

**International Practices Task Force (IPTF)**  
**June 2, 2008 – Joint Meeting with SEC Staff**

**Discussion Document B**

**Topic: Venezuela Exchange Controls**

**1. Background**

Pursuant to certain foreign currency exchange control regulations in Venezuela (the "Exchange Regulations"), the Central Bank of Venezuela ("BCV") centralizes the purchase and sale of foreign currency within the country. Under these regulations, the purchase and sale of foreign currency is required to be made at an official rate of exchange that is fixed from time to time by the Executive Branch and BCV (the "Official Rate"), and which currently is Bs. 2,150.00 per United States Dollar ("Dollar"). In addition to providing for exchange controls, the Exchange Regulations require the sale to the BCV, at the Official Rate, of all foreign currency received by virtue of exportation of goods, services or technology from Venezuela, and of all foreign currency that enters the country for any reason except in certain industries or other specific situations as further detailed below.

- Oil and gas companies engaged in certain qualifying activities (e.g., exploration) may retain 100% of the foreign currency collected from exportation.
- All other exporters may retain up to 10% of foreign currency collected from exportation activities to cover export costs.
- Companies selling goods or services in Venezuela, but receiving payment in foreign currency outside of Venezuela, may retain the foreign currency outside of Venezuela. However, if such currency is brought into Venezuela or exchanged for Bolivars, it must be sold to the Foreign Exchange Administration Board (CADIVI) at the official rate or through a parallel market (as discussed below) for certain qualifying activities..

As a result of the foregoing, there has been no free market for the purchase and sale of foreign currency in Venezuela since February 2003. Although approvals for foreign currency exchanges exist they are limited. Specifically:

- Effective April 1, 2005 exports must be expressed in the currency of the destination country or in US dollars (not Bolivars) and foreign currency obtained from export operations (other than the exceptions noted above) must be sold to the BCV within 180 days.
- After proper submission and approval by the CADIVI US dollars may be acquired for imports (currently approximating US \$90 million a day) and for payment of dividends, capital gains, interest or private external debt.

In October 2005, the Venezuelan government enacted the Criminal Exchange Law that imposes strict sanctions, criminal and economic, for the exchange of Venezuelan currency with other foreign currency through other than officially designated methods, or for obtaining foreign

currency under false pretenses. The law provides for fines and penalties, including prison time in certain circumstances. However, the Criminal Exchange Law provides for an exemption for the purchase and sale of securities. The definition of securities is not explicit in the law. In practice, however, we understand that the term "securities" has come to include a) National Public Debt bonds (DPNs) denominated in Bolivars, (b) American Depository Receipts (ADRs), (c) other securities issued by Venezuela, and (d) bonds issued by Venezuela and denominated in US dollars.

The exemption for transactions in certain securities as described above has 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 CADIVI. The average rate of exchange in the parallel market is variable, and may differ significantly from the Official Rate. Publicly available quotes do not exist for the foreign exchange rates in this parallel market but such rates may be obtained from brokers or other means. In this market, the purchase of foreign currency is performed through a series of transactions made through a broker. For example, a company would purchase a DPN, swap it for a U.S. Dollar denominated security, sell the US Dollar denominated security on the international securities market, and obtain U.S. dollars. The swap and the subsequent sale of the US security would be performed outside of Venezuela. As such, these parallel market transactions are used to settle foreign currency obligations and to move currency in and out of Venezuela.

## **2. Previous IPTF discussion on the matter**

The Task Force has previously discussed Venezuela exchange controls at its meetings on March 4, 2003, November 25, 2003, March 9, 2004, July 27, 2004 and November 21, 2006.

A recap of certain decisions made in those meetings includes the following:

- The translation of financial statements into the reporting currency should be made at the rate that will be available for dividend remittance. Paragraph 27a of SFAS 52 requires the applicable rate at which a particular transaction could settle and the date shall be used to translate and record the transaction. Since dividends can only be remitted using the official rate, the official rate should be used. (November 21, 2006)
- The rate used for re-measurement of foreign currency denominated transactions into the functional currency depends on the type of transaction being re-measured. Since the Criminal Exchange Law, by virtue of exemption, provides for a parallel exchange mechanism and since there is an observable market rate of exchange for securities traded in this market, based on facts and circumstances this market rate may be appropriate for the re-measurement of foreign currency denominated transactions that could be settled through the parallel market mechanism. All other foreign currency transactions should be re-measured at the official rate. (November 21, 2006)
- US GAAP does not permit the use of a black market exchange rate since such a rate is not objective or determinable. Instead, transactions should be translated at the official exchange rate, and if there are more than one official exchange rate depending on the transaction (e.g., dividend remittances), then the appropriate exchange rate should be used (March 4, 2003).

- It would not be appropriate to deconsolidate Venezuelan operations absent any other control considerations, as the lack of exchangeability by itself does not appear to meet the "other than temporary" threshold in paragraph 26 of Statement 52 (July 27, 2004). Nor do they meet the criteria for deconsolidation as set forth in ARB 51 (November 21, 2006)
- Use of the U.S. Dollar as the functional currency would not be precluded as a result of the currency restrictions in place (July 27, 2004 meeting). The functional currency should be determined based on the specific facts and circumstances and the criteria in Statement 52. (November 21, 2006)
- The rate used for re-measurement purposes or translation of financial statements may not be reflective of economic reality and additional disclosure may be necessary (e.g., summarized financial information of Venezuelan operations in a footnote; disclosure of exchange rate used; disclosure of the net monetary assets and liabilities by currency; discussion of potential impact of a change in exchange rates on financial statements in MD&A) (March 4, 2003).

### **3. Recent Developments:**

On December 28, 2007, the Venezuelan Government published an amendment to the Criminal Exchange Law that became effective on January 27, 2008. Such amendment, among other changes, established that firms or individuals, who offer, advertise or divulge financial or stock exchange information in written, audiovisual, radio-electric or any other form, regarding the quoted prices for foreign exchange, other than the official rate, will be fined 1,000 tax units for the first violation, and 2,000 tax units per subsequent violation. We understand that as a result of this amendment, brokers no longer publish the implicit parallel market exchange rates. However, prices for the purchase and sale of the underlying bonds are still available from brokers. We understand that the purchase and sale of U.S. Dollar denominated securities is still legal in Venezuela and is an accepted method of converting Bolivars to US Dollars. Further, we understand that the amendment had the following impacts:

- it is now illegal to offer, advertise or divulge financial or stock exchange information regarding the quoted prices for foreign exchange rates other than the Official Rate;
- as a result of this amendment to the Criminal Exchange Law, there is no longer any public information about trading volumes; and
- as a result of the amendment to the Criminal Exchange Law, quotations may vary more widely among financial institutions and brokers due to the increase in the volatility of this type of transaction and lack of public information regarding rates.

### **4. Issues**

The question has been raised as to whether the recent amendment to the Criminal Exchange Law as described above impacts the Task Force's prior conclusions on Venezuelan currency issues. These issues include 1) whether foreign exchange restrictions in Venezuela are so severe that they potentially cast significant doubt on an entity's ability to control (and therefore consolidate) a Venezuelan subsidiary and, 2) which exchange rate should be used to re-measure transactions and translate financial statements of Venezuelan companies. The Task Force's consideration of these issues is as follows:

**Issue 1:**

**Since restrictions regarding exchangeability have remained in place for almost six years and there is no indication that the restrictions will be removed, and in fact enforcement of the restrictions has been enhanced, should companies continue to consolidate Venezuelan subsidiaries?**

**Task Force Recommendation:**

The Task Force continues to believe that exchangeability restrictions in Venezuela are not so severe as to represent a “lack of exchangeability” under Statement 52. Nor does the Task Force believe that they meet the criteria for deconsolidation as set forth in ARB 51.

However, consistent with its prior discussions on this issue, the Task Force believes that additional restrictions on a parent company’s ability to control the subsidiary entity should be carefully considered. In circumstances where exchange controls exist, other regulations or conditions could be present that impact the parent company’s control over the operations of the subsidiary. If other conditions are present, they should be evaluated on a facts and circumstances basis, together with the exchange controls, to determine whether sufficient control exists to support consolidation.

**SEC Staff Response:**

*The staff agrees with the Task Force’s view.*

**Issue 2:**

**Is it appropriate to use the parallel market rate for purposes of foreign currency translation under FAS 52?**

View A: Paragraph 27b of SFAS 52 indicates that "In the absence of unusual circumstances, the rate applicable to conversion of a currency for purposes of dividend remittances shall be used to translate foreign currency statements." The existence of the parallel market does not constitute unusual circumstances potentially justifying the use of an exchange rate other than the Official Rate for purposes of foreign currency translation. Further, footnote 4 in SFAS 52 clearly contemplates that unsettled transactions may be subject to and translated using preference or penalty rates, while translation of foreign currency statements is based on the rate applicable to dividend remittances, and establishes a mechanism for reconciling differences arising from such translation relating to intercompany receivables and payables. As a result, it would appear to be appropriate to continue to use the Official Rate applicable to conversion of currency for purpose of dividend remittances to translate foreign currency financial statements.

View B: While footnote 4 in SFAS 52 clearly contemplates that unsettled transactions may be subject to and translated using preference or penalty rates, while translation of foreign currency statements is based on the rate applicable to dividend remittances, it establishes a mechanism for reconciling differences arising from such translation relating to intercompany receivables and

payables, but does not contemplate the anomalies that may result from using different rates for translation and remeasurement of foreign currency transactions with third parties. Further, 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 rate. As a result, companies should consider whether the existence of the parallel market constitutes "unusual circumstances", as contemplated in paragraph 27.b. which might warrant use of parallel market rates for purposes of foreign currency translation based on their specific facts and circumstances.

**Task Force Recommendation:**

View A

**SEC Staff Position:**

*The staff agrees with the Task Force's view.*

**5. Examples**

The following Examples are provided for discussion purposes only and illustrate application of the above views to determine which exchange rate should be used for re-measurement and to translate Bolivar denominated financial statements into the Reporting Currency:

**Example 1**

A US multinational company with a wholly-owned subsidiary in Venezuela. The functional currency of the subsidiary is the Bolivar. The subsidiary purchases inventory from its parent in US Dollars creating a US Dollar denominated inter-company payable. The subsidiary's reporting currency is the US Dollar. The subsidiary believes that it is probable that they will settle the inter-company payable at the parallel rate. Historically, the Subsidiary has been able to remit dividends to its US parent at the official exchange rate.

The subsidiary should re-measure its US Dollar inter-company payable at the parallel market exchange rate and translate its financial statements into US Dollars at the official rate. Any difference created between inter-company receivable and payables should be treated as a receivable or payable in the enterprise's financial statements, until the difference is eliminated by settlement, in accordance with Footnote 4 of paragraph 27.b. of SFAS No 52.

**Example 2**

A US multinational with a subsidiary in Venezuela. The functional currency of the subsidiary is the Bolivar. The subsidiary has an investment in USD denominated securities, considered to be debt securities under SFAS No. 115. The securities have been designated as Available For Sale. If sold, it is probable that the investment securities would be sold in the parallel market. In addition, the subsidiary holds cash denominated in US Dollars in a financial institution outside of Venezuela. If converted to Bolivar, it is probable that the transaction would be settled at the parallel market exchange rate. The subsidiary originally purchased the US Dollar denominated securities and the US Dollar cash at the parallel market exchange rate in order to economically

hedge further devaluation of the Bolivar at parallel market rates. The Subsidiary has historically remitted dividends to its parent at the official exchange rate.

The subsidiary should re-measure the investment securities and the cash at the parallel market exchange rate. The subsidiary should translate the securities and cash, as well as the remainder of its net assets, at the official rate, because this is the rate that is available for dividend remittances.