FASB Emerging Issues Task Force

Issue No. 10-B

Title: Accounting for Multiple Foreign Exchange Rates

Document: Issue Summary No. 1, Supplement No. 1, with Working Group Report No. 1*

Date prepared: September 7, 2010

FASB Staff: Farber (ext. 282) / Brower (ext. 468)

EITF Liaison: Uhl

Date previously discussed: July 29, 2010

Previously distributed EITF materials: Issue Summary No. 1, dated June 25, 2010

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 under governments that 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 that the government considers nonessential goods

* **The alternative views presented in this Issue Summary Supplement and Working Group Report 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.**

and services. These preference and penalty rates may be different from the rates the government may specify apply to dividend remittances.

Scope

3. 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. Also, this Issue does not address the accounting implications of an economy changing to highly inflationary.

Prior EITF Discussion

4. At the July 29, 2010 meeting, the Task Force discussed whether it is appropriate to use a different exchange rate for (a) remeasurement of foreign currency transactions at a foreign subsidiary and (b) the translation of the foreign subsidiary's financial statements into its parent's reporting currency when multiple exchange rates exist. Some Task Force members expressed concern with the view that it may be appropriate to use different exchange rates if a foreign currency-denominated transaction will be settled at either the preferential rate or the penalty rate and there are no unusual circumstances to preclude the use of the dividend rate for translating the subsidiary's financial statements, because amounts denominated in the parent's reporting currency could be different in the consolidated parent's financial statements as a result of the remeasurement and translation process. Other Task Force members were particularly concerned about situations in which the subsidiary's foreign-denominated bank accounts are held off-shore in the reporting entity's jurisdiction. Some Task Force members indicated that they believe that it may be appropriate to use different exchange rates when multiple exchange rates exist because the entity may be able to receive the benefit from an exchange rate arbitrage if the entity has the ability to access the preferential rate for dividend purposes. However, Task Force members noted

that additional guidance would be beneficial for determining when an unusual circumstance exists that would cause an entity to use a rate other than the dividend rate for translation, such as when a government's lack of performance on a rate raises questions as to the entity's ability to realize the rate arbitrage.

5. At the July 29, 2010 EITF meeting, the Task Force was not asked to reach a consensus on this Issue. However, the Task Force directed the FASB staff to perform further analysis on the current practice issues in Venezuela. Specifically, the Task Force asked the staff to investigate whether additional guidance is required to clarify (a) what constitutes an "unusual circumstance" as referred to in paragraph 830-30-45-6, (b) what the accounting should be if an unusual circumstance exists, and (c) when deconsolidation is required based on a lack of exchangeability of a foreign currency.

6. A Working Group was formed to assist the staff in identifying potential issues associated with practice issues arising in Venezuela as well as potential solutions to address those issues. The Working Group met on August 24, 2010, and was asked to provide perspectives on the various questions but was not asked to form a Working Group recommendation at that meeting. A Working Group Report from that meeting is included as an appendix to this Issue Supplement.

Accounting Issue and Alternatives

Issue 1: Does the Task Force want to provide guidance for determining whether it is appropriate to use different exchange rates (such as a market rate and a preferential/penalty rate) for (a) remeasurement of a foreign-currency-denominated transaction and (b) translation of a foreign subsidiary's financial statements when multiple exchange rates exist?

View A: The Task Force should <u>*not*</u> *provide additional guidance on this Issue as the accounting anomaly that existed in Venezuela prior to Venezuela's economy becoming highly inflationary (an amount denominated in the same currency as the parent entity's reporting currency being reported as a different amount as a result of the remeasurement and translation process) is rare.*

Exchange rates for distributing dividends are typically penalty rates rather than preferential rates, and amending the model in Topic 830 to address this situation is not warranted.

7. Subsequent to Venezuela being considered highly inflationary under Topic 830, a reporting entity's Venezuelan operations functional currency is no longer its local currency, and for subsidiaries of a U.S. parent would be the U.S. dollar. Accordingly, proponents of View A believe that the accounting anomaly that arose for an entity's operations in Venezuela prior to the economy being highly inflationary no longer exists. In addition, proponents of View A believe that this situation is unlikely to arise elsewhere as they do not expect governments in other jurisdictions to provide a preferential rate for remitting dividends outside of their countries. Rather, it is more likely that a government would impose a penalty rate on such dividends. Accordingly, they believe that the situation that cash denominated in a parent's reporting currency could be reflected at a higher amount in the consolidated parent's financial statements as a result of the remeasurement and translation process is unlikely to exist in the future. Opponents of View A believe that similar issues could arise in the future particularly when a penalty rate exists for dividends and an entity with a local functional currency has liabilities denominated in its parent's reporting currency.

View B: The Task Force should provide additional guidance on this Issue.

8. Proponents of View B believe that it is appropriate to continue to address this Issue. Although the Issue is currently not relevant in Venezuela, View B proponents believe that the Task Force should continue to address this Issue as similar issues may arise in the future. In addition, View B supporters believe that this situation may exist wherever there is a penalty rate for dividends and an entity with a local functional currency has liabilities denominated in its parent's reporting currency. For example, a foreign entity may have an obligation for $100, which is remeasured into its local currency at the market rate of 4LC/1USD and then translated back into U.S. dollars at the dividend penalty rate of 5LC/1USD. In this example, the obligation would be reflected as $80 in the parent's consolidated financial statements.

9. Opponents of View B believe that in the example above, the assets of the foreign entity that will be used to pay the U.S. dollar-denominated obligation (and all locally denominated obligations) are reflected in the parent entity's financial statements at the dividend penalty rate. Accordingly, they believe that if an entity were required to reflect the obligation at $100 in the parent's financial statements, that would not reflect the solvency of the subsidiary because the obligation will be settled with assets of the subsidiary that are translated at the dividend penalty rate. For example, if an entity will settle a 100 U.S. dollar-denominated obligation with LC400 of cash, translating the LC400 of cash at the rate of 5LC/1USD or $80 and reflecting the obligation at $100 in the parent's financial statements would be misleading.

Issue 2: 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.

10. 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.

11. 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.

12. Proponents of View A understand that there may be situations in which an entity has the ability to access a preferential rate or a penalty rate for the remeasurement of foreign currency transactions that are 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 that would 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.

13. 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 that would apply to dividends 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 is effectively an exchange rate subsidy that will be realized when the subsidiary sells the inventory and recognizes 400LC (rather than 500LC) as cost of sales.

14. 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 10-B1, 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 Venezuelan Bolivars (BsF) 270 (denominated in the local currency) at the preferential dividend rate instead of the parallel rate.

15. 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.

16. 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 assets 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."

17. 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 10-B1, the cash balance of \$50, which is denominated in U.S. dollars, should not be reflected as \$125 in the consolidated financial statements.

18. 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.

19. 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 the anomaly should be addressed by requiring additional disclosures in the financial statements. In addition, they believe that View B and View B' do not address the situation in which a Venezuelan subsidiary holds cash or other financial assets denominated in a foreign currency other than its parent's currency (that is, U.S. dollars). Specifically, under both View B and View B', if a Venezuelan entity holds cash in a Euro-denominated bank account, the remeasurement and translation process could result in a U.S. dollar amount in the parent's financial statements that is different from the amount that would be reflected if the Euro/Dollar exchange rate had been applied to the Euro amount.

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.

20. 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 that 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.

21. 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.

22. 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.

23. 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.

24. 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.

View C: It is appropriate to use the dividend rate for translating the subsidiary's financial statements if there are no unusual circumstances to preclude the use of that rate. However, additional guidance should be provided for determining which dividend rate to use when multiple rates exist for remitting dividends.

25. Similar to View A proponents, View C proponents do not believe that the existence of the multiple exchange rates in and of itself constitutes an unusual circumstance that would justify the use of an exchange rate other than the dividend rate for purposes of translating a subsidiary's financial statements. In addition, they also 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. However, View C proponents believe that the situation that existed in Venezuela prior to the economy becoming highly inflationary

under Topic 830 does not relate to whether a rate other than the dividend rate should be used for translation purposes, but rather how to determine which dividend rate should be used for translation purposes when multiple dividend rates exists. Said differently, View C proponents believe that unless unusual circumstances exist, the dividend rate should always be used to translate a foreign entity's financial statements; however, additional guidance should be provided on determining which dividend rate to use in situations in which multiple dividend rates exist.

26. In addition, View C proponents believe that when multiple exchange rates exist for remitting dividends, the least favorable rate should be used to translate an entity's foreign operations unless the entity can overcome that presumption based on its ability and intent to access a preferential rate. They believe that any difference between the least favorable rate and the actual dividend remittance rate 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). They believe that this approach is consistent with the gain contingency guidance in Topic 450, Contingencies (originally issued as FASB Statement No. 5, *Accounting for Contingencies*).

27. Opponents of View C believe that requiring an entity to use the least favorable rate is overly onerous. They believe that the selection of a translation rate requires judgment based on facts and circumstances that are specific to each entity and, accordingly, prescribing the use of the least favorable rate is inappropriate. In addition, opponents of View C believe that if the guidance in Subtopic 830-30 were amended to require the use of the least favorable rate for translation purposes, a similar amendment would need to be made to the criteria for determining the rate used for remeasurement purposes in Subtopic 830-20. Specifically, View C opponents believe that similar uncertainty exists as to whether a preferential rate will be realized for settlement of foreign assets and liabilities. Opponents of View C are concerned that making a similar change to Subtopic 830-20 would distort the financial statements if additional guidance is not provided on reclassifying realized exchange gains and losses to the corresponding income statement line items. For example, if an entity purchased $100 of inventory that it expects to pay for at a rate of 4LC/1USD, but is required to record the purchase using the least favorable available rate of 5LC/1USD, and the entity subsequently sold the inventory for LC500, it would not record any

gross margin on the transaction. If the entity ultimately settles the obligation at 4LC/1USD, and the gain of LC100 is not reclassified from exchange gains and losses to cost of sales, the financial statements would be distorted.

Issue 3: If the Task Force concludes that View A is appropriate in Issue 2, 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.

28. 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. That 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 those disclosures should be required for all entities and not only SEC registrants.

29. 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.

30. 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 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.

31. 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 (for example, Euro denominated bank accounts) 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 10-B1, 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 BsF 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.

Issue 3a: If the Task Force concludes that View B is appropriate in Issue 2, 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).

32. 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.

33. View B supporters believe that the determination of the exchange rate to be used for translation purposes does not warrant specific disclosures.

Transition Method and Disclosures

If the Task Force concludes that View B, View B', or View C is appropriate for Issue 2, the Task Force will need to determine the appropriate transition method. If the Task Force concludes that View A is appropriate for Issue 2, then no transition would be required because the conclusion would only affect the disclosure requirements in Update 2010-19 that are already in effect for SEC registrants. In addition, if the Task Force believes that there are any additional items identified in the Working Group Report that should be addressed by the FASB staff, the transition for those items would be addressed separately.

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

34. 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 Venezuelan Bolivar 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.

35. 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.

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

Other Items

Based on the information included in the Working Group Report, are there any items that the Task Force believes should be addressed by the FASB staff?

Exhibit 10-B1

TRANSLATION USING THE PARRALLEL AND OFFICIAL RATES

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 Venezuelan Bolivars 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 – BsF 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 5BsF 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.

Appendix 10-BA

FASB Emerging Issues Task Force

Issue No. 10-B

Title: Accounting for Multiple Foreign Exchange Rates

Document: Working Group Report No. 1

Date prepared: August 25, 2010

FASB Staff: Farber (ext. 282) / Brower (ext. 468)

EITF Liaison: Uhl

Date previously discussed: July 29, 2010

Previously distributed EITF materials: Issue Summary No. 1, dated June 25, 2010

Background

1. The purpose of this document is to summarize the discussion of this Issue at the EITF Issue 10-B Working Group meeting held on August 24, 2010. The Working Group was assembled to obtain feedback on the concerns related to the current practice issues in Venezuela raised by the Task Force as well as any other accounting concerns related to the current economic conditions in Venezuela. Members of the Working Group represented the four largest accounting firms and four preparers with operations in Venezuela. One SEC staff member also participated as an observer.

Working Group Discussion

2. The Working Group discussed a number of questions, which are discussed in the following sections. Responses to the first two sections (Section I, Determination of the remeasurement rate, and Section II, Other-than-temporary lack of exchangeability) are based on the assumption that the economy of Venezuela is highly inflationary and, accordingly, the functional currency for a Venezuelan subsidiary is the parent's reporting currency (assumed to be the U.S. dollar (USD)). The last section (Section III, Unusual circumstance) relates to the Issue discussed at the July 2010 EITF meeting which is also included in the September 2010 Issue Supplement No. 1.

I. Determination of the remeasurement rate

Question 1: When determining the rate used to remeasure monetary assets of a Venezuelan subsidiary that are not denominated in USD, should the entity consider its business strategy and how it will use its monetary assets to settle its obligations when determining the appropriate exchange rate used to remeasure its monetary assets? For example, if a Venezuelan subsidiary has receivables denominated in the Bolivar and a portion of the cash to be collected from those receivables will be used to settle a USD denominated liability that has been or is expected to be approved for settlement at the official rate, should the entity be required to remeasure a corresponding portion of the receivables at the official rate? Alternatively, should the rate used to remeasure the receivables be determined in isolation (without consideration of the related obligations)?

3. Paragraph 830-20-35-2 of Topic 830, *Foreign Currency Matters*, requires amounts receivable or payable that are not denominated in an entity's functional currency, to be remeasured at each balance sheet date at the rate the receivable or payable could be "settled" at that date. Working Group members generally supported the notion that a Venezuelan subsidiary's monetary assets could be considered "settled" at the balance sheet date, as that term is used in paragraph 830-20-35-2, by paying its monetary liabilities. Accordingly, based on facts and circumstances, it may be appropriate (but not required) to consider how an entity will use its monetary assets to settle its obligations when determining the rate used to remeasure monetary assets. Overall, the Working Group supported the general concept that an entity should evaluate the nature of its operations and its individual facts and circumstances when determining the remeasurement rate for its monetary assets and liabilities. For example, the Working Group noted that the evaluation could be different for an entity that is distributing products that are sourced from the United States and that qualify for the preferential rate when imported into the country compared to an entity with manufacturing operations in Venezuela with all of its transactions denominated in the local currency (BsF).

Question 2: The Venezuelan government recently imposed daily and monthly limits on the newly regulated SITME market. How should those limits affect the determination of the rate used to remeasure foreign currency transactions? For example, if the Venezuelan

subsidiary holds monetary assets in excess of those limits, should the newly regulated SITME market rate be applied only to a portion of the monetary assets? If so, how would the entity identify the portion of its monetary assets that will be settled at the newly regulated SITME market rate? Alternatively, if an entity determines that the newly regulated SITME market is the appropriate rate for remeasurement, can the entity apply that rate to remeasure all of its monetary assets and liabilities (even if the entity's monetary assets and liabilities exceed the imposed daily and monthly limits) on the basis that the entity either (1) expects to settle some of the monetary liabilities with proceeds from the monetary assets or (2) expects to settle the monetary assets and liabilities over an extended period of time?

4. Overall, Working Group members supported the requirement in Subtopic 830-30 that a legal exchange rate should be used to remeasure monetary assets and liabilities. The Working Group members also indicated that it may be appropriate to use different legal exchange rates for different portions of monetary assets or liabilities, as determine in Question 1 above. Further, Working Group members believe it is appropriate to use the new Transaction System for Foreign Currency Denominated Securities (SITME) rate when remeasuring monetary assets even if the entity has monetary assets in excess of the SITME limits. Working Group members also supported using the official rate when remeasuring monetary assets even if an entity is currently experiencing a delay in payments from the Venezuelan Foreign Exchange Administration Board (CADIVI), provided the entity continues to believe that such a rate is appropriate (for example, the payment has been approved and the entity expects to be paid by CADIVI). Working Group members noted that while transactions in the SITME market are explicitly limited and access to the official rate (a preferential rate) may be limited based on the control of CADIVI, use of these legal exchange rates continues to be appropriate.

5. One Working Group member suggested that as it may take an extended period of time for an entity to settle its monetary assets through the SITME mechanism, the rate used for remeasurement should be based on the SITME rate, but incorporate a discount for the time value of money. The majority of the Working Group members disagreed with that approach because

they agree with the requirement in Topic 830 that a legal exchange rate should be used for remeasurement purposes.

6. The Working Group also discussed that when transitioning from the now illegal parallel rate to the SITME rate, a number of companies recorded a gain even though the change to the SITME rate was a result of the foreign exchange market becoming more restricted. That practice arose due to the U.S. dollar being the functional currency for Venezuelan subsidiaries, and most of those subsidiaries have dollar-denominated liabilities but local currency denominated assets (primarily Bolivar receivables and cash). As monetary assets are now converted from the local currency to functional U.S. dollar currency at the SITME rate (5.3BsF/1USD on June 9, 2010), rather than the previous parallel rate (approximately 8.5BsF/1USD on May 18, 2010), the remeasured balance for those monetary assets increased with a corresponding credit to net income. As most of the entity's liabilities are denominated in US$, there is no offsetting amount for the liabilities.

7. In order to resolve this issue, certain Working Group members suggested that if there is a temporary lack of exchangeability at a free market rate, rather than using the government controlled SITME rate, an entity should use the most recent free market rate. That approach would have required an entity to continue to use the historical parallel rate (even though it was prohibited to transact at this rate) because that rate represents a free market rate and better represents economic reality than a government controlled rate. These Working Group members believe that using the SITME rate does not reflect economic reality because most entities will never be able to settle all of their monetary assets at the SITME rate. However, the majority of the Working Group members disagreed with that approach because they agree with the requirement in Topic 830 that a legal exchange rate should be used for remeasurement purposes.

8. Alternatively, some Working Group members suggested using the SITME rate for remeasurement and then applying the guidance in Topic 450, Contingencies (originally issued as FASB Statement No. 5, *Accounting for Contingencies*), to establish a reserve for each monetary asset. Other Working Group members stated that establishing a reserve for certain accounts (for

example, a cash balance) seems counter-intuitive and were not supportive of such an approach as they believe that it would result in inconsistent application.

9. The majority of the Working Group members support the current model in Subtopic 830-20, which requires an entity to use a legal rate for remeasurement purposes. They were concerned that allowing entities to delay their transition to the SITME rate would have resulted in inconsistencies between entities.

10. Finally, the majority of Working Group members generally also do not believe that the SITME restrictions should be considered when evaluating whether monetary assets should be classified as either current or long-term. One Working Group member believes that it may be appropriate to consider those restrictions in the classification of monetary assets as either current or long-term but did not believe that a U.S. dollar liability could be classified as long-term solely due to the SITME restrictions.

Question 3: If it is appropriate for an entity to determine the rate used to remeasure its monetary assets considering how it expects to settle its USD denominated obligations (Question 1) and the entity has obligations that will be settled at either (a) one of the official rates or (b) at the rate of the newly regulated SITME market, is it practicable to identify (and continuously update) a business strategy for each monetary asset? Alternatively, should the entity be permitted to use a blended rate for remeasurement purposes that would be applied to all of the monetary assets?

11. The Working Group's discussion of this question was based on the conclusion for Question 1 that an entity could consider the related obligations when determining what rate to use for remeasurement of its monetary assets. One Working Group member supported using a blended rate, which would be calculated on a weighted average basis of the entity's outstanding liabilities and the rate that would be used to settle those liabilities. This blended rate (which would be updated quarterly) would then be applied to each of the entity's monetary assets and liabilities.

12. Most Working Group members did not support using a blended rate because although the blended rate would be based on a combination of multiple legal rates, the blended rate itself would not be a legal rate. Additionally, the use of a blended rate would introduce judgment into the remeasurement process and therefore reduce comparability between entities. Rather, most Working Group members believe that the rate used to translate a particular monetary asset could consider how the entity intends to use the monetary assets to settle its obligations. One Working Group member supported a practical expedient that would allow an entity to apply a preferential rate or a penalty rate to all of an entity's monetary assets if substantially all of the entity's liabilities are expected to be settled at that rate.

Question 4: If an entity that has historically had success in transacting at a preferential rate currently has concerns with regards to the future availability of that rate, should the entity be required to use the lowest legally available rate (that is, the penalty rate) to remeasure all monetary assets since the use of a more favorable rate could be viewed as recording a gain contingency? Should this rate also be applied to all monetary liabilities?

13. Some of the Working Group members supported using the least favorable legally available rate in all circumstances, unless an entity can overcome the presumption that the least favorable legally available rate should be used. For example, an entity might use a preferential rate for monetary assets if it has already obtained approval to transact at the preferential rate and payment at the preferential rate is expected.

14. A number of Working Group members also indicated that they believe that based on the current situation in Venezuela, with significant limits imposed on the amounts that may be transacted through both the official and SITME mechanisms, the lowest legally available rate exceeds the actual rate at which they could settle their monetary assets and liabilities. Accordingly, they believe that using the lowest legally available rate does not reflect economic reality. However, they do not believe that a rate other than a legal rate was appropriate for remeasurement. Rather, they believe this could be addressed by requiring an impairment analysis focusing on the difference between the lowest legally available rate and a rate at which the entity projects the market will settle the transaction.

Question 5: Paragraph 830-20-45-1 requires that the aggregate transaction gain or loss included in determining net income for the period be disclosed in the financial statements or the notes thereto. The staff understands that although the predominant practice is to aggregate all exchange gains and losses as a single amount on the income statement, some entities with operations in highly inflationary economies have reclassified the components of the exchange gains or losses against the related income statement line item. In addition, some constituents believe that the exchange gains or losses arising from settling monetary assets and liabilities at a different rate than originally expected (for example, settling at the SITME rate while the transaction was originally recorded using the official rate) should be offset against the related income statement line item. Do you believe additional guidance is required related to the income statement classification? If so, what additional requirements should be included?

15. Working Group members generally did not believe additional guidance is needed requiring an entity to reclassify components of exchange gains or losses against the related income statement line items. Working Group members noted that constituents generally understand when such reclassification is appropriate.

Question 6: What additional disclosures would you recommend, if any?

16. Most Working Group members thought that additional disclosure requirements would be beneficial. However, Working Group members were concerned that the disclosure requirements should not be so broad that they result in voluminous disclosures that distract from the financial statements. They believe that an entity should consider the size of its operations relative to the consolidated financial statements when determining if the disclosures are required. In addition, a number of Working Group members commented that the disclosures should focus more on the effect that a particular rate has on the income statement and the overall financial position in a country; rather than individual balance sheet items. Working Group members also indicated that the accounting firms recently issued guidance summarizing the disclosure requirements currently

in GAAP that would be applicable for an entity's operations in Venezuela. In addition, the firm's guidance includes the relevant SEC requirements for both the financial statements and MD&A.

Question 7: What do you believe would be the best way to ensure consistent application in the determination of an appropriate rate for remeasurement when multiple rates are available for settlement?

17. Some of the Working Group members support changing the underlying model in Topic 830 to include a rebuttable presumption that the least favorable exchange is used for remeasurement purposes. In addition, some Working Group members believe that the Task Force should explore amending Topic 830 to include an impairment analysis for situations in which the least favorable legal rate may be unobtainable. Others believe that companies should continue to apply judgment in determining the exchange rate and provide disclosures related to their policy or method of determining the rate used for remeasurement purposes and the effect of using such a rate to clearly identify the affect of using the selected rate.

II. Other-than-temporary lack of exchangeability

Question 8: Currently in Venezuela there are volume restrictions on the amounts of currency that may be converted on the newly regulated SITME market, and there are prolonged periods to obtain approval for currency exchanges with only partial approval being obtained in the end. What criteria should be used to evaluate whether a situation is so severe that it represents an other-than-temporary "lack of exchangeability"?

18. The Working Group does not believe that current conditions in Venezuela indicate an other-than-temporary "lack of exchangeability." However, they believe that whether an other-than-temporary "lack of exchangeability" exists should be continually assessed based on current facts and circumstances.

19. From a practical perspective, Working Group members noted that most entities only would consider an other-than-temporary "lack of exchangeability" to have occurred immediately prior to losing legal control or ceasing their operations in Venezuela. Because of that position,

Working Group members also noted that the equity method of accounting would not be appropriate in situations in which an other-than-temporary "lack of exchangeability" has occurred..

Question 9: What actions of a parent would be considered inconsistent with management's conclusion that an other-than-temporary "lack of exchangeability" exists? For example, a parent continuing to supply its Venezuelan subsidiary may be an indicator that the parent believes that exchangeability still exists.

20. The Working Group did not identify any other inconsistencies between management's conclusion that an other-than-temporary lack of exchangeability exists and management's actions or stated intentions. Working Group discussion of this question focused on whether a history of using a rate other than the official rate is an indicator that management had previously concluded that there is a lack of exchangeability at the official rate. This is based on the assumption that if there was exchangeability at the official rate, the entity would have accessed that mechanism rather than accessing a penalty rate. A number of Working Group members discussed that companies had made a business decision in the past to transact at the parallel rate rather than the official rate. They noted that in those situations companies were able to price their products in Venezuela knowing that they would have to use the parallel rate mechanism to settle the related obligation. These Working Group members believe that the decision to use a rate other than the official rate was not due to an other-than-temporary lack of exchangeability of the official rate, and, accordingly, these companies could still use the official rate for remeasurement purposes.

Question 10: When determining whether an other-than-temporary "lack of exchangeability" exists, should the assessment be entity-specific or country-specific?

21. Working Group members agreed that the determination of whether an other-than-temporary lack of exchangeability exists should be done on an entity-by-entity basis, rather than on a country-by-country basis. However, a number of Working Group members indicated that similar to the way in which the SEC announced that as of January 1, 2010, the economy in Venezuela would be considered highly inflationary, the SEC should make a similar announcement if it

believes that the situation in Venezuela represents an other-than-temporary lack of exchangeability.

Question 11: What do you believe would be the best way to ensure consistent application in determining whether an other-than-temporary "lack of exchangeability" exists?

22. The Working Group concluded that each entity should evaluate its involvement in Venezuela to determine if an other-than-temporary lack of exchangeability exists. In addition, they agreed that no additional guidance is needed in determining whether an other-than-temporary lack of exchangeability exists.

III. Unusual circumstance

Question 12: Please describe any situations you are aware of in which a rate other than the dividend remittance rate was appropriate for conversion purposes due to the existence of an unusual circumstance. Do you believe that the existence of multiple exchange rates constitutes an "unusual circumstance"?

23. The Working Group members were not aware of any situations in which constituents had used a rate other than a dividend rate due to the existence of an "unusual circumstance." Working Group members also agreed that the requirement in Subtopic 830-30 to use the dividend rate for translation purposes unless unusual circumstances exist, is appropriate. However, some Working Group members believe that additional guidance should be provided to assist constituents in determining which dividend rate to use when multiple dividend rates exit. One of the Working Group members noted that they believe using a preferential rate for translation purposes is inappropriate as the rate will only be realized when the dividends are ultimately paid to the parent company. Accordingly, an entity should always use the least favorable legally available dividend rate unless the entity can overcome the presumption that the least favorable legally available rate should be used.

Question 13: What criteria should be used to evaluate whether an unusual circumstance exists?

24. The Working Group did not identify any criteria that should be used to evaluate whether an unusual circumstance exists.

Question 14: If an entity has never declared a dividend and has no plans to do so in the foreseeable future (for example, indefinite reinvestment of earnings—mainly for tax purposes), what should the entity consider when determining the rate applicable for conversion? Should the entity use the rate that could be available if the entity "hypothetically" remitted all accumulated earnings at the balance sheet date?

25. Certain of the Working Group members believe that when determining the rate applicable for translation purposes, the decision should be based on the ability and intent of the entity. For example, prior to the Venezuelan economy being considered highly inflationary, the determination of the rate used to translate an entity's operations should have considered whether the entity has the ability to access the official rate based on the nature of the entity's operations and if the entity intends to use the official mechanism or the parallel mechanism for dividend remittances.

Question 15: What do you believe would be the best way to ensure consistent application in the determination of when an unusual circumstance exists?

26. The Working Group generally did not believe that additional guidance is required as the evaluation of whether an unusual circumstance exists should be based on facts and circumstances.