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Consolidation and Disclosure Considerations Related to Venezuelan Operations

Financial Reporting Alert 14-5

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This alert discusses considerations related to accounting and disclosure under U.S. GAAP in connection with an entity's Venezuelan operations.

Background

Through recent discussions with the SEC staff, we are aware that the SEC staff recently did not object to a registrant's conclusion to deconsolidate its Venezuelan operations as of December 2014. We understand that the two primary arguments cited by the registrant were (1) an other-than-temporary lack of currency exchangeability and (2) the existence of several government limitations on the registrant's ability to control its Venezuelan operations. Examples of government intervention might include restrictions on (1) labor force reductions, (2) decisions about product mix or pricing, and (3) sourcing of raw materials or other inputs into the production process.

Accounting Considerations

Regarding the lack of currency exchangeability, ASC 830-20-30-2[1] notes, in part:

> If the lack of exchangeability is other than temporary, the propriety of consolidating, combining, or accounting for the foreign operation by the equity method in the financial statements of the reporting entity shall be carefully considered.

Further, ASC 810-10-15-10 notes, in part:

> A majority-owned subsidiary shall not be consolidated if control does not rest with the majority owner — for instance, if [the] subsidiary operates under 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.

An entity's evaluation of whether deconsolidation of a foreign subsidiary is appropriate should be based on the entity's specific facts and circumstances. We believe that in making such a determination with respect to operations in Venezuela, an entity should consider factors that include, but may not be limited to, the following:>

- Volume restrictions on currency exchange activity in Venezuela (either explicit or in-substance), in conjunction with the uncertainties about the entity's ability to obtain approval for foreign currency exchange through the established exchange mechanisms.
- The ability, currently and historically, to access available legal currency exchange mechanisms in volumes desired or needed by the entity.
- Recent developments in the downward trend of the price of oil and how that trend might affect expectations about the future direction of restrictions on currency exchange in Venezuela (i.e., the trend could adversely affect the Venezuelan government's supply of U.S. dollars and thus further limit the amount of currency available through the established currency exchange mechanisms).
- The extent and severity of restrictions imposed by the government on an entity's Venezuelan operations

and whether those restrictions demonstrate an entity's inability to control its Venezuelan operations. This factor requires considerable judgment since many governments, including the U.S. federal government, require companies to make decisions within a framework of laws and regulations over operational matters such as those noted above.

The mere fact that currency exchangeability is lacking or that government controls exist may not in and of itself create a presumption that an entity should deconsolidate its Venezuelan operations, nor does the ability to exchange some volume of currency create a presumption that continued consolidation of Venezuelan operations is appropriate. However, the existence of the above factors represents negative evidence that an entity should consider in determining whether deconsolidation is appropriate on the basis of the entity's specific facts and circumstances.

If an entity ultimately concludes that deconsolidation is appropriate, the entity still must determine the appropriate date for deconsolidation, including the appropriate currency exchange rate to use for remeasuring its deconsolidated investment and any other outstanding monetary balances that are no longer eliminated in consolidation (provided that they are not considered fully impaired).

Editor's Note: Given the late date of the SEC staff's recent decision not to object to a particular registrant's conclusion to deconsolidate its Venezuelan operations as of December 2014, we do not believe that the SEC staff has an expectation that other entities must deconsolidate their Venezuelan operations as of December 31, 2014. However, there could be greater attention from the SEC staff during ensuing quarters. For the time being, it is unclear to us whether restrictions on currency exchange alone could require deconsolidation or whether some level of government influence on decision making should be present as well. Accordingly, entities should have well-reasoned documentation that supports their position. Since it is likely that accounting practice related to this topic will continue to evolve during the next few quarters, entities should continue to reassess their conclusions going forward.

Disclosures

In light of the SEC staff's recent decision, an entity should provide clear disclosure of the basis for its consolidation/deconsolidation conclusion regarding an investment in Venezuelan operations. An entity that continues to consolidate may wish to consider disclosing its intention to continue monitoring developments in coming quarters, along with a description of the possible financial statement impact, if estimable, of deconsolidation were that to occur.

In addition, as historically recommended by the staff of the SEC's Division of Corporation Finance, an entity should consider providing disclosures such as the following (to the extent that the entity's Venezuelan operations and its disclosures about them are material):

- The overall environment in Venezuela and its effect on the entity's financial statements both historically and currently. This disclosure can include information about (1) price controls, inflation, and foreign currency exchange limitations or restrictions; (2) changes in the entity's revenues and associated costs; and (3) any triggering events, impairment indicators, or impairments.

- The extent of the entity's exposure to Venezuelan operations. This includes the nature of the entity's activities in Venezuela (e.g., imports, manufacturing, and size of operations) and other meaningful financial information, such as disaggregated financial information about the Venezuelan operations (e.g., summarized balance sheets, income statements, and cash flow statements).

- A description of the possible effects of Venezuela's currency exchange limitations or government restrictions on the entity's operations, including how such limitations or restrictions may affect the entity's liquidity, cash flows, or debt covenants. An entity should also describe how the existence of such limitations or restrictions affects the application of the entity's accounting policies.
- The exchange rate(s) used for remeasurement and the basis for judgments made in determining the rate(s), including:
    - If multiple exchange rates are used, how each rate was determined, what transactions each rate applies to, and the relative significance of the various exchange rates.
    - Any volume restrictions or limitations on a particular exchange rate.
    - Any assumptions used in the determination of the appropriate exchange rate.
    - Any risks or uncertainties related to the entity's ability to settle at the exchange rate selected.
    - A description of the use of any exchange rates that differ from those used in prior reporting periods (e.g., changing from the official rate to the SICAD 1 rate or SICAD 2 rate, or both).

We believe that an entity should also consider the following disclosures:

- The impact of remeasurement on the financial statements, including (1) the amount of any foreign exchange gain or loss that arises from using the official, SICAD 1, or SICAD 2 rate for remeasurement and (2) the financial statement line item in which the gain or loss is recorded.
- The amount of Venezuelan bolivar fuertes that is awaiting government approval for settlement at the official, SICAD 1, or SICAD 2 rate and the time that has elapsed since such approval was requested.

Conclusion

Because of the complexity of these accounting and disclosure issues, we encourage entities with material Venezuelan operations to continue to consult with their accounting advisers and legal counsel.

For further considerations related to the accounting under U.S. GAAP in connection with the foreign currency exchange environment in Venezuela, refer to **Financial Reporting Alert 14-1**.[2]

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1 For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's **"Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."**

2 Financial Reporting Alert 14-1, "Foreign Currency Exchange Accounting Implications of Recent Government Actions in Venezuela."
