MANAGING EXCHANGE FLUCTUATION RISKS

Introduction
The South African Medical Research Council (MRC) is one of Africa’s premier health research organizations. Total annual revenue for the financial year that ended 31 March 2011 was ZAR553 million, of which ZAR235 million was obtained from international funding sources. Foreign funding, therefore, accounts for a significant part of the total revenue, leaving the MRC vulnerable to exchange rate fluctuations. Considering various exchange rate scenarios during the proposal development stage, and utilizing the MRC’s contract administration database to actively monitor exchange rates during the post-award stage, would contribute towards effectively managing the potential risks involved.

Why monitoring exchange rates is important
A substantial increase in international collaboration over recent years has prompted the MRC to recognize the following potential risks that relate to exchange rates:
- currencies fluctuate daily and can be very volatile;
- different exchange rates will apply at each stage of a project development and implementation cycle;
- adverse currency fluctuations could result in financial losses on the project;
- major risk to grantees;
- if actual income in local currency is considerably less than the budgeted costs, the potential exists that scope of project could be affected, and/or grantee might be unable to meet project objectives;
- risk to grantor and grantee.

USD/ZAR exchange rate history
A graphical illustration of actual USD/ZAR exchange rates from the years 2000 to 2011 provides a clear indication of the extent to which exchange rates can fluctuate.

The stages during a research project cycle
Daily fluctuating exchange rates result in different exchange rates that will apply at each of the following stages during a project cycle:
- pre-award stage:
  - the rate used during proposal budget development and submission to funding institution;
  - award acceptance:
    - the rate at the time a contract/grant is awarded;
- post-award stage:
  - the rates used to prepare financial reports;
  - the actual rates at which first pre-financing, additional interim, and final payments are received.

NIH awarded 4-year modular grant
Award value: $1,080,000
Period of grant: July 2002 – June 2006
Fixed quarterly payments over 4 years: 16 x $67,500
Exchange rate used during proposal development: USD = ZAR10

USD/ZAR exchange rates
The following is a graphical illustration of the actual USD/ZAR exchange rates from the years 2002 to 2006 at which the quarterly payments were received:

- USD started depreciating shortly after grant was awarded;
- at its weakest in Dec ’04 (1$ = R5.66): USD ↓ 43.4% from proposal development rate;
- from Jul ’02 (1st payment) to Apr ’06 (final payment): USD ↓ 38.2%;
- USD/ZAR exchange rate was below proposal submission rate for 14 of 16 payments received.

US$ starting to depreciate shortly after award

Financial summary

<table>
<thead>
<tr>
<th>Award Value</th>
<th>Grant Value</th>
<th>Award Acceptance</th>
<th>Post Award</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1,080,000</td>
<td>ZAR553,000</td>
<td>USD/ZAR10</td>
<td>USD/ZAR10</td>
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- anticipated annual income: $270,000 x R10 = R2,700,000;
- actual income received was substantially less than anticipated income during years 2 (↓ 31.9%), 3 (↓ 40%) and 4 (↓ 36.9%);
- at project close-out, total income received was R3,158,559 (29.2%) less than the budgeted costs of R10,800,000;
- unforeseen consequence: deficit on project subvented by MRC.

Conclusion
The MRC’s Contract Management Office introduced certain measures to mitigate the potential risks of adverse currency fluctuations. The pre-award office coordinator will ensure that the most appropriate exchange rates are applied during the proposal development stage, while the post-award contract administrators will implement an additional functionality on the contract administration database to monitor exchange rate fluctuations on a monthly basis. Implementation of these risk management measures will be periodically reviewed to ensure its continued effectiveness.

Mr Pierre Boshoff
Dr Nireesh Bhagwandin
Mr Philip du Plessis
Ms Tasnim Mohsam