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TRANSLATION OF FOREIGN CURRENCY FINANCIAL STATEMENTS

Statement of Financial Position Exposure

As exchange rate changes, items of statement of Financial Position (assets and liabilities) translated at the current exchange rate change in value because they are exposed to translation adjustment. While items of Statement of Financial Position translated at historical exchange rates do not change because they are not exposed to translation adjustment. Exposure to translation adjustment is known as Statement of Financial Position Exposure. This transaction exposure gives rise to foreign exchange gains and losses.

There is a positive translation adjustment on assets when the foreign currency appreciates and a negative translation adjustment on assets when the foreign currency depreciates. Meanwhile there is negative translation adjustment on liabilities when the foreign currency appreciates and a positive translation adjustment on liabilities when the foreign currency depreciates.

**Translation Methods**

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

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

**Current/non-current method**: this method of translating foreign currency financial statements is simple. Current assets and current liabilities are translated at the current exchange rate while non-current assets, non- current liabilities and equity are translated historical rate. This method currently is not acceptable in USA and is rarely used in other countries.

**Monetary/non-monetary method**: Hepworth developed this method in 1956. Monetary assets and liabilities are translated at the current exchange rates while non-monetary assets, non-monetary liabilities and equity are translated at historical exchange rates. Monetary assets are cash and receivables (assets whose value does not fluctuate over time) while non-monetary assets are all assets apart from cash and receivables. This method mainly has to do with cash, receivables and payables carried on the foreign operation’s SOFP exposed to foreign exchange risk. Net asset exposures when cash + receivables exceed payables while a net liability exposure when payables exceed cash + receivables.

**Temporal method**: Under this method, assets and liabilities reported on the foreign operation’s SOFP at historical costs are translated at historical exchange rates to yield an equivalent historical cost in parent currency terms. While assets and liabilities reported on the foreign operation’s SOFP 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**: Under this method, all assets and liabilities of the foreign operations are translated using the current exchange rate while the equity accounts are translated at the historical exchange rates. Net asset exposure is when total assets exceed total liabilities. A positive translation adjustment occurs when the foreign currency appreciates, and a negative translation adjustment occurs when the foreign currency depreciates. Revenue and expenses are translated using the exchange rate in effect at the date of recognition and in most cases current exchange rate is used. However, there is an assumption that revenue or expenses is incurred evenly throughout the year and an average for the period exchange rate is used.