THE INSTITUTE OF CHARTERED ACCOUNTANTS OF ZIMBABWE

TECHNICAL BULLETIN

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MID-YEAR REFLECTIONS AND TOP BUSINESS RISKS FOR 2017 & BEYOND

Mission

"To enhance the International standing and recognition of the qualification Chartered Accountant (Zimbabwe), for the benefit of its members, to support them in providing quality services in the public interest.

Vision

"To be the pre-eminent professional body in the development and promotion of accountancy, assurance and advisory services, business and good governance practices."

Values

Honesty
Upholding the truth – no half truths, putting across the right facts, being impartial and full disclosure.

Responsibility
Taking ownership and being dependable.

Integrity
Acting in good faith, standing by what we believe in, independent, fair and transparent, do the right thing, walk the talk in respect of all things.

Focus Goal

Expand the ICAZ membership while maintaining quality and growing influence.

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1. Introduction

In this bulletin, we explore the recent major accounting events and how companies can respond going forward. We also examine 8 top business challenges for 2017 and beyond that have emerged from our study. As we examined the Zimbabwean economic outlook both from a financial reporting and business point of view, I have been struck by the frenetic activity taking place within most businesses as they struggle to meet head on a mountain of impending challenges and develop new propositions for the 2017 environment.

I hope that this publication will provide a few minutes respite from the 'what we must do by when' imperative and offer some food for thought on how you can differentiate and succeed in the uncharted waters that lie ahead.

While the months ahead will be challenging and uncertain, beginning a new era of success is front of mind for many. Positioning the customer at the heart of your organization through a genuine understanding of their expectations is vital to achieving this.

Needless to say, I would be most interested to receive any comments or feedback on this publication, after all, we also need to listen to our members!

2. Major Accounting Events

i. New Insurance Contract Standard (IFRS 17)

The new insurance contracts standard – IFRS 17 – will bring a fundamental shift in insurance accounting. The greatest value IFRS 17 will give users of financial statements is that in brings in a whole new perspective to insurance reporting and the ways that those financial statements can be interpreted. The new standard brings both benefits and challenges for insurers, who will need to gain an understanding of the accounting changes and the impacts on their businesses.

What's new in IFRS 17?

Increased transparency about the profitability of new and in-force business will give users more insight into an insurer's financial health than ever before.

- Separate presentation of underwriting and finance results will provide added transparency about the sources of profits and quality of earnings.
- Premium volumes will no longer drive the 'top line' as investment components and cash received are no longer considered to be revenue.
- Accounting for options and guarantees will be more consistent and transparent.

These have the potential to reduce the cost of capital for leading insurers. Greater comparability could facilitate merger and acquisition activity, encourage greater competition for investment capital and help gain the trust of investors.

At the same time, there are likely to be a number of other effects. For example, there could be greater volatility in financial results and equity due to the use of current market discount rates. Insurers may also need to revisit the design of their products and other strategic decisions, such as investment allocation.

ii. New Leases Standard Adopted in Zimbabwe

In 2016 the IASB released the new standard on Leases (IFRS 16) which is expected to have a huge impact on reported profitability and balance sheets of companies.

Highlights from the study conducted by PwC include observed median increase in entities debt loads would be around 22%, median increase in entities' EBITDA would be around 13% and median leverage increases would be from 2.03 to 2.14. The impact of the new standard differs significantly between industries. The industries that are likely to experience the most significant impact on reported financial ratios and performance measures are retail, airlines, professional services, health care, textile and apparel, as well as wholesale. The leases standard will be effective 1 January 2019.

iii. Long Form Audit Report

The major drive for reforming the auditor report is that the report is the key deliverable communicating the results of the audit process. Investors and other financial statement users have asked for a more informative auditor's report - in particular for auditors to provide more relevant information to users.

iii. Long Form Audit Report (cont'd)

What are the intended benefits?

- Enhanced communication between auditors and investors, as well as those charged with corporate governance.
- Increased user confidence in audit reports and financial statements.
- Increased transparency, audit quality and enhanced information value.
- Increased attention by management and financial statement preparers to disclosures referenced by the auditor's report.
- Renewed auditor focus on matters to be reported that could result in an increase in professional scepticism.
- Enhanced financial reporting in the public interest.

iv. Complexities over accounting for treasury bills explained

Accounting for treasury bills emerged as one of the complex areas in financial reporting. The types of treasury bills and bonds (the instruments) in the market were:-

a. Issued by the Government of Zimbabwe (GoZ) to banks on behalf of the various entities amongst them, parastatals, private entities, agricultural entities, commercial farmers and some individuals that were owed by Reserve Bank of Zimbabwe, under different government schemes, pre-dollarisation of the economy.

b. Voluntarily acquired treasury bills from the Reserve Bank, by banks.

c. Treasury bills issued by government to banks and other corporates, as settlement of amounts owed by the Ministry of Finance.

d. Bills issued by the Reserve Bank of Zimbabwe in pursuance of the Afrexibank Trade Debt-backed Securities (AFTRADES).

e. Treasury bills issued by the Reserve Bank, through ZAMCO, as private placements in distressed companies.

ICAZ has produced articles on how to account for all these treasury bills and these are available on the ICAZ website.

v. Accounting for Bond Notes is similar to accounting for the USD currency

In November 2016, the RBZ issued bond notes which have the following characteristics:

- Are 1:1 with the USD.
- Released into the market linked to the level of export receipts generated by exporters.
- No separate bank account created for them. It has been clarified that bond notes are accounted for in the same manner that USD transactions are accounted for.

3. The ICAZ Top Business Challenges for 2017

i. Elections mood

The country is beginning to be focused on the forthcoming elections in 2018.We believe that as we get into 2018 the atmosphere of uncertainty as with any pre-election situation will begin to rise. Most businesses may fail to attract any meaningful investment as investors adopt a wait and see attitude.

ii. Difficulties in accessing funding

Zimbabwe businesses are facing difficulties in accessing funding. Most organisations, from SMEs to the largest companies, need debt or preferably equity capital to finance new investments or to refinance existing debt. Companies need to reengineer their processes by phasing out old costly methods of production to pave way for more efficient processes.

iii. Continuing liquidity challenges

Since the start of 2009, the Zimbabwean economy has faced liquidity challenges that have their roots in the adoption of the US$ and other currencies while at the same time no serious liquidity injection has been made.

iv. High credit risk Zimbabwe

The introduction of multi – currencies in February 2009 saw a phenomenal expansion of consumer credit in Zimbabwe with many retail shops, commercial banks, and micro- finance institutions coming on board to offer various credit facilities and loans to consumers who invariably are workers in the public and private sectors.The high rate of default witnessed recently amongst consumers has heightened awareness of credit risk amongst local banks.

v. Fraud and corruption ever increasing in Zimbabwe

Fraud and corruption has become endemic in business, both in private and public sectors. There appears to be an ever-increasing reported incidents of fraud, corruption, misrepresentation, illegal acts, financial misstatements, or other fraudulent conduct.

In a survey conducted by the Association of Certified Fraud Examiners (ACFE) the following findings came through:

- It is estimated that the typical organisation loses 5% of its revenues to fraud each year. Applied to the 2015 Gross World Product, this figure translates to a potential projected annual fraud loss of more than $3.5 trillion, and for Zimbabwe this translates to $500 million annually.
- A typical fraud lasted a median of 18 months before being detected.
- The longer a perpetrator has worked for an organisation, the higher fraud losses tend to be.
- Most occupational fraudsters are first-time offenders with clean employment histories. Approximately 87% of occupational fraudsters had never been punished or terminated by an employer for fraud – related conduct.

v. Fraud and corruption ever increasing in Zimbabwe (cont'd)

- In 81% of cases, the fraudster displayed one or more behaviour red flags that are often associated with fraudulent conduct. Living beyond means (36% of cases), financial difficulties (27%), unusually close association with vendors or customers (19%) and excessive control issues (18%) were the most commonly observed behavioural warning signs.

vi. Low profit margins

In emerging markets like China, producers are now leaders in a number of sectors because of their low prices thereby creating margin pressure to Zimbabwean companies. Whilst the government has tried to protect the home industries by imposing duties and taxes on some products and also through the SI64 gazetted in 2016, the pressure on profit margins in astounding.

vii. Unavailability of quality managerial and technical labour

Whilst there is generally abundant labour on the market in search of jobs, qualified and adequately experienced especially for technical and managerial positions is a problem in Zimbabwe.

The solutions are clear. We need to:

- Train new graduates that meet the demands of industry today and that can adapt to the challenges of the future.
- Retain the best by creating attractive working environments and conditions.
- Attract and retain good people from abroad – we make effort to ensure most Zimbabweans that have left for better opportunities abroad come back.
- Provide good opportunities for re-skilling the existing workforce and encourage companies to enhance in-house training.
- Increase expenditure on research and development, particularly in the private sector.

At macro level, the education system needs to relook at its education system and adapt it so that education can be relevant to the state-of-art curriculums.

viii. Weak corporate governance systems

Many corporate scandals and failures that we have seen in the past two years largely stem from weak corporate governance systems. The country needs effective corporate boards of directors to assume full responsibility for the overall management of each and every public or private entity.

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