THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF ZIMBABWE

ICAZ GUIDANCE ON

ACCOUNTING FOR FOREIGN CURRENCY LEASES

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Background

The Institute received enquiries from members who are facing difficulties in accounting for a lease in United States Dollars whilst having a Zimbabwean Dollar functional currency.

There are a number of lease agreements with the lease payments (monthly rentals) concluded in USD, however the actual monthly rentals are paid in ZWL using the spot rate at the date of payment. Due to the volatility of USD: ZWL exchange rate, the rental payments vary from one month to another. This guidance is for entities whose functional currency is the ZWL.

These entities are now having challenges on whether to compute the lease in ZWL and account for modifications every month for ZWL payments or compute using USD and convert to ZWL. Concerns are if entities are to convert, when are they going to do so for right-of-use asset and for the lease liability? How will that affect the statement of financial position and the statement of comprehensive income?

What are the best accounting practises to compute the lease liability and the right-of-use assets considering the Zimbabwean situation and what are other entities are doing in that regards?

This paper will seek to answer the questions posed above and provide some guidelines.

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ACCOUNTING GUIDANCE

Despite the entity paying the lease payments in local currency (ZWL$), the leases are concluded in United Stated Dollars (USD) and are therefore USD leases. This is further supported by the fact that payments are fixed in the USD price but fluctuates depending on the spot rate applied on the date of payment.

When a reporting entity enters into a lease in a currency other than its functional currency, the entity must apply the provisions of IAS 21 in order to translate the resultant Right of Use Asset, Lease Liability and any subsequent adjustments and payments. IAS 21. 21 highlights that "A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction."

Furthermore, as per IAS 21. 23 the following shall be applied when:

At the end of each reporting period:
a) foreign currency monetary items shall be translated using the closing rate;
b) non-monetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction; and
c) non-monetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the fair value was measured.

On initial recognition therefore of the lease, the entity should thus compute the lease liability and Right of Use Asset in USD and translate these to the functional currency using the requirements of IAS 21.21 i.e. by applying to the foreign currency amounts, the spot exchange rate between the functional currency and the foreign currency at the date of initial recognition.

Subsequently the enquiring entity will have to apply the requirements of IAS21.23 and thus determine an appropriate rate to translate the Right of Use Asset, Lease Liability and payments. The pertinent issue will therefore be whether the Right of Use Asset and lease liability arising from the US Dollar denominated lease meet the definition of a Monetary item, Non-monetary item or a Non-monetary item held at fair value.

IAS 21 defines Monetary items as units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency.

The essential feature of a monetary item is a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. The lease liability meets the definition of a monetary asset as it is an obligation to deliver units of currency to the lessor in the form of lease payments. The Right of Use Asset (ROUA) (measured at cost) arising from the lease does not give the leasee a right to receive units of currency and as such is a non-monetary asset. IAS 21.16 also highlights a lease liability as an example of a monetary item while at the same time giving the right of use asset as an example of a non-monetary item.

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As the ROUA measured at cost is a non-monetary item, the requirements of IAS 21.23(b) should be applied, i.e. it should be translated using the exchange rate at the date of the transaction. The value of the ROUA measured at cost does not have any effect of the change in foreign currency and should be recognized to the exchange rate at the date of the transaction i.e. initial recognition.

Lease liabilities related to the foreign currency leases should be translated using the principles under IAS 21.23(a), that is, at each reporting period, using the closing exchange rate.

Computation of the lease liability will thus be as follows:

Details	**Rate applied to bring to ZWL functional currency**
Lease liability at beginning of period in USD	Exchange rate: closing rate on previous reporting date
Lease expense paid	Exchange rate on date of transaction
Finance Cost	Exchange rate on date of transaction
Balancing figure will be the exchange gain/ loss recognised in P/L	
Lease liability at end of period in USD	Exchange rate: closing rate on reporting date

IMPACT ON THE PROFIT OR LOSS

As per IAS 21.28 any exchange differences arising on settlement or translation of a monetary asset are recognised in profit or loss in the period in which they arise. Therefore, changes in the exchange rate utilised to translate the lease liabilities will give rise to a foreign exchange gain or loss recorded in profit or loss.

WHERE THE RIGHT OF USE ASSET IS MEASURED AT FAIR VALUE

IFRS 16 highlights that if a lessee applies the fair value model in IAS 40 Investment Property to its investment property, the lessee shall also apply that fair value model to its right of- use assets that meet the definition of investment property in IAS 40. Also if right-of-use assets relate to a class of property, plant and equipment to which the lessee applies the revaluation model in IAS 16, a lessee may elect to apply that revaluation model to all of the right-of-use assets that relate to that class of property, plant and equipment.

In this case, given that the ROU asset becomes a non-monetary asset which is measured at fair value, the reporting entity should apply the requirements of IAS 21.23 and on reporting date should be translated using the exchange rates at the date when the fair value is measured.

For more information on this and other matters contact technical@icaz.org.zw

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