Exchange rate developments in financial reporting

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Since 2016, Zimbabwe has experienced a litany of currency and exchange control reforms starting with the introduction of bond notes and coins, coming to a crescendo in February 2019 with Statutory Instrument (SI) 33 followed by SIs 85 and 185 of 2020. These reforms impacted the currency in use in Zimbabwe – resulting in the economy being a multicurrency one. Financial reporting practitioners have also seen changes in what they term to be the functional (operating) currency and the exchange rates to be used in converting foreign currency balances for many entities across the country. The everchanging regulations may have had an impact on foreign currency shortages. Resultantly this has raised an array of questions in financial reporting such as what currency a company should report in and at what rate a company should translate their foreign currency transactions. Regulators, practitioners, auditors and academics have had multiple discussions and debates on the above questions, and they continue to have them to this day. In this article, we will explore the discussion from an International Financial Reporting Standards (IFRS) perspective.

IFRSs have been evolving over the years to better meet the general financial reporting objective which is enshrined in the Conceptual Framework of "providing financial information to investors, lenders and creditors that is useful in making decisions". International Accounting Standard (IAS) 21, which deals with accounting for the effects of changes in foreign exchange rates states that transactions should be translated at the spot rate on the day of the transaction. The spot rate is defined as the "rate for immediate delivery". IAS 21 does not then give guidance in cases where an exchange rate lacks immediate delivery. This is somewhat commonplace in the Zimbabwean context where foreign currency funds may not be readily available at the rate stipulated to be the current one.

The accounting body responsible for issuing out standards does so in a consultative form using exposure drafts. An exposure draft is part of the consultative process that the financial reporting standards body uses to improve the financial reporting process by inviting comments for discussion from the various stakeholders affected. In trying to get guidance on what to do when a rate lacks immediate delivery, we can refer to the existing literature in these exposure drafts.

An exposure draft on the lack of exchangeability was released in 2021 for comments from stakeholders. The exposure draft defines a situation when a currency lacks exchangeability as when a currency is not available for immediate delivery. A currency is exchangeable if a company would be able to exchange that currency for another currency at a specified date. Further to the distinctions between exchangeability and lack of exchangeability, the exposure draft outlines the criteria for assessing whether a currency lacks exchangeability. Preparers must use judgement in coming to a conclusion about the currency's exchangeability based on the criteria in the assessment.

When a currency lacks exchangeability the rate that is accessible to the company can be estimated based on the factors that are affecting the company. The objective should be to estimate a spot rate that "reflects at the measurement date the rate at which an orderly exchange transaction would take place between market participants under prevailing economic conditions;."

This brings in an element of subjectivity that preparers will be allowed to use when determining an appropriate exchange rate for reporting purposes. To be noted, the exposure draft does not say use the parallel market rate, but the rate should be estimated to suit the blend of income and expenses in foreign currency that the company may be exposed to. The exposure draft also describes the different disclosures that the entity should make in the process to allow stakeholders to be able to understand the process of preparation and estimation. Such disclosures include making the justifications that show that exchangeability was lacking and the spot rate that was eventually used amongst other disclosures.

The financial reporting process should not just be a tick box exercise but rather be a value-adding process which is why it is necessary to adhere to the principles that have been set out to guide the exchange rate determination process. It is necessary for stakeholders to continuously engage in adopting these standards in a manner that allows for financial statements to purport a true and fair view and meet the primary stakeholder objectives.

The information in this article generalises the principles set out in the exposure draft, and it should be noted that these principles should be applied on a case-by-case basis with an emphasis on entity specific needs. It should also be noted that the exposure draft is still in draft phase and is yet to be included in IAS 21. This article does not substitute reading the actual Exposure Draft or consulting your professional advisor.

If you have any questions on the exchange rates usage in financial reporting and any other financial reporting queries kindly contact us at *marketing@tas.co.zw or +263 8688 007098.*