

CNH vs. CNY

Which of these currencies is the “right” balance sheet rate?

For the most part determining the appropriate balance sheet rate is fairly straight forward under ASC 830. Data sources and timing of rate collection differ between companies but rarely are we challenged to review which rate we use, namely because it is unusual for two or more rates to be represented in the market place. A relatively new exception is the presence of CNY and CNH. US companies have generally identified the CNY rate to convert their Chinese assets and liabilities into USD. Over the past few years China has eased its monetary policy and opened its currency markets by creating the CNH. The two rates demand an ASC830 decision, which Chinese currency rate, CNY or CNH is most appropriate for use in US GAAP financial statements. Bloomberg describes the CNY as a reference rate and not a rate at which a US company can exchange USD for Chinese currency. CNH on the other hand they define as a rate at which entities can exchange USD for Chinese currency albeit through Hong Kong. The two rates are rarely more than a few pips apart.

Why does it matter?

We bring this to your attention for several reasons. First, it may be time to revisit your accounting currency selection for China. Secondly, many Treasuries have begun to transition their hedges from CNY to CNH for its ease of use, convertibility, and less stringent governmental controls. In cash flow hedge scenarios we are concerned that using CNH hedges may be less effective if used to offsetting changes in CNY accounting rates.

Accounting: Consolidations

In ASC 830-30-45-6 we are told: “In the absence of unusual circumstances, the exchange rate applicable to conversion of a currency for purposes of dividend remittances shall be used to translate foreign currency statements.” The FASB had concluded that if multiple rates existed, the rate to be used to translate foreign statements should generally be the rate applicable to dividend remittances—the rate that “is more meaningful than any other rate because cash flows to the reporting enterprise from the foreign entity can be converted at only that rate, and realization of a net investment in a foreign entity will ultimately be in the form of cash flows from that entity.”

Why the confusion?

The confusion about Chinese currencies began even before it started trading in two different markets. Is the currency a Yuan or Renminbi? The Yuan was the first national currency introduced in China in 1889 and was replaced by the Renminbi in 1949 when the communists took control of the country. So the same currency is called by two names the Yuan (round object) and the Renminbi (people’s money), similar to calling the US currency a dollar, green back, USD, etc.

Both CNY and CNH denote the value of Renminbi. The currency, denoted RMB, is the name for the currency traded onshore and offshore. When traded onshore (in mainland China) generally by Chinese exporters, it is referred to as CNY, when traded offshore (mainly through Hong Kong) it trades as CNH. When executing CNY derivatives outside of China, there is no delivery of currency. The contracts settle against a fixing. In contrast CNH derivatives result in the exchange of currencies with RMB distributed through Hong Kong. Thus, while the RMB is just one currency, it trades at two different exchange rates.