



*Full report*

Value for money in foreign aid? - Currency  
management in international development  
cooperation (RiR 2014:19)





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# Summary

The Swedish National Audit Office has audited central government management of currency exchange and currency risk in international development aid.

## Audit background

*Reasons for the audit:* In 2013 Swedish development aid amounted to SEK 31 billion, which makes Sweden one of the largest aid donors internationally, both in relation to gross national income and in absolute figures. A large part of Swedish aid funds must be converted from Swedish kronor to foreign currency before they can be used by the recipients. This means that currency exchange issues are of significance for how effective and results-oriented the aid is. One prerequisite for effective currency management in development aid is that Swedish aid funds must be converted to the recipients' currencies at the best possible exchange rates. This is to ensure sound management of public funds.

Swedish aid commitments should also be predictable. Changes in exchange rates between decision and disbursement can rapidly affect the costs of aid, or the amount that reaches recipients of Swedish aid. Consequently, well-considered management of this type of currency risk is of significance for both the recipients and the central government budget. That Swedish funds are conveyed in a way that is results-oriented, predictable and transparent is also something that Sweden has undertaken to guarantee in international agreements.

*Purpose of the audit:* The purpose of this audit was to examine whether the Swedish International Development Agency (Sida) and the Government and Government Offices (Ministry for Foreign Affairs) management of currency exchange and currency risks contributes to effective and predictable aid.

*Implementation of the audit:* The Swedish NAO's audit covers currency management by Sida and the Ministry for Foreign Affairs in 2013. The work has included studying documents and interviewing representatives of Sida, the Ministry for Foreign Affairs, the National Debt Office, Kammarkollegiet (the Legal, Financial and Administrative Services Agency), the Pensions Agency, the Defence and Security Export Agency, the Exports Credits Guarantee Board and Skandinaviska Enskilda Banken (SEB). The Swedish NAO has also gone through all Sida's foreign exchange purchases in 2013 and compared the exchange rates obtained with historical market data. Comparisons have also been made with how foreign exchange trading and hedging is managed by other agencies.

## Audit findings

The Swedish National Audit Office's overall conclusion is that Sida's and the Ministry for Foreign Affairs' management of currency exchange and

currency risks is deficient in effectiveness and predictability. Currency risks in development aid have not been taken into account, and Sida's currency exchanges cost more than those of comparable agencies. According to the Swedish NAO, currency management cannot be considered to contribute to the Government's ambitions regarding performance, cost effectiveness and transparency in aid.

One main explanation for the situation is that neither Sida nor the Ministry for Foreign Affairs have specific competence in currency issues and have only used the expertise at other agencies to a limited extent. The Swedish National Debt Office also has a responsibility here, since that agency is responsible for the central government framework agreement with the commercial banks on payment services. The National Debt Office has not given Sida sufficient support in implementing cost-effective foreign exchange transactions. The position taken by the National Debt Office is that it is the responsibility of each respective agency to determine how the framework agreement is to be used for currency issues and to analyse the need for any hedging. The Swedish NAO's assessment is that the National Debt Office should have been more active in these matters.

In this report the Swedish NAO has shown several examples of how other Swedish agencies work to achieve cost-effective foreign exchange, predictability in payment flows and matching of guarantee commitments in foreign currency. These examples show that there is great potential for improving the effectiveness of foreign currency management in Swedish development aid.

*Sida's foreign currency purchases have not been cost effective*

The Swedish NAO's review shows that Sida pays an unnecessarily high amount for its foreign currency exchange. According to the Swedish NAO's calculations in 2013 Sida paid a total of about SEK 6 million too much for payments made. At the same time aid recipients have lost out on the equivalent of about SEK 33 million.

There are several reasons why Sida pays too much for its foreign currency exchange. The Swedish NAO notes that Sida does not have staff with special competence in currency trading. Nor is there any internal guidance for how the agency should achieve good currency management. At present Sida's currency purchases are dealt with entirely automatically, in that payment orders are sent electronically to the agency's bank. The agency does not collect information on current market rates, and does not contact the bank to obtain information about, or negotiate, the current rate. Nor has Sida formed any opinion as to the effectiveness of foreign currency exchange, for example by using the bank's reporting of payments made or by engaging external expertise.

The Swedish NAO notes that it is possible to organise foreign currency exchange differently. Kammarkollegiet, which annually completes foreign exchange purchases for about SEK 2 billion can be mentioned for

comparison. Unlike Sida, that Agency has experts in the currency area, and access to updated market information. Kammarkollegiet uses this actively, and thus obtains better foreign exchange rates than Sida.

*The National Debt Office's framework agreement for payment services does not ensure the best price for foreign currency transactions*

Central government agencies are bound by the National Debt Office's centrally procured contract for payment services. To achieve cost effective currency management in central government as a whole and for foreign aid payments it is important that this contract guarantees a good rate. The Swedish NAO's review shows, however, that there are deficiencies in this respect. The National Debt Office's framework agreement for payment services uses a construction with volume discounts in arrears that means that the agency is not necessarily offered favourable net foreign exchange rates. Instead the individual agency must negotiate with their bank to ensure a good exchange rate. In this light the National Debt Office should have worked more actively to give support to agencies that carry out foreign exchange transactions to enable them to conduct these transactions efficiently. However, the Swedish NAO notes that Sida did not receive sufficient support from the National Debt Office.

The position taken by the National Debt Office is that it is the responsibility of each respective agency to determine how the framework agreement for payment services is to be used for foreign currency. Different agencies have also been given differing information concerning the use of the framework agreement. This has meant that different agencies interpret and use the framework agreement in different ways. For example, Kammarkollegiet exposes its foreign exchange transactions to competition, which helps to lower foreign exchange costs. At Sida, which does not have staff with specific knowledge of foreign currency matters, the National Debt Office's unclear information has contributed to Sida's paying too much for foreign exchange transactions.

*The currency risk for decisions made in Swedish kronor lies with the recipient*

Sida makes all its decisions on development aid in Swedish kronor. The agency does not hedge its decisions, which means that the recipient and provider of Swedish development aid assume the risk of any changes in the exchange rate between Swedish kronor and the currency in which the development aid is to be provided. The rate between two currencies can move considerably over time, and therefore the recipients cannot be sure of the actual amount of Swedish development aid they will ultimately receive. In many cases Sida supports projects that span several years, which entails increased currency risk for the recipients. The Swedish NAO notes that Sida has overlooked the possibility of offering hedged payments to aid recipients who need them.

*Lack of hedging leads to development aid with poorer forecasts and transparency.*

The Government and Government Offices make certain decisions on development aid in currencies other than Swedish kronor. These decisions often apply to commitments that span long periods of time, on average about five years. At present Sweden has outstanding commitments equivalent to about SEK 11.9 billion. These commitments are not hedged by the Ministry for Foreign Affairs or by Sida. Instead a forecast rate is used so as to calculate the Swedish commitment for the entire duration. The result is a weak budget forecast and major differences in outcome from year to year. The Ministry for Foreign Affairs deals with this reactively by redistributing funds between different appropriation items within the expenditure area, depending on exchange rate gains or losses. In 2013 SEK 136.5 million of the budgeted funds for the commitments approved in foreign currency had to be redistributed in this way.

The Swedish NAO notes that there are other corresponding currency risks in central government that are dealt with by means of active hedging. Through the activities of the Swedish Defence and Security Export Agency central government is exposed to a currency risk that in many ways resembles that of the unhedged development aid decisions. Unlike the Ministry for Foreign Affairs and Sida, however, the Defence and Security Export Agency uses the National Debt Office for hedging. The agency states that hedging is undertaken at a rate very close to the daily rate, and that there is great flexibility for handling variable payment dates.

*There is no clear responsibility for hedging of development aid approved by the Government*

According to the Swedish NAO, the fact that hedging has not been considered for the commitments the Government has made is partly due to the broken chain of responsibility that exists in dealing with these development aid decisions. This is since the Government instructed Sida to deal with payments on behalf of the Government Offices, which processes the decisions. In most cases there are sound reasons for sharing tasks and responsibility between different central government actors. However, joint responsibility must not entail broken chains of responsibility resulting in no actor having or taking responsibility for the central government commitment or for public funds being used in accordance with sound financial management. In its audit the Swedish NAO has shown not only that there is no sound currency management in development aid, but also that there is no consensus as to whose responsibility it is.

*Considerable currency risk in Sida's guarantee operations*

A central government guarantee commitment means that central government stands surety for someone else's payment commitment, which entails a financial risk for the State. The Riksdag has approved a guarantee framework for Sida of SEK 10 billion which is used in international development cooperation. At present Sida has issued guarantees worth SEK

2.3 billion. The agency intends to fill the framework in the next 2-3 years. The Swedish NAO notes that it is Sida's practice to assume a currency risk of up to SEK 10 per dollar, which means that the agency has considerable currency risk in guarantees issued.

The Swedish NAO further notes that since currency risk is covered by Sida's guarantee framework, the framework is worth about SEK 6.7 billion instead of the SEK 10 billion that applies under the Riksdag decision. This means that Sida cannot effectively issue guarantees to the full value of the framework.

As a comparison it can be mentioned that the Swedish Exports Credits Guarantee Board (EKN) manages currency risk for its guarantee operations by placing liquid assets in foreign currency, which is regulated in the Ordinance on loans and guarantees (2011:211). In the current situation that possibility is not applied to Sida's guarantees, which are also subject to the Ordinance on funding of development loans and guarantees for development cooperation (2009:230).

## Recommendations

### RECOMMENDATIONS TO THE GOVERNMENT

- *Ensure that Swedish commitments are not characterised by currency risk.* The Government should make the chain of responsibility clear for development aid payments approved by the Government Offices. Thereafter the organisation responsible should be instructed, with support from the Swedish National Debt Office, to clarify the currency risks in development aid commitments and how these can best be managed.
- *Ensure that agencies impacted by currency issues get help from the Swedish National Debt Office.* The Swedish National Audit Office recommends an amendment to Sections 12-13 of the Ordinance on central government agencies' payments and management of funds (2006:1097), to indicate that agencies with major currency management need to obtain help from the Swedish National Debt Office to analyse their need of foreign currency accounts and hedging.
- *Give Sida the opportunity to hedge its guarantees.* The Government should change Ordinance (2009:230) on financing of development loans and guarantees for development cooperation to clarify that Sida's guarantee reserves for commitments in foreign currency can be matched against assets in foreign currency.

### RECOMMENDATIONS TO SIDA

- *Ensure that foreign currency purchases in development aid are made cost effectively.* Sida should immediately change to more



active management of its currency purchases. The agency should seek help from the Swedish National Debt Office to obtain support in the best management for the remainder of the current framework agreement. As the framework agreement only runs until the end of March 2017 this should be done immediately.

- *Increase knowledge of currency matters in Swedish development aid.* Sida should strengthen its competence in currency matters. The agency should also more actively use central government competence in currency management and guarantees, found at the Swedish National Debt Office and the Swedish Exports Credits Guarantee Board.
- *Investigate whether Sida can contribute to reducing currency risks for recipients of Swedish development aid.* Sida's decisions in Swedish kronor entail currency risks for the recipients and providers of Swedish development aid. Sida should, in dialogue with the parties concerned and the Swedish National Debt Office, investigate whether it is possible to offer cost-effective central government hedging for approved funds.

#### RECOMMENDATIONS TO THE SWEDISH NATIONAL DEBT OFFICE

- *Clarify how the framework agreement for payment services can be used.* The Swedish National Debt Office should clarify how the current framework agreement for payment services should be interpreted as regards renewed exposure to competition of services that include foreign currency exchange. As the framework agreement only runs until the end of March 2017 this should be done immediately.

# 1 Introduction

In February 2014 the Swedish National Audit Office started an audit of multilateral development cooperation.<sup>1</sup> During the audit work there were indications that currency issues in development aid – both multilateral and bilateral – are not handled in line with sound management of public funds. Consequently, the Swedish NAO decided to conduct a separate audit of how currency issues are handled within the framework of Swedish aid.<sup>2</sup>

## 1.1 Reasons for the audit

Swedish development aid amounted to SEK 31 billion in 2013. A large part of these funds must be converted from Swedish kronor to foreign currency before they can be used by the recipients. This means that currency exchange issues are of significance for effective and results-oriented aid. One prerequisite for effective currency management in development aid is that Swedish aid funds must be converted to the recipients' currencies at the best possible exchange rates. This is to ensure sound management of public funds, but also to contribute to the best possible outcome at the recipient stage.

Swedish aid commitments should also be predictable both for Sweden and the recipients. Changes in exchange rates between decision and disbursement can rapidly affect the costs of aid, or the amount that reaches recipients, both negatively and positively. Well-considered management of this type of currency risk is thus of importance both for the recipients of aid and for the central government budget.

During the audit of multilateral aid, spot checks of Sida's foreign payments showed that the exchange rates received by the agency were very high in relation to the prevailing market rates. It also emerged that neither Sida nor the Government Offices seemed to have reflected on how to carry out foreign currency purchases effectively or that foreign currency exposure in development aid was not hedged. Furthermore, our investigations showed that other agencies making foreign payments work in a more conscious way on these matters.

## 1.2 Purpose and audit issues

The purpose of this audit was to examine whether Sida's and the Government's and Government Offices' (Ministry for Foreign Affairs) management of currency exchange and currency risks contributes to effective and predictable aid. The Swedish National Debt Office was also examined in the audit, as that agency is responsible for the framework agreement used for central government currency transactions.

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<sup>1</sup> As the report is about overall currency management no distinction is made between long-term development cooperation and humanitarian aid; the terms are used interchangeably for the sake of simplicity.

<sup>2</sup> Publication of the performance audit on Sweden's multilateral development cooperation is planned for autumn 2014.

The audit answers the following audit questions:

- Are central government currency purchases within development aid made in a way that ensures a good exchange rate?
- Do the Ministry for Foreign Affairs and Sida handle currency risk in development aid effectively?

### 1.3 Basic premises for the audit

The overall premise for the audit is the Budget Act requirement that central government activities must be characterised by a high degree of effectiveness and sound financial management.<sup>3</sup> The Government has also particularly emphasised the importance of results, cost-effectiveness and transparency in development aid.<sup>4</sup> According to the Swedish National Audit Office cost effective foreign currency exchange and well-balanced management of currency risk can contribute to this.

Furthermore, the audit is based on rules for agency payments in the Payments and Funds Management Ordinance (2006:1097). Under Section 6 payments to and from an agency must be made in a way that is cost-effective and secure for central government as a whole. Section 13 stipulates that agencies that need hedging arrangements must apply to the Swedish National Debt Office.

Central government cash management at the Swedish National Debt Office must ensure, under the appropriation directions, that the central government payment model fulfils the explicit requirements of the Riksdag and Government for cost effectiveness, security, information and freedom of choice. There must be neutrality of competition in the State's relation to the banks and service to the Debt Office's cash management customers must be good.<sup>5</sup>

To assess the effectiveness of management of currency issues in aid in practice the Swedish NAO compared how foreign currency purchases and currency risk are dealt with by other agencies with large foreign payments and similar currency exposure.

### 1.4 Method and definitions

The Swedish National Audit Office's audit covers currency management by Sida and the Ministry for Foreign Affairs in 2013. To answer the audit questions Sida's foreign currency purchases during the year were audited. The Swedish National Audit Office has gone through all Sida's currency purchases in 2013, and compared them with historical market data to assess whether the agency has carried on cost effective foreign currency exchange. Sida's volumes and procedures for foreign currency trading have not changed appreciably in recent years and we assess that the past year's currency trading is a sufficient sample in relation to work input.

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<sup>3</sup> Chapter 1 Section 3§ of the Budget Act (2011:203)

<sup>4</sup> Development assistance policy platform, Government Communication 2013/14:131.

<sup>5</sup> Appropriation directions for 2013 budget year for the Swedish National Debt Office, Fi2012/3287, 14 February 2013.

Furthermore, an audit was conducted of Sida's and the Ministry for Foreign Affairs' measures to hedge outstanding commitments approved by the Government and the Government Offices, as well as Sida's management of currency risk in the agency's guarantees. The impact of the Debt Office's framework agreement for payment services on Sida's currency management was also included in the audit.

Data on currency management in development aid was collected through interviews with representatives of Sida, the Ministry for Foreign Affairs, the Debt Office and Skandinaviska Enskilda banken (SEB), which handles Sida's foreign payments. Documents were also obtained and analysed.

In addition, interviews were held with Kammarkollegiet (Legal, Financial and Administrative Services Agency), the Swedish Pensions Agency, the Swedish Defence and Security Export Agency and the Swedish Exports Credits Guarantee Board (EKN) to describe how currency management is dealt with in other areas of central government.

## 1.5 Arrangement of the report

Chapter 2 provides a background to central government foreign currency exchange via the National Debt Office framework agreement for payment services and a short description of the management of central government currency risks. This is followed in Chapter 3 by an examination of Sida's procedures for foreign currency exchange and an analysis of foreign currency purchase costs for government agencies. This is then compared with procedures and results of foreign currency exchange at Kammarkollegiet (Legal, Financial and Administrative Services Agency). Chapter 4 describes currency risk in Swedish development aid commitments and how they are dealt with by Sida and the Ministry for Foreign Affairs. Comparisons are thereafter made with the Swedish Defence and Security Export Agency and the guarantee operations of the Swedish Exports Credits Guarantee Board. The conclusions and recommendations of the Swedish National Audit Office are presented in Chapter 5. The method of calculating the cost of Sida's currency purchases is described in Annex 1.

## 2 Central government currency management

Foreign exchange rates are an obvious factor to take into account in all forms of international transactions, for example for firms with major exports or imports. Central government agencies have reason to take exchange rates into account when dealing with foreign payments. Effective currency management may include such factors as exposing foreign currency exchange to competition, as well as eliminating or limiting the currency risk that arises when assets and liabilities are held in foreign currency or when agreements are made that entail future currency transactions.

### 2.1 Cost effective foreign currency exchange

The most important factor for cost-effective currency exchange for central government foreign payments is ensuring that the rates given to government agencies for foreign currency exchange are as favourable as possible. What is required for this to be effective is for example to have centrally procured agreements that guarantee a good price and good insight into how the currency market functions on the part of the agencies concerned. At present the main part of central government foreign currency exchange takes place via the framework agreement for payment services between the National Debt Office and four commercial banks. The reason for agencies to exchange inflows and outflows of foreign currency at all is that the central government main account at the Riksbank, which collects all liquidity from central government incoming and outgoing payments, is in Swedish kronor.

#### 2.1.1 *The National Debt Office framework agreement for payment services*

Under the Payments and Funds Management Ordinance (2006:1097) agencies in the central government accounting organisation must call off payment services under the framework agreement made on behalf of central government.

When making call-offs under the agreement the ranking for the various services must be followed. As regards foreign currency exchange the ranking is in accordance with a fixed discount offered by the banks in the framework agreement. The discount is calculated on the entire volume exchanged in one year in excess of SEK 50 million and is paid to the agencies as a lump sum in arrears, called kick-back. The highest-ranking bank for the “foreign currency exchange” service is Swedbank, which offers a discount of 0.125 per cent of the volume exchanged. However, foreign currency exchange also takes place in the context of other services in the framework agreement, for example “Payment to bank branches abroad”, where foreign exchange normally takes place automatically in the payment. SEB is ranked highest for the service, as the bank offers the lowest price per transaction. SEB then applies its own discount to the entire volume exchanged in arrears, in accordance with the conditions of the framework agreement. It is quite possible for agencies to exchange currency in one bank and make foreign payments in another, even in this may entail practical problems.

The total annual payment volume exchanged for the Swedish State is just over SEK 50 billion. A few agencies account for about 80 per cent of all foreign currency exchange at the framework agreement banks. These are: the Swedish Pensions Agency, Sida, the Swedish Exports Credits Guarantee Board (EKN), the Defence Materiel Administration (FMV) and the Swedish Social Insurance Agency.

Table 2.1. Payment flows with foreign currency exchange in central government agencies 2012–2013

Agencies	2012 bn SEK	2013 bn SEK
Swedish Pensions Agency	17	14.8
Sida	9.5	10.3
Swedish Exports Credits Guarantee Board (EKN)	5	5
Defence Materiel Administration (FMV)	3.1	4.6
Swedish Social Insurance Agency	3.6	3.7
Other agencies	14.2	14.6
<b>Total volume exchanged</b>	<b>52.4</b>	<b>53</b>

*Source: Swedish National Debt Office, email 13 June 2014.*

Procurement of the latest framework agreement for payment services was made by the National Debt Office in 2009 for a period of four years with the possibility of extension by another two years. The extension has been made and the agreement now runs up to and including March 2017. Ahead of the procurement of the next framework agreement the National Debt Office plans to separate currency management and locate it centrally there by introducing a central government currency account to improve the effectiveness of agencies' currency management. Through central management via the National Debt Office the possibilities of obtaining more favourable exchange rates than the agencies obtain from the framework agreement banks at present will improve. According to the National Debt Office the idea of a central government currency account has existed since the mid-2000s, but cannot be implemented until the present framework agreement expires.<sup>6</sup>

<sup>6</sup> Email from the National Debt Office, 13 June 2014.

#### PRICING OF FOREIGN CURRENCY

Currency trading is conducted in all time zones and the prices are updated continually 24 hours a day. Unlike share trading there is no central market place for currencies; the trading is between two parties (over-the-counter, OTC). The financial actors that offer exchange rates take no commission; instead they earn money on the difference, called the spread, between the buying and selling rates. Thus spread is the same as these actors' margin, but can also be seen as the customers' transaction cost. Generally speaking the margin is less for highly liquid currencies, such as euros and American dollars. One example of a situation with a very large spread is when private individuals buy currency for travel. Private individuals thus pay considerably more for their currency than companies that exchange currency on the spot market to make foreign payments.

## 2.2 Management of central government currency risk

Central government currency risks consist mainly of the risk of exchange rate fluctuations impacting central government assets and liabilities in foreign currency; primarily the Riksbank currency reserve and the Debt Office foreign currency debt. In addition central government foreign payments are exposed to currency risk to the extent they are guaranteed in foreign currency. The risk increases the longer the time between entering into a contract and the actual time of payment. In the long term it can be assumed that exchange gains and exchange losses will cancel each other out. Consequently the management of currency risk for central government payment commitments is not primarily a matter of management of public funds but rather a matter of reliability of forecasts and predictability, in other words that the actual outcome of central government payments does not deviate too much from budgeted amounts. From a central government perspective reliability of forecasts is of course important for the current budget year, but also for the entire period covered by the central government expenditure ceiling, which is three years.

### 2.2.1 *Currency hedging for government agencies*

An agency needing to hedge a foreign payment may apply to do this via the central government cash management at the National Debt Office, which draws up an agreement on forward cover between the agency and the National Debt Office. Forward cover means that the National Debt Office takes over the agency's currency risk and sells or buys the foreign currency for the agency when the forward cover matures. Altogether about 15 agencies are licensed for forward cover of their foreign payments by central government cash management.

Forward cover is not for speculation but should be an aid to the agencies concerned in their budgeting. There are no general central government guidelines for when it may be relevant to use forward cover. Instead, each agency decides for itself whether to use forward contracts or not. Nor does the National Debt Office set any maximum or minimum limits on amounts

for hedging, but states that a large amount for one agency could be a small amount for another. The plans mentioned above for a central currency account with the National Debt Office will not affect agencies' opportunities to eliminate foreign exchange risk through forward transactions.<sup>7</sup>

Examples of large central government payment flows that are not hedged are Sweden's EU contribution<sup>8</sup> to and receipts from the EU, such as agricultural support. In the latter case central government bears the entire currency risk, since the support is paid in Swedish kronor, while the claim for payment from the EU budget is in euro under current rules for foreign currency conversion.

#### WHAT IS A CURRENCY FORWARD CONTRACT?

A forward contract is a binding contract between two parties on the right and obligation to buy and sell an item, in this case currency, at a pre-determined price at a given time in the future. The pricing of currency forwards is based on the difference between the domestic interest rate and the interest rate in the country whose currency the forward contract refers to.

For example, if a bank is to supply USD 1 million in one year the bank needs to borrow SEK today that is converted (at the spot price) and invested in USD to be able to give USD 1 million in a year's time at the contracted price. When the year has passed the bank supplies the currency as agreed and pays back the SEK loan with interest. This simplified example gives the following formula for calculating the forward contract price:

$$T = \frac{(1 + r_s)}{(1 + r_x)} * S$$

Where:

$T$  = implicit forward contract price

$r_s$  = interest rate, Sweden

$r_x$  = interest rate, USA

$S$  = Spot rate SEK/USD

If the interest rate in Sweden is higher than in the USA the forward contract price will be higher than the spot rate. If instead the interest rate is lower than in the USA the forward contract price will be lower than the spot rate.

## 2.3 Currency management in Swedish development aid

Sida is responsible for handling grants and other funding to support initiatives to fulfil the targets for the Swedish State's international development cooperation.<sup>9</sup>

<sup>7</sup> Email from the National Debt Office, 13 June 2014.

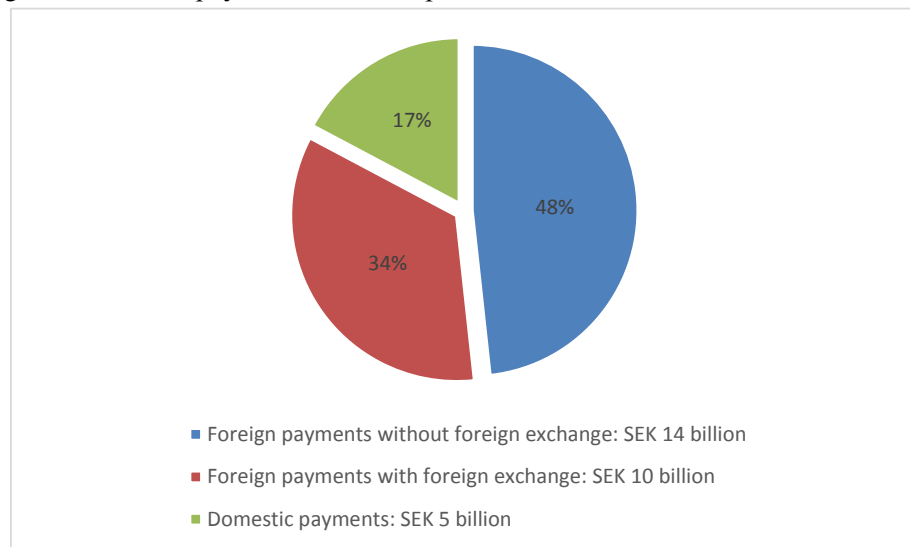
<sup>8</sup> The EU contribution (apart from customs duty) is set in euro and paid in instalments over twelve months at the exchange rate in force on the last business day of the year prior to the budget year. When the central government budget is set a forecast is used for the rate applicable for the budget year.

<sup>9</sup> Ordinance containing instructions for the Swedish International Development Cooperation Agency (Sida).



As most of Swedish development aid is given abroad, Sida makes a large number of foreign payments every year. This means that the agency has extensive currency management. In 2013 Sida paid out a total of SEK 29 billion, of which almost SEK 24 billion was in foreign payments. The agency mainly bought American dollars, euro and sterling. A number of other currencies are also traded, but to a lesser extent. A large proportion of the payments were made in Swedish kronor to recipients with SEK accounts. Altogether the agency exchanged just over SEK 10 billion for foreign currency in 2013 in connection with foreign payments.

Figure 3.1. Sida’s payments of development aid funds.



Of the SEK 29 billion paid out by Sida in 2013 about SEK 11 billion were funds approved by the Government and the Government Offices. Since 2011 Sida has a special mandate as regards payments of funds approved by the Government and Government Offices. It mainly concerns the part of Swedish development aid that is paid as core support to multilateral organisations, which is handled by the Government Offices. For these decisions Sida is to “carry out certain administrative control and assessment procedures for the processing of grants and handling payments and recovery in practice”.<sup>10</sup>

Some of the commitments decided on by the Government run for several years and are guaranteed in foreign currency. As these are paid out by Sida it means that the agency must also deal with outstanding aid commitments entailing currency risk for several years ahead. According to Sida’s annual report commitments in foreign currency amounted to about SEK 11.9 billion in 2013, valued at the exchange rate on the balance sheet date.

Sida also has loan and guarantee operations and decides on funding with development loans and guarantees (loan aid). At the turn of the year 2013/2014 guarantee commitments amounted to SEK 2.3 billion and a further SEK 0.2 billion in new pledges. The guarantees are approved in

<sup>10</sup> Instruction to the Swedish International Development Agency (Sida) to transfer parts of the responsibility for processing of grants in expenditure area 7 from the Government Offices/Ministry for Foreign Affairs to Sida, UF2010/37907/USTYR, 23 June 2010.

Swedish kronor but normally issued in foreign currency. Sida's guarantee framework approved by the Riksdag amounts to SEK 10 billion.

### 3 Sida's foreign currency exchange

Every year Sida deals with a large number of foreign currency purchases in the context of the agency's outgoing payments. The payments, as described above, can be approved by the Government Offices or the agency.

Depending on the recipient the processing of the decisions may vary.

However, Sida handles the actual currency purchases in the same way regardless of whether the payment was approved by Sida or the Government Offices.

#### 3.1 What is the procedure for Sida's foreign currency exchange?

When a payment decision has been made Sida draws up a payment order. This is quality assured by a controller, to ensure that the payment is registered in accordance with the decision. For decisions made by the Government Offices in foreign currency, a check is also made of the relevant exchange rate to ensure that allocated appropriation items in Swedish kronor are not exceeded when currency is purchased and that any amounts specified in decisions are not exceeded. The controls are made against the bank's spot rates for the currency in question, which are published on the bank's website. If there is a risk that appropriations or amounts in decisions will be exceeded Sida notifies the Government Offices for a decision to be made concerning the payment in question.<sup>11</sup>

The payment itself is registered in the accounting system by Sida's accounts payable ledger function.<sup>12</sup> After the audit procedures the payment file generated is sent to the agency's bank by a finance officer. A payment file is normally sent twice a week.<sup>13</sup> Sida's bank (SEB) receives the file and payment order and checks that no data is missing. The bank also checks that no payment order is in conflict with international decisions on sanctions or the Act on Measures against Money Laundering and Terrorist Financing (2009:62).<sup>14</sup>

Exchange and payment are normally effected the day after the order was sent from Sida. The bank effects a currency purchase in accordance with the payment order and then transfers the payment to the recipient's account. The bank reports back to Sida on which business day the payment was effected and the exchange rate used.<sup>15</sup>

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<sup>11</sup> Sida's procedure description for handling the Government Offices funding activities, 14 December 2012, p. 11.

<sup>12</sup> Sida's procedure description for handling the Government Offices funding activities, 14 December 2012, p. 12.

<sup>13</sup> Interview, Sida, 15 April 2014.

<sup>14</sup> SEB's procedure description: *Payment process, Sida's SISU payments to the Swedish National Audit Office*, 28 July 2014.

<sup>15</sup> Interview, Sida, 14 April 2014. The bank also reports other information on payments made, as well as any changes/cancellations, see *Payment process, Sida's SISU payments to the Swedish National Audit Office*, SEB, 28 July 2014.

In cases where a payment is approved in foreign currency Sida's system is updated. Any exchange rate differences are calculated and registered to obtain the correct amount in SEK.<sup>16</sup>

Sida also handles incoming foreign payments. However these only occur to a very limited extent. The incoming payments may concern funds that have not been used within the intended period, and are consequently recovered by Sida or the Government Offices. Of funds at the disposal of Sida after Government Offices approval, in 2013 about SEK 15 million was repaid.<sup>17</sup> Repaid funds are paid into a SEK account, which means that they must be exchanged from the sender's currency.

### 3.2 Are Sida's exchange rates cost effective?

The Swedish NAO requested data on all Sida's foreign payments in 2013 to be able to compare the exchange rates obtained by Sida with the market rates at the time of each exchange transaction. The data on exchange rates for the payments is not saved electronically but are printed in files of remittance lists sent weekly from the agency's bank.

To be able to evaluate exchange rates obtained by Sida the Swedish NAO has manually supplemented Sida's list of data on site with data from the bank's written reports to the agency. We thereafter processed the material to be able to assess whether Sida's exchange rates are reasonable in relation to other comparable actors. Currency purchases refer to both foreign payments where decisions were made by Sida and where decisions were made by the Government Offices.

#### 3.2.1 *Exchange rates obtained by Sida compared with other actors*

In 2013 Sida purchased fourteen different currencies to the value of about SEK 10.4 billion. By far the major part of the volume traded referred to USD, EUR and GBP. In 2013 Sida bought these three currencies for the equivalent of SEK 9.7 billion.

The Swedish NAO has compared the exchange rates obtained by Sida for these currencies with the Riksbank's fixing rates for each currency. The fixing rates (see fact box) represent the median value of the banks' buying and selling rates at a particular time every morning. We then used the difference between the median rate and the exchange rates obtained by Sida to calculate the average spread, in other words a transaction cost, which can then be compared with the rate that other actors in the currency market can trade for. The average spread should be as narrow as possible.

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<sup>16</sup> Interview, Sida, 15 April 2014.

<sup>17</sup> Interview, Sida, 15 April 2014.

#### THE RIKSBANK'S FIXING RATES

The Swedish banks submit exchange rates to NASDAQ OMX every day between 9.15 and 9.45. The rates the banks give are called mid-market rates and are the mean average of the buying and selling rates. AT 10.05 NASDAQ OMX Stockholm AB sets a fixing rate by calculating the mean average of the various banks' exchange rates after excluding the highest and lowest rates quoted. These fixing rates are available on the Riksbank's website at about 12.10. Sida's currency purchases are made at SEB's selling rate between about 12.00 and 14.00.

For dollars the average deviation between Sida's exchange rates and the Riksbank's fixing rates during the year was about 3 öre, or a little more than 300 points. For euros the deviation was about 4 öre and for sterling about 4.75 öre.<sup>18</sup> These deviations from the mean rate imply an average spread of double for each currency, see Table 3.1.

By its own account, Kammarkollegiet, with an exchange volume of about SEK 2 billion per year, gets down to a deviation from the median of less than 50 points per euro during one year's trading. This means a spread of 100 points. The corresponding estimated spread for dollars and sterling respectively, where Kammarkollegiet does not trade in such great volumes, is 200 and 250 points.<sup>19</sup> In view of the fact that Sida's volume of exchange is five times greater than that of Kammarkollegiet, the difference between the agencies' spread obtained seems remarkably great, which is also confirmed by experts at the National Debt Office who quality assured our method.<sup>20</sup> When trading in the euro the average spread we calculated for Sida was as much as 700 points greater than Kammarkollegiet managed. This means that Sida on average pays 3.5 öre more than Kammarkollegiet for every euro. One reason for the large differences is that Kammarkollegiet has a more active approach in its foreign currency exchange compared with Sida's automatic processing. A more detailed description of Kammarkollegiet's foreign currency exchange is given in Section 3.4.

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<sup>18</sup> A point is a term used by banks for the fourth decimal in the krona rate for one unit of quote currency. 100 points is thus equivalent to one öre per unit of foreign currency.

<sup>19</sup> Telephone conversation with Kammarkollegiet (Legal, Financial and Administrative Services Agency), 23 June 2014. The information refers to gross rates, i.e. before deduction of the banks' discount on the entire volume exchanged.

<sup>20</sup> Mail exchange with the Swedish National Debt Office, 19 June 2014.

Table 3.1. Estimated average spread for Sida and Kammarkollegiet respectively, points (100 pt = 1 öre).

	Sida		Kammarkollegiet
	Deviation from mid	Spread in	Spread in
Currency	market rate (SEK)	points	points
USD	0,0311	622	200
EUR	0,0406	812	100
GBP	0,0474	947	250

Source: Sida, Macrobond, Swedish National Audit Office calculations as well as Kammarkollegiet.

Another comparison that can be made is that if Sida had been a large company with its own treasury department that dealt with the exchanges itself through several bank contacts, the corresponding trading volume would probably have gone down to a spread of 60-80 points.<sup>21</sup> Yet another example is that the National Debt Office, which is a major actor in the foreign exchange market, trades the largest global currencies at a spread of less than 50 points. This cannot be compared with an actor like Sida, but indicates that it is possible to save considerable amounts by changing to central state currency management.

### 3.2.2 How great is the additional cost?

Based on the assumption that Sida, with its foreign exchange volumes of more than SEK 10 billion, could get down to a spread of 100 points for the three largest currencies, the Swedish NAO calculated that it is possible to achieve annual savings of almost SEK 40 million with more active currency management in development aid. The greatest part of this, SEK 33 million, refers to decisions made in SEK, thus accruing to the recipients in the form of more foreign currency per Swedish krona. The remaining SEK 6 million or so refers to decisions made in foreign currency (USD, EUR and GBP) and would thus be a saving for the Swedish treasury as the currency purchased would be cheaper in kronor terms.

We have not made any calculations for the many smaller currencies bought by Sida due to lack of relevant comparative data. The method behind the calculations is presented in Annex 1.

## 3.3 The National Debt Office framework agreement for payment services

Under the Payments and Funds Management Ordinance (2006:1097) Sida is to use the framework agreement for payment services entered into by the National Debt Office on behalf of the Swedish State. Consequently, this framework agreement and support given by the Debt Office to agencies using the agreement are of importance for cost-effective foreign currency exchange in development aid.

<sup>21</sup> Mail exchange with the Swedish National Debt Office, 19 June 2014.

### 3.3.1 *The design of the framework agreement does not ensure a good rate for foreign exchange*

Through the framework agreement for payment services the Debt Office has negotiated a discount on foreign currency exchange with the participating banks. The discount is calculated on the entire exchange volume in one year that exceeds SEK 50 million. The discount is paid to the agencies as a lump sum in arrears. The ranking in the part of the framework agreement that refers to foreign currency exchange is based on the discount offered by the banks.

However, the design of a discount on the exchanged volume provides no guidance on the actual foreign exchange rate. It is not necessarily the bank that gives the best discount that offers the most favourable net exchange rates. The actual exchange rate an agency receives is determined instead by how well that agency can negotiate with the bank. As described in section 3.2.1. there are large differences between the rates obtained by different agencies. For example, Kammarkollegiet has succeeded in obtaining a considerably lower rate than Sida through active currency trading. (For more on Kammarkollegiet's currency trading see section 3.4).

The Swedish NAO can note that the framework agreement lays considerable responsibility on the agencies that use it to conduct foreign currency exchange. They must themselves ensure that exchanges are carried out cost-effectively.

### 3.3.2 *Unclear how the framework agreement can be used*

After interviews with the Debt Office and other agencies with extensive currency trading, the Swedish NAO can state that there are several aspects of using the Debt Office's framework agreement for payment services that are unclear.<sup>22</sup> One of these concerns the possibilities of deviating from the ranking and exposing the banks to competition regarding foreign currency exchange. A new call for competition would make it possible for agencies to reduce the cost of their foreign currency exchange.

In autumn 2013 and spring 2014 Sida investigated the possibility of a renewed call for competition. The agency's lawyers have assessed the matter and also conducted discussions with the National Debt Office.<sup>23</sup>

Sida and the Swedish Pensions Agency are the two largest users of the foreign currency exchange service within the framework agreement. Together they account for about half all foreign currency exchange, with currency purchases equivalent to SEK 25 billion. In spring 2014 Sida and the Swedish Pensions Agency met to exchange experiences of the framework agreement for payment services as regards foreign currency exchange.<sup>24</sup> One central issue was the possibility of deviating from the ranking and exposing foreign currency exchange to competition. It is worth noting that the agencies in this discussion had not received support from the National Debt

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<sup>22</sup> Interview, National Debt Office, 7 March 2014, Interview, Swedish Pensions Agency, 4 April 2014, Interview, Kammarkollegiet, 7 April 2014, Interview, Sida, 28 April 2014, Participation at meeting between Sida and the Swedish Pensions Agency, 19 May 2014.

<sup>23</sup> Quality assurance correspondence with Sida, 25 August 2014.

<sup>24</sup> Participation in a meeting between Sida and the Swedish Pensions Agency, 19 May 2014.

Office, which is responsible for the framework agreement. Instead, Sida and the Swedish Pensions Agency assert that they have received contradictory information from the National Debt Office. First the Debt Office informed them that deviation is possible, but then retracted this. The Swedish Pensions Agency and Sida have independently concluded that the framework agreement allows very limited scope for renewed calls for competition.<sup>25</sup>

At the same time the Swedish NAO can note that Kammarkollegiet, with the knowledge of the National Debt Office, has used renewed calls for competition as one of several tools to ensure cost-effective foreign currency exchange.

In an interview, representatives of the National Debt Office state that there is some scope for interpreting the agreement more freely, for example by deviating from the ranking and exposing the banks to competition. However, the National Debt Office does not consider it to be their place to express an opinion on these possibilities. According to them, deviating from the ranking is instead the responsibility of each individual agency.<sup>26</sup>

### 3.3.3 *Insufficient support from the Swedish National Debt Office*

A contributory reason for Sida paying a relatively large amount for its foreign currency exchange is that the bank manages Sida's operational risk. Representatives of SEB maintain that automatic processing through the service "Payment to bank branches abroad" is a secure method for customers with many and complex payments. The difference in prices between automatic and manual currency management, according to SEB, should be weighed against the cost of maintaining own staff with currency competence and against the operational risk entailed by carrying out necessary controls manually for each payment.<sup>27</sup>

The Swedish NAO can note, however, that Sida currently carries out manual controls for each payment, in line the agency's payment guidelines.<sup>28</sup> This means that the agency pays extra for a risk that is already largely managed by the agency itself.

In an interview the National Debt Office has pointed out the possibility of making manual exchanges, in other words, phoning up the bank and negotiating exchange rates. This normally gives a better outcome than an automatic rate. The National Debt Office has not communicated this to Sida, despite the fact that Sida has its own manual controls. Aside from discussions of the possibility of exposure to competition, neither Sida nor the National Debt Office have made any analysis of the possibilities of more effective foreign currency exchange in the context of the framework agreement.

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<sup>25</sup> Participation in a meeting between Sida and the Swedish Pensions Agency, 19 May 2014.

<sup>26</sup> Interview, National Debt Office, 7 March 2014.

<sup>27</sup> Telephone interview with SEB, 18 June 2014.

<sup>28</sup> Sida's procedure description for handling the Government Offices funding activities, 14 December 2012.



### 3.3.4 *Unclear how the volume discount may be used*

If an agency has exchanged more than SEK 50 million in one year, the agency receives a volume discount from the bank on the excess amount. The amount is paid as a lump sum at the end of the year. For 2013 Sida received about SEK 12 million for its foreign currency exchange.

The National Debt Office has not given instructions for how the discount obtained is to be dealt with. For 2011 Sida returned the entire amount to the agency's administration appropriation.<sup>29</sup> The Swedish NAO reacted to this, and after a statement by the National Financial Management Authority Sida returned the discount to the appropriation items it referred to. The Swedish NAO can note, however, that the National Debt Office did not inform other agencies of how the discount should be dealt with, and therefore some agencies decided to retain the funds for their own administrative costs.<sup>30</sup>

Furthermore, it can be noted that the discount can lead to unplanned appropriation savings. Instead of the funds being used to achieve the intended purpose during the budget year, the construction may result in unused funds that must be returned to the central government budget.

## 3.4 Comparison: Kammarkollegiet's foreign currency exchange

Kammarkollegiet exchanges foreign currency at noticeably better rates than Sida. Like Sida Kammarkollegiet handles a number of foreign payments for the Government Offices. The agency, like Sida, used the National Debt Office's framework agreement for payment services for currency trading and payments. Thus Kammarkollegiet has a remit from the Government Offices that is in line with that of Sidas, and the same formal conditions for its foreign exchange and payments. The agency's currency management differs from Sida's on several points, however.<sup>31</sup>

### 3.4.1 *Internal competence in currency trading*

Kammarkollegiet has several tasks within the area of asset management and a department for this purpose with about 30 employees. The department is also responsible for the agency's currency trading. There are several people at the agency with experience of currency trading. This differs from Sida, whose assessment is that it does not need staff with specific competence in currency trading. Kammarkollegiet also has written guidelines for its currency management, which clearly describes the steps of the process.<sup>32</sup>

### 3.4.2 *Access to market information*

Kammarkollegiet has two systems (SIX and Bloomberg) that give the agency continuously updated market information on current rates for relevant currencies, for example. Thus the agency does not trade at the spot rates set by the framework agreement banks for the day, as Sida does, but

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<sup>29</sup> Swedish NAO, Sida, Findings from audit of 2012 annual report, 13 April 2011.

<sup>30</sup> Interview, Kammarkollegiet, 7 April 2014.

<sup>31</sup> This entire section is based on interviews with Kammarkollegiet, 7 April 2014 and 6 May 2014.

<sup>32</sup> Kammarkollegiet, procedure description, currency transactions, 11 August 2010.

instead base their trading on selling and buying rates offered at the time of exchange. Information on rates is available for a large number of banks. This means that Kammarkollegiet is able to analyse the market and establish a reasonable spread for the currency transaction in question.

#### **3.4.3**            *Contact with the trading bank*

Unlike Sida, Kammarkollegiet has made the assessment that it is not bound by the ranking in the framework agreement in cases where the highest ranked bank cannot offer the best market price. The agency uses its knowledge of current buying and selling rates and chooses the framework agreement bank that offers the best rate for the current currency transaction. To ensure the best rate, one or more banks are also contacted by telephone to negotiate an even better rate than the bank's advertised rate if possible.<sup>33</sup>

#### **3.4.4**            *Access to foreign currency accounts*

Kammarkollegiet has currency accounts for the most commonly traded currencies. Consequently the agency can receive foreign currencies without needing to convert them. This means that some payments can be made without purchasing currency, by using the balance in the foreign currency account. Sida does not have this possibility, since they do not have incoming foreign payments to the same extent as Kammarkollegiet.

#### **3.4.5**            *Cost of Kammarkollegiet's payments*

Kammarkollegiet's procedures for currency trading mean that the agency's rates for its currency purchases differ considerably from Sida's. As described above, Sida trades its currency at the bank's advertised spot rate. Kammarkollegiet has instead a considerably more active approach and focuses its trading on prices that are as close to the mid-market price as possible. The agency's estimated average spread for SEK/EUR is 1 öre over one year, compared with almost nine öre for Sida. The corresponding estimated spreads for dollars and sterling, where Kammarkollegiet does not purchase in such great volume, are 2 and 2.5 öre, compared with more than 6 and 9 öre for Sida.<sup>34</sup>

### **3.5**    **Summary of findings**

To achieve cost-effective currency trading for Sida's foreign payments it is important that the centrally negotiated agreements the agency is bound by guarantee a good rate, and that the agency has a good understanding of how the currency market functions. Our audit shows, however, that there are deficiencies in these respects. We summarise below our findings concerning the Swedish National Debt Office framework agreement for payment services and how Sida manages its foreign currency exchange.

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<sup>33</sup> As described in the report, different agencies interpret the possibility of a renewed call for competition differently. The Swedish National Audit Office has not itself reviewed the matter.

<sup>34</sup> Telephone conversation with Kammarkollegiet, 23 June 2014

### **3.5.1** *The Swedish National Debt Office framework agreement for payment services does not guarantee cost-effective foreign currency exchange.*

The Swedish NAO can note that the National Debt Office's framework agreement for payment services uses a construction with volume discounts in arrears that means that the bank offering the best discount does not necessarily offer the most favourable net foreign exchange rates. Even if the framework agreement does not provide a guarantee that the agency will receive a good rate, according to the National Debt Office there is nothing in the framework agreement to prevent manual foreign exchange, in other words, telephoning the bank and negotiating exchange rates. Unless this is done the exchange is automatic, which normally gives less favourable outcomes than a negotiated rate. However, the National Debt Office has not given Sida any assistance on how more cost-effective exchanges could be made, apart from discussing the possibility of exposure to competition.

The National Debt Office has left it to the agencies themselves to determine whether the framework agreement allows deviation from the ranking to get the best rate. This has resulted in Kammarkollegiet considering that the framework agreement allows this and choosing the framework agreement bank offering the best rate for the currency transaction in question. Sida and the Swedish Pensions Agency on the other hand have made a different assessment and consider that it is not possible to deviate from the framework agreement ranking.

### **3.5.2** *Sida has not given priority to foreign currency issues and pays too much for its currency purchases*

The Swedish NAO's audit shows that Sida pays an unnecessarily high amount for its foreign currency exchange. Comparisons with other actors show that Sida should be able to obtain considerably better rates in its currency trading. The Swedish NAO's calculations for Sida's purchases of USD, EUR and GBP show that for these three currencies Sida has had an additional cost of about SEK 40 million.

#### **AUTOMATIC PLACING OF ORDERS WITHOUT CONTACT WITH THE TRADING BANK**

For payments in foreign currency Sida sends payment orders in a file to the agency's bank. The agency has no telephone contact with the bank to obtain information about, or negotiate, current rates.

Sida uses the National Debt Office framework agreement for payment services. The bank that is ranked first in the framework agreement for foreign payments executes all Sida's foreign exchange in connection with foreign payments. Sida has made the assessment that it is not possible to deviate from the ranking in the framework agreement to compare rates at other banks.

#### **NO SPECIFIC FOREIGN EXCHANGE COMPETENCE**

Sida has no staff with special competence in currency trading, but has used the framework agreement for payment services on the basis that it should ensure cost-effective foreign payments. Currency purchases made in the

context of approved payments are decentralised and processed by officials and administrators in the unit responsible. The agency's currency purchases are conducted according to the same guidelines as payments in SEK, and there is no special guidance as to how the agency should achieve sound currency management. Nor has Sida formed any opinion as to the effectiveness of foreign currency exchange, for example by using the bank's reporting of payments made or by engaging external expertise.

#### NO ACCESS TO MARKET INFORMATION

Sida bases its currency management on the daily spot rate published on SEB's website. This rate is entered into Sida's accounting system three times a week and is used by the agency's officials for calculating currency costs. The agency does not use any other market information about current rates.

## 4 Management of currency risk in development aid

Swedish development aid commitments are exposed to currency risk to the extent agreements made refer to foreign currency. For the part of aid that is to be paid in Swedish kronor it is instead the recipients who bear the currency risk. There are a number of more or less advanced methods for calculating currency exposure. We make no such calculations but confine ourselves to noting that the total exposure depends on the currencies in which the aid commitments are made, the liquidity of these currencies and the share of each currency in the total aid commitment. Other factors to take into account are payment dates and the risk of deferred payments.

### 4.1 Recipients bear the currency risk for Sida's aid decisions

Sida only makes decisions on outgoing payments in Swedish kronor. This means that the agency does not bear any currency risk for its own operations. However, there has been a discussion within the agency that aid decisions in Swedish kronor may entail currency risk for providers and recipients of Swedish aid. This is a consequence of fluctuations in the exchange rates for the Swedish krona and the recipients' currencies. Since in many cases Sida funds projects or programmes over a period of several years, exchange rate fluctuations over time may be substantial. For aid recipients that type of risk may entail great uncertainty as to future payment flows.

The Swedish NAO notes that this type of currency risk for recipients also includes a large proportion of the payments that are not exchanged by Sida. This is because the major part of Swedish aid is provided outside Sweden, and must therefore be exchanged by the recipient from SEK. This currency purchase is then normally carried out by a party who probably has a worse negotiating position than the Swedish State.

In common with other agencies, through the National Debt Office Sida is able to hedge future payments in foreign currency. The agency should thus be able to offer hedged payments to recipients of Swedish aid. However, this has not been implemented by the agency.

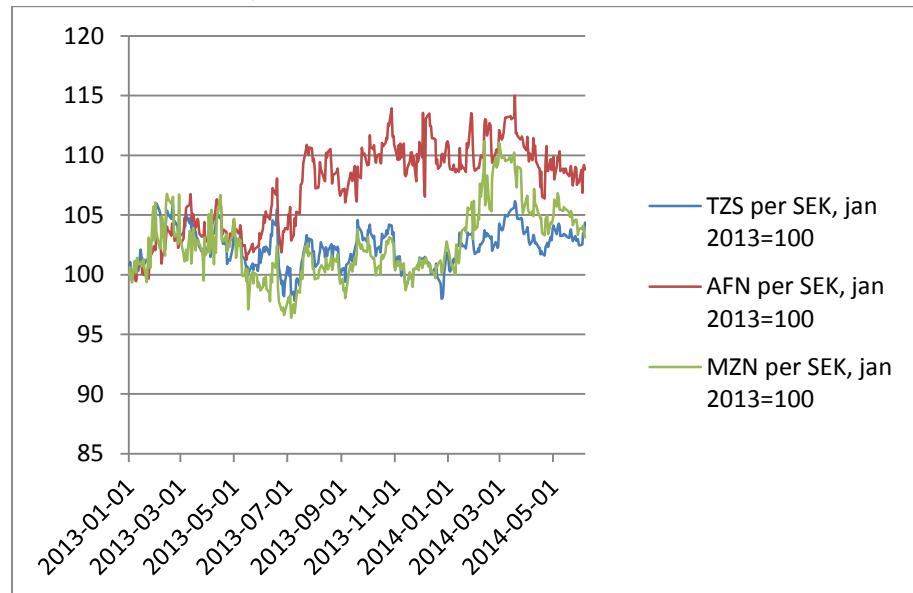
There are recipients of Swedish development aid that have their own active currency management, and the need for hedged payments differs between different recipients. UN organisations, development banks and global funds, as well as some large non-government international aid organisations work actively with different methods to prevent development aid funds being exposed to exchange rate fluctuations and high inflation rates in the countries where they operate.<sup>35</sup> But for organisations without their own resources for managing these issues it would be an opportunity to increase the security of incoming funds.

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<sup>35</sup> The Wall Street Journal, Charities Turn to Currency Hedging, 17 March 2011, Charity Finance Directors' Group and Stamp Out Poverty (2011), Better FX, A Guide to Improved Foreign Exchange Practice in the UK Charity Sector and quality assurance correspondence with the Ministry for Foreign Affairs, 25 August 2014.

Figure 4.1 shows how the currencies in the three countries that receive most development aid from Sida (Mozambique, Tanzania and Afghanistan) have developed relative to the Swedish krona since January 2013. The fact that the rates fluctuate up and down could be an argument to review the current system of aid decisions in SEK without hedging. However, the major part of Swedish development aid is channelled into the recipient countries via projects in which the payments are made in USD and EUR, rather than in local currency. Consequently, it is more relevant to consider the need for hedging against these currencies. As the value of the krona also varies against these currencies (see Figure 4.2 on page 30) hedging would mean that both donor and recipient would know the exact value of Swedish aid in advance.

Figure 4.1. Relative exchange rate movements against SEK in selected aid recipient countries, index 1 January 2013=100



Source: Macrobond and own calculations. Cross rates calculated on rates against USD.

As described above, Sida has not taken any initiative to offer recipients hedged payments, to protect aid-funded operations from negative exchange rate movements. At the same time the Swedish NAO notes that the agency has not taken any action either to ensure exchange rate gains when exchange rate movements are positive. If exchange rates fluctuate in such a way as to give the recipients more funds in local currency than they applied for, these are not paid back to the Swedish State.

This issue is dealt with differently by Sida's Norwegian equivalent, Norad, for example. Norad has formulated requirements that exchange rate gains arising due to exchange rate fluctuations must be paid back by the recipient. Only budgeted funds applied for can be used by the recipient.<sup>36</sup>

<sup>36</sup> Email from Norad, 15 August 2014.

## 4.2 Management of currency risk for development aid approved by the Government and Government Offices

### 4.2.1 *The Government Offices make decisions in foreign currency*

Unlike Sida, in some cases the Government makes decisions in currencies other than Swedish kronor. These decisions are dealt with by the Government Offices, and paid out by Sida. This mainly refers to funds that are allocated to multilateral and international organisations and funds. Decisions in foreign currency are normally commitments for several years. In 2013 there were eleven approved commitments in EUR and USD, with periods of validity of between two and thirteen years, as well as about 30 one-year decisions. The longest commitment approved in foreign currency runs until 2022. Outstanding commitments in foreign currency amounted to a total of about SEK 11.9 billion in 2013, valued at the exchange rate on the balance sheet date. In 2013 about SEK 920 million was paid out under decisions made by the Government Offices in foreign currency.

For commitments longer than one budget year there must be Riksdag authorisation. Every year in the Budget Bill the Government requests an authorisation framework from the Riksdag for outstanding and new commitments. The authorisation framework is decided in Swedish kronor, and consists of both commitments in SEK and other currencies. The size of the part approved in foreign currency is calculated using an exchange rate forecast from the Ministry of Finance.<sup>37</sup>

Up to and including 2010 these commitments were handled entirely by the Ministry for Foreign Affairs. The Ministry for Foreign Affairs then used the Ministry of Finance forecast rate for all calculation and reporting of the authorisation framework. The situation changed in that the Government decided to give Sida the responsibility for reporting the authorisation framework from 2011.<sup>38</sup> Sida measures incoming and outgoing commitments in foreign currency based on the exchange rate on the balance sheet dates<sup>39</sup>. This means that the valuations of the use of the authorisation framework by the Ministry for Foreign Affairs and Sida differ from year to year, in pace with exchange rate fluctuations.

The Ministry for Foreign Affairs makes a forecast of payments for the coming budget year. This planning uses a budgeted exchange rate for the coming year that is specified by the Ministry of Finance. A margin between outstanding commitments and the authorisation framework is added to avoid exceeding the appropriation ceilings.<sup>40</sup> Apart from this margin, neither Sida nor the Ministry for Foreign Affairs carries out any hedging of the decisions made in foreign currency.

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<sup>37</sup> Interview, Ministry for Foreign Affairs, 18 June 2014.

<sup>38</sup> Instruction to the Swedish International Development Agency (Sida) to transfer parts of the responsibility for processing of grants in expenditure area 7 from the Government Offices/Ministry for Foreign Affairs to Sida, UF2010/37907/USTYR, 23 June 2010. In 2011 and 2012 Sida prepared accounts based on information on financial commitments provided by the Ministry for Foreign Affairs. In 2013 the agency obtained documentation from the Ministry for Foreign Affairs that enabled it to prepare the accounts itself.

<sup>39</sup> Sida's annual report 2013, p. 157.

<sup>40</sup> Interview, Ministry for Foreign Affairs, 18 June 2014.

#### 4.2.2 *Lack of hedging leads to deficient budgeting*

##### THE GOVERNMENT OFFICES FORECAST FOR THE AUTHORISATION FRAMEWORK

The commitments approved in foreign currency normally run for several years. Most run for at least three years. This means that the risk of considerable exchange rate fluctuations is great. The forecast rates used by the Ministry for Foreign Affairs to calculate the authorisation framework in the Government's Budget Bills have therefore been slightly higher than the daily rates. The average forecast rate for EUR is about SEK 9.3 per EUR and the corresponding rate for USD is SEK 7. However, there are considerable differences between the forecast rates for individual commitments.<sup>41</sup>

A high estimated forecast rate initially leads to an authorisation framework with a high value. The purpose of the highly estimated rate is to leave room for exchange rate fluctuations. The long periods of commitment mean, however, that currency changes over time may be considerable. This is shown, for example, in calculations of outstanding commitments at the closing rate that Sida carried out when preparing its annual report for 2013. The difference between the Government Offices forecast rate and the daily rate on 31 December 2013 was SEK 5 million. For individual commitments, however, there were differences of more than SEK 400 million.<sup>42</sup> This led Sida to conclude that there is a risk that an appropriation item and/or an allocated authorisation framework may be exceeded.<sup>43</sup> In the financial audit of Sida's annual report for 2011 the Swedish NAO found that Sida reported outstanding commitments in the authorisation report that were more than SEK 1.2 billion too high, mainly for commitments in EUR, since they did not then use the closing day exchange rate.<sup>44</sup>

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<sup>41</sup> Email from Sida, 9 May 2014.

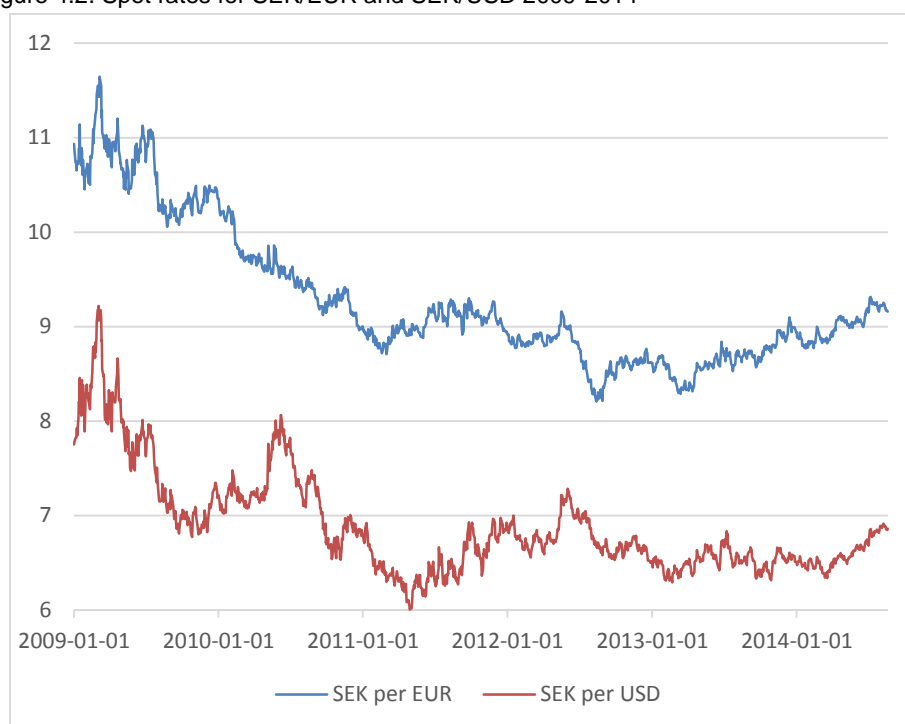
<sup>42</sup> Email from Sida, 9 May 2014.

<sup>43</sup> Sida's annual report 2013, p. 149.

<sup>44</sup> Swedish NAO, Sida, Findings from audit of 2011 annual report, 13 April 2011.



Figure 4.2. Spot rates for SEK/EUR and SEK/USD 2009-2014



The average period for commitments in foreign currency is about five years. The graphs above show movements for EUR and USD over a five-year period. As can be seen, the fluctuation in rates is considerable, which underlines the difficulty of forecasting a rate over such a long period.

#### THE GOVERNMENT OFFICES FORECASTS FOR PAYMENTS DURING THE BUDGET YEAR

As described above, the Ministry for Foreign Affairs makes a forecast of payments for the coming budget year. When calculating the equivalent in Swedish kronor a forecast rate is used with a margin, to reduce the risk of exceeding appropriation ceilings. The Ministry for Foreign Affairs handles any differences between forecast and outcome and where necessary makes changes to appropriation directions to redistribute funds between appropriation items in the expenditure area. This is done either to cover exchange rate losses or allocate exchange rate gains.<sup>45</sup> For 2013 the difference between forecast and outcome was a surplus of SEK 136.5 million.<sup>46</sup> This was equivalent to about 13 per cent of budgeted funds and thus had to be reposted to other appropriation items.

#### 4.2.3 *Sida bears the currency risk for decisions dealt with by the Government Offices*

In that Sida is responsible for payments and reporting appropriation items where the Ministry for Foreign Affairs makes decisions, the currency risk for

<sup>45</sup> Interview, Ministry for Foreign Affairs, 18 June 2014.

<sup>46</sup> Email from Sida, 9 May 2014.

the decisions lies with the agency. This is despite the fact that the agency is not responsible for the entire chain from the decision.<sup>47</sup>

The National Financial Management Authority (ESV) has previously proposed that Sida should conduct a dialogue with the Government Offices to seek an agreement on hedging to improve the budget work and eliminate the risk of unforeseen exchange rate costs.<sup>48</sup> According to Sida, in a meeting with the Ministry for Foreign Affairs in December 2013 the agency pointed out that currency exposure could be hedged. According to Sida the Ministry for Foreign Affairs commented that in that case it was a matter for the Ministry of Finance.<sup>49</sup> As described above, in its annual report for 2013 Sida also pointed out risks associated with these commitments.<sup>50</sup> The shared responsibility between the agencies seems, however, to be an obstruction and according to Sida it is an open question whether it is Sida or the Government Offices that where necessary should enter into a forward cover agreement. Sida cannot hedge before the agency has been notified by the Government Offices of the date of payment, and according to Sida this can in some cases come at short notice even if the commitment had been known for a long time.

In its financial audit of Sida's annual reports, as well as in its annual report, the Swedish NAO has for a number of years been pointing out the problems of shared responsibility between the Government Offices and Sida. Since the aid commitments concerned are prepared by the Government Offices and approved by the Government, they are not covered either by the Government Agencies Ordinance (2007:515) or by the Ordinance on Internal Control (2007:603). In other words, in this case there is no explicit responsibility for internal control regarding future commitments totalling SEK 11 billion of central government funds. Sida's responsibility is limited to administrative controls and effecting payments.<sup>51</sup>

The Ministry for Foreign Affairs and the Ministry of Finance have previously held a discussion on whether the authorisation framework can be approved in foreign currency and the question has been put to the Riksdag Committee on Finance. The Riksdag Committee on Finance has, however, decided that only bank guarantees are to be in foreign currency, not funds intended for payment. The decision of the Committee on Finance has become a guiding principle.<sup>52</sup>

### 4.3 Comparison: The Swedish Defence and Security Export Agency's management of currency risk

The remit of the Swedish Defence and Security Export Agency (FXM) is to promote Swedish defence exports when of interest from the point of view of

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<sup>47</sup> Since Sida was tasked with this the Swedish NAO has on several occasions pointed out problems with the broken chain of responsibility. See for example the Annual Reports of the Auditors General for 2012, 2013 and 2014.

<sup>48</sup> The National Financial Management Authority (2010) Sidas arbete med internal control (Sida's internal control), Government commission, Report part 1.

<sup>49</sup> Quality assurance correspondence with Sida, 25 August 2014.

<sup>50</sup> Sida's annual report 2013, p. 149-50.

<sup>51</sup> See the Annual Reports of the Auditors General for 2012, 2013 and 2014.

<sup>52</sup> Interview, Ministry for Foreign Affairs, 18 June 2014.

defence and security policy. When FXM represents the Swedish State in intergovernmental agreements the agency manages the currency risk to which the State is exposed. Like Sida, FXM processes agreements that run for many years with a number of annual payments. The difference is that in the case of FXM it is almost exclusively a matter of incoming payments to the Swedish State instead of outgoing payments, which is the case for Sida. The annual volumes in FXM's agreements amount to about SEK 1-1.5 billion, which is about the same volume as the annual payments as regards Swedish development aid commitments in foreign currency. The largest transactions involving FXM are the intergovernmental agreements in the JAS project, which will have a turnover of about SEK 35 billion up to 2027. The agreements normally run for ten years or more. The counterpart countries, currently Thailand, Hungary and the Czech Republic, pay a fixed amount per year during the period of the agreement which includes all auxiliary services.<sup>53</sup>

#### *4.3.1 All intergovernmental agreements are hedged*

FXM signs forward contracts with the National Debt Office for all intergovernmental agreements after each agreement is signed. FXM signs a forward contract for each individual payment. If, for example, an agreement runs for ten years with one payment for each year, this entails ten forward contracts with ten different maturities, from one to ten years. What is hedged is the current price in the sale. The various indexations that are normally written into the agreements are not, however, hedged.

Forward cover is normally more expensive the longer the maturity, which is an argument against hedging Swedish aid commitments<sup>54</sup>. But FXM feels that the cost is very low, despite long maturities. In an interview, representatives for the agency say that they can eliminate the entire risk at low cost and that the National Debt Office prices are often close to the current rate.

If FXM signs agreements in a currency that is not convertible to SEK, an exchange is made into USD that then becomes a SEK forward agreement.

#### *4.3.2 Deferred payments are not seen as a problem*

Another argument against hedging Swedish aid commitments is that the exact time for payments of long-term commitments is not known in advance. This makes it more difficult, since currency forwards must include the exact future maturity date when the currency must be delivered. This is also a factor to take into account in defence export cases, as payments can be deferred or brought forward in relation to the agreed payment date. The Swedish Defence and Security Export Agency does not feel, however, that deferred payments would entail any major problems for forward cover. If a payment is received too early the money is put into a foreign currency account. If a payment is delayed the forward contract is rolled out instead, which is dealt with by the National Debt Office. According to FXM this is

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<sup>53</sup> This entire section is based on an interview with the Swedish Defence and Security Export Agency, 13 June 2014.

<sup>54</sup> Provided the interest rate in Sweden is higher than in the counterparty country.

fully possible, even if there were repeated delays, which is, however, very unusual.

#### **4.3.3 *Supplementary competence***

The Swedish Defence and Security Export Agency's currency management is dealt with by the agency's chief financial officer and two controllers. The agency states that it does not wish to build up an unnecessary amount of competence since this would just duplicate the competence that exists in other parts of central government, such as the National Debt Office or the Swedish Exports Credits Guarantee Board. On the other hand, the agency has a business responsibility and needs to have control and some measure of own knowledge, for example in dialogue with the National Debt Office and counterparties. In the interview with the Swedish NAO representatives of the agency stress the need for balance and supplementary competence in this respect.

### **4.4 Management of currency risk in Sida's guarantee operations**

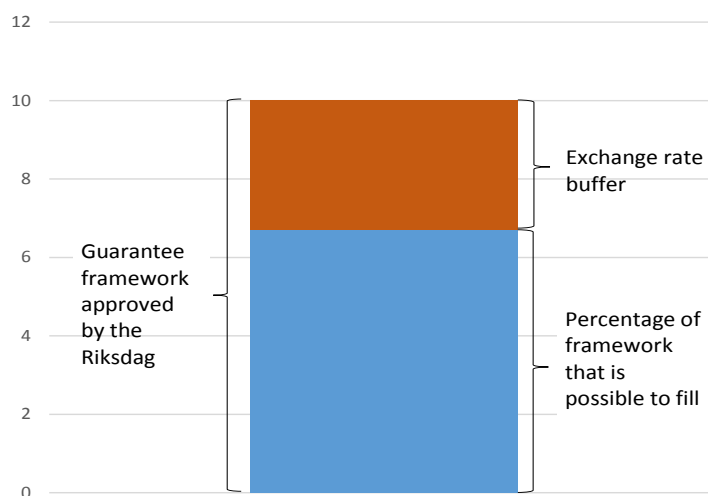
A central government guarantee commitment means that central government stands surety for someone else's payment commitment, which entails a financial risk for the State. Sida has an approved guarantee framework of SEK 10 billion and to date has issued guarantees worth about SEK 2.3 billion.

Sida's guarantees are approved in SEK, but in international contexts Sida's partners, such as other countries' aid agencies, normally require guarantees in USD. In these contexts Sida's practice has been to bear currency risk up to SEK 10 per USD, which is stated in the guarantee agreements. This means that the agency enters into agreements to eliminate currency risk for the extreme cases when a US dollar costs more than SEK 10, but in other respects is exposed to currency risk, since the underlying commitment is in USD. For new agreements<sup>55</sup> the commitment is instead set at the current USD rate plus 50 per cent, which at present is about the same as SEK 10. Since currency risk is included in Sida's guarantee framework, the framework does not amount to the SEK 10 billion decided by the Riksdag but rather to SEK 6.7 billion, i.e. the maximum amount that can be utilised to enable Sida to have a foreign exchange rate buffer of 50 per cent.

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<sup>55</sup> Applied to agreements prepared after the decision date 23 October 2013.

Figure 4.3. Sida's approved guarantee framework adjusted for exchange rate buffer, SEK billion.



Source: Swedish National Audit Office calculations

Sida's guarantee operations are regulated in the Ordinance on financing of development loans and guarantees for development cooperation (2009:230). Under this Ordinance a contingency reserve must be set up to cover any losses for guarantees issued under the ordinance. The contingency reserve must include the guarantee recipients' premium payments and provisions. According to the Ordinance the contingency reserve must be administered by the Swedish Exports Credits Guarantee Board and placed in an interest bearing account with the National Debt Office.

As a comparison it can be mentioned that the Swedish Exports Credits Guarantee Board (EKN) manages currency risk for its own guarantee operations by placing liquid assets in foreign currency, which is regulated in the Ordinance on loans and guarantees (2011:211) (see also section 4.5) . That possibility is not applied for Sida's guarantees. Nor is hedging through forward transactions under consideration since guarantee operations do not include any cash flows that are known in advance.

According to representatives of Sida the agency has tried to have the Ordinance on funding of development loans and guarantees for development cooperation (2009:230) rewritten so that Sida can apply for foreign currency accounts for guarantee operations.<sup>56</sup> The Ministry for Foreign Affairs states that Sida and the Ministry for Foreign Affairs have been discussing amendments to the Ordinance. Questions on hedging have been mentioned, but not discussed in detail.

The main reason for a review is instead that the current Ordinance stipulates that Sida must apply to EKN for risk assessment of its guarantees. However, it has proved difficult for EKN to evaluate Sida's project, since they have other types of risk in their guarantee portfolio. Sida has therefore started to apply to the National Debt Office for help, which Sida considers should be formalised in the Ordinance. In July 2014 Sida formally proposed such amendments to the Ordinance, in the agency's reporting of a

<sup>56</sup> Interview, Sida, 12 June 2014.

government assignment to develop innovative forms of aid and financing.<sup>57</sup> In this context it can be noted that the National Debt Office does not consider that this Ordinance explicitly prevents Sida from setting up a guarantee reserve in foreign currency.

#### 4.5 Comparison: Hedging in EKN's guarantee operations

The Swedish Exports Credits Guarantee Board (EKN) is tasked with promoting Swedish exports by offering export credit guarantees and investment guarantees. The operations differ from Sida's guarantee operations in that the agency only deals with business risk and not the type of risk that is specific to different types of aid projects.

EKN's performance is influenced by the movements of the Swedish krona against above all EUR and USD, since two thirds of EKN's guarantees are concluded in these two currencies. For the purpose of minimising the effect of exchange rates on performance EKN matches the insurance-based debt in different currencies with the corresponding assets in each currency. The outstanding currency exposure is adjusted at the time of each quarterly report.<sup>58</sup> The objective is zero currency exposure. EKN's assets in foreign currency are placed in government securities, government-guaranteed bonds issued by international financial organisations, such as the Nordic Investment Bank or the European Investment Bank. EKN has no equivalent to the exchange rate buffer included in Sida's agreement for freestanding guarantees.

#### 4.6 Summary of findings

Every year Sida, the Government Offices and the Government make decisions on funds that will mainly be spent outside Sweden, in currencies other than SEK. In addition Sida issues guarantees for financing development projects. However, neither Sida nor the Ministry for Foreign Affairs has dealt with the resulting currency risk apart from the currency buffer applied by Sida to guarantees. Currency risk entails uncertainty for both recipients and the Swedish State.

##### 4.6.1 *The currency risk for decisions made in SEK lies with the recipient*

Sida makes its decisions in SEK. The agency does not hedge its decisions, which means that the recipients and providers of Swedish development aid assume the risk of any changes in the exchange rate between SEK and the currency in which the development aid is to be provided. The rate between two currencies can move considerably over time, and therefore the recipients cannot be sure of the actual amount of Swedish development aid they will ultimately receive. In many cases Sida supports projects that span several years, which entails increased currency risk for the recipients.

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<sup>57</sup> Sida (2014) Reporting under appropriation directions for the 2014 budget year under Government decision of 19 December 2013.

<sup>58</sup> Telephone conversation with EKN, 23 June 2014.

#### **4.6.2 *Unhedged decisions made in foreign currency lead to deficient forecasts***

Unlike Sida, the Government makes some decisions in foreign currency. These decisions often apply to commitments that span long periods of time. On average existing commitments run for about five years. These commitments are not hedged. Instead a forecast rate is used to calculate the Swedish commitment at the time of the decision. The result is a weak budget forecast and major differences in outcome from year to year. The Ministry for Foreign Affairs handles this reactively by redistributing the authorisation framework for different appropriation items in the expenditure area, depending on exchange gains, exchange losses or updated forecasts. In 2013 SEK 136.5 million of the budgeted funds for the commitments approved in foreign currency had to be redistributed.

Since Sida took over the accounting for the authorisation framework the agency bears the risk of any exchange rate losses, without having responsibility for decisions made. The agency has noted that there is a risk of an appropriation item and/or an allocated authorisation framework being exceeded. However, there is no agreement between Sida and the Ministry for Foreign Affairs on how this risk should be managed. The matter is instead dealt with through regular contacts. The unclear division of responsibility between Sida and the Ministry for Foreign Affairs means in this specific case that there is no explicit responsibility for internal control regarding future commitments totalling SEK 11.9 billion of central government funds.

Through FXM central government is exposed to currency risk that in many ways resembles that of the unhedged development aid decisions. FXM has contracts that run for up to ten years, with annual currency flows of about SEK 1-1.5 billion. Unlike the Ministry for Foreign Affairs and Sida, however, FXM uses the Swedish National Debt Office for hedging. The agency states that hedging is undertaken at a rate very close to the daily rate, and that there is great flexibility for handling variable payment dates.

#### **4.6.3 *Sida's guarantees are not explicitly hedged***

The Riksdag has decided on a guarantee framework for Sida of SEK 10 billion. At present Sida has issued guarantees worth SEK 2.3 billion. The agency intends to fill the framework in the next 2-3 years.

Sida approves its guarantees in SEK, but the underlying commitment is normally in USD. Sida's practice is to bear currency risk up to the current USD rate plus 50 per cent, which is stated in the guarantee agreements. This entails a considerable currency risk for the agency. Since currency risk is covered by Sida's guarantee framework, the framework is worth about SEK 6.7 billion instead of the SEK 10 billion that applies under the Riksdag decision.

Sida's guarantee operations have a hedging reserve set up to cover any defaults. Under the Ordinance on financing of development loans and guarantees for development cooperation (2009:230) the hedging reserve must be placed in an interest-bearing account with the National Debt Office.

As a comparison it can be mentioned that the Swedish Exports Credits Guarantee Board (EKN) manages currency risk for its own guarantee

operations by placing liquid assets in foreign currency, which is regulated in the Ordinance on loans and guarantees (2011:211). That possibility is not at present applied for Sida's guarantees. In July 2014 Sida proposed an amendment to the Ordinance (2009:230) that would allow corresponding treatment of Sida's guarantees. In this context it can be noted that the National Debt Office does not consider that this Ordinance explicitly prevents Sida from setting up a guarantee reserve in foreign currency.



## 5 Conclusions and recommendations

The Swedish National Audit Office has audited central government management of currency exchange and currency risk in international development aid.

Cost-effective currency management for central government foreign payments can save money for the treasury or give a better exchange for funds allocated. Hedging future central government commitments can create predictability and transparency. In light of this, currency exchange issues are of significance for effective and results-oriented aid.

The Swedish NAO's overall conclusion is that Sida's and the Ministry for Foreign Affairs' management of currency exchange and currency risks do not contribute to effective and predictable development aid. Currency risks have not been taken into account, and Sida's currency exchange cannot be said to exhibit high effectiveness and sound management of public funds. The National Debt Office bears part of the responsibility, since it has not given the agencies conducting foreign exchange sufficient support in how this should be conducted cost-effectively. According to the Swedish NAO, currency management cannot be considered to contribute to the Government's ambitions regarding performance, cost effectiveness and transparency in aid.

### 5.1 Currency issues are not given priority in development aid

The Swedish NAO notes that currency management in international development aid has not been a priority issue for either the Ministry for Foreign Affairs or Sida. Neither Sida nor the Ministry for Foreign Affairs have staff with specific competence in foreign exchange and they have not used the expertise available in other agencies to a sufficiently high degree.

#### *5.1.1 Sida's foreign currency purchases are not cost effective*

Sida has paid too much for the foreign currency exchange in connection with the agency's outgoing payments to recipients outside Sweden. According to the Swedish National Audit Office's calculations central government paid about SEK 6 million too much for purchase of currency in 2013. At the same time the recipients have lost about SEK 33 million. The Swedish NAO does not consider that Sida has done enough to ensure that currency purchases are cost effective. The agency does not collect information on current market rates, and does not contact the bank to obtain information about, or negotiate, the current rate. Nor has Sida formed any opinion as to the effectiveness of foreign currency exchange, for example by using the bank's reporting of payments made or by engaging external expertise.

### **5.1.2** *There is no allocation of responsibility for currency risk in Swedish commitments*

There are currency risks in Swedish aid that are not managed either by the Ministry for Foreign Affairs or Sida. There is a total of unhedged commitments approved by the Government of almost SEK 11.9 billion. The need for hedging to create reliability of forecasts and transparency for the central government budget and foreign recipients has not been evaluated. Instead funds have been allocated reactively between appropriation items on the basis of exchange rate gains/losses. In 2013 SEK 136.5 million of the budgeted funds for the commitments approved in foreign currency had to be redistributed in this way.

According to the Swedish NAO, the fact that these commitments are not hedged is partly a result of the broken chain of responsibility that exists in the processing of some development aid decisions. This is since the Government instructed Sida to deal with payments on behalf of the Government Offices. In most cases there are sound reasons for sharing tasks and responsibility between different central government actors. However, joint responsibility must not entail broken chains of responsibility resulting in no actor having or taking responsibility for the central government commitment or for public funds being used in accordance with sound financial management. As the Swedish NAO has shown in the audit, there is not only a lack of sound currency management within development aid, there is also a lack of consensus between the Ministry for Foreign Affairs and Sida as to whose responsibility this is.

### **5.1.3** *Both central government and recipients of Swedish aid are exposed to currency risk in Sida's operations*

Sida makes all its decisions on development aid in Swedish kronor. The agency does not hedge its decisions, which means that the recipient and provider of Swedish development aid assume the risk of any changes in the exchange rate between Swedish kronor and the currency in which the development aid is to be provided. The rate between two currencies can move considerably over time, and therefore the recipients cannot be sure of the actual amount of Swedish development aid they will ultimately receive. In many cases Sida supports projects that span several years, which entails increased currency risk for the recipients.

The Swedish NAO notes that Sida has overlooked the possibility of offering hedged payments to aid recipients who need them.

It is true that there is an awareness of the issue at the agency, but despite this no initiatives have been taken to investigate how the situation could be improved.

The commitments included in Sida's guarantee operations also have deficiencies regarding hedging. The Swedish NAO notes that it is Sida's practice has been to assume a currency risk of up to SEK 10 per dollar, which means that the agency has considerable currency risk in guarantees issued. In addition the agency's actions mean that the guarantee framework is worth about SEK 6.7 billion instead of the SEK 10 million that applies under the Riksdag decision. This means that Sida cannot effectively issue guarantees to the full value of the framework.

## 5.2 The National Debt Office must contribute more for currency management to be efficient

The Swedish NAO notes that the National Debt Office's framework agreement for payment services etc. does not in itself ensure that agencies get a good foreign exchange rate. Instead each individual agency must itself negotiate with the bank to obtain a good exchange rate. In this light the National Debt Office should have worked actively to give support to agencies that carry out foreign exchange transactions to enable them to conduct these transactions efficiently.

However, the Swedish NAO notes that Sida did not receive sufficient support from the Swedish National Debt Office. The position taken by the National Debt Office is that it is the responsibility of each respective agency to determine how the framework agreement for payment services is to be used for foreign currency. Different agencies have also been given differing information concerning the use of the framework agreement. This has meant that different agencies interpret and use the framework agreement in different ways. Sida, with no knowledge of foreign exchange matters, has thus been overcharged for its currency purchases.

Central government cash management at the Swedish National Debt Office must ensure, under the appropriation directions, that the central government payment model fulfils the explicit requirements of the Riksdag and Government for cost effectiveness, security, information and freedom of choice. There must be neutrality of competition in the State's relation to the banks and service to the Debt Office's cash management customers must be good. The Swedish NAO's assessment is that the National Debt Office, as the agency responsible for the framework agreement and for the central government payment model has not contributed sufficiently to effective central government currency management.

## 5.3 Great potential for more effective currency management in development aid

In this report the Swedish NAO has shown several examples of how other agencies work to achieve cost-effective foreign exchange, predictability in payment flows and matching of guarantee commitments in foreign currency. These examples show that there is great potential for improving the effectiveness of foreign currency management in Swedish development aid.

## 5.4 The Swedish National Audit Office's recommendations

### RECOMMENDATIONS TO THE GOVERNMENT

- *Ensure that Swedish commitments are not characterised by currency risk.* The Government should make the chain of responsibility clear for development aid payments approved by the Government Offices. Thereafter the organisation responsible should be instructed, with support from the Swedish National Debt Office, to clarify the currency risks in development aid commitments and how these can best be managed.

- *Ensure that agencies impacted by currency issues get help from the Swedish National Debt Office.* The Swedish National Audit Office recommends an amendment to Sections 12-13 of the Ordinance on central government agencies' payments and management of funds (2006:1097), to indicate that agencies with major currency management need to obtain help from the Swedish National Debt Office to analyse their need of foreign currency accounts and hedging.
- *Give Sida the opportunity to hedge its guarantees.* The Government should change Ordinance (2009:230) on financing of development loans and guarantees for development cooperation to clarify that Sida's guarantee reserves for commitments in foreign currency can be matched against assets in foreign currency.

#### RECOMMENDATIONS TO SIDA

- *Ensure that foreign currency purchases in development aid are made cost effectively.* Sida should immediately change to more active management of agencies' currency purchases. The agency should seek help from the Swedish National Debt Office to obtain support in the best management for the remainder of the current framework agreement. As the framework agreement only runs until the end of March 2017 this should be done immediately.
- *Increase knowledge of currency matters in Swedish development aid.* Sida should strengthen its competence in currency matters. The agency should also more actively use central government competence in currency management and guarantees, found at the Swedish National Debt Office and the Swedish Exports Credits Guarantee Board.
- *Investigate whether Sida can contribute to reducing currency risks for recipients of Swedish development aid.* Sida's decisions in Swedish kronor entail currency risks for the recipients and providers of Swedish development aid. Sida should, in dialogue with the parties concerned and the Swedish National Debt Office, investigate whether it is possible to offer cost-effective central government hedging for approved funds.

#### RECOMMENDATIONS TO THE SWEDISH NATIONAL DEBT OFFICE

- *Clarify how the framework agreement for payment services can be used.* The Swedish National Debt Office should clarify how the current framework agreement for payment services should be interpreted as regards renewed exposure to competition of services that include foreign currency exchange. As the framework agreement only runs until the end of March 2017 this should be done immediately.

## Annex 1 - Method of calculating the cost of Sida's currency purchases

A description is given in this annex of how the Swedish NAO has calculated the cost of Sida's currency purchases. A description is also given of the method used to assess which rates the agency could have obtained if its currency management had been more active.

### Data collection from Sida

The Swedish NAO has obtained a list from Sida of all its payments for 2013, from Sida's accounting system. The list did not, however, contain information about exchange rates, or the outcome in amount exchanged. This information, as well as the value date, was found separately in the form of paper reports from SEB. The Swedish NAO therefore compiled the information for all payments where foreign exchange took place manually on site at Sida. For each payment the value date and currency rate were noted. In all 1 382 payments were noted where foreign exchange took place.

Table 1: Sida's payments by currency

Currencies		Number of payments	Total
AUD	Australian dollars	3	9 781 321
CAD	Canadian dollars	9	26 962 554
CHF	Swiss francs	31	138 696 086
DKK	Danish krona	43	152 272 791
<b>EUR</b>	<b>EUR</b>	<b>319</b>	<b>2 137 466 315</b>
<b>GBP</b>	<b>Pounds sterling</b>	<b>103</b>	<b>353 084 728</b>
HKD	Hong Kong dollars	1	5 000 000
INR	Indian rupees	9	6 459 818
KES	Kenyan shillings	17	163 983 054
NOK	Norwegian krona	20	62 362 714
SGD	Sudanese pounds	1	1 775 000
THB	Thai baht	17	46 491 324
<b>USD</b>	<b>American dollars</b>	<b>779</b>	<b>7 188 413 341</b>
ZAR	South African rand	30	112 041 515
<b>Total amount</b>		<b>1 382</b>	<b>10 404 790 562</b>

### Calculation of deviation from the Riksbank's fixing prices

The Swedish NAO selected three currencies for the calculation: USD, EUR and GBP. These three currencies were used in 87 per cent of the 1382 payments. In total Sida purchased these three currencies for almost SEK 9.7 billion.

For each of the three currencies the Swedish NAO compared the rate obtained by Sida with the Riksbank's fixing rate<sup>59</sup> for the relevant value date. The fixing rates represent the median value of the banks' buying and selling rates at a certain point every morning, in comparison with Sida's currency trading that takes place at the selling rate between about 12.00 and 14.00.<sup>60</sup> The comparison shows a difference between the rates obtained by Sida and the fixing rates that vary from payment to payment. The average deviation for each exchange during the year varies between the three currencies purchased; from about 300 points for USD to almost 500 points for GBP.

Table 6. Deviation between exchange rates obtained by Sida and the Riksbank's fixing rates

	<b>Average deviation in SEK</b>	<b>Average spread in SEK</b>
USD rate	0,0311	0,0622
EUR rate	0,0406	0,0812
GBP rate	0,0474	0,0947

## Establishment of alternative spread

To assess a conceivable alternative cost for Sida's foreign exchange transactions the Swedish NAO obtained help from the National Debt Office and Kammarkollegiet to establish commercial transaction costs, or spreads, for the three currencies.

By its own account, Kammarkollegiet, with an exchange volume of about SEK 2 billion, gets down to a deviation from the median of less than 50 points per EUR during one year's trading. This means a spread of 100 points. The corresponding estimated spread for USD and GBP respectively, where Kammarkollegiet does not trade in such great volumes, is 200 and 250 points.<sup>61</sup>

The National Debt Office states that a large company with about the same trading volume as Sida trades the largest currencies at an estimated spread of 60–80 points.<sup>62</sup>

On the basis of this, the Swedish NAO has assumed that Sida should be able to achieve an average spread for its three largest currencies of about 100 points, over one year's trading. This assumption is the basis of the calculation of the alternative cost for Sida's currency purchases.

<sup>59</sup> The Swedish banks submit exchange rates to NASDAQ OMX every day between 9.15 and 9.45. The rates the banks give are called mid-market rates and are the mean average of the buying and selling rates. At 10.05 NASDAQ OMX Stockholm AB sets a fixing rate by calculating the mean average of the various banks' exchange rates after excluding the highest and lowest rates quoted. These fixing rates are available on the Riksbank's website at about 12:10.

<sup>60</sup> SEB's procedure description: *Payment process, Sida's SISU payments to the Swedish National Audit Office, 28 July 2014.*

<sup>61</sup> Telephone conversation with Kammarkollegiet, 23 June 2014. The information refers to gross rates, i.e. before deduction of the banks' discount on the entire volume exchanged.

<sup>62</sup> Mail exchange with the Swedish National Debt Office, 19 June 2014.

## Calculation of cost

When calculating the alternative costs of Sida's currency purchases the Swedish NAO divided up the payments into two groups, depending on the currency used in the decision.

For decisions made in SEK a small transaction cost, or spread, means that Sida obtains more of the purchased currency (USD/EUR/GBP). Thus this means that the recipients receive a larger amount of the currency purchased, while the cost in SEK for Sida and the Swedish State is the same.

If the decision is made in foreign currency Sida must buy a certain amount in that currency. A small transaction cost, or spread, means that Sida pays fewer SEK to obtain the currency being purchased (USD/EUR/GBP). Thus the outcome is a saving in SEK that accrues to the central government budget.

In the calculations the Swedish NAO has disregarded the volume discount obtained by Sida within the framework of payment services etc. This is because the volume, and thus the discount, are not affected in the calculation example.

### *Decisions made in SEK*

When calculating the alternative cost of currency purchases for decisions made in SEK, 962 payments were analysed. For each separate payment the difference between the spread obtained by Sida and the spread of 100 points was calculated.

We then calculated how much of the purchased currency Sida received and sent to the recipient, and how much would have been received with the alternative spread. The result is a total of funds lost for each of the three currencies.

These three amounts in USD, EUR and GBP were then converted to a value in SEK. This was done by converting the value of lost funds for each individual payment at the respective daily rate. This rate also has a spread of 100 points.

Table 7. Decisions in SEK. Amounts not reaching the recipient in the respective currency.

<b>Purchased currency</b>	<b>Number of payments</b>	<b>Total in SEK</b>	<b>Lost funds in respective currency</b>	<b>Lost funds converted to SEK</b>
USD	655	7 002 673 667	4 046 612 USD	26 405 754
EUR	231	1 204 547 076	565 906 EUR	4 939 903
GBP	76	216 707 163	113 977 GBP	1 180 619
<b>Total</b>	<b>962</b>	<b>8 423 927 905</b>		<b>32 526 276</b>

### *Decisions made in foreign currency*

When calculating the alternative cost for currency purchases for decisions made in foreign currency 239 payments were analysed. For each separate payment the difference between the spread obtained by Sida and the spread of 100 points was calculated.

For each separate payment the difference in the cost of the currency purchase was then calculated.

Table 8. Decisions made in foreign currency. Additional cost for Sida.

<b>Purchased currency</b>	<b>Number of payments</b>	<b>Total in SEK</b>	<b>Additional cost in SEK</b>
USD	124	185 739 674	855 193
EUR	88	882 919 239	5 353 424
GBP	27	26 377 565	93 393
<b>Total</b>	<b>239</b>	<b>1 095 036 479</b>	<b>6 302 010</b>