



Office of the Comptroller and Auditor General
Report on Value for Money Examination

Department of Agriculture,
Food and Forestry

FEOGA Borrowing

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Report of the Comptroller and Auditor General

Department of Agriculture, Food and Forestry FEOGA Borrowing

I have, in accordance with the provisions of Section 9 of the Comptroller and Auditor General (Amendment) Act, 1993, carried out a value for money examination on the management of FEOGA borrowing by the Department of Agriculture, Food and Forestry.

I hereby submit my report of the above examination for presentation to Dáil Éireann pursuant to Section 11 of the said Act.

A handwritten signature in black ink, appearing to read 'John Purcell', with a large, stylized loop at the end.

**John Purcell
Comptroller and Auditor General**

22 December 1995

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Summary of Findings

Background

The Department of Agriculture, Food and Forestry borrows funds on a bridging finance basis to meet the cost of purchasing commodities for intervention storage and to fund payments in respect of certain schemes under the Common Agricultural Policy (CAP). The Department is subsequently reimbursed by the EU at agreed rates. Borrowing levels have fallen considerably in recent years mainly as a result of reductions in intervention stocks following reform of the CAP.

The examination focused on

- how efficiently the Department engaged in borrowing activities
- how well the associated risks were managed
- the lessons which can be learned for the future.

Borrowing Policy

No formal policy statement has been drawn up by the Department in relation to its borrowing activities. However, the general aim of the Department is to minimise the extent and cost of borrowing. In our view, there is merit in drawing up a policy document.

Borrowing in Foreign Currencies 1983 to 1994

Between 1983 and 1994, recoveries of £436m from the EU more than covered the actual interest costs of £363m. However, as a consequence of engaging in foreign borrowing during this period, there were further costs in the form of exchange losses totalling £89m, which were not recoverable, resulting in a net shortfall of £16m. Nevertheless, foreign borrowing was still more economic since the equivalent cost of domestic borrowing of £509m would have resulted in a shortfall of £73m.

The strategy of borrowing in foreign currencies during the period was generally well managed, particularly through borrowing in currencies within or aligned to the Exchange Rate Mechanism. However, in December 1992, as a result of a shortage of other currencies, borrowing was undertaken in Japanese yen. The borrowing of £85m in Japanese yen cost a net additional £5.8m compared to borrowing in Deutschmarks.

The Currency Crisis

Exchange losses of £66m, of the total of £89m, were realised mainly as a result of the currency crisis. The net effect of the devaluation on the Department's debt portfolio was largely similar to that on the foreign component of the National Debt. The

Department was unable to switch to domestic borrowing at the time of the currency crisis as this would have been in contravention of Government policy.

Reversion to Domestic Borrowing

A conversion back to Irish pounds was carried out on a phased basis with the consent of the Department of Finance up to May 1994. The conversion in the early part of the year, when the Irish pound was relatively strong, resulted in an estimated gain of £7.5m compared to what would have been achieved later in the year.

Borrowing Strategy

The overall strategy of borrowing in low interest foreign currencies during the 1983 to 1994 period was reasonable. It could be argued that, as the Department's transactions were exclusively in Irish pounds, some portion of the portfolio should have been denominated in Irish pounds.

In respect of the borrowing after May 1994, based on an analysis of the potential interest savings and the currency risks involved, we are of the view that the Department is correct in funding its entire borrowing requirement in domestic currency in present circumstances.

The Management of Future Borrowing

We identified a number of options which could be considered in relation to the management of the borrowing.

Flexibility in Borrowing

Under existing procedures, the Department borrows mainly for periods of one month. We concluded that the Department should determine the period of the borrowing after an analysis of interest rates and yields. While any outcome projected on such a basis can never be guaranteed, an analytical approach gives the best prospect of borrowing economically. As an example of what could be achieved using an alternative borrowing term, we have calculated that, had the Department borrowed half of its funds on a weekly rather than a monthly basis over the first six months of 1995, an interest saving of over £100,000 could have been made.¹

¹ *This is for illustration only. The actual saving would depend on the proportion of funds borrowed on this basis.*

Identifying a Core Borrowing Requirement

There appears to be merit in setting a core funding requirement which could be borrowed over a longer term at a fixed rate of interest. The purpose of this would be to fix a proportion of interest costs in order to manage the risk that arises since all its debt is currently exposed to interest rate increases. Our analysis of recent borrowing levels shows that a core element of borrowing of £100m would not have resulted in over-borrowing by the Department at any stage since January 1994.

Treasury Management

It is our view that the Department should consider using Forward Rate Agreements (FRAs) in the management of its domestic borrowing. FRAs would allow for the fixing of future interest costs.

Should the option of borrowing in foreign currencies be considered, we would recommend the use of forward foreign exchange contracts and currency swaps as an efficient means of managing the currency risks involved.

At present, the Department does not have the expertise to engage in treasury management operations. It could be beneficial for the Department to periodically receive the advice of the National Treasury Management Agency (NTMA) in this regard since the timing of treasury management interventions is crucial to their successful deployment.

The NTMA provides the Department with a facility of £100m. Any extension of this facility would directly impact on the National Debt which has to be managed in conformity with criteria laid down for economic convergence at EU level. Borrowing at rates achieved by the NTMA during the first six months of 1995 would have reduced interest costs by £119,000 and, on that basis, the option of assigning the borrowing and treasury management functions to the NTMA as an agent could be cost effective. Such a move, however, would need to be considered in the context of the wider debt management strategy of the State.

Part 1 : Introduction

Background

- 1.1 Under the Treaty of Rome, a Common Agricultural Policy (CAP) was adopted. This policy was designed to improve agricultural productivity, stabilise markets and assure a supply of produce to consumers at reasonable prices. The funds to support this policy are made available from the European Agricultural Guidance and Guarantee Fund, more commonly known by its French initials, FEOGA.²
- 1.2 The Department of Agriculture, Food and Forestry (the Department) is responsible for the management of the CAP in Ireland and engages in borrowing to finance certain policy expenditures pending reimbursement from the EU.
- 1.3 The Department borrows funds on a bridging finance basis in order to
 - finance the cost of purchasing commodities for market management purposes (intervention)
 - fund certain other schemes (guarantee schemes).
- 1.4 The borrowing is State guaranteed. At present, borrowing is in domestic currency. However, in the period between January 1983 and May 1994, the Department borrowed mainly in foreign currencies.
- 1.5 Appendix A outlines the legislation and administrative practices under which these activities are carried out.

Intervention

- 1.6 Ireland operates intervention for butter, beef, skimmed milk powder and cereals. The Department buys produce which is stored until market conditions allow it to be sold. A proportion of the purchase cost is recouped from the EU at the time of storage. Any further difference between the purchase price and the eventual sales price is made up by the EU on sale.

Guarantee Schemes

- 1.7 Guarantee schemes are made available on the basis of funding from the Guarantee Section of FEOGA and include export refunds and premium schemes. Appendix B outlines the guarantee schemes administered by the Department.

² *Fonds Européen d'Orientation et de Garantie Agricole.*

Level of Activity

- 1.8 The bulk of market regulation and agricultural support measures are mandatory, operating under EU legislation. Entitlements under schemes are largely demand-led with the level of activity on schemes depending on market conditions and decisions taken by the EU to alter support levels or scheme conditions.
- 1.9 Table 1.1 sets out the extent of FEOGA borrowing in recent years.

Table 1.1
FEOGA borrowing ^a

	Intervention £m	Guarantee schemes £m	Total £m
1988	553	162	715
1989	260	156	416
1990	182	232	414
1991	396	234	630
1992	286	189	475
1993	317	197	514
1994	144	172	316
1995 ^b	48	222	270

^a The figures are the average annual borrowing levels.

^b The averages for 1995 are based on borrowing up to 21 December 1995.

- 1.10 Borrowing levels have fallen considerably in recent years. This is due mainly to a reduction in intervention stocks, particularly beef. Overall EU intervention beef stocks amounted to only 63,000 tonnes in December 1994 compared to 249,000 tonnes in December 1992. Reform of the CAP in 1992 changed the emphasis from market support to direct payments to producers, in tandem with price and quota reductions. It is expected that all beef stock will be cleared at the beginning of 1996.

Recoupment from the EU

- 1.11 The Department is entitled to recover certain financial costs from the EU on a monthly basis as part of its claim for reimbursement of guarantee scheme and intervention expenditure. The reimbursement of financial costs associated with

guarantee schemes is only made available to four EU member states¹, as part of cohesion measures.

1.12 Recoupment is at standard rates set by the EU and so is independent of the actual cost of borrowing.

- In the case of intervention, it contributes at pre-determined rates towards the transport, handling, storage, financial and other costs associated with intervention activity. The rate for intervention expenditure is set every September and is currently 6 per cent of allowable costs of stocks.
- For guarantee schemes, it recoups the actual expenditure incurred each month together with the financial costs associated with this expenditure, based on a pre-determined rate. Recoupment is received on average six weeks in arrears. On 20 December 1995, the EU adopted a Regulation
 - reducing the interest rate subsidy from 7 per cent of allowable expenditure to 6 per cent for the 1995 financial year ending 15 October 1995
 - providing for the abolition of the interest rate subsidy thereafter.

Purpose and Scope of the Study

1.13 The study set out to examine

- whether the Department borrowed funds efficiently
- how well the associated risks were managed
- the lessons which can be learned for the future.

The methodology used in the course of the examination is set out at Appendix C.

¹ *The four member states are Ireland, Spain, Portugal and Greece.*

Part 2 : Management of Borrowing

Borrowing Policy and Strategy

- 2.1 No formal policy document has been drawn up for the FEOGA borrowing activity. The Department informed us during the examination that the policy is to ensure that funds are available at minimum cost to meet ongoing FEOGA expenditure and that the Department is not over-borrowed. There is, accordingly, an emphasis on cash management which seeks to match loan borrowing periods to EU recoupment dates.
- 2.2 While cash management is an important factor in good treasury management, it should be operated in conjunction with the management of risk. There is merit in drawing up a detailed policy document in respect of the borrowing operations. Such a policy approach would ensure that strategic objectives are identified and managed. The policy approach would need to accord due weight to
- good cash management
 - minimising the overall cost of funds
 - managing the associated interest rate and currency risks.

Interaction with the Department of Finance

- 2.3 The authority to borrow rests with the Department. However, it takes decisions in relation to this activity in consultation with the Department of Finance (Finance).
- 2.4 Finance holds periodic meetings with the Department and has given explicit guidelines in respect of the debt composition. A comparison of the Department's minutes of these meetings against the currency profile of the borrowing revealed that the Department generally followed the guidelines set by Finance.
- 2.5 It would appear that, in practice, the specific authority to approve the terms and conditions of each individual loan has been interpreted as incorporating the more general authority to give guidance as to the type and currency of loan that can be expected to be acceptable to Finance on the basis of the interest rate and currency risk involved.

Organisation and Procedures

- 2.6 The Department has documented the operational procedures relating to its borrowing activities. These procedures are outlined in Appendix A.
- 2.7 From a summary review of files and ledger entries it is evident that these procedures are being followed and appear to offer an acceptable level of control over the day-to-day operations of the borrowing function.

- 2.8 Our only major reservation is that the procedures are manually based. Manual systems can be time consuming and lead to inadvertent errors. It has been noted that gains and losses on foreign exchange borrowing have been incorrectly calculated in the past.
- 2.9 The merits of a computerised treasury management system to assist in the borrowing operations should be evaluated.

Internal Control

- 2.10 Segregation of duties between the dealing activity, the preparation of borrowing records and the transfer of funds is essential in any treasury operation. While the Borrowing Section has responsibility for all of these functions, due to the small scale of operations, individual tasks are distributed with a view to maximising segregation of duties and where individual officers carry out and record a task this is fully checked by another officer who is not authorised to carry out the same mix of tasks.
- 2.11 Due to the nature of the work being carried out, a specialist expertise has been built up. This expertise is accumulated from experience rather than formal training or qualifications. A manual outlining all of the procedures for the borrowing operation is available to train new staff members. A reserve panel of dealers has been set up in the event of existing dealers being absent on sick leave or holidays. These controls ensure that the borrowing operation is not vulnerable to staff movements.

Banking Arrangements

- 2.12 Funds raised by the Department are placed on account with the Paymaster General (PMG). PMG accounts do not attract interest on credit or overdrawn balances. Funds are raised on the basis of issued payable orders. The examination found that the net cost to the State of funding the account on the basis of issued payable orders was negligible since any surplus funds in PMG accounts are used by the NTMA in the overall management of the National Debt.

Borrowing Arrangements

- 2.13 FEOGA borrowing was funded exclusively in domestic currency until 1983. Thereafter, on foot of a Government decision, the Department commenced borrowing in foreign currency and with the approval of Finance.⁴ This practice continued until 1994 when the Department reverted to domestic borrowing.

⁴ *The decision was taken in the light of the then prevailing economic conditions and in combination with a number of other measures designed to curtail State expenditure and reduce the Exchequer Borrowing Requirement.*

Arrangements 1983 to 1994

- 2.14 The reasons advanced by the Department for borrowing in foreign currency during the period 1983 to 1994 can be summarised as follows
- the Exchequer was dominating the domestic market
 - the only access the Department had to the domestic market was through short-term Exchequer issues
 - the extent of funding required would have placed undue pressure on domestic interest rates
 - there was a high interest rate differential between domestic and foreign interest rates, in favour of borrowing in foreign currency
 - the European Monetary System (EMS) regime (i.e. currencies operating within the narrow band of 2.25 per cent) offered a considerable degree of exchange rate stability.

Current Arrangements

- 2.15 Funds are now borrowed in domestic currency. At the end of October 1995, the Department had eight loan facilities in Irish pounds totalling £673m, of which £299m had been drawn down.
- 2.16 The Department has a further four foreign loan facilities totalling £443m which are not currently active as the interest rates are not competitive with Irish pound rates. However, these facilities are open-ended and, as such, provide an avenue for the return to foreign borrowing, should the need arise.
- 2.17 The facilities drawn down are of two types
- an NTMA facility of £100m, which is provided at DIBOR less five basis points
 - bank facilities, which are provided at rates close to DIBOR but, in general, would not be more than DIBOR plus one-sixteenth of a percentage point.
- 2.18 Under current borrowing arrangements, the Department aims to obtain the best available rate on a day-to-day basis. Our examination established that the rates accepted by the Department on drawdowns and rollovers in July 1995 ranged from 6.38 per cent to 6.56 per cent and compared favourably with the average monthly DIBOR for July 1995 of 6.51 per cent.

Recoupment from the EU

- 2.19 Between 1983 and 1994, the Department had, in overall terms, covered its actual interest costs of £362.7m with amounts received from the EU of £435.9m. However, when exchange losses of £89.5m (not subsidised by the EU) are taken into account there has been a shortfall of some £16.3m. Table 2.1 illustrates this point. However, it should be noted that the equivalent cost of domestic borrowing of £509.3m⁵ during this period would have resulted in a shortfall of £73.4m.

Table 2.1
FEOGA borrowing – cost and recovery ^a

	Recoupment	Actual interest	Exchange (gains)/losses	Total financial charges
	£m	£m	£m	£m
1983	18.4	6.3	4.7	11.0
1984	27.9	12.7	0.9	13.6
1985	30.0	19.0	-	19.0
1986	28.3	24.0	19.5	43.5
1987	43.1	36.3	9.2	45.5
1988	49.6	39.6	(1.6)	38.0
1989	33.5	38.7	10.4	49.1
1990	37.4	32.5	(3.8)	28.7
1991	56.8	48.5	(0.7)	47.8
1992	43.6	41.6	1.1	42.7
1993	44.0	44.7	65.4	110.1
1994	23.3	18.8	(15.6)	3.2
Total	435.9	362.7	89.5	452.2

^a While the above table presents the actual financial charges incurred and recoupment received, the costs and recoupments in individual years are not directly comparable due to the time lag in recoupment.

⁵ This amount represents actual domestic interest costs of £21.2m and the estimated cost of borrowing on the domestic market of an amount equivalent to the foreign loans over the period of £488.1m (see Table 2.2).

Outturn on Borrowing 1983 to 1994

- 2.20 The contribution of foreign borrowing during the period from 1983 to 1994 is summarised in Table 2.2. This indicates that borrowing in currencies other than the Irish pound reduced borrowing costs by £57.1m during this period. The savings occurred primarily in the 1983 to 1989 period when the higher interest cost of domestic borrowing was not reflected in the depreciation of the currency over that time.

Table 2.2
Net savings on debt servicing of foreign borrowing 1983 to 1994

	Period		Total
	1983 to 1989	1990 to 1994	
	£m	£m	£m
Estimated interest on equivalent domestic loans ^a	265.6	222.5	488.1
Interest on foreign loans	<u>168.9</u>	<u>172.6</u>	<u>341.5</u>
Estimated gain on interest	96.7	49.9	146.6
Less exchange losses	<u>43.1</u>	<u>46.4</u>	<u>89.5</u>
Net saving	53.6	3.5	57.1

^a *This is the estimated cost of servicing an equivalent amount of domestic borrowing. The calculation has been done on the basis of the rates which actually prevailed during the period. It is likely that additional domestic borrowing on this scale by the State would have put upward pressure on those rates and increased the cost of borrowing in the domestic market.*

- 2.21 Had borrowing been sourced totally in domestic currency the shortfall in recoupment from the EU would have increased by at least £57m bringing the total unrecoverable costs to around £73m.
- 2.22 During 1993 there were substantial exchange losses of £66m⁶ mainly arising as a result of the currency crisis and the devaluation of the Irish pound in January 1993. (See Table 2.4 below.) These losses were partly offset by other exchange gains in the period 1990 to 1994.

⁶ *This figure is based on a comparison of the exchange rates at the drawdown date and eventual repayment date of loans repaid in 1993.*

Evaluation of Currencies Borrowed

- 2.23 The borrowing strategy adopted by the Department was reviewed on our behalf by a firm of corporate financial management consultants.⁷ They concluded that
- some part of the portfolio should have been in domestic currency
 - the general strategy of borrowing in currencies aligned to the Exchange Rate Mechanism (ERM) was reasonable
 - prior to the devaluation, Swiss francs borrowing was an appropriate proxy for ERM currencies but US dollars and Japanese yen were not
 - the contribution of treasury management instruments would have been limited during the currency crisis.

Domestic Currency Option

- 2.24 In the late 1980s, there was limited availability of domestic funding to meet the considerable requirements of FEOGA operations. Furthermore, opportunities existed at that time to borrow in foreign currency at cheaper interest rates and at a perceived low risk.
- 2.25 However, it would have been the norm in that period for companies with revenues and costs denominated in domestic currency, and with no compensation for foreign exchange losses, to have at least a base percentage of domestic funding.
- 2.26 For example, prior to the currency crisis, the Electricity Supply Board and Bord Telecom Éireann sourced a considerable portion of their funds (30 to 40 per cent) in domestic currency. Similarly, the NTMA obtained over 60 per cent of the Exchequer Borrowing Requirement on the domestic market.
- 2.27 It is our view that, given that the related expenditure and recoupment from the EU are denominated in Irish pounds, it would have been prudent for the Department to have had some percentage of its borrowing portfolio denominated in domestic currency. While there would have been higher interest costs in domestic borrowing, such a policy would have lessened the extent of exchange losses which arose at the time of the currency crisis.

⁷ *FTI Finance.*

Foreign Borrowing Option

- 2.28 The bulk of the Department's borrowing was in low interest rate ERM currencies and, from time to time, in Swiss francs. However, there were occasions when the Department borrowed in Japanese yen or US dollars.
- 2.29 The currency composition in percentage terms of the borrowing from 1988 to 1993 is summarised in Table 2.3 below.

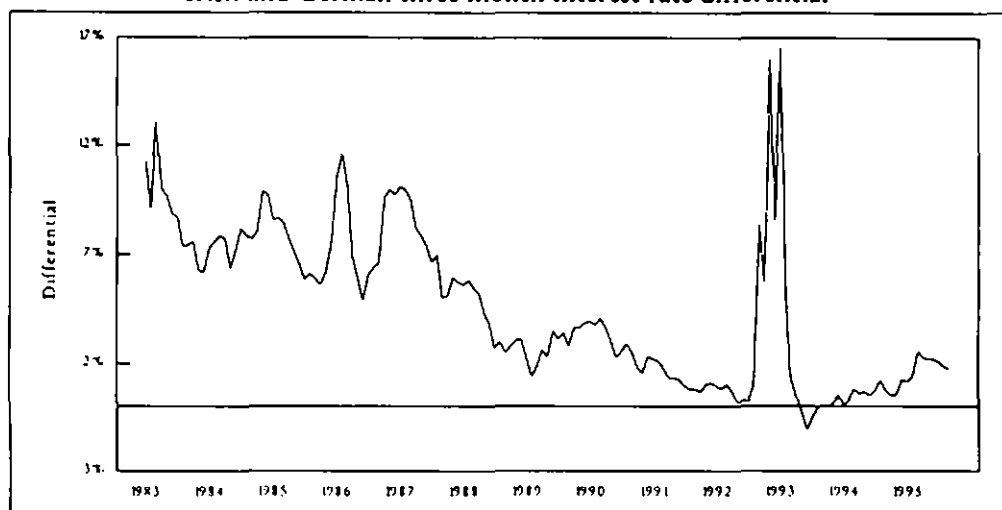
Table 2.3
Currency composition of borrowing ^a

Year	DEM %	NLG %	ECU %	BEF %	CHF %	JPY %	USD %	IEP %	FRF %
1988	39	9	25	-	1	-	22	4	-
1989	71	7	6	-	-	-	14	2	-
1990	55	23	15	-	2	-	5	-	-
1991	62	20	4	-	12	-	2	-	-
1992	52	31	2	4	9	2	-	-	-
1993	23	49	11	8	-	4	-	2	3

^a See Glossary for exact title of each currency. These percentages are based on month-end borrowing averaged over each of the years.

- 2.30 While Irish interest rates moved closer to European rates in the period between 1990 and 1994, a considerable differential existed between Irish and European interest rates in the period 1983 to 1989. This trend is illustrated in Figure 2.1 which shows the differential between Irish and German rates during this period.

Figure 2.1
Irish and German three month interest rate differential ¹



¹ The left hand axis of the graph shows the percentage difference between Irish and German rates. The 'spike' in the graph in 1992/1993 represents the period of the currency crisis where Irish interest rates were forced higher to defend the currency in the ERM.

- 2.31 From the viewpoint of interest rates alone there was considerable advantage between 1983 and 1990 in borrowing in Deutschmarks, or currencies whose movement have traditionally tended to be closely related to the Deutschmark. However, when determining the optimum strategy for borrowing in foreign currency, it is also essential to consider the related exchange rate exposure.
- 2.32 Had borrowing occurred in domestic currency, the currency risk would have been eliminated but, as indicated in Table 2.2, there would have been an additional interest cost of £146.6m.

Non-ERM Borrowing

- 2.33 The decision to borrow in US dollars in earlier years and Japanese yen in 1992 was inappropriate. Irrespective of the actual net outcome of interest savings and currency movement, the risk attached to this borrowing vis-a-vis the Irish pound would have been greater than the prevailing ERM currency risk. The Irish pound was never linked to these currencies and therefore it was unwise to use them as a proxy for domestic borrowing.
- 2.34 A total of JPY 17,750m (£85m) was borrowed in December 1992. When these loans were repaid a currency loss of £13.4m occurred. While borrowing in Japanese yen resulted in an interest saving of £1.2m, the overall exchange loss would have been £7.0m lower had the Department borrowed in Deutschmarks. Therefore, the

decision to borrow in Japanese yen cost the Department a net £5.8m. The Department has informed us that the decision to borrow in Japanese yen, at that point, was due to a surge in year-end borrowing and the unavailability of other currencies.

Treasury Management Instruments

- 2.35 The Department is permitted under legislation⁸ to use treasury management instruments to manage its borrowing. Treasury management instruments are outlined further in paragraphs 3.40 to 3.48.
- 2.36 However, specific Finance approval is necessary before any entity covered by the legislation can actually deal in such instruments. To date, the Department has not sought approval in relation to the use of treasury management instruments.
- 2.37 While treasury management instruments are beneficial in normal circumstances, allowing for balancing of costs and risks, their contribution during the currency crisis would have been limited since
- there is no guarantee that the overall outcome would have been better or worse through the use of such instruments
 - even if the Department had the facilities to switch foreign currency liabilities for domestic debt in 1993, it would not have been allowed to do so as this would have been in contravention of Government policy to defend the Irish pound.

Effect of the Currency Crisis

- 2.38 As a result of pressure on the Irish pound (see Appendix D), the Irish currency devalued by a nominal 10 per cent from its central rate in the ERM on 30 January 1993. Foreign exchange losses materialised as loans were repaid. The 1993 exchange losses on the borrowing were calculated as being £66m.⁹
- 2.39 The total exchange losses in 1993 combined the effect of the actual devaluation on 30 January 1993 (£40.5m) and the impact of an adverse movement in exchange values of the Irish pound both before and after the devaluation. Table 2.4 indicates the composition of the overall loss in 1993.

⁸ *Financial Transactions of Certain Companies and Other Bodies Act, 1992.*

⁹ *These figures are based on the movement between the exchange rates prevailing at the date of the loan drawdown and the ultimate repayment date. £0.6m of this loss, while realised in 1993, was brought to account in 1994.*

Table 2.4
Analysis of 1993 exchange loss^a

Net loss on exchange movements	£m
Losses realised prior to devaluation	1.4
Losses accrued up to the date of revaluation	6.0
Effect of devaluation ^b	40.5
Post-devaluation loss ^c	18.1
Total 1993 loss	66.0

^a Loss in respect of loans repaid in 1993.

^b The effect of the devaluation was calculated by valuing the debt at rates prevailing immediately before and upon devaluation.

^c A further adverse movement occurred on borrowing transactions after devaluation.

- 2.40 The net effect of the devaluation is dependent on the exact mix of currencies included in the Department's portfolio of debt. A comparison was made with the NTMA debt portfolio and the effect was found to be largely similar. While the Department's liability increased by 8.27 per cent, the foreign currency portion of the National Debt increased by 8.33 per cent.

Post Devaluation Management

- 2.41 Following the devaluation of 30 January 1993, the Department continued to borrow foreign currency into 1994.
- 2.42 Discussions were held with Finance in early 1993 to consider the option of domestic borrowing. At that stage, Finance were not in favour of such borrowing. However, by September 1993 Finance's opinion had altered to favour a gradual moving of the portfolio into domestic currency. The basis for this view was that
- the ERM bands had widened
 - the currency risk attached to the foreign borrowing outweighed the interest rate savings
 - a more favourable national external currency reserves position existed
 - the overall value of the borrowing requirement had fallen.
- 2.43 The decision was taken to gradually switch to Irish pound borrowing. Short-term Exchequer facilities were made available to the Department up to the end of 1993 prior to putting more permanent Irish pound facilities in place. A rate of repatriation of £25m per month was agreed.

- 2.44 In January 1994, Finance agreed to a request to accelerate the changeover to Irish pound borrowing up to a level of £50m per month. By May 1994 all borrowing was domestic.
- 2.45 The Department has calculated that the saving made by converting back into domestic borrowing early in 1994, when the Irish pound was relatively strong, was approximately £7.5m, as compared to a conversion at the end of that year.
- 2.46 The time taken to convert the foreign currency borrowing into Irish pound borrowing (January 1993 to May 1994) was primarily influenced by decisions made in relation to access to the domestic market. The administrative time taken up by putting Irish pound facilities in place with Irish-based banks was also a contributory factor.
- 2.47 In regard to the conversion to Irish pound borrowing and the subsequent borrowing activity, we have been advised by corporate financial management consultants that the policy of domestic borrowing is an appropriate approach based on recent higher levels of currency volatility and narrower interest rate differentials. (Risk and return factors are further examined in Part 3.)

Part 3 : Management of Future Borrowing

Background

- 3.1 The purpose of this part of the report is to examine and evaluate options which the Department should consider in relation to its borrowing activities.
- 3.2 The options identified were
- borrowing over periods other than the current one month norm
 - fixing liabilities in respect of a core borrowing element
 - borrowing in foreign currency
 - using the services of the NTMA.

In addition, the application of treasury instruments to manage interest rate and currency risk was examined.

Determining the Borrowing Period

- 3.3 The Department does not, at present, have access to interest risk management techniques to enable it to manage movements in the servicing cost of its Irish pound borrowing. In practice, the only way it can benefit from expected movements in interest rates is by shortening or lengthening the duration of its loan tranches.
- 3.4 The Department typically borrows funds for one month periods. The choice of borrowing period can impact on the cost of funds. Consequently, it is important to analyse borrowing options in terms of
- interest rate quotations for different periods of borrowing
 - projected trends in interest rates.
- 3.5 Analysis of interest rate quotations can assist in deciding the optimum borrowing approach. While this analysis must be redone at each decision point it has the merit of ensuring that borrowing decisions have the best prospect of resulting in the most economic funding at any point in time. By way of example, using rates prevailing at 8 September 1995 the differentials between weekly rates and those for one, two or three month facilities were

one month	0.18 per cent
two months	0.29 per cent
three months	0.39 per cent. ¹⁰

¹⁰ These rates have been adjusted for any compounding effect and are thus based on the week-to-week equivalent of one month, two month and three month rates.

- 3.6 The analysis leads to a tentative conclusion that weekly funding would be most economic.¹¹ In order to evaluate the available options, we have compared average weekly and monthly interest rates obtained by the Department for the first six months of 1995 and estimated potential savings on weekly borrowing.
- 3.7 It is recognised that there would be an increase in the administrative burden if tranches were rolled over at weekly intervals. However, it has been calculated that, had the Department borrowed 50 per cent of its funding requirement on a weekly rather than on a monthly basis in the first six months of 1995, an interest saving of £101,000 could have been made.¹²
- 3.8 Borrowing must also be conducted with an eye to likely future costs. Yield curves¹³ can assist in this regard. Yield curve analysis is outlined further at Appendix E.
- 3.9 While rational predictions can be made on the basis of yield curves this is not to say that any particular saving can be predicted or guaranteed in advance. While we have concluded that the Department should be more analytical in considering the borrowing period, we recognise that personnel in the Department do not, at present, have the required experience and expertise to manage interest rate risk strategically. This matter should be addressed by the Department as a matter of urgency. There is merit in considering using the advice of the NTMA in this regard.

Identifying a Core Borrowing Requirement

- 3.10 In the absence of interest rate management facilities, the only way in which the Department can hedge against interest rate increases is by borrowing some of its funds at fixed rates over a longer period. The Department should consider, as a matter of policy, its approach to risk management and the possible contribution of fixing outgoings for a proportion of its debt.
- 3.11 In the Department's case, most of the guarantee schemes will exist for a number of years and intervention stocks have an average holding period, although it is recognised that this may be difficult to estimate in advance. Accordingly, it may be realistic to have a core element of funding borrowed on a fixed rate basis for up to five years. We analysed forecast requirements for 1995. The results were as follows

¹¹ *This is based on a working assumption that one week interest rates would not increase during the month.*

¹² *The 50 per cent assumption has been made for purposes of illustration recognising that the Department would fund only part of its requirement on this basis.*

¹³ *A yield curve is a graphical representation of interest costs for different time periods. The slope and shape of a yield curve can give important signals as to likely future interest rate movements.*

	Intervention	Guarantee
	£m	£m
High	113	356
Low	44	84

- 3.12 This analysis would indicate a likely core borrowing requirement of around £100m at the start of 1995. The actual outturn in the year to November 1995 has shown that at no stage would the Department have been over-borrowed. Similarly, in 1994 a core element of £100m would not have resulted in over-borrowing. However, it would be important to keep the intervention element under review as it could fall below £30m before the end of 1995.
- 3.13 If the Department borrowed a core amount of £100m on a fixed rate basis, this portion of its portfolio would be protected from interest rate increases. At the time of the examination, all of the Department's borrowing was exposed to such interest rate increases. Most borrowing organisations would try to avoid this level of interest rate risk and would have some element of fixed rate funding in place over time. The timing of any implementation of such a change would be dependent on analysis of interest rates trends on an ongoing basis.
- 3.14 In order to fix the future interest liabilities it may be necessary, in practical terms, to use treasury management facilities such as swap or forward rate agreements (see paragraphs 3.40 to 3.45) since existing floating rate facilities are competitive and the NTMA has priority in relation to the issue of Government guaranteed paper.

Borrowing in Foreign Currencies

- 3.15 The Department makes all its payments to the Irish agriculture sector in domestic currency. Thus the Department can eliminate all exposure to exchange losses by borrowing domestic funds.
- 3.16 However, depending on prevailing circumstances in the currency markets foreign borrowing can be cost-effective as has been the case in the past. In practice, Irish-based companies and public sector organisations borrow in a range of currencies and manage the associated risks.
- 3.17 If a return to foreign borrowing is to be considered the following pre-conditions should exist
- a favourable interest rate differential against the Irish pound
 - a strong currency relationship with the pound so that currency risks are low
 - the capacity to manage the attendant risks on an ongoing basis.

Interest Rate Differentials

- 3.18 One of the principal reasons for borrowing in foreign currency is to take advantage of any favourable interest rate differential.¹⁴ Corporate financial management consultants analysed the differential between Irish and foreign three month rates prevailing at 25 August 1995. It must be stressed that such analysis is only valid at the time and in the conditions prevailing. Favourable differentials were found to exist in a number of currencies.
- 3.19 The main savings, based on these differentials, that could be made in order of size were found to result from borrowing in Japanese yen, Swiss francs, Dutch guilders and Deutschemarks.
- 3.20 However, consideration of a possible return to borrowing in foreign currencies would have to take account of currency risks which would, in current circumstances, rule out borrowing in currencies such as the Japanese yen.

Currency Risk

- 3.21 Currency risk, in relation to the main categories of foreign borrowing, can be measured using statistical measures of historical currency volatility. This measure of risk is based on the normal trading activity of currencies. Thus, it does not take into account the impact of any major re-alignment of currencies such as the devaluation in January 1993. This measure can then be used as an indicator of the likely currency movements that might occur over the following 12 months.
- 3.22 In general terms, there is now greater risk in ERM currencies given that the Irish pound operates within a 15 per cent band rather than the previous narrower band of 2.25 per cent.
- 3.23 For the purposes of this report, eight different types of currency borrowing portfolios were analysed by corporate financial management consultants on our behalf and the currency risks involved were quantified.¹⁵

¹⁴ *Although, conceptually, a currency with a higher interest rate than domestic currency could be borrowed on the assumption that the high rate currency would devalue by more than the interest premium, the speculative nature of such judgements would make it inappropriate for State funding.*

¹⁵ *A mix of portfolios was chosen, some of which mirrored the historical currency composition of FEOGA borrowing.*

- 3.24 In summary, depending on the portfolio composition, the risk and return factors varied from

	Interest Saving	Currency Risk ¹⁶
High	2.5%	14%
Low	0.5%	5%

- 3.25 While favourable or adverse fluctuations could occur, given the level of volatility indicated, should those fluctuations be adverse, the interest rate differentials could be outweighed by potential currency fluctuations.
- 3.26 In the view of corporate financial management consultants, a return to foreign borrowing should be considered, in conjunction with other borrowing policy factors, only where the interest saving is greater than the potential adverse currency movement.¹⁷
- 3.27 Corporate financial management consultants have advised us that, in present circumstances, the Department is correct in funding its total borrowing requirement in domestic currency as
- the domestic market is sufficiently liquid to supply the funds
 - the risk/return trade-off in the case of foreign borrowing is unfavourable
 - a return to foreign borrowing would need to be accompanied by active treasury management facilities which are not available to the Department at the present time.

Using the Services of the NTMA

- 3.28 At present the NTMA makes a £100m loan facility available to the Department at five basis points below DIBOR. This is sourced from the Post Office Savings Bank Fund.

¹⁶ *Using past exchange rate movements as a predictor for the future, there is a 95 per cent probability that the Irish pound value of the currency debt portfolio will increase or decrease within the range of percentages indicated over the period of a year.*

¹⁷ *For example, if the Irish pound was to return to its previous 2.25 per cent ERM band and an interest rate saving of greater than 2.25 per cent was to prevail in an ERM currency being borrowed.*

- 3.29 The possible future contribution of the NTMA could be to
- advise the Department on specific treasury management issues
 - borrow and manage the debt on behalf of the Department.
- 3.30 The NTMA could act on behalf of the Department either by increasing the existing £100m facility it makes available or by acting as its agent.

Treasury Management Advice

- 3.31 The Department has been reasonably successful in its negotiation of primary borrowing. However, it does not have the expertise to engage in hedging operations. It may well be beneficial for it to periodically take the advice of the NTMA on how best to manage interest rate risk and, in the event of a return to foreign borrowing, how the associated currency risks might be managed.
- 3.32 In the short term the NTMA could contribute to improving treasury management of the Department's borrowing if a mechanism was put in place under which it could periodically advise the Department in this regard.
- 3.33 The NTMA itself would favour a more direct involvement and sees no advantage at this stage in providing advice only on the basis that, in its opinion, both the authority and responsibility should vest in the same entity.

NTMA as an Agent

- 3.34 Under existing legislation the NTMA functions extend only to borrowing and managing the National Debt on behalf of the Minister for Finance. New legislation would be required to enable the NTMA to borrow as an agent of the Department.
- 3.35 In the view of Finance, the scope for transferring the management of this borrowing is constrained by a number of factors.
- Any absorption of the debt into the National Debt would impact on both the general Government deficit and the level of debt itself.¹⁸
 - The experience in regard to the securitisation of Local Loans Fund receipts was that the cost of borrowing exceeded that on Government bonds.

¹⁸ *Under the applicable accounting rules for the purpose of reporting Ireland's performance under the criteria laid down for European Monetary Union any assumption of new debt would be reckoned as part of both the general government deficit and the National Debt.*

- The sole purpose of setting up the NTMA in 1990 was to manage the National Debt. The National Debt, being the biggest portfolio of debt in the State, requires specific attention.
- It would not be desirable to mix Exchequer borrowing and other borrowing as this could affect the market perception of the NTMA and cause a deterioration in terms available on Exchequer borrowing.

3.36 As a consequence, such a move would have to be carefully examined. It would be undesirable to include funding required for the administration of EU schemes in the National Debt and thereby risk breaching certain EU guidelines on domestic funding. This would appear to rule out any extension of the existing facility of £100m in tight financial circumstances.

3.37 The extension of the role of the NTMA to borrowing as agent of the Department can only be beneficial if it could secure funds at rates cheaper than the Department does at present. The terms achieved by the NTMA on its domestic borrowing approximate to DIBOR minus 12.5 basis points. The application of actual rates obtained by the NTMA during the six months to June 1995 to the Department's borrowing in that period indicates a potential saving of £119,000.

3.38 There appears to be merit in considering whether the constraints outlined by Finance can be overcome. It may be worthwhile exploring whether

- Conferring power on the NTMA to act as an agent of the Department could be achieved without absorbing the borrowing into the National Debt.
- More favourable terms could be achieved by the NTMA borrowing on behalf of the Department compared to those achieved under its securitisation of Local Loans Fund receipts. Cost comparisons with that borrowing arrangement may be inappropriate as
 - such bonds have a 10 year maturity
 - they are less liquid than corresponding National Debt.
- Acting as an agent of the Department, the NTMA could secure competitive rates similar to those for Exchequer borrowing as the Department's borrowing is guaranteed by the State and de facto underwritten by the EU which recoups the costs and finance charges. (See paragraph 1.11).¹⁹

¹⁹ *The NTMA has expressed itself confident that it could achieve terms for FEOGA borrowing similar to those for Exchequer borrowing.*

- 3.39 The NTMA does not consider that borrowing on behalf of the Department would affect the market perception of the NTMA or cause a deterioration in its borrowing terms. The funding required by the Department is insignificant when compared to the National Debt of some £30 billion for which borrowing is raised in a variety of ways and from a wide variety of sources. The NTMA, through its Exchequer Notes programme, has access to funds at competitive rates from numerous sources throughout the State. It believes that some of these sources could be used to fund the Department's borrowing requirement.

Treasury Management Instruments

- 3.40 The Department's borrowing exposes it to potential risks in two main areas

- interest rate increases
- adverse currency movements.

In present circumstances, since all borrowing is in domestic currency, Irish pound interest rate risk is the major exposure of the Department.

- 3.41 Treasury instruments can be used to manage some of these risks by fixing interest or exchange rates at agreed levels for borrowing transactions. The Department should consider the potential contribution of treasury management instruments in the management of risk in the context of a documented policy approach.

Interest Risk Management Instruments

Forward Rate Agreements

- 3.42 Forward Rate Agreements (FRAs) can be used to fix the interest cost of future borrowing. They are used for periods of up to 18 months. The Irish pound market is considered to be liquid so if the Department hedged a borrowing requirement that did not subsequently materialise, the FRA position could be reversed. FRAs are widely used by State-sponsored bodies and corporate organisations in Ireland.
- 3.43 In the course of the study the use of FRAs was discussed with Finance who would be required to approve their use. Finance accepted that FRAs could be of benefit and stated that they would consider any reasoned proposal in this regard.

Interest Rate Swaps

- 3.44 In the Department's situation, interest rate swaps could be used to lock in the interest cost on a core element of borrowing for a period of up to five years. (See paragraph 3.10 to 3.14.)

- 3.45 The Irish pound interest rate swap market is considered to be a liquid market for a duration of up to five years. Prices can be obtained for longer periods up to 10 years but pricing conditions can vary.

Currency Risk Management Instruments

- 3.46 As stated in paragraph 3.27, the present environment is not conducive to borrowing in foreign currencies. However, if this should change there are a number of instruments available to manage currency risks.

Forward Foreign Exchange Contracts

- 3.47 Forward foreign exchange contracts could be used to fix the Irish pound interest cost on a foreign currency borrowing.

Currency Swaps

- 3.48 A currency swap would allow the Department to effectively fix the Irish pound liability for both the redemption and servicing of borrowing originally denominated in foreign currency. It could, accordingly, contribute to the management of both the currency risk and interest rate risk of the borrowing for a period of up to five years. Currency swaps can be used to switch strategically between currencies at any point in time.

Glossary

<i>BEF</i>	Belgian franc
<i>CAP</i>	Common Agricultural Policy
<i>CHF</i>	Swiss franc
<i>Currency Swap</i>	In the case of borrowing operations, currency swap contracts usually involve an exchange of liabilities in respect of agreed principal amounts. Currency swaps against the Irish pound are typically available for periods of up to five years.
<i>DEM</i>	Deutschemark
<i>DIBOR - Dublin Inter-Bank Offer Rate</i>	The rate at which financial institutions borrow funds from each other on the Dublin Inter-Bank market
<i>ECU</i>	European Currency Unit
<i>EMS</i>	European Monetary System
<i>ERM</i>	Exchange Rate Mechanism
<i>FEOGA</i>	Fonds Européens d'Orientation et de Garantie Agricole - European Agricultural Guidance and Guarantee Fund
<i>FRF</i>	French franc
<i>Forward Foreign Exchange Contract</i>	A forward foreign exchange contract represents a contractual obligation to buy or sell currency at a future date at an exchange rate agreed now. Forward foreign exchange contracts are the major way in which Irish companies hedge currency risk. Contracts are available for periods of up to five years and in some cases beyond. However, pricing is difficult beyond 18 months.
<i>FRA - Forward Rate Agreement</i>	An FRA allows purchasers and sellers to fix the interest rate for a specified period in advance. The transaction is done on a nominal amount of principal and, on settlement, only the difference between contracted and actual interest costs is paid.

<i>IEP</i>	Irish pound
<i>Interest Rate Swap</i>	In the case of borrowing operations, an interest rate swap is an agreement to exchange servicing liabilities. In its commonest form, the fixed-floating swap, one counter-party exchanges a fixed rate liability for the other's floating rate liability (based on a reference rate such as DIBOR). The exchange is based on notional principal amounts. Swaps are commonly available in Irish pounds for periods up to five years.
<i>JPY</i>	Japanese yen
<i>NLG</i>	Dutch guilder
<i>NTMA</i>	National Treasury Management Agency
<i>PMG</i>	Paymaster General
<i>USD</i>	US dollar

Appendices

Appendix A

Legislation and Administrative Practices

Legislation

Regulations governing the Department's CAP activities have been made under the European Communities Act, 1972 (No. 27)

- the European Communities (Common Agricultural Policy) (Market Intervention) Regulations, 1973 (S.I. No. 24), Section 11 of which empowers the Minister for Agriculture, Food and Forestry, with the consent of the Minister for Finance, to borrow money for CAP operations
- the European Communities (State Financial Transactions) Regulations, 1972 (S.I. No. 329), Section 7 of which provides for a guarantee by the Minister for Finance on borrowing by the Minister for Agriculture, Food and Forestry to discharge functions in connection with the CAP.

Organisation

All FEOGA guarantee activities, including borrowing, are administered by a section in the Department. This contrasts with the UK where a separate intervention board was established. While Ireland engages in separate borrowing to fund these activities, expenditure in the UK on CAP support is funded, initially, by the Exchequer through Supply Estimates approved by Parliament.

Staffing

Six officers in the section are involved in the borrowing activities.

In line with decreasing borrowing levels in recent years, the time spent by personnel on operating the borrowing portfolio has decreased and an increasing amount of time is being spent on other EU-related matters.

Table A.1 shows a breakdown of the current and pre-1995 staff costs attributable to the borrowing activity.

Table A.1
Staff costs – borrowing activity ¹

Grade	1995 £	Pre-1995 £
Principal Officer	13,238	33,095
Assistant Principal	10,142	25,354
Higher Executive Officer	14,748	25,810
Executive Officer	13,122	19,682
Staff Officer	14,232	21,348
Clerical Assistant	8,910	13,366
Total	£74,392	£138,655

¹ *Estimated annual cost at 1994 rates.*

Accountability of the Department

Each year, an account of all FEOGA expenditure is compiled by the Department for the financial year ending 15 October. The expenditure is subsequently audited by the EU Commission and any amounts disallowed or adjusted arising from that audit may become payable by the Exchequer.

Reporting

Since March 1995, the Department has produced a number of monthly reports in relation to its borrowing activities. Prior to this, the information had been prepared in various formats. The reports cover

- the maturity profile of outstanding borrowing
- the current loans outstanding
- the utilisation profile of facilities
- the monthly profile of interest and ancillary costs.

Role of the Department of Finance

There is considerable recourse to Finance for advice. Finance approval is required for each individual loan facility as a State guarantee is provided.

Finance monitors the Department's borrowing activity through

- monthly reports from the Department
- half yearly meetings on matters such as
 - prospects for interest rates
 - borrowing requirements
 - currency issues.

It is evident that the Department follows closely the advice given by Finance. Therefore, even though the authority to borrow rests in the Department, it appears that Finance exercises a significant level of influence over the operations.

Intervention Stock

The Department is authorised to borrow in order to fund the direct cost of purchasing commodities for public storage. Apart from an advance from the EU on purchase, it is necessary to fund this borrowing until such time as the commodities are sold. The EU recoups any 'losses on sale'. However, losses incurred through a member state's own negligence must be borne by that state. Each member state is responsible for ensuring that proper controls are maintained to prevent pilferage, deterioration and loss of stock through negligence.

Our review indicates that, taking into account timing differences between the movement of stock in/out of storage and related payments, there was a broad correspondence between the levels of stock and borrowing. Our examination did not, however, extend to a detailed reconciliation of stocks and borrowing.

Negotiation of Facilities

Loan facilities are negotiated with financial institutions and ultimately approved by Finance. The majority of the loan facilities are open-ended which cuts down the administrative burden on renewal.

The Department does not pay commitment fees on its loan facilities, as the major portion of these facilities are uncommitted. This means that an institution has no commitment to make funds available on request and so, in a time of tight liquidity, may not do so. Consequently, the Department has set up loan facilities in excess of its borrowing requirement.

Drawdown of Funds

Tranches are drawn down from existing or newly negotiated facilities.

Drawdown decisions are based primarily on the most competitive interest rates. The rate of interest on offer from the banking institutions is sought by telephone. Comparison is made with

- DIBOR weekly, monthly and quarterly rates
- the current short-term Exchequer rate.

The decision is recorded showing details of

- the interest rates quoted by the institutions
- the DIBOR rate on that day for the relevant period
- the interest rate chosen
- the tranche reference number
- the tranche amount.

When confirmation documents on the tranche drawdowns are received from the institution, the details are compared to local records.

All documentation pertaining to a particular tranche is identified by its tranche reference number. Details of the transactions are manually entered in a ledger. The expiry date of the tranche is entered in a diary and two days prior to this date a decision is made on whether to repay or extend the tranche.

Banking Arrangements

All funds drawn are placed in two Paymaster General (PMG) accounts held at the Central Bank of Ireland.

The management of the cash balances is effected by the Department through its daily monitoring of the

- opening balances on the accounts
- daily receipts to the accounts
- daily payments from the accounts
- closing balances on the accounts
- known payments for the following day.

Monitoring is based on payable orders issued rather than projected encashments. The PMG accounts are reconciled at month end.

The banking arrangement with the PMG does not attract interest on credit balances or overdraft interest on debit balances due to the fact that the PMG operates one large account with all the other accounts being components thereof. Thus debit and credit balances are offset against each other and any surplus or deficit is handled by the NTMA in its role as manager of the National Debt.

Determination of Borrowing Requirement

Annual Estimates

At the beginning of the year, the Department prepares an estimate of its borrowing requirement for each month of the forthcoming year and updates the estimate on an ongoing basis as more detailed information becomes available.

Estimates produced at the beginning of the year are used to determine the year's requirements for loan facilities. We examined the accuracy of these estimates for 1994. While some variation was noted there was considerable consistency over the year.

Quarterly Forecasts

Divisions dealing with intervention prepare estimates of costs for the subsequent three months. A schedule of estimated cash movements is also prepared on a weekly basis based on purchases and sales of intervention stock. A three-week cash profile is prepared based on

- contract information on purchases and sales of intervention
- tendering meetings at EU level in Brussels, which inform the divisions of the trading activity over the coming fortnight.

Divisions dealing with guarantee schemes prepare estimates of expenditure every month covering the following three months. Details of estimated weekly expenditure for the four weeks in the first month are also included. These estimates are based on

- trader information with regard to production for the month
- comparison with the equivalent period in the previous year
- market information.

When estimating outturn, short-term estimates on intervention are reasonably accurate due to the tendering meetings at EU level while over the long term the activity is less predictable.

Estimates on guarantee schemes, on the other hand, are reasonably predictable over the long term since the divisions, know with some degree of certainty, which schemes will be in operation. However, over the short term, the information is less reliable due to the unpredictability of the actual payment dates for the schemes.

Weekly Forecasts

The Department reviews the weekly forecasts of expenditure against the daily returns from its Accounts Division to pinpoint the necessity for extra funding.

At present there is flexibility in the borrowing operations as

- funds are drawn down on a relatively short-term basis
- expenditure is matched to receipts
- the best available rate is achieved on a day-to-day basis.

A last minute requirement for funds can be easily arranged due to

- good relations with lending institutions
- the short-term nature of borrowing
- current stable interest rates.

Appendix B

Guarantee Schemes

The following are guarantee schemes administered by the Department.

Aids for private storage of butter and cream
Financial compensation for producer organisations - fruit and vegetables
Financial compensation for producer organisations - fishery products
Production refunds for the manufacture of approved products
Co-responsibility levies on cereals
Scheme of aid for small producers of cereals
Arable area aid scheme 1994
Aid for skimmed milk powder which has been denatured
Aid for skimmed milk powder denatured or processed into compound feedstuffs in the territory of another member state
Aid for skimmed milk produced and processed in a dairy and sold to farms for use as feed
Aid for skimmed milk used exclusively for feeding farmers' own animals
Aid for skimmed milk used as feed on the farms where it was produced
Aid for skimmed milk processed into casein and caseinates
Aid for private storage of long-keeping cheeses
Aid for butter, concentrated butter and cream for use in the manufacture of pastry products, ice cream and other foodstuffs
Aid for butter for Social Welfare beneficiaries
Aid for the purchase of butter by non-profit making organisations
Co-responsibility levy on milk and milk products
Co-responsibility projects
Supply of milk and certain milk products at reduced prices to school children
Milk super levy
Community milk cessation scheme
Premium for definitive abandonment of milk production
Scheme for restructuring milk production
SLOM compensation scheme ²⁰
Refunds for chemical industry
Premiums for maintaining suckler cows
Special beef premium
Extensification scheme
Deseasonalisation slaughter premium scheme
Calf premium scheme
Premium for good quality ewes
Rural world premium

²⁰ *Compensation scheme for milk producers who were awarded quotas following a European court case.*

Aid for private storage of lamb
Aid for private storage of pigmeat
Aid for grass seed production
Special measures for peas and field beans
Production aid for dried fodder
Production aid for seed flax
Production aid for fibre flax
Aid for hops production
Scheme of early retirement from farming
Afforestation programme
Export refunds.

Appendix C

Examination Methodology

The study was carried out by the Office of the Comptroller and Auditor General with the assistance of a firm of corporate financial management consultants (FTI Finance).

The assistance provided by the consultants consisted of

- advice on the validity of the methodologies proposed for analysis of the different borrowing options
- assistance in reaching conclusions on
 - options for short-term borrowing
 - options for identifying and using a core borrowing requirement over the medium or long term
 - the evaluation of the management of borrowing before and during the currency crisis of 1992/1993
 - the evaluation of the management of borrowing since the currency crisis
 - the use of treasury management instruments
- a review of the findings, conclusions and recommendations arising from the study.

In the course of the study, interviews were carried out with relevant personnel in the Department of Agriculture, Food and Forestry, the Department of Finance and the National Treasury Management Agency.

The study included an examination of

- minutes of meetings between Department of Agriculture, Food and Forestry and Department of Finance officials
- documents and records relating to borrowing transactions
- documents and records relating to recoupment from the EU
- the systems, practices and procedures in the Borrowing Section of the Department of Agriculture, Food and Forestry.

Appendix D

The Currency Crisis

At the start of 1992, the European financial markets were of the general view that the EU economies would converge and that movement towards monetary union would happen over a short time frame. However, higher German interest rates, due to the impact of re-unification, were causing problems in other economies where domestic conditions alone would have warranted lower rates. Their scope to reduce rates was limited by the constraints of a narrow 2.25 per cent band of currency movement within the Exchange Rate Mechanism (ERM).

In June 1992, the Danish electorate rejected the Maastricht Treaty. This caused the financial markets to assess whether there would be a move towards European Monetary Union as had been envisaged. Currency pressures increased during the summer and in September 1992 the UK and Italy, who were operating in a wider 6 per cent band within the ERM, were forced to suspend their membership and devalue their currencies.

Following the September devaluation, the UK authorities were then free to cut interest rates without the constraint of maintaining an exchange target.

By the end of January 1993, UK base rates had fallen to 6 per cent and, with the Irish pound valued at £1.09 Sterling and domestic interest rates at levels higher than warranted by domestic economic factors, the Irish pound was forced to devalue by 10 per cent from its central rate in the ERM on 30 January 1993.

With the devaluation, the Central Bank was able to gradually reduce interest rates to more normal levels and the Irish pound exchange rate moved lower against other currencies. In August 1993, the ERM bands were extended to 15 per cent for all currencies with the exception of the Deutschmark and Dutch guilder which remained in the 2.25 per cent band.

Appendix E

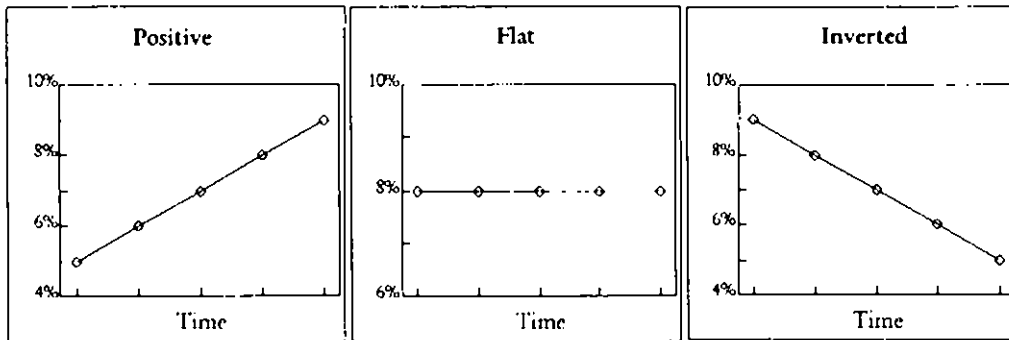
Yield Curve Analysis

Introduction

In order to manage interest rate risk, an assessment of future interest rate movements is necessary. This can be done by examining financial market expectations which can then be compared with economic forecasts of interest rate movements.

Yield Curves

A yield curve is a graphical representation of interest costs for different time periods. The slope and shape of a yield curve can give important signals as to likely future interest rate movements. There are three basic yield curve shapes as shown in the graphs below.



Interpreting Yield Curves

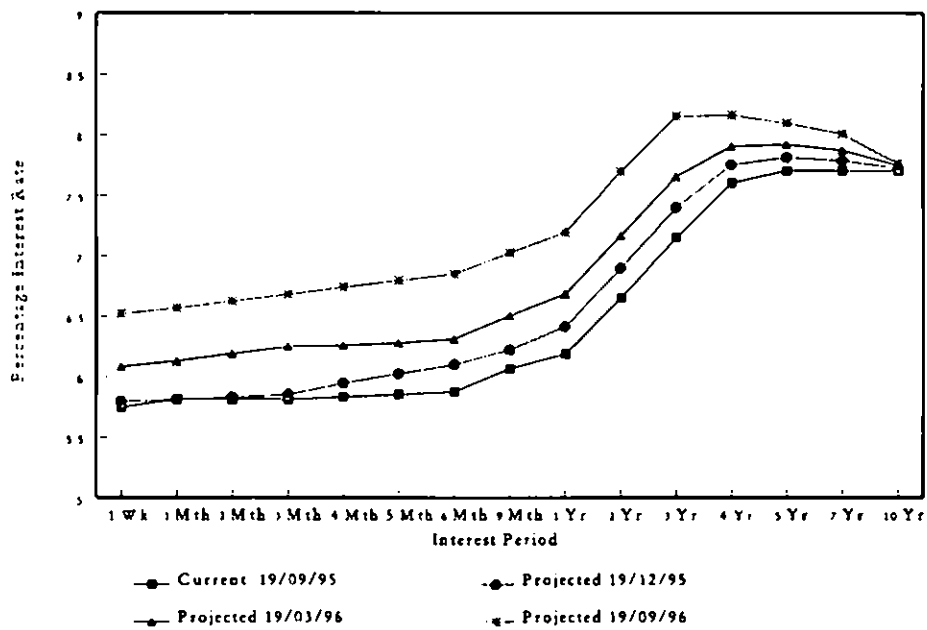
A positive yield curve shows that interest costs for shorter durations are cheaper than those of longer durations. An inverted yield curve indicates the reverse. In interpreting a positive yield curve, the slope of the curve is the important factor. If the slope is gentle, then there may be scope for interest rates to fall further. A steep positive curve can mean that interest rates are likely to increase. An inverted curve is associated with the expectation that short-term interest rates will fall sharply. A flat yield curve can arise as the market expectation is changing, usually with regard to falling interest rates.

This form of analysis can assist in deciding whether to borrow for shorter or longer durations. There is a refinement on yield curve analysis called forward yield curve analysis which gives an indication of where the market expects interest rates to be in the future.

Current Irish Pound Yield Curve

Figure E.1 below shows the yield curve as at 19 September 1995 and the implied forward yield curves at that date. These forward curves show the market expectation of where interest rates would be in three months, six months and in one year.

Figure E.1
Irish Pound Forward Yield Curve Analysis



The graph shows that the market expected short-term interest rates to rise by up to 1 per cent over the following year.

Value for Money Reports by the Comptroller and Auditor General

Report Number	Title of Report	Date
1	The LEADER Programme	December 1994
2	Energy Management in the Health Service	April 1995
3	Garda Transport	August 1995
4	Gas Interconnector Project	August 1995
5	Management of Telephone Facilities in the Civil Service	November 1995
6	Regional Development Measures	December 1995
7	FEOGA Borrowing	December 1995