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RETURN OF THE ZIM-DOLLAR TRANSITION TO NORMALCY?

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Accounting from a banks' perspective— the challenges of interest rates, NPLs and interbank rate.


Minister of Finance and Economic Development: Mthuli Ncube

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THE Reserve Bank of Zimbabwe (RBZ) and the Ministry of Finance and Economic Development have promulgated a series of exchange control operational guidelines and compliance frameworks as part of monetary reforms. These include:

- Introduction of bond notes and wider use of electronic money in October 2016. The bond notes were introduced under a $200 million facility guaranteed by Afreximbank, in which exporters would get an additional 5% of their proceeds in bond notes.

- On October 1 2018, RBZ gave banks a directive to create separate nostro (external bank) foreign currency accounts (FCAs) and (RTGS) FCA accounts.

- On February 22 2019, Statutory Instrument 33 of 2019. The effect of this legislation was to introduce a "new" currency called the RTGS$ and provided instruction on how the conversion from US$ to RTGS$ was going to be done. The new currency commenced trading at an exchange rate of US$1:RTGS$2,5.

- Promulgation of Statutory Instrument 142 and ExCon Directive on June 24, which, in essence, banned the use of multi-currency system and made the Zimdollar the only legal tender to be used for all local transactions.

- On September 27 2019, Statutory Instrument 212 of 2019, Exchange Control (Exclusive Use of Zimbabwe Dollar for Domestic Transactions) Regulations 2019 was issued. The regulations were promulgated to ensure a continued use of the US dollar and any other foreign currencies in domestic transactions.

These reforms have had a significant impact on the banking sector both operationally and in financial reporting. This article aims to assess whether the financial statements from banks would be useful for the users considering the above.

As the environment continues evolving and monertary reforms are made, certain changes may bring about the need for an entity to be cognisant of hyper-inflation considerations where applicable, in order to provide its stakeholders with high quality and value financial statements that can provide relevant and comparable financial information.

As the reforms have an impact on financial reporting, preparers of financial statements would always need to consider the ultimate objective of financial statements, which is to provide financial information about the reporting entity that is useful in making economic decisions. Financial statements should be produced in a way that accurately reflects the condition of a business.

In Zimbabwe, these financials should realistically present currency reforms, inflation and conditions of the banking sector business.

Date of change in functional currency

Based on Statutory instrument 33, the date of change in functional currency was 22 February 2019 but with entity-specific International Fincial Reporting Standards (IFRS) assessments some entities, including banks, were likely to have an earlier date (even as early as end of 2017) for the change in functional currency as confirmed by the October 1 2018 directives. This resulted in non-compliance with IFRS on the determination of the date of change in functional currency which brought about adverse or modified opinions from external auditors.

Functional currency and presentation of financial information

Most banks presented their financial statements in US dollars for December 2018 as dictated by SI 33 of 2019. These banks needed to assess if there was a change in the functional currency from US$ to ZWS before the legislation was promulgated. The banks needed an assessment of the appropriateness of the presentation currency where the functional currency had changed from US$ to RTGS$. This resulted in most banks presenting their 2018 financial reports in US dollars as this was still determined to be the functional currency and presentation currency.

After February 22 2019, the ZWS was then determined to be the functional currency for most entities including banks but a different

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emerged when comparing the 2019 ZW$ to 2018 US$ transactions and balances. This meant the presentation of financial statements from this date would need to be reassessed going backwards to allow financial information to be comparable. Entities presenting financial statements in RTGS/ZW$ for the first time would need to restate comparatives which were reported in US$ to RTGS$/ZW$ going back to end of 2016.

Some banks considered whether the balance sheet on the date of change is a real US dollar balance sheet to avoid overstating converted balances in RTGS$/ZW$. At the time of the introduction of the new currency, SI 33 of 2019 fixed the exchange rate between the RTGS balances, bond notes and coins at 1:1 to the US dollar for the period prior to the effective date of the introduction of the RTGS dollar. This resulted in prior year balances being converted at 1:1, confirming that these were not US$. The fixing of an exchange rate of 1:1 for the period prior to the effective date of February 22 2019 is not in compliance with International Accounting Standard 21 (IAS 21) which deals with "The Effects of Foreign Exchange Rates". IAS 21 requires, among other key requirements, that the financial statements be presented at an exchange rate which approximates the market exchange rate.

There has been debate on the deemed market to be used and the rates to be compared to, resulting in most banks mantaining a fixed rate of 1:1 in compliance with the law.

Legacy debts

In line with Exchange Control Directive RU28 dated February 22 2019 and Exchange Control Circular 08 dated July 24 2019, banks registered the amounts due to various lines of credit providers, supplier, investors and service providers both regional and international as legacy debt with a total amount of US $ 1,2 billion. The amounts were to be paid to the Reserve Bank in line with the directive at a rate of 1:1. Banks would need to consider the continued accounting recognition and treatment of these amounts, that is:

- Disclosure of the current value of the liabilities at the current exchange rate as compared to the settlement of the promise by the RBZ at the pre-settled amount beteween the bank and the RBZ at 1:1;
- Where the RBZ has confirmed that it will settle the amounts but the settlement has not yet been done, the need to assess whether a potential receivable from the RBZ should be recognised, the value of the receivable thereof and the resulting IFRS 9 implications of this receivable;
- If the liabilities are significant to the entity, there is need to perform a going concern assessment taking into consideration the ability of the RBZ to honour this obligation after settlement at 1:1. Some of these foreign obligations are exponentially growing in ZW$ due to the spiking exchange rate of the ZW$ to the US$ since 22 February.

Interest rates

Although the cost of borrowing had dropped to below 15% under the US$-dominated multi-currency regime, a drastic spike in inflationary pressures on the new currency caused the RTGS dollar to lose value against major currencies. The official year-on-year inflation rate rose to 175,66% in the month of June. This saw the interest rate increasing from average 15% to 50% in June and to 70% in September as inflation continued to increase.

Although the interest rates have increased, the September Monetary Policy Statements stated that the quality of the banking sector loan portfolio continued to improve, reflected by the decline in the non-performing loans (NPLs) to total loans, from 6,92% as at December 31 2018 to 3,95% as at June 30 2019. The fall in NPLs does not emphasise the loss of value of the banks of US$ loans which were deemed to be ZW$, whereas some of these loans were from lines of credit for which banks are still liable.

Interbank exchange rate

An interbank exchange rate is one that is agreed by the bank and its client to dispose or buy foreign currency. Most of the transactions are where the bank is buying foreign currency and very little are where the banks are selling foreign currency. The price is at a "willing buyer willing seller", meaning the price is agreed between the bank the specific counterparty. Each bank has its own interbank rate arising from willing buyer willing seller transactions.

The interbank helped banks' reporting by giving some reference exchange rate to use in financial reporting. It provided an official indicative exchange rate other than the 1:1 as previously pegged by the RBZ. However, it is unfortunate that the interbank rate does not effectively represent the market exchange rate as required by IAS 21 and as prescribed by IFRS 13 "fair value measurement". For it to be a market rate it shall be the exchange rate arising in a formal market where any player can transact from which the highest volume of transactions and the market has the highest level of activity. Thus, the market rate is weighted average rate in formal foreign exchange market of buyers and sellers instead of the current practice of private transactions. The current interbank, if unadjusted, will cause non-compliance with IFRS.

IFRS 9 is the new accounting standard that gives guidance on how to account for receivables, deposits and investments in banks otherwise known as financial assets. With the implementation of IFRS 9, the changes in the currency, subsequent increase in inflation and interest rate changes as well as fluctuations to the quality of non-performing loans, the recognition and measurement of financial instruments in financial statements shifted significantly.

Under IFRS 9, banks are supposed to recognise financial assets at amounts that they expect to receive, which is net of the amounts that they think might not end up being paid. In taking into account the monies that banks expect to receive, macro-economic, forward-looking factors such as GDP, interest rates and inflation need to be considered. The quality of the forward-looking information affects the quality of data and judgements management employ when implementing IFRS 9. These considerations would need to change between the judgements and estimates used in the US$ multi-currency system and the Zimdollar-based currency system. ■

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