceptance of such offers from counterparties to the AOFM and the suppliers of goods and services.

2.76 In the case of gifts, AOFM's internal and external registers do not include information on whether the individual making the declaration retained the gift, surrendered it to AOFM, or disposed of it in some other way. There was no evidence of an inventory of gifts surrendered to AOFM. Transparency of its internal register of gifts, benefits and hospitality could be improved by introducing requirements to capture this information.

2.77 Treasury is responsible for policies on gifts, benefits and hospitality for the AOFM Advisory Board. Treasury advised that '[s]hould Advisory Board members, by virtue of their Advisory Board role, receive gifts, benefits or hospitality advice that could be considered as influencing their advice, members would be expected to declare that conflict'. Treasury's conflict of interest policy does not contain guidance in relation to gifts, benefits and hospitality. The CEO, while an employee of the Treasury, as the head of a Commonwealth entity, should follow the APSC guidance.[84]

## Recommendation no. 3

2.78 The Australian Office of Financial Management and the Department of the Treasury implement conflict of interest processes consistent with internal policies and legislative requirements.

**Australian Office of Financial Management response:** *Agreed.*

2.79 *The AOFM will review and enhance existing conflict of interest processes to ensure they support full compliance with internal policy and legislative requirements. Analysis of conflicts declared will be fully documented to ensure there is evidence of consideration of conflict of interest matters.*

**Department of the Treasury response:** *Agreed.*

83 Australian Public Service Commission, *Guidance for Agency Heads – Gifts and Benefits* [Internet], APSC, available from https://www.apsc.gov.au/working-aps/integrity/integrity-resources/guidance-agency-heads-gifts-and-benefits [accessed 23 October 2023]. The APSC principles underpinning their guidance includes that 'there is consistency in relation to agency heads' management of gifts and benefits across APS agencies and Commonwealth entities and companies'. See also: Australian National Audit Office, *Probity Management: Lessons from Audits of Financial Regulators* [Internet], ANAO, available from https://www.anao.gov.au/work/audit-insights/probity-management-lessons-audits-financial-regulators [accessed 23 October 2023].

84 ibid.

## Recommendation no. 4

2.80 The Australian Office of Financial Management should:

(a) review whether a guiding principle, consistent with other Australian Public Service agencies, that officials are to generally avoid the acceptance of gifts, benefits and hospitality is appropriate for the organisation;

(b) document the basis for accepting offers of gifts, benefits and hospitality;

(c) document conflict of interest considerations for accepting offers of gifts, benefits and hospitality;

(d) document the disposal of gifts; and

(e) document considerations and benefits of providing official hospitality in line with the AOFM's Accountable Authority Instructions.

**Australian Office of Financial Management response:** *Agreed.*

2.81 *The AOFM will review its gifts and benefits (including hospitality) policies.*

2.82 *While the AOFM is transparent in its public reporting of all gifts and benefits (including hospitality) that its employees accept, the AOFM acknowledges that established policies and processes could be improved with clearer policy statements (which include guiding principles), and additional documentation. Additional documentation could include recording any declined gifts and benefits, and explicit approval of accepted (or provided) gifts and benefits.*

## Were appropriate arrangements established to monitor, measure and report on government debt?

The AOFM has appropriate internal monitoring arrangements which report on the AOFM's stated targets, limits and guidelines as outlined in key debt management oversight documents, however, monitoring and reporting does not lead to clear actions if targets, limits and guidelines are operationally exceeded. There is transparency around the levels of Government debt. The Treasurer is required to report on debt through the Debt Statement at each Budget and Mid-Year Economic and Fiscal Outlook; this is developed by the Department of the Treasury with the advice of the AOFM. The AOFM publishes a range of debt information publicly through its Annual Report and website. To support added transparency, there is scope for the AOFM to publish more information publicly on its debt management approach and strategy.

### Internal monitoring and reporting

2.83 Internal monitoring and reporting should follow the processes and procedures stated in the AOFM's FRMP and limits should refer to the Annual Remit and Debt Issuance Strategy. The key measure monitored and reported is the WAM for the year ahead, which is developed in the DMS and approved in the Annual Remit.

2.84 While monitoring and reporting is undertaken by the AOFM, debt management activities are undertaken with a degree of flexibility, meaning there are few limits in relation to which monitoring and reporting would support compliance assessments.

2.85 Information relating to government debt is captured through financial and accounting software programs used by the AOFM. The most relevant of these for monitoring and reporting purposes is FIS Quantum (Quantum), a Treasury Management System.[85] The source of reporting in the daily report, weekly issuance minute, and analyses used in the strategic cost and risk management documents is provided by Quantum. The AOFM has also developed internal dashboards, such as the Business and Market Intelligence (BMI) Portal, which allow for staff to generate reporting as required (this is discussed in more detail at paragraph 3.64).

### *Daily report*

2.86 The daily report reports on market value (revaluation) of the whole portfolio, including AGS instruments, cash and securities on a given day, the long-term gross issuance of Treasury Bonds and Treasury Indexed Bonds, the total face value of the Australian Government Securities on issue, and recent transactions (including issuance and cash management).

2.87 The daily report is an internal document produced by the Middle Office Business and Data Systems unit. AOFM advised the ANAO in September 2023 that the report was utilised primarily by the Front Office teams to confirm issuance activities, such as the upcoming maturity dates, remaining outstanding securities, and is a primary source for the data that is provided to the secretary as part of the monthly update to the secretary. The Business and Data Systems unit produces the report, and Enterprise Risk Assurance group uses it for portfolio checks.

2.88 The Middle Office uses one part of the daily report to perform daily compliance checks. This is a compliance monitoring and reporting task which involves checking daily information against relevant 'targets, limits and guidelines', including total AGS on issue, liquidity buffer, issuance as aligned with the Debt Issuance Strategy, and details of AOFM bank accounts with the Reserve Bank of Australia.

### *Weekly issuance minute*

2.89 The weekly issuance minute is the key decision-making instrument for the approval of debt issuance on a weekly operational basis, consistent with legislative delegations to senior officials in the AOFM. It is approved by the CEO. The weekly issuance minute contains qualitative analysis by the Front Office of market conditions, compliance with recently announced issuance, and the annual issuance program.

2.90 The weekly issuance minute, once approved, informs a public announcement to the market by the AOFM at noon each Friday, outlining the following week's issuance, including the instrument (coupon and maturity), the amount and the day of issuance. The weekly issuance minute is developed by the Front Office, drawing on market information gained in weekly phone calls with market makers.

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85 A 'Treasury Management System' is used by institutional financial market participants to record transactions and provide portfolio and security valuations with respect to market pricing information.

### *Monthly update to the secretary*

2.91 The monthly update to the secretary is a short qualitative and quantitative report which contains information including the planned AGS issuance for the year, the WAM of issuance compared to the target specified in the Debt Management Strategy for the financial year, overall portfolio status, yields of selected bond lines, the coverage ratio of tenders, other qualitative assessments of the perceived depth, liquidity and investor engagement in the AGS market, and economic conditions including actions which could potentially shift the market.

2.92 The monthly update to the secretary is sent by the CEO of the AOFM and noted by the secretary.

## External monitoring and reporting

### *Debt statement*

2.93 The Treasury has the responsibility to develop the debt statement. The debt statement forms part of Budget Paper No. 1 and the Mid-Year Economic and Fiscal Outlook (MYEFO) and is mandated by the *Charter of Budget Honesty Act 1998*. The *Charter of Budget Honesty Act 1998* also requires that additional statements are tabled 'when the actual face value of Commonwealth stock and securities on issue has increased by $50 billion or more' since the last such statement or fiscal outlook.[86]

2.94 The debt statement is required to include the value of stock and securities (including their market and face value, and their value as a proportion of gross domestic product), the total expected interest expenses relating to the stock and securities, and a breakdown, by maturity and timing of interest payments, of Commonwealth stock and securities on issue at the time of the report.

### *Public website and communications to the market*

2.95 The AOFM website is the primary instrument for AOFM reporting to AGS market participants and the public.

2.96 The total face value of AGS on issue, the planned total term issuance for the AOFM and the issuance calendar for the following week is published on the front page of the website.[87] The 'Issuance Program' page, reporting the planned issuance to the market, is updated following Budget and MYEFO each year.[88]

2.97 Announcements for tender auctions and syndications are posted to AOFM's website on the Friday of the week before on the 'Forthcoming Transactions' page.[89]

86 *The Charter of Budget Honesty Act 1998* section 33.

87 AOFM, *Home* [Internet], AOFM, available from https://www.aofm.gov.au/ [accessed September 2023].

88 AOFM, *Historical Issuance Program Updates* [Internet], AOFM, available from https://www.aofm.gov.au/program/issuance-program/historical-issuance-program-updates [accessed September 2023].

89 AOFM, *Forthcoming Transactions* [Internet], AOFM, available from https://www.aofm.gov.au/program/forthcoming-transactions [accessed September 2023].

2.98 Other transactional data can be found on the 'Data Hub' page, which outlines the most recent assessment for the amount of AGS on issue, calculated each week.[90]

2.99 Under the 'Wholesale Investors' section of the website, the AOFM communicates to investors through an investor insights publication and updated chart packs which provide information about the government's fiscal and economic position and policy settings. Speeches provided by the AOFM CEO and senior staff are published, together with semi-annual market updates in January and July that provide additional details on AOFM's planned operations over the following six month period.[91]

2.100 Unlike some comparable sovereign debt managers, the AOFM does not publish its Debt Management Strategy.[92]

- The UK Debt Management Office publishes a 'Debt management report' each financial year which outlines a debt management policy and the financing remit for the financial year, in addition to quantitative information about the debt portfolio.
- The Canadian Department of Finance publishes a 'Debt Management Report' each year as part of annual reporting to Parliament which reports against the 'Debt Management Strategy' which contains forecasts for Government debt in the upcoming year. The Debt Management Report includes information on the Objectives, Strategic Direction and Principles, in addition to quantitative information about the debt portfolio.

**Opportunity for improvement**

2.101 The Australian Office of Financial Management could consider providing more public transparency through its public and market facing website, on its debt management approach and strategy, including considering the publication of not market sensitive aspects of the annual Debt Management Strategy and Liquidity Management Strategy.

90 AOFM, *Data Hub* [Internet], AOFM, available from https://www.aofm.gov.au/data-hub [accessed November 2023].

91 AOFM, *Speeches* [Internet], AOFM, available from https://www.aofm.gov.au/publications/speeches [accessed September 2023]. AOFM, *Historical program updates* [Internet], AOFM, available from https://www.aofm.gov.au/program/issuance-program/historical-issuance-program-updates [accessed February 2024].

92 The US Department of the Treasury's Office of Domestic Finance (Debt Management Office) does not publish a debt management strategy.

# 3. Debt management

**Areas examined**

This chapter examines whether the Australian Office of Financial Management (AOFM) appropriately managed Australian Government debt during the period 1 January 2020 to 30 June 2023.

**Conclusion**

The AOFM is largely effective at managing costs and risks associated with Australian Government debt. The AOFM has a framework for managing funding risk and interest rate risk relating to its borrowing activities. The AOFM met the Australian Government's borrowing requirements between 1 January 2020 and 30 June 2023. The AOFM did not define any targets, limits or benchmarks for the cost of the debt portfolio. The AOFM has policies and processes in place to support cost-effective borrowing, but it does not assess whether the debt portfolio was managed at least cost subject to acceptable risk. Debt management activities were supported by relevant information from internal and external sources in respect of economic and financial market conditions, and the fiscal conditions of the Australian Government. The AOFM's borrowing decisions were consistent with relevant aspects of guidelines on best practices for public debt management published by the World Bank and International Monetary Fund.

**Areas for improvement**

The ANAO recommended that the AOFM and Treasury should consider how transparency around the impacts of debt management decisions on cost and risk outcomes for the debt portfolio can be enhanced. The ANAO also identified opportunities for the AOFM: to conduct and publish retrospective analysis to evaluate whether its debt management activities and issuance transactions achieved least cost outcomes subject to acceptable risk; to document its policy for determining the rationale and timing for its syndicated borrowing activities; and to document its compliance with Division 1 of the Commonwealth Procurement Rules in respect of its syndicated borrowing activities.

3.1 Public debt management involves establishing and executing a strategy for managing government debt in order to raise the required amount of funding at the least possible cost over the medium to long run, consistent with a prudent degree of risk. Debt management activities should also meet any other debt management objectives set by the government, such as maintaining an efficient market for government securities.[93]

3.2 This chapter considers whether the Australian Office of Financial Management (AOFM) appropriately managed Australian Government debt at least cost subject to an acceptable level of risk. This audit does not assess fiscal policies in relation to Australian Government debt. Annual Australian Government Budget papers reference the overarching aim of reducing debt[94], and note that the AOFM 'exercises operational independence in the execution of its duties'.[95]

93 World Bank and International Monetary Fund, *Revised Guidelines for Public Debt Management* [Internet], IMF, Washington, D.C. 2014, available from https://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/Revised-Guidelines-for-Public-Debt-Management-PP4855 [accessed 4 August 2023].

94 For example, see 2023–24 Budget Paper No 1, Statement 3, p. 87.

95 ibid., p. 253.

## Was government debt managed at the least cost and within acceptable risk?

The Australian Office of Financial Management (AOFM) has a framework for managing funding and interest rate risk relating to its borrowing activities. The AOFM met the Australian Government's borrowing requirements between 1 January 2020 and 30 June 2023. There were no targets, limits or guidelines for the cost of the debt portfolio. The AOFM has policies and processes in place to support cost-effective borrowing, but it does not assess whether the government debt portfolio was structured at least cost subject to acceptable risk.

### Debt management policy

3.3 The Australian Government requires the AOFM to finance budget deficits and maturing debt in a cost-effective manner and subject to acceptable risk, to ensure its outlays are met as due, and to maintain a liquid[96] market in Australian Government Securities (AGS).[97]

3.4 Once the funding task for the Australian Government is set at fiscal updates such as the annual Budget and Mid-Year Economic and Fiscal Outlook (MYEFO)[98], the AOFM exercises operational independence in its activities to borrow on behalf of the Australian Government to meet the funding task, and service the existing portfolio of debt, paying interest and repaying principal on Australian Government Securities as and when these payments are due to investors (see paragraph 1.12).[99]

3.5 The AOFM's Financial Risk Management Policy (FRMP) sets out the principles with which the AOFM applies judgement and exercises its operational discretion to achieve the funding task for the Australian Government and manage the Australian Government's debt portfolio and 'describes the requirements for measuring, mitigating and reporting on risks'. The FRMP characterises the 'primary' measure of costs associated with servicing the debt portfolio as 'accrual debt service cost', which is defined as 'interest payments made on AGS, realised market value gains and losses on repurchases, capital indexation of TIBs [Treasury Indexed Bonds], and amortisation of issuance premia and discounts'.[100]

3.6 Accrual debt service cost excludes 'unrealised market value gains and losses'.[101] The 'effective yield' on the debt portfolio is defined as the accrual debt service cost expressed as a percentage of the book value of total debt outstanding.[102] The level and variability of accrual debt service costs are influenced through time by the interest rate environment.

96 Liquidity refers to the relative ease with which a debt instrument may 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.

97 Department of the Treasury, *2023–24 Portfolio Budget Statements – Australian Office of Financial Management Portfolio Budget Statement*, p. 115.

98 AOFM, *2021–22 Annual Report*, p. 10.

99 Payment of principal and interest on money raised by AGS issued under the *Commonwealth Inscribed Stock Act 1911* is made by AOFM under an administered special appropriation. See AOFM, *2022–23 Annual Report*, p. 149.

100 AOFM, *2021–22 Annual Report*, p. 21.

101 ibid.

102 ibid.

3.7 The FRMP splits the AOFM's administered balance sheet into the 'Long-Term Debt Portfolio (LTDP)' which includes long term debt securities such as Treasury Bonds and Treasury Indexed Bonds, and the 'Cash Management Portfolio (CMP)', which includes short term assets such as cash and the cash management facility that is managed by the Reserve Bank of Australia, together with short term-funding instruments such Treasury Notes. The separation between the LTDP and the CMP helps to distinguish between the ongoing debt management task and within-year variability in Australian Government cash flows.

3.8 The FRMP describes the key risks associated with the Australian Government's debt portfolio including funding risk and interest rate risk (see Chapter 1 at Box 2 for a description of these risks), and states that the AOFM's role is to 'use its technical understanding of financial risks and markets to apply judgement (with oversight from the Secretary to the Department of the Treasury) in managing costs without unduly exposing the Australian Government to downside risk'. A description of the elements of sovereign debt management is at Box 3.

3.9 The FRMP notes, that '[i]n addition to financial risks, the AOFM should consider the impact of its activities on its reputation, and that of the Australian Government'. In terms of its 'philosophy' of debt management, the AOFM advised in November 2023 that 'transparency', balancing 'short-term and long-term' considerations, and 'dealing with the [AGS] market in a consistent and predictable manner' that 'avoids opportunism' constitute its 'principles', which, while not articulated in the FRMP or Debt Management Strategy (DMS), are 'important in understanding the way the AOFM operates more broadly and its approach to debt management more specifically'.

**Box 3: Elements of sovereign debt management**

Sovereign debt management involves issuing government debt securities in financial markets and managing the financial risk exposures resulting from the portfolio of government debt. By issuing debt securities and thereby borrowing on behalf of the government, funds are raised by the sovereign debt management agency for the government in the financial markets.

The sovereign debt management agency must decide which securities to issue, and when and how to issue these securities.

- Key choices with respect to security selection include instrument (Treasury Bond, Treasury Indexed Bond or Treasury Note) and maturity, which ranges from 2 to 30 years for Treasury Bonds.
- Key decisions with respect to timing include whether to publish a detailed issuance calendar in advance, whether to issue on an ad-hoc basis, or whether to take an intermediate approach between those two extremes and retain operational discretion with respect to issuance in consultation with market participants.
- Key decisions with respect to issuance include whether to issue via electronic auction (otherwise known as a tender, these are conducted by sovereign debt managers using electronic platforms for the trading of debt securities, such as the Yieldbroker DEBTS

**Box 3: Elements of sovereign debt management**

System (Yieldbroker)[103]) or syndication (which is a fund raising process undertaken by a panel of joint lead manager banks).

Interest rates on longer maturity bonds are generally higher than interest rates on shorter maturity bonds, because investors demand higher compensation for investing their money for longer periods of time — this is known as the 'term premium'. As the yield curve is a plot of the yield on bonds against the time to maturity, a term premium is likely to be present in a persistently positively sloped yield curve environment. In the presence of a positive term premium, sovereign debt management agencies could therefore issue shorter dated bonds and expect to incur lower debt service costs given the lower interest rates that are generally observed on shorter dated bonds. However, taking this approach would mean that the shorter dated issuance would mature quicker, and thereby roll over more rapidly, which could expose the government to funding risk and interest rate risk in respect of the refinancing task.

Conversely, longer dated issuance incurs higher debt servicing costs via higher interest rates on longer maturity bonds but involves lower refinancing risk because the debt portfolio rolls over relatively slower. In other words, shorter duration debt portfolios are generally lower cost but involve higher risk of variability in debt service costs; whereas longer duration debt portfolios are generally higher cost (with a positive term premium and positively sloped yield curves) but involve lower risk of variability in debt service costs.

Source: See World Bank, *Debt Management Learning & Training Notes*, 2017: Washington, DC; and World Bank, *Debt Management Performance Assessment Methodology*, 2021; Washington, DC.

3.10 The FRMP acknowledges the trade-offs between cost and risk faced by the AOFM in managing the Australian Government's debt portfolio, and states that while the Australian Government does not articulate its risk tolerance to AOFM, the AOFM's overriding concern is to fund the Australian Government and thereby minimise funding risk:

> The AOFM typically faces trade-offs between cost and risks. For example, longer-dated issuance reduces funding risk and interest rate risk but tends to be more costly. The Government does not provide the AOFM with a tolerance for risk, although the appetite for funding risk is perceived to be extremely low, so the AOFM must apply judgement in minimising cost without taking undue risk. The DMS [debt management strategy] is the expression of this trade-off.
>
> Risk considerations will tend to dominate cost considerations when annual issuance tasks are high in the near-term. At these times, a long-dated bias is the default strategy for Treasury Bond issuance (to manage funding risk), although there may be reasons to deviate from this default. When issuance tasks are lower, the balance of considerations can shift from reducing risk to reducing expected costs.
>
> The potential cost implications of strategic choices are viewed through a 'regret minimisation' lens – aiming to avoid extremely adverse cost outcomes rather than pursuing strategies that may minimise expected costs but come with higher risks.

103 Australian Office of Financial Management, Conditions of Operation [Internet], AOFM, available from https://www.aofm.gov.au/sites/default/files/2021-02-02/AOFM%20Tender%20Conditions%20of%20Operation%20-%20Fillable%20PDF.pdf [accessed 23 October 2023], p 1.

> The AOFM has no control over the outright levels of bond yields and has no comparative advantage in predicting future yields. However, if bond yields are perceived to be particularly low it may be appropriate to bias the WAM [weighted average maturity][104] of Treasury Bond issuance longer – this is consistent with a regret minimisation approach. On the other hand, it is generally not judicious to concentrate issuance into short-dated bonds to deliberately increase refinancing tasks in coming years because bond yields are expected to decrease.

## Debt management strategy

3.11 The AOFM regards its annual Debt Management Strategy (DMS) as the expression of how it applies judgement to minimise cost and support cost-effective borrowing without taking on undue risk in managing the debt portfolio and funding the Australian Government. The DMS sets out a justification for recommended issuance parameters over the year ahead, focusing on the weighted average maturity (WAM)[105] of the new issuance as the principal cost and risk parameter for debt issuance, and, by extension, debt portfolio management.

3.12 The DMS considers a range of qualitative and quantitative metrics to arrive at the WAM recommendation for the next year of issuance. The funding task provided by the Australian Government at a fiscal update is taken as the starting point for an analysis of funding, interest rate and inflation risks. Applying scenarios for the funding task, interest rates and inflation and allowing instrument choice and WAM to vary leads to a range of scenario results in respect of modelled cost and risk characteristics for the debt portfolio for a given future year. These scenario results are considered by the AOFM in arriving at its WAM recommendation for a year's issuance task, in conjunction with analysis of macroeconomic and global market conditions, investor demand and the fiscal outlook.

3.13 The accrual debt service costs of outstanding Treasury Bonds issued in past years (which comprise the vast bulk of the debt portfolio, see Box 1 in Chapter 1) are treated by the AOFM as 'locked-in', such that accrual debt service costs are known and fixed until those securities mature or a decision is made to repurchase.[106]

3.14 The AOFM has not invested in or held long-dated assets since April 2011[107], has not repurchased Treasury Bonds prior to maturity since March 2020, and has not utilised financial derivatives such as interest rate swaps since 2008–09 to manage the interest rate risk of the debt portfolio. As such, the AOFM does not actively manage the cost of debt issued in prior years, and accepts the cost and risk implications of historical Treasury Bond issuance. Rather, the focus is on meeting the year-ahead financing task through issuance that is consistent with the WAM recommendation in the DMS. The only portfolio parameters that the AOFM targets in order to manage the cost and risk of the debt portfolio through time are the WAM of the issuance in the

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104 The WAM of the Treasury Bond portfolio indicates the rate at which outstanding Treasury Bonds will mature and is a simple summary refinancing risk and interest rate risk indicator.

105 ibid.

106 For nominal fixed coupon Treasury bonds issuance, the accrual debt service cost is known until the maturity of the bond unless the bond is repurchased by the AOFM prior to the maturity of the bond. For Treasury Inflation-linked Bonds issuance, the real coupons are known but the nominal cost varies as a result of inflation outcomes, and the break-even inflation rate will determine the relative cost of nominal versus inflation-linked issuance. See AOFM, *2021–22 Annual Report*, pp. 19, 21 and 22.

107 AOFM Data Hub, Portfolio Aggregate End of Month Positions [Internet] available from https://www.aofm.gov.au/media/577 [accessed 5 October 2023].

current financial year and the instrument choice between Treasury Bond issuance and Treasury Inflation-linked Bond issuance.

3.15 The AOFM states in the FRMP that there is an alignment between its mandate to maintain an efficient market in AGS and its objective to maintain the Australian Government debt portfolio at least cost subject to acceptable risk:

> Strategic issuance decisions should be cognisant of the aims of facilitating the efficient operation of the Treasury Bond market and developing that market. Over time this approach will enhance the attractiveness of the market to investors, which should reduce costs.

3.16 This approach to debt management is consistent with the World Bank and International Monetary Fund's *Revised Guidelines for Public Debt Management*[108], which states that '[i]n order to minimize cost and risk over the medium to long run, debt managers should take adequate measures to develop an efficient government securities market'. An efficient government securities market can help to lower debt service costs by reducing the transaction costs and frictions that are faced by investors.

## Implementation of the debt management strategy

3.17 Once the annual DMS is approved by the Secretary to the Treasury (the secretary) via the Annual Remit program and the WAM for the annual issuance task is set, an issuance program is constructed with reference to the agreed WAM, that sets out the indicative timing, amounts and maturities of all AGS to be issued during the year by tender and syndication, consistent with the DMS.

3.18 AOFM AGS issuance activity then proceeds within-year according to the issuance program, with the AOFM CEO, on advice from the AOFM Front Office, exercising discretion to vary the issuance program according to market conditions and updates or revisions in the Australian Government's financing task.

3.19 The AOFM conducts market liaison activities on a regular basis to inform itself about market conditions. Three to five business days ahead of transacting, the AOFM Front Office team contacts 'market makers' (financial intermediaries that deal in AGS) to gauge market demand across the AGS that constitute the risk-free nominal and real yield curves. Market maker feedback, combined with frequent liaison facilitated by the AOFM Investor Relations team with domestic and global investors in AGS, is utilised to refine the AOFM Front Office's plan of action.

3.20 The AOFM CEO provides approval for issuance transactions, which is documented via issuance minutes. An announcement is made to the AGS market most Fridays through the year at noon to specify the amounts and details of the securities that will be issued by tender in the following week.

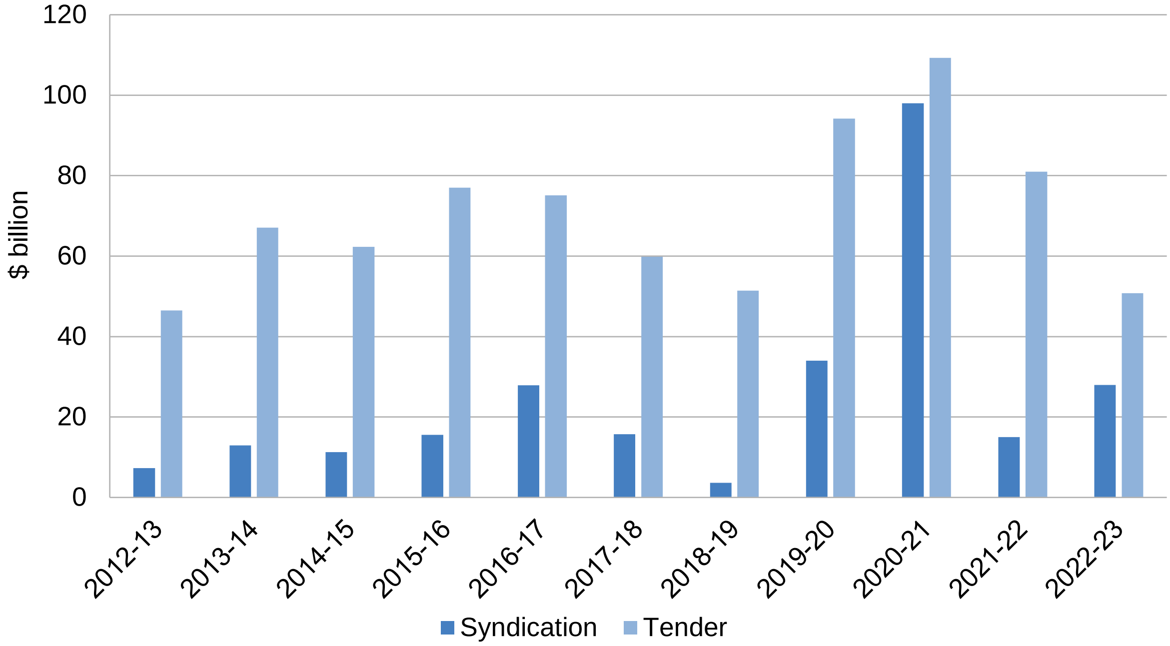
108 World Bank and International Monetary Fund, *Revised Guidelines for Public Debt Management* [Internet], IMF, Washington, D.C. 2014, available from https://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/Revised-Guidelines-for-Public-Debt-Management-PP4855 (accessed 4 August 2023), p. 10.

## Debt management outcomes

### *Management of funding risk*

3.21 The AOFM met the borrowing requirements of the Australian Government during the period 1 January 2020 to 30 June 2023. A total of $848.7 billion in AGS was issued during this time through tender and syndication, comprising $355 billion in Treasury Notes, $483.1 billion in Treasury Bonds and $10.6 billion in Treasury Indexed Bonds.[109] Figure 3.1 depicts Treasury Bond issuance over the decade to 30 June 2023, and illustrates the increase in issuance during 2019-20 and 2020-21. As at 30 June 2023, there was a total of $889.8 billion in outstanding AGS on issue in face value terms.

**Figure 3.1: Treasury Bond issuance**




Source: AOFM, *AOFM Annual Report 2022–23*, p. 28.

3.22 The AOFM assesses its performance outcome in 'executing the debt issuance program' and meeting the borrowing requirements of the Australian Government in its annual performance statements by considering the 'term issuance indicator', which measures 'the shortfall in volume in dollar terms for the fiscal year between actual Treasury Bond issuance and planned issuance announced at the most recent official Budget related update'.[110] The AOFM recorded the outcomes that the term issuance indicator was 'zero' in 2019–20 and 2020–21, and 'partially met' in 2021–22 and 2022–23 (Table 3.1).

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109 These figures describe gross issuance and do not account for maturities.

110 AOFM, *AOFM Annual Report 2019–20* at p 31; AOFM, *AOFM Annual Report 2020–21* at p 22; AOFM, *AOFM Annual Report 2021–22* at p 38; *AOFM Annual Report 2022–23* at p 25 and 32.

**Table 3.1: Selected Australian Office of Financial Management (AOFM) measures of funding outcomes**

| Measure | 2019–20 | 2020–21 | 2021–22 | 2022–23 |
|---|---|---|---|---|
| Term issuance indicator[a] | Zero | Zero | Partially met[e] | Partially met[f] |
| Settlement outcome[b] | No failed settlements | No failed settlements | No failed settlements | No failed settlements |
| Coverage ratio for Treasury Bond tenders[c] | 3.67 | 4.29 | 3.92 | 3.35 |
| Spread to mid-market for Treasury Bond tenders[d] | (0.32) basis points | (0.64) basis points | (0.74) basis points | (1.20) basis points |

Note a: This refers to a difference in Treasury bond issuance relative to the borrowing requirements announced at Budget as updated by subsequent official releases. See paragraph 3.22.

Note b: This refers to the cash proceeds of issuance activities being received by the Australian Government as expected, and all Australian Government Securities (AGS) coupon or redemption cash payments being made to holders of AGS as expected. See paragraph 3.23.

Note c: Coverage ratio refers to the value of bids received at an AGS tender as a ratio to the amount being issued. This is the average of all coverage ratios for each financial year. See paragraph 3.24.

Note d: Spread to mid-market refers to the pricing of successful bids allocated at an AGS tenders relative to the mid-point between the bid yield and offer yield of the AGS being issued. This is a weighted average of spreads to mid-market for each financial year. Measured in basis points, one basis point is equivalent to 0.01 per cent. See paragraph 3.24.

Note e: 'There was a small difference between actual issuance and guidance announced at the 2021–22 Budget and updated at subsequent official releases.' This was a small positive difference and there was no shortfall in actual issuance relative to updated guidance. AOFM, *AOFM Annual Report 2021–22*, pp. 38–39.

Note f: 'There was a small difference between actual issuance and guidance announced at the 2022–23 Budget and updated at subsequent official releases.' This was a small positive difference and there was no shortfall in actual issuance relative to updated guidance. AOFM, *AOFM Annual Report 2022–23*, p. 32.

Source: AOFM, 2019–20, 2020–21, 2021–22 and 2022–23 AOFM Annual Reports.

3.23 All AGS transactions conducted by the AOFM were settled effectively, meaning that the Australian Government received the cash proceeds of the AOFM's AGS issuance activities as expected, and there were no failed settlements in respect of AGS transactions or AGS coupon or redemption payments.[111]

3.24 Average AGS tender coverage ratios were above the target of 2.5 times covered for all years within audit scope, which implies that the AOFM received demand at its AGS tenders on average of more than two and a half times the amount being issued.[112] The average spread to mid-market yields of AGS issuance was negative during this period[113], meaning that the AOFM received favourable pricing for the Australian Government during AGS issuance transactions relative to

111 AOFM, *AOFM Annual Report 2021–22*, at p. 32.

112 AOFM, *AOFM Annual Report 2019–20*, p. 42; AOFM, *AOFM Annual Report 2020–21,* p. 33; AOFM, *AOFM Annual Report 2021–22*, p. 41.

113 'Mid-market yields' are the average of secondary market bid yields and offer yields and reflect the prevailing pricing of AGS on the secondary market, abstracting away from transaction costs. The 'spread to mid-market' is the difference between the average of bid yields at AGS issuance tenders relative to mid-market yields.

prevailing AGS pricing in the financial markets.[114] No actions are required under the FRMP for the circumstances where the AOFM receives coverage ratios of below 2.5 times covered or for positive spreads to mid-market.

3.25 The secretary advised in September 2023 that given the high degree of volatility in global financial markets associated with the COVID-19 pandemic[115], the AGS issuance outcomes described above indicated that the AOFM's approach to managing funding risk as articulated in the FRMP and successive debt management strategies has been tested in financial crisis circumstances and was effective during the period 1 January 2020 to 30 June 2023.

3.26 Throughout the period 1 January 2020 to 30 June 2023, AGS market conditions supported and facilitated the AOFM's debt issuance activities to fund the Australian Government.[116] Across the economic cycle, there has been demand for AGS from domestic and global investors given the risk and return characteristics of AGS, which draw on the relative strength of the Australian economy and fiscal outlook — in particular, the Reserve Bank of Australia (RBA) stated that the AGS market remained resilient and liquid relative to peer government bond markets around the world through the pandemic and episodes of financial market stress in early 2023.[117]

3.27 To analyse the cost-effectiveness of the AOFM's transaction execution process, the ANAO collected all bids submitted to the AOFM for primary AGS issuance via tender, and determined whether the bids submitted by market makers on behalf of AGS investors reflected the highest prices (as represented by the lowest bid yields) for the Australian Government. The results of each transaction are published on the AOFM's public website in an aggregated format, whereas the ANAO analysis was conducted using bid-by-bid data, that incorporated commercially sensitive information including registered bidder names, amounts and pricing on every bid received by the AOFM during the period 1 January 2020 to 30 June 2023. The ANAO's analysis confirmed that the AOFM provided allocations of AGS to the highest priced bids at AGS tenders.

### *Debt portfolio performance and management of interest rate risk*

3.28 The AOFM does not directly manage the entire portfolio of Australian Government debt with respect to portfolio cost and risk outcomes. The issuance program, which is discussed at paragraphs 3.18 to 3.20, is the means with which the AOFM manages the financial performance (cost outcomes and interest rate risk exposures) of the debt portfolio. Pursuant to the DMS, the WAM profile of new AGS issuance influences the cost and risk characteristics of the debt portfolio at the margin.[118]

3.29 Interest rates were relatively low from 2020 to early 2022, in part due to monetary policy easing and purchases of AGS in the secondary market by the RBA (Figure 3.2).

114 AOFM, *AOFM Annual Report 2019–20*, p. 41; AOFM, *AOFM Annual Report 2020–21*, p. 33; AOFM, *AOFM Annual Report 2021–22*, p. 40. The secondary market is 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.

115 See AOFM, *Annual Report 2019–20,* AOFM, p. 38.

116 See speech by David Jacobs (Head of Domestic Markets Department, Reserve Bank of Australia), Australian Fixed Income Markets – Recent Developments and a Look Ahead, Tokyo, 24 May 2023 [Internet] available from https://www.rba.gov.au/speeches/2023/sp-so-2023-05-24.html (accessed 5 October 2023).

117 ibid.

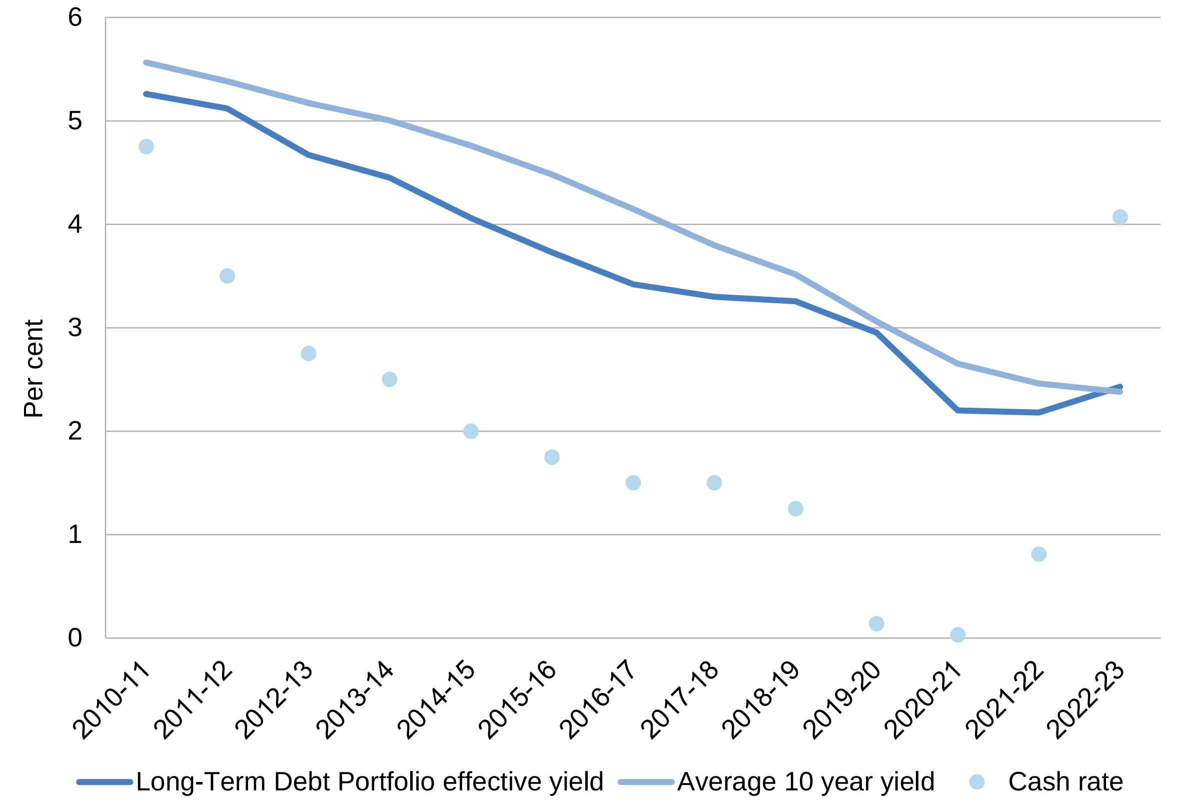
118 For example, the WAM of new Treasury issuance was 10.3 years in 2020–21 and 8.4 years in 2021–22, and the WAM of the debt portfolio was 7.7 years in 2020–21 and 7.0 years in 2021–22.

**Figure 3.2: Treasury Bond yields**


Source: Australian Office of Financial Management.

3.30 Due to the interest rate environment, the cost of servicing the debt portfolio declined in effective yield terms in recent years through to 2021–22. The effective yield on the portfolio (defined at paragraph 3.6) has been falling at a time of increasing debt on issue, and its recent outcomes were 2.20 per cent in 2020–21 and 2.18 per cent in 2021–22 (Figure 3.3). The effective yield on the portfolio increased to 2.43 per cent in 2022–23 (Figure 3.3).

**Figure 3.3: Effective yield on debt portfolio (with moving average 10-year Treasury Bond yield and Reserve Bank of Australia cash rate comparators)**




Source: AOFM.

3.31 The effective yield outcome for the debt portfolio is determined by the AOFM's DMS and issuance activities against the backdrop of the interest rate environment and funding task.

3.32 From 2014–15 until 2021–22, the AOFM set the rolling ten-year average of the ten-year Treasury bond yield as the performance indicator for the effective yield on the Long-Term Debt Portfolio (which includes Treasury Bonds and Treasury Indexed Bonds). The AOFM stated that it:

> monitor[ed] issuance cost outcomes against the 10-year Treasury Bond rate because it is a market relevant benchmark and represents a highly liquid part of the AGS yield curve (making it a useful cost indicator). The 10-year average is used because the portfolio primarily comprises securities issued over the last decade.[119]

3.33 The AOFM's historical performance indicator for portfolio cost was met in every year from 2010–11 to 2021–22, because the effective yield on the Long-Term Debt Portfolio was below the rolling ten-year average on the ten-year Treasury bond yield in these years (Figure 3.3).

3.34 The portfolio cost performance indicator is not mentioned in the FRMP or the DMS and was discontinued in the 2022–23 AOFM Corporate Plan and Annual Report. The AOFM advised in November 2023 that the portfolio cost performance indicator was 'removed' because 'portfolio decisions made many years ago are not relevant for assessing current year performance'. The AOFM continues to evaluate the debt servicing costs of its current year Treasury Bond issuance against the 12-month average yield on the 10-year Treasury Bond, while recognising 'that a comparison to the

119 AOFM, *AOFM Annual Report 2022–23*, p. 45.

10-year bond yield may not be appropriate if the WAM of issuance for the period is materially different [to ten years]'. The WAM of new Treasury Bond issuance was close to ten years in 2020–21 and 2022–23 and was materially different to ten years in 2019–20 and 2021–22. (Figure 3.4).

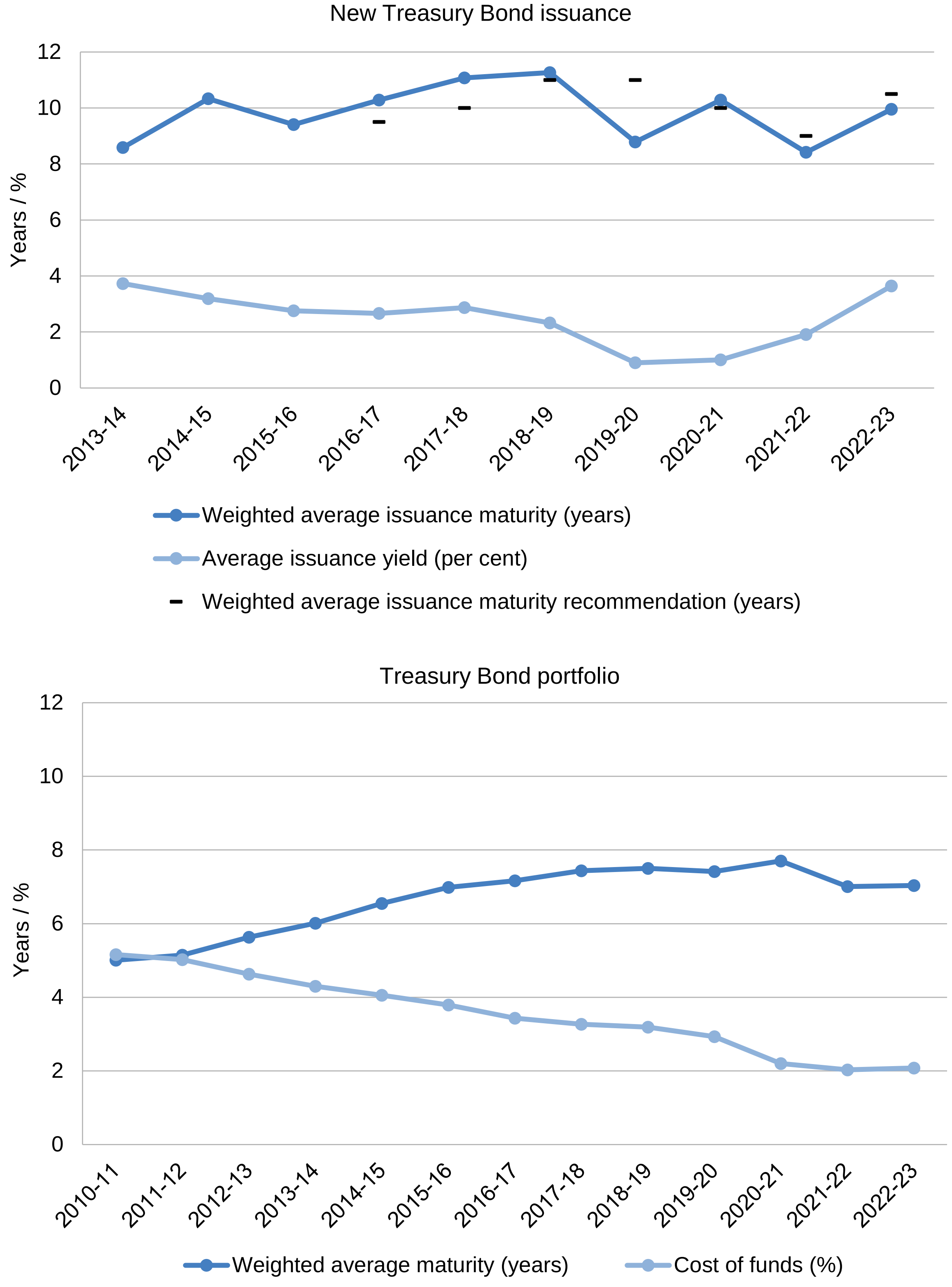
3.35 The AOFM did not assess whether the debt portfolio cost and risk outcome between 1 January 2020 and 30 June 2023 represents the least cost outcome subject to acceptable risk.[120] Apart from highlighting the connection between a liquid and efficient AGS market and the cost of funds to the Australian Government over the long-term, the AOFM does not define or characterise what the least cost outcome for the debt portfolio should be, and there was no performance target for the effective yield on the debt portfolio.

3.36 As at 30 June 2022, just over half of the debt portfolio had been issued between 1 July 2019 and 30 June 2022, at a time of record low interest rates[121], and the relatively low average yield on issuance during these years decreased the effective yield of the debt portfolio (Figure 3.4). Yields on AGS have been increasing from early 2022 (refer to Figure 3.2), putting upward pressure on the average yield of issuance in the latter half of 2021–22 and 2022–23, which when combined with bond maturities, served to increase the effective yield on the Treasury Bond portfolio and the debt portfolio in 2022–23.

120 Historical AOFM Annual Reports included discussions and analysis of whether AOFM had minimised cost subject to acceptable risk for the debt portfolio. For instance, see AOFM, *AOFM Annual Report 2016-17*, p. 20: 'In managing the Commonwealth's debt portfolio and meeting the Government's financing requirements, the AOFM seeks to minimise debt servicing costs over the medium term at an acceptable level of risk, by which is meant an acceptable level of variability in cost outcomes. It also seeks to maintain liquid bond lines to facilitate the issuance of debt at acceptable cost and to manage the refinancing risk that arises when bond lines mature.' References to 'least cost subject to acceptable risk' were not included in AOFM Annual Reports from 2017-18 onwards.

121 AOFM, *AOFM Annual Report 2021–22*, p. 46.

**Figure 3.4: Yield and maturity — new Treasury Bond issuance and Treasury Bond portfolio**




Note: The WAM recommendation for new Treasury Bond issuance was "at least 9.5 years" in 2016–17; "at least 10 years" in 2017–18; "at least 11 years" in 2018–19; "around 11 years" in 2019–20; 'at least 10 years' in 2020–21; '8.5 to 9.5 years' in 2021–22; and '10 to 11 years' in 2022–23. The minimum point of WAM 'floor' recommendations and the mid-point of WAM 'range' recommendations has been depicted in the upper panel of Figure 3.4. Prior to 2016–17, the AOFM did not use WAM recommendations for Treasury Bond issuance, and instead framed its recommendations for Treasury Bond issuance in terms of the proportion of securities to be issued in 'short versus long maturity buckets' of Treasury Bonds.

Source: Australian Office of Financial Management, *AOFM Annual Report 2022–23*, p. 39 and p. 43; and successive AOFM Annual Remits, from 2016–17 to 2022–23.

3.37 Through its issuance strategy and the maturities of existing bond lines through time, the AOFM has managed the maturity profile of the Treasury Bond portfolio with a view to mitigating interest rate risk. In managing Treasury Bond issuance over time against the successive WAM recommendations from the DMS, the AOFM has sought to limit the exposure of the debt portfolio within the next three to five years against cost outcomes associated with potentially higher future interest rates when refinancing maturing securities (Figure 3.5).

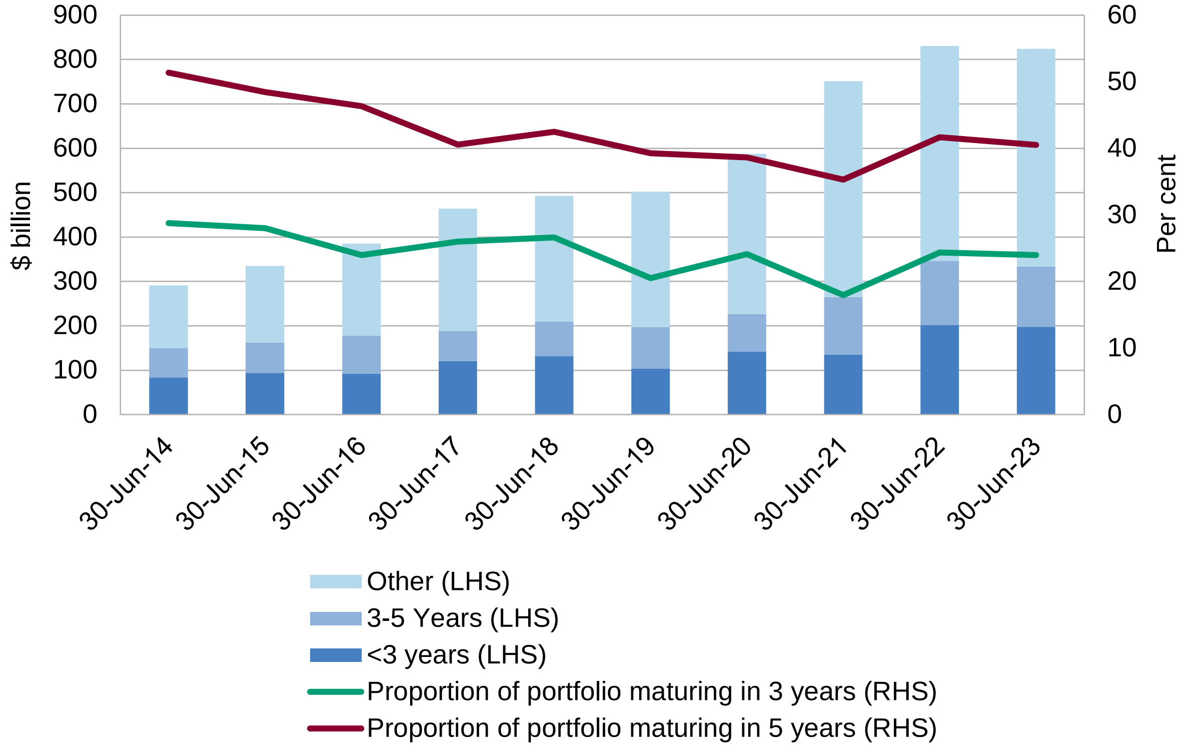
3.38 Successive WAM recommendations determine the refinancing profile and the interest rate risk exposure of the debt portfolio. As at 30 June 2023, 24 per cent of the Treasury Bonds within the debt portfolio mature within three years, and 40 per cent of the Treasury Bonds within the debt portfolio mature within five years (Figure 3.5).[122]

3.39 Successive annual issuance tasks with shorter WAMs would have resulted in a shorter average maturity debt portfolio, meaning higher percentages of the portfolio would have required refinancing within 3 and 5 years. The AOFM uses the approved issuance WAM recommendation from the DMS to tailor the portfolio maturity profile and interest rate risk exposure. As the debt portfolio includes all outstanding issuance (that has not matured) at any point in time, each issuance WAM recommendation in each successive year's DMS builds up to the debt portfolio's WAM and maturity profile, which determines the debt portfolio's interest rate risk exposure.

3.40 The AOFM tracks and monitors the market risk associated with the debt portfolio and issuance activities in the form of daily portfolio revaluations using secondary market valuation rates (see paragraph 2.86). However, market risk is not managed by the AOFM, and the financial implications of market risk for the overall cost and risk of the debt portfolio, and by extension the implications of changes in the market value of debt for the balance sheet fiscal aggregates of the Australian Government such as net debt and net financial worth, are not managed by the AOFM. The AOFM advised in January 2024 that 'AOFM accepts the market risk arising from the debt portfolio noting that market risk (unrealised revaluation gains and losses) has little to no impact on the AOFM's primary measures of cost and risk' and that 'the AOFM has no mandate to manage the implications of changes in market value of debt for the broader balance sheet'.

122 AOFM, *AOFM Annual Report 2022–23*, p. 39.

**Figure 3.5: Maturity profile of Treasury Bond portfolio**




Source: Australian Office of Financial Management, *AOFM Annual Report 2022–23*, p. 40.

## Evaluation of the debt management strategy and outcomes

3.41 To perform an evaluation of its DMS and the associated debt portfolio cost and risk outcomes, the AOFM assesses the adherence of its past years' issuance activities to the recommendations of the previous DMS as part of the Annual Remit each year. Over the course of the year, the AOFM monitors market conditions (including investor demand, the level and slope of the yield curve and break-even inflation levels[123]), and subject to an assessment of market conditions, may submit a revised DMS to the secretary for approval.

3.42 These evaluation activities are supported by a series of reporting requirements. The AOFM compares the WAM of new AGS issuance to the WAM recommendation from the DMS on a daily basis, as part of the Daily Report. The debt portfolio WAM is reported in monthly reporting provided to the secretary to track compliance through time with the DMS. Debt portfolio and AGS issuance cost and risk outcomes are reported, and the AOFM's performance is assessed as part of the AOFM's Annual Performance Statements[124], but the Annual Performance Statements do not provide an evaluation of the WAM recommendation in the DMS.

3.43 The AOFM does not analyse retrospectively whether its Debt Management Strategies and issuance activities have delivered the lowest possible cost outcomes for the government's debt

123 The break-even inflation rate is the inflation rate required for a TIB to generate the same return to an investor as a nominal Treasury Bond with the same maturity, if the investor holds the bonds to maturity. An estimate of the break-even inflation rate is reflected by the difference between the nominal yield of a Treasury Bond and the real yield of a TIB with a similar tenor.

124 The AOFM's Annual Performance Statements form part of the AOFM's Annual Reports.

portfolio, subject to acceptable risk. Further, the AOFM does not evaluate whether deviations from the WAM recommendation in the DMS, such as longer or shorter Treasury Bond issuance, may have led to lower cost or risk outcomes than those that were recorded by the AOFM. Rather, in November 2023 the AOFM advised that its current strategic and operational debt management process provides the 'best guarantee' of acceptable debt portfolio cost and risk outcomes because this process is designed to support AGS market liquidity and efficiency:

> The AOFM's long held position is that the presence of a well-functioning, deep and liquid market in Australian Government Securities, underpinned by an operational approach that avoids opportunism and emphasises transparency and consistency, combined with the presence of a competitive primary market for debt issuance, provides the best guarantee of achieving value for money for the taxpayer (or least cost) over the long term while also minimising risk and providing 'scalability' to the AOFM's operations (in the event of another crisis).

3.44 This statement is not articulated in the Financial Risk Management Policy.

3.45 Apart from a consideration of coverage ratios and spreads to mid-market yields at the time of issuance, the AOFM also does not evaluate the cost-effectiveness of its issuance execution strategy, and whether alternative issuance strategies, or approaches to market, may result in lower cost outcomes.

**Opportunities for improvement**

3.46 The Australian Office of Financial Management (AOFM) could evaluate retrospectively whether deviations from the weighted average maturity (WAM) recommendation in the DMS, such as longer or shorter Treasury Bond issuance, may have led to lower cost or risk outcomes than those that were recorded by the AOFM, and publish the results of this evaluation.

3.47 The AOFM could perform retrospective analysis and publish its results on whether the timing and structuring of its past issuance activities have delivered the lowest possible cost outcomes for the Government's debt portfolio, subject to acceptable risk.

3.48 From its establishment until 2007–08, the AOFM maintained a portfolio benchmark in terms of the modified duration and short-dated exposure of the debt portfolio to capture the desired trade-off between expected debt service cost and variability of the expected debt service cost.[125] The benchmark was used to construct the DMS, and the cost and risk outcomes of the debt portfolio were assessed against the benchmark. Interest rate swaps, which are interest rate derivative instruments used by financial institutions to manage interest rate risks, were used by AOFM historically to adjust the cost and risk characteristics of the debt portfolio towards those of the benchmark.

3.49 The debt portfolio benchmark was a requirement of the Debt Management Charter, and was maintained until the AOFM changed its FRMP framework in 2007–08 and made a consequent decision to abandon the benchmark and unwind the interest rate swap portfolio from 2009–10 onwards. Specifically, in June 2008, the AOFM Advisory Board agreed that the strategy for managing the duration of the long-term debt portfolio to reduce debt servicing costs should be terminated, and drawing on this advice the secretary approved the termination of the debt portfolio benchmark as part of the 2008–09 Annual Remit.

125 AOFM, *AOFM Annual Report 2008–09*, p. 87.

3.50 The reasons cited in the June 2008 Advisory Board minutes for the decision to discontinue the portfolio benchmark were as follows:

> [C]urrent market conditions remained unattractive for undertaking swaps to increase the duration of the portfolio and substantial uncertainty remained about future market conditions. Until this was reduced, there was no pressing need to increase duration aggressively.
>
> Advisory Board members were sympathetic to this conclusion as a practical outcome, but discussed whether some change in the way the portfolio management strategy is formulated and presented should be considered in the light of changing circumstances and the need to manage the proceeds of additional Treasury Bond issuance as part of the AOFM's portfolio. In particular it was suggested that the approach of setting a benchmark to identify a desired trade-off between risk and return had become more problematic as the yield curve had flattened and inverted and it had become more difficult to identify a positive term premium. In these circumstances, unless and until markets normalised and a positive term premium re-emerged, it would be better to accept the maturity structure that resulted from the issuance of Treasury Bonds, rather than seeking to obtain savings from shortening the maturity structure. Under this approach, the current benchmark and the relative performance framework based on it would be discontinued. Existing swaps would be regarded as a legacy component of the portfolio, to be managed in the light of market conditions and run off gradually over time.
>
> Following detailed discussion, the Chairman [of the AOFM Advisory Board, the then Secretary to the Treasury, Dr Ken Henry AC] concluded that this alternative approach should be adopted and the current interest rate risk management framework concluded. As a result, the structure of the portfolio would follow from the outcomes of debt issuance to support the Treasury Bond and Treasury bond futures markets, together with management of the assets resulting from the proceeds of additional issuance and short-term cash management.

3.51 This reasoning shows that the decision to discontinue the portfolio benchmark was originally envisaged to be temporary in nature, 'unless and until markets normalised and a positive term premium re-emerged'.[126] The AOFM advised in November 2023 that:

> The AOFM sees no similarities to the circumstances that prevailed when a benchmark was last a component of the AOFM's debt management framework over 15 years ago. Gross debt is now much larger (and expanding) while appetite for risk (seen primarily through the prism of liquidity risk) is very low. The previous benchmark may have been appropriate for a world where debt was steady but low in the face of sustained budget surpluses but required constant adjustment as circumstances changed. This undermined the case for having a benchmark and contributed to the Secretary's decision to 'conclude' it in 2008.

3.52 Since 2009–10, the AOFM has estimated the term premium as part of its annual debt strategy deliberations and published its term premium estimates[127], but has not considered re-establishing a benchmark for the debt portfolio. The AOFM advised in November 2023 that '[t]he DMS is the expression of the AOFM's view of the appropriate level of cost and risk exposure', and that 'a benchmark will not provide insight to the performance of the DMS, nor the AOFM's

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126 The 'term premium' is defined in Box 3 above. A positive term premium exists when investors expect to earn additional returns by investing in a longer maturity bond over a given time horizon relative to series of rolling investments in a shorter maturity bond over that time horizon.

127 AOFM, 'Daily yield decomposition of Australian Treasury Bond term structure and term premium estimates' [Internet] https://www.aofm.gov.au/media/575 (accessed 12 November 2023).

performance in executing the funding program. The selection of [a portfolio] benchmark will be as contestable and subjective as the actual portfolio's performance versus [the] said benchmark.'

3.53 The AOFM has policies and processes in place to support cost-effective borrowing, but it does not assess whether the government debt portfolio was structured at least cost subject to acceptable risk. The AOFM's views of the appropriate level of costs and financial risk exposures for the debt portfolio and its tolerances for incurring costs and taking on financial risks with respect to debt management activities are not fully articulated by the FRMP and DMS. Under the FRMP and DMS, a determination or evaluation of whether the debt portfolio and issuance activities are being structured at least cost subject to acceptable risk is not made by the AOFM. A debt portfolio benchmark may facilitate a determination or evaluation of whether the debt portfolio has achieved performance outcomes that are consistent with minimising debt service costs, subject to acceptable risk. In November 2023, the AOFM advised:

> [H]ad a benchmark been in place prior to 2020, it is likely that it would have been suspended or disbanded with the ramp up in debt associated with the pandemic. This reflects the primacy of meeting Government financing needs in a crisis over all other factors.
>
> The AOFM does not agree with the statement that a benchmark would enable the AOFM to determine and evaluate whether the debt portfolio and its issuance activities are being structured at least cost, subject to risk. A benchmark facilitates relative performance evaluation only, it provides no insight to nor guarantee of least cost, subject to risk in absolute terms.

## Recommendation no. 5

3.54 The Australian Office of Financial Management and Department of the Treasury should:

(a) consider how transparency around the impacts of debt management decisions on cost and risk outcomes for the debt portfolio can be enhanced;

(b) review the Financial Risk Management Policy and debt management performance measurement framework with a focus on increasing transparency around the impacts of debt management decisions on cost and risk outcomes for the debt portfolio; and

(c) annually evaluate the Debt Management Strategy and the performance of the debt portfolio over various time horizons.

**Australian Office of Financial Management response:** *Agreed.*

3.55 *Together with the Department of the Treasury, the AOFM will consider how transparency on cost and risk outcomes for the debt portfolio can be enhanced and will implement actions that address the intent of this recommendation.*

**Department of the Treasury response:** *Agreed.*

## Did the Australian Office of Financial Management avail itself of relevant information in managing government debt?

> The Australian Office of Financial Management (AOFM) availed itself of relevant information in its debt management strategy and activities. The AOFM effectively sourced and analysed information that it received from market-makers, Australian Government Securities (AGS) investors, the Department of the Treasury, the Reserve Bank of Australia, and from internal IT systems and analysis. The information was used by the AOFM to support and refine its debt management strategies, decisions and activities.

### Information requirements

3.56 The AOFM's debt management activities rely on information regarding fiscal and financial market conditions. This information supports the exercise of judgement by the AOFM in undertaking debt management activities and underpins its debt strategy deliberations and debt issuance transactions. The AOFM draws on this information at every stage of its operations, from strategic analysis and deliberations to execution and implementation, through to reporting on outcomes (see paragraphs 2.83 to 2.101).

3.57 The AOFM has access to a range of information from internal and external sources to inform its strategy, research and operations. The AOFM undertakes market liaison activities and engagements with market makers and investors in AGS and works with public sector organisations such as the RBA.

3.58 To utilise this information in its strategic processes and decision-making with respect to debt issuance and portfolio management, the AOFM runs a debt management information system known as Quantum and produces internal reports on the cost and risk characteristics of the debt portfolio through time. The AOFM also prepares forward-looking analysis and projections of the cost and risk of the portfolio under various funding task and interest rate assumptions.

3.59 To support its debt management activities, the AOFM draws on information from four primary sources in structuring its debts: IT systems; internal analysis; market liaison; and public sector liaison.

### IT systems

3.60 The Yieldbroker market platform is used by the AOFM Front Office to issue AGS and transact in AGS and to monitor secondary market AGS pricing in real-time. The Yieldbroker platform gives AOFM Front Office staff visibility over bids for AGS at primary market auctions, and secondary market bid and offer yields, as well as AGS pricing relative to Government bond futures contracts that are traded on the Australian Securities Exchange (ASX).

3.61 The Quantum system provides a financial reporting system for capturing all AOFM transactions and revaluing them according to market close interest rates on a daily basis. Using end-of-day interest rates from Yieldbroker for revaluations, and dealt interest rates on transactions, the Quantum system tracks the market value, book value and accrual debt service cost of the debt portfolio, and records financial information about every deal transacted by the AOFM.

3.62 The Bloomberg terminal system provides visibility over domestic and global economic and financial market conditions for each staff member in the AOFM Front Office. The AGS market is interconnected with other domestic and global financial markets, and is also sensitive to economic and fiscal developments, as well as major geopolitical news and events both in Australia and internationally. Bloomberg terminals include both monitoring and analytical capabilities and allow AOFM staff to observe relevant news items, events and developments in order to understand how the flow of information is being continually repriced by the AGS market. The Refinitiv system supplements the monitoring and analytical functions of the Bloomberg terminals and is used by Front Office staff as the AOFM's financial market data platform for accessing financial and economic time series datasets.

3.63 The ASX Austraclear clearing and settlement facility is used to settle transactions that have been priced by the AOFM. Using Austraclear, the AOFM receives funds from market-maker banks that have successfully bid at AOFM primary market transactions and issues AGS to those successful bidders. Computershare provides registry services and settlement services for retail AGS investors who transact AGS on the ASX.

3.64 The Business and Market Intelligence (BMI) portal constructs and presents a collection of reports and analytics related to AOFM transactions and the debt portfolio. The BMI portal was designed to track an array of information that investors would consider relevant to constructing a portfolio of AGS and trading AGS. By promoting an understanding of the financial markets that a sophisticated AGS investor or market maker would have, the BMI portal helps to build awareness amongst AOFM staff of the key financial risks faced by the AOFM as part of its debt management activities. Some reports within the BMI portal are updated daily, others are updated on a less frequent basis as data becomes available.

## Internal analysis

3.65 The AOFM has developed a debt strategy modelling framework, which facilitates projections and scenario analysis for the debt portfolio and future issuance. The modelling framework takes the current debt portfolio (all deals executed to date that have not matured or been unwound) as a starting point, and then projects future cost and risk outcomes given assumptions on future interest rates (could be fixed as constant or vary according to modelling assumptions), and issuance programs that specify the securities to be issued over a future time horizon.

3.66 The fiscal and interest rate scenarios that underpin the forward-looking debt strategy modelling are informed by the Government's economic and fiscal outlook as articulated in Budget papers, by deterministic scenarios, and using statistical modelling techniques. This analytical framework informs debt strategy deliberations by quantifying the cost and risk characteristics of the portfolio under various interest rate and fiscal scenarios, and showing how the AOFM's future issuance and debt management decisions may affect the cost and risk characteristics of the portfolio. The analytical framework enables the AOFM to undertake stress testing of the debt portfolio, analyse vulnerabilities and calibrate its forward-looking view on the expected costs and financial risks associated with the debt portfolio.

3.67 The AOFM also produces other reports, such as the Daily Report and the Monthly Portfolio Report (see paragraph 2.87) that are used to provide internal visibility and understanding of the market valuation, cost and risk characteristics of the debt portfolio and current debt issuance transactions. These reports translate information available from the Quantum system into a format that is accessible and practical for staff members to use.

## Market liaison — banks

3.68 The AOFM maintains contact with financial market participants to inform its debt management activities.

3.69 Nineteen market makers participate in the AGS market.[128] Market makers are banks that buy AGS directly from the AOFM at bond tenders, and also provide secondary market liquidity in AGS to investors by buying AGS from investors and selling AGS to investors. The AOFM Front Office consults with AGS traders employed by market maker banks to understand market conditions, the flow of transactions, and traders' views on market pricing. This assists AOFM to understand where there is demand for AGS, across instruments and maturities to inform its week-to-week issuance decisions.

3.70 ANAO consultations with eleven of the nineteen market maker banks (including seven banks that have acted as joint lead managers on AOFM syndication deals), as well as meetings with AOFM Front Office staff, indicated that there is a flow of information regarding the AGS market from banks to the AOFM.[129] AOFM Front Office staff are engaged in a dialogue about market conditions with their trading counterparts at the market makers. This information assists the AOFM Front Office to plan issuance activities for the week ahead and supports the recommendations in issuance minutes.

3.71 The information provided by market makers also assists the AOFM in times of market dysfunction, where the AOFM can act to support the AGS market and relieve or ameliorate dysfunction by providing supply when liquidity is weak. Discussions with market makers are also relevant when the AOFM issues debt via syndication, as the joint lead managers can play a role in both informing the AOFM about market conditions and the demand for AGS, as well as raising awareness amongst investors globally about the Australian economy and bond market.

## Market liaison — investors

3.72 The AOFM also consults extensively with AGS investors to obtain information from them regarding their investment preferences, demand for AGS, and their forward-looking views on the functioning of the AGS market. The AOFM Investor Relations team leads a program of structured and unstructured engagements with domestic and global AGS investors. The Investor Relations team presents to investors about the AGS market and the AOFM's planned issuance activities, as well as the Australian economic and fiscal outlook.

3.73 These events also allow the Investor Relations team to reflect market intelligence back to the AOFM about the views, investment strategies and constraints of institutional AGS investors, which then informs debt strategy deliberations and debt issuance activities.

128 A list of market maker banks is maintained by AOFM at https://www.aofm.gov.au/securities/treasury-bonds (accessed 24 October 2023).

129 The remaining eight market makers either declined to participate in consultation calls with ANAO or did not respond to ANAO's request for consultation calls.

### Public sector liaison

3.74 The Department of the Treasury (Treasury) provides the AOFM with the funding task implied by the latest fiscal update, and the AOFM estimates the public debt interest cost and public debt interest expense and the market valuation and face valuation of the debt portfolio that is used in the Government's financial statements. Treasury does not forecast interest rates, but its forward estimates of the borrowing task (without factoring in public debt interest expenses) are a central determinant of the government's funding task. The AOFM takes the information it receives from Treasury to inform its debt strategy deliberations and announce its borrowing intentions to market.

3.75 Another key relationship that the AOFM maintains in the financial markets and in the macroeconomic policy space is with the Reserve Bank of Australia (RBA). The AOFM has an information sharing agreement in place with the RBA. The RBA's monetary policy transmission mechanism intersects with the AGS market and the AOFM.

3.76 The RBA's monetary policy stance influences pricing on AGS through the cash rate target, and investors' expectations of the future path of the cash rate target influence AGS yields. The RBA provides a cash management facility for the AOFM whereby as banker to government, the RBA receives cash deposits from government and pays interest (via the Cash Management Account).[130] The RBA purchases AGS on an outright and repurchase agreement basis for monetary policy purposes[131] — in recent years outright RBA purchases of AGS have supported the quantitative easing policy of the RBA. The AOFM also shares information with the RBA about the cash management and borrowing requirements of Government.

3.77 The AOFM receives information as required from most major Australian Public Service agencies about their cash outlay requirements, and information from the Australian Taxation Office about revenue collection. This information supports the AOFM's cash management task, allowing it to ensure cash is available to meet outlays as and when due, and also earn interest on cash balances.

## Were debt management decisions consistent with better practices and government guidelines?

International best practices with respect to sovereign debt management have been described by the World Bank and International Monetary Fund's *Revised Guidelines for Public Debt Management* (Guidelines). Aspects of the AOFM's debt management decisions were assessed as consistent with the relevant provisions of the Guidelines. There are no Australian Government guidelines with respect to debt management. The AOFM's syndicated borrowing activities are exempt from Division 2 of the Commonwealth Procurement Rules (CPR). The AOFM's self-assessments of the compliance of its syndicated borrowing activities with the applicable provisions from Division 1 of the CPR were not fully documented.

130 AOFM, *AOFM Annual Report 2021–22*, p. 62.

131 RBA, Domestic Market Operations [Internet], https://www.rba.gov.au/mkt-operations/domestic-market-ops-and-standing-facilities.html [accessed 24 October 2023].

## International best practices

3.78 Guidelines for best practices in public debt management have been published by the World Bank and International Monetary Fund (Guidelines).[132] The World Bank has published a performance assessment framework for evaluating public debt management agencies, although this framework is not directly relevant to this audit as it was designed for use in evaluating debt management activities in developing countries.[133]

3.79 The main requirements of the Guidelines that are relevant to the AOFM's borrowing decisions are described in Table 3.2.

**Table 3.2: World Bank and International Monetary Fund *Revised Guidelines on Public Debt Management***

| Provision from World Bank / IMF Guidelines | ANAO assessment |
|---|---|
| The main objective of public debt management is to ensure that the government's financing needs and its payment obligations are met at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk. (Guidelines p. 7) | Discussed at paragraphs 3.10, 3.15 and 3.16. The AOFM has advised that it seeks to achieve this objective through developing an efficient and effective AGS market, rather than through debt issuance or debt portfolio management strategies. |
| Although the responsibility for ensuring prudent debt levels and conducting debt sustainability analysis [DSA] lies with fiscal authorities, debt managers should monitor any emerging debt sustainability problems based on portfolio risk analyses and market reactions observed when conducting debt management operations, and inform the government on a timely basis. (Guidelines p. 7) | Discussed at paragraphs 3.65 and 3.66. The AOFM's debt strategy modelling framework does not address fiscal sustainability but can provide a forward-looking view on financial vulnerabilities (ie. elevated costs or risks) associated with the debt portfolio. Section 33 of the *Charter of Budget Honesty Act 1998* requires the Treasurer to notify Parliament when the face value of AGS increases by $50 billion or more since the last budget update. |
| The objectives for debt management should be clearly defined and publicly disclosed, and the measures of cost and risk that are adopted should be explained. (Guidelines p. 8) | The objectives and cost and risk measures are defined by the FRMP as discussed in paragraphs 3.5 to 3.9, but the FRMP is not publicly disclosed. The AOFM annual reports address debt management objectives and measures of cost and risk but does not include the same level of detail as the FRMP. |
| The government is likely to benefit from a function within the debt management office that deals regularly with the main debt stakeholders and produces investor-friendly reports with debt statistics and other relevant information. (Guidelines p. 8) | The AOFM Investor Relations team provides these functions (refer to paragraphs 3.19, 3.72 and 3.73). |

132 World Bank and International Monetary Fund, *Revised Guidelines for Public Debt Management* [Internet], International Monetary Fund, Washington, D.C. 2014, available from https://www.worldbank.org/content/dam/Worldbank/document/Debt/Revised%20Guidelines%20for%20Public%20Debt%20Management%202014_v2.pdf [accessed 18 August 2023].

133 World Bank, *Debt Management Performance Assessment Methodology* [Internet], 2021, World Bank, Washington D.C. available from https://www.worldbank.org/en/programs/debt-toolkit/dempa [accessed 20 October 2023].

| Provision from World Bank / IMF Guidelines | ANAO assessment |
|---|---|
| Debt management activities should be supported by an accurate and comprehensive management information system with proper safeguards. (Guidelines p. 9) | Addressed at paragraph 3.61, the Quantum debt management information system provides these functions. |
| A framework should be developed to enable debt managers to identify and manage the trade-offs between expected cost and risk in the government debt portfolio. (Guidelines p. 10) | The FRMP, DMS and LMS provide the framework for debt management, and articulate the trade-offs between cost and risk in the government debt portfolio. Addressed at paragraphs 3.5 to 3.17. |
| To assess risk, debt managers should regularly conduct stress tests of the debt portfolio on the basis of the economic and financial shocks to which the government and the country more generally are potentially exposed. (Guidelines p. 10) | Discussed at paragraphs 3.65 and 3.66, the AOFM's debt strategy modelling framework is used for stress testing and provides a forward-looking view on financial vulnerabilities (i.e. elevated costs or risks) associated with the debt portfolio. |
| In order to minimize cost and risk over the medium to long run, debt managers should take adequate measures to develop an efficient government securities market. (Guidelines p. 10) | Discussed at paragraphs 3.10, 3.15 and 3.16. The AOFM has a focus on AGS market efficiency as a means for achieving low cost and risk outcomes for the performance of the debt portfolio and issuance activities over the long term. |
| The government should strive to achieve a broad investor base for its domestic and foreign debt instruments, with due regard to cost and risk, and should treat investors equitably. (Guidelines p. 10) | Diversification of the investor base is a key priority of the AOFM, and is addressed in paragraphs 3.19, 3.72 and 3.73. |
| Debt management operations in the primary market should be transparent and predictable. To the extent possible, debt issuance should use market-based mechanisms, including competitive auctions and syndications. (Guidelines p. 11) | As discussed at paragraphs 3.18 to 3.20, the AOFM has developed a transparent and predictable process for debt issuance transactions. |
| Governments and central banks should promote the development of resilient secondary markets that can function effectively under a wide range of market conditions. (Guidelines p. 11) | Discussed at paragraphs 3.10, 3.15 and 3.16. The AOFM has a strong focus and weighting on AGS market efficiency as a means for achieving low cost and risk outcomes for the performance of the debt portfolio and issuance activities over the long term. |
| The systems used to settle and clear financial market transactions involving government securities should reflect sound practices. (Guidelines p. 11) | Discussed at paragraph 3.23. The AOFM did not fail any settlements for issuance transactions during the period within audit scope. |

Source: World Bank and the International Monetary Fund, *Revised Guidelines for Public Debt Management*, 2014 and ANAO analysis.

## Syndication practices

3.80 In addition to its regular AGS issuance activities using electronic tenders, the AOFM issues AGS by syndication (see Box 3 above). While there are no Australian Government guidelines with respect to debt management, the AOFM's syndicated borrowing activities are subject to the Commonwealth Procurement Rules (CPRs).

3.81 As part of its AGS issuance task, the AOFM can decide to conduct an issuance transaction of Treasury Bonds and Treasury Indexed Bonds using an appointed syndicate of financial institutions.

This type of issuance transaction is referred to as 'syndications'. This process takes place over the course of a week, from the selection of Joint Lead Managers (JLMs) to the settlement of the transaction, which is conducted by the Back Office team within the AOFM.

3.82 The AOFM states on its website that this method is used for two primary reasons.[134]

- Syndications can be used to establish new bond lines, most notably ultra-long bond lines. Syndications can also 'tap' a pre-existing bond line to promote liquidity.
- Syndications are often undertaken if there is a higher level of risk, such as funding risk or execution risk.

3.83 Syndications are a 'book build' process; this is a process that requires selected JLMs to 'approach investors and source demand' within a 24-hour window. Unlike other market syndications, the AOFM does not require its syndications to have an underwriter, which would be responsible for underwriting (setting a floor) on the price of the AGS to go on issue. Instead, the deal team representing the AOFM determines price guidance by conducting a 'fair value analysis', and then communicating this to the JLMs.

3.84 The AOFM's syndication procedures describe the circumstances in which syndications are typically undertaken in preference to regular tender process:

> The Commonwealth reserves the right to issue AGS in any manner deemed appropriate. This includes, but is not limited to, the Commonwealth appointing a syndicate of financial institutions from time to time for the placement of Treasury Bonds or Treasury Indexed Bonds. Syndicate panel members may only be selected from parties that are Registered Bidders.
>
> A syndicated offer (rather than a tender) is typically undertaken when there is a higher-than-normal level of risk associated with the issue of a new bond line (for example when issuing a bond line that extends the yield curve) or when there is a desire to issue a large volume of bonds in order to immediately establish a large liquid bond line ... The final decision to proceed with a syndicated offering is made by the CEO.

3.85 The AOFM states further on its website:

> While syndications have been a highly effective and efficient method for establishing new bond lines, achieving yield curve extensions and facilitating liquidity in ultra-long bond lines, competitive tenders will remain the focal point of the AOFM's issuance operations. Market conditions and the size of annual issuance tasks will be the most important factors underlying future consideration by the AOFM of using syndications. Regular issuance by tender remains the best way for AOFM to support the market while meeting its commitment to achieve cost effective financing for Government on behalf of taxpayers over time. However, operational decisions require informed judgement in circumstances for which syndications will be useful to AOFM and the market and this will remain an active part of issuance planning.[135]

**Opportunity for improvement**

3.86 The Australian Office of Financial Management (AOFM) should document its policy for determining the rationale and timing for its syndicated borrowing activities. As part of this documentation, the AOFM should document the value it expects to receive from syndicated borrowing transactions relative to issuance of Australian Government Securities (AGS) via electronic tender.

134 AOFM, *Bond issuance methods – tenders versus syndications* [Internet], AOFM, available from https://www.aofm.gov.au/investors/wholesale-investors/investor-insights/bond-issuance-methods-tenders-versus-syndications [accessed 31 August 2023].

135 ibid.

3.87 In October 2022, the AOFM revisited its syndication practices. AOFM engaged a legal firm, King & Wood Mallesons (KWM), to undertake an external legal review of syndication practices, limited to the documentation that focussed on the appointment of JLMs. The review found that there were no material risks associated with the current syndication process, but the AOFM could benefit from a more streamlined process in relation to the contracts for the appointment of the JLMs and the agreement for the purchase of the bonds by the JLMs.

3.88 KWM created an alternative structure, which involved the creation of a 'Dealer Common Terms' (Common Terms) and a Subscription Agreement. The Common Terms is a deed poll[136] that the JLMs enter into for each syndication, replacing the Placement Letter previously outlined in the AOFM's process document. The Subscription Agreement[137] is completed within the settlements process, and replaces the 'Settlement Letter' previously used. KWM specified that the Common Terms and the Subscription Agreement were 'usual market practice' and 'generally well understood and accepted in the Australian market'. AOFM then amended the process per the review, and both documents were added to the AOFM's syndication process.

3.89 JLMs are not required to sign any formal documentation until the Subscription Agreement, as it is understood that there is an obligation to follow the Common Terms. The Common Terms are accepted through email, or likewise a phone call, where they are asked to reply with their acceptance. This response is then held internally. The Syndication procedures document was updated to reflect these changes.

3.90 As part of its assurance framework for a given year, the AOFM has included in its assurance program a requirement to assess the risk management practices of JLMs on a biennial basis.

### *Selection of Joint Lead Managers*

3.91 For a bank to be selected as a JLM, it must already be a Registered Bidder with the AOFM, which obligates banks and other financial institutions to comply with the AOFM's Conditions of Operation for the Yieldbroker tender system. For a given syndication, three to five (typically four) banks will be selected to participate as JLMs in the syndication. This selection is provided to the CEO as part of the 'Approval to Commit' documentation.

3.92 Justification for the selection of the JLMs are broken down into three criteria, as described in Box 4. JLMs are scored on a scale of five points, five being the highest, and one being the lowest.

**Box 4: Selection criteria for Joint Lead Managers**

**Takedown of Australian Government Securities (AGS) in tenders and bidding consistency:** Takedown refers to the amount the financial institutions are able to successfully bid for during tenders within the primary market.

**AGS distribution capability:** This refers to the capability of financial institutions to trade AGS with a diverse range of investors. Secondary market turnover is one component in the assessment of AGS distribution capability, and refers to the percentage of total trading activity in the secondary AGS market that financial institutions are able to generate with their

136 A deed poll is a legal document that binds one individual, or several individuals acting together, to an obligation.

137 A Subscription Agreement, in this context, refers to an agreement made between the Commonwealth and the JLMs for issuance conducted by the Commonwealth, and the subscription by the JLMs, of any bonds.

**Box 4: Selection criteria for Joint Lead Managers**

successful bids. Domestic and offshore staff contribute to these distribution and trading activities. The Australian Office of Financial Management (AOFM) receives this information by surveying registered bidders.

**Research quality:** This refers to '[t]he quality of research pertinent to the AOFM's funding, portfolio management and market development objects', and goes to the quality of research relevant to the AGS market developed by teams of economists and interest rate strategists at prospective Joint Lead Managers (JLMs). As part of the weekly calls that AOFM holds with market makers, the Front Office teams discuss market conditions with traders.

To encourage competitiveness amongst market makers, the AOFM looks to rotate the selection of JLMs. If JLMs have represented the AOFM on the previous panel, they are less likely to be accepted as part of the next panel, regardless of scoring against the selection criteria (also see paragraphs 3.97 and 3.98).

3.93 Once the JLMs have been chosen, the deal team will then decide which JLM will also be assigned 'duration risk manager'. The risk manager has the responsibility to oversee the risk management for the book-building process (to hedge the interest rate risk exposures implied by the AGS being issued in the syndication transaction), and the management of legal documentation. JLMs are assigned this role with consideration to previous experience, such as participating in state tenders as a risk manager, as well as the other criteria listed in Box 4.

### *Syndication fees*

3.94 Fees form part of the overall compensation received by banks that participate in syndications, and from the AOFM's perspective can be seen to offset the pricing through mid-market yields observed at electronic AGS tenders conducted on the Yieldbroker platform.[138] This encourages JLMs to participate.

3.95 As part of the syndication process, the AOFM must comply with subsection 23(3) of the *Public Governance, Performance and Accountability Act 2013*: 'The accountable authority of a non-corporate Commonwealth entity may, on behalf of the Commonwealth, approve a commitment of relevant money for which the accountable authority is responsible.' To comply with this, as part of the 'Approval to Commit' document for the CEO, team members of the Front Office will outline the amount of fees that would be provided to the JLMs upon completion.

3.96 As of June 2023, the AOFM has paid $351.8 million (including GST)[139] in fees towards banks that participate in syndications, since 2009, and raised $292.7 billion in syndicated Treasury Bond and Treasury Indexed Bond issuance, which equates to a fee of twelve cents per $100 issued (including GST). In the procedural documentation for syndications conducted by the AOFM, it states that the fees paid are to be set at eight cents per $100 issued (including GST) and this number is 'negotiable' with the CEO. The fee rate has been as high as 18 cents per $100 issued (including GST). AOFM documentation states that '[p]aying fees to Joint Lead Managers compensates them for the work of their syndicate, sales and trading teams. The costs of maintaining these teams are largely

138 See footnote 113 above for a definition of 'mid-market yields'. Pricing through mid-market yields refers to the favourable issuance pricing relative to prevailing market pricing described at paragraph 3.24.

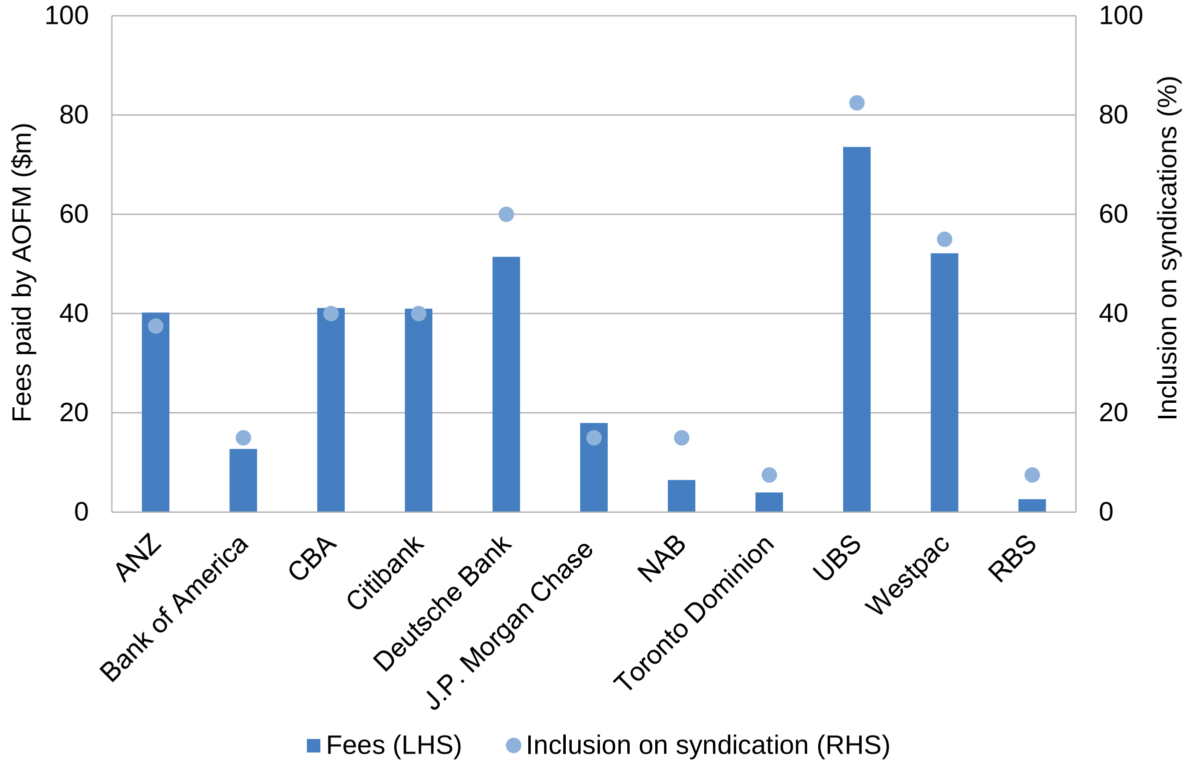
139 Nominal bonds, as well as indexed bonds. Not including the amount paid towards the RBA.

fixed (i.e. JLMs do not incur significant marginal costs when they participate in a syndicated transaction)'. However, there is no guidance for negotiating or setting the pricing of the fees mentioned in the AOFM's procedural documentation. In relation to the magnitude of fees paid, AOFM advised in November 2023:

> When the AOFM's funding task was significantly upsized from around April 2020, the decision was taken to reduce fees (on a cents per $100 face value basis) in recognition of the increase in average deal size. Pre 2020 fees averaged around 15 cents per $100 face value. During the period in [audit] scope [of 1 January 2020 to 30 June 2023] fees averaged 8.7 cents.

3.97 As well as increasing competition between JLMs, rotations can be utilised to diversify the amount of fees paid between JLMs. Figure 3.6 shows the distribution of fees by JLM.[140]

**Figure 3.6: Total fees paid by AOFM to Joint Lead Managers (by entity) for issuance by syndication, 2011 to 2023[a, b]**




Note a: The Royal Bank of Canada, Barrenjoey and Barclays also participated as JLMs, however have not been included in the graph as they were only present once. AOFM paid these banks fees of $1,430,000, $1,408,000 and $357,500 respectively for their participation as JLMs.

Note b: RBS stands for the Royal Bank of Scotland.

Source: ANAO analysis.

3.98 As shown in Figure 3.6, UBS received the most amount of fees from the AOFM. This is because it has been a JLM on 83.3 per cent (25 of 30) of all syndications to date. The AOFM advised in January 2024 that 'UBS have consistently been the strongest performing counterparty across the selection criteria, [as] is reflected in their inclusion on more panels and less frequent rotation compared with other JLMs'.

140 AOFM advised in January 2024 that 'fees paid by the AOFM [to JLMs for syndicated issuance] are proportionally low by comparison with other issuers'.

3.99 The ANAO compared the amount of fees that were paid to JLMs, and therefore the number of times they are selected as part of the syndication panel, with the value of gifts that financial institutions provided to the AOFM. The three banks that received the highest syndication fees from AOFM during the period within audit scope (UBS, Westpac and Deutsche Bank) provided AOFM with gifts and benefits of a value of $8,785 during this period.

### Syndication as a procurement process

3.100 Procurement is defined as 'the process of acquiring goods as services', with the objective of achieving value for money.[141] Procurements from non-corporate Commonwealth entities are expected to follow the CPRs. As syndications compensate JLMs for their services, this is considered a procurement process.

3.101 As AOFM syndications directly relate to 'sale and distribution services for government debt', AOFM syndications are exempt from sections of the CPRs under Appendix A, Item 9: '[A]cquisition of fiscal agency or depository services, liquidation and management services for regulated financial institutions, and sale and distribution services for government debt[142]'.

3.102 While exempt procurements do not have to follow the additional rules within Division 2 of the CPRs, the AOFM must still comply with the rules in Division 1 of the CPRs. This exemption excludes sections 4.7 and 4.8, which relate to the consideration of how a procurement can benefit the Australian economy; and 7.26, which relates to the application of relevant standards and determining compliance with these standards.

3.103 In Approval to Commit documents, syndications are listed as '[a] limited procurement method' and should outline how value for money has been achieved, in line with section 7.3(c) of the CPRs. The AOFM lists the recommended fee for the syndication within this section. While final pricing for the contract is not listed in this document, as the final total of pricing cannot be calculated until after the launch and purchase of the syndicated bond, JLM fees are considered a 'proper use of relevant money'. There is no procedural documentation that outlines the determination of relevant money through fees.

3.104 The ANAO sought advice from the Department of Finance on the purpose of the exemption of government debt, and if it is still relevant for the purposes of syndication. The Department of Finance advised in September 2023 that:

> Australia is party to a range of international trade obligations regarding government procurement. Relevant international obligations have been incorporated in the CPRs. Therefore, an official undertaking a procurement is not required to refer directly to international agreements. However, in relation to this exemption, it should be noted that Division 1 of the CPRs, setting out the rules for all procurements, still apply. Further, officials may apply elements of Division 2 as 'better practice', however are not obligated under the CPRs to do so.

3.105 The international obligations that the Department of Finance refers to are sourced from the World Trade Organisation Agreement of Government Procurement, which recognised that

141 Department of Finance, *Commonwealth Procurement Rules* [Internet], Finance, available from https://www.finance.gov.au/government/procurement/commonwealth-procurement-rules [accessed 8 September 2023].

142 ibid., p. 29.

government procurement requires internationally agreed trade rules. Article II(3)(c) of this agreement references the exemption of public debt:

> [T]he procurement or acquisition of fiscal agency or depository services, liquidation and management services for regulated financial institutions or services related to the sale, redemption and distribution of public debt, including loans and government bonds, notes and other securities.

3.106 This wording underpins Appendix A, Item 9 of the CPR exemptions.

3.107 The AOFM's exemption in respect of its syndicated borrowing activities from Division 2 and aspects of Division 1 of the CPR meant that its self-assessments of compliance with the applicable provisions of the CPR were not fully documented. The AOFM Approval to Commit documents' 'value for money' section, outlining the exemption for government debt, shows that the applicable provisions of the CPR were considered during the JLM selection process but does not fully document whether procurements in respect of syndicated borrowing activities comply with the applicable provisions of the CPR.

**Opportunity for improvement**

3.108 The Australian Office of Financial Management should document its compliance with the Commonwealth Procurement Rules, in particular how it complies with Division 1 in the procurement processes for its syndicated borrowing transactions.

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Grant Hehir
Auditor-General

Canberra ACT
12 February 2024

# Appendices

# Appendix 1 Entity responses

Australian Government
Australian Office of Financial Management

AOFM

Mr Grant Hehir
Auditor-General
Australian National Audit Office
By email: OfficeoftheAuditorGeneralPerformanceAudit@anao.gov.au

Dear ~~Mr Hehir~~ Grant

**Australian National Audit Office (ANAO) Section 19 Proposed Report – AOFM's Management of the Australian Government's Debt**

Thank you for providing the Australian Office of Financial Management (AOFM) with the opportunity to comment on the ANAO's proposed report on the AOFM's Management of the Australian Government's Debt.

The AOFM welcomes the audit findings and has agreed with the recommendations presented in the report. The AOFM notes that the recommendations primarily represent enhancements to established documentation and processes to achieve greater transparency. Implementation of the recommendations has already commenced.

The AOFM appreciates the report's recognition that the AOFM's policies and procedures facilitated our ability to meet the Government's significantly increased funding requirements during the COVID-19 pandemic. The AOFM also notes the finding that our policies and processes support cost-effective borrowing and that financial risks are managed appropriately.

The AOFM will work with the Department of the Treasury (Treasury) to increase transparency and enhance existing documentation of governance arrangements and debt management decisions.

The AOFM will also review and enhance existing policies and procedures relating to gifts, benefits (including hospitality) and conflicts of interest. The AOFM notes the finding relating to coverage of conflict of interest declarations of the AOFM CEO. The Treasury has updated its processes for conflict of interest, including the declaration and capture of interests for CEOs within the portfolio.

In addition to the ANAO's recommendations, the AOFM notes the opportunities for improvement outlined in the report. We will consider each of the suggested improvements and implement solutions that are fit-for-purpose.

Attached are the AOFM's summary response (Attachment A) and responses to the ANAO's recommendations (Attachment B).

I would like to thank the ANAO for their professionalism and constructive approach to this audit.

Yours sincerely

A Hughes

Anna Hughes
Chief Executive Officer
2 February 2024

Treasury Building, Level 3, Newlands Street, Parkes, ACT 2600, Australia
Telephone: +61 2 6263 1111 | enquiries@aofm.gov.au | www.aofm.gov.au

Australian Government
The Treasury

EC23-003820

**Secretary**
**Dr Steven Kennedy PSM**

Mr Grant Hehir
Auditor-General
Australian National Audit Office
38 Sydney Avenue
FORREST ACT 2603

Dear Mr Hehir Grant

**Response to the Australian National Audit Office (ANAO) proposed report on the *Australian Office of Financial Management's (AOFM) Management of the Australian Government's Debt***

Thank you for providing the Department of the Treasury (Treasury) with the opportunity to comment on the ANAO's proposed report on the *AOFM's Management of the Australian Government's Debt.*

Treasury welcomes the report. In particular, I welcome the ANAO's recognition that, during the period of COVID-19 global financial market volatility, the AOFM had appropriate policies and procedures in place to raise the funding required to respond to the effects of the pandemic. Since the establishment of the AOFM in 1999, fundamental responsibility for debt management has resided with the AOFM. The AOFM CEO has been delegated operational powers to issue and manage debt by the Treasurer, and I have delegated the *Public Service Act 1999* powers with respect to AOFM employees.

Treasury has a range of governance processes to provide assurance around the AOFM's debt management approach. These include: the AOFM Advisory Board, the Annual Remit (signed by myself and provided to the Treasurer); and ongoing collaboration between Treasury and the AOFM around the borrowing task.

Treasury and AOFM governance arrangements for debt management are set out in the AOFM's Financial Risk Management Policy (FRMP).

We will work with the AOFM to increase transparency and strengthen documentation of governance processes, including reviewing the FRMP and making governance arrangements publicly accessible.

Treasury and the AOFM will engage with the AOFM Advisory Board to consider how transparency can be enhanced around the impacts of debt management decisions on cost and risk outcomes for the debt portfolio.

Langton Crescent, PARKES ACT 2600 • Telephone: 61 2 6263 3738 • Facsimile: 61 2 6263 3360
Website: www.treasury.gov.au • ABN 92 802 414 793

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As part of Treasury's ongoing efforts to mature and enhance its pro-integrity culture, processes related to managing conflicts of interest have been strengthened. This has included the declaration and capture of interests for CEOs within the portfolio. Further opportunities to improve Treasury's guidance for officials on potential and actual conflicts, including in relation to gifts and benefits, have been identified, with implementation work underway.

Treasury welcomes the ANAO's findings and agrees with the Treasury recommendations presented in the section 19 report, Attachment A, with a summary response is at Attachment B.

I would like to thank the ANAO for their professional and collaborative approach during this audit.

Yours sincerely

Steven Kennedy

29 January 2024

# Appendix 2 Improvements observed by ANAO

1. The existence of independent external audit, and the accompanying potential for scrutiny improves performance. Improvements in administrative and management practices usually occur: in anticipation of ANAO audit activity; during an audit engagement; as interim findings are made; and/or after the audit has been completed and formal findings are communicated.

2. The Joint Committee of Public Accounts and Audit (JCPAA) has encouraged the ANAO to consider ways in which the ANAO could capture and describe some of these impacts. The ANAO's Corporate Plan states that the ANAO' s annual performance statements will provide a narrative that will consider, amongst other matters, analysis of key improvements made by entities during a performance audit process based on information included in tabled performance audit reports.

3. Performance audits involve close engagement between the ANAO and the audited entity as well as other stakeholders involved in the program or activity being audited. Throughout the audit engagement, the ANAO outlines to the entity the preliminary audit findings, conclusions and potential audit recommendations. This ensures that final recommendations are appropriately targeted and encourages entities to take early remedial action on any identified matters during the course of an audit. Remedial actions entities may take during the audit include:

- strengthening governance arrangements;
- introducing or revising policies, strategies, guidelines or administrative processes; and
- initiating reviews or investigations.

4. In this context, the below actions were observed by the ANAO during the course of the audit. It is not clear whether these actions and/or the timing of these actions were planned in response to proposed or actual audit activity. The ANAO has not sought to obtain assurance over the source of these actions or whether they have been appropriately implemented.

- The Department of the Treasury re-established the AOFM Advisory Board in March 2023 to provide external debt management advice to the Secretary to the Treasury. The AOFM Advisory Board met two times during the audit period including an introductory meeting on 9 March 2023 and a substantive meeting on 16 June 2023. Planning was underway to re-establish the Advisory Board in August 2022.
- The Department of the Treasury included the AOFM CEO in its annual SES and portfolio CEO conflict of interest declaration process in November 2023. The AOFM requested and received a conflict of interest declaration from the AOFM CEO in August 2023.
- To provide documentation of AOFM CEO decisions, a Minute to the AOFM CEO is required to support all AOFM CEO approvals from late 2023 onwards.

# Appendix 3 Australian Government Securities market conditions

1. Table A.1 draws on the market commentary presented in AOFM annual reports to describe the evolution of AGS market conditions through the period within audit scope of 1 January 2020 to 30 June 2023.

**Table A.1: AOFM annual reports — market conditions narrative**

| Timing | Market conditions narrative from AOFM annual reports |
| --- | --- |
| 2019–20 | **Onset of the COVID pandemic**<br>'[At the beginning of the COVID-19 pandemic in early 2020], a flight to high quality defensive assets drove sovereign yields to historic lows. Muted expectations of economic output and inflation due to worldwide economic shutdowns exacerbated this trend. As a result, a combination of factors including restricted access to funding channels, an abrupt and widespread requirement for redemptions and asset reallocations together triggered a wave of selling in the month of March [2020]. Market intermediaries struggled to absorb the large volume investor selling and some reached balance sheet risk limits, which created severe domestic market congestion. The yield on 10-year bonds increased by around 100 basis points in just two weeks. The bid-offer spread on 10-year bonds reached as high as 10 basis points [that is, 0.1 per cent] compared to a pre-COVID-19 norm of on average 1 basis point (indicative of market function). In response, the AOFM suspended issuance into the Treasury Bond market to allow congestion to clear. The Treasury Note market remained open for issuance throughout the crisis and proved vital in meeting the financing task'.[a] |
| | **RBA policy intervention**<br>'The RBA stepped in with a range of [monetary policy] announcements on 19 March 2020, including an operation to purchase AGS in the secondary market so as to help clear trading congestion due to the market dislocation, and to achieve a 3 year yield target of around 0.25 per cent. The RBA's announcement and the commencement of its operations together with the AOFM's issuance decisions immediately helped lower yields, clear intermediary balance sheets and reopen the Treasury Bond primary market. Throughout the remainder of 2019-20 the RBA purchased around $40 billion of AGS with tenors up to 10 years. This, together with the issuance suspension, removed much of the dislocation in the market' by the middle of 2020.[b] |
| 2020–21 | **Emergence of inflation and market repricing**<br>'Yields were steady around historic low levels for the first half of 2020–21, before rising at the beginning of calendar 2021, a repricing that reflected widespread momentum in expectations for emerging inflation … Short-dated yields remained anchored at extremely low levels by the RBA's cash rate and yield target settings [during 2020–21].'[c] |
| 2021–22 | **Conclusion of RBA policy support and continuing market repricing**<br>'Large-scale RBA bond purchases, as part of extraordinary pandemic monetary policy settings, significantly reduced the amount of some bond lines available for market trading [during 2021–22, noting that the RBA's concluded its yield target and bond purchasing policy in February 2022]'[d] and AOFM responded with issuance activities designed 'to assist liquidity in these bond lines' and support the functioning of the AGS market.[e]<br>'[B]ond markets sold off during 2021–22 due to inflationary concerns [however] the interest rate environment remained low as compared to long-term historical averages, and accordingly continued to offer low financing costs on new borrowings and for the cost of refinancing maturing debt.'[f] |

| Timing | Market conditions narrative from AOFM annual reports |
| --- | --- |
| 2022–23 | **Market normalisation**<br>‘While bond markets [continued to sell off] and experienced volatility during 2022–23, trading conditions in the AGS market remained liquid, deep and functional. In response to an environment of higher inflation and tightening monetary policy the interest rate environment in 2022–23 was higher than that experienced in 2021–22.’[g] |

Note a: AOFM, *Annual Report 2019–20,* AOFM, 2020, p. 38.

Note b: AOFM, *Annual Report 2019–20,* AOFM, 2020, p. 39.

Note c: AOFM, *Annual Report 2020–21*, AOFM, 2021, p. 15.

Note d: AOFM, *Annual Report 2021–22,* AOFM, 2022, p. 75.

Note e: AOFM, *Annual Report 2021–22,* AOFM, 2022, p. 75.

Note f: AOFM, *Annual Report 2021–22,* AOFM, 2022, p. 118.

Note g: AOFM, *Annual Report 2022–23,* AOFM, 2021, p. 102.

Source: AOFM annual reports.