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Audit Report No. 14, 1999-2000

Commonwealth Debt Management

Introduction

3.1 Since Federation, the Commonwealth has issued a wide range of debt instruments to finance its expenditure programs. To ensure effective separation between monetary policy and debt management, the Commonwealth fully funds its budget deficits by borrowing from the short-term money market and the fixed interest market.[1]

3.2 At 30 June 1999 the Commonwealth had an $85.5 billion repayment liability with a market value of $93.9 billion. The Department of the Treasury (Treasury) uses the domestic market as its primary funding source and has not issued physical debt securities in offshore markets since 1987.[2]

3.3 The Commonwealth is also an active participant in the over-the-counter derivatives market, entering into interest rate and cross-currency swaps to manage the cost and risk of the Commonwealth debt portfolio by adjusting the duration and currency exposure of the portfolio. The annual swaps strategy, which is part of the overall debt management strategy, is endorsed by the Treasurer as part of the Budget process.[3]

3.4 Until 30 June 1999, Treasury advised the Treasurer on all aspects of Commonwealth debt management. A specialist agency, the Australian

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1 *Audit Report No. 14, 1999-2000*, pp. 27, 35.
2 *Audit Report No. 14, 1999-2000*, pp. 27, 36.
3 *Audit Report No. 14, 1999-2000*, p. 27.

Office of Financial Management (AOFM), assumed responsibility for Commonwealth debt management on 1 July 1999. AOFM is an advisory board whose reporting line is through the Secretary to the Treasury and the Treasurer.[4]

3.5 The ANAO's aim in conducting the audit was to provide enhanced assurance to Parliament about the management of the debt portfolio and to identify opportunities for improvement. The audit found that Treasury's debt issuance programs had met Budget funding requirements and domestic debt management had been effectively undertaken. However, the audit found that the Commonwealth was exposed to a number of significant risks in its debt management operations.[5]

3.6 The ANAO made six recommendations, all of which were agreed to by the AOFM. Treasury endorsed the AOFM's comments on the report and responses to the recommendations.[6]

3.7 The Committee invited the AOFM and the Reserve Bank of Australia (RBA) to a public hearing on 16 May 2000 to examine a number of issues raised in the audit report.

3.8 In the course of the public hearing, the Joint Committee of Public Accounts and Audit (JCPAA) took evidence on the following:

- AOFM resourcing;
- debt portfolio benchmark;
- foreign currency exposures;
- derivatives and risk management, and
- cash management framework.

AOFM resourcing

3.9 The funding provided in the 1999-2000 Budget allowed for staffing and resources additional to those of Treasury's Debt Management Office which the AOFM replaced.[7] The JCPAA sought information from the AOFM on whether it had the resources to take on personnel with the necessary high level commercial skills.

4 *Audit Report No. 14, 1999-2000*, p. 10; *Transcript, 16 May 2000*, p. 15.
5 *Audit Report No. 14, 1999-2000*, p. 11.
6 *Audit Report No. 14, 1999-2000*, p. 21.
7 *Audit Report No. 14, 1999-2000*, p. 30.

3.10 The AOFM's new CEO responded that his appointment highlighted the move by Treasury to be able to introduce new skills into the office, and to improve and obtain skills to manage the debt portfolio consistent with commercial best practice. The CEO stated that:

> … addressing our need to be able to introduce new commercial skills to our organisation, in line with the development of our business and of our strategic debt management plans …[was] certainly a major emphasis of the brief I have joined the organisation with.[8]

3.11 In response to a question from the Committee on whether there had been a significant increase in staff as a result of setting up AOFM, AOFM stated that the Office was currently resourced at 23 and that there were plans in the original proposal for the Office to include up to 40 staff. AOFM indicated that once it had looked at the strategic issues, the Office would specifically address the resourcing needs required to undertake the management task.[9]

3.12 The Committee examined the issue of remuneration and expertise with the Reserve Bank of Australia (RBA).

3.13 The RBA noted that remuneration in the RBA was well below that in the marketplace but that the advantages seen in the quality of the work at the bank would be very attractive to some people. The RBA continued:

> Every year the bank hires a stream of graduates, maybe 20 or 30 a year. We target the top honours graduates in economics and finance essentially. Out of that pool we tend to keep some very good people because they are attracted to the quality of the work. We send some of those off to study overseas to further their education in finance and economics. So all in all I do not think the bank really has a problem retaining good people at the moment.[10]

3.14 Responding to the Committee's questioning on the role of external expertise, the RBA confirmed that it had a lot of interaction with other central banks and investment banks worldwide. However, the RBA's experience was that paying for external consultancy services was not very cost effective. The RBA told the Committee:

> I think [the AOFM has] to make a judgment about what the qualifications of their staff are…. Certainly I feel that we have the expertise within the bank to do a lot of the work that we need to

8 *Transcript, 16 May 2000*, p. 3.
9 *Transcript, 16 May 2000*, p. 16.
10 *Transcript, 16 May 2000*, p. 12.

> do ourselves rather than get consultants in. Whether Treasury feel the same, I am not sure.[11]

3.15 The AOFM's position was that it needed both internal knowledge and expertise maintained over time, particularly to provide an understanding of the benchmarking process, as well as external advice where the expertise was not available in-house. It noted that its resource base was much smaller than that of the RBA and that to introduce skills across a broad range of skill sets did not easily allow the resources to develop an in-house competence in other areas. The AOFM noted that under the formation of the Office, plans existed to allow the employment of further expertise from the private sector.

3.16 The AOFM agreed that in employing external advisers, it was very important to '…have the expertise and in-house skills to ensure that the advice you do get from outside is of value'.[12]

Committee comments

3.17 The funding provided for the AOFM in the 1999-2000 budget allowed for staffing and resources additional to those of Treasury's Debt Management Office. The Government expects the new agency to significantly enhance the Commonwealth's capacity to manage its net debt portfolio and to offer the prospect of savings in debt service costs and an improvement in balance sheet worth over time.[13]

3.18 The Committee considers it very important that opportunities to obtain and retain in-house expertise, provided by the establishment of AOFM and the commitment to increased resources, should not be wasted. Where the risks are high, the relevant expertise is required. This does not and should not come cheaply.

3.19 While agreeing that the RBA has a higher level of resourcing than the AOFM, the Committee notes with interest the comments of the RBA in relation to its assessment of the expertise of some of its external advisers and the view that using independent experts was not necessarily cost effective:

> [The consultants] came in and did a competent job [on the benchmark review], but there were plenty of people in the bank

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11 *Transcript, 16 May 2000*, p. 14.

12 *Transcript, 16 May 2000*, p. 15.

13 *Budget Related Paper No.1.16, Portfolio Budget Statements 1999-2000, Treasury Portfolio,* p.16.

> who knew more about the topic than they did. That was my assessment.[14]

3.20 A related issue for the Committee is that some Commonwealth agencies have engaged external advisers and have failed to adequately oversight and fully understand the process being undertaken.

3.21 The Committee considers it essential to the proper management of the Commonwealth's debt that the AOFM has available a high degree of in-house expertise.

Recommendation 3

3.22 **The Committee recommends that the Australian Office of Financial Management take action to obtain and maintain the high level of in-house expertise required to enhance its own management and to retain control and exercise judgment over external adviser inputs.**

Debt portfolio benchmark

3.23 Since 1989 Treasury has retained consultants to advise on the management of the Commonwealth debt portfolio. Portfolio management is concerned with managing the ongoing cost and risk of the Commonwealth debt portfolio. This requires a focus on changes in interest rates and exchange rates as these variables can have a significant impact on borrowing costs.[15]

3.24 The stated purpose of the portfolio benchmark is to specify the optimal exposure to foreign currencies and interest rates to achieve Treasury's debt management objective. The annual swaps strategy is used to move the portfolio towards the portfolio benchmark targets.[16]

3.25 At the hearing, the Committee noted that over the last few years the Commonwealth's debt had reduced substantially and that the 10-year bond rate differential between Australian and the United States (US) had fallen significantly. The Committee asked why, in view of this, the benchmark had not been reviewed.[17]

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14 *Transcript, 16 May 2000*, p. 14.

15 *Audit Report No. 14, 1999-2000*, pp. 47, 48.

16 *Audit Report No. 14, 1999-2000*, pp. 49, 50.

17 *Transcript, 16 May 2000*, p. 4.

3.26 The AOFM stated that the benchmarking process was subject to review on an ongoing basis. It also noted that the benchmark was not based on exchange rate or interest rate views:

> It is a long-term benchmark grounded in long-term structural relationships between interest rates and exchange rates …. Typically, benchmarks ought to be reviewed on a four or five-year cycle, and that is where we are at the moment.[18]

3.27 The AOFM also noted that the 1996 report by external consultants adopted a long-term framework for analysing the cost and risk implications of currency and interest rate exposures. The AOFM acknowledged that the long term refers to a five-year time horizon in the analysis.[19]

3.28 When the Committee noted that the benchmark was due for review, the AOFM replied that the appropriate review process had not yet been undertaken but there was an intention to undertake such a review:

> Any appropriate recommendations in terms of changing the benchmark will be put to our board and from there it will be put to the Treasurer for approval. ….[20]

> We have conducted a tender to invite people from the marketplace to come and analyse and review our benchmarking process. That could reasonably be expected to take from a couple of months to less than six months. So that time line would suggest that we would have a new benchmark in place by the latter part of this calendar year.[21]

3.29 The AOFM stated that the current benchmark US dollar exposure was based essentially on the notion that there was a systemic bias in the relationship between the Australian dollar and US dollar interest rates, and conceded that while it did not tell the whole story, a zero interest differential was certainly a signal to re-evaluate the benchmark:

> … we are … again testing that proposition and again mindful of some of the major changes in the environment in which we operate since the original recommendation in favour of US dollars. …. I think that this review process will indicate quite a different approach to the benchmark to what we currently have.[22]

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18 *Transcript, 16 May 2000*, p. 4.

19 AOFM, Submission No. 4, p. 3.

20 *Transcript, 16 May 2000*, p. 4.

21 *Transcript, 16 May 2000*, p. 10.

22 *Transcript, 16 May 2000*, pp. 5, 6, 7.

3.30 The Committee explored with the AOFM whether the review would address the concept of future reviews being triggered by a set of events rather than by the expiry of a set review period.

3.31 The AOFM replied that the commercial approach would be to review benchmarks on a regular basis, while monitoring risks on a dynamic basis so that any weaknesses in approach would be identified:

> … I agree with the view that it has to be a dynamic approach.[23]

Committee comments

3.32 The Committee notes that the current benchmark was adopted by Treasury in July 1996 and that the five-year time horizon adopted for the modelling expires in 2000-01.

3.33 The Committee also notes that Treasury's most recent (August 1998) review of the foreign currency benchmark target acknowledged that, if the US exposure resulted in excessive cost volatility, the expected long-term cost savings may involve unacceptable risk and therefore may not be worthwhile.[24]

3.34 The Committee has some concern about the reliance of the portfolio benchmark on mean reversion theories of long-term interest rate movements. As the audit report points out, mean reversion theory does not recognise that the future may see new economic situations and trading regimes emerge such that history is not a guide to the future.[25]

3.35 Effective management of the Commonwealth debt portfolio can only occur if the benchmarks are appropriate. The Committee strongly supports the audit report recommendation that as part of its ongoing debt portfolio management, the AOFM continue to evaluate the data and assumptions underlying its US dollar exposures.

3.36 Despite the assurances of AOFM that the portfolio benchmark review process is underway, the Committee is concerned to ensure that it leads to a review mechanism with the required dynamism.

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23 *Transcript, 16 May 2000*, pp. 12-13.

24 *Audit Report No. 14, 1999-2000*, p. 56.

25 *Audit Report No. 14, 1999-2000*, p. 51.

Recommendation 4

3.37 **The Committee recommends that the Australian Office of Financial Management put processes in place to monitor risks and identify weaknesses which may impact on the appropriateness or timing of the portfolio benchmark review process.**

3.38 The Committee acknowledges that the AOFM operates under constraints which do not apply to its corporate counterparts. Treasury has adopted an approach to debt management that specifically avoids sending signals to the market regarding the future direction of interest and exchange rates.[26]

3.39 Effective management of the Commonwealth debt portfolio can only occur if the portfolio benchmark targets are appropriate. The Committee awaits with interest the result of the benchmark review process.

Foreign currency exposures

3.40 The audit noted that Treasury had not issued physical debt securities in offshore markets since 1987. Accordingly, as of 30 June 1999, there was $91.8 billion (market value) of Australian dollar denominated debt securities on issue compared to a relatively low level of $722 million of securities denominated in foreign currencies.[27]

3.41 A key conclusion of the 1996 portfolio management consultancy was that the Commonwealth could look to minimise the long-term expected cost of the debt portfolio (subject to acceptable risk) by adjusting the foreign currency composition of the debt portfolio, without taking interest and exchange rate views. The report recommended holding 10 to 15 per cent of the debt portfolio in US dollars. The three key underlying assumptions in this recommendation were: the timeframe adopted for analysis, interest rate differentials; and the exchange rate.[28]

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26 *Transcript, 16 May 2000*, p. 5.

27 *Audit Report No. 14, 1999-2000*, p. 52.

28 *Audit Report No. 14, 1999-2000*, pp. 52-4.

3.42 In adopting this recommendation as part of its portfolio management approach, Treasury has actively increased its exposure to foreign currency risk through the use of derivatives.

3.43 The Committee sought information from the AOFM on the merits of increasing the Commonwealth's foreign currency risk exposure above the level necessary to fund expenditure.[29]

3.44 The AOFM told the Committee that many other sovereign debt managers maintain open foreign currency exposures:

> In some instances the sovereign debt manager has merely borrowed in foreign currencies to replenish central bank foreign reserves, but in many others the foreign currency exposure has resulted from their debt management activities.[30]

Committee comments

3.45 Despite AOFM's understanding that open foreign currency exposures are maintained by other sovereign debt managers, the Committee notes Treasury's 1996 institutional arrangements and resourcing consultancy which stated that the Commonwealth's practice of seeking a net foreign currency exposure, **independent of foreign exchange needs or the need to offset foreign currency assets**, was in contrast to the practices of other sovereign debt managers, State treasury corporations and most private sector practice.[31] The Committee has not been provided with any evidence that this situation has altered.

3.46 Foreign currency exposures from debt management operations usually arise where a country borrows offshore. A decision may then be taken to use derivatives to manage (or hedge) the foreign currency exposure. Australia has not needed to borrow offshore. Our exposure arises from a deliberate policy of using derivatives (cross-currency swaps) to create new exposures to try to reduce the cost of debt.

3.47 The Committee remains unconvinced of the validity of the underlying assumptions and the acceptability of the risk in relation to the Commonwealth's foreign currency exposures.

3.48 Unless the Australian dollar appreciates against the US dollar, significant cash flow losses will be borne by the Commonwealth in future years as the out-of–the-money positions start coming forward.

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29 AOFM, Submission No. 4, pp. 1-4.

30 AOFM, Submission No. 4, p. 1.

31 *Audit Report No. 14, 1999-2000*, p. 53.

3.49 The Committee looks forward to seeing the result of the benchmark review process.

Derivatives and risk management

3.50 Holders of financial assets face a number of financial risks in managing the portfolio, including interest rate risk, foreign exchange risk, credit risk, liquidity risk and settlement risk. The audit report found that the Commonwealth is exposed to a number of significant risks through Treasury's debt management operations.

3.51 Between May 1998 and June 1999 Treasury entered into 332 swap transactions with a notional principal value of around $38 billion. At 30 June 2000, the aggregate Commonwealth swap portfolio consisted of 208 swaps with 25 counterparties with an outstanding notional principal value of around $30 billion.[32]

3.52 Treasury does not use swaps to hedge existing exposures, but creates new exposures to try and reduce debt costs for an acceptable level of risk.[33]

3.53 The audit report noted that significant unanticipated financial losses can occur as a result of unfavourable movements in interest and exchange rates or flawed corporate governance systems that do not ensure approved policies are applied and are effective.[34]

3.54 The report identified control deficiencies in a number of areas, namely:

- a lack of internal audits or external reviews of compliance with the controls associated with Treasury's use of financial derivatives;
- the dated nature of some of Treasury's Master Agreements;
- the lack of facsimile bid confirmations for 22 per cent of unsuccessful bids in the swap tender sample examined by ANAO; and
- review and reporting of significant movement in the net exposures around the mid-point of the relevant benchmark ranges for swaps.[35]

3.55 The Committee asked the Reserve Bank of Australia (RBA) to outline the measures it takes to ensure effective control of its derivatives.

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32 *Audit Report No. 14, 1999-2000*, p. 84.
33 *Audit Report No. 14, 1999-2000*, p. 84.
34 *Audit Report No. 14, 1999-2000*, p. 103.
35 *Audit Report No. 14, 1999-2000*, Chapter 5.

3.56 The RBA stated that the first requirement was 'a very clear idea' of what the bank wanted to do in terms of its investment strategy and what risk the bank was prepared to accept. 'Within that we have a benchmark and the government then delegates trading in the ranges that it is prepared to allow the staff to undertake.'[36]

3.57 The RBA indicated that it had very good control systems common to each of its portfolios, such as close management oversight and reporting, separation of duties between front and back and middle offices to avoid conflicts of interest and reduce the scope for fraud, and regular audits by both internal and external auditors.[37]

3.58 The Committee then asked the AOFM to respond to the audit report findings in relation to derivatives.

Internal audits and external reviews

3.59 The AOFM told the Committee that a 1997 review of the control environment for financial derivatives, undertaken as part of a consultancy report on institutional and resourcing arrangements for Commonwealth debt management, found that the control environment was essentially sound, with a clear segregation of duties. The AOFM also stated that derivative transactions had been subject to audits each year as part of the ANAO's audits of the Treasury's financial statements:

> Aspects of theses audits have involved testing compliance with the control framework.[38]

3.60 The AOFM informed the Committee that it intends to have external reviews undertaken on a regular basis, and that the AOFM Audit Committee had agreed to the appointment of a consultant in early 2000-01 to advise on an internal audit program.[39]

Committee comments

3.61 The audit report made it quite clear that there have been no internal audits or independent reviews of controls over derivatives. The review referred to by the AOFM looked at the control environment but did not actually test whether the documented controls were being complied with. As was evident from the audit report, controls were not being complied with. For

36 *Transcript, 16 May 2000*, p. 11.
37 RBA, Submission No. 2, p. 2.
38 AOFM, Submission No. 4, p. 6.
39 AOFM, Submission No. 4, p. 6.

example, 22 per cent of a sample of swap bids were not confirmed in writing by Treasury, despite a stated Treasury control that this was to occur.[40]

3.62 The Committee considers it essential to the effective oversight of AOFM's derivative activities that recommendation no. 3 of the audit report be implemented. The Committee acknowledges the steps AOFM is taking to improve the internal control framework.

Master Agreements

3.63 In response to the Committee's questions about AOFM's actions to address legal issues arising from uncompleted Master Agreements, AOFM outlined the steps which had been taken:

> Where there have been deficiencies identified in terms of the signatories to agreements or authorisations of the like, we have certainly put in place management actions to make sure those outstanding lists are received from counterparties. …. There are a number of issues that remain outstanding, particularly in terms of renegotiating existing contracts. There is a very strong reluctance from counter parties to negotiate some of the existing clauses, particularly where they have a preference for using English law and New York law to swap agreements. But our policy is that, for any new agreements entered into, these issues have to be negotiated before those agreements can be signed.[41]

3.64 AOFM later advised the Committee that:

- counterparties had been advised that an updated Master Agreement was a prerequisite for new business after 30 June 2000;
- a requirement for Australian governing law was the AOFM's opening stance in negotiation, and
- assurances concerning the power, capacity and due authorisation of counterparties to enter into swap transactions were now sought as part of standard procedures.

Committee comments

3.65 The Committee acknowledges the actions being taken by the AOFM to improve internal controls. The Committee commends the establishment of

40 *Audit Report No. 14, 1999-2000*, pp. 85, 92.
41 *Transcript, 16 May 2000*, pp. 16-17.

the Liability Management Committee to which reports on failed settlements, progress on the updating Swap Master Agreements and details of future derivative settlement activity are provided.[42]

Bid confirmations

3.66 The AOFM acknowledged that all unsuccessful bid confirmations were followed up, but that this action did not always lead to the receipt of confirmations:

> A much tougher approach is now taken with unsuccessful bidders. It is made clear that potential counterparties with outstanding bid confirmations will not be asked to participate in further tenders. Since this approach has been instituted there has been 100 per cent compliance in the receipt of confirmations.[43]

3.67 The control framework for swap tenders is aimed at ensuring the best bid is accepted. The AOFM stated that the 'number of officers involved in the execution of swaps and the confirmation process prior to acceptance of the best bid provide a high level of assurance that the best bids are accepted'.[44]

Committee comments

3.68 The telephone tender process referred to by the AOFM is not wholly consistent with better practice. The AOFM might seek bids from more than one bank, but the absence of telephone recording facilities mean that there is no one outside of the officer or officers involved that can attest that the best bid was accepted.

3.69 A more comprehensive approach on unsuccessful bid confirmations is welcome but needs to be supplemented by telephone recording systems. The AOFM noted at the hearing that the planned upgrade to the existing Treasury telephone system which would enable digital recording, or recording of conversations, was not scheduled to occur until January 2001.[45] However, it is clear to the Committee that the AOFM is taking steps in line with the audit report recommendations to improve procedural controls.

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42 AOFM, Submission No. 4, p. 5.

43 AOFM, Submission No. 4, p. 6.

44 AOFM, Submission No. 4, pp. 6-7.

45 *Transcript, 16 May 2000*, p. 16; AOFM, Submission No. 3, Attachment p. 2.

Monitoring and reporting of exposures

3.70 The Committee asked AOFM what monitoring of foreign currency exposures occurred and at what frequency.

3.71 AOFM responded that exposures were monitored on an ongoing basis and reported against the predetermined benchmark on a bi-weekly basis:[46]

> Each week the Middle Office provides a report to management on the total portfolio position, including the position of the derivatives portfolio. The Middle Office also prepares a weekly report on credit exposure to derivative counterparties, which includes details of both market and potential exposure and credit limit utilisation.[47]

3.72 In response to the Committee's inquiry as to how often reports were made to the Minister on the portfolio's performance, the AOFM acknowledged that there was currently no regular reporting to the Minister. The AOFM stated that there was only reporting of portfolio management operations and performance in meeting portfolio benchmark targets in the annual Commonwealth Debt Management report.[48]

3.73 The AOFM agreed with audit report recommendations in this area and told the Committee that it was working towards a comprehensive reporting and governance regime that incorporated the Minister.[49]

3.74 The Committee noted that at 30 June 1999, the economic gain on swap transactions was $539.2 million. However, at 26 June 2000, the swap book was "out of the money" by $2.134 billion. The Committee asked the AOFM about the implications of large swings in the net position of the Commonwealth.

3.75 The AOFM responded that:

> Market value and indeed swings in that market value carry no implications for current year fiscal balance or underlying cash budget balance measures. Further, the market value is not a valid indicator of the economic benefit of the Commonwealth's swap portfolio, nor of the underpinning long-term portfolio management strategy.[50]

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46 *Transcript, 16 May 2000*, pp. 3-4.
47 AOFM, Submission No. 4, p. 5.
48 AOFM, Submission No. 4, p. 3.
49 AOFM, Submission No. 4, p. 4.
50 AOFM, Submission No. 4, p. 3.

Committee comments

3.76 In assessing the performance of the swap book, the AOFM makes much of the realised cash flow savings that have accrued ($1.8 billion) and the resulting reduction in public debt interests (estimated by the AOFM to be $150 million per annum). However, the AOFM's assessment is inconsistent with its own performance measures used in developing the portfolio, which involved a market measure of cost.[51]

3.77 The Committee notes that the market value of the Commonwealth debt portfolio has continued to fall as the amount of debt on issue has continued to be reduced. Although the physical debt on issue is falling, there has been a marked deterioration in the market value of the derivatives portfolio as a result of the further deterioration in the exchange rate and increases in interest rates.

3.78 In adopting the strategy to be exposed to the US dollar, Treasury expected the savings on interest rates to outmatch the depreciation on the dollar. However, the 10-year bond differential has narrowed dramatically over the last 5 years and the Australian / US exchange rate has been volatile.

3.79 According to the AOFM, as at 26 June 2000, the swap book was 'out of the money' by $2.134 billion, an increase of $0.838 billion in the unrealised loss of $1.296 billion reported by the ANAO as of 30 June 1999.

3.80 This means that, unless the Australian dollar appreciates against the US dollar, significant cash flow losses will be borne by the Commonwealth in future years as the out-of–the-money positions start coming forward.

3.81 The Committee considers that if Treasury is going to use financial derivatives, there must be a good control framework for the process. It seems clear from the audit report and the Committee's own inquiries that Treasury is only now looking to introduce systems, procedures and expertise for an activity already underway.

Recommendation 5

3.82 **The Committee recommends that the Australian Office of Financial Management move as quickly as possible to implement all of the Australian National Audit Office recommendations.**

51 AOFM, Submission No. 4, p.2; *Audit Report No. 14, 1999-2000*, p. 49.

Cash management framework

3.83 As the audit report noted, the interrelationship between Treasury and the Office of Asset Sales and IT Outsourcing (OASITO – the agency responsible for implementing the sale of major Commonwealth assets) is important in planning the issue and repurchase of Commonwealth debt:

> This is because Treasury relies on information from agencies to forecast revenues and expenses[,] and changes in the quantum and / or timing of these cash flows can significantly alter Treasury's borrowing and repurchase decisions.
>
> Treasury develops a profile of the pattern of receipts expected from major asset sales based on information provided by OASITO and previous asset sales experiences.[52]

3.84 During the hearing the Committee referred to deficiencies in the information flow experienced by Treasury which led to difficulties with forecasting the timing and size of the receipt of proceeds from the 1997 Telstra public share offer. The AOFM was asked to comment on the nature of and reason for the difficulties it had encountered.

3.85 The AOFM stated that there was no requirement on the part of agencies to provide forecasts of their cash flows to Treasury (or now to the AOFM) to assist in its cash management operations:

> The whole framework is based on voluntary provision of detail and checking of that detail by us in conjunction with relevant agencies. That framework has been tightened up very significantly over the last two or three years and it is far more efficient. Nonetheless, we continue to look for further improvements in that framework. I would say, on looking back to that 1997 exercise that, at the margin there was certainly scope for better-quality and more timely information form the Office of Asset Sales. They might argue, as they have [in the report], that we might have expressed our requirements in that regard a little more explicitly to them.[53]

3.86 The AOFM went on to say that the flow of information was now very effective and that there were no such difficulties with the Telstra 2 proceeds.[54]

52 *Audit Report No. 14, 1999-2000*, p. 80.
53 *Transcript, 16 May 2000*, pp. 8-9.
54 *Transcript, 16 May 2000*, p. 9.

3.87 The Committee sought more information on the late banking of retail application moneys for Telstra 1, and the impact on the repurchase dates of some fixed coupon bonds.

3.88 In a later submission to the Committee, the AOFM confirmed that an early repurchase of $1.8 billion of January 1998 Bonds from the RBA's portfolio, scheduled for Tuesday, 4 November 1997 could not be undertaken because Telstra proceeds received by the Commonwealth by Monday, 3 November were less than expected:

> Subsequent investigation revealed that, contrary to expectations, no processing of cheques occurred on Sunday, 2 November. ….The repurchase … actually took place on Wednesday, 5 November 1997, when sufficient cash was available to fund the repurchase.[55]

Committee comments

3.89 The ability to accurately forecast the timing and quantum of the significant cash flows associated with major Commonwealth asset sales is important to AOFM's borrowing and repurchase programs.[56]

3.90 The Committee has consistently sought improvements in the Commonwealth's cash management operations. The Committee notes AOFM's claims that there have been recent improvements in information flow and expects the AOFM to actively maintain and improve agencies' awareness of its information requirements.

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55 AOFM, Submission No. 3, p. 1.

56 *Audit Report No. 14, 1999-2000*, p. 81.