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ASSIGNMENT TITLE: TRANSLATION OF FOREIGN CURRENCY FINANCIAL STATEMENTS.

SUMMARY OF TRANSLATION OF FOREIGN CURRENCY FINANCIAL STATEMENTS

As exchange rates change, asset 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 which are exposed to translation adjustments while statement of financial position translated at historical exchange rate do not change and the items are not exposed to translation adjustment. Statement of financial position, translation, or accounting exposure is also referred to as exposure to translation adjustment.

A separate translation adjustment exists for each of the exposed item in the financial position and as such the net translation adjustment that is required to keep the consolidated statement of financial position in balance relies solely on the net asset or net liability exposed. If total assets exposed are equal to the total liability exposed throughout the financial year the translation adjustment net to a zero balance. Also, in a foreign operation, when assets translated at the current exchange rate are greater in amount than the liabilities translated at the current exchange rate, the operation is said to have a net asset statement of financial position exposure but when the liabilities translated at current exchange rate is greater in amount it is said to have a net liability statement of financial position exposure.

There are 4 major methods of translating foreign currency financial statements;

1. Current/Non-current Method: There is no theoretical basis underlying this method. It simply states that “current assets and 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: This method was developed by Hepworth to remedy the lack of theoretical justification of the current/noncurrent method. Under this method monetary asset (are asset whose monetary value does not fluctuate over time e.g. cash and receivables) and monetary liabilities (are liabilities whose monetary value cannot fluctuate overtime e.g. payables) are translated at the current exchange rate while non-monetary assets. Nonmonetary liabilities and stockholders’ equity accounts are translated at historical exchange rate. To simply understand this method one can assume that the foreign operations cash, receivables, and payables belong to the parent company.
3. Temporal Method: This method simply explains that whatever transaction or operation that was carried out by the foreign subsidiary should be reported in the translated financial statement as if the foreign subsidiary had actually used the parent currency in conducting its operations. Assets and liabilities reported on the foreign operations at historical cost and the equity account are translated at historical exchange rate while those at the current value are translated at the current exchange rate to yield an equivalent value in parent currency terms.
4. Current Rate Method: This method explains that risk cannot be avoided in parent’s entire investments and as such the translation of the foreign operations financial statements should reflects the risk. To measure the exposure to foreign risk all assets and liabilities are translated at current exchange rate while equity accounts are translated at historical rates.