Topic: Foreign Currency Issues

Date Discussed: March 18, 2010

The SEC staff has received a number of inquiries regarding certain foreign currency issues related to investments in Venezuela. This announcement is in response to those inquiries that have been received by the SEC staff on the issues described below.

Amongst other requirements, current restrictions of foreign currency exchange in Venezuela provide that entities use the official rate of exchange (official rate) to exchange funds. The official rate is set by the Venezuelan government and in order to use the official rate to exchange currency, entities seek the ability to utilize the official rate from Venezuela's Commission for Administration of Foreign Currencies (CADIVI).

As an alternative to the use of the official rate it may also be legal to utilize the parallel rate. It is possible that the parallel rate provides entities with a more liquid exchange and entities can access the parallel rate using a series of transactions via a broker. The parallel rate has recently been significantly different from the official rate.

With respect to accounting for a subsidiary in Venezuela in cases where the parent's reporting currency is the U.S. dollar and the Venezuelan subsidiary's functional currency is the Venezuelan Bolivar ("Bolivar" or "BsF"), the staff has recently become aware of the following fact pattern: In years prior to 2010, certain entities may have used the parallel rate to remeasure certain U.S. dollar denominated balances that the Venezuelan subsidiary held and then subsequently translated the Venezuelan subsidiary's assets, liabilities, and operations using the official rate. The effect of this accounting treatment resulted in reported balances in an entity's financial statements that differed from their underlying U.S. dollar denominated values.[1] In order to illustrate the impact that these differences may have on different accounts within the financial statements, two illustrations are provided below.

First, assume that at a period end prior to January 1, 2010 (for a calendar year entity), a U.S. entity's Venezuelan subsidiary held $10 million of cash denominated in U.S. dollars. Further assume that at the period end, the parallel rate was 5 Bolivars to every 1 U.S. dollar and the official rate was 2 Bolivars to every 1 U.S. dollar. Upon the remeasurement of the U.S. denominated cash to Bolivars and the subsequent translation of the Venezuelan subsidiary's financial statements, an entity would have reported cash of $25 million[2] for financial reporting purposes.

Second, assume that at a period end prior to January 1, 2010 (for a calendar year entity), a U.S. entity's Venezuelan subsidiary held $15 million of accounts payable denominated in

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[1] The staff notes that these differences arise when different rates are used for remeasurement and translation.

[2] The $25 million is calculated as follows. First, the $10 million of cash is remeasured using the parallel rate to 50 million BsF. Subsequently, the 50 million BsF is translated back to U.S. dollars using the official rate of 2 Bolivars to 1 U.S Dollars, resulting in a translated reported balance of $25 million.

U.S. dollars (please also assume the exchange rates are the same as in the example above). Upon the remeasurement of the U.S. denominated accounts payables to Bolivars and the subsequent translation of the Venezuelan subsidiary's financial statements, an entity would have reported accounts payable of $37.5 million[3] for financial reporting purposes.

Finally, the staff has noted that Venezuela has met the thresholds for being considered highly inflationary and accordingly, calendar year entities that have not previously accounted for their Venezuelan investment as highly inflationary will begin applying highly inflationary accounting beginning January 1, 2010.

Disclosures

The staff believes that in cases where reported balances for financial reporting purposes differ from the actual U.S. dollar denominated balances (such as in the illustrations above), a registrant should make disclosures that inform users of the financial statements as to the nature of these differences. When material, the disclosures in the financial statements should, at a minimum, consist of the following:

- Disclosure of the rates used for remeasurement and translation.
- A description of why the actual U.S. dollar denominated balances differ from the amounts reported for financial reporting purposes, including the reasons for using two different rates with respect to remeasurement and translation.
- The magnitude of the difference between the amounts reported for financial reporting purposes versus the underlying U.S. dollar denominated values.
- To the extent possible, disclosure of the amount that will be recognized through the income statement (as well as the impact on the other financial statements) as part of highly inflationary accounting beginning in 2010 (see below).

Impact of Highly Inflationary Accounting on Differences between Amounts Recorded for Financial Reporting Purposes versus the Underlying U.S. Denominated Values

The staff notes that upon application of highly inflationary accounting (January 1, 2010 for calendar year registrants), registrants must follow the accounting outlined in ASC Topic 830, Foreign Currency Matters, which states that "[t]he financial statements of a foreign entity in a highly inflationary economy shall be remeasured as if the functional currency were the reporting currency."

Accordingly, upon the application of highly inflationary accounting requirements, a U.S. reporting currency parent and subsidiary effectively utilize the same currency (U.S. dollars) and accordingly there should no longer be any differences between the amounts

[3] The $37.5 million is calculated as follows. First, the $15 million of accounts payable is remeasured using the parallel rate to $75 million BsF. Subsequently, the $75 million BsF is translated back to U.S. dollars using the official rate of 2 Bolivars to 1 U.S. Dollars, resulting in a translated reported balance of $37.5 million.

reported for financial reporting purposes and the amount of any underlying U.S. dollar denominated values that are held by the subsidiary. Therefore, the staff believes that any differences that may have existed prior to January 1, 2010, between the reported balances for financial reporting and the U.S dollar denominated balances should be recognized in the income statement, unless the registrant can document that the difference was previously recognized as a cumulative translation adjustment (in which case the difference should be recognized as an adjustment to the cumulative translation adjustment).

Furthermore, the staff believes that these differences should be recognized in 2010 at the time of adoption of highly inflationary accounting.

Other

The SEC staff is aware that the EITF will be discussing certain issues related to foreign currency, including the accounting for multiple exchange rates in Venezuela, and accordingly the guidance in this D-Topic is intended to be interim guidance pending the EITF completing its deliberations.