PUBLIC ACCOUNTANTS AND AUDITORS BOARD

Currency considerations in the Zimbabwean context

26 February 2018

1. BACKGROUND

1.1. Zimbabwe witnessed significant monetary and exchange control policy changes in 2016 through to 2017. The changes were a result of continued economic challenges faced by the country that resulted in the liquidity crisis. In response, the RBZ promulgated a series of exchange control operational guidelines and compliance frameworks to alleviate the cash shortage and boost the economy.

1.2. The accountancy profession accepted the positive impact of these measures on entities but also noted some concerns that arose from this policy implementation on the financial reporting of entities in Zimbabwe, hence, this document.

1.3. The aim of this paper is to:

I. lay out the functional currency considerations that preparers and auditors are having to make before year end reporting commences;

II. outline the relevant International Financial Reporting Standards (IFRS) implications; and

III. offer recommended guidance to preparers of financial statements with the intention of achieving fair and consistent presentation to the benefit of the users.

2. FUNCTIONAL CURRENCY CONSIDERATIONS

2.1. In 2009, Zimbabwe adopted the multi-currency system upon the abandonment of the Zimbabwean dollar (ZW$). For financial reporting purposes (presentation of the national budget and levying of taxes etc.) the government of Zimbabwe adopted the United States Dollars ("USD") as the functional and reporting currency. Consequently, business also adopted the USD as the functional and reporting currency.

2.2. From the fourth quarter of 2015, there have been notable changes in the availability of foreign currency. This has resulted in a need to assess whether there has been a change in the functional currency.

2.3. Currency is defined as a system of money in general use in a particular country (e.g. money, legal tender, medium of exchange, cash, banknotes, notes, paper money, coins, coinage).

2.4. Summarised below are the factors that were noted in 2016 that gave rise to indications of a possible change in functional currency:

- Introduction of directives to open the RTGS system to use other currencies and the requirement for entities to adopt and embrace multi-currencies; and
- Introduction of $200 million worth of bond notes in addition to the bond coins initially issued.
- The bond notes and coins were supported by the gazetting of Statutory Instrument 133 of 2016 (http://www.veritaszim.net/node/1887) which prescribed that the bond notes were legal tender and would be at par with the USD.

2.5. In 2017, there was further reduction in availability of USD cash which resulted in:

- The RBZ notifying the country of its intention to introduce $300 million worth of bond notes into the financial markets;
- Promulgation of new legislation in the form of statutory instruments 122A (http://www.veritaszim.net/node/2208) that defines currency to include bond notes and coins; and
- The table below is an analysis of supply of local notes and coins, foreign notes and coins, Balances with Foreign Banks and Balances with Central Bank from January 2011 to August 2017:

Analysis of Notes and Coins, Balances with Foreign Banks and RTGS Balances from 2009 to July 2017 (Balances with Commercial Banks-Source RBZ)			
	Dec 2010' 'Millions'	**August 2017 'Millions"**	**% Movement**
Local Notes and Coins	0	11.80	1180%
Foreign Notes and Coins	206.3	37.90	-82%
Balances with Foreign Banks	364.3	161.20	-56%
Balances with RBZ (RTGS Balances)	136.2	1,882.09	1282%

- 2.5 million RTGS transactions were processed for the 6 months to June 2017, accounting for just above 70% of all transactions in the country.
- Between 2010 and 2015 customers could withdraw any amount of cash as they required from bank institutions. The cash shortages resulted in the RBZ introducing a maximum withdrawal limit of USD1 000 per day and banks went on to reduce the limits further. Currently, customers are able to withdraw amounts ranging from USD20-100 per week.
- Zimbabwe now has a fast-growing parallel market for the exchange of USD cash with RTGS balances, bond notes and mobile money. According to the June 2017 Monetary Policy Statement, one could obtain USD cash in the parallel market at a premium of close to 50% for both the RTGS or bond notes.
- There is also an increased migration to perceived safer assets like equities on the ZSE and fixed property as most market participants are off-loading the depreciating local bank balances or bond notes.
- As at 23 February 2018, the Old Mutual shares were trading at $5.20 on the Zimbabwe Stock Exchange (ZSE) versus an average of $3.58 on both the Johannesburg Stock Exchange (JSE) and the London Stock Exchange (LSE). The shares are fungible and ideally should be comparable across all these markets including the Malawi and Namibia Stock Exchange as well. The current Old Mutual share price implies a 1:1.45 exchange rate with currencies that have a readily determinable exchange rate against the USD. Thus, the above issue points to the need to assess the whether there has been a change in functional currency from the USD to some local currency.

2.6. There are also considerations for no change in functional currency:

- Pricing by major retailers remain the same regardless of the mode of settlement. There is, however, a need to assess the underlying cause for increases in product prices that has been experienced in the last few months.
- Other entities have continued to be able to access foreign currency and therefore their product pricing has not been impacted.
- Other business are able to operate in Zimbabwe without importing or exporting. They have, however, been affected by the increases in prices that is prevalent in the country.
- Accessing of foreign currency is a matter of time and patience,- entities will eventually get allocated foreign currency through the formal banking channels.
- Absence of a local currency – should there be a change from the USD, what alternative currency would be applied?

2.7. It is critical that, whilst Zimbabwe adopted a multi-currency system, business transactions and events should be recorded in a specific functional currency. Refer to IFRS assessment below:

3. IFRS IMPLICATIONS

3.1. In terms of IAS 1 *Presentation of Financial Statements* ("IAS 1"), financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses that are set out in the Framework. The application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve fair presentation. [IAS 1.15].

The key consideration from an IFRS perspective is whether or not fair presentation is achieved if assets, liabilities, income and expenses denominated in USD cash/Nostro balances are considered to be of the same currency with those that are denominated in RTGS balances, bond notes and coins and mobile money.

3.2. As per IAS 21 *Effects of Changes in Foreign Exchange Rates* ("IAS 21"), functional currency is the currency of the primary economic environment in which the entity operates. The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash. [IAS21.9]

- An entity considers the following factors in determining its functional currency as per IAS 21:
  - ✓ The currency that mainly influences sales prices for goods and services (this will often be the currency in which sales prices for its goods and services are denominated and settled); and
  - ✓ The currency of the competitive forces and regulations that mainly determine the sales prices of its goods and services.

- ✓ the currency that mainly influences labour, material and other costs of providing goods or services (this will often be the currency in which such costs are denominated and settled).

The following factors may also provide evidence of an entity's functional currency:

- ✓ The currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generated.
- ✓ The currency in which receipts from operating activities are usually retained.

3.3. When the above indicators are mixed and the functional currency is not obvious, management should apply judgement to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and conditions. As part of this approach, management gives priority to the primary indicators contained in IAS 21 before considering the secondary indicators, which are designed to provide additional supporting evidence to determine an entity's functional currency.

3.4. An entity's functional currency reflects the underlying transactions, events and conditions that are relevant to it. Accordingly, once determined, the functional currency is not changed unless there is a change in those underlying transactions, events and conditions.

Earlier Assessment- End of 2016 to beginning of 2017

3.5. For the 2016 financial reporting period, having assessed the above factors, it was concluded that the Zimbabwean functional currency was still the United States Dollars (USD) due to the following reasons:

- The prices of goods and services were still primarily denominated in USD; and
- Salaries and wages were still paid out in USD and Loans obtained locally were pegged in USD.

Subsequent assessment- end of 2017

3.6. At the end of 2017, it is appropriate to revisit the conclusions reached earlier in January above.

3.7. IAS 21’s first primary indicator of functional currency refers to *the currency that mainly influences its selling price*. The selling prices of goods in Zimbabwe in some cases are now dependent on the manner or form of settlement. The USD, therefore, is still influencing the pricing. However, settlement is now influenced by the form and manner of settlement with premiums of varying percentages being experienced on some transactions when settlement is undertaken using RTGS balances, bond notes and mobile money.

3.8. The *competitive forces and regulations that mainly determine the sales prices of goods and services* remain Zimbabwean and therefore there has been no change with regards to this factor. Competitive forces include (1) bargaining power of the buyers and suppliers, (2) threat of new entrants, and (3) rivalry among existing companies.” (Read more: http://www.businessdictionary.com/definition/competitive-forces.html)

3.9. Some suppliers of imported goods and services in Zimbabwe have increased their selling price in order to cover the cost of acquiring USD on the parallel market. Some suppliers have had outstanding foreign payments for very long time even if they are on the priority list. Most suppliers have therefore resorted to charging a premium to cover their cost of accessing foreign currency.

3.10. Loans disbursed in Zimbabwe are still denominated in USD. However, companies and individuals are accessing these loans through local payment platforms such as RTGS, bond notes and coins. Financing and retained earnings of businesses are also being raised in the local dollars and not USD unless these are transferred from a source outside Zimbabwe or directly deposited as such.

3.11. There is no guarantee that the money that one deposits can be accessed at a future date in USD cash, nor is there a guarantee that Bond Notes deposited will be available in the future.

3.12. The level of transactions using local forms of payment in proportion to those in USD cash has significantly increased as reflected in 2.5 above.

4. Conclusion

4.1. After considering the issues discussed above, the functional currency of the country remains as the United States Dollar. However, in order to achieve fair presentation, it is important that the financial statements disclose how business has been impacted by the scarcity of foreign currency and cash.

5. Some recommended disclosures

A. All financial statements

5.1. Functional and presentation currency

These financial statements are presented in United States Dollars (USD) which is the Company's functional currency.

5.2. Use of estimates and judgement

Determination of the functional currency

The company operates in an economy which is experiencing a shortage of foreign currency and consequently has exchange control regulations that impact the timing of payment of foreign payables among other matters. Given the context of the environment, management has assessed if there has been a change in the functional currency used by the company. The assessment included consideration of whether the various modes of settlement may represent different forms of currency. It is observed that whether cash, bond notes, electronic money transfers or point of sale transactions, the unit of measure across all these payment modes remains US Dollars. Management concluded that the US dollar is still the functional currency as presented in the prior year financial statements.

B. Disclosure for Banks, Building Societies and related deposit taking institutions

5.3. Cash and Cash Equivalents/ Deposits note

Restrictions on the use of bank balances held in foreign banks

Balances with Reserve Bank of Zimbabwe and Foreign Banks are used to facilitate customer transactions which include payments and cash withdrawals. In 2016, the Reserve Bank of Zimbabwe, through Exchange Control Operational Guide 8 (ECOGAD8), introduced prioritisation criteria which are to be followed when making foreign payments for customers. After prioritisation, foreign payments are then made subject to availability of bank balances with our foreign correspondent banks, resulting in possible delay of payment of telegraphic transfers. However, no delay is expected in the settlement of local transactions through the RTGS system.

Please also refer to note XX above on the determination of functional currency.

C. Disclosure for other corporates excluded from entities noted in part A above

5.4. Cash and Cash Equivalents/ Foreign Payables note

In 2016 the Reserve Bank of Zimbabwe, through Exchange Control Operational Guide 8 (ECOGAD8), introduced prioritisation criteria which are to be followed when making foreign payments. Any foreign payments which are made from bank balances above are ranked based on the Reserve Bank of Zimbabwe prioritisation criteria and paid subject to the banking institution having adequate funds with its Foreign Correspondent Banks. The timing of funds flows is therefore dependent on the approvals the company receives.

Please also refer to note XX above on the determination of functional currency.