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Audit Report No.17 2006–07
Performance Audit

Treasury's Management of International Financial Commitments—Follow-up Audit

Department of the Treasury

Australian National Audit Office

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Canberra ACT
23 January 2007

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Department of Treasury in accordance with the authority contained in the *Auditor-General Act 1997*. 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 and the accompanying brochure. The report is titled *Treasury's Management of International Financial Commitments—Follow-up Audit.*

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

Yours sincerely

Ian McPhee
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. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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Abbreviations

ADB	Asian Development Bank
AEIFRS	Australian Equivalent of the International Financial Reporting Standards
ANAO	Australian National Audit Office
APEC	Asia-Pacific Economic Cooperation
CEIs	Chief Executive Instructions
EBRD	European Bank for Reconstruction and Development
Finance	Department of Finance and Administration
FMA Act	*Financial Management and Accountability Act 1997*
FMOs	Finance Minister's Orders
FTP	IMF Financial Transactions Plan
G-20	Group of Twenty. The members of the G-20 are the finance ministers and central bank governors of 19 countries: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom and the United States of America. The European Union is also a member.
GAB	General Arrangements to Borrow (through IMF)
GCI	General Capital Increase
HIPC	Heavily Indebted Poor Countries
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association

IFC	International Finance Corporation
IMAA	*International Monetary Agreements Act 1947*
IMF	International Monetary Fund
MIGA	Multilateral Investment Guarantee Agency
MoV	Maintenance of Value adjustments
NAB	New Arrangements to Borrow (through IMF)
OECD	Organisation for Economic Cooperation and Development
PRGF	IMF's Poverty Reduction and Growth Facility
PWC	Price Waterhouse Coopers
SDR	Special Drawing Right
the Treasury	the Department of the Treasury

Summary and Recommendations

Summary

Background

1. The Department of the Treasury (the Treasury) manages Australia's relations with the International Monetary Fund (IMF) and various development banks. As of 30 June 2006, the Treasury's administered assets in the IMF and other international financial institutions totalled A$7.1 billion. Liabilities totalled A$4.8 billion. In addition to the liabilities of A$4.8 billion, there were contingent liabilities of A$7.3 billion, comprising uncalled share capital subscriptions.

2. In October 2002 a performance audit of the Treasury's management of international financial commitments (ANAO Audit Report No.10 of 2002–03 *Treasury's Management of International Financial Commitments*) was tabled in the Parliament. This audit is a follow-up to that audit. The objective was to assess the progress made by the Treasury in addressing the four major audit findings and two recommendations of the 2002 audit report.

Overall Audit Conclusion

3. The Treasury's response to the findings and recommendations of the previous audit has been effective. The audit found that:

- both audit recommendations have been implemented; and
- the two major findings without recommendations have also been addressed. However, whilst Treasury provides a range of information to the Department of Finance and Administration (Finance) on its foreign exchange transactions, the Treasury reporting to Finance under the Government's Foreign Exchange Risk Management Policy should identify and provide an estimate of all foreign exchange gains, losses and exposures. ANAO has recommended accordingly.

Key Findings

4. The previous Australian National Audit Office (ANAO) audit included four major findings, with recommendations made in relation to two of these findings (see Table 1.2). ANAO's assessment of the Treasury's response on the key issues arising from the previous audit is summarised in the following table:

Key Issue	ANAO Assessment
Has the Treasury enhanced its performance measurement and reporting so as to address the Treasury's financial management responsibilities in relation to the international financial commitments it administers? (Recommendation No.1 of the previous audit)	The Treasury's Portfolio Budget Statements for 2004–05 and 2005–06 included a suitable performance indicator for Output 1.1.2 – *International economic policy advice and assessment*. The Treasury has reported its performance and has further improved its performance reporting in its 2005–06 annual report. *(Para 2.17)*
Has the Treasury comprehensively documented procedures so as to mitigate risks associated with staff turnover and the irregular nature of transactions? (Recommendation No.2 of the previous audit)	The Treasury has improved its Chief Executive Instructions and has in place comprehensive staff guidelines on the management of the Treasury's international financial commitments, including the assessment and management of foreign exchange risk. (*Paras 3.5 and 3.6*) The Treasury's management and control over the issue, storage and reporting of promissory notes have been satisfactory. However each promissory note does not have a unique number or title identifying it, as advocated by the Finance Circular on promissory notes, and the Treasury's "register" of promissory notes could include more complete information on the notes, particularly in respect of development bank notes. Treasury has now taken steps to do this. (*Paras 3.11 to 3.12*)
Has the Treasury explicitly identified and quantified risks in relation to proposed expenditure commitments, consistent with the emphasis on agency risk management outlined in the policy for Commonwealth foreign exchange risk management that was introduced with effect from July 2002? (previous major audit finding)	The Treasury's procedures for the processing of foreign exchange transactions comply with the requirements of the Government's Foreign Exchange Risk Management Policy. Treasury also provides a range of information to Finance on its foreign exchange transactions. However, in its reporting to Finance on its foreign exchange exposure in 2004 and 2005, the Treasury reported that it did not have any exposure to foreign exchange movements when it should have reported its exposures to possible gains or losses in relation to IMF maintenance of value adjustments and its euro-based capital payments to the European Bank for Reconstruction and Development. (*Paras 3.17 to 3.25*)
Has the Treasury revised its accounting practices and procedures so as to ensure that the value of all assets and liabilities are consistently recorded and reported? (previous major audit finding)	Valuations of the Treasury's investments in the development banks were reviewed and necessary changes were made. Two studies were also undertaken of the Treasury's accounting treatment of its international financial commitments. These studies endorsed the Treasury's approach to the reporting of its international financial commitments. (*Paras 2.6 to 2.10*)

Agency Response

5. A copy of the proposed report for this audit was provided to the Treasury. Its overall response was as follows:

> The Treasury welcomes this follow-up audit and the conclusion that its response to the findings and recommendations of the previous audit has been effective.
>
> In relation to the recommendation, the Treasury notes that the ANAO found that foreign exchange gains or losses on Australia's investments in the international financial institutions are reported in its financial statements and that Treasury's procedures for the processing of foreign exchange transactions comply with the Department of Finance and Administration (Finance) requirements.
>
> The Treasury currently provides a range of information to Finance for the purpose of complying with the Government's Revised Foreign Exchange Risk Management Policy. The Treasury and Finance have agreed to work together to determine if there is a need for Treasury to amend its current reporting practices to meet the objectives of the Government's policy. If it is determined that changes are necessary, then the Treasury will introduce those changes.

Recommendations

Recommendation No.1 **Para 3.26**	ANAO *recommends* that the Department of the Treasury, in its annual reporting to the Department of Finance and Administration of its foreign exchange exposures, required by the Government's Foreign Exchange Risk Management Policy, identify and report the necessary data on all exposures to exchange rate movements. **Treasury response:** *Agreed*

Audit Findings and Conclusions

1. Introduction

This chapter sets out the context for the audit; summarises the Treasury's role in administering international financial commitments; and explains the audit approach.

Background

1.1 The Department of the Treasury (the Treasury) manages Australia's relations with the International Monetary Fund (IMF) and various development banks. As of 30 June 2006, the Treasury's administered assets in the IMF and other international financial institutions totalled A$7.1 billion. Liabilities totalled A$4.8 billion. In addition to the liabilities of A$4.8 billion, there were contingent liabilities of A$7.3 billion reported, comprising uncalled share capital subscriptions. These assets and liabilities are summarised at Table 1.1. Given the scale of these assets and liabilities, sound financial and risk management practices are necessary to protect the Commonwealth's interests. In particular, significant financial calls could be made on Australia and other shareholders, consistent with Australia's international agreements.

1.2 In the above role, the Treasury is responsible for ensuring that Australia's financial obligations are met in the most efficient manner consistent with government policy and that they are properly accounted for. In this context, the Treasury's financial relationship with the development banks largely involves managing capital subscription payments, whereas financial dealings with the IMF involve more complex arrangements.[1]

1.3 Further details of the international financial commitments administered by the Treasury are given in Appendix 1.

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[1] Other financial transactions that occur between Australia and the IMF include annual adjustments to maintain the foreign currency value of Australia's investment (called 'maintenance of value') and payment of various charges related to Australia's membership of the Fund.

Table 1.1 The Treasury's Estimated Administered International Financial Institution Assets and Liabilities as at 30 June 2006

	Paid-in Capital	Uncalled Capital	Other	Total
	A$m	A$m	A$m	A$m
Assets				
International Monetary Fund				
Quota	6 388.47			6 388.47
IMF Related Moneys Owing			2.51	2.51
Multilateral Development Banks				
International Bank for Reconstruction and Development	259.05	3 725.90		3 984.95
Multilateral Investment Guarantee Agency	10.69	35.60		46.30
International Finance Corporation	69.14			69.14
Asian Development Bank	287.07	3 292.80		3 579.87
European Bank for Reconstruction and Development	84.82	242.59		327.41
Total Assets	***7 099.25***	***7 296.89***	***2.51***	***14 398.65***

	Paid-in Capital A$m	Uncalled Capital A$m	Other A$m	Total A$m
Liabilities				
International Monetary Fund				
SDR Allocation	928.83			928.83
Loans - IMF Promissory Notes	3 807.62			3 807.62
Maintenance of Value Payable			27.08	27.08
IMF Related Moneys Payable			5.60	5.60
Poverty Reduction and Growth Facility - Grant			7.50	7.50
Multilateral Development Banks				
International Bank for Reconstruction and Development	57.25	3 725.90		3 783.15
Multilateral Investment Guarantee Agency	2.49	35.60		38.10
Asian Development Bank		3 292.80		3 292.80
European Bank for Reconstruction and Development	3.47	242.59		246.05
Total Liabilities	***4 799.65***	***7 296.89***	***40.18***	***12 136.73***
Net Assets	**2 299.60**	**-**	**- 37.68**	**2 261.92**

Source: ANAO analysis of Treasury data.

Previous Audit

1.4 In October 2002 a performance audit of the Treasury's management of international financial commitments (Audit Report No.10 of 2002–03 *Treasury's Management of International Financial Commitments*) was tabled in the Parliament. This audit is a follow-up to that audit. The previous ANAO audit included four major findings with recommendations made in relation to two of these (see Table 1.2).

Table 1.2 Findings and Recommendations of Previous ANAO Audit

Finding	Recommendation
The Treasury's performance measures and reporting in relation to its international financial commitments have focussed on facilitating the achievement of government finances in international forums; providing advice that meets the Treasury portfolio ministers' needs in administering their responsibilities; and implementing government decisions. However, the Treasury's performance measures and performance reporting currently do not adequately address its financial management responsibilities, including the management of financial risk and asset and liability management. In these respects, identifying an appropriate exposure management objective and related financial performance measures could markedly contribute to improved financial management which is consistent with government policy that agencies effectively manage financial risk.	The Treasury further examine the merits of including in its Portfolio Budget Statements performance measures and performance reporting that addresses its financial management responsibilities in relation to the international financial commitments it administers.
In respect of the Treasury's international financial commitments, procedural documentation is not complete. More comprehensive documentation, with key procedures being part of the Treasury's Chief Executive's Instructions, would strengthen the control environment. This would at least help alleviate the difficulties arising from the turnover in staff responsible for administering the Treasury's international financial commitments and the irregular nature of transactions which can involve significant commitments stretching over many years.	The Treasury implement a more comprehensive framework of policies and procedures for the administration of its international financial commitments.
The major financial risk faced by the Treasury in this area is foreign exchange risk. On some occasions, the Treasury analysed exchange rate risk. However, on other occasions it has not performed this analysis or the analysis performed did not adequately reflect the sensitivity of the proposed expenditure to exchange rate movements. In terms of risk treatment, the Treasury has retained an open position to foreign exchange risk exposures.	No recommendation was made as a Commonwealth Government Foreign Exchange Risk Management Policy came into effect on 1 July 2002.
Some inconsistency in the accounting treatment of the Treasury's administered investments in the development banks were also identified for follow-up in the audit of the Treasury's financial statements.	No recommendation was made as this issue was to be addressed in the context of the audit of the Treasury's financial statements.

Source: ANAO Audit Report No.10 of 2002–03.

1.5 In March 2004, the Treasury's contracted internal audit provider undertook a follow-up review of the ANAO's Audit Report No.10 on behalf of the Treasury. In the 2004 report, the internal auditor concluded that:

> Nothing has come to our attention that causes us to believe that Treasury has not implemented the recommendations arising from the ANAO review *Management of International Financial Commitments* and the recommendations found in DoFA's [the Department of Finance and Administration] Finance Circular 'Foreign Exchange Risk Management', in all significant respects[2].

Audit Objectives and Methodology

1.6 The objective of the audit was to assess the progress made by the Treasury in addressing the major audit findings and recommendations of the 2002 audit report. The scope of the audit was limited to a follow-up of the two recommendations and two major findings without a recommendation from the 2002 audit report.

1.7 Accordingly, the audit assessed whether the Treasury had:

- enhanced its performance measurement and reporting so as to address the Treasury's financial management responsibilities in relation to the international financial commitments it administers (Recommendation No.1);
- documented procedures so as to mitigate risks associated with staff turnover and the infrequent nature of transactions (Recommendation No.2);
- explicitly identified and quantified risks in relation to proposed expenditure commitments, consistent with the emphasis on agency risk management outlined in the policy for Commonwealth foreign exchange risk management that was introduced with effect from July 2002 (major audit finding); and
- revised its accounting practices and procedures so as to ensure that the value of all assets and liabilities are consistently recorded and reported (major audit finding).

1.8 The audit was conducted in accordance with ANAO Auditing Standards, at a cost to the ANAO of $107 000.

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[2] Deloitte Touche Tohmatsu, *Department of the Treasury: Follow-up Review of the Management of Treasury's International Financial Commitments, Final Report March 2004*, p. 2.

2. Accountability to the Parliament

This chapter examines the legislative framework for Australia's membership of international financial institutions and the Treasury's performance in reporting to Parliament on Australia's involvement with them.

Legislative Framework

2.1 The primary legislation governing the Treasury's administration of its international financial commitments is the *International Monetary Agreements Act 1947* (IMAA). This Act approves Australia's membership of the IMF and the International Bank for Reconstruction and Development (IBRD) and provides special appropriations for actual payments to such institutions. Amendments to the Act in 1997 and 1998:

- introduced a new framework for recording financial transactions with the IMF;
- allowed Australia to adhere to the IMF's New Arrangements to Borrow (NAB); and
- established a framework of financial assistance for countries that are undertaking economic adjustment programs with the support of the IMF, flowing from the Heavily Indebted Poor Countries (HIPC) Initiative.

2.2 In addition, Australia's memberships of the Asian Development Bank (ADB), International Finance Corporation (IFC), Multilateral Investment Guarantee Agency (MIGA) and the European Bank for Reconstruction and Development (EBRD) are governed by the following Acts respectively:

- *Asian Development Bank Act 1966*;
- *International Finance Corporation Act 1955*;
- *Multilateral Investment Guarantee Act 1997*; and
- *European Bank for Reconstruction and Development Act 1990*.

Appropriations

2.3 These Acts provide special appropriations and authority to issue securities to give effect to Australia's membership of each institution. Furthermore, a number of additional subscription, quota and share increase

Acts have been passed to allow Australia to take up further shares in the IMF, IBRD, IFC and ADB.

2.4 Most of the Treasury's payments to international financial institutions and bilateral loans have been made under the special appropriations provided by the IMAA and other enabling Acts. However, there have been some instances[3] where amounts have been paid from annual appropriations. In Audit Report No.10 of 2002–03, ANAO suggested that, where future subscriptions are to be made, the Treasury should consider using the authority of the special appropriations, as this better reflects the Parliament's intent and facilitates continuity of information in the interests of greater transparency and accountability. No new additional subscriptions have been made since the previous audit.

2.5 As required, in a note to its 2004–05 financial statements[4], the Treasury has reported the cash drawn from the Consolidated Revenue Fund under special appropriations. This included amounts drawn under the *Asian Development Bank (Additional Subscription) Act 1995* for Australia's subscription to the fourth General Capital Increase (GCI IV). However, this note incorrectly stated that the appropriation was unlimited – this special appropriation is, in fact, limited by the amount of US dollars payable for the number of subscribed shares specified in the Act, and the amount of remaining available appropriation should therefore also have been included in the notes to the accounts. Payments to the ADB under GCI IV were finalised in 2004–05. The comparative information in the 2005–06 financial statements was again shown in the same numbered note on unlimited appropriations.

Accounting Policies

2.6 The previous audit noted that the international financial commitments administered by the Treasury range from short-term bridging finance to major long-term capital injections. It found that the Treasury's financial reporting involved a mixture of current and historic market valuations, actual historic costs and notional costs for assets. As well as the different stated accounting approaches, ANAO noted instances, which were not material in a financial statement context, where the Treasury reporting departed from its stated accounting policy.

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3 For example, in relation to the additional subscription to the EBRD shares that was announced in the 2000–01 Budget.

4 Note 31C in the 2004–05 financial statements.

2.7 In 2002–03 the Treasury revalued its investments in the multilateral development banks to put them on a consistent basis. Promissory notes are now consistently valued as at the date of issue. This was to address the findings of the previous ANAO performance audit.

2.8 To ensure it was well placed for the introduction of the Australian Equivalent of the International Financial Reporting Standards (AEIFRS), in 2004 and 2005 the Treasury arranged for two studies of its accounting treatment of its international financial commitments. These were undertaken by WalterTurnbull (completed in October 2004) and by Price Waterhouse Coopers (PWC – completed in April 2005). These studies endorsed the Treasury's approach to the reporting of its international financial commitments.

2.9 In its review of the Treasury's accounting treatment of its international financial instruments, PWC advised the Treasury that, in its opinion, under the accounting standards, the at-call shares with the multilateral development banks should appropriately be classified as a 'commitment', rather than a 'contingent liability'. This was on the basis that there is no requirement to provide cash until the call of the payment. However, PWC noted that Appendix 1 to the FMOs on the Requirements and Guidance for the Preparation of Financial Statements appear to require uncalled shares to be shown as a contingent liability. PWC recommended that the Treasury refer this issue to Finance and to the ANAO for consideration. The Treasury did not do this because:

- it considered that, although there is a present obligation from a past event, it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- where there is a conflict between the FMOs and the accounting standards, the FMOs take precedence.

2.10 This issue was addressed in the context of ANAO's audit of the Treasury's 2005–06 financial statements. The Treasury will continue to classify the at-call shares as contingent liabilities, based on its judgement that the risk of these shares being called is low for the foreseeable future, and will include a note to the accounts explaining the reasons for this accounting treatment.

Performance Information

2.11 The ANAO, in conjunction with Finance, has published two Better Practice Guides in recent years on performance information and reporting. These are *Better Practice in Annual Performance Reporting* (2004) and *Performance Information in Portfolio Budget Statements* (2002).

2.12 The 2004 Guide identifies the following features of good performance measurement and data management:

- clear definition of performance indicators;
- sound data assurance arrangements;
- sound annual report coordination and clearance arrangements; and
- data that are used to support performance information in the annual report should be built on information used for ongoing management and decision making.[5]

2.13 It further recommends that, as far as possible, performance measures should be specific, measurable, achievable, relevant and timely[6]. The 2002 Guide provides similar recommendations and, for quality indictors, indicates that they should relate to tangible criteria such as timeliness, coverage, accuracy and conformity to specifications.[7]

2.14 In response to the recommendation in the previous ANAO audit, the Treasury's Portfolio Budget Statements for 2004–05 and 2005–06 included the following performance indicator for Output 1.1.2 – International economic policy advice and assessment: *'timely and accurate financial transactions with international financial institutions are made with due regard to minimising cost and risk for Australia'*. This measure is appropriate because of the clear obligations that Australia has with international financial institutions and the Treasury's own processes for the management of these transactions.

2.15 In its 2004–05 annual report, it was noted that: '*Treasury continued to support the IMF's financial activities by participating in the Financial Transactions Plan, and conducting timely and accurate financial transactions'*[8]. Similar comments were included in the 2002–03 and 2003–04 reports.

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[5] ANAO, *Better Practice Guide: Better Practice in Annual Performance Reporting* (2004), p. 27.

[6] ibid, p. 13.

[7] ANAO, *Better Practice Guide: Performance Information in Portfolio Budget Statements* (2002), p. 21.

[8] Treasury Annual report 2004–05, p. 28

2.16 In relation to the development banks, there was a footnote that stated: *'By law, the Treasurer must report to Parliament on Australia's dealings with the IMF and the World Bank. That report, which is expected to also address Australia's relations with the Asian Development Bank, will contain information on the last two performance measures.'*[9] This report – *Australia and the International Financial Institutions, 2004–05* – provides information on Australia's transactions in 2004–05 with the IMF, the World Bank Group and the ADB.

2.17 The Treasury has reported on its performance against indicator 1.1.2. In addition, the Treasury included in its 2005–06 annual report (and it advised ANAO that it would also do so in subsequent annual reports):

- a summary statement of the transactions that took place with the IMF and the development banks; and
- commentary on its performance in making timely and accurate financial transactions in accordance with Australia's obligations. Where no transactions have occurred, this will be noted. Where action has also been taken to minimise the cost and risk to Australia, this will also be reported.

2.18 There is only a statutory requirement for reports to be presented to the Parliament in respect of Australia's dealings with the IMF and the World Bank. Until 2001–02, separate reports were presented to the Parliament on Australia's dealings with these institutions, as well as a separate report on Australia's dealings with the ADB, given the particular relevance of the operations of the ADB to Australia's involvement in the Asia-Pacific region. These reports were combined for the first time in 2002–03. This has improved the presentation of these reports. However, the reports to the Parliament do not include information on Australia's dealings with the EBRD (as with the ADB, there is no statutory requirement for the Treasury to do so). In this respect, the Treasury has advised ANAO that in future reports it will refer readers to its departmental annual report for information on Australia's dealings with the EBRD.

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[9] ibid.

3. Risk Management

This chapter examines the Treasury's risk management control framework, including its management of foreign exchange risk and its management of promissory notes.

Introduction

3.1 Australia's commitments to international financial institutions are entered into, and the investments are held for, policy purposes, rather than as an investment portfolio.

3.2 As a partly-paid shareholder in a number of these institutions, the greatest risk faced by Australia is that of institutional failure resulting in Australia and other shareholders being asked to pay for the uncalled portion of subscriptions in order to meet the borrowing obligations and guarantees of the institutions. In May 2002, in the context of the previous audit, the Treasury advised ANAO that it considered *'the risk of the contingent or at call liabilities being called as low and the risk of Australia being asked to repay IMF allocations of SDRs – which comprise the bulk of payable liabilities*[10] *– as low for the foreseeable future'*. The Treasury also advised that one of its roles in its management of this risk was its monitoring of the financial position of the international financial institutions.

3.3 The Treasury is also exposed to foreign exchange risk in relation to its investment in the IMF (which, as noted in Appendix 1, is revalued according to movements in exchange rates, with gains being paid to the Treasury and losses payable to the IMF) and to capital subscription and other payments to, and any receipts from, the various international financial institutions.

Control Environment

3.4 A robust control environment assists agencies to effectively manage risk. The existence of up-to-date policies and procedural documentation provides guidance on how best to manage and process transactions with the institutions. The previous audit report recommended that the Treasury adopt a

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[10] Budget Paper No.1 for 2006–07 stated (Statement 2: Fiscal Outlook; Appendix A: Reporting Standards) that: 'The Australian Accounting Standards (AAS) financial statements currently record IMF Special Drawing Rights (SDRs) as a liability. This is consistent with AAS. The Government Finance Statistics (GFS) statements also record SDRs as a liability. However, in accordance with the IMF's GFS manual, IMF SDRs are not treated as a liability in ABS GFS although the IMF treats them this way in some of its other documentation. As the statistical standard underpinning the GFS manual (the System of National Accounts 1993) is currently being updated and includes a proposal to treat SDRs as a liability, the current approach will remain in place at least until this update is finalised.'

more comprehensive framework of policies and procedures. This was to include:

- improvements to the Treasury's Chief Executive Instructions (CEIs); and
- more comprehensive staff guidelines on the management of the Treasury's international financial commitments, including the assessment and management of foreign exchange risk.

Manuals and Instructions

3.5 Two operational manuals have been produced – one for the IMF and the other for the multilateral development banks. These manuals are comprehensive and contain useful checklists for processing various transactions. There was evidence on the Treasury files that these checklists have been frequently used since the last audit and now appear to be standard practice.

3.6 This follow-up audit also found that the Treasury's CEIs now contain detailed instructions on the management of its international financial commitments. The audit identified some references to documents that had not been updated and the Treasury has now either updated these or is in the process of doing so.

Promissory Notes

3.7 Finance's requirements for the management of promissory notes are set out in Finance Circular No.2004/03 (copy at Appendix 2). These require agencies to:

- consider whether the instruments should be reported in the Statement of Risks in the Budget Papers;
- consider whether there is a need to update Budget estimates;
- consider whether notes are correctly incorporated into all relevant financial reports;
- control the issuance of instruments;
- maintain a register of all instruments;
- periodically review all instruments for their effectiveness;
- make the existence of the instrument known when required;

- produce the instrument in an accessible, usable and meaningful form for access by someone else as required;
- preserve the authenticity of the instrument over time;
- ensure that the instrument is not disposed of unlawfully;
- account for the management of the instrument while it is under their care;
- ensure adequate security and storage of the instrument; and
- control access.

3.8 Agencies are also required to ensure that each debt instrument is labelled with a unique number or title which identifies it. Additional information should also be recorded so that instruments can be located when there is a need to know about the matters documented within them.

3.9 The Treasury's procedures for the issue and control of promissory notes are set out in Section 3.2.5 of the CEIs. These refer to the requirements contained in Finance Circular No.2004/03.

3.10 Where a note is issued the Treasury:

- arranges for the Treasurer to sign and date the note;
- sends the note to the Reserve Bank for safe keeping and to record drawdowns against the note;
- arranges for the Reserve Bank to confirm drawdowns or reductions against promissory notes in accordance with the Treasury's instructions;
- arranges for the Reserve Bank to return all fully acquitted promissory notes for safe keeping in the Treasury; and
- keeps a copy of all fully acquitted notes on the relevant files (eg IMF files, relevant development bank file).

3.11 The promissory notes are reported in the Treasury's annual financial statements. The Treasury's management and control over the issue, storage and reporting of promissory notes have been satisfactory. However,

- while only one note has been issued since the date of Finance Circular No.2004/03, each promissory note did not have a unique number or title identifying it, as advocated by the Circular. In some cases, a promissory note can be identified by reference to its date of issue.

However, there have been instances – with the ADB in 1997, 1998, 1999, 2000 and 2001 and EBRD in 2000 – where more than one note is issued on a particular date. In these cases, the date and value of the note have to be used to identify it; and

- the Treasury's "register" of promissory notes consists of a spreadsheet that is updated for estimates and annual financial reporting purposes to show the values and estimated known drawdowns of the notes. The spreadsheet did not contain full details of all notes. For example, the register did not contain the dates of development bank notes. More complete information on IMF notes (dates of issue and drawdowns) that were outstanding as at April 2002 have been entered into the register. However, reasons for IMF drawdowns have to be obtained by reference to the Treasury's files.

3.12 The Treasury has advised ANAO that it will add an identifier to future promissory notes and that it has updated its financial manuals accordingly. Treasury has also revised its register of promissory notes to include the additional information on existing notes and to include the promissory note identifier that will be included on future notes. The ANAO considers that these changes satisfactorily address the issues that were identified.

Foreign Exchange Risk Management

3.13 An ANAO audit report tabled in May 2000[11] examined the foreign exchange risk management practices of four agencies with large foreign exchange payment exposures. Among other things, the audit report recommended that Finance, in consultation with relevant agencies and, as appropriate, the Government, develop an overarching Commonwealth position statement on foreign exchange risk management for agencies subject to the *Financial Management and Accountability Act 1997* (FMA Act).

3.14 In response to the 2000 audit report, the Government commissioned a Task Force on Commonwealth foreign exchange risk management practices. The Task Force reported to Government in July 2000. Following the report of the Task Force, further policy development was undertaken by Finance and the Treasury. On 28 May 2002, the Finance Minister announced the Revised Government Foreign Exchange Risk Management Policy. The Revised Policy is given effect by:

[11] ANAO Audit Report No.45 1999–2000 *Commonwealth Foreign Exchange Risk Management Practices*, Canberra, May 2000.

- the Government Decision announced by the Finance Minister on 28 May 2002;
- a Finance Circular issued on 26 June 2002 which described the major features of the Revised Policy; and
- *Guidelines for the Management of Foreign Exchange Risk* issued by Finance in November 2002, with the agreement of the Finance Minister. The Guidelines set out principles for foreign exchange risk management and the key features of the Government decision. They also incorporate principles-based guidance in relation to exposure management and controls and include prescriptive risk identification, measurement and reporting requirements.

3.15 Consistent with the Commonwealth's financial framework legislation, each entity captured by the Revised Policy is responsible for the management of its foreign exchange risks. Specifically, entities are expected to:

- implement foreign exchange risk management practices that are consistent with the Guidelines, including:
  - identifying the risk arising from foreign currency exchange expenditures;
  - considering and understanding the sensitivity of its foreign exchange exposures;
  - reporting exposures and transactions to Finance;
  - selecting the best value for money alternative when negotiating payment arrangements for contracts or supply agreements; and
  - maintaining sufficient documentation to provide evidence that foreign exchange risk has been managed in accordance with the guidelines and to support an effective audit trail;
- provide, in a timely manner, foreign exchange information and reports requested by Finance; and
- certify to Finance that proper risk management practices, consistent with the Policy, are in place.

3.16 In 2004–05, ANAO completed an audit that examined the overarching implementation of the Revised Policy by Finance and General Government Sector entities. As part of this audit, in July 2004, Finance advised ANAO that it was going to revise parts of its *Guidelines for the Management of Foreign*

Exchange Risk. In addition, Recommendation No.2 of that audit (to which Finance agreed) was that Finance amend *'the Guidelines to achieve consistency with the Government decision, as to whether FMA Act agencies are able to obtain a general exemption from the hedging prohibition under the Revised Policy'*[12]. The November 2002 Guidelines were revised and reissued in September 2006 in the light of revised reporting requirements and experience gained since the introduction of the Policy. The revised reporting requirements apply from 1 July 2006. The major change is to advise General Government Sector entities on the process for applying to opt out of reporting obligations under the Policy.[13]

Implementation by the Treasury

3.17 In February 2006 the Treasury published *A Corporate Policy and Framework for Managing Risk*. This policy was later publicised to staff in Staff Notice 2006/62.

3.18 For most of the Treasury's financial commitments, the Treasury has little, if any, flexibility about the timing of its payments and how these might be arranged to minimise cost or risk to Australia.

3.19 With a favourable movement in the exchange rate between the Australian dollar and the Special Drawing Right (SDR) and major currencies since 2002, maintenance of value and other adjustments have generally been in Australia's favour. Favourable world economic conditions over this time have also resulted in fewer calls for assistance under the IMF's Financial Transactions Plan. Indeed there have been a large number of repayments of previously provided assistance.

3.20 Since the previous audit, there have been no decisions to take up additional capital subscriptions in any of the international financial institutions. Should this occur in the future, the Treasury would need to make an assessment of the various risks and, where choices of currency exist, select the best value for money option. While hedging is not permitted under the Finance Guidelines, the assessment would need to consider such things as the timing of payments and, where relevant, the currency in which any cash transactions or promissory notes should be denominated.

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12 ANAO Report No.11 2004–05, *Commonwealth Entities' Foreign Exchange Risk Management*, p. 19.

13 For Treasury, the process would involve advising the Treasurer and the Treasury Secretary obtaining the written agreement of the Secretary of Finance that the Treasury has a 'strong case that their exposures are not a material risk to the agency or the budget.'

3.21 Foreign exchange gains or losses on Australia's investments in international financial institutions are reported in the Schedule of Administered Items in its financial statements and in notes to the accounts. Impairment tests are also applied to the valuations of each financial institution in the preparation of the financial statements.

3.22 The Treasury's procedures for the processing of foreign exchange transactions comply with the requirements in Finance Circular No.2002/01. However, in its reporting to Finance on its foreign exchange exposure, the Treasury advised Finance that it did not have any exposure to foreign exchange movements (that is, expenditure or revenue is denominated in a currency other than Australian dollars) because:

- its foreign exchange gains or losses are principally based on revaluation of its assets and liabilities at year end;
- the IMF maintenance of value adjustment to maintain the value of Australia's quota in terms of the SDR is calculated annually by the IMF as at 30 April; and
- gains or losses on EBRD encashments of euro-based promissory notes are minor and the required funds are drawn down at the time of payment.

3.23 The previous report noted that the major financial risk faced by the Treasury in its administration of commitments to international financial institutions is foreign exchange risk. For example:

- IMF maintenance of value adjustments vary significantly. As noted in Table 3.1, over the four years from 2002–03 to 2004–05, they ranged from a payment to the IMF of A$27 million to a payment by the IMF to Australia of A$355 million; and
- the foreign exchange loss on the value of the EBRD related promissory notes remaining at 30 June 2006 compared to their balance sheet value was about A$82 000.

Table 3.1 Maintenance of Value Transactions, 2002–03 to 2005–06

Year	Amount in A$
2002–03	228 287 631
2003–04	355 413 860
2004–05	152 522 929
2005–06	- 27 082 032
Total	**709 142 388**

Source: ANAO analysis of the Treasury records.

3.24 Treasury has drawn Finance's attention to the fact that IMF maintenance of value and EBRD related promissory note adjustments are needed. However, since the IMF maintenance of value adjustments and EBRD encashments of promissory notes do involve exposure to foreign exchange movements, the Treasury should be advising that it does have a foreign exchange risk exposure and be providing estimates of these exposures to Finance, rather than providing nil returns.

3.25 The Department of Finance and Administration advised ANAO in December 2006 that, in its view:

> Treasury should report whatever its annual foreign exchange exposure is. We note that Treasury has not applied to opt out of the foreign exchange reporting obligations, and has indicated that it did not intend to. We will work with Treasury on a modified form of input that is appropriate to Treasury's foreign exchange exposures.

Recommendation No.1

3.26 ANAO *recommends* that the Department of the Treasury, in its annual reporting to the Department of Finance and Administration of its foreign exchange exposures, required by the Government's Foreign Exchange Risk Management Policy, identify and report the necessary data on all exposures to exchange rate movements.

3.27 Treasury agreed to the recommendation. It commented as follows:

> The Treasury notes that the ANAO found that foreign exchange gains or losses on Australia's investments in the international financial institutions are reported in its financial statements and that Treasury's procedures for the processing of foreign exchange transactions comply with the Department of Finance and Administration (Finance) requirements.

The Treasury currently provides a range of information to Finance for the purpose of complying with the Government's Revised Foreign Exchange Risk Management Policy. The Treasury and Finance have agreed to work together to determine if there is a need for Treasury to amend its current reporting practices to meet the objectives of the Government's policy. If it is determined that changes are necessary, then the Treasury will introduce those changes.

Ian McPhee
Auditor-General

Canberra ACT
23 January 2007

Appendices

Appendix 1 International Financial Institutions

This appendix provides background information on the international financial institutions and on the international financial commitments administered by the Treasury.

Introduction

1. The Treasurer is Australia's Governor to the International Monetary Fund (IMF), the World Bank Group, the Asian Development Bank (ADB) and the European Bank for Reconstruction and Development (EBRD).

2. The Treasury:

- provides advice and support to the Treasurer in his role as Australia's Governor to these institutions; and
- manages Australia's financial transactions with the IMF, the International Bank for Reconstruction and Development, Multilateral Investment Guarantee Agency, the ADB and the EBRD[14].

3. In addition to a board of governors, each development bank and the IMF has a board of executive directors to whom the board of governors has delegated oversight of the organisation's day-to-day operations. The Treasury prepares briefings for Australia's representatives at the various international financial institutions and the Treasury officials also attend meetings of the various institutions.

The International Monetary Fund

4. The IMF is an organisation of 184 member countries established by the Bretton Woods Conference in 1944 to:

- promote international monetary cooperation and exchange rate stability;
- foster economic and employment growth; and
- provide temporary financial assistance to countries under adequate safeguards to help ease balance of payments adjustment.

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[14] Australia's financial contributions to the concessional lending arms of the World Bank and ADB (International Development Association and the Asian Development Fund respectively) are administered by AusAID.

5. Australia became a member of the IMF on 5 August 1947 and is currently the 15th largest member with 1.48 per cent of the voting power. [15]

6. All member countries are required to pay a capital subscription – called a 'quota' – to join the IMF. The size of a member's quota determines its voting rights[16], the amount of balance of payments assistance that a member can normally obtain from the IMF and allocation of Special Drawing Rights or SDRs[17].

7. Quota increases usually arise from a General Review of Quotas, which occur at least every five years. However, on 18 September 2006, the IMF Board of Governors adopted a Resolution on Quota and Voice Reform which included an immediate ad hoc increase for a group of the most underrepresented countries – China, Korea, Mexico and Turkey. The Resolution also requests that, by the Annual Meetings in 2007, the IMF Executive Board reach agreement on a new formula to guide the assessment of the adequacy of members' quotas in the IMF. Such a formula should provide a simpler and more transparent means of capturing members' relative positions in the world economy. The new quota formula will provide a basis for a further rebalancing of quotas to be recommended to the Board of Governors by the Annual Meetings in 2007 and no later than by the Annual Meetings in 2008.[18]

8. Australia's quota is SDR3 236.4 million, part of which is held in reserves by the IMF and part in promissory notes and cash at the Reserve Bank

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[15] <http://www.imf.org/external/np/sec/memdir/members.htm>.

[16] Each member has 250 basic votes, plus one additional vote, for each SDR100 000 of quota.

[17] The SDR is an international reserve asset (similar to a currency), created by the IMF to supplement the existing reserve assets of member countries. They are allocated to member countries in proportion to their quotas. Its value is based on a basket of four key international currencies (US dollar, euro, Japanese yen and pound sterling). As of the last revision on 1 January 2006, the currency weights in the SDR were 44 per cent US dollars, 34 per cent Euros, 11 per cent Japanese Yen and 11 per cent Pounds Sterling (see IMF press release No.05/265 of 2 December 2005).

[18] See IMF Press Release No 06/205 of 18 September 2006: <http://www.imf.org/external/np/sec/pr/2006/pr06205.htm>.

of Australia[19]. As of 30 June 2006, the value of Australia's quota with the IMF was A$6 388 million[20].

9. The IMF allocates SDRs to member countries in proportion to their quotas to meet global liquidity requirements. Australia's current allocation is SDR470.545 million (valued at A$928.83 million as at 30 June 2006[21]). Each country may choose to hold more or fewer of its net SDR cumulative allocations. Australia's SDRs were on-sold to the Reserve Bank of Australia and the RBA held SDR135 million as at 30 June 2006.

10. The main transactions with the IMF comprise:

- *Maintenance of Value* (MoV) adjustments – to maintain the value of a member's quota with the IMF in terms of SDRs. This is needed because a part of a country's quota is held by the member country in its own currency, the value of which against the SDR changes during the course of a year. This adjustment is determined after the close of the IMF's financial year on 30 April. Where there is a shortfall, a member is required to increase the value of its currency holdings and where there is a surplus, the IMF refunds the relevant amounts.[22]
- *Remuneration* – A return (equal to the SDR daily interest rate, adjusted for burden sharing[23], but paid quarterly) on a member's reserve tranche position in the IMF (except for a small portion that is provided to the IMF as an interest-free resource). A member has a remunerated reserve

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[19] Three accounts are held at the RBA and are denominated in A$:
No 1 Account – For transactions in A$ between the Fund and Fund members. A minimum account balance of 0.25 per cent of Australia's quota (SDR8.091 million) is required.
No 2 Account – Small balance predominantly used for making small, miscellaneous administrative payments/receipts to and from the Fund.
Securities Account – Made up entirely of promissory notes.

[20] Treasury Annual Report 2005–06, p. 208. The quota is classified as a financial asset under Investments and is valued at the balance date using the RBA mid exchange rate on that date (Note 24 to the 2004–05 financial statements). Adjustments are reflected as a foreign exchange gain or loss in the Schedule of Administered Expenses (Note 23 to the 2004–05 statements).

[21] The Quota Allocation is shown under 'Other payables' in the Schedule of Administered Items Note 25 in Treasury's 2005–06 financial statements and is valued at the exchange rate applying at balance date. It represents the current value of Australia's liability to repay to the IMF Australia's cumulative allocation of SDRs.

[22] MoV adjustments are reflected in the schedule of administered expenses as foreign exchange losses or gains – Note 23 to the 2005–06 financial statements.

[23] The burden sharing mechanism is a mechanism for sharing between members the financial consequences of overdue obligations. The rate of charge is adjusted upwards and the rate of remuneration is adjusted downward to cover the loss of income due to overdue charges. The rate of charge and remuneration are also adjusted to finance allocations to the Special Contingent Account, established to strengthen the Fund's financial position in light of protracted overdue obligations. Adjustments are refundable when overdue members settle their arrears.

tranche position when the IMF's holdings of the member's currency are below the *norm for remuneration position*. A member's norm is the total of 75 per cent of its quota before the Second Amendment of the Articles (1 April 1978), plus the amounts of any subsequent quota increase[24]. In 2004–05, Australia received remuneration (net of burden sharing) of SDR18.7 million or A$37 million[25]. For 2005–06 it was A$23 million[26].

- *SDR Charges* – Charges levied in accordance with country's net cumulative SDR allocations. Charges are calculated at the same rate and in the same way as interest or remuneration on SDR holdings.
- *Annual Assessment Charge* – A charge to cover expenses of the IMF's SDR Department. The expenses are divided among the participants in proportion to their net cumulative allocations and are expressed in the form of a percentage. It is charged to member countries' accounts at the end of the IMF financial year (30th April).
- *IMF Financial Transactions Plan (FTP) Transfers and Receipts* – Transfers and receipts associated with the IMF's lending program, which is managed through the FTP. The IMF selects those members' currencies that are to be used in the FTP and allocates the financing of those transactions against the countries specified in the FTP. Only countries with a sufficiently strong balance of payments position are selected to participate in the FTP. Where Australia finances an IMF loan, its reserve position held with the IMF will increase and when loans are repaid and the funds are repaid, the reserves held with the IMF will decrease.

11. The various transactions with the IMF are summarised in Figure A1.1.

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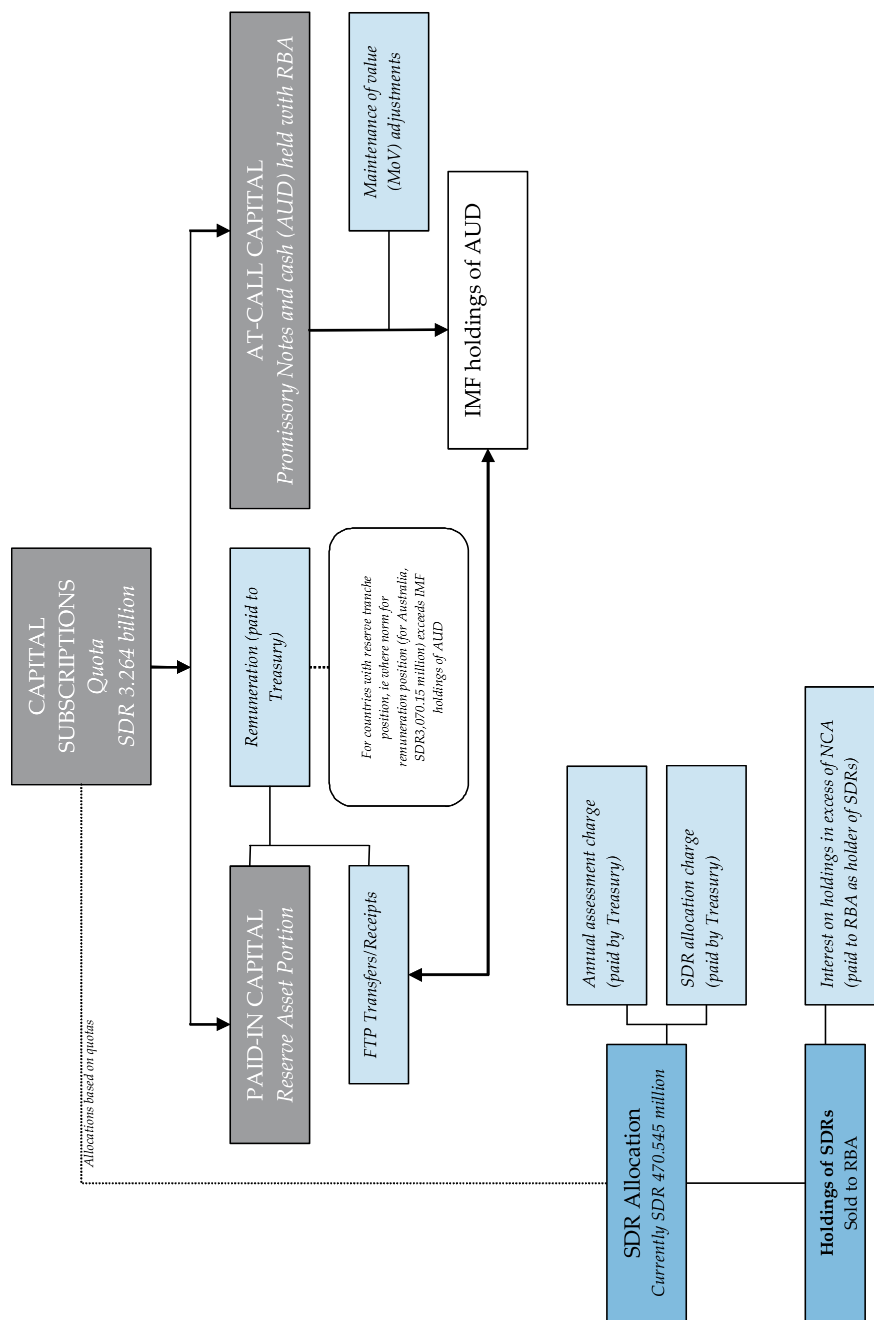
[24] For countries that became members after 1 April 1978, the norm is the weighted average of the norms applicable to all other members on the date that the member joined the IMF, plus any increase in quota after that date.

[25] *Australia and the International Financial Institutions 2004–05*, Annual Report to the Parliament, pp. 12-13 and Note 22 to the 2004–05 financial statements.

[26] Treasury Annual Report 2005–06, Note 22, p. 206.

Figure A1.1 Summary of Transactions with the IMF



Source: ANAO analysis of Treasury and IMF explanatory material.

12. The IMF has in place two sets of arrangements to enable it to borrow to supplement its resources and help finance drawings by members in a situation where such financing would forestall or cope with an impairment in the international monetary system. These arrangements are:

- the General Arrangements to Borrow (GAB) – these enable the IMF to borrow specified amounts of currencies from 11 major industrialised countries, under certain circumstances at market-related rates of interest. Australia is not one of these countries[27]; and
- the New Arrangements to Borrow (NAB) – these enable the IMF to borrow from 26 members and institutions. Australia is one of these countries. The NAB would typically be the first and principal recourse to borrowing in the event of a need to provide supplementary funding.[28]

13. Australia also provides support to the IMF to enable it to provide concessional financing to eligible low-income countries undertaking three-year comprehensive macroeconomic and structural adjustment programs under its Poverty Reduction and Growth Facility (PRGF). In February 1994, Australia agreed to provide A$30 million to the Facility's Interest Subsidy Account[29] in 12 equal instalments of A$2.5 million beginning in 1997–98 and ending in 2008–09. These payments are made through annual appropriations. As at 30 June 2006, the outstanding liability under the PRGF was A$7.5 million[30].

14. IMF appropriations used in the reporting period are shown in Table A1.1.

15. Because of the appreciating Australian dollar, the IMF made payments to Australia for MoV transactions in the IMF financial years[31] from 2002–03 to 2004–05. For 2005–06, however, an amount of A$27 082 032 is payable to the Fund. These adjustments are shown in Table 3.1.

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[27] The GAB was last reviewed by the IMF in November 2002 and renewed for a period of five years from November 2003.

[28] The NAB was renewed for a period of 5 years from November 2003. Further details are at: <http://www.imf.org/external/np/exr/facts/gabnab.htm>.

[29] The Facility at that time was known as the Enhanced Structural Adjustment Facility.

[30] Note 25 to the Treasury's 2005–06 financial statements, p. 209.

[31] The IMF financial year is from 1 May to 30 April.

Table A1.1 IMF – Appropriations Drawings

Appropriation Drawings	2002–03 $A	2003–04 $A	2004–05 $A	2005–06 $A
International Monetary Agreements Act (Sections 8, 8A, 8B, 8C)				
Encashment of promissory notes				
MoV encashments	196 647 321	221 333 561	-	-
FTP encashments	617 844 121	-	-	-
Charges	22 695 268	15 215 355	19 489 312	26 628 555
Total IMAA	*837 186 710*	*236 548 916*	*19 489 312*	*26 628 555*
Appropriation Act No.2, Non-operating administered appropriation				
Poverty Reduction and Growth Facility	2 500 000	2 500 000	2 500 000	2 500 000
Total annual appropriations	*2 500 000*	*2 500 000*	*2 500 000*	*2 500 000*
Total appropriations	**839 686 710**	**239 048 916**	**21 989 312**	**29 128 555**

Source: ANAO analysis of the Treasury records.

Development Banks

16. Multilateral development banks are international financial entities that finance economic and social development projects and programs in developing countries. Development bank operations are financed through retained earnings, paid-in capital from members and funds borrowed from capital markets using members' paid-in and callable capital as backing. The use of members' capital obligations as backing enables the banks to obtain very favourable financing terms when borrowing from world capital markets. Table 1.1 summarises Australia's shareholdings in the various development banks as at 30 June 2006.

17. Appropriations drawn from 2002–03 to 2005–06 for payments to the multilateral development banks are shown in Table A1.2.

Table A1.2 Multilateral Development Banks – Appropriations Used 2002–03 to 2005–06

		Total
Special Appropriations		
	Asian Development Bank (Additional Subscription) Act 1995	13 967 318
Annual Appropriations		
	European Bank for Reconstruction and Development	16 579 902
TOTAL PAYMENTS FROM APPROPRIATIONS		**30 547 221**

Source: ANAO analysis of the Treasury records.

The World Bank Group

18. The World Bank was established in the mid-1940s to provide long-term investment for the reconstruction and development of members. The World Bank Group comprises:

- the International Bank for Reconstruction and Development;
- the International Development Association; and
- three affiliates:
  - the International Finance Corporation;
  - the Multilateral Investment Guarantee Agency; and
  - the International Centre for Settlement and Investment Disputes.

The International Bank for Reconstruction and Development or IBRD (The World Bank)

19. The IBRD was established in the mid-1940s. It provides loans, related hedging products and guarantees to its borrowing member countries to help meet their development needs. It also provides technical assistance and other services to support poverty reduction in these countries. Voting power is linked to members' capital subscriptions, allocated to reflect each member's quota in the IMF.

20. Australia has been a member of the IBRD since 1947. As at 30 June 2006, Australia held 24 464 shares in the IBRD, valued at $US2.95 billion (A$3.98 billion). The Treasury has paid for some 6 per cent of the value of the shares ($US182 million / A$259 million), with the remainder ($US2.8 billion / A$3.7 billion[32]) at call. Australia is

[32] Based on 30 June 2006 exchange rate of A$1=US$0.7433.

the 17th largest of the 184 shareholders in the IBRD, holding 1.56 per cent of the shares on issue with a voting power of 1.53[33]. There is one outstanding promissory note for the IBRD for US$42.554 million. This was issued in October 1991 for a maintenance of value liability.

The International Development Association (IDA)

21. The IDA provides highly concessional funding to the world's poorest countries to help country-led poverty reduction strategies in key policy areas. Australia's contributions to the IDA are administered by AusAID and are therefore outside the scope of this audit. They were, however, examined by ANAO in ANAO's 2000 audit of foreign exchange risk management practices.

International Finance Corporation (IFC)

22. Established in 1956, the IFC aims to promote growth in the developing world by financing private sector investments and providing technical assistance to governments and the private sector. In partnership with private investors, the IFC provides both loan and equity finance for business ventures in developing countries.

23. Australia was a founding member of the IFC and subscribed to an additional allocation of 20 578 shares from the 1991 General Capital Increase (GCI). As of 30 June 2006, Australia held 47 329 shares (2.0 per cent of the IFC's capital stock) valued at $US47.329 million (A$69.14 million) which have been fully paid for[34]. This shareholding makes Australia the 12th largest of the 178 shareholders in the IFC[35].

Multilateral Investment Guarantee Agency (MIGA)

24. MIGA was established in 1988. It aims to help encourage foreign investment in developing countries by providing guarantees to foreign investors against loss caused by non-commercial risks such as wars and instability. Australia applied to join MIGA in 1995 and became a member on 10 February 1999 by subscribing to 1 713 shares. It subscribed to a further 1 306 shares under the 1998 GCI. It is the 14th largest of the 168 shareholders[36]. It now holds 3 019 shares (1.7 per cent of MIGA's capital stock), of

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33 *The World Bank Annual Report 2006*, IBRD Financial Statements – Statement of Subscriptions to Capital Stock and Voting Power, p. 57.

34 The final payment was made in the 1999–2000 financial year.

35 International Finance Corporation, 2006 Annual Report, Statement of Capital Stock and Voting Power, p. 40.

36 See Multilateral Investment Guarantee Agency Annual Report 2006, p. 87 and press release <http://www.miga.org?index.cfm?aid=526>.

which 573 are paid-in shares (US$6.2 million or A$10.7 million)[37] and 2 446 (A$35.6 million[38]) are at-call.

25. The final instalment of Australia's commitments under the 1998 GCI was paid in March 2002 and no further payments are required under the 1998 GCI[39]. There was one outstanding promissory note, issued in January 1999. This obligation would be cashed only in the event that all subscribed capital of the Bank had been called.

The Heavily Indebted Poor Countries (HIPC) Initiative

26. The HIPC Initiative was introduced by the IMF and World Bank in 1996. It involves a package of measures designed to ensure that economic reform in a number of highly indebted countries, mostly in Africa, is not put at risk by crippling debt and debt service obligations. It provides multilateral debt relief to the world's poorest and most heavily indebted countries. In the 2005–06 Budget, the Government provided an additional A$34.8 million to the HIPC Initiative (bringing the total contribution to A$112 million). This assistance was provided through AusAID, and is therefore outside the scope of this audit.

Multilateral Debt Relief Initiative (MDRI)

27. On 11 June 2005, the G8 Finance Ministers announced a proposal to provide HIPCs with 100 per cent cancellation of their outstanding obligations with the IMF, the IDA and the African Development Fund[40]. The Initiative asks donor countries to increase their contributions to the World Bank and the African Development Bank to enable debts to be written off where a country has successfully demonstrated that it is pursuing a poverty reduction strategy, has implemented economic reforms and is maintaining economic stability. Australia has contributed A$136.2 million to the MDRI[41]. This is in addition to the A$122 million provided through the HIPC Initiative. Like the HIPC Initiative, the assistance is being provided through AusAID, and is therefore outside the scope of this audit.

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[37] Treasury revalued the MIGA shares in its 2002–03 financial statements following Audit Report No 10 from A$10.818 million to A$10.694 million. This revised valuation reflected the rates of exchange applying at the dates of payments of the subscriptions, rather than the exchange rate that applied at the time of the initial subscription.

[38] Based on 30 June 2006 exchange rate of A$1=US$0.7433.

[39] ibid, footnote 1.

[40] G8 Finance Ministers' Conclusions on Development, London, 10-11 June 2005, <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTDEBTDEPT/0,,contentMDK:20634752~pagePK:64166689~piPK:64166646~theSitePK:469043,00.html>.

[41] See 2006-07 Budget Paper No.2, *Budget Measures 2006–07*, p. 232 and <http://www.treasurer.gov.au/tsr/content/pressreleases/2006/099.asp>.

Asian Development Bank (ADB)

28. The ADB was established in 1966 to assist the economic and social development of countries in the Asia-Pacific region. To achieve this goal, it provides financial and technical assistance for projects and programs. The ADB's financial assistance includes loans, equity investments and guarantees. It finances these types of operations through borrowings, paid-in capital and retained earnings. Australia has been a member of the ADB since it was established.

29. Australia is the fifth largest shareholder in the ADB, with 204 740 shares held as at 30 June 2006, valued at $US2.6 billion (A$3.6 billion), of which $US194 million (A$287 million) is paid-in capital and $US2.45 billion (A$3.3 billion[42]) is at call.

30. The most recent GCI – the fourth, known as GCI IV – was ratified by the ADB Board of Governors in Resolution No.232 on 22 May 1994. In this subscription, Australia subscribed to an additional 102 370 shares at a price of US$12 063.50 per share, totalling US$1.235 billion. Of these shares 2 047 (US$24.7 million) – 2 per cent – are paid-in and the remaining 100 323 (US$1.210 billion) are callable. Authority for this subscription was given in 1995 with the passage of the *Asian Development Bank (Additional Subscription) Act 1995* and the signing by Australia's then Governor of the Bank of the *Instrument of Subscription, Representation and Undertaking* for GCI IV.

31. Australia chose to pay for its subscription in GCI IV in six equal annual instalments – consisting of cash payments (15 per cent) and convertible currency promissory notes (25 per cent) and national currency promissory notes (60 per cent). These payments were made through the special appropriation contained in the *Asian Development Bank (Additional Subscription) Act 1995*. Both the convertible and national currency promissory notes were issued annually from 1995–96 to 2000–01[43]. The convertible currency promissory notes were cashed between 1996–97 and 2001–02. The six national currency promissory notes were cashed in five equal instalments of A$4 655 772.73, beginning in June 2001 and ending in June 2005. This was in line with a revised encashment program for the national currency promissory notes for Australia and other regional and non-regional members that was approved by the ADB Board of Directors on 27 September 2000. Australia has now completed payment of all called GCI IV shares.

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42 Based on 30 June 2006 exchange rate of A$1=US$0.7433.

43 In March 1996, the first convertible currency and national currency promissory notes were reduced by A$34 026.25 and A$81 663.01 respectively because of overpayments resulting from use of an incorrect exchange rate. There was also a refund of A$20 415.75 in respect of the cash contribution for the same reason.

European Bank for Reconstruction and Development (EBRD)

32. The EBRD was established in 1991 to assist the countries of central and eastern Europe in the transition to market economies by investing in projects in both the private and public sectors. Australia has been a member of the EBRD since it was established and is the 22nd largest of the 62 shareholders[44].

33. On 15 April 1996, the Board of Governors of the EBRD approved a general increase in the authorised capital stock of the Bank and allocated 10 000 additional shares to Australia at a price of €10 000 per share totalling €100 million. Of the total, 2 250 shares (€22.5 million or A$37.181 million) are paid-in and the remaining 7 750 (€77.5 million) are callable. Australia initially did not subscribe to this GCI, but did agree to do so in the 2000–01 Budget[45]. Australia is paying for these shares over a nine year period from 2000–01 to 2008–09. The first of these payments encompassed 'catch-up' payments for 1997–98, 1998–99 and 1999–2000.

34. As of 30 June 2006, Australia's capital contributions to the EBRD totalled A$327 million, of which A$84.8 million (5 250 shares) comprised called capital and A$242.6 million uncalled capital (14 750 shares).

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[44] From <http://www.ebrd.com/about/basics/members.htm>.

[45] 2001–02 Budget, Budget Paper No.2, pp. 187-88.

Appendix 2 Finance Circular No.2004/03: Promissory Notes, Bills of Exchange, Commercial Bills and Other Securities of a Similar Nature

Australian Government
Department of Finance and Administration

Finance Circular No.2004/03

To all Agencies under the *Financial Management and Accountability Act 1997*

Promissory Notes, Bills of Exchange, Commercial Bills and Other Securities of a Similar Nature

Purpose

To advise Financial Management and Accountability Act 1997 (FMA Act) agencies of government policy in relation to promissory notes, bills of exchange, commercial bills and other securities of a similar nature.

Key points

1. Promissory notes, bills of exchange, commercial bills and other securities of a similar nature affect the indebtedness of the Australian Government.

2. Under the Administrative Arrangements Order, the Department of the Treasury has responsibility for borrowing money on the public credit of the Commonwealth and has in place standard debt issuance arrangements.

3. Accordingly, agencies should not use promissory notes, bills of exchange, commercial bills and other securities of a similar nature unless specifically provided for under legislation or authorised by the Minister for Finance and

Administration. Finance Leases are not covered by this Circular. These types of debt instruments are defined in Attachment A.

4. In the main there will be few agencies with outstanding debt instruments in the nature of those mentioned above. It would be expected that, in the future, they would generally only be issued by a few agencies that have specific statutory authority. Where agencies issue these instruments, agencies should comply with the issuance and management requirements set out in Attachment B.

5. In considering what statutory authorities may exist, agencies should bear in mind that the Finance Minister has delegated investment powers to certain Chief Executives pursuant to section 39 of the FMA Act. These investment powers allow those Chief Executives to invest amounts from specific Special Accounts in accordance with the authorised investments detailed in section 39(10) of the FMA Act. These investments include certain government securities and bills of exchange.

Contacts

6. If you have any queries, please contact the Foreign Exchange Team at finframework@finance.gov.au.

Michael Culhane
Branch Manager
Finance and Banking Branch
Financial Management Group
30 April 2004

Attachment A

Definitions

Promissory notes are defined under section 89 of the *Bills of Exchange Act 1909* as 'an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money, to the order of a specified person, or bearer'.

Bills of exchange are defined under section 8(1) of the *Bills of Exchange Act 1909* as 'an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money or to the order of a specified person, or to bearer'.

Commercial bills are bills of exchange (defined above) which are issued specifically by merchant banks or large corporations.

Securities are documentary evidence of ownership of financial assets (i.e. equity) or an acknowledgement of debt for repayment at some time in the future. Examples of equity securities include ordinary shares, preferred ordinary shares and trust units. Examples of debt securities include bonds, floating rate notes, commercial bills and promissory notes. Securities can have characteristics of both equity and debt. A comprehensive legal description of securities is provided under section 92 of the *Corporations Act 2001*.

Finance Lease means a lease under which all the risks and benefits incidental to ownership of property are transferred to the lessee. The lessee's obligation to make payments under the lease arrangement continues even if the property is lost, destroyed or disposed of. Legal ownership of the asset may or may not eventually be transferred to the lessee at the end of the lease.

Requirements for Issuance and Management of Debt Instruments

Agencies are required to:

- consider whether the instruments should be reported in the Statement of Risks in the Budget Papers;
- consider whether there is a need to update Budget estimates;
- consider whether notes are correctly incorporated into all relevant financial reports;
- control the issuance of instruments;
- maintain a register of all instruments;
- periodically review all instruments for their effectiveness;
- make the existence of the instrument known when required;
- produce the instrument in an accessible, usable and meaningful form for access by someone else as required;
- preserve the authenticity of the instrument over time;
- ensure that the instrument is not disposed of unlawfully[46];
- account for the management of the instrument while it is under their care;
- ensure adequate security and storage of the instrument; and
- control access.

Agencies may wish to review the information produced by the National Archives of Australia relating to Commonwealth Record keeping – Custody. This information can be viewed online at: http://www.naa.gov.au/recordkeeping/custody/summary.html.

Control and Retrieval

Agencies should ensure that each debt instrument is labelled with a unique number or title which identifies it. Additional information should also be recorded so that instruments can be located when there is a need to know about the matters documented within them. This additional information is termed "metadata" and agencies are urged to review the publication produced by the National Archives of Australia entitled

[46] The vast majority of Commonwealth records are temporary in nature. Although they have value to the Australian community, to the individuals and organisations who do business with the Commonwealth, and to Commonwealth agencies themselves, this value only lasts for a finite period of time. *Temporary records* need to be kept for certain minimum periods and the ***Archives Act 1983*** or other Commonwealth legislation controls their eventual destruction.

Recording Metadata Standard for Commonwealth Agencies (1999). This publication can be viewed online at:
http://www.naa.gov.au/recordkeeping/control/rkms/summary.htm.

This information should be maintained in a register of all debt instruments to assist in transparent reporting and disclosure. The register should contain the details of the instruments including their status and the scope and nature of the risks involved. Prudent and efficient management clearly dictates the need to maintain such registers in order to provide the information required for the purposes of audit and financial reporting.

Agencies should put in place procedures to ensure that all such instruments are captured by the register.

Disposal

Agencies should regularly review their register of debt instruments to determine whether an instrument can be destroyed or should continue to be maintained. The register of debt instruments should also contain a sentencing category which determines the useful life of the instrument (eg. one year, indefinite etc.). The register should also discuss how the documents will be disposed of. The National Archives has produced an Administrative Functions Disposal Authority which is available from their website at
http://www.naa.gov.au/recordkeeping/disposal/authorities/gda/afda/pdf/establishment.pdf. The Administrative Functions Disposal Authority authorises the disposal of records of administrative functions commonly performed by most Commonwealth agencies.

Security and Storage

An integral part of sound risk management is maintaining adequate physical security of these instruments and associated documents. This will assist in enhancing agencies' records management procedures. Agencies must also ensure adequate physical security of instrument stationery.

Loss, misplacement or destruction of these instruments, or the debt instrument stationery, is likely to place the Commonwealth at a disadvantage, and increase the level of risk.

Agencies should ensure that instruments which may be called upon in the future for evidentiary purposes should be accorded special attention to ensure their continued visibility and accessibility.

In ensuring adequate physical security of relevant documents, both electronic and paper, agencies should consider:

- the long term and/or indefinite nature of some of the obligations; and
- the use of special security storage, such as the Commonwealth Security System provided by the Attorney-General's Department for valuable, long term or otherwise significant instruments.

For the preservation of any debt instrument, agencies should have regard to the Guidelines for Implementing the Standard for the Physical Storage of Commonwealth Records (http://www.naa.gov.au/recordkeeping/storage/standard.html) which is produced by the National Archives of Australia.

Access

Agencies should ensure that only appropriate staff have access to debt instruments. The register should list the relevant staff within the agency who may access these documents. Agencies should also be aware of their obligations under the *Freedom of Information Act 1982* and the *Archives Act 1983* which both give the public a statutory right to access records.

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