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ASSIGNMENT TITLE: Translation of Foreign Currency Financial Statements

The three main accounting terms which continues to be referenced in this topic are **translation adjustments**, **statement of financial position exposure**, **transaction exposure.**

Foreign currency translation is the accounting method in which an international business translates the results of its foreign subsidiaries into domestic currency terms so that they can be recorded in the books of account. As exchange rates change, assets and liabilities translated at the current rate vary in different statement of financial positions in agreement with the parent company are exposed to translation adjustment as opposed to recording SOFP items at historical exchange rates. This is referred to as **statement of financial position exposure**. Therefore each exposed item has a separate translation. Positive translation adjustments on assets when the foreign currency appreciates are thrown off balance when there is a negative adjustment on liabilities. Hence, if there’s equality in the exposed assets and liabilities for an accounting period there will be no translation adjustments. The same thing goes with **net asset statement of financial position** as it is a result of the collection of translated assets greater than translated liabilities. The reverse is the case for **net liability statement of financial position exposure.**

Translation exposure differs from transaction exposure in that the former does not directly result in cash inflows/outflows but the latter arises when a company has foreign currency receivables and payables which in turn create foreign exchange losses and gains that are received in cash.

While stating IAS 21, the effects of changes in Foreign exchange rates, accepts the current rate method and the temporal method, there are two other methods which are the Current/non-current method and the Monetary/non-monetary method.

In current/non-current method, 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. Under the Monetary/non-monetary method, monetary assets(primarily cash and receivables) and monetary liabilities(mostly payables) 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 as the opposite of monetary liabilities while non-monetary assets are assets whose monetary value can fluctuate as opposed to non-monetary liabilities.

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. 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. It’s the same procedure for 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.

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 is based on the concept 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.