

Australian Government foreign exchange risk management - guidelines for entities

Resource Management Guide (RMG) 120

May 2021

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ISBN: 978-1-925537-69-7 (Online)

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The words '**must**', '**required**', '**requires**' and '**requiring**' denote mandatory compliance by accountable authorities/officials. The use of the words 'could', 'may', 'encouraged' or 'consider' convey non-mandatory guidance. The guidance to which these words relate may or may not be applied by accountable authorities/officials in their approach to resource management, depending on the operating circumstances of the entity and its appetite for risk.

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Audience

Australian Government foreign exchange risk management – guidelines for entities (RMG 120) applies to officials and officers, particularly chief financial officers (CFOs), in Commonwealth entities and companies that:

- are subject to the *Public Governance, Performance and Accountability Act 2013* (the PGPA Act) and associated legislation (finance law)
- transact, or may be required to transact, in currencies other than the Australian dollar (AUD).

This RMG applies from 1 July 2021 onwards and does not apply retrospectively.

Exceptions:

The *Foreign exchange risk management* policy and this RMG do not apply to:

- Australian Broadcasting Corporation (ABC)
- Australian Office of Financial Management (AOFM)
- Export Finance Australia (EFA)[1]—National Interest Account
- entities classified as Public Financial Corporations or Public Non-Financial Corporations[2].

Key points

This guide:

- explains the Australian Government's policy on foreign exchange (forex) risk management and its implications for entities' operations
- supports officials in determining what may be considered a hedge
- assists officials in identifying and calculating forex gains, losses and exposures
- briefly describes how forex data must be reported to the Department of Finance (Finance) via the Central Budget Management System (CBMS)
- replaces:
    - Financial Management Guidance No. 2: *Australian Government Foreign Exchange Risk Management Guidelines,* September 2006
    - Finance Circular No. 2006/06: *Australian Government Foreign Exchange Risk Management Guidelines*.

[1] In certain circumstances, EFA may seek supplementation for forex losses made on its National Interest Account, but must also return forex gains to the Official Public Account.

[2] Further information on these types of entities can be found on the Finance website: *https://www.finance.gov.au/government/managing-commonwealth-resources/structure-australian-government-public-sector/pgpa-act-flipchart-and-list*.

For ease of reference and presentation, in this guide:

- **entities**—means Commonwealth entities and companies subject to the PGPA Act
- **officials**—means officials under the PGPA Act and officers of Commonwealth companies
- **manage**—means:
    - identifying, measuring, monitoring and reporting actual and expected financial transactions with a forex component
    - identify whether an arrangement (such as a contract, grant agreement, memorandum of understanding, deed or other similar arrangement) will be considered a hedge under the forex policy and identifying whether there may be non-compliance with the finance law
    - ensuring that procurements or arrangements with a forex component achieve value for money.

Resources

This guide is available on Finance website at *www.finance.gov.au*.

Other relevant publications include:

- the *Commonwealth Risk Management Policy*
- the *Commonwealth Procurement Rules*
- the *Model Accountable Authority Instructions (AAIs) - RMG 206* covering Commonwealth entities
- the *Government Policy Orders (GPOs)* covering corporate Commonwealth entities (CCEs)
- the *Finance Minister's delegation to accountable authorities of non-corporate Commonwealth entities.*

Part 1 – Introduction

1. This guide explains the Australian Government's policy on forex risk management and the framework under which it operates. The forex risk management policy (the forex policy) has been in place since 1 July 2002.

2. Prior to 2017, entities were required to provide a separate annual report on their forex exposures to Finance. Entities with immaterial forex exposures (with respect to both the entity's resourcing and the overall budget) were permitted to 'opt out' of reporting their actual gains and/or losses and expected exposures to Finance. However, by doing so, entities would forfeit any adjustments to appropriations for forex gains or losses.

3. Since 2017, entities no longer have to provide Finance with a separate annual report on their forex exposures. Entities should continue to report on forex in their annual financial statements in accordance with the relevant Australian Accounting Standards. Entities may seek an exemption in limited circumstances from the hedging restriction under the forex policy, however in doing so, the entities will forfeit any adjustments to appropriations for forex gains and losses (please refer to *Appendix A. Applying for an Exemption* for more information).

4. The forex policy applies to all entities[3] that form part of the general government sector under the *PGPA Act*. Under:

   - section 21 of the PGPA Act, non-corporate Commonwealth entities must comply with Australian Government policies
   - section 22 of the PGPA Act, corporate Commonwealth entities must comply with Australian Government policies that are specified in a government policy order applying to the entity
   - section 93 of the PGPA Act, Commonwealth companies must comply with Australian Government policies that are specified in a government policy order applying to the entity.

5. Entities must manage forex risk within the constraints set by the policy and consistent with this guide.

6. This guide provides information on the forex risk management responsibilities of entities under the resource management framework.

7. This guide has been reissued to add clarity to the operation of the forex policy in relation to:

   - the experience gained since its revision in July 2006
   - revisions to Australian Accounting Standards and reporting requirements
   - the introduction of the PGPA Act in 2013
   - the introduction of CBMS Legacy and CBMS in 2006 and 2017 respectively.

[3] Except for the AOFM and the ABC. The National Interest Account of the EFA has also been granted a general exemption from the policy, but may still apply for supplementation under certain circumstances.

Part 2 – Overview

Overarching principle of the forex policy

8. Under the Australian Government's resource management framework and the PGPA Act, accountable authorities of entities are responsible for ensuring the proper use and management of public resources[4], and establishing and maintaining systems of risk oversight and management[5].

9. One of the risks that may impact an entity's operations is forex risk when using or managing public resources, such as appropriations.

10. The **key overarching principle** of the Australian Government's forex policy is that entities are responsible for the ongoing monitoring and management of their forex risks, however they **must not act to reduce forex risk** that they would otherwise face in the course of their operations, i.e. entities **must not undertake 'hedging'** to offset expected financial gains or losses as a result of forex movements. Entities may only undertake hedging if they have been granted an exemption by the Finance Minister.

11. When undertaking procurements or entering into arrangements which involve a forex component, entities should also ensure that the procurements, after reasonable enquiries, achieve a value for money outcome, and expenditure is for a proper purpose.

Hedging

12. Forex risk is the risk that an entity's financial performance or position will be adversely affected by fluctuations in the exchange rate between the Australian dollar and other currencies.

13. For the purposes of the forex policy, hedging includes any arrangement (covered in a grant agreement, contract, deed or otherwise) that might mitigate forex risks/movements. Hedging is not limited to definitions in accounting standards, nor arrangements involving securities and other financial instruments.

14. Regardless of whether or not an arrangement attempts to mitigate forex risk, either directly or indirectly, entities must always strive to achieve 'value for money'[6].

15. Where an arrangement attempts to mitigate forex risk, but is unable to demonstrate that the activity achieves value for money, it may be prohibited under the forex policy[7].

16. The Australian Government self-insures against exposures to forex rate movements on a whole-of-government basis. The Australian Government has a broad spread of assets and liabilities, along with a range of revenues and expenses, both geographically and across classes. This assists in the management of movements in

[4] PGPA Act – section 15.
[5] PGPA Act – section 16.
[6] Commonwealth Procurement Rules
[7] PGPA Act – section 21.

exchange rates, and means that arrangements that mitigate forex risk by individual entities are viewed as unnecessary by the Australian Government.

17. Entities are prohibited from entering into contracts, agreements or arrangements that seek to actively mitigate forex risk, i.e. entities are prohibited from hedging unless they seek an exemption. A defining feature of many such hedging arrangements is the locking-in of an exchange rate prior to payment becoming due. Examples of hedging arrangements that would be prohibited under the forex policy are provided below:

Example 1: An external hedge

An entity has entered into a contract to make a payment to a Swiss firm in twelve months time. The payment is to be made in Swiss francs.

In order to gain certainty over the price to be paid in Australian dollars, the entity converts the Australian dollars to Swiss francs and deposits the amount in a Swiss bank account. The amount is held in the Swiss bank account until the payment is made in twelve months time.

This is considered an external hedge and is prohibited under the forex policy.

This arrangement is considered a hedge because the entity attempted to mitigate its forex risk by purchasing the foreign currency around the time it entered into the contract with the Swiss firm rather than making contractual payments at the relevant spot rate on the day.

Example 2: A request for tender conducted overseas

An entity is conducting a request for tender for a project in another country and requests that all tenders be priced in Australian dollars.

This is likely to result in a hedge as defined by the forex policy. The tenderers will likely have built into their tender bids the costs for taking on the forex risk, and therefore the procurement may not deliver the best value for money. When assessing the tenders, the entity should look out for elements which may involve a buffer/allowance for forex risks.

Example 3: A Request for Tender conducted within Australia

An entity is conducting a request for tender to build a specialist asset within Australia. Whilst the tenderers are located in Australia, the specialist asset will require parts which are likely to be sourced from Europe, and hence involve a forex risk.

The successful tenderer has included a fixed Australian dollar price for these parts in its contract. The price for the parts currently exceeds the cost that would be incurred had the parts been purchased at the relevant spot rate on the day, even after factoring in the general trend in the spot rates.

This fixed price represents an ‘embedded floor’, which will protect the supplier from adverse movements in exchange rate, and is likely to result in a hedge as defined by the forex policy.

Entities should consider the costs and risks before agreeing to these types of contractual terms, as they may not offer the best value for money.

An example of an arrangement that does not involve hedging is provided below.

Example 4: Awarding a tender to an overseas supplier

An entity has received tender bids from a range of potential suppliers, including local and overseas businesses. The entity did not specify what currency bids had to be submitted in, as that could be considered a hedging arrangement under this policy.

The bids received are priced in a range of currencies. In assessing the bids, the entity converts the bids into Australian dollars using the spot rate on a particular day, to allow comparison of costs.

An overseas supplier is selected as the successful tenderer based on a value for money assessment in accordance with the Commonwealth Procurement Rules. The overseas supplier's bid was specified in New Zealand dollars. The cross-comparison of bids in Australian dollars and the signing of the contract in New Zealand dollars are not considered hedging arrangements.

As part of contract negotiations, the supplier has also requested invoices be issued in New Zealand dollars, with milestone payments specified in New Zealand dollars and certain variable costs incurred in other currencies to be converted at the New Zealand dollar spot rate on the day the invoice is issued. These invoicing arrangements also do not constitute hedging arrangements.

18. Entities may also be presented with contracts, agreements or arrangements that contain clauses (that is, embedded hedging structures) and methodologies that claim to mitigate forex risk. Only under exceptional circumstances will the Australian Government permit arrangements involving embedded structures to proceed.

19. The following are examples of embedded hedging structures:

Embedded hedging structures within contracts, arrangements or agreements

It is important for entities to note that embedded structures will normally involve a cost (usually hidden) or additional risk and, therefore, entities must carefully consider the cost or risk involved before seeking an exemption allowing them to use such structures.

Embedded floor - guarantees the supplier (or the purchaser) a minimum exchange rate, protecting them from decreases in an exchange rate.

Embedded cap - guarantees the purchaser (or the supplier) a maximum exchange rate, protecting them from increases in an exchange rate.

Stop-loss clause - similar to a cap or floor where a predetermined exchange rate, when triggered, will alter the terms of the contract.

Demand triggered contract - alters the exchange rate mechanism where there is a change in the underlying demand for the service or product.

Rise and fall clause - uses changes in the exchange rate to alter the delivery price of goods or services. This clause may relate to the direct currency exposure or to a third currency exposure relating to input costs for the supplier. This clause may also include a multiplier effect on the exchange rate or have a non-linear impact upon the underlying currency exposure. Rise and fall clauses may also use an average rate methodology for calculating the exchange rate, which may not align to the actual exchange rate transacted by the entity. This could result in a cash flow mismatch for the entity. These clauses are typically encountered in building contracts.

20. There are a number of ways to mitigate forex risk, which do not necessarily occur through traditional financial instruments. These are all prohibited under the forex policy. For example, pricing a contract, agreement or arrangement in Australian dollars may give rise to additional costs for the contractor accepting the forex risk.

21. These additional costs, if passed on to the entity, would ordinarily not represent best value for money. Where additional costs for accepting forex risk are identified as forming a component of an Australian dollar price, they must be excluded.

22. Additionally, entities must not seek to mitigate forex risk by:

    - using foreign currency bank accounts to purchase foreign currency and place the money in a foreign bank account for a future payment
    - pre-pay purchases where the primary purpose of the prepayment is to remove forex risk[8].

Entering into contracts, agreements or arrangements that include hedges

23. Embedded structures in contracts, agreements or arrangements (or other arrangements that reduce forex risk) can seem covetable to an entity. Nonetheless, they normally involve a cost or an additional risk and may be inconsistent with the forex policy.

24. In accordance with the forex policy, entities are required to exclude embedded structures from contracts, agreements or arrangements that they enter into and ensure that any actions they commit to are not viewed as hedging their risk. However, if the embedded structures presented or the approaches contemplated are considered to be the best value for money, the entities should seek a project specific exemption through their Minister. Please refer to *Appendix A. Applying for an Exemption* for further information.

[8] However, this does not prohibit contracts, arrangements or agreements from being priced in Australian dollars, provided this represents best value for money, and has not been directly requested by the entity. The forex policy does not prohibit arrangements in which a contractor may have assumed a forex risk, it has not been expressly recognised in the arrangement, and it represents the best value for money at the time the tenders are evaluated.

25. Entities may also consider it appropriate to seek external financial or legal advice, to assist in identifying and excluding requests for embedded structures in contracts, agreements and arrangements (or other arrangements that reduce forex risk). Where appropriate, entities must also seek advice to justify an application for an exemption from the hedging restriction in the forex policy.

Part 3 – Managing foreign exchange risk in accordance with the Foreign Exchange Policy

Identifying foreign exchange risks, foreign exchange exposures and hedging arrangements

26. As noted in paragraph 12 above, forex risk is the risk that an entity's financial performance or position will be adversely affected by fluctuations in the exchange rate between the Australian dollar and other currencies.

27. Foreign exchange exposure is an entity's exposure or sensitivity to loss or profit due to movements in the exchange rate between the Australian dollar and other currencies.

28. Hedging arrangements are arrangements to reduce the risk of adverse or advantageous exchange rate movements in financial transactions. These normally involve actions to take an offsetting position, either through creating an offsetting forex risk or through the use of securities such as derivatives.

29. See also 'external hedge' and 'natural hedge' in the *Appendix B. Acronyms and Glossary of Terms* for further information.

Measuring foreign exchange risk and hedging arrangements

30. Entities are required to manage their forex risk in accordance with the forex policy. As entities are prohibited from hedging against their forex risk unless they have been granted an exemption, the term 'manage' means identifying, measuring, monitoring and reporting financial transactions/expected financial transactions with a forex component. It also means being able to assess whether an arrangement involves forex risk and whether elements will be considered a hedge under the forex policy by the Australian Government.

31. Entities must be able to identify whether a proposed arrangement will be considered a hedge by the Australian Government, and hence instances of non-compliance with the finance law. If a hedge has been identified, entities will need to take appropriate action, such as reporting significant non-compliance to their Minister. Further information on what constitutes significant non-compliance can be found in RMG214 - *Notification of significant non-compliance with the finance law*.

32. Where an entity has received an exemption in relation to hedging, the entity must ensure they keep their Minister and the Finance Minister informed of any significant activities or decisions[9].

[9] PGPA Act sections 19 and 91.

33. Identifying and measuring forex risk enables entities to better understand their exposure to foreign currency and accurately report to the Australian Government. The revised reporting requirements from 1 July 2017, mean that all entities will only need to report forex risk as required by the Australian Accounting Standards, CBMS estimates and actuals reporting requirements and standard Budget processes. Finance will no longer require a separate forex report from entities.

34. However, entities must still forecast their payments and receipts, for both internal reporting and CBMS purposes, in terms of:

    - amounts payable or receivable in a foreign currency
    - the Australian dollar equivalent of these foreign currency payables or receivables.

35. When forecasting amounts payable or receivable, entities are to use the Budget Exchange Rates (BERs) provided through the relevant Finance Agency Advice Unit (AAU).

36. Entities must ensure that all foreign currency amounts relating to either operational or capital expenditure are correctly identified so their reporting requirements can be met.

Consultation on material exposures

37. Entities that have a material forex expenditure commitment (i.e. an expenditure commitment where the total forex exposure exceeds the equivalent of AUD 100 million) must consider the impact that the large exposure may have on the Budget, and are required to consult with their AAU. Please see Example 4 below:

Example 4: A commitment exceeding AUD 100 million

An entity begins managing a project in another country. It engages local firms to complete the work and pays them in the local currency.

Three firms will be engaged to perform contracts worth AUD 60 million, AUD 40 million and AUD 20 million at the time contracts are executed. Although no single contract exceeded the AUD 100 million limit, this project will need to be considered as a whole.

In consequence, the entity will be required to consult with their AAU before entering into these contracts. If the entity later undertakes another procurement for AUD 200 million, in addition to the AUD 120 million already committed, then the entity would also need to consult with their AAU on the new commitment.

Operational risk management and internal controls

38. Monitoring and management of the operational risk related to forex risks and exposures forms a part of an entity's overall risk management obligations. Consequently it is recommended that each entity develop and document a distinct set of procedures for the monitoring and management of forex risks and exposures. Any internal procedures developed should take into account these guidelines and the entity's particular business practice. Each entity may wish to consider developing an

Accountable Authority Instruction that sets out its internal policy governing forex transactions.[10]

39. It would be prudent for any entity-specific internal forex policy or procedure documents to:

- clearly state that hedging is prohibited
- incorporate a set of controls that efficiently and effectively manage the risks associated with transacting in foreign currencies and maintaining records of forex contracts, agreements or arrangements, including ensuring there are sufficient funds to make payments (including confirming whether the entity's bank has sufficient foreign currency reserves to make the payment), and which bank's (entity's versus recipient's) exchange rate will apply to the transaction
- ensure the effective segregation of the transaction, authorisation, confirmation and recording functions.

40. Set out below are suggested good practice internal control procedures for the day-to-day management of forex exposures once a procurement/arrangement involving forex has been entered into:

- There should be a complete segregation/separation of duties between responsibility for executing forex transactions and responsibility for reconciling, settling, reporting, verifying and accounting for those transactions. Ideally the person responsible for reconciling and accounting for forex transactions should not also be responsible for settling that transaction.
- A system should be in place to:
    - control access to counterparty payment details, or require independent verification of counterparty payment details. This will provide a reasonable assurance that every payment is made to the correct counterparty and to the correct bank account
    - accurately record and allow the review, audit and reporting of foreign currency transactions including the following details:
        - forex amount or currency paid, including the cost of the transaction (if any)
        - Australian dollar equivalent amount of the amount paid (calculated by converting the foreign currency amount at the spot rate on the day of the transaction)
        - counterparty name
        - counterparty payment details
        - payment/settlement date
        - applicable Budget Exchange Rate (BER)

[10] RMG 206 Accountable Authority Instructions

        - forex rate if specified in contract/agreement ('transaction rate')
        - current spot rate on:
            - the date the agreement/contract was entered into
            - settlement date
            - other specific reporting dates, such as the end of the financial year on 30 June.
        - reason for the difference between the spot rate and the transaction rate
        - reason for the transaction, including information on the revenue, expenses, assets and/or liabilities recognised
        - person authorising the transactions.
    - ensure that a record is kept of any forex transaction that is modified (e.g. changes to dates, amounts or rates) or cancelled, including the cost of, and reason for, any such modification or cancellation.
- A process should be in place to:
    - ensure that counterparties to forex transactions are approved by the entity prior to executing the transaction
    - ensure all forex transactions are effectively reconciled
    - ensure that any exceptions or variations to the authorised procedure for forex transactions is reported to an appropriate senior manager who can review and provide guidance on any remedial action that should be undertaken.
- Entities should also consider maintaining a register of foreign currency exposures as a way of monitoring the impact of forex rate movements on their operations, financial position and financial performance.
- Entities should also maintain forecasts of foreign currency amounts payable and receivable to assist in with internal budgeting and financial management, as well as comply with the budget estimates requirements of the PGPA Act.

Foreign exchange guidance for CCEs

41. For CCEs, there are no specific forex requirements under the PGPA Act or the *Public Governance, Performance and Accountability Rule 2014* (PGPA Rule).

42. However by complying with this forex policy, CCEs will be eligible for supplementary funding through the annual Appropriation Acts if they make a foreign exchange loss.

43. CCEs should report any significant/material breaches of the forex policy to their Minister, the Finance Minister and/or in their annual report.

44. The PGPA Act requires CCEs to provide forex information and report their activities under the following sections:

- CCE accountable authorities have a duty to give the Finance Minister 'any reports, documents and information in relation to those activities' as required (section 19(1)(b)).
- CCE accountable authorities must prepare 'budget estimates' for their activities, and the Finance Secretary may give written directions to the accountable authority for the purposes of this section (section 36(3)).
- CCE accountable authorities must 'cause records to be kept that properly record and explain the entity's performance in achieving its purposes' in accordance with the PGPA rules. The Finance Minister is 'entitled to full and free access to the records kept under this section', subject to privacy laws (section 37).
- CCE accountable authorities must 'cause accounts and records to be kept that properly record and explain the entity's transactions and financial position' in accordance with the PGPA rules. The Finance Minister is 'entitled to full and free access to the records kept under this section', subject to privacy laws (section 41).
- In making decisions to govern a CCE, accountable authorities must 'take into account the effect of those decisions on public resources generally' (section 15(2)).
- Annual financial statements of a CCE must be prepared in compliance with accounting standards (section 42), such as the Australian Accounting Standards Board (AASB) 7 - *Financial Instruments* and AASB 121- *The Effects of Changes in Foreign Exchange Rates*.

Part 4 – Adjustments to appropriations and estimates

Maintaining budget estimates

45. Under section 36 of the PGPA Act, Finance will issue requirements on budget estimates, including keeping estimates up-to-date for forex movements including the current financial year. These powers have been delegated to the Finance Secretary or Finance Secretary's delegate under section 107 of the PGPA Act. Further information on reporting requirements is outlined in *Part 5 - Changes in reporting requirements* below.

46. Entities must ensure expenditure estimates are kept up to date, using the appropriate BERs provided through their AAUs. Entities are provided with updated BERs three times a year, and should ensure their expenditure estimates are updated accordingly. Entities should ensure that they use the reason code *'change in forex rates'* when entering forex estimates adjustments.

47. Where updating expenditure estimates for multiple currency movements, supporting documentation/calculations should be provided to the relevant AAU in Finance to substantiate the changes.

48. Entities must update their departmental and administered operating and/or capital expenditure estimates for the Revised Budget, Next Budget and Forward Estimate years for movements in the BERs.

49. Departmental and administered appropriation estimates must be updated for the Next Budget and Forward Estimate years, however appropriation estimates for the Revised Budget (i.e. current financial) year may only be updated where one of the following scenarios apply:

    - no-win, no-loss supplementation amount has been agreed by Finance in relation to forex losses made on departmental expenditure for the prior or current financial year(s), or
    - there is a pre-existing government decision to provide supplementation on forex losses made in relation to administered activities/programs.

Example 5: Updating departmental budget estimates

An entity has forecast departmental expenditure of $100 million per year over ten years, which involves purchasing services from the United States. The entity is currently in its second year of the ten-year contract.

Updated BERs are issued, which results in a 5 per cent (or $5 million) increase in expected expenditure in each of the revised budget, next budget and forward years.

To update its estimates, the entity enters the following adjustment in CBMS:

Account	Revised Budget (current financial year) $m	Next Budget $m	Forward Year 1 $m	Forward Year 2 $m	Forward Year 3 $m
Supply of goods and services expense	+ 5	+ 5	+ 5	+ 5	+ 5
Cash at bank	- 5	- 5	- 5	- 5	- 5
Appropriation revenue - Appropriation Bill (No. 1)	Nil	+ 5	+ 5	+ 5	+ 5

For the previous financial year (year one of the contract), the entity conducts a reconciliation as part of preparing its annual financial statements and identifies a forex loss of $6 million due to unfavourable movements in the exchange rate.

The entity seeks no-win, no-win supplementation for the prior year forex loss. The AAU agrees to the retrospective supplementation, as it is above the relevant thresholds (more than $5 million). The entity recognises the expected supplementation in its financial statements in accordance with *RMG116 Accounting for annual appropriations*.

To receive the actual supplementation through the next set of Appropriation Bills in February, the entity enters the following adjustment in Annual Estimates module of CBMS:

Account	Revised Budget (current financial year) $m	Next Budget $m	Forward Year 1 $m	Forward Year 2 $m	Forward Year 3 $m
Appropriations receivable	+ 6	Nil	Nil	Nil	Nil
Appropriation revenue – Appropriation Bill (No. 3)	+ 6	Nil	Nil	Nil	Nil

Departmental no-win, no-loss supplementation

50. Subject to the thresholds outlined in paragraph 51 below, all relevant entities will have departmental appropriation estimates adjusted on a 'no-win, no-loss' basis for realised (actual) net forex gains as follows:

- for realised forex losses (i.e. those typically identified as part of preparing annual financial statements), supplementation for departmental appropriations for the current or previous financial year will be provided through the next set of annual Appropriation Acts, usually the Additional Estimates Appropriation Acts
- for realised forex gains, the excess cash amount for the current or previous financial year must either be remitted to the Official Public Account (OPA) or withheld under section 51 of the PGPA Act
- for forex exposures, the most recent BERs (provided at each estimates update) should be used to update appropriation estimates for the forward estimate years only (not the current or prior financial years).

Where an entity considers supplementation may be required for the current financial year, they should contact their AAU to discuss the realised forex losses made to date.

51. Entities can claim supplementation for departmental forex losses and/or must return forex gains to the OPA (or amounts will be withheld under section 51 of the PGPA Act), if the net forex loss/gain is greater than either of the following thresholds:

    - AUD 5 million; or
    - one per cent of the entity's departmental appropriations for that financial year (operating and capital combined).

    Any amounts below these thresholds will not be eligible for supplementation and gains may be retained by the entity.

52. Any entity may apply for an exemption from the forex policy. In these cases, the entity still needs to demonstrate why an exemption is required and that the granting of an exemption by the Finance Minister will not adversely affect the Australian Government. The exemption will mean that the entity will be allowed to undertake hedging and will not have to return realised forex gains to the OPA/have amounts withheld under section 51 of the PGPA Act. However the entity will not be eligible for supplementation and will still be required to comply with the reporting requirements. Please refer to *Appendix A. Obtaining an Exemption* for further information.

Administered supplementation

53. Supplementation is not automatically available for forex losses made on administered activities/programs.

54. Forex gains made on administered activities/programs are to be returned to the OPA or amounts will need to be withheld under section 51 of the PGPA Act by the end of the financial year, as administered forex gains cannot be retained under the section 74 of PGPA Act and section 27 of the PGPA Rule.

55. Where an entity is likely to make a forex loss in the current financial year, an entity may seek Finance agreement to use other funding sources to cover the additional costs in the short-term, such as using prior year appropriations where available, underspends from another administered program within the same outcome, or if the expenditure fits within certain legislated requirements, seeking an allocation from the Advance to the Finance Minister provisions (see the *RMG100 Guide to Appropriations* for more information on the Advance to the Finance Minister).

56. Should entities be unable to identify alternative funding sources to cover expected administered forex losses, or if forex losses are expected over a longer period, they may seek funding through the normal Budget processes, for example, seeking an explicit government decision to ongoing estimate variations to activity/program funding in relation to exchange rate movements or seeking one-off supplementation through the next set of Appropriation Bills. Entities should contact their AAU for advice on how they can seek additional funding.

57. Entities may also wish to consider including a contingency for forex movements when developing proposals which involve overseas payments, particularly those that span a number of years. Any proposed contingencies should be explicitly noted in the policy proposal and costing, and include a description of how forex movements in expenditure and appropriation estimates will be handled.

Measurement of gains and losses

58. A reconciliation of forex gains and losses involves comparing the Australian dollar amounts of transactions incurred in a particular financial year (converted at the spot rate on the transaction date(s)), with the appropriations provided for that financial year (which were calculated using the BERs at the time). For expected gains and losses (‘exposures’), the reconciliation involves comparing the estimated Australian dollar amount of the expected transactions, converted at the ‘closing’ spot rates on 30 June.

For more information on how to measure foreign currency transactions, please see AASB 121 - *The Effects of Changes in Foreign Exchange Rates* (AASB 121).

59. Where an entity expends foreign currency, the calculation requires a reconciliation of the Australian dollar amount that the entity originally budgeted for, against the Australian dollar amount that the entity requires to make the payment.

60. Where an entity is able to retain amounts in foreign currency and use these towards expenditure (that is, for non-corporate Commonwealth entities, the amounts are subsequently retained by crediting a Special Account or by crediting its departmental appropriation in accordance with section 74 of the PGPA Act), the calculation requires a reconciliation of the Australian dollar amount that the entity was budgeted to receive in Australian dollars, against the Australian dollar amount that the entity actually receives.

61. Entities should provide a copy of their reconciliation to their AAU if seeking supplementation for forex losses or returning forex gains.

Part 5 – Changes in reporting requirements

62. The reporting requirements of the forex policy were designed so that the Government is provided with information regarding the Government's realised forex gains and losses. However, effective from 1 July 2017, changes have been made to forex reporting requirements and how entities adjust departmental funding estimates on a 'no-win, no-loss' basis.

63. Entities are no longer required to provide a separate annual report on their actual and/or expected forex risks and exposures. All relevant entities have automatically been 'opted in' to forex reporting and their forex risks and exposures are monitored using information captured in CBMS and their audited financial statements.

Foreign exchange reporting in CBMS and annual financial statements

64. When payments are made, the actual spot rate or an appropriate average rate must be used when recording the transaction. This figure will be the basis for the reconciliation back to the original budgeted amount in order to record the net realised gain or loss in any single financial year.

65. Under AASB 121, if multiple transactions/payments occur during a specific time period (such as a week or month), then it is acceptable for practical reasons to use an average rate that approximates the actual rate on the date of each transaction. However, this is only acceptable if the exchange rate does not fluctuate significantly during that time period.

66. If the entity makes a net loss for a year greater than AUD 5 million or more than one per cent of that year's total departmental appropriations (whichever is lower), then entities will be able to adjust their appropriation estimates for supplementation. Entities normally adjust their estimates for supplementation during the Additional Estimates period following the financial year in which they made an actual (realised) loss. There

will usually be a lag of one financial year between the year the loss is made and the year the supplementation to appropriation estimates is received.

67. Forex information included in entities' annual financial statements and the actuals data entered into CBMS is used to produce the whole-of-government Consolidated Financial Statements, which are prepared in accordance with Australian Accounting Standards.

Part 6 – Entity case study

Case Study

Issue

EFG Pty Ltd is a Public Non-Financial Corporation (PNFC) and is a wholly owned and controlled subsidiary of the XYZ Organisation (a corporate Commonwealth entity within the General Government Sector, or GGS). The business of EFG Pty Ltd is to supply products to the international market (US and European markets). EFG Pty Ltd's products are priced in USD and Euro, so they are subject to considerable foreign exchange risks which they have entered into hedging arrangements to mitigate.

XYZ Organisation seeks advice on whether the activities of its subsidiary are subject to the forex policy.

Advice

XYZ Organisation has not opted out of the forex policy. This means they are eligible for supplementary funding via the annual Appropriation Acts should they make an actual forex loss, however as a condition of that supplementary funding, they are not allowed to hedge.

The 'no hedging' rule applies to the XYZ Organisation itself and is based on the forex losses reported in their financial statements.

If EFG Pty Ltd's financials are consolidated into XYZ Organisation's financial statements, then EFG Pty Ltd's activities may also be indirectly subject to the forex policy.

If the XYZ Organisation wishes to continue receiving supplementary funding and also allow their subsidiary EFG Pty Ltd to hedge, they should write to the Finance Minister to seek an exemption for their subsidiary from the 'no hedging' policy.

The XYZ Organisation can also choose to opt out of the forex policy completely, but they will forgo any supplementary funding from Government and would need to seek the Finance Minister's approval to report an operating loss for any forecast or actual forex losses.

Frequently asked questions (FAQs)

Question 1:

We are updating our appropriation estimates as part of our Budget updates, but we are finding these are not covering our actual departmental forex costs:

- what is the appropriate avenue to cover these additional costs— can we seek supplementation for a loss that was incurred two years ago as part of this budget update, with the funding to be provided in the upcoming Appropriation Act?

Answer:

Yes, you can seek supplementation for prior year departmental forex losses in a subsequent budget update, provided the loss is over the relevant thresholds ($5 million or one per cent of the entity's total departmental appropriations for the year the loss was made). You will just need to enter an adjustment in CBMS, and provide your AAU with supporting documentation to support the validation, such as an extract from the relevant annual report outlining the actual forex loss made and the appropriations provided for that particular year.

Question 2:

Can my entity claim departmental supplementation for forex loss if the loss is less than two per cent of my entity's total departmental appropriations for that year? Does the threshold include equity injection and Departmental Capital Budget (DCB) funding?

Answer:

The threshold for your entity to be eligible for supplementation for departmental forex losses is the lesser of:

- forex losses of more than $5 million; or
- forex losses of more than one per cent of your (total) departmental appropriation.

For example, if an entity's total departmental appropriations for the year were $10 million and the forex loss made was $200,000, the entity could seek supplementation for the $200,000 as the loss represents more than one percent (i.e. two per cent of the entity's total departmental appropriations for that year).

The threshold covers the total of all departmental appropriations - operating, equity injection and DCB.

Question 3:

Our entity estimates that we will incur approximately $5.5 million in departmental forex losses. Can you please advise if we are eligible for supplementation and what is the process for seeking the funding?

Answer:

Your entity will be eligible for departmental supplementation via the next annual Appropriation Acts, as the current estimate of the loss is over the $5 million threshold.

The amount of supplementation actually provided will be determined through a reconciliation of your total actual foreign exchange losses (across all currencies) from annual financial statements with the budget estimates at the time the appropriations were provided.

Once the amount of the actual loss has been confirmed, your entity will be able to enter an adjustment in CBMS at the next estimates update for supplementation. Please contact the relevant AAU for more information.

Question 4:

In the previous financial year, our entity processed a journal to recognise the supplementation required for departmental forex losses as an appropriation receivable. Do we need to wait until the appropriation is legally available before recognising the appropriation receivable?

Answer:

Supplementary funding for forex losses is provided via the next available annual Appropriation Acts (usually through the Additional Estimates process), so the appropriation should not be recognised as an appropriation receivable, but rather accrued appropriation revenue.

The *Public Governance, Performance and Accountability (Financial Reporting) Rule 2015*, *RMG125 Commonwealth Entities Financial Statements Guide* and *RMG116 Accounting for annual appropriations* provide information on when appropriation adjustments or supplementation can be recognised.

Question 5:

If the entity was to establish a new mandatory whole of government arrangement with a US based company, can we agree for invoices to be provided in USD or must invoices be in AUD?

Answer:

The forex policy does not require invoices (whether issued by Commonwealth entities, or received from external parties) to be denominated in any particular currency. The preference for Australian Government dealings is AUD, but use of USD or any other currency is not prohibited. The guiding principle is what is in the best interests of and represents best value for money for the Australian Government as a whole. Any reporting by Commonwealth entities must still be in AUD, in accordance with accounting standards. Entities may choose to request invoices be issued in a particular currency, however costs in the invoice should be converted at the spot rate on the day the invoice is issued, rather than another exchange rate. For guidance on how to measure transactions subject to forex movements, please refer to AASB 121.

Question 6:

The Government agreed to provide additional administered funding for my entity's forex expenditure via estimates variations. How should we recognise this?

Answer:

Where the Government has agreed to updates in administered funding for forex movements, these should be recognised in a similar manner to changes in appropriations for indexation, for example:

Reason code: Change in forex rates

DR	Expenses/Assets
CR	Administered appropriations from the Official Public Account/Revenue from Government

Appendix A – Applying for an Exemption

A GGS entity may apply to the Finance Minister (via its own Portfolio Minister) for an exemption from the hedging restriction imposed by the forex policy. The Finance Minister will consult with the Treasurer on any such application. All entities seeking an exemption must liaise with their Finance AAU in the first instance prior to initiating ministerial correspondence.

All applications must be supported by a robust argument demonstrating the business need for an exemption. Exemptions can either be in the form of a general exemption from the entire forex policy, for a specific activity/transaction involving foreign currencies, or for a wholly-owned subsidiary of the GGS entity.

General exemptions

General exemptions from the forex policy will only be granted in exceptional circumstances, such as if the entity demonstrates that the restrictions imposed by the forex policy would unduly restrict the entity from carrying out core functions. In general, only CCEs will be granted a general exemption from the forex policy.

Partial exemptions

If an entity intends to undertake an activity or a transaction involving an arrangement that would be described as hedging under the forex policy, then the entity may apply to the Finance Minister for a partial exemption from the forex policy. For example, the entity is unable to exclude a request for a fixed exchange rate in a proposed contract, or the restrictions imposed by the forex policy would unduly restrict an entity from carrying out a function.

Appendix B – Acronyms and Glossary of Terms

AUD – Australian dollar(s).

Budget Exchange Rate (BER) – the exchange rate used for calculating the Australian dollar equivalent of budgeted foreign currency amounts, as provided to entities through Finance Agency Advice Units.

Cap/s – an option contract whereby the seller agrees to pay the purchaser, in return for an upfront premium, the difference between a reference rate and a strike rate when the reference rate exceeds the strike rate.

Commonwealth company – see section 89 of the *Public Governance, Performance and Accountability Act 2013 (PGPA Act).*

Commonwealth entity – see section 10 of the PGPA Act.

Corporate Commonwealth entity (CCE) – see section 11 of the PGPA Act.

Counterparty – the other party that participates in a (foreign currency) financial transaction. Every transaction must have a counterparty in order for the transaction to go through.

Currency – the Australian dollar or any foreign currency.

Derivatives – securities that move in terms of one or more underlying assets. Examples include options, swaps, futures and forward contracts. Underlying assets can be stocks, bonds, commodities, currencies, indices or interest rates. Derivatives can be effective hedges against their underlying assets, since the relationship between derivatives and underlying assets is more or less clearly defined.

Export Finance Australia (EFA) – means the entity established under section 6 of the *Export Finance and Insurance Corporation Act 1991* and trading under one of the names in section 81 of that Act.

Embedded structures – options or other structures, included within a contract, agreement or arrangement, which alter or transfer the forex risks faced by either party.

Entity – see Commonwealth entity or Commonwealth company.

Exchange rate – see foreign exchange rate.

Exposure – see foreign exchange exposure.

External hedge – any transaction strategy undertaken by an entity with a counterparty external to the GGS, which alters or transfers the forex risk faced by the GGS entity. External hedges include, but are not limited to:

- Structures inserted (embedded) into contracts or arrangements that reduce or alter the exposure to exchange rate fluctuations
- Financial instruments such as forward exchange contracts, swaps and options.

Finance – the Department of Finance.

Floor – an option contract whereby the seller agrees to pay the purchaser, in return for an upfront premium, the difference between a reference rate and a strike rate, if the strike rate exceeds the reference rate.

Foreign currency – the currency of any country other than Australia, which is an authorised medium of exchange.

Foreign exchange – transactions that cause a change in the foreign currency position of an entity. Usually abbreviated to 'forex' and sometimes to 'FX'.

Foreign exchange exposure – an entity's exposure or sensitivity to loss (or profit) due to movement in the exchange rate between the Australian dollar and a foreign currency. May be measured in terms of the value of the underlying transaction (i.e. the purchase of an asset), or its financial impact on elements of the entity's balance sheet or income statement (revenue, expenses, cash flows, assets or liabilities).

Foreign exchange rate – the amount of one currency required to purchase another, and always expressed in terms of a currency pair. Also known as the exchange rate.

Foreign exchange risk – the risk that an entity's financial performance or position will be affected by changes in forex rates when financial transactions involve currencies other than the base/home currency of the entity. Can be divided into three main types:

- Transactions risk – arises if an entity must pay and/or receive foreign currency at a future date and at an unknown exchange rate. This type of exposure is generally contractual and affects the income statement.
- Translation/accounting risk – arises if assets and/or liabilities are held in a foreign currency and must be translated (converted into the base currency) at a future date. This type of exposure affects the balance sheet. Often observed with companies that own subsidiaries operating in a different country.
- Economic/operating risk – defined as the change in the economic value of an entity due to unanticipated changes in exchange rates.

This RMG only relates to transactions risk.

Forex – see foreign exchange.

Forward exchange contract – an agreement to exchange a specified amount of one currency for another at a future date.

FX – see foreign exchange.

General government sector – a group comprising entities that are primarily budget-funded or that obtain their funds from the Australian Government generally. Defined by the Australian equivalents of international statistics standards known as the *Government Finance Statistics*. Please see the PGPA Act Flipchart for a list of Australian Government entities that form part of the general government sector. Typically comprises NCEs and CCEs.

GGS – see general government sector.

GGS entity – any Commonwealth entity classified as part of the general government sector.

Government policy order – specifies a policy of the Australian Government that is to apply in relation to one or more corporate Commonwealth entities or Commonwealth companies. It is a legislative instrument, but section 42 (disallowance) of the *Legislation Act 2003* does not apply to it.

Hedge – an arrangement to reduce the risk of adverse exchange rate movements in a financial transaction. Normally consists of taking an offsetting position in a related security such as derivatives. See also external hedge and natural hedge.

Managing – identifying, measuring, monitoring and reporting forex exposures. Also includes being able to identify whether an arrangement will be considered a hedge by the government.

Natural hedge – a hedge that occurs naturally as a result of an entity's normal operations, without the use of derivatives. For example, revenue received in a foreign currency and used to pay known commitments in the same foreign currency would be considered a natural hedge.

NCE – see non-corporate Commonwealth entity.

Non-corporate Commonwealth entity (NCE) – see section 11 of the PGPA Act.

PGPA Act – *Public Governance, Performance and Accountability Act 2013*

Reference rate – an interest rate benchmark upon which a floating-rate security or interest rate swap is based.

Segregation of duties – the separating of the transacting, settlement and accounting/reporting functions with regard to forex activities.

Settlement – actual physical exchange of one currency for another between a dealer and a client.

Settlement rate – the exchange rate applying at the time the foreign currency is purchased by an entity.

Spot rate – the current exchange rate at which a currency can be bought or sold. It prices the value of the Australian dollar compared to foreign currencies today rather than at some point in the future.

Strike rate – the interest rate at which a specific derivative contract can be exercised. Used mostly to describe stock and index options in which strike rates are fixed in the contract.

Treasury – the Department of the Treasury.