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Level: 400

Course: Acc 406 (International Accounting)

 ASSIGNMENT

TRANSLATION OF FOREIGN CURRENCY FINANCIAL STATEMENTS

**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 (for example, U.S. dollar). These items are exposedto translation adjustment.

Statement of Financial Position exposurecan be contrasted with the transaction exposurediscussed earlier that arises when a company has foreign currency receivables and payables in the following way:

Transaction exposure gives rise to foreign exchange gains and losses that are ultimately realized in cash; translation adjustments that arise from Statement of Financial Position exposure do not directly result in cash inflows or outflows can be summarized as follows:

 Foreign currency

|  |  |  |
| --- | --- | --- |
| Statement of financial positionexposure | Appreciates | Depreciates |
| Net assets | Positive Translation adjustment | Negative Translation adjustment |
| Net liability | Negative Translation adjustment | Positive Translation adjustment |
|  |  |  |

**TRANSLATION METHODS**

Four major methods of translating foreign currency financial statements have been used worldwide:

i. Current/noncurrent method,

ii. Monetary/nonmonetary method,

iii. Temporal method, and

iv. Current rate (or closing rate) method.

**Current/Noncurrent Method**

These foreign exchange gains would be offset by a foreign exchange loss on the parent’s Japanese ye payables resulting from foreign purchases. Whether a net gain or a net loss exists depends on the relative size of yen cash and receivables versus yen payables. Under the monetary/nonmonetary method, the translation adjustment measures the net foreign exchange gain or loss on the foreign operation’s cash, receivables, and payables as if those items were actually carried on the books of the parent.

**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 fourth major method used in translating foreign currency financial statements is the 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).

Total assets > Total liabilities → Net asset exposure