# LITERATURE REVIEW OF THE IMPACT OF MULTICURRENCY REGIME ON FINANCIAL REPORTING

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## ABSTRACT

*The research sought to examine literature on the impact of Multicurrency regime on financial reporting. The research findings showed that, during the Multicurrency regime firms saw financial reporting becoming a challenge due to shifts in government policies which preclude them from reporting in accordance with prescribed standards such as IAS 21, failure to attract skilled staff with foreign currency exposure experience as well as failure to acquire multicurrency system tailored software. The research findings further established the best industry practises that firms can use, in case redollarization occurs in future. The study recommends firms to establish seminars and training programmes for the workforce carry out multicurrency diversification to hedge risks, make use of multicurrency programs to track exposure, consult regulatory boards and foreign currency specialists, and approach the government to work hand in hand when making monetary policies.*

**Keywords:** Multicurrency, Regime, Financial Reporting, Redollarisation.

## INTRODUCTION

This desktop research study mainly focused on reviewing the theoretical and empirical literature of the impact of multicurrency regime on financial reporting. In the theoretical view several authors found that the argument of dollarization has its bases on currency substitution theory. In discussing the empirical views of several authors in line with the objectives, the authors well-defined multicurrency system/ dollarization and they agreed that there are three stages of dollarization namely official, semi-official and unofficial dollarization by Mutengezanwa et al. (2012); Nkomazana & Niyimbanira (2014). These stages were fully explained in this study.

## OBJECTIVE

To establish the implications of Multicurrency System on financial reporting system of SMEs.

## REVIEW OF THEORETICAL LITERATURE

### Currency Substitution Theory

In line with the sentiments of Miles (1978), the dollarization argument has its basis within the theory of currency substitution. Currency substitution brings up the extent to which totally different currencies replace within the assortment of varied prosperity owners according to Girton & Roper (1976). Currency substitution is derived from the uses of money which are the store of value, unit of account also as a medium of exchange according to Savastano (1992). Several factors that affect the effective functions of each currency are always in place. In this particular case, the Zimbabwean dollar is no exception, the currency lost its value store purpose and was well ahead unacceptable as a method of exchange however, remained the prescribed currency for official markets apart from consumer durables according to Bonga & Dhoro (2015). As the economy was in recession according to Kanyenze (2010), demand for the dollar ablated daily. Responding to Gresham's proposition (commonly mentioned as Gresham's law) smart cash replaced unhealthy money Ortiz (1983).

## REVIEW OF EMPIRICAL LITERATURE

### Multicurrency System/Dollarization

#### Multicurrency system

Multi-currency system has been defined, according to the International Monetary Fund (2004) as an intercontinental fiscal system that is centred not a single currency of one nation but rather a group of them. Bloch (2009) has also labelled (MCSs) as a book-keeping program which allows transactions to take place in numerous currencies, facilitating global trade. Selinger (2015) argued that in a multicurrency setting, a higher likelihood of further control by currency issuers is likely as consumers can move their possessions from one currency to another. MCSs promote financial reporting and accounting in three main areas as suggested by Selinger (2015) which are multicurrency trade, reporting and accounting.

#### Dollarization

According to Kabote et al, (2016) dollarization is the adoption by a nation that is not part of the United States of America of the U.S dollar as the paper money, means of trade as proposed by Aubon, (2012) by a country that is not part of the United State of America. The dollarization procedure can also be mentioned as currency substitution according to Ortis (2012) The process also includes saving in hard currency which means asset replacement argued by Nkomazana and Niyimbanira (2014) which means dollarization can be equated to eurorisation or randification according to Buguit (2015). Official dollarization occurs when a country wholly substitutes its local legal tender with foreign currency predominantly the US dollar according to Anderson (2016). The foreign currency becomes the legal tender.

### Stages of Dollarization

According to Munanga (2013) propounded that dollarization takes places in three stages that is unofficial, semi-official and official dollarization.

### Unofficial dollarization

Agreeing with Chitambara (2012), Munanga (2013), unofficial dollarization is the unintentional introduction by the general public of the dollar's usage without government statute help. Zimbabwe also experienced it form the period of 2000 to 2009 according to the International monetary fund (2004). Foreign currency circulated within public without the Zimbabwean government's consent according to Zimstats (2014). Freely convertible currency cannot be regarded as a legal tender even within an illegal dollarization. Domestic exchange is replaced informally and unofficially by foreign currency in such a way that if one is caught with foreign currency then one is punished Berg & Borensztein (2000). Individuals are likely to sustain their fiscal fortunes in terms of imported monies especially when they lack self-reliance on the home currency as Rossimi & Quispe (2015) say.

### Semi-official dollarization

Semi-official dollarization happens through adoption of foreign currency by country as subordinate legal tender, with local currency still commonly within the public Munanga (2013). Semi-dollarized countries usually hold strong national store and follow their locally designed fiscal policy. Foreign currency is permitted in part, and operates side by side with the national currency. Bills are quoted in whichever the domestic or freely convertible currency equivalent. Monetary institutions such as foreign exchange bureaux are licensed to operate. According to Bourne (2012), Zimbabwe also went through this process between 2007 and 2009.

### Official dollarization

Endorsed dollarization happens, according to the International Monetary Fund (IMF) (2004), when a nation adopts forex as a means of exchange and as a key component of its monetary base. The domestic currency is withdrawn, and as legal tender according to Duangploy & Helmi (2015), the government ends all other currencies. Zimbabwe formally embraced the multi-currency scheme when it accepted the various freely convertible currencies comprising of U.S dollar, British pound and the Euro and South African Rand as means of exchange and in February 2009 finally abolished and eliminated the Zimbabwean dollar from circulation according to RBZ (2014).

## The Origins of the Adoption of Multicurrency System on Financial Reporting of Firms in Zimbabwe

According to Munanga (2013, the government of Zimbabwe in February 2009 adopted multicurrency system as a means to tame the devastating hyperinflation that was prevailing. A sequence of events unfolded since independence according to Kanyenze (2010) and the economy of Zimbabwe being labelled by trend-setting inflation for an extended period as suggested by Buguit (2015). The reasons for the fall of Zimbabwe's economy are provocative between economists and accountants, though the matter arguable its complicated according to Noko (2016); Kanyenze et al. (2017); Hanke (2008).

## Factors That Lead to Extreme Devaluation of the Zimbabwean Dollar

### Mismanagement of money supply

According to Coomer & Gstraunthaler (2011), suggested that hyperinflation in Zimbabwe was as result of various econometric situations when the national government increased money supply to cover the funding gap of the rising national debt according to IMF (2010), this comes after substantial downfall in total output and exports, absence of investor confidence in the government, price controls which worsens availability of commodities availability, as well as higher expectations of inflation according to Besada and Moyo (2008). Kanyenze (2010); Maseko & Manyani (2011) alluded that a land redistribution programme was launched by the government of Zimbabwe in the 1990s, which was aiming at reallocating land owned by surviving white farmers to the local farmers, hence due to lack of knowledge by the local farmers, there was large deterioration of the total outputs as they struggled to produce according to Mnangagwa (2009).

### Failure of the agriculture sector

This sector essentially started slopping eventually after birth, that is in 1980 according to Mnangagwa (2009), when Zimbabwe begun a very slanted land redistribution programme suggested by Kanyenze (2010). During that time enormous scope business ranches where claimed by the whites alone covering roughly 11 million of the best arable land while blacks suited just 1.2 million hectares of more unfortunate and dry spell inclined land as subsistence farmers according to Kanyenze et al. (2017), hence the administration of Zimbabwe to address the problem they began the resettlement programme according to Besada and Moyo (2008), which was intended to appropriate land similarly yet this procedure eases back down on the second time of the 1980s Kumar (2018).

## Emerge of Black Market Premium on Foreign Currency and Commodities

Chagonda (2016) argued that in spite of the fact that the financial viewpoint left some antagonistic social consequences for Zimbabweans during the time of emergency, it ought to be recollected that sellers profited tangibly from the Zimbabwe's criminal dark market Bogetic (2000). The purely hypothetical nature of the underground market of Zimbabwe for the period of the trend-setting inflation was a principal feature (Makochekanwa, 2007); Liviatan (2014). The underground market otherwise the parallel market, was entirely productive during the period as the official swapping scale deteriorated in mid-2004 suggested by IMF (2005), because of deficiencies of foreign currency and items in the general stores (Chaavure, 2017).

### The mounting external debt

Makochekanwa (2007) asserts that Zimbabwe, at her birth in 1980, she innate an external debt equivalent to 700 million united states dollars from the government of Rhodesia, which arose from the white regime borrowing funds from the United Nations to finance fights throughout the civil war. That undeserved loan, was due for small term which was almost 15% of the national income (Kanyenze, 2010), encompassed by heavy interest rates which imposed repayment burden to the newly formed government of Zimbabwe in the early years of her independence (Mnangagwa, 2009). At independence, the World Bank made estimation and that

7 to 15% of net exports was being used to cover up the debt as suggested by IMF (2001), yet Zimbabwe was still rebuilding itself, hence it has to assume internationally borrowed funding to finance restoration to assist it to repay the transmitted mortgages according to Kramankel et al. (2010).

### Unfavourable balance of payment

Kenton (2019) postulates that the balance of payment is a summary document that shows all dealings made between local firms of a nation with the entire globe for a certain period of time. According to Bonga (2018), there are three components of the Balance of Payment (BOP) that is the capital account, current account and the official financing. The current account constitutes net visible exports (the variance amongst the visible exports and visible imports), the difference also known as the balance of payment and net invisibles (trade in services) as advocated by Kenton (2019); Kulshreshtha (2008). The capital account constitutes a venture and extra capital arrangements, outflows create deficit and inflows surpluses. The official financing (Currency Flow) is a statement that shows the balance of fiscal arrangements inside and outside the country.Net inflows into the country are shown by positive figure whilst a negative figures denotes movements of cash flows from the country. Negative balances are financed by external borrowings through making use of reserves saved up before (Maseko, & Manyani, 2011).

### Adoption of multicurrency system on financial reporting

According to RBZ (2016) argued that banking and IT systems encountered capacity constraint as large volumes of transactions with multiple digits in value where being processed on a daily basis since the Reserve Bank of Zimbabwe (2016) continued to issue out notes increasing zeros up to quadrillions and trillions (Chaavure , 2017). In the hyperinflationary environment, financial reporting and budgeting (or forecasting) became a challenge since some accounting software such as pastel cannot cater for multiple digits' currency hence there wasn't credibility and transparency in financial statements that were being produced. Hence in 2009, Zimbabwe adopted the multicurrency system upon the abandonment of the Zimbabwean dollar. For financial reporting purposes the government announced a bag of exchanges with the U.S dollar as the functional and reporting currency (Herr & Kazandziska, 2016). Consequently, business entities also adopted the U.S dollar as the serviceable currency (ICAZ, 2016)

## THE IMPLICATIONS OF MULTICURRENCY SYSTEM ON FINANCIAL REPORTING OF SMES IN ZIMBABWE

## Positive Implications

### Improvement on the credibility of financial statements

The Institute of Chartered accountants of Zimbabwe (ICAZ) (2014) posit that the hyperinflation environment in 2008 resulted in difficult financial reporting due to multiple interest rates, multiple exchange rates and an exponential increase of over 250 million percent of inflation, hence as the multicurrency system stabilised inflation, financial statements that are reliable were produced. According to Swieboda (2017), it was suggested reporting was difficult to produce that was trustworthy and that could drive investors to make sound decisions as inflation increased on a daily basis and the central bank was proceeding to issue notes with increased zeros (Chaavure, 2017).

### Improvement of the budgeting system

According to Barth & Wong (2017), in a multicurrency operating environment, conversion rates, interest rates and inflation dominate as the main exterior features distressing entities and the market as whole. Even though these variables have some relationship, for instance, higher level of inflation depreciates the value of home currency in addition distresses the exchange rates as a result ups and downs of currency rates have higher effect on the budgeting process. Translation exposures impact the financial reports throughout budget progress or when the financial plan is used for control purposes as argued by Barth & Wong (2017).

### Transparency in financial reporting

The International Monetary Fund (2004) says that the multicurrency regime has brought substantial aids, particularly by promoting the re-financing of the country's economy, by helping to maintain fiscal discipline by pre- empting inflationary budget financing and by making financial reporting more transparency after a long period of inflation. Multicurrency accounting, according to Kramankel et al. (2010), presents financial information to make informed analysis of the results, financial condition and sustainability of the business Hess (2009).

Barth & Schipper (2015) articulate that transparency is a desirable characteristic of financial reporting, which can be described as the degree to which financial statements disclose the underlying economy of an individual in a manner that is readily understandable by those using financial reports (Munhupedzi & Chidhakwa, 2017).The setting up of transparency and useful financial statements is very essential to lenders, borrowers and issuers according to Lepardatu & Pirnau (2009), for the purpose of responsibility which makes the market participants vindicate every action or decisions they make and admit the end results of their decisions Bryman (2015).

### Lower accounting costs and transaction costs

Mackie (2018) argued that multicurrency accounting is an important method for managing capital in present world's advanced technology and comprehensive economy, and differentiate its competences in reporting with the Generally Accepted Accounting Principles (GAAP) (Auboin, 2012). The accounting program recommends that multicurrency accounting be incorporated into internal reporting and as supplementary reports. Mileris (2014) says that administration requires an ERP system that will facilitate transaction tracking and asset and equity controlling in all currencies and in one reporting method. According to Mackie (2018), the integrated accounting framework which is the Enterprise Resource Planning (ERP) is more effective and consistent for both users and the preparers, eliminating the risk of preparing poor financial statements which could cost the firm (Barll, 2015).

## Negative Implications

### Foreign currency exposure risk

Harper (2015) asserts businesses operating in different operations are vulnerable to risk of currency exposure because they can be currency fluctuations and the rise and fall can directly impact the performance of a venture unit, the valuation of assets and liabilities, and cash flows. Dhani & Groves (2014) articulate that calculating exchange dealings and interpreting transactions is where things become complicated, that is, assets can be overvalued or undervalued resulting in breaching of fundamental and enhancing qualitative characteristics of financial statements by Edens (2015); Conceptual Framework (2018). Useful financial information must be faithfully represented according to Conceptual Framework (2018), meaning it should reflect what it may be meant to portray, so it should be accurate, objective and error-free (Creswell, 2013).

## To Establish the Challenges That Were Faced By Firms during Multicurrency System on Financial Reporting

### Shifts in government policies

According to the Institute of Chartered Accountants in Zimbabwe (2018), the administration of Zimbabwe saw numerous fundamental changes in fiscal and exchange regulation from the perspective of changes in the arrangements during the period 2009 to 2018, the financial reporting system was henceforth unfavourably affected due to infringement of financial reporting requirements such as IAS 1 and IAS 21 by reporting organisations as they sought to put up with the government regulation. Several strategies that were utilised since 2009 have driven financial reporting practises that have suggested that the companies have to hold the currency as their reporting currency since the beginning of the U.S dollar (Business Times, 2018).

### Failure to manage foreign currency exposure risk

Lavis (2018) suggested that firms that have different foreign operations are vulnerable to risk of currency exposure because they might be currency fluctuations and the fluctuations can have direct negative impact on business performance, valuation of assets and liabilities, and cash flows. According to Edens (2015), computing and interpreting foreign currency transactions is where things get a little complicated, that is to say assets can be overvalued or undervalued resulting in prejudiced presentation of financial statements. Muller et al. (2014) asserts that exchanges usually have time they encounter great unpredictability which may harmfully have emotional impact on profit boundaries hence firms should make sure appropriate approaches have been implemented to safeguard cash flow from the abrupt exchange movements. Marston (2010) coined that defining the calculation of FX exposure risk is the main issue in any form of multicurrency system business activity. Williamson (2012) says that the lack of multicurrency accounting system tools and experience contributes to a failure to keep track of the FX exposure.

### Failure to comply with IAS 21

According to Business Times (2018) many reporting entities in Zimbabwe have failed to meet the terms of IAS21 (Effects of the changes in foreign currency exchange rate) due to the necessity to act in accordance with the legislation of the country which is Statutory Instrument 33 of 2019 which prohibited the organisations to act in accordance with the standard, incapability to purchase multicurrency accounting software due to lack of funds by SMEs Munanga (2013). The multiple pricing atmosphere which was lead from 2017 to 2018 according to Newsday (2018); Herald (2017), required the need to take these effects into account, as payment of transactions depended on payment mode, whether USD currency, RTGS, bond notes and mobile money (Standard Report, 2017). Independent (2018) says foreign currency shortage also gives rise to foreign exchange rate disparities between RTGS and US$.As a result, this influenced the pricing structures to integrate foreign exchange rate movements on the RTGS and the bond notes according to RBZ (2018), henceforth IAS 21 was required to reflect effects of these changes in the preparation of financial statements (Auditor General Report, 2018).

## Strategies That Can Help Firms on How to Report Under Multicurrency System in the Future

### Engage in training and seminars

Lee (2016) advocated the necessity to include seminars and training staff as this enriches their understanding and expertise. Kulshretha (2016) states that seminars revitalize the mind and the workers will gain new abilities. Al-Momani & Gharaibeh (2018) proposed that in order to furnish financial executives with the prescribed knowledge on the importance of FX risk and the technicalities for risk management adequate training programmes should be carried out. Drexler et al. (2011) argue that training programmes for SMEs should increase their impact if they are targeted at the level of sophistication of owners. Jones et al. (2013) illustrate that seminars and training programmes are costly and thus they should be wiped out while Abduli & Arifi (2017) states that when some personnel lack competence for a post that personnel should dessert the position Griffin (2013).

### Risk assessment

Saunders & Cornnert (2016) suggested that firms should develop sophisticated methods for them to examine their additional exposure from foreign exchange as a result to improve and complement the calculation of their risk positions. The familiarity about the net position of risk is very essential however the idea of operational size is also crucial. The operational size is determined by two rudiments. Primarily, the unpredictability of exchange sets depicts the behaviour of the currencies. The similarity of two open positions in diverse freely convertible currencies with the same worthiness in home exchange most probably remain with the same worth it means the operational sizes completely varies according to Karppien (2013).

### Consultation of accounting firms and regulatory boards

According to International Federation of Accountants (2018) the regulatory board the Public Accountants and Auditors Board (PAAB) under the Public Accountants and Auditors Act is there to give guidelines on financial reporting, defining and enforcing ethical practice and discipline among all professional accountants. Ndamba & Matamande (2016) posit that the Companies' Act (24.03) requires all reporting entities in Zimbabwe to follow regulations as set by Zimbabwe Accountants Public Boards (ZAPB) being a subsidiary of Public Accountants and Auditors Board (PAAB) (2018) which was meant to curb self-regulation which occurred from (1905-1992) according to Fang & Miller (2014).According to Al-Momani & Gharaibeh (2018) suggested that banks and other financial firms should play a vital role in handling of risk management issues, financial derivatives should be offered and promoted more and consulting services should be provided to manage risks associated with foreign currency exposure Cosmin (2010).

### Use of Multicurrency system accounting tailored software

Adhikari et al. (2016) says in a multicurrency system, the transactions can incur foreign exchange gain or losses, hence the transactions need to be posted in such way that they present fair results hence companies should look for software that functions across different currencies so that an invoice logged in one currency and paid in another allowing spreading of funds across currencies. Also there is need for the ability to set expiry dates for exchange rates such as period rates this aid when posting retrospective transactions. According to Bae & Archcroft (2010), the multicurrency system software can maintain different nominal codes per currency for gains and losses visibility. This means you can have a different exchange gain/ loss nominal account to track the postings per currency and this will allow you to drill into the cost of trading in different currencies (Digrigoli & Lee, 2018).

### Use of currency trading accounts

Archer (2012) defined currency trading account as an account that is denominated as a difference of multiple currencies like in exchange gain account. It is important to note that a currency trading account does not represent assets. According to Selinger (2015), the purpose of this type of account is to calculate gains and losses arising from fluctuations of foreign exchange rates. By conversion gains are recorded as positively and losses as negative amounts, hence the currency trading account is more like an income account. Currency trading accounts do reflect currency exchanges that took place in the past and in an ideal situation where exchange rates never change argued by Schiller (2014)

## CONCLUSION

This study focused on brushing up the applicable writings by more than a few intellectuals who were backing the research topic. The authors in order to come up with a well-supported research, a precarious appraisal and scrutiny of thoughts, philosophies, observations and doctrines of many scholars was carried out. Various intellectuals were of the view that multicurrency regime has an impact on financial reporting. In the theoretical view several authors found that the argument of dollarization has its bases on currency substitution theory. In discussing the empirical views of several authors in line with the objectives, the authors well-defined multicurrency system/ dollarization and they agreed that there are three stages of dollarization namely official, semi-official and unofficial dollarization. Most of the literature reviewed indicated that firms adopted multicurrency system accounting after its introduction in 2009 and some authors were of the view that the system brought about more benefits in financial reporting while others were on the view that once firms are exposed to foreign currency there is a risk that value of its assets, liabilities and cash flows can be adversely impacted. Some went on to establish the challenges that were faced by the firms during the era and the strategies that can help firms on how to report in future under multicurrency system.

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