Government of **Western Australia**
Department of **Treasury and Finance**

Foreign Exchange Risk Management Guideline

Introduction to Foreign Exchange Risk Management

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This document is part of the suite of whole-of-government procurement resources designed for use by State agencies that are subject to the Western Australian Procurement Rules and other procurement connected policies and directions. Refer to the Buying for government page on WA.gov.au to access these resources.

This document is available on the Manage Risk Guidelines page on WA.gov.au.

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Contents

Introduction

When State agencies purchase goods and/or services directly from overseas, or when purchasing high value goods and/or services domestically with a large, imported content, the potential impact of foreign exchange risk should be considered.

This guideline provides an overview of how to identify foreign exchange risk within a procurement and when to consider changing the standard pricing schedule in a Request.

Should foreign exchange risk be assessed as high during the procurement planning phase, it may be necessary to ask for greater pricing detail in the approach to market document (e.g. a Request document used for a goods and services process).

If the foreign exchange risk is deemed to be high, or you are uncertain of the approach to take, you should contact Western Australian Treasury Corporation (**WATC**) to assist you with managing foreign exchange risk as part of your procurement planning.

You can contact WATC by phone on (08) 9235 9100 or by email at watc@watc.wa.gov.au.

1. Foreign Exchange Risk

Foreign exchange risk is the risk of a transaction's value changing due to movements in exchange rates.

In the case of a State agency procuring goods and/or services, exposure to foreign exchange risk means that the Australian dollar (**AUD**) cost of your purchase is at risk of changing due to the impact of changes in an underlying exchange rate.

1.1 How purchasing from overseas creates foreign exchange risk

When purchasing from overseas, a State agency is, in fact, purchasing two things – the goods and/or service itself and the foreign currency necessary to pay for the goods and/or service. Whilst the purchase of the good and/or service is visible, quite often the purchase of the foreign currency is not.

Remember that when a good and/or service originates from overseas, its cost-base will be denominated in another currency. If payment is made in AUD, at some point, this payment will need to be translated back into the original cost-base currency.

A supplier based overseas will most likely prefer to receive payment in their local currency. If they are paid in a foreign currency (i.e., AUD), they will be exposed to exchange rate movements and cannot guarantee whether they will ultimately receive a fair price for their goods and/or services. Similarly, a State agency may prefer to pay in AUD because it will have certainty over how much its purchase is going to cost and will not need to be concerned with movements in exchange rates and risk exceeding their budget.

The party who pays/receives payment in their domestic currency has transferred the foreign exchange risk to the other party.

Standard procurement templates request pricing in AUD as a default method of transferring foreign exchange risk to the supplier. However, as the value of exposure to foreign exchange risk increases, it is necessary to examine whether the State is receiving fair value for transferring the risk to the supplier as opposed to the State agency holding the risk and managing it through WATC.

2. Exposure to Foreign Exchange Risk

There are several ways in which exposure to foreign exchange risk can occur when purchasing goods and/or services. While the list below should not be taken as exhaustive, considering these scenarios should identify the most likely circumstances in which foreign exchange risk may occur:

- payment for goods and/or services denominated in a foreign currency,
- payment for goods and/or services denominated in AUD but where the amount of AUD is conditional upon an exchange rate,
- payment for goods and/or services denominated in AUD but where the amount of AUD is conditional upon a price variation clause linked to an exchange rate,
- during a period of negotiation prior to agreeing a fixed AUD price, where the AUD price is dependent on an exchange rate.

3. Preliminary Foreign Exchange Risk Assessment

It is preferable that the potential for foreign exchange risk is identified early in the procurement process. If material, purchases with significant or high foreign exchange risk may require a tailored approach to ensure that pricing information requested from respondents is suitable to make a fully informed value for money assessment.

During the procurement planning phase, you should consider the following:

- Are the goods and/or services originating from overseas?
- Is the supplier sourcing directly from overseas, or through several intermediaries? Suppliers who are sourcing directly from overseas are more exposed to foreign exchange risk and are more likely to pass this risk onto the State agency.
- Has market sounding identified terms of payment which indicate that foreign exchange risk exists? For example, price variation clauses or indicative pricing subject to exchange rates.
- Does the foreign exchange risk matrix (see Figure 1 below) indicate that the exposure to foreign exchange risk is material?
- If the exposure to foreign exchange risk is deemed to be high, or you are uncertain of the approach to take, contact WATC.

4. Foreign Exchange Risk Matrix

Although many goods (and some services) originate from overseas, moving to a tailored procurement approach is only warranted where the foreign exchange risk to the transaction's value is deemed material. To assist you with your preliminary risk assessment, the risk matrix below has been designed to categorise purchases into a foreign exchange risk rating of low, moderate or high.

If your purchase (regardless of value) will require payment in a foreign currency (i.e. the supplier is not offering AUD pricing) contact WATC.

Figure 1 Foreign exchange risk matrix

Total Cost of Contract*	Overseas Content / Exposure to Foreign Currency									
	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
less than 100,000	—	—	—	—	—	—	—	—	—	—
250,000	25,000	50,000	75,000	100,000	125,000	150,000	175,000	200,000	225,000	250,000
500,000	50,000	100,000	150,000	200,000	250,000	300,000	350,000	400,000	450,000	500,000
750,000	75,000	150,000	225,000	300,000	375,000	450,000	525,000	600,000	675,000	750,000
1,000,000	100,000	200,000	300,000	400,000	500,000	600,000	700,000	800,000	900,000	1,000,000
1,500,000	150,000	300,000	450,000	600,000	750,000	900,000	1,050,000	1,200,000	1,350,000	1,500,000
2,000,000	200,000	400,000	600,000	800,000	1,000,000	1,200,000	1,400,000	1,600,000	1,800,000	2,000,000
2,500,000	250,000	500,000	750,000	1,000,000	1,250,000	1,500,000	1,750,000	2,000,000	2,250,000	2,500,000
5,000,000	500,000	1,000,000	1,500,000	2,000,000	2,500,000	3,000,000	3,500,000	4,000,000	4,500,000	5,000,000

FX Risk Rating: low moderate high

* All values in AUD

4.1 Low FX risk rating

If your assessment of the foreign exchange risk within your purchase is low (refer to **Figure 1**), document this within your risk assessment and continue to use the applicable template Request with pricing in AUD.

4.2 Moderate FX risk rating

If your assessment of the foreign exchange risk within your purchase is moderate (refer to **Figure 1**), document this within your risk assessment and continue to use the applicable template Request with pricing in AUD.

However:

- if the payment is due to occur later than one year following date of contract, or
- if the exposure is material relative to the State agency's budget,

then you should escalate the foreign exchange risk to high and contact WATC.

4.3 High FX risk rating

If your assessment of the foreign exchange risk within your purchase is high (refer to **Figure 1**), or you are uncertain of the approach to take, contact WATC.

4.4 When foreign exchange risk is material

Material exposure to foreign exchange risk will require greater pricing detail from respondents to ensure that the price paid by the State agency to transfer this risk to the supplier is fair. Where warranted, the State agency may consider allowing suppliers to quote in AUD and their preferred currency (dual pricing). WATC can advise on the necessary changes to the pricing schedule in your Request document.

To achieve price certainty the State agency may need to implement a foreign exchange hedge (protection) with WATC. Access to foreign exchange goods through WATC will require a Master Agreement to be established with the State agency if such an agreement is not already in place. Protection of the State agency's budget should be undertaken as soon as is practicable on advice from WATC.

WATC can assist State agencies to determine the appropriate approach and can provide support in developing a Request suited to the individual procurement situation and the ensuing financial evaluation process.

5. Government Approach to Foreign Exchange Risk Management

Further guidance on managing foreign exchange risk can be found within Treasurer's Instruction 826.

Treasurer's Instruction 826 requires that "*The accountable authority shall ensure that foreign exchange risk ...is identified, measured and managed.*" The Instruction further requires that where a foreign exchange exposure exceeds the minimum threshold specified in the instruction, the accountable authority shall seek and obtain advice from WATC in the management of that exposure.

6. Consideration of Commodity Risk

Commodity risk is the risk of a transaction's value changing due to movements in underlying commodity prices. Some examples of commodities include electricity, diesel, oil, and steel.

Commodities are often priced in a currency other than AUD. If you believe that the exposure to commodity risk within your purchase is high, or you are uncertain of the approach to take, contact WATC.

~ END OF GUIDELINE ~