

FREQUENTLY ASKED QUESTIONS
FOREIGN EXCHANGE MANAGEMENT AT UNESCO

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1. What is foreign exchange risk?

Foreign exchange risk is a financial risk caused by an exposure to changes in the exchange rate between two currencies which could result in a loss. It is also called currency or exchange risk.

2. How is UNESCO exposed to foreign exchange risk?

UNESCO, with worldwide operations, is exposed to foreign exchange risk mainly due to the mismatch between the currencies in which its revenues and expenses are denominated.

3. How does UNESCO manage the foreign exchange risk?

The foreign exchange exposure of the Regular programme is managed through the split assessment mechanism that matches the EUR and USD income from assessed contributions as closely as possible to UNESCO's expenditures in EUR and USD.

Other UN agencies and similar international organizations (such as WHO, IAEA, FAO and ICAO) also assess partly in the currency of the country where their headquarters is based.

As to currencies other than USD and EUR representing less than 10% of total Regular programme expenditure over the past biennia, no specific hedging strategy has been used. The reason is the high number of different currencies (about 70) and their limited individual share in the total expenditure (weighted average of 0.4%) without material impact on the Regular programme's purchasing power. Hedging foreign exchange risk for each individual currency would also be very difficult in practice because of the small amounts involved and/or even impossible in regards to certain currencies for which there are no hedging instruments available.

Extra-budgetary projects need to take into account possible currency fluctuations through individual budget planning. If a project foresees revenue or expenditure in other currency than USD, a contingency must be reserved for foreign exchange fluctuation.

4. How does the split assessment work?

The split assessment mechanism for Regular programme contributions was introduced at UNESCO by the General Conference in 1987 as it was considered the most effective solution to protect the Regular programme budget from adverse currency fluctuations.

With split assessment, changes in purchasing power as a result of USD/EUR exchange rate fluctuations are minimized as long as the EUR expenditure forecast used for the determination of the split assessment proportions is accurate.

Member states are assessed partly in USD and partly in EUR in a proportion determined by the General Conference. The expenditure portion of the Regular budget to be assessed in EUR is based on a study of EUR requirements for the current biennium together with projections of any changing pattern of expenditure expected in EUR and USD in the

forthcoming biennium. For the biennium 2014-2015, the split percentage approved by the General Conference was 57% in EUR and 43% in USD (calculated with the constant dollar rate of 0,869).

5. What is the impact of a modification of the EUR requirement on the total Regular programme budget reported in USD and assessed contributions?

The EUR requirement may change over time in line with UNESCO's expenditure pattern which would then be reflected in a modified split assessment rate. The invoiced amounts payable by Members States in EUR and USD would change but the total C/5 budget reported in USD would remain the same.

Please see below a table summarizing the impact of the change in the EUR requirement. For a detailed illustration, see Annex I.

Impacts of a change in EUR assessment		
	Scenario 1 lower EUR assessment	Scenario 2 higher EUR assessment
- On total C/5 budget reported in USD	None	
- On assessed contributions (i.e. invoices in EUR and USD)	↓ for EUR ↑ for USD	↑ for EUR ↓ for USD
- On the split percentage	↓ for EUR ↑ for USD	↑ for EUR ↓ for USD

6. Are there other measures available for hedging against foreign exchange risk than the split assessment?

The only effective long term foreign exchange hedge is to match the currencies of receivables and payables like it is the case with the split assessment mechanism as described above.

Short term currency hedging can be achieved by contracting financial instruments such as forward currency contracts or currency options that allow fixing the future exchange rates. However, this kind of instruments can only provide short term currency hedging over a fixed budgetary period and they cannot protect against long term currency movements. It should also be noted that the use of this kind of financial instruments would require adaptations in the current accounting and budget management systems and that the cost of hedging can be expensive in particular in the case of currency options.

7. What is a “constant dollar principle”?

The constant dollar principle is a budgeting technique adopted by the General Conference of UNESCO for the elaboration and management of the regular budget in order to eliminate the impact of exchange fluctuation between the USD and EUR in which the majority of the regular budget expenditure is incurred.

It should be noted that the regular budget is not hedged i.e. protected against the fluctuation of EUR against USD with the constant dollar principle but with the split assessment mechanism that is detailed under the FAQ 4.

The constant dollar principle is not applied to other currencies than EUR due to the high number of different currencies and their limited individual share in the regular budget. In this regard, see also the reply to the FAQ 5.

8. What are the advantages and disadvantages of applying the “constant dollar principle”?

Using a fixed USD/EUR allows the monitoring and reporting of UNESCO’s regular budget in accordance with the budget ceiling approved by Member States without having to adjust the budget due to currency fluctuation. It also facilitates the comparison of the regular budget from one biennium to another if the same constant dollar rate is used over the biennia. On the other hand, if the constant dollar rate is very different from real USD/EUR market exchange rate, this principle distorts the real economic value of the USD denominated regular budget for which assessments are made in USD and EUR. It can also make the comparison of UNESCO’s budget with other organizations difficult.

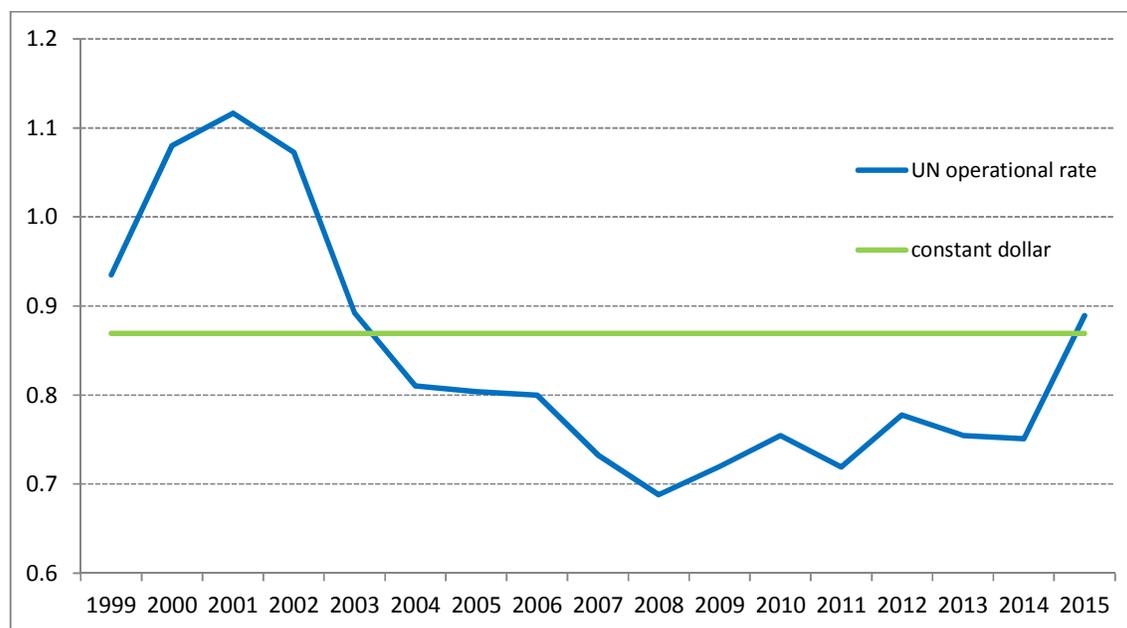
9. What is a “constant dollar rate”?

Constant dollar rate is a fixed exchange rate between the euro and the US dollar. It was adopted by the General Conference of UNESCO for the elaboration and monitoring of the C/5 regular budget.

Since 1996, the General Conference has adopted the same constant dollar of 0,869 EUR to 1 USD. However, the rate should be reviewed in the future in connection with each General Conference to reflect the UN operational rate of exchange prevailing one month before the approval of the relevant C/5 document.

10. How has the constant dollar evolved in relation to the market exchange rates over the past years?

The graph below shows the evolution of the monthly UN operational rate of exchange in comparison to the constant dollar rate since the year 1999.



11. What is the impact of a constant dollar modification on the total Regular programme budget reported in USD and assessed contributions?

The change of constant dollar does not have any impact on the assessed contributions amounts in USD and EUR. On the other hand, taking into account that the EUR expenditure portion of the budget is converted into USD with a revised constant dollar, the total budget reported in USD would be modified accordingly.

Please see below a table summarizing the impact of the change in the constant dollar rate. For a detailed illustration, see Annex II and III.

Impacts of a change in the constant dollar		
	Scenario 1 lower constant dollar rate	Scenario 2 higher constant dollar rate
- On total C/5 budget reported in USD	↑	↓
- On assessed contributions (i.e. invoices in EUR and USD)	None	
- On the split percentage	↑ for EUR ↓ for USD	↓ for EUR ↑ for USD

For an analysis of the combined effects of both a change in constant dollar rate and a change in EUR assessment, see Annex IV.

Annex I**Change of EUR requirement for the total C/5 budget**

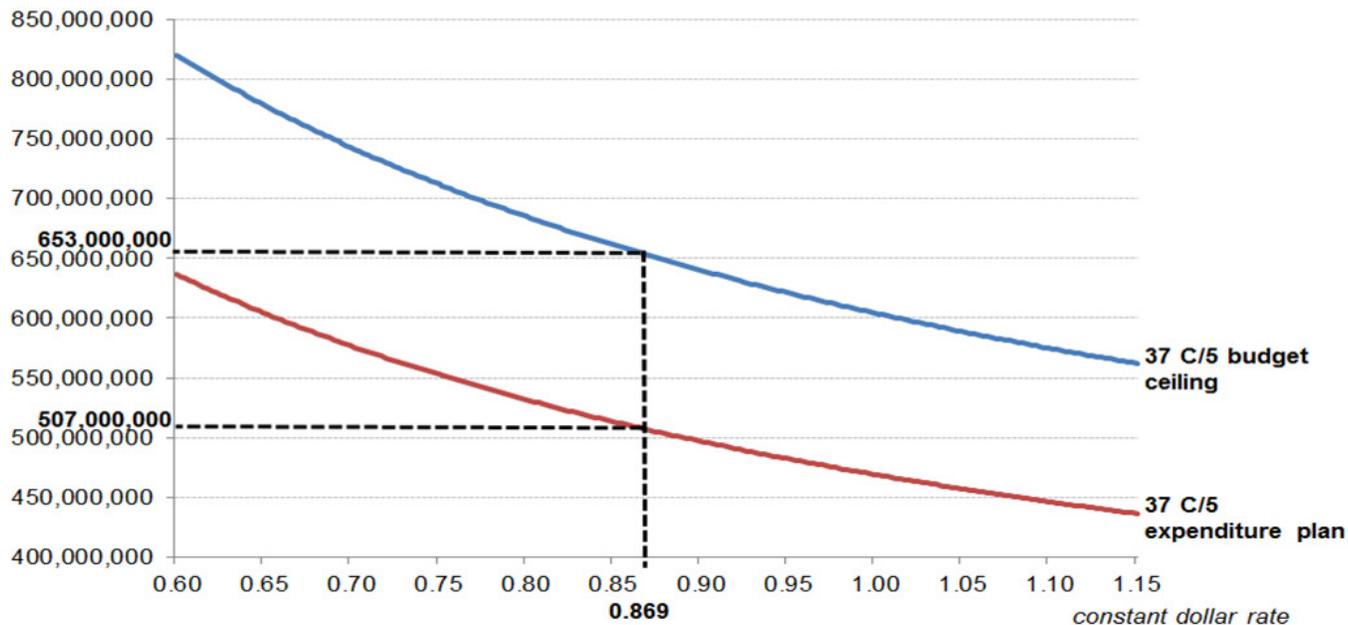
Currency	Base case		Scenario 1: decrease of EUR assessment		Scenario 2: increase of EUR assessment	
	Amounts	Split-%	Amounts	Split-%	Amounts	Split-%
Assessment for EUR expenditure	EUR	500	400		600	
Assessment for EUR expenditure translated in USD with constant dollar rate	USD	500	400	40%	600	60%
Assessment for USD expenditure	USD	500	600	60%	400	40%
Total C/5 budget reported in USD	USD	1000	1000	100%	1000	100%
Constant dollar rate	the constant rate is the same for all 3 cases: 1 USD = 1 EUR					

Conclusions	With a lower EUR assessment	With a higher EUR assessment
- Impact on total C/5 budget reported in USD	None	
- Impact on assessed contributions i.e. invoices in EUR and USD	↓ for EUR, ↑ for USD	↑ for EUR, ↓ for USD
- Impact on the split percentage	↓ for EUR, ↑ for USD	↑ for EUR, ↓ for USD

Annex II**Change of the constant dollar rate**

Currency	Base case		Scenario 1: decrease of constant rate		Scenario 2: increase of constant rate	
	Amounts	Split-%	Amounts	Split-%	Amounts	Split-%
Assessment for EUR expenditure	EUR	500	500		500	
Assessment for EUR expenditure translated in USD with constant dollar rate	USD	500	1000	67%	333	40%
Assessment for USD expenditure	USD	500	500	33%	500	60%
Total C/5 budget reported in USD	USD	1000	1500	100%	833	100%
Constant dollar rate	1 USD = 1 EUR		1 USD = 0.5 EUR (decrease of USD against EUR)		1 USD = 1.5 EUR (increase of USD against EUR)	

Conclusions	With a lower constant rate	With a higher constant rate
- Impact on total C/5 budget reported in USD	↑	↓
- Impact on assessed contributions i.e. invoices in EUR and USD	None	
- Impact on the split percentage	↑ for EUR, ↓ for USD	↓ for EUR, ↑ for USD

Annex III**Simulation of total budget ceiling and expenditure plan using different constant dollar rates for 37 C/5****Annex IV****Change of both the EUR requirement for the total C/5 budget and the constant dollar rate**

Impact on total C/5 budget reported in USD	With a lower constant rate	With a higher constant rate
With a lower EUR assessment	↑	↓
With a higher EUR assessment	↑	↓

Impacts on assessed contributions (i.e. the invoice in EUR and USD)	With a lower constant rate	With a higher constant rate
With a lower EUR assessment	↓ for EUR , ↑ for USD	↓ for EUR , ↑ for USD
With a higher EUR assessment	↑ for EUR , ↓ for USD	↑ for EUR , ↓ for USD

Impact on the split percentage	With a lower constant rate	With a higher constant rate
With a lower EUR assessment	it would depend on the magnitude of each component	↓ for EUR , ↑ for USD
With a higher EUR assessment	↑ for EUR , ↓ for USD	it would depend on the magnitude of each component