FASB Emerging Issues Task Force

Issue No. 10-B

Title: Accounting for Multiple Foreign Currency Exchange Rates

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Background

1. Topic 830, Foreign Currency Matters, provides guidance on the use of an appropriate exchange rate for translation of an entity's operations in a foreign country and remeasurement of its foreign currency transactions. This Issue addresses the accounting implications for entities that operate in foreign countries that have multiple exchange rates.

2. Countries that do not have exchange controls generally have a single free market exchange rate that is used to settle all foreign currency denominated transactions and remit dividends to foreign investors. However, countries that have exchange controls often have multiple exchange rates. Such is the case where governments mandate that foreign currencies (including U.S. dollars) needed to settle certain types of transactions may be obtained at a rate that is either favorable (a preference rate) or less favorable (a penalty rate) than the rate that would apply to other transactions, including a remittance of dividends to a foreign investor. For example, a preference rate may be available to pay for imports of essential goods and services, while a penalty rate would apply to pay for imports of what the foreign government considers as

* **The alternative views presented in this Issue Summary are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

nonessential goods and services. These preference and penalty rates may be different from that government's specified dividend remittance rate.

3. For situations in which multiple exchange rates exist, there appears to be diversity in practice in the application of the guidance in Topic 830 with respect to the selection of an appropriate exchange rate for translation of an entity's operations in a foreign country and the remeasurement of foreign currency transactions. This Issue was raised most recently in the context of the multiple exchange rates in Venezuela. Appendix 10-BA to this Issue Summary provides additional background on the multiple exchange rates in Venezuela and also illustrates the effect of using different exchange rates for translation and remeasurement.

4. In 1983, the FASB was asked to address accounting for preference and penalty exchange rates applicable to monetary items denominated in a foreign entity's functional currency (for example, a U.S. dollar denominated debt of a foreign entity whose functional currency is the U.S. dollar). At that time, the Board believed that most of the issues involving multiple exchange rate systems were primarily questions of fact and the underlying facts and circumstances must be considered in evaluating the validity of exchange rates. The Board also believed that if significant uncertainties exist concerning the availability of currency at a particular exchange rate, the principles regarding recognition of gain and loss contingencies established in FASB Statement No. 5, *Accounting for Contingencies*, would apply.

Scope

5. The scope of this Issue applies to any reporting entity that has a foreign subsidiary in a country in which multiple exchange rates exist, and the functional currency of that foreign subsidiary is the local currency. While this Issue was recently raised in the context of the situation in Venezuela prior to its economy becoming highly inflationary, its scope is not limited to any specific country. Further, this Issue is not currently relevant for a reporting entity's Venezuelan operations because that economy recently became highly inflationary under Topic 830, and, therefore, the Venezuelan subsidiary's functional currency is no longer its local currency (that is, the Bolivar) but for subsidiaries of a U.S. parent would be the U.S. dollar. This

Issue does not address the accounting implications of an economy changing to highly inflationary.

Accounting Issues and Alternatives

Issue 1: In an economy with multiple exchange rates (such as a market rate and a preferential/penalty rate), the exchange rate that should be used for (a) remeasurement of a foreign-currency-denominated transaction and (b) translation of a foreign subsidiary's financial statements.

View A: It may be appropriate to use different exchange rates if a foreign-currency-denominated transaction will be settled at the preferential/penalty rate and there are no unusual circumstances to preclude the use of the dividend rate for translating the subsidiary's financial statements.

6. Proponents of View A believe that it may be appropriate to use a different exchange rate for the remeasurement of foreign currency transactions versus the rate used for the translation of the foreign subsidiary's financial statements. Paragraph 830-20-30-3 indicates that a foreign currency transaction should be translated at the applicable rate at which a particular transaction could be settled at the transaction date. In contrast, paragraph 830-30-45-6 requires that in the absence of unusual circumstances, the exchange rate used to translate foreign currency financial statements should be the rate available for purposes of dividend remittances. As such, View A supporters believe that Topic 830 clearly distinguishes between the exchange rate that should be used to remeasure foreign currency transactions and the rate used for translating foreign currency financial statements.

7. View A supporters also cite paragraph 121 of the basis for conclusions of FASB Statement No. 52, *Foreign Currency Translation*, which notes that the Board concluded that gains or losses resulting from foreign currency transactions have a different economic nature than those resulting from translating foreign currency financial statements. At that time, the Board believed that transaction gains and losses have a direct cash flow effect when the foreign-currency-denominated monetary asset or liability is settled at an amount greater or less than the functional

currency equivalent of the original transaction. The Board also believed that the use of a dividend rate for translating foreign currency financial statements was more meaningful than any other rate because cash flows to the reporting entity can only be converted at that rate and, ultimately, the realization of the net investment in the foreign entity would be in the form of cash flows from that entity. Accordingly, those supporting View A believe that their view is consistent with the Board's intention that it is appropriate to use the rate at which a particular transaction could be settled for remeasuring foreign currency transactions and the dividend rate for translating foreign currency financial statements.

8. Proponents of View A understand that there may be situations in which an entity has the ability to access a preferential or penalty rate for the remeasurement of foreign currency transactions that is different from the rate used for dividend remittances. However, View A proponents do not believe that the existence of the multiple exchange rates in and of itself constitutes an unusual circumstance to justify the use of an exchange rate other than the dividend rate for purposes of translating a subsidiary's financial statements. Said differently, View A proponents believe that even when a foreign country has multiple exchange rates, the reporting entity still may be able to realize its net investment in a subsidiary operating in that foreign country at the dividend rate.

9. Further, View A supporters believe that the use of different exchange rates for remeasuring a foreign denominated financial asset or liability to the foreign entity's functional currency, and subsequently translating the asset or liability back into the foreign currency, is clearly contemplated in Topic 830. Those proponents cite paragraph 830-30-45-7, which observes that unsettled foreign currency intercompany transactions may be settled using preference or penalty rates and establishes a mechanism for reconciling differences between the intercompany receivables and payables arising in such circumstances. The following example illustrates the application of paragraph 830-30-45-7:

- A parent entity sells 100USD worth of inventory to its foreign subsidiary when the market exchange rate of the local currency is 5LC/1USD.

- The foreign subsidiary is able to access a preferential rate of 4LC/1USD when settling this particular intercompany obligation.
- The parent entity records an intercompany receivable of 100USD, while the foreign subsidiary reflects the inventory and an intercompany payable at the local currency of 400LC.
- When the inventory and the intercompany payable are translated to USD for consolidation purposes, the entity would be required to use the market exchange rate of 5LC/1USD.
- Accordingly, the foreign subsidiary's intercompany payable remeasured at 80USD would not equal the parent's intercompany receivable of 100USD.
- Paragraph 830-30-45-7 requires that the difference of 20USD be treated as an additional intercompany payable in the foreign subsidiary's translated financial statements with a corresponding debit recorded to receivables such that the intercompany balances would be equal and could be eliminated on consolidation.
- The 20USD receivable is effectively treated as an exchange rate subsidy, which will be collected when the intercompany transaction is settled.

10. Those supporting View A believe that if a foreign subsidiary has U.S. dollar denominated financial assets or liabilities, and the foreign subsidiary has access to preferential exchange rates or is exposed to a penalty rate, the "subsidy" or "penalty" should be recorded in the reporting entity's consolidated financial statements (as part of the financial asset or liability). For example, in Exhibit 1 of Appendix 10-BA the $75 ($125 less $50) "subsidy" resulting from remeasuring the U.S. dollar denominated cash balance into the local currency and subsequently translating the asset back to U.S. dollars would be recorded as part of the consolidated cash balance, similar to the "subsidy" of $81 ($135 less $54) related to translating the cash balance of Bs.F 270 (denominated in the local currency) at the preferential dividend rate instead of the parallel rate.

11. Proponents of View A also note that the Center for Audit Quality's SEC Regulation Committee's International Practices Task Force (IPTF) has discussed this issue over the past several years. At the November 2008 meeting, the IPTF indicated that it supports a view that it

may be appropriate to use different exchange rates for translating financial statements and remeasuring foreign-currency-denominated transactions.

12. Opponents of View A believe that the foreign currency translation process should not result in the reporting of a different amount when the original balance is denominated in the same currency as the parent entity's reporting currency. Accordingly, they believe that when the subsidiary's financial asset or liabilities are denominated in the same currency as the parent entity's reporting currency, the exchange rate used for translation purposes should be identical to the rate used for remeasurement purposes.

View B: The same rate should be used for both remeasuring a foreign-currency-denominated transaction and translating the financial statements because the existence of multiple exchange rates constitutes an "unusual circumstance."

13. Proponents of View B believe that the foreign currency translation process should not result in the reporting of a different amount when the original balance is denominated in the same currency as the parent entity's reporting currency. These proponents believe that the use of different exchange rates can produce results that are not representationally faithful. For example, these proponents believe that in Exhibit 1 of Appendix 10-BA, the cash balance of $50, which is denominated in U.S. dollars, should not be reflected as $125 in the consolidated financial statements.

14. View B proponents point out that in its July 12, 1983 Status Report, the FASB noted that "issues involving multiple exchange rate systems are primarily questions of fact and the underlying facts and circumstances must be considered in evaluating the validity of exchange rates." As a result, proponents of View B believe that the existence of the multiple exchange rates constitutes "unusual circumstances" as contemplated in paragraph 830-30-45-6. Proponents of View B point out that the use of different exchange rates for the remeasurement of a foreign-currency-denominated transaction and translation of the subsidiary's financial statements may result in the reporting of amounts that are inconsistent with the underlying economics and, therefore, believe that the existence of multiple exchange rates should be

considered an unusual circumstance. As such, View B proponents believe that in this circumstance it is appropriate to use the same exchange rate for the remeasurement of foreign currency transactions and to translate the foreign currency financial statements.

15. Opponents of View B acknowledge that the application of the requirements in Topic 830 could potentially lead to anomalous results. However, those View B opponents believe that this anomaly should be addressed by requiring additional disclosures in the financial statements.

View B': Modify the requirements in Subtopic 830-30 to require that the exchange rate used for the translation of foreign company financial statements be the same as the rate used for remeasuring foreign currency transactions.

16. View B' proponents believe that the existence of multiple exchange rates does not constitute an "unusual circumstance" as contemplated in paragraph 830-30-45-6. However, View B' proponents do agree that the use of different exchange rates can produce results that are not representationally faithful. Therefore, View B' proponents believe that the requirements in Topic 830 for determining the exchange rate used to translate a foreign subsidiary's financial statements should be amended so they are the same as the requirements in paragraph 830-20-30-3 for the remeasurement of foreign-currency-denominated transactions. The amended requirement would apply to the translation of financial statements of all foreign entities and not only those that operate in an economy with multiple exchange rates. View B and View B' both require that in situations in which multiple exchange rates exist, the exchange rate used to translate a foreign subsidiary's financial statements must be the same as the rate used to remeasure foreign currency transactions (and, accordingly, the accounting for foreign subsidiaries that operate in economies with multiple exchange rates would be identical under View B and View B'). However, proponents of View B' believe that the accounting literature needs to be amended to obtain the desired accounting result, rather than interpreting that the existence of the multiple exchange rates constitutes "unusual circumstances" as contemplated in paragraph 830-30-45-6.

17. View B' proponents believe that if there is a difference between the exchange rate for settling transactions and the dividend remittance rate (for example, there is a preferential or

penalty exchange rate related to the remittance of dividends), then that difference should only be reflected in the reporting entity's financial statements when the entity's net investment in a subsidiary is monetized (that is, when the dividends are paid). Proponents of View B' believe that although the Board originally concluded that using the dividend rate is more meaningful than any other rate, until the dividends are paid it is inappropriate to use this exchange rate because the investment in the entity has not been realized. Accordingly, they believe that the financial statements should be translated at the exchange rate applicable for remeasurement of foreign currency transactions, and any difference between the exchange rate used for translation purposes and remitting dividends would be realized when the dividends are ultimately paid.

18. In addition, View B' proponents believe that for those economies in which a single exchange rate exists, the exchange rate used for the translation of a foreign subsidiary's financial statements would be identical to the rate used to remeasure foreign transactions. Accordingly, proponents of View B' believe that although the requirements in Subtopics 830-20 and 820-30 require the use of different rates for remeasurement and translation, changing the guidance in Subtopic 830-30 in this manner would not have a significant effect because in most situations only one exchange rate exists. The amendment, however, would eliminate the anomaly that arises when multiple exchange rates exist.

19. Opponents of View B' believe that it may be appropriate to use a different exchange rate for remeasurement versus translation. For example, if an entity has access to a preferential rate to settle foreign currency transactions (the entity is buying products considered essential) that is not available for dividend remittances, it may be inappropriate to use the preferential rate for translation purposes because the reporting entity is unable to ever realize its net investment in the foreign subsidiary at that preferential exchange rate. Opponents of View B' believe that in most situations in which multiple exchange rates exist, the remittance of dividends would usually be at a penalty rate, which should be reflected in the consolidated financial statements.

20. In addition, opponents of View B' are concerned that in situations in which multiple exchange rates exist for settling foreign transactions (for example, certain items may be settled at a preferential rate), questions may arise as to which settlement exchange rate should be used for

translation purposes. In other words, for those items included in a foreign subsidiary's balance sheet that are not denominated in a foreign currency and, therefore, there is no specified remeasurement rate, questions may arise as to which of the multiple exchange rates specified for remeasurement purposes should be used to translate those balance sheet items that are not denominated in a foreign currency. View B' opponents have similar concerns with regards to View B.

Issue 2: If the Task Force concludes that View A is appropriate in Issue 1, the additional disclosures that should be reflected in the financial statements of the reporting entity.

View A: Provide the disclosures required by Update 2010-19 related to situations in which the reported balance for financial reporting purposes differs from the U.S dollar denominated balance.

21. In May 2010, the FASB published Accounting Standards Update No. 2010-19, *Foreign Currency (Topic 830): Foreign Currency Issues: Multiple Foreign Currency Exchange Rates*, which updates the Codification for an announcement made by the staff of the U.S. Securities and Exchange Commission. This announcement requires that where reported balances for financial reporting purposes differ from the actual U.S. dollar denominated balances (as a result of the use of multiple exchange rates), a registrant should make disclosures that inform users of the financial statements as to the nature of those differences. Proponents of View A believe that these disclosures should be required for all entities and not only SEC registrants.

22. Update 2010-19 requires that when material, the disclosures in both annual and interim 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.

- Disclosure of the relevant line items (e.g. cash, accounts payable) on the financial statements for which the amounts reported for financial reporting purposes differ from the underlying U.S. dollar denominated values.
- For each relevant line item, the difference between the amounts reported for financial reporting purposes versus the underlying U.S. dollar denominated values.

View B: Replace the disclosure requirements in Update 2010-19 with a requirement to explain why a particular rate was used for translating a foreign subsidiary's financial statements when multiple exchange rates exist.

23. Proponents of View B believe that the disclosure requirements in Update 2010-19 were announced to address specific concerns that the financial assets of a Venezuelan subsidiary that are denominated in U.S. dollars may be reported in the parent entity's financial statements at a different amount than the original balance. View B supporters believe that although the disclosures are more broad, the announcement was made to address a concern that in certain circumstances entities were using a parallel rate to remeasure U.S. dollar denominated financial assets into Venezuelan Bolivars (Bs.F) and then using the official rate (preferential rate) to translate the assets back into U.S. dollars. That accounting would result in those assets being reflected at an amount greater than their original U.S. dollar denominated values.

24. View B proponents believe that in that situation, using the preferential rate for translating the foreign entity's financial statements, rather than the parallel rate, would increase the amounts recorded for all of the foreign entity's assets and not just financial assets that are U.S. dollar denominated. Therefore, View B proponents do not believe that the additional disclosures in Update 2010-19 should be required, as they only focus on financial assets and liabilities that are denominated in U.S. dollars and not on all of the foreign entity's assets and liabilities. For example, in Exhibit 1 of Appendix 10-BA, the risk that a reporting entity will be able to ultimately realize $125 for the U.S. dollar denominated cash balance, is identical to the risk that they will realize $135 for the cash balance of Bs.F 270, which is denominated in the local currency. As such, supporters of View B believe that the disclosure requirements in Update 2010-19 should be replaced with a requirement to explain why a particular rate was used for translation purposes and describe the effect of using such rate.

View C: Require the disclosures in Update 2010-19, but expand the scope of when the disclosures are required to include situations contemplated by paragraph 830-30-45-7.

25. Proponents of View C support the disclosure requirements in Update 2010-19; however, they believe that the scope of the disclosure requirements in Update 2010-19 should be expanded to include situations in which intercompany transactions can be settled at preference or penalty rates as described in paragraph 830-30-45-7. They believe that if the foreign entity receives a preferential rate subsidy or is exposed to a penalty rate, the disclosures required in Update 2010-19 should be required regardless of whether the financial asset or liability is intercompany and therefore eliminated in consolidation.

Issue 2a: If the Task Force concludes that View B is appropriate in Issue 1, the additional disclosures that should be reflected in the financial statements of the reporting entity.

View A: Disclose situations in which a rate other than the rate for the purpose of dividend remittance is used (that is, when unusual circumstances exist).

26. View A supporters believe that in situations in which the reporting entity has determined that unusual circumstances exist and, therefore, are required to use an exchange rate that is other than the dividend remittance rate, that fact should be disclosed. Proponents of View A believe that if the effect of using an alternative rate is material to the financial statements, users of those statements should understand the reasons why a different rate was used.

View B: No additional disclosures are required.

27. View B supporters believe that the determination of the exchange rate to be used for translation purposes is based on management's assessment of facts and circumstances and does not warrant specific disclosures.

Transition Method and Disclosures

If the Task Force concludes that either View B or View B' is appropriate for Issue 1, the Task Force will need to determine the appropriate transition method. If the Task Force concludes that View A is appropriate for Issue 1, then no transition would be required because the conclusion would only affect the disclosure requirements that are already in effect for SEC registrants.

View A: The consensus should be applied by recording a cumulative-effect adjustment to the opening equity balance in the period of adoption.

28. The staff is unaware of any economies in which multiple exchange rates currently exist and the local currency is the functional currency of the foreign entity. In addition, because the functional currency of any Venezuelan subsidiary would now be the U.S. dollar (for U.S. parent companies) as a result of its hyperinflationary economy, the rate used to remeasure Bs.F denominated assets and liabilities of a Venezuelan subsidiary would be the exchange rate determined in accordance with paragraph 830-20-30-3 and not the exchange rate for dividend remittances. Accordingly, this Issue is not expected to currently affect entities with subsidiaries in Venezuela. In addition, the staff believes that the cost of retrospective application would outweigh the benefits compared to a cumulative-effect adjustment.

View B: The consensus would be applied retrospectively to all prior periods, consistent with the requirements of paragraph 250-10-45-5.

29. Under View B, retrospective application to earlier periods would be required. Proponents of View B believe that this transition method would provide users with the benefit of comparability for all periods presented. Proponents of View B believe that information should be readily available to revise the financial statements for the different exchange rates in effect at those times.

30. The disclosure requirements in paragraphs 250-10-50-1 through 50-3 would be required under both View A and View B.

Appendix 10-BA

1. In February 2003, the Venezuelan government announced certain foreign currency exchange controls, and since then there has been no free market for the purchase or sale of foreign currency in Venezuela. In conjunction with these exchange controls, the Bolivar was officially pegged to the U.S. dollar (herein referred to as the "official rate").

2. In October 2005, the Venezuelan government enacted the Criminal Exchange Law to impose strict sanctions, criminal and economic, for the exchange of Venezuelan currency with other foreign currency through other than the officially designated method, or for obtaining foreign currency under false pretenses. However, the Law appears to have provided an exemption for the purchase or sale of securities. That exemption for transactions in certain securities resulted in the establishment of an indirect "parallel" market of foreign currency exchange, through which companies may obtain foreign currency without resorting to, or requesting it from, the Venezuelan Foreign Exchange Administration Board (CADIVI). The average rate of exchange in the parallel market (hereinafter referred to as the "parallel rate") is variable and has historically differed significantly from the official rate. The parallel rate has been in excess of 5 Bs.F for 1 U.S. dollar.

3. In January 2008, the Venezuelan government introduced a redenominated Bolivar, known as the "Bolivar Fuerte" (plural: Bolivares Fuertes or Bs.F) with an official rate of 2.15 Bs.F for 1 U.S. dollar. The official rate remained unchanged until January 2010, when the Venezuelan government introduced a dual official rate system, with a pegged exchange rate of 2.6 Bs.F per U.S. dollar for products considered essential and 4.3 Bs.F per U.S. dollar on all other products.

4. The Venezuelan economy has also recently qualified to be considered highly inflationary as defined in Topic 830. Therefore, effective January 1, 2010, many U.S. entities changed the functional currency of their Venezuelan operations from Bs.F to U.S. dollars.

5. Prior to Venezuela qualifying as a highly inflationary economy, there appears to have been diversity in practice concerning the application of the guidance in Topic 830 to the multiple

exchange rates in Venezuela, particularly when a Venezuelan subsidiary has financial assets or liabilities that are denominated in U.S. dollars. For example, assume that a U.S. dollar parent company has a subsidiary in Venezuela and had previously determined that the foreign subsidiary's functional currency is the Bs.F. Also assume that the subsidiary has cash or receivables denominated in U.S. dollars. Under that scenario, the staff understands that some entities used the parallel rate to remeasure the foreign-currency-denominated items into Bs.F and then the official rate to translate the Venezuelan subsidiary's financial statements for consolidation purposes. However, other entities in similar situations have applied the parallel rate for both remeasurement and translation purposes. Under the first alternative, financial asset or liabilities of the Venezuelan subsidiary that are denominated in U.S. dollars were recorded at a different amount than the original U.S. dollar balance in the consolidated financial statements. See Exhibit 1 below.

6. Subsequent to Venezuela qualifying as a hyperinflationary economy, the functional currency for a Venezuelan subsidiary would be the reporting currency. Accordingly, any U.S. dollar denominated amounts would not be required to be remeasured in the local currency and then translated back to U.S. dollars.

7. In May 2010, the Venezuelan government suspended trading in the parallel market. The parallel market was subsequently reopened a month later; however, the Central Bank of Venezuela (BCV) now determines a daily price band for the buying and selling rates of the foreign currency bonds. In addition, companies are now limited to buying $50,000 a day through the parallel market administered by the central bank and a maximum of $350,000 a month.

Exhibit 1

This exhibit illustrates the effect of translating a foreign subsidiary's financial statements at the parallel rate as compared to the official rate. In this example, the entity has $50 of cash, which is denominated in U.S. dollars. In Column A, the parallel rate is used for both remeasurement and translation purposes. In Column B the parallel exchange rate is used to remeasure the foreign-currency-denominated cash into Bs.F and then the official rate is used to translate the Venezuelan subsidiary's financial statements for consolidation purposes.

		A	B
	Local currency amount	Translated at the parallel rate (5Bs.F to 1USD)*	Translated at the official rate (2Bs.F to 1USD)*
Cash - 50USD denominated	250**	**50**	**125**
Cash – Bs.F denominated	270	54	135
Accounts receivable	100	20	50
Fixed Assets	30	6	15
Total	650	130	325
Liabilities	500	100	250
Equity***	150	30	75
Total	650	130	325

* The exchange rates used in this example are for illustrative purposes only and do not represent actual exchange rates.
** The U.S. dollar denominated cash balance is converted to the local currency at an exchange rate of 5Bs.F for 1USD (in this case the parallel rate) based on the requirements in paragraph 830-20-30-3.
*** Equity includes the cumulative translation adjustment.
Amounts presented are for illustrative purposes only.