RIKSREVISIONEN
The Swedish National Audit Office

RiR 2010:17 Summary

Capital management in times of large value fluctuations

An audit of eight foundations established by the government

Summary

Riksrevisionen (the Swedish National Audit Office, SNAO) has examined whether capital management has been handled in a qualified manner at foundations established by the central-government sector (i.e. by the state). The audit covers a period of large value fluctuations, which is a situation when capital-management approaches are put to the test. The SNAO assessed how well-prepared the foundations were and how appropriately they dealt with the major changes that occurred in 2008 and adjoining years. The foundations chosen for the audit manage assets that, taken together, exceed SEK 30 billion. This audit supplements a previous one of central-government foundations' capital management in more normal circumstances (RiR 2007:30).

The auditees are:

- the Knowledge Foundation (KK);
- the Swedish Foundation for Strategic Research (SSF);
- the Foundation for Baltic and East European Studies;
- the Swedish Foundation for International Cooperation in Research and Higher Education (STINT);
- the Chalmers University of Technology Foundation;
- the Foundation for Strategic Environmental Research (MISTRA);
- the Bank of Sweden Tercentenary Foundation;
- the Vårdal Foundation (which supports research into health-care and allergies); and
- the Government and the Government Offices (ministries).

Capital management by the foundations

Preparedness for large value fluctuations is deemed to have been good at six of the foundations: Chalmers, MISTRA, Bank of Sweden Tercentenary Foundation, STINT, SSF and Vårdal. At the latter two, however, the SNAO finds that there were certain shortcomings in preparedness. KK and the Baltic Foundation are deemed not to have had a good level of preparedness.

The characteristic features of the foundations deemed to have been well-prepared include having reviewed their strategies on the basis of analyses of appropriate long-term allocations in the light of the foundation's commitments (asset–liability modelling or ALM) and having established an explicit desirable level of risk and explicit restrictions on risk-taking. The well-prepared foundations also either had strategies involving a relatively low level

of risk because of a large proportion of interest-bearing investments, or else they had made reallocations to reduce their equity holdings in order to lessen the risk of value losses.

As regards foundations' handling of capital during times of large value fluctuations, the SNAO's main impression is that the foundations audited handled their capital management appropriately in 2008 even though certain aspects are called into question.

The SNAO finds that its 2007 audit has had a positive impact. Referring to that audit, the foundations have taken a large number of measures to enhance control over their capital management in terms of strategy, organisation and monitoring.

The general weaknesses that the SNAO wishes to highlight in the present audit concern the fundamental tasks of the boards of trustees. The board of trustees is the supreme body of a foundation. The Foundations Act (SFS 1994:1220) lays down that the board of trustees must make all relevant decisions independently, in accordance with the statutes of the foundation.

The SNAO finds that the fundamental tasks of the board of trustees as regards capital management should not be delegated to the extent that they have been. In particular, the board of trustees should not delegate the decision to set return targets, to determine the highest permissible level of risk in capital management or to determine strategies proposed by capital managers.

The division of tasks between the board of trustees, the executive director and capital managers is in several cases unclear, entailing only a limited exercise of control and direction. The SNAO finds that, for several foundations, the lack of risk-management directives and restrictions emanating from the board of trustees has probably been part of the reason why capital management has yielded fairly low returns in periods of large value fluctuations.

The audit shows that it would have been possible at several foundations to organise capital management in such a way that reasonable requirements for both effective handling and effective control would have been met. The requirement for an explicit division of tasks and responsibilities can be reconciled with a significant and appropriate freedom of action for the financial committee and the capital managers.

Several of the boards of trustees have not adjusted the design of monitoring and control to suit the extent to which they have delegated authority. Far-reaching delegation of capital management presupposes reinforced monitoring and evaluation on the part of the board of trustees.

Among the foundations audited, there is a not insignificant potential for improvement given that the foundations differ strongly in their return on capital during periods of large value fluctuations as well as in the amount of capital actually restored after a fall in value.

The SNAO's conclusion is that, against the background of the overall experiences from 2008 and 2009, the boards of trustees and top executives of several foundations could improve their preparedness and exploit opportunities to reduce their capital losses in times of large value fluctuations.

The Government's responsibilities

The SNAO considers that any entity created using public funds and established by the Government as authorised by the Riksdag (parliament) should be the subject of recurrent evaluation by the central government. This should aim to ensure both that operations are transparent and that capital management is efficient.

In the light of the SNAO's 2007 audit and in response to other statements, the Government has announced that it does not intend to increase central-government control over the foundations audited by the SNAO since those foundations 'are separate legal persons and not part of the central-government asset stock'.

The SNAO considers that, as founder, the central government retains responsibility for the originally public funds that constituted the capital of the foundations at the time of their creation. As founder, the central government also has a legally protected interest when it comes to ensuring that the assets are used in accordance with the founder's wishes. Two additional arguments in favour of regular evaluation of foundations established by the central government are that citizens have justified grounds for demanding insight into entities set up by public bodies and that the Riksdag presupposed that it would be kept informed about developments at the foundations.

The foundations audited manage a considerable amount of capital, and they show palpably different rates of return. This is yet another reason why evaluation should not be neglected. Evaluations can be carried out either by the Government itself or by other bodies instructed by the Government to do so.

Government Bill 2009/10:136 on increased freedom for certain foundations that fund research, which was endorsed by the Riksdag at the end of April 2010, entails that the Government will from now on appoint and remove only two members of the board of trustees for most of the audited foundations that were established using assets from 'wage-earners' investment funds' (collectively owned and managed funds financed from corporate profits which were wound up in 1992). This change reduces the Government's opportunities to hold the boards of trustees to account.

The SNAO recommends that the boards of trustees of the foundations audited should:

- always set return targets and determine the strategy and highest permissible level of risk of their foundation;
- regularly carry out reviews of the rules of procedure of the board of trustees and of the delegation of authority between the board of trustees, the executive director and capital managers, and ensure that the financial committee has a relevant mandate and is not allowed to take over duties that should be performed by the board of trustees;
- ensure, whenever the authority to make financially important decisions is delegated, that relevant monitoring and evaluation is performed;
- as part of its future developmental efforts, improve preparedness and make use of opportunities to reduce capital losses in times of large value fluctuations.

The SNAO recommends that the Government should:

- exercise the rights that the central government enjoys by virtue of the Foundations Act and the statutes of the individual foundations in order to evaluate, or have evaluations performed of, foundations' capital management on a regular basis; in order to bring about transparency; and in order to ensure that there is a more qualified basis for decisions:
  - to appoint and remove members of boards of trustees;
  - to determine the need for amendments to the statutes of foundations.