**NAME: AKEJU PRAISE DAMILOLA**

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**ASSIGNMENT TITLE: Translation of Foreign Currency Financial Statements**

Changes in exchange rate causes assets and liabilities to be translated at the current exchange rate change in value from statement of financial position to statement of financial position in terms of the parent company’s reporting currency and they are exposed to translation adjustment. These assets and liabilities are exposed to translation adjustment. Statement of Financial Position items translated at historical exchange rates do not change. Exposure to translation adjustment is referred to as **accounting exposure.**

Transaction exposure gives rise to foreign exchange gains and losses that are ultimately realized in cash while translation adjustments that arise from Statement of Financial Position exposure do not directly result in cash inflows or outflows. Different items have separate translation adjustment. Positive translation of an asset can be offset with the negative translation of a liability. However if the translation of assets equals that of liabilities then the translation adjustment net to a zero balance.

A foreign operation will have a net asset Statement of Financial Position exposure when assets translated at the current exchange rate are greater in amount than liabilities translated at the current exchange rate while a net liability Statement of Financial Position exposure exists when liabilities translated at the current exchange rate are greater than assets translated at the current exchange rate.

**Translation Methods**

1 **Current/Non-current Method**: There is no theoretical basis underlying this method. Current assets and current liabilities are translated at the current exchange rate while noncurrent assets, noncurrent liabilities, and stockholders’ equity accounts are translated at historical exchange rates.

2 **Monetary/Non- monetary Method:** Monetary assets are those assets whose value does not fluctuate over time primarily cash and receivables. Nonmonetary assets are assets whose monetary value can fluctuate. Under this method, monetary assets and liabilities are translated at the current exchange rates; non-monetary assets, nonmonetary liabilities, and stockholders’ equity accounts are translated at historical exchange rates.

3 **Temporal Method:** Assets and liabilities reported on the foreign operation’s Statement of Financial Position at historical cost are translated at historical exchange rates to yield an equivalent historical cost in parent currency terms. Conversely, assets and liabilities reported on the foreign operation’s Statement of Financial Position at a current (or future) value are translated at the current exchange rate to yield an equivalent current value in parent currency terms.

4 **Current Rate/ Closing Rate Method:** The fundamental concept underlying the current rate method is that a parent’s entire investment in a foreign operation is exposed to foreign exchange risk and translation of the foreign operation’s financial statements should reflect this risk. All assets and liabilities of the foreign operation are translated using the current exchange rate while all equity accounts are translated at historical exchange rates.