

# *In brief*

## A look at current financial reporting issues

22nd November 2018

### *Accounting considerations for Venezuelan entities (update as of November 2018)*

This In brief supersedes In brief INT2018-09, 'Accounting considerations for Venezuelan entities (update as of April 2018)'.

#### *Background*

In recent years, the Venezuelan government has maintained a regime of strict currency controls. Multinational companies continue to face significant difficulties 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. The Venezuelan economy continues to exhibit high inflation. There is also a continuing high level of government regulation (that is, price regulation and labour law), which might limit the decision-making powers of management.

During 2017, two currency exchange mechanisms were in place, namely the DIPRO and DICOM mechanisms.

At the end of January 2018, and with the aim of establishing a unified system, the Venezuelan government:

- i. relaunched the DICOM mechanism, which applies to all foreign exchange transactions from 26 January 2018; and
- ii. eliminated the DIPRO mechanism, which was used previously for imports of goods and services identified as critical or priority.



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In August 2018, the Venezuelan government announced a monetary reconversion, which created a new currency, the Sovereign Bolivar (VES), that replaces gradually from 20 August 2018 the previous currency (VEF) at a conversion rate of VES 1 to VEF 100,000. Entities need to adapt their systems and processes to the new currency.

In September 2018, the government also introduced certain changes to the currency exchange system. The new exchange system would introduce the possibility for financial institutions to exchange foreign currency, which is in practice exchanged at a single rate regulated by the Venezuelan Central Bank (VCB). However, the relevant regulator has not yet issued the rules and regulations that would enable the application of the new exchange system. Therefore, DICOM continues to operate.

### *Exchange rates in Venezuela*

The DICOM exchange system is a single legal exchange rate that is published by the VCB.

The auctions on the DICOM mechanism held in 2018 (up to the date of this publication) resulted in an exchange rate that fluctuated between VEF 25,000/USD 1 (equivalent to VES 0.25/USD 1) on 5 February 2018 and VES 77.21/USD 1 on 22 November 2018. Volumes on these auctions have been very low throughout the year, but they have started to increase in recent months due to the significant devaluation of the currency.

### *Measuring assets and liabilities denominated in foreign currency*

IAS 21 requires the use of closing rates. In determining whether a rate is a closing rate, an entity should consider whether currency is obtainable at an official quoted rate and whether the quoted rate is available for immediate delivery. In practice, a normal administrative delay in obtaining funds would be acceptable.

Where exchangeability between two currencies is temporarily unavailable at a transaction date or a subsequent balance sheet date, [paragraph 26 of IAS 21](#) requires entities to use the rate on the first subsequent date at which exchanges could be made.

The DICOM exchange rate published by the VCB can be considered a spot rate, and it can be used to translate monetary assets and liabilities. However, each entity will need to determine, considering their specific circumstances, whether the official exchange rate meets the definition of a closing rate (see below for further references to the IFRS IC agenda decision issued in September 2018).

Entities should disclose the rate used and the effect on the amounts reported in the financial statements. Any significant accounting policies and judgements made in determining the rate should be disclosed in accordance with the requirements in [paragraphs 117 to 124 of IAS 1, 'Presentation of financial statements'](#). Management should also consider disclosing the sensitivity of using a different exchange rate in accordance with [paragraph 129 of IAS 1, as part of the disclosures of sources of estimation uncertainties \(required by paras 125 to 133 of IAS 1\)](#).

### *Net assets of a subsidiary in Venezuela*

Parent companies typically use the dividend remittance rate to translate the net assets of a foreign operation, because this is usually the rate that would apply if funds from the foreign operation were remitted to the parent at the reporting date.

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Management should consider the particular circumstances (including, where relevant, the views of the relevant regulator), and might also consider taking legal advice over the rate that will be available for the payment of dividends. Management should also consider the IFRS IC agenda decision issued in September 2018 addressing the determination of the exchange rate in the extreme circumstances that currently exist in Venezuela. The circumstances described in the agenda decision consider situations where: the exchangeability of the currency is administered by exchange mechanisms, and the authorities set the exchange rates; and the currency is subject to a long-term lack of exchangeability, which results in an entity being unable to access foreign currencies using the exchange systems in place.

The IC concluded that, in the situations described, entities need to determine if the official exchange rate or rates meet the definition of the closing rate (which is the spot exchange rate at the end of the reporting period).

Since economic conditions change frequently in Venezuela, the IC also observed that entities need to reassess, at each period end, any relevant changes in circumstances.

The rate used in translation, and the impact of that rate, should be disclosed. Any significant accounting policies and judgements made in determining the rate should be disclosed in accordance with the requirements [in paragraphs 117 to 124 of IAS 1](#). Management should also consider disclosing the sensitivity of using a different exchange rate in accordance with [paragraph 129 of IAS 1](#), as part of the disclosures of sources of estimation uncertainties ([required by paras 125 to 133 of IAS 1](#)). The IC agenda decision referred to these disclosure requirements, and also observed that any significant restrictions on the ability to access or use assets and settle liabilities of operations in Venezuela should be disclosed in accordance with [paragraphs 20 and 22 of IFRS 12](#).

### *Consolidation of Venezuelan subsidiaries*

Some have questioned whether continuing uncertainty and difficulties 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 situation should be addressed on its individual merits.

An investor controls an investee if it has all of the following elements:

- (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.

[\[IFRS 10 para 7\(a\)–\(c\)\]](#).

If one or more of the elements of control changes, an entity should reassess control. This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

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

This follows from [paragraph B83](#) of IFRS 10, which 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, and it is likely to remain exposed to the variable returns. Those returns could be positive or negative, and they are not only financial in nature (see [paras B56 and B57](#) of IFRS 10).

Different multinational parents might find themselves in different circumstances, and 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 there is significant doubt about the existence of control. An entity should also consider what should be disclosed to explain the significant judgements and assumptions made in its control assessment. [[IFRS 12 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](#)].

### *Hyper-inflation, estimation of the general price index and impairment considerations*

Venezuela is a hyper-inflationary economy, and [IAS 29](#), ‘Financial reporting in hyper-inflationary economies’, should be applied. Please refer to [In brief INT2018-01](#) ‘Hyper-inflationary economies at 31 December 2017’ for a list of hyper-inflationary economies at 31 December 2017.

The application [of IAS 29](#) requires the use of a ‘general price index that reflects changes in purchasing power’. The official body responsible for publishing inflation rates in Venezuela is the VCB. However, no official indices have been published by the VCB since December 2015.

[IAS 29](#) considers circumstances in which a general price index might not be available, and it suggests that the inflation rate can be estimated based on the devaluation of the hyper-inflationary currency against a relatively stable foreign currency. However, due to the strict currency controls in place in Venezuela, the devaluation of the currency has not depicted inflation rates and therefore is not used as an alternative to estimate inflation.

In these circumstances, judgement will be required to estimate a general price index. That could be done, for example, by using external experts to estimate inflation. Alternatively, entities could estimate inflation internally and validate the estimates by reference to the ranges estimated by experts and any other publicly available information, such as financial reports, or other economic information provided by official sources, etc.

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The level of the price index used and its impact should be disclosed in accordance with [paragraph 39 of IAS 29](#). Any significant accounting policies and judgements made in determining the inflation rate should be disclosed in accordance with the requirements in [paragraphs 117 to 124 of IAS 1](#). Management should also consider disclosing the sensitivity of using a different inflation rate in accordance with [paragraph 129 of IAS 1](#), as part of the disclosures of sources of estimation uncertainties ([required by paras 125 to 133 of IAS 1](#)).

Finally, taking into consideration the significantly high levels of inflation that exist in Venezuela, entities should bear in mind that non-monetary assets that have been restated following the guidance in IAS 29 are still subject to impairment assessment in accordance with the relevant guidance. If an asset's recoverable amount is less than its restated amount, the asset is written down, even if no impairment of the asset was required in the historical cost financial statements. Any impairment charge is recognised in profit or loss.

### *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.

