**MATRIC NO**: **16/SMS02/030**

**TRANSLATION OF FOREIGN CURRENCY FINANCIAL STATEMENTS**

**Statement of Financial Position Exposure**

Translation adjustments are made during the process of converting an entity’s financial statements from its functional currency into its reporting currency. Exposure to translation adjustment is referred to as Statement of Financial Position translation or accounting exposure. The change in exchange rates affect assets and liabilities translated at the current exchange rate change in value from the Statement of Financial Position of the subsidiary to the parent company reporting currency are exposed to translation adjustment. Items in the Statement of Financial Position translated at historical exchange rates are not exposed to translation adjustment. Transaction exposure can be compared with Statement of Financial Position exposure.

A separate transaction adjustment exists for each of these exposed items. However, positive translation adjustments on asset when the foreign currency appreciates are balanced by negative translation adjustment on liabilities.

There are four major and widely used methods of translating foreign currency financial statements

1. Current/non-current method
2. Monetary/non-monetary method
3. Temporal method
4. Current rate (or closing rate) method

**Current/Non-current Method**

The rules for the current method are as follows: current assets and current liabilities are translated at the current exchange rate: non-current assets, non-current liabilities, and stockholders’ equity accounts are translated at historical exchange rates.

**Monetary/Non-monetary Method**

Under this method, monetary assets and liabilities are translated at the current exchange rates; nonmonetary assets, nonmonetary liabilities, and stockholders’ equity accounts are translated at historical exchange rates. Under the monetary/nonmonetary method, cash, receivables, and payables carried on the foreign operation’s Statement of Financial Position are exposed to foreign exchange risk. One way to understand the concept of exposure underlying the monetary/nonmonetary method is to assume that the foreign operation’s cash, receivables, and payables are actually foreign currency assets and liabilities of the parent company.

**Temporal method**

The basic objective underlying the temporal method of translation is to produce a set of parent currency translated financial statements as if the foreign subsidiary had actually used the parent currency in conducting its operations.

**Current 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. To measure the net investment’s exposure to foreign exchange risk:

i. All assets and liabilities of the foreign operation are translated using the current exchange rate. ii. Equity accounts are translated at historical exchange rates.

The Statement of Financial Position exposure measured by the current rate method is equal to the foreign operation’s net asset position (total assets minus total liabilities). A positive translation adjustment results when the foreign currency appreciates, and a negative translation adjustment results when the foreign currency depreciates (assuming that assets exceed liabilities).

The current rate method and the temporal method are the two methods required to be used under IAS 21, The Effects of Changes in Foreign Exchange Rates.