Frequently Asked Question on the Zimbabwe functional currency

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Introduction
The purpose of this Q&A is to address various accounting questions relating to the consolidated financial statements of reporting entities with interests in Zimbabwean reporting entities. This Q&A also provides clarity on the announcements made by the Reserve Bank of Zimbabwe (RBZ) of new monetary policies on:

- 1 October 2018 instructing the separation and official opening of the Foreign Currency Account Real Time Gross Settlement (RTGS) account (FCA RTGS for local electronic money transfers) and the FCA Nostro for actual foreign currency deposits or export proceeds; and
- 20 February 2019 establishing an inter-bank foreign exchange market.

Subsequent to these announcements, the Zimbabwe Public Accountants and Auditors' Board published *Financial Reporting and Auditing Guidance on Currency Considerations Under the Environment Prevailing,* on 21 March 2019.

Question 1
The announcement on 20 February 2019 makes the RTGS an official currency. However, did the RTGS system meet the definition of an additional currency in Zimbabwe before 20 February 2019?

Answer
Currency is not specifically defined in IFRS. Currency is defined as a system of money in general use in a particular country or the fact or quality of being generally accepted or in use (Oxford dictionary). Synonyms of currency include money, legal tender, medium of exchange, cash, banknotes, paper money, coins and coinage.

RTGS met the definition of an additional currency in Zimbabwe before 20 February 2019 based on the following factors:

- RTGS was a system in Zimbabwe which facilitated the payment of goods and services in electronic form.

- The prices for goods and services quoted were different depending on whether RTGS or USD were used as settlement, indicating that RTGS was a medium of exchange in Zimbabwe.
- RTGS was the most frequently used payment mechanism in Zimbabwe.
- The Nostro FCA's were separated from RTGS on 1 October 2018, therefore the price distinction between the different mediums of exchange happened before 20 February 2019.

Question 2

Based on the conclusion that RTGS meets the definition of currency in Zimbabwe, is there a need to reassess the functional currency of Zimbabwean entities?

Answer

Yes, a reassessment of functional currency is required based on the following factors:

- Day-to-day transactions were primarily transacted in RTGS. Previously, similar transactions were conducted primarily in USD.
- The reintroduction of local bank accounts de-dollarised the economy.
- The separation of Nostro FCA's from RTGS indicated that RTGS was a different currency.
- As a result of the above-mentioned separation, it became clear that there was very little USD in the local Zimbabwe market.
- The fast-growing parallel market for the exchange of USD combined with the premium to acquire RTGS is an indicator of changes in circumstances.

These factors indicate a change in events which indicates that the functional currency has potentially changed.

Depending on the facts and circumstances specific to an entity, it is possible that the functional currency may remain unchanged. However, a reassessment is still required based on the requirements of IAS 21 paragraph 13 and applying the factors as per IAS 21 paragraphs 9 to 12.

Accounting references

Paragraph 13 of IAS 21 states *"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."*

Paragraph 9 of IAS 21 states "*The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash. An entity considers the following factors in determining its functional currency:*

(a) the currency:

(i) 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

(ii) of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.

(b) 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).”

Paragraph 10 of IAS 21 states *“The following factors may also provide evidence of an entity’s functional currency:*

(a) the currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generated.

(b) the currency in which receipts from operating activities are usually retained.”

Paragraph 11 of IAS 21 states *“The following additional factors are considered in determining the functional currency of a foreign operation, and whether its functional currency is the same as that of the reporting entity (the reporting entity, in this context, being the entity that has the foreign operation as its subsidiary, branch, associate or joint arrangement):*

(a) whether the activities of the foreign operation are carried out as an extension of the reporting entity, rather than being carried out with a significant degree of autonomy. An example of the former is when the foreign operation only sells goods imported from the reporting entity and remits the proceeds to it. An example of the latter is when the operation accumulates cash and other monetary items, incurs expenses, generates income and arranges borrowings, all substantially in its local currency.

(b) whether transactions with the reporting entity are a high or a low proportion of the foreign operation’s activities.

(c) whether cash flows from the activities of the foreign operation directly affect the cash flows of the reporting entity and are readily available for remittance to it.

(d) whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligations without funds being made available by the reporting entity.”

Paragraph 12 of IAS 21 states *“When the above indicators are mixed and the functional currency is not obvious, management uses its judgement to determine the functional currency that most faithfully the economic effects of the underlying transactions, events and conditions. As part of this approach, management gives priority to the primary indicators in paragraph 9 before considering the indicators in paragraphs 10 and 11, which are designed to provide additional supporting evidence to determine an entity’s functional currency.”*

Question 3
If it is concluded that there is a change in functional currency, from which date is the change in functional currency effective?

Answer
The Nostro FCA's were separated from RTGS on 1 October 2018. Prior to this date there was no mechanism to distinguish between RTGS and Nostro FCA's. Accordingly, the date of the change in functional currency is 1 October 2018.

The monetary policy statement on 20 February 2019 confirms the change of functional currency but is not considered to be the date that the change is effected because the primary economic environment that Zimbabwean entities were trading in changed before that date as described above.

Question 4
What factors should be considered in determining the translation rate for consolidation purposes for entities with RTGS functional currencies?

Answer
Before the announcement on 20 February 2019, the RTGS was not an officially traded currency.

IAS 21 requires the use of a spot rate. Paragraph 8 of IAS 21 defines (a) the 'closing rate' as the spot exchange rate at the end of the reporting period; and (b) the 'spot exchange rate' as the exchange rate for immediate delivery. In the light of those definitions, in determining whether a rate is a spot rate, an entity should consider whether the:

- currency is obtainable at an official quoted rate; and
- whether the quoted rate is available for immediate delivery.

Judgement should be applied in determining the translation rate for consolidation purposes, taking into consideration the following:

- As the RTGS was not acknowledged as an officially traded currency before 20 February 2019, there was no observable market for the exchange rate between the RTGS and other currencies, and multiple rates may have been obtained in practice.

- IFRS requires that when several exchange rates are available:

    - the rate to be used is that at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred at the measurement date.
    - If exchangeability is temporarily lacking, the rate used is the first subsequent rate at which exchanges could be made.

- IFRS does not have specific guidance on determining the rate when exchangeability is temporarily lacking. However, a matter was discussed by the IFRS Interpretations Committee (Interpretations Committee) regarding the determination of an exchange rate when there is long-term lack of exchangeability. The Interpretations Committee) considered the circumstances that might result in the departure from the official rate of exchange with respect to the Venezuelan currency. They concluded that, in these circumstances, an entity should assess whether the official exchange rate meets the definition of the closing rate, that is, the rate to which the entity would have access at the end of the reporting period.

- As at 1 October 2018, RTGS were officially valued at 1:1 to the USD. Following the announcement on 20 February 2019, RTGS were officially valued at 1:2.5 to the USD. An entity needs to assess whether or not it had access to USD at the official rates.

- A temporary lack of exchangeability existed in Zimbabwe after 1 October 2018. If an entity was unable to access currency at the official rate (for example, 1:1 against the US dollar), then an estimation should be made of the applicable exchange rate to be used by an entity. The rate to be used to translate the results and financial position of foreign operations into the presentation currency could be the 'dividend remittance rate'. All exchange mechanisms or markets to which an entity is not legally prevented from having access to should be considered.

- A possible gauge of the Zimbabwean exchange rate is the so-called 'Old Mutual Implied Rate', a comparison of the price of shares of the insurer, Old Mutual, in South Africa and Zimbabwe where the share is simultaneously listed. Note that this implied rate is at a significant discount to the previous and current official USD rate and the use of this mechanism to remit funds out of Zimbabwe is not widely accessible.

- The use of a black-market rate is not permissible in terms of IFRS because it is neither legal nor observable.

Accounting references

Paragraph 26 of IAS 21 states that "*When several exchange rates are available, the rate used is that at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred at the measurement date. If exchangeability between two currencies is temporarily lacking, the rate used is the first subsequent rate at which exchanges could be made.*"

Paragraph 8 of IAS 21 states that the *"Closing rate is the spot exchange rate at the end of the reporting period" and "Spot exchange rate is the exchange rate for immediate delivery".*

Question 5

From what point should RTGS be assessed for hyperinflation?

Answer

The re-introduction of local bank accounts was formally made on 1 October 2018 as part of the monetary policy. Prior to this, there was no mechanism to distinguish between RTGS and Nostro FCA's. On that basis, the hyperinflation assessment should be tracked from 1 October 2018 which the date is considered to be the effective date of the change in functional currency.

Question 5A
Is RTGS (now also known as Zim$) hyperinflationary for the second half of 2019?

Answer
IAS 29 does not establish an absolute rate at which hyperinflation is deemed to arise. It is a matter of judgement when restatement of financial statements in accordance with IAS 29 becomes necessary. Hyperinflation is indicated by characteristics of the economic environment of a country which include, but are not limited to, the following:

- People accumulate wealth in non-monetary assets or in a relatively stable foreign currency. Amounts of local currency are invested immediately to maintain purchasing power.
- Monetary amounts are expressed in terms of a relatively stable foreign currency. Prices (for example, rent, wages and capital goods) might be quoted in that foreign currency.
- Prices for credit sales and purchases are calculated to compensate for the expected loss of purchasing power during the credit period, even for short-term credit.
- Interest rates, wages and prices are linked to a price index.
- The cumulative inflation rate over three years is approaching, or exceeds, 100%. [IAS 29 paragraph 3].

A cumulative three-year inflation rate exceeding 100% is a strong indicator of hyperinflation, but the qualitative factors should also be considered. The factors have to be carefully weighed, because it is not desirable to move into and out of hyperinflationary reporting within a short period.

Other characteristics that are not mentioned, but that can be useful in determining the presence of hyperinflation, include:

- Severe exchange controls to protect the local currency.
- Frequent central bank intervention in the currency.

Based on information available, including the cumulative inflation data, it is expected that RTGS is hyperinflationary for the second half of 2019.

Making the assessment of whether RTGS is hyperinflationary is a matter of judgement. In making this judgment, consideration should be given to the usefulness of the financial information [IAS 29 paragraph 2] as well as ensuring that the financial information is a fair presentation of the relevant phenomena [*Conceptual Framework for Financial Reporting* paragraph QC12]. Restating

financial information under IAS 29 provides useful information about an entity's financial position, performance and changes in financial position. This is because money loses purchasing power at such a rate that comparison of amounts from transactions and other events that have occurred at different times, are likely to be misleading. Therefore, restating financial information under IAS 29 will assist with comparability, ensuring profits are not overstated and that materiality is set at the appropriate level.

The judgement applied in determining whether RTGS is hyperinflationary for the second half of 2019, should be disclosed if considered significant, see question 6 below.

Question 5B
Should the comparative consolidated financial statements be restated for the effects of IAS 29?

Answer
IAS 29 applies to the financial statements of an entity from the beginning of the reporting period in which hyperinflation becomes applicable.

The requirements of IAS 29 are applied in respect of the subsidiary's functional currency financial statements in the reporting period in which it identifies the existence of hyperinflation in the economy of its functional currency as if the economy had always been hyperinflationary. The financial statements of the subsidiary are then translated to the group presentation currency for consolidation purposes.

For the purpose of the consolidated financial statements, comparative amounts are not restated when the presentation currency of the parent's consolidated financial statements is non-hyperinflationary.
However, opening equity for the current reporting period reported in the non-hyperinflationary presentation currency will be affected by the cumulative effect of restating non-monetary items from the date they were first recognised and the effect of translating those balances to the closing rate (i.e. the effect of price changes in prior periods). In the consolidated financial statements, this will result in a difference between the closing equity of the previous reporting period and the opening equity of the current reporting period that should be recognised. See question 5D for further guidance on what constitute a reporting period. The judgement applied in determining a reliable general price index to calculate the cumulative catch-up for the initial reporting period to which hyperinflation accounting is applied, should be disclosed if considered significant, see question 6 below.

Question 5C
As IAS 29 should be applied in the reporting period in which the group identifies the existence of hyperinflation, should the group adjust its interim financial statements for the effects of IAS 29 where hyperinflation is triggered after the end of the interim reporting period, but before the financial statements are authorised for issue?

Answer
Making the assessment of whether RTGS is hyperinflationary is a matter of judgement and should consider all the factors as pointed out in question 5A. If hyperinflation is triggered after the end of

the interim reporting period, this would be a non-adjusting event, i.e. the event is indicative of conditions that arose after the reporting period.

Question 5D

As IAS 29 should be applied in the reporting period in which the group identifies the existence of hyperinflation, should the group restate previously published interim financial statements for the effects of IAS 29?

Answer

If it is concluded that the RTGS becomes hyperinflationary after an interim period, but before year-end, the group with a subsidiary that has a functional currency of RTGS that has become hyperinflationary in the second half of the financial year, is not required to restate the previously issued interim reports.

The application of IAS 29 is treated as a non-adjusting post-balance sheet event in the context of previously published interim reports.

The question is then how the beginning of the reporting period should be interpreted for the purpose of the annual financial statements:

Given the absence of specific provisions, we have considered the following two options for the purpose of the annual financial statements:

- The first option considers the reporting period to include an interim reporting period. For financial periods aligned with the calendar year that has published interim results for 30 June 2019, beginning of the reporting period would be 1 July 2019. This will result in not restating data published for the first half of the year, and in recognising the restatement for the first half of the year in full on 1 July 2019 as if the Zimbabwe economy had always been hyperinflationary.

- The second option considers the beginning of the reporting period to be the beginning of the annual reporting period. For financial periods aligned with the calendar year, entities will apply IAS 29 with effect from 1 January 2019 as if the Zimbabwean economy had always been hyperinflationary.

It could be considered that the second option is preferable given that IAS 29 is applicable from the beginning of the year as if Zimbabwe had always been a hyperinflationary economy and ensures better comparability between interim results.

Question 6

What are the disclosure considerations?

Answer

IAS 21 paragraph 54 requires disclosure regarding the change in functional currency, including the fact that there is a change in the functional currency of a significant foreign operation, and the reason for the change.

In addition, an entity is required to provide information that is relevant to an understanding of an entity's financial statements (paragraph 112 of IAS 1 - *Presentation of Financial Statements)*. In this regard, the following disclosure requirements may be relevant to an understanding of an entity's financial statements:

- significant accounting policies, and judgements made in applying those policies that have the most significant effect on the amounts recognised in the financial statements (paragraphs 117–124 of IAS 1);

- sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year, which may include the estimated spot rate, a description of the estimation methodology and the key inputs used and a sensitivity analysis of the impact of using a different closing rate. (paragraphs 125–133 of IAS 1); and

- the nature and extent of significant restrictions on an entity's ability to access or use assets and settle liabilities of the group, or in relation to its joint ventures or associates (paragraphs 10, 13, 20 and 22 of IFRS 12 - *Disclosures of Interests in Other Entities*).

Question 7
Is a parent permitted to exclude a Zimbabwe subsidiary from consolidation if it is concluded that it operates under severe long-term restrictions that significantly impair its ability to transfer funds to the parent?

Answer
No, a parent is not permitted to exclude a Zimbabwe subsidiary from consolidation merely by the fact that it operates under severe long-term restrictions that significantly impair its ability to transfer funds to its parent. The existence of severe long-term restrictions over the transfer of funds, do not in themselves preclude control. For the Zimbabwe subsidiary not to be consolidated, control as defined in IFRS 10 needs to be lost such that it is no longer a subsidiary.

In terms of IFRS 12 paragraph 13, disclosure should be provided around the nature and extent of significant restrictions on an entity's ability to access or use the assets of the group. IAS 7 – *Statement of Cash Flows* paragraph 48 also requires disclosure of the amount, together with commentary by management, of significant cash and cash equivalent balances held by the entity that are not available for use by the group.

Accounting references
Paragraph 3 of IAS 29 states that *"this Standard does not establish an absolute rate at which hyperinflation is deemed to arise. It is a matter of judgment when restatement of financial statements in accordance with this Standard becomes necessary. Hyperinflation is indicated by characteristics of the economic environment of a country which include, but are not limited to, the following:*

a) the general population prefers to keep its wealth in non-monetary assets or in a relatively stable foreign currency. Amounts of local currency held are immediately invested to maintain purchasing power;

b) the general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency;

c) sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short;

d) interest rates, wages and prices are linked to a price index; and

e) the cumulative inflation rate over three years is approaching, or exceeds, 100%."

Paragraph 2 of IAS 29 clarifies that in a hyperinflationary economy, reporting of operating results and financial position in the local currency without restatement is not useful. Money loses purchasing power at such a rate that comparison of amounts from transactions and other events that have occurred at different times, even within the same accounting period, is misleading.

The *Conceptual Framework* paragraph QC12 states that financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only represent relevant phenomena, but it must also faithfully represent the substance of the phenomena that it purports to represent. In many circumstances, the substance of an economic phenomenon and its legal form are the same. If they are not the same, providing information only about the legal form would not faithfully represent the economic phenomenon.

IAS 21 paragraph 42 requires that *"The results and financial position of an entity whose functional currency is the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:*

(a) all amounts (i.e. assets, liabilities, equity items, income and expenses, including comparatives) shall be translated at the closing rate at the date of the most recent statement of financial position, except that

(b) when amounts are translated into the currency of a non-hyperinflationary economy, comparative amounts shall be those that were presented as current year amounts in the relevant prior year financial statements (i.e. not adjusted for subsequent changes in the price level or subsequent changes in exchange rates)".

Paragraph 3 of IAS 10 – *Events after the Reporting Period* states that *"Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue. Two types of events can be identified:*

(a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and

(b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period)."

Paragraph 54 of IAS 21 requires that *"When there is a change in the functional currency of either the reporting entity or a significant foreign operation, that fact and the reason for the change in functional currency shall be disclosed."*

Paragraph 122 of IAS 1 states *"An entity shall disclose, along with its significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 125), that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements."*

Paragraph 125 of IAS 1 requires *"An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of:*

(a) their nature, and
(b) their carrying amount as at the end of the reporting period."

Paragraph 129 of IAS 1 clarifies that *"An entity presents the disclosures in paragraph 125 in a manner that helps users of financial statements to understand the judgements that management makes about the future and about other sources of estimation uncertainty. The nature and extent of the information provided vary according to the nature of the assumption and other circumstances. Examples of the types of disclosures an entity makes are:*

(a) the nature of the assumption or other estimation uncertainty;
(b) the sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity;
(c) the expected resolution of an uncertainty and the range of reasonably possible outcomes within the next financial year in respect of the carrying amounts of the assets and liabilities affected; and
(d) an explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved."

Paragraph BCZ21 of IFRS 10 states "*The Board decided to remove the exclusion of a subsidiary from consolidation when there are severe long-term restrictions that impair a subsidiary's ability to transfer funds to the parent. It did so because such circumstances may not preclude control. The Board decided that a parent, when assessing its ability to control a subsidiary, should consider restrictions on the transfer of funds from the subsidiary to the parent. In themselves, such restrictions do not preclude control."*

Paragraph 13 of IFRS 12 requires an entity to disclose:

a) significant restrictions (eg statutory, contractual and regulatory restrictions) on its ability to access or use the assets and settle the liabilities of the group, such as:

   (i) those that restrict the ability of a parent or its subsidiaries to transfer cash or other assets to (or from) other entities within the group
   (ii) guarantees or other requirements that may restrict dividends and other capital distributions being paid, or loans and advances being made or repaid, to (or from) other entities within the group.

b) the nature and extent to which protective rights of non-controlling interests can significantly restrict the entity's ability to access or use the assets and settle the liabilities of the group (such as when a parent is obliged to settle liabilities of a subsidiary before settling its own liabilities, or approval of non-controlling interests is required either to access the assets or to settle the liabilities of a subsidiary).

c) the carrying amounts in the consolidated financial statements of the assets and liabilities to which those restrictions apply.

Paragraph 48 of IAS 7 requires an entity to disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the group.

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