

The accounting dilemma experienced in Zimbabwe

Contents

Purpose of this paper.....	1
Historical context	1
Hyperinflation and its effects.....	1
Chronic-hyperinflation and its ramifications on financial reporting.....	3
The response of the market and professional bodies	8
Future prospects for a return to full compliance with IFRS.....	10
<i>Annexures 1 to 5 - Joint press releases and guidance offered to their members by the Public Accountants and Auditors Board (“PAAB”), the Zimbabwe Stock Exchange (“ZSE”), and the Zimbabwe Accounting Practices Board (“ZAPB”)</i>	

Purpose of this paper

The purpose of this paper is to provide a background summary of the events that impacted Zimbabwean entities resulting in the accounting dilemma in 2008 and 2009. It is hoped that this will assist external users of financial statements prepared in respect of this period to appreciate the circumstances that forced most Zimbabwean entities into departure from full compliance with International Financial Reporting Standards for the financial reporting periods impacted by these unique and severe circumstances.

Historical context

Since the inception of International Accounting Standards, the Institute of Chartered Accountants of Zimbabwe (“ICAZ”) has encouraged its members to adopt and apply this framework. The Zimbabwe Stock Exchange Listing Requirements require financial information to be prepared and independently audited in accordance with International Accounting Standards / International Financial Reporting Standards (“IFRS”). Most listed Zimbabwean entities have a proud history of full compliance with IFRS, and the local financial reporting culture is historically considered strong and reliable.

Hyperinflation and its effects

For financial reporting purposes the Zimbabwean economy was defined as hyperinflationary in early 2000 (as defined by IAS 29 “Financial Reporting in Hyperinflationary Economies”, hyperinflation is when the cumulative inflation rate over three years is approaching, or exceeds, 100%). Economists however, generally define hyperinflation as inflation over 50% month on month. For the purpose of this paper, this level of inflation will be referred to as “Chronic-hyperinflation”. Zimbabwe entered Chronic-hyperinflation in March 2007, the period from April 2007 to the complete abandonment of the Zimbabwe dollar in late 2008/ early 2009 will be discussed in the next section.

The beginnings of hyperinflation

On 14 November 1997 the Zimbabwean dollar crashed and lost 75 percent of its value against the USD on a single day, on what is now known as “Black Friday” in Zimbabwean economic history. The stock market also plummeted and the index was down by 46 percent by day end from the peak August levels. The central bank was obliged to intervene and raise interest rates by six percentage points within that single month (Bond, 1998). Thereafter the fair value of the Zimbabwe dollar continued to depreciate, thus the 1997 financial and currency turbulence set the stage for a potentially long slump in the real economy.

The crash of the Zimbabwean dollar in the foreign exchange markets was immediately mirrored by its loss of value on the domestic markets, as in January 1998 there was an upsurge in consumer prices of 25 percent. In response to the threatening levels of inflation already experienced, the government reintroduced price controls, which paradoxically led to an increase in activity on the “parallel market” (also commonly known as the informal or black market). This activity on the parallel market had several effects throughout the economy, which included a lack of

transparency in the market, as there were multiple prices for a similar product (i.e. the official price, and the “parallel market” prices). This phenomenon was in part created by shortages in the supply of products at the controlled prices. The foreign exchange “spot rate” was also subject to this phenomenon, for example, the official exchange rate to the USD compared to the “parallel” rate of exchange for the period are shown in the table to the right.

Foreign Currency Market Rates: Annual Average			
Zimbabwe dollars to one US dollar	Annual Average Official Market	Annual Average Parallel Market	Parallel Market Average Premium %
2000	44	49	11
2001	55	215	291
2002	55	1,049	1,807
2003	698	3,675	427
2004	5,123	6,354	24
2005	25,142	45,868	82
2006	162,699	768,713	372
2007	81,937,500	818,000,000	898

Source - John Robertson, leading local economist

It should be noted that the parallel market was not a consistent market; due to its nature there was a lack of transparency in this market, which led to a high range of prices within this market at any single point in time. During the period that Zimbabwe was in hyperinflation, and prior to the chronic-hyperinflation period it was possible to reasonably measure the value of a transaction, however the degree of reliability of these measurements was noted to diminish as the levels of inflation increased. There also developed a widening range in unofficial exchange rates and the effective disappearance of a single spot rate.

The key accounting challenges that were encountered during this period were the application of IAS 21 “The Effects of Changes in Foreign Exchange Rates” which assumes that there is a single spot rate prevailing in the economy at a single point in time, and the application of IAS 29 “Financial Reporting in Hyperinflationary Economies” which assumes logically that the rate of inflation is even across all sectors of industry, and over the period. These two standards were consistently applied by all listed entities during this period; however users of these Zimbabwe dollar financial statements began questioning these assumptions as the levels of inflation increased. The logic and validity of the assumptions underlying IAS 21 and IAS 29 are compromised in an environment where the exchange rate is artificially legislated and there is unequal access to foreign currency, which is further exacerbated by the official and unofficial use of arbitrary exchange rates.

In early 2007, in an effort to more fairly present their real value to their shareholders, several listed entities chose not to apply the official exchange rate to measure their foreign assets and liabilities, but used instead the Old Mutual implied rate (“OMIR”), which was a fair value exchange rate derived by comparing the share price of Old Mutual Plc on the Zimbabwe Stock Exchange, and the share price of Old Mutual Plc on the London Stock Exchange. Although this derived exchange rate was probably a closer reflection of fair value, and it was transparent, it was characterized by high volatility and was significantly influenced by local market factors (such as local liquidity levels and local interest rates, political announcements on the ability to trade these shares on foreign markets, and whether other locally listed entities became more or less attractive to those trading on the market) and is not simply a reflection of the actual trading in foreign currencies. In this connection it is worth noting that even since the liberalization of the exchange control regulations, Old Mutual shares listed on the Zimbabwe Stock Exchange trade at a discount (presently 2 per cent) when compared to the Johannesburg and London Stock Exchanges.

The choice of the appropriate exchange rate to be applied was complicated further by the local monetary policies which required entities to surrender a certain percentage of their foreign revenues to the central bank at the official rate. The percentage to be surrendered varied not only from time to time, but also according to the industry in which the exporter was engaged. This often resulted in blend rates being applied, for example to revenue and receivables, whilst fair value rates were applied to payables and other liabilities.

Chronic-hyperinflation and its ramifications on financial reporting

Subsequent to March 2007, the level of inflation in Zimbabwe increased at an ever increasing rate, as displayed by the table to the right.

Reliability of the official index

These official figures are based, in part, on the controlled prices for products, and did not consider the price of the same goods that were traded on the parallel market. In a number of cases goods were simply not available at controlled prices, but were readily available at parallel market prices. When Zimbabwe entered hyperinflation in early 2000 the level of activity on the parallel market was significantly less than when Zimbabwe entered the period of Chronic-hyperinflation. This significantly increased level of activity on the parallel market, particularly within foreign currency transactions, led to severe distortions within the economy, and the reliability of the Consumer Price Index diminished as the inflation levels reached exponential levels.

CONSUMER PRICE INDEX: OFFICIAL FIGURES FROM CENTRAL STATISTICAL OFFICE		
Date	Monthly % increases	Year-on-year % increases
Mar-07	51	2,200
Apr-07	101	3,714
May-07	55	4,530
Jun-07	86	7,251
Jul-07	32	7,635
Aug-07	12	6,593
Sep-07	39	7,982
Oct-07	136	14,840
Nov-07	131	26,471
Dec-07	240	66,219
Jan-08	121	100,520
Feb-08	126	164,850
Mar-08	224	354,950
Apr-08	314	735,118
May-08	380	2,263,284
Jun-08	827	11,268,759
Jul-08	2,600	231,162,000
From Aug-08	No information released by the Central Statistical Office	
<i>Source - John Robertson, leading local economist</i>		

Cash is king

Due to the nature of the parallel market, there was a premium for physical cash, rather than funds transferred through a registered financial institution. This premium was often realised in the form of a cash discount and was noted to be increasing as the level of economic activity on the parallel market increased during 2008. However, in August 2008 the levels of inflation began to exceed the Reserve Bank's ability to produce physical cash necessary to transact, and the amount of physical cash that could be withdrawn daily from the banks was limited. This, coupled with the high loss of value when waiting for funds to clear through financial institutions, placed further value on physical cash, and a new phenomenon emerged where the value of physical cash began to exceed the value of funds in a financial institution by ever increasing percentages. This appeared to peak in November 2008, when the value of physical cash exceeded the value of the same "amount" in a bank by several trillion per cent. This is illustrated on the right by a comparison of the value of 1 USD at the "cash rate" compared to the "Old Mutual implied rate", which is an indicator of the fair value of funds traded.

Month	Average ZWD Old Mutual implied rate to 1 USD	Average ZWD "cash rate" to 1 USD	Effective premium for cash
Mar-08	42,904,410	34,309,285	25%
Apr-08	101,641,267	74,759,851	36%
May-08	362,551,900	302,911,456	20%
Jun-08	20,776,401,940	6,866,824,105	203%
Jul-08	307,453,608,696	67,273,356,522	357%
(Note that the currency was debased by 10 zero's on 1 Aug 08)			
Aug-08	312	88	255%
Sep-08	88,431	578	15 195%
Oct-08	159,269,899,330	31,041	513 090 788%
Nov-08	75,700,617,933,333,300	773,367	9 788 451 092 525%
Dec-08	13,091,290,322,580,600	629,748,387	2 078 812 739%

Source – developed from the LSE, the ZSE and ZIn daily bulletins of the range of market rates

Extreme volatility

Whilst there was an obvious difference between the value of physical cash transactions, and transactions that were conducted through financial institutions, there were further measures of value within what was still defined as a single Zimbabwe dollar in this period. These values were often expressed in relation to a stable currency, and described as exchange rates. The value was driven by the mode of settlement, for example, the "Zimbabwe dollar" simultaneously had a different value if it was being paid via a cheque, or as cash, or as an electronic transfer, or through a share based transaction. This was not simply a function of the how long the transaction took to complete, but was also driven by the risk associated with the transaction. For example, the volatility of the "cheque rate", the ability for the authorities to monitor electronic transactions, and the anticipated movement on the stock exchange were risk factors that influenced the value of these transactions. Another influence in these different values was the level of liquidity in that particular mode of settlement (e.g. the supply of physical cash in that region, the availability of internationally transferrable shares to trade). The effective rate of exchange even varied between cities within Zimbabwe.

In substance the Zimbabwe dollar took on a multiple currency nature, and it was as if there were several different currencies with different economic fundamentals influencing their behaviour within a single trading environment. Beyond this, there was extreme volatility and a high range of value within each of these different measures of value, or modes of settlement. For example, the range of "RTGS rates" (which is a reflection of the value of the electronic Zimbabwe dollar at the time) was known to be 40%+ between the

highest on offer, and the lowest at a point in time in the same city. This range was never permitted to settle, as this rate increased by hundreds of per cent on a day to day basis during this period. It should also be noted that although the trend was an increase in these rates, the increases in these “rates” were not consistent. For example in the 20 working days in November 2008, the “RTGS rate” increased by between 100% and 600% on seven of the days, it increased by less than 100% on five of the days, decreased on seven of the days, and increased by over 3000% on a single day in the month.

In summary, the Zimbabwe dollar had multiple values at a single point in time that were all individually highly volatile and each of these different values had a significant range of potential values depending on a host of factors, and these values were subject to an inconsistent, but exponential movement within a single month. As a result of this phenomenon, the reliability of the Zimbabwe dollar as a unit of measure in this period was severely compromised.

A return to barter trade

During 2008, partly as a consequence of the dysfunctional Zimbabwean dollar described above, rather than using the Zimbabwe dollar, an increasing number of entities resorted to barter transactions. This was also in part driven by the controlled prices of products, which were often argued to be below their production cost. For example, a tyre manufacturer may have sold four tyres in exchange for cow, and invoiced the transaction at the “official price” of the tyres. Some entities that sought to comply fully with IAS 18 “Revenue” would post the difference between the fair value of the revenue and the “official price” to a separate revenue account; however it was not always possible to reliably establish this fair value in Zimbabwe dollars. The variety of these barter transactions was significant, and almost any product that could be traded was, from cement for fish to sugar for marketing costs, it was so significant that the Zimbabwe dollar value for many transactions was difficult to establish as at times it was not used as a mode of settlement.

In response to the inability of the Zimbabwe dollar to hold value, or indeed reliably represent value, and the severe liquidity crisis that resulted from the lack of physical cash in the market, and as a mechanism to avoid the consequences of price controls, many entities began to use “fuel coupons” as a form of currency. It is unclear whether these coupons meet the definition of a currency, as they are not monetary units and are intrinsically linked to the price of petrol, so perhaps these are closer to the definition of a derivative financial instrument than a currency. As fuel itself was a product governed by the price control regulations, when these transactions were invoiced they were often invoiced based on the official Zimbabwe dollar price of fuel. However, it was commonly understood what the “real value” of fuel was during the period which enabled entities to trade. The value of fuel coupons was also volatile, as these coupons that were used for trading created artificial demand, and the price per litre ranged from 65 US cents to USD 1.80, however at the time this was significantly less volatile than the Zimbabwe dollar. These fuel coupons were not entirely homogenous, as they represented different products (for example diesel, petrol, and bulk petrol) and were issued by a variety of entities, some with greater risk profiles than others, and with differing expiry dates, which contributed to the value of these coupons. In some cases, certain “brands” of fuel coupons were not accepted as a medium of exchange because the market sentiment suggested that the particular coupons were not underpinned by physical fuel.

The high degree of barter trade, and severe shortages in some products, coupled with the multiple measures of value within the Zimbabwe dollar meant that it became impossible to develop a reliable and representative Zimbabwe dollar based “basket of goods” to determine the Consumer Price Index.

Consequently, since July 2008 the Central Statistics Office was unable to generate a general price index for use as required by IAS 29 “Financial Reporting in Hyperinflationary Economies”. There have been independent attempts to develop a general price index, but as there was no consistent measure of value for a single Zimbabwean dollar, these attempts are based on an assumption that all transactions occurred in a single mode of settlement. For example, one estimate of inflation based on activity in the stock market assumed that all transactions that were settled via trading in Old Mutual shares. Which may be a good measure of inflation in that particular mode of settlement, but it does not represent the majority of transactions in the economy and cannot be applied as a general price index as required by IAS 29. Attempts to apply this index to transactions that were settled for example, in cash, or were based on the controlled price of fuel would yield entirely misleading and unfair results. By its very nature, complete information on prices and volumes traded on the parallel market was impossible to obtain. To illustrate this point further, during the period beyond July 2008, there were several independent estimates of inflation which were all based on reasonable mathematical models, however as the mode of settlement which the data was based on were inconsistent; the range in these estimates was very high. John Robertson, a leading local economist, estimated the monthly inflation in November 2008 (which appeared to be peak of Zimbabwe’s inflation) as 5.7 billion per cent, whilst Paul Hanke of the Cato Institute estimated monthly inflation in the same month at 79.6 billion per cent. These estimates are based on settling transactions via electronic payments, or based on the movements in the share prices on the stock exchange. The inflation experienced within cash transactions for the same month was in a significantly lower, with monthly inflation estimates on cash based transactions at 2,000% to 3,000% for November 2008.

Suspension of trading on the Zimbabwe Stock Exchange

During November 2008, the Zimbabwe Stock Exchange was experiencing a “bull run” of exponential proportions. Very few entities were accepting Zimbabwe dollar cheques, or electronic transfers as means of settlement, partly due to the extremely high loss in value over the few days it would take to process these transactions. It should also be noted that the sheer size of these numbers had caused significant processing challenges within the financial sector, as the software in use never anticipated transactions that involved numbers in excess of 24 digits (ZWD quintillion transactions were common in this period). As a result, many entities were engaged in barter trading and nearly all the Zimbabwe dollar liquidity in the economy was being directed towards the Zimbabwe Stock Exchange in an attempt to hold some value. There have been several attempts to measure the inflation in Zimbabwe based on the movement in Zimbabwe Stock Exchange during this period. However, the fundamental principles that caused these exponential movements in share prices were not consistent with the level of trading or general price increases in the economy as many entities were on cash only terms. The exponential movement in this market was driven in part by a lack of any real alternative investment options for those with Zimbabwe dollars. As such an attempt to measure inflation based on the movements in this market, and then apply this “derived inflation” to transactions outside of this market have also yielded unreasonable and inappropriate results.

In mid-November 2008 there were several instances of counterparty fraud, in particular the overbuying of shares in the absence of funds on the assumption that the bull run would continue. This led to the suspension of trading on this market from the 23rd of November 2008 until it re-opened on the 19th of February 2009 trading thereafter in United States Dollars. Given the extreme volatility, and exponential inflation that the country was experiencing, the ability for entities to establish a reliable fair value of the shares listed on the market at 31 December 2008 in Zimbabwe dollars was compromised.

Collapse of the Zimbabwe dollar

This extremely difficult trading environment was coupled with general shortages of most products, and severe shortages of some. It was common for individuals to do their grocery shopping in neighbouring countries due to these shortages. As these levels of chronic-hyperinflation continued to rise, the local prices became unmanageable and entities began to abandon pricing their products in Zimbabwe dollars. In October 2008 the Reserve Bank of Zimbabwe responded by issuing licences to trade in foreign currencies to certain entities that could meet the conditions. Trading in foreign currency in Zimbabwe is subject to exchange control approval. This “dollarization” was formally recognised in January 2009 when the acting finance minister presented the 2009 budget in United States Dollars, and then on the 2nd of February 2009 the Reserve Bank governor announced that they were relaxing the exchange control regulations, which would permit all entities in Zimbabwe to trade in foreign currency.

Accounting challenges for the Chronic-hyperinflation period

The significant challenges that preparers of financial statements faced during this period of Chronic-hyperinflation include, but are not limited to: -

1. The absence of a general price index, which as described above, could not be reliably estimated, and consequently it was not possible to apply IAS 29 “Reporting in Hyperinflationary Economies”. Given the multiple uncertainties that impacted the price of products in Zimbabwe dollars during this period, and the absence of reliable verifiable information as the parallel market was secretive by its nature and the multiple measures of value within the Zimbabwe dollar, it would be impracticable to develop an estimate of an inflation index. Indeed any estimate developed could not be applied generally without attempting to first re-measure every transaction in the economy into the same measure of the Zimbabwe dollar (for example, adjusting all transactions done via electronic transfer to the value of those transactions if they were settled via physical cash, in the same city). Due to the absence of reliable information pertaining to cash transactions this would be an impossible task.
2. The inability to reliably measure an exchange rate during the period, due to the multiple measures of value within the Zimbabwe dollar. Consequently, without a reliable record of spot rates it was not possible to apply IAS 21 “The Effects of Changes in Foreign Exchange Rates” for transactions in the chronic-hyperinflation period.
3. For entities that were previously reporting in Zimbabwe dollars, and have now adopted another currency (most have adopted the USD) as their functional currency, they are required by IAS 21 to apply the spot rate on the date of the “change in functional currency” to translate their results. However, as the Zimbabwe dollar was not a “functional currency” as it was not a consistent, homogenous and reliable measure of value, and as no reliable spot could be developed at this date, it was not possible to apply these provisions of IAS 21 and obtain reasonable results.
4. As there was no trading for over a month on the Zimbabwe Stock Exchange, in an extremely volatile market, it was not possible to develop a reliable fair value in Zimbabwe dollars for equities. And as there was no reliable discount rate or reasonable mechanism to project future cash flows, the alternative valuation techniques described in IAS 39 “Financial Instruments: Recognition and Measurement” could not be applied.
5. The inability to measure in Zimbabwe dollars the fair value of barter transactions, which were often invoiced at controlled prices, severely compromises the reliability of the revenue value for many entities. As a key recognition criterion in IAS 18 “Revenue” is that the cost of the transaction can be

measured reliably, many transactions entered into by entities may not qualify for revenue recognition, despite the substance of the transaction.

6. The inconsistency of value within the Zimbabwe dollar meant that balances held in financial institutions may not have met the definition of “cash and cash equivalents” as they could not be converted into a known amount of “cash” at an insignificant loss in value. For example, in mid-November 2008, an amount of ZWD 150 Quadrillion in a bank account could be sold, via electronic transfer, for an amount of ZWD 1 million in physical cash. This poses challenges in applying IAS 7 “Statement of Cash Flows” as payments made via electronic transfer, or via cheques may not have met the strict definition of a cash flow.
7. The inability to reliably measure fair value in Zimbabwe dollars has an implication on nearly all accounting standards. For example IAS 16 “Property, plant and equipment” where an entity was on a revaluation model, or when attempting to determine the residual values for assets. Another example is IFRS 2 “Share based payments” that were awarded during the period, and entities could not reliably apply any valuation models except for the intrinsic value method, which itself was a significant challenge without reliable discount rates.
8. There were multiple interest rates within the economy, which ranged from 100% to 10 000% per annum, but were nearly all negative in real terms. This compromised the ability to consider future cash flows, and perform impairment tests in Zimbabwe dollars (IAS 36 “Impairment of Assets”).
9. Due to the high degree of political and economic uncertainty prevailing in the period, and the inability to reliably measure most assets and liabilities in Zimbabwe dollars, it was less clear whether entities that were reporting in this period were appropriately applying the going concern assumption.

The response of the market and professional bodies

As a consequence of the inability of the Zimbabwe dollar to measure value reliably, and the exponential and inconsistent rate of change, Zimbabwe dollar financial statements became increasingly unpopular with most external users. It should be noted here that most entities were simultaneously suffering from the severe “brain drain” that was limiting the amount of available skilled man hours to address these challenging limitations to financial reporting. And that those appropriately skilled accountants in the market were being forced to devote the majority of their time to managing cash flows as these had to be considered carefully, on a daily and often hourly basis. These users acknowledged that financial statements had been prepared in accordance with International Financial Reporting Standards whilst the inflation index was available. However, as the rate of inflation increased, the time lapse and significant change in value of the Zimbabwe dollar between the year end and the date of issuing the financial statements resulted in these financial statements being very disconnected from the current environment, and consequently increasingly less relevant.

In response to this, many entities prepared a statement of financial position in USD as at 31 December 2008, based on what they believed the fair value of their assets and liabilities were and supplied this as “unaudited supplementary information” to their Zimbabwe dollar financial statements.

As a consequence of the impact of the chronic-hyperinflationary environment described above, a joint statement was issued by the Public Accountants and Auditors Board, the Zimbabwe Accounting Practises Board and the Zimbabwe Stock Exchange in early 2009 which indicated that it would not be possible for auditors to offer an unqualified opinion on Zimbabwe dollar financial statements for the period. This

statement outlined the severe limitations to reliable financial reporting, which have been described above, and indicated that auditors were likely to issue adverse or disclaimed opinions with an emphasis of matter on going concern for all Zimbabwe dollar financial statements for the year ended 31 December 2008.

During this period, the Institute of Chartered Accountants of Zimbabwe had been engaging the market, and its members and had developed guidance (attached here as Annexure A) that acknowledged the qualitative characteristics of financial statements, particularly relevance and reliability, were compromised due to the limitations to financial reporting experienced. This guidance offered an interim solution to preparers of financial statements, and sought to encourage the principles of IFRS 1 “First-time Adoption of International Financial Reporting Standards” and assist in ensuring that preparers of financial statements have a practical solution, that would be consistently applied across the market.

This guidance was prepared after lengthy consideration and consultations with the local and regional technical staff of the “big four” audit firms, and is believed to be the best option for the market. The guidance does not claim to be fully IFRS compliant, as it is the opinion of the Institute’s members that IFRS was not designed to address the severe circumstances that characterised financial reporting in Zimbabwe in the period in late 2008. Specifically, the guidance encourages entities to fair value their assets and liabilities on the date that they adopt a new functional currency, and the limitations of the Zimbabwe dollar are removed. The guidance also encourages entities not to present comparative information, unless high quality and reliable information can be prepared at a cost that does not exceed the benefit of preparing this information. This guidance has been designed to address the general challenges faced by entities in Zimbabwe. It was concluded that the cost of developing exhaustive guidance, which includes the financial burden, the impact on the timely delivery of this guidance and the readability of this guidance, would outweigh the benefit the market would receive. Any “gaps” in the guidance would be dealt with on a case by case basis. The guidance does indicate that where it is not explicit, entities should apply IFRS.

In substance, nearly all listed entities in the market have already developed their “opening balance sheets” for 2009 in USD based on the principles within this guidance, and have already published their results, albeit unaudited. For the interim results that have been reported at June 2009, entities which have assets that have decreased in value since 1 January 2009, have reported impairment losses. This provides an indication that the local market has adopted these results, and has proceeded on the basis of this guidance.

Of interest are those larger entities which are subsidiaries of regionally and internationally based companies. Several of these entities appeared immaterial to their parent companies when reporting in Zimbabwe dollars, and subsequently have reported financial positions in USD that may be material. This was driven in part by distortions within the inflation index previously, as this was based on a basket of goods that had highly volatile prices, and an unreliable exchange rate and in part by the inability of entities to report inflation adjusted results for the year ended 31 December 2008 in the absence of a reliable inflation index.

Several international holding companies had ceased consolidating Zimbabwe entities in the recent years, asserting that they had effectively “lost control” as they were unable to effectively govern the entity, or receive the benefits from them, as:

1. they were unable to control the price of the local products (due to enforced price controls), and

2. they were unable receive any dividend flow from their subsidiaries (as exchange control approval is required within 12 months of the financial year end, and this was not granted in their particular circumstances)

Other international holding companies had impaired their investments in Zimbabwe subsidiaries, as in their views the pending Indigenisation legislation combined with the inability to receive dividend payments without exchange control approval compromised any future cash flows.

As the price controls on nearly all products have been lifted, and the exchange control regulations have been relaxed, these entities have effectively “regained” control, and have applied IFRS 3 “Business Combinations” to recognise these subsidiaries. This has meant that they could adopt the “fair value opening balance sheet” and were not hindered by the lack of meaningful comparative information available.






Future prospects for a return to full compliance with IFRS

Whilst the guidance proposed by ICAZ does not conform entirely to the existing set of International Financial Reporting Standards, which would require Zimbabwean entities to inflation adjust their results to the date of the change in their functional currency, and then apply the ruling spot rate on that date, in the absence of a stable and reliable spot rate and a reliable general price index this guidance is considered to be the most plausible interim solution. This guidance has been developed in order to assist Zimbabwean entities to prepare meaningful financial information, which is not compromised by the severe limitations to financial reporting that were experienced during the later part of 2008 and more closely meets the key objectives of fairness, relevancy and reliability.

Entities in Zimbabwe are planning to apply the guidance developed by ICAZ as a transitional mechanism that acknowledges that they will be unable to develop IFRS compliant comparative information (which relates to the period from July 2008 to January 2009) for the financial years ending in 2009. For example, for financial statements presented for the year ended 31 December 2009, it is likely that the statement of financial position may have an unmodified audit report, that refers to compliance with the guidance issued, and carry qualifications on the comparative information and the income statement where trading related to the “dysfunctional” period.

For the financial reporting periods that begin on or after January 2010, entities are planning to formally adopt IFRS 1 “First-time Adoption of International Financial Reporting Standards”, which the guidance issued by ICAZ should have prepared them for, and thereafter return to a fully IFRS compliant set of financial statements for the year ended 31 December 2010.

Annexure:

<p>1 - Joint media statement on compliance with the Companies Act (24:03) and International Financial Reporting Standards (“IFRS”) by the Public Accountants and Auditors Board (“PAAB”), the Zimbabwe Stock Exchange, and the Zimbabwe Accounting Practices Board (“ZAPB”) published in March 2009</p>	 <p>PAAB, ZSE & ZAPB Press Statement - 20</p>
<p>2 - Detailed guidance on financial reporting for 2008 issued by the PAAB to its members in March 2009, including the proposed audit opinions for December 2008</p>	 <p>PAAB, ZSE & ZAPB Detailed guidance - 21</p>
<p>3 - Joint media statement on the impact on financial reporting as a consequence of the change in functional currency issued by the Public Accountants and Auditors Board, the Zimbabwe Accounting Practices Board and the Zimbabwe Stock Exchange, published on 5 August 2009</p>	 <p>PAAB, ZSE & ZAPB Press statement guid:</p>
<p>4 - Draft detailed guidance on the change in functional currency approved by the PAAB to be issued to its members in October 2009</p>	 <p>Draft PAAB, ZSE & ZAPB Detailed guidan</p>
<p>5 - Draft detailed guidance on financial reporting for 2009 to be issued by the PAAB to its members in October 2009, including the proposed audit opinions for the period after December 2008</p>	 <p>Draft PAAB, ZSE & ZAPB Detailed guidan</p>