In brief
A look at current financial reporting issues

31 July 2017

Accounting consideration for Venezuelan entities (update as of July 2017)

This In brief supersedes In brief INT2015-14, '*Accounting considerations for Venezuelan subsidiaries*' and In brief INT2016-06, '*Accounting considerations for Venezuelan entities – updates as of February 2016*'.

Background

The Venezuelan government (the "Government") has maintained a regime of strict currency controls over recent years. Multinational companies continue to face significant difficulty in repatriating earnings from Venezuelan entities. There is significant uncertainty about exchange rates, the amount that can be repatriated at a given exchange rate and the timing of repatriation. There is a continuing high level of government regulation (that is, price regulation and labour law) that might limit the decision-making powers of management.

Consolidation of Venezuelan subsidiaries

Some have questioned whether continuing uncertainty and difficulty in repatriation mean that multinational companies should consider de-consolidation of their Venezuelan subsidiaries under IFRS.

Multinational companies should only de-consolidate Venezuelan subsidiaries if they no longer meet the three criteria for control under IFRS 10 '*Consolidated financial statements*'. Uncertainty about repatriation of profits and exchange restrictions alone are unlikely to result in a loss of control under IFRS 10. However, each circumstance should be addressed on its individual merits.

An investor controls an investee if it has all of the following elements [IFRS 10 para 7 (a)-(c)]:

(a) power over the investee;

(b) exposure, or rights, to variable returns from its involvement with the investee; and

(c) the ability to use its power over the investee to affect the amount of the investor's returns.

If one or more of the elements of control changes an entity should reassess control.

An investor will lose control of its subsidiary when it no longer has the power to direct its relevant activities and hence loses the ability to vary its returns. This is a high

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hurdle. Where an entity has power, it must demonstrate that it has no exposure to variable returns to determine it does not have control. Difficulty in repatriating earnings, and uncertainty about the exchange rate, is not the same as a loss of control.

This follows from paragraph B 83 of IFRS 10 that states "*An investor that has power over an investee can lose control of an investee if the investor ceases to be entitled to receive returns or to be exposed to obligations.*"

A parent that continues to direct the relevant activities of its investee in Venezuela meets the power criterion. It is likely to remain exposed to the variable returns. Those returns could be positive or negative and are not only financial in nature (see IFRS 10 App B paras B 56 and B 57).

Different multinational parents may find themselves in different circumstances. Each fact pattern should be carefully considered, however, we believe that most multinational parents with subsidiaries in Venezuela will continue to consolidate in the current environment.

A parent needs to consider whether significant doubt about control exists. An entity should also consider what should be disclosed to explain the significant judgements and assumptions made in its control assessment. [IFRS 12 '*Disclosure of interests in other entities*' para 7]. An entity is also required to disclose significant restrictions on its ability to access or use the assets and settle the liabilities of the group. [IFRS 12 para 13].

Previous exceptions to consolidation

A much earlier version of the consolidation guidance under IFRS (IAS 27, revised in 2003) contained a number of exceptions to consolidation including '*foreign exchange restrictions, controls, or other governmentally imposed uncertainties so severe that they cast significant doubt on the parent's ability to control the subsidiary*.' This specific exception has been removed from IFRS.

Hyperinflation

Venezuela is a hyperinflationary economy and IAS 29 '*Financial reporting in hyper-inflationary economies*' should be applied. Please refer to In brief INT2017-01 '*Hyperinflationary economies at 31 December 2016*' for a list of hyperinflationary economies at 31 December 2016. We will further publish later this year a list of hyperinflationary economies at 31 December 2017.

Cash balances

Management should also consider disclosing under IAS 7 '*Statement of cash flows*' the effect of the exchange controls in Venezuela on whether cash balances are available for general use by the group.

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