NIMFA JOSIAH

16/SMS02/039

ACC 406

**Statement of Financial Position Exposure**

As exchange rates change, assets and liabilities 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.

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

**TRANSLATION METHODS**

There are four major methods of translating foreign currency financial statements:

i. Current/noncurrent method,

ii. Monetary/nonmonetary method,

iii. Temporal method, and

iv. Current rate (or closing rate) method.

**Current/Noncurrent Method**

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

**Monetary/Nonmonetary Method**

Hepworth developed the monetary/nonmonetary method of translation in 1956. 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. 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.

**Temporal Method**

Consistent with the temporal method’s underlying objective, 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.

**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 exchangerate.

ii. Equity accounts are translated at historical exchangerates.

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).

Under the current rate method, revenues and expenses are translated using the exchange rate in effect at the date of accounting recognition.

The current rate method and the temporal method are the two methods required to be used under IAS 21.