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Technical Alert N° 2015-03

Exchange rates in Venezuela (III)

Accounting of SICAD and SIMADI in accordance with IFRS (IAS 21)

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Accounting of SICAD and SIMADI in accordance with IFRS (IAS 21)

As at December 31, 2014 there were three legal exchange rates in Venezuela that could be used for valuation and translation under IAS 21: CENCOEX, SICAD-I and SICAD-II.

Currency exchange legislation in Venezuela was amended in February, 2015 to create a new mechanism (known as SIMADI), which permits buy-sell cash and securities in foreign currency. SIMADI allows both individuals and entities to buy and sell foreign currency with fewer restrictions than other mechanisms in Venezuela (CENCOEX and SICAD).

The merge of SICAD-I and SICAD-II and the creation of SIMADI means that there continue to be three legal exchange rates between the Venezuelan currency (VEF) and US dollars (USD). The rates at February 12, 2015 are:

- **CENCOEX:** 6.3 VEF/1 USD (fixed)
- **SICAD:** variable average based on each auction (12 VEF/1 USD, based on last auction)
- **SIMADI:** daily variable average based on free market transactions (170 VEF/1 USD as of February 12, 2015)

PwC's point of view

Management will need to consider the entity's specific circumstances and apply judgment to determine the most appropriate rate to value each asset and each liability and to translate the net investment in Venezuelan subsidiaries. Entities should disclose the rates used, the basis for using those rates and the effect on the amounts reported in the financial statements.

Measuring assets and liabilities denominated in foreign currency

IAS 21 requires that the rate used to valuate and record foreign currency transactions and balances, where several exchange rates are available, is the "rate at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred at the measurement date."

All three official exchange rates available qualify as a spot rate and can be used to valuate monetary assets and liabilities. Judgment is required to determine which rate best reflects the guidance in IAS 21.

There might be specific assets and liabilities that management clearly expects will be settled at a specific rate (for example: an specific liability for which management has properly applied for dollars using CENCOEX or SICAD, or an specific asset that can be freely sold using SIMADI); in such a case, that rate should be used. In other less clear circumstances, management should use judgment to determine the appropriate rate at which each balance could have been settled. In some cases, legal advice may be needed to determine the applicable rate under the currency exchange legislation.

The rate (or rates) used in the valuation and the implications should be disclosed clearly. The rate (or rates) used might also be a significant accounting judgment to be disclosed under IAS 1, and management should consider disclosing the sensitivity of using a different exchange rate, as a consequence of a possible foreign exchange fluctuation.

Net assets of a subsidiary in Venezuela

Parent companies typically use the dividend remittance rate to translate the net assets of a foreign operation.

None of the current regulations specifically addresses dividends. Management should therefore use judgment to determine which rate best reflects the rate at which the future cash flows represented by the net investment could have been settled at the balance sheet date.

Management should be aware, in making this judgment, that dollars available for dividends through the previous mechanisms have been very limited during the last years, and it is not yet clear how the new mechanisms will be used for dividends. The current regulations appear to permit the SICAD and SIMADI mechanisms to be used for dividends, but no dollars have yet been delivered for this purpose.

Management should consider the particular facts and circumstances, and in some cases the accounting views of the relevant regulator, and might also consider taking legal advice to determine what rate will be available for dividends following the recent changes in the currency exchange legislation.

The rate used in the translation and the implications should be disclosed clearly. The rate used might also be a significant accounting judgment to be disclosed under IAS 1, and management should consider disclosing the sensitivity of using a different exchange rate.

Cash balances and consolidation

Management should consider disclosing under IAS 7 the implications of the currency exchange controls in Venezuela on whether cash balances are available for general use by the consolidated group.

These limitations for dividend remittance does not imply the loss of control on the Venezuelan subsidiary, for consolidation purposes in accordance with IFRS 10.

Deferred Income Tax

The exchange rates used for accounting purposes my differ from the ones used for tax purposes, creating as a consequence a temporary differences that should be considered when calculating the deferred income tax in accordance with IAS 12. Management determination of the tax consequences of the foreign exchange differences, may require a complex analysis and will depend on the specific facts and circumstances. Management should consider to consult a tax specialist on this area.

Effect on 31 December 2014 financial statements

Entities should not apply the SIMADI exchange rate to valuate balances or to translate the net investment in Venezuelan subsidiaries at 31 December 2014. The introduction of the new system is a non-adjusting event under paragraph 10 of IAS 10. Entities should include the disclosures required by paragraph 21 of IAS 10 if the impact is material.

Insight

Recent history of exchange rates in Venezuela

As of December 31, 2014 there were three legal exchange rates in Venezuela that qualified as a spot rate and could be used for translation under IAS 21: the official fixed rate, known as CENCOEX, available to certain specific sectors considered to be priority; and the SICAD-I and SICAD-II rates derived from currency auctions.

SICAD-I was created to operate alongside the official mechanism in 2013. It is an auction system that permits entities in specific sectors to purchase foreign currency for imports. It is not a free auction, as the counterparty that offers the highest price does not necessarily receive foreign currency; and each auction could have different rules and different participants. The Central Bank began publishing the average exchange rate achieved in each auction in December 2013, and in 2014 it became possible to use SICAD-I for international investment and finance transactions, possibly including dividends.

The law was amended in March, 2014 to permit buy-sell cash and securities in foreign currency in a new mechanism named SICAD-II. The new system allows both individuals and entities to buy and sell foreign exchange with fewer restrictions than the other two mechanisms. The Central Bank has oversight of the system and is allowed to intervene to control the exchange rate. It appears that there are relatively fewer restrictions on the sectors or the transactions that can use SICAD-II; and the corresponding average exchange rate has been published daily by the Central Bank (At February 11, 2015 the exchange rate of SICAD-II was 52VEF / 1 USD). It is not yet clear whether SICAD-II was available to use for dividend remittances. SICAD-II ceased to operate on February 12, 2015 with the implementation of the new system SIMADI.

PwC's point of view in accordance with Venezuelan GAAP (VEN-NIF)

These accounting points of view are also applicable for VEN-NIF purposes.

Related publications

Technical Alert 2014-06 issued in April, 2014:
Exchange rates in Venezuela (II)

http://pwc.to/1koNB2Z

Technical Alert N° 2015-02 issued in January, 2015:
Consolidation considerations for Venezuelan subsidiaries applying International Financial Reporting Standards (IFRS)

http://pwc.to/1F1XRtL

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