Implementation Tips *for* USAID Partners

Sharing Resources and Knowledge Among the Global CSO Community

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Definitions

Burn Rate—The rate at which an organization spends its award funds (obligated amount) on a periodic basis, typically monthly.

Exchange Rate—The amount of money needed in one currency to purchase another. This process is frequently called "currency conversion."

Obligated Amount—The amount the USG has committed to spending on the project to date, which may be a portion of the award amount.

Pipeline—The amount of funds obligated but not yet spent.

Weighted Average Exchange Rate—The average of the exchange rates over a given period of time.

References

U.S. Government Standards for Financial Management Systems
U.S. Code of Federal Regulations 2 CFR 200.302

US Government Standards for Internal Controls
US Code for Federal Regulations 2 CFR 200. 303

Practical Financial Management for NGOs—Getting the Basics Right.
Mango (Management Accounting for Non-governmental Organisations)

A Practical Guide to the Financial Management of NGOs. Namibia Institute for Democracy.

Understanding Fluctuating Exchange Rates

Q. What are fluctuating exchange rates, and how do they impact project implementation?

A. While most transactions with vendors in-country need to be completed in local currency, the budget submitted for your U.S. Government (USG) award, the amount obligated and the financial reports you provide to your funding agency need to be in U.S. dollars (USD). Consequently, as you convert funds from one currency to another, you need to be aware of how changes in the exchange rate between currencies can affect the actual amount of funding available to implement your program.

This issue of *Implementation Tips* discusses the effects of fluctuating exchange rates and provides strategies for addressing the issue with minimum disruption to program services.

Fixed versus Fluctuating Exchange Rates

An exchange rate is the price for which one currency may be exchanged for another at a given moment in time. There are two ways the price of a currency can be established: 1) the government (central bank) determines the rate and maintains it as the official exchange rate; or 2) the private foreign-exchange (forex) market determines the rate based on supply and demand for a particular currency relative to other currencies. As a result, the rate fluctuates or floats. The majority of the world's currencies are fluctuating.

One example of a country with a fluctuating exchange rate is South Africa, where the value of the Rand might be 8 Rand to 1 USD one day and 11 Rand to 1 USD the next day.

Program Impact

When you created the budget for your program, you likely used the exchange rate in effect when you submitted your proposal. But that rate has likely changed since you won the award and began receiving funding in USD. As a result, when you convert your allocation from USD into local currency, you may find that the actual amount will vary depending on how different the current exchange rate is from the rate projected in your original budget. In some cases, this may work to your advantage, and you will end up with more funding than anticipated; in others cases, you will end up with less.

Managing the Effects of Fluctuating Exchange Rates

Sound financial management practices are the best way to anticipate the impact of fluctuating exchange rates and mitigate any negative effects on your program. Ideally, an organization will have a multi-currency accounting system that can automatically record transactions in local currency and generate reports in local currency and equivalent USD.

For organizations that do not have a multi-currency system, there are two methods suggested to account for the exchange rate:

- "first in, first out;" and
- weighted average exchange rate.

1. "First In, First Out" Method

The "first in, first out" (FIFO) method uses the oldest exchange rate to account for expenses until funds received at that exchange rate have been fully expensed. For example, let's say your organization receives 1,000 USD on January 1, and the exchange rate at that time is 1 USD = 7 Rand. Then on January 15, you receive 2,000 USD at an exchange rate of 1 USD = 8 Rand, and on January 23, you receive 500 USD at an exchange rate of 1 USD = 5 Rand. During this period of time, you spend 17,300 Rand. Using the "first in, first out" method, this amount will be converted to USD as follows:

Date	Amount Received in USD	Exchange Rate	Amount Received in Rand	Expenses in USD
January 1	1,000	7	7,000	7,000/7=1,000.00
January 15	2,000	8	10,300	10,300/8=1,287.50
January 23	500	5	-	-
TOTAL	**3,500**		**17,300**	**2,287.50**

In this example, if you spent 17,300 Rand, it would equal 2,287.50 USD, and your balance of funds in USD would be $1,212.50 ($3500 – $2,287.50)

2. Weighted Average Exchange Rate Method

In locations where the exchange rate fluctuates significantly during a month, using the weighted average is the preferred method to calculate a realistic exchange rate.

The weighted average exchange rate is the average of the exchange rates over a given period of time. It is calculated by multiplying each rate by the amount exchanged at that rate, adding the three subtotals together and dividing by the total USD amount exchanged. Using the same example, the table below shows the exchange rate at which costs can be converted back to USD for reporting on expenses.

Date	Amount Received in USD	Exchange Rate	Amount Received in Rand	Expenses in USD
January 1	1,000	7	7,000	7,000
January 15	2,000	8	16,000	8,000
January 23	500	5	2,500	2,300
TOTAL	**3,500**		**25,500**	**17,300**

In this example, the weighted average exchange rate would be 7.29 (25,500/3,500). If you spent 17,300 Rand, using the weighted average exchange rate method, it would be equal to 2,373.11 USD (17,300/7.29), and the balance of funds on hand would be $1,126.89 ($3500 – $2,373.11).

With the weighted exchange rate, the program can accurately capture the costs incurred and what funds are remaining and minimize the exchange rate variance, which should be accounted for in your accounting system.

As you can see, the different methods result in slightly different answers. However, the goal is to limit the foreign exchange risk using a relatively simple conversion method.

As mentioned above, you may have used a different exchange rate in effect when you submitted your proposal. For this example, had the exchange rate been 10 Rand to 1 USD at the time, either illustrated method would provide a more accurate reflection of costs in USD than if you were to use your initially budgeted exchange rate.

Pipelines

Calculating how much you are spending in both local currency and USD is crucial to manage your award effectively, but it is only the first step. Once you account for the fluctuating exchange rate, it is important to keep track of your spending by regularly updating your pipeline and burn rate so that you know how much funding remains for planned activities, and you can adjust these activities if necessary. (For information on how to calculate your pipeline and burn rate, see Implementation Tips on "Pipelines and Burn Rates.")

It is important for your financial team to be in touch with your program team regarding the project's pipeline and the amount of funding remaining for activities. Workplanning, in particular, should be done with careful consideration of updated pipelines.

Reporting

Quarterly and annual financial reports to the USG must be in USD. Local costs will be captured in the report according to the exchange rate method your organization selects.

For More Information

For this or other issues of *Implementation Tips*, please visit www.NGOConnect.net. The Web site is a dynamic and interactive portal dedicated to connecting and strengthening CSOs, networks and CSO support organizations worldwide.

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Maintaining communication with your funder is essential. If the exchange rate has a measureable impact on your programming and your targets, it is critical to share this information and troubleshoot how you will address a shortfall. On the other hand, should the exchange rate result in some additional money, it may be reprogrammed but ONLY after discussion and approval from the USG.

Documentation

Establish a written policy on how you will address foreign exchange rates. Not only will this help ensure that the policy is applied consistently by all staff, but it will also serve as backup documentation if questions arise during an audit.

Managing Subgrantees

To reduce the burden of managing foreign exchange rates, it is recommended that all subgrants be signed in local currency. This allows your subpartner to better manage its budget, since both the budget and actual expenditures are in the same currency.