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Summary on Translation of Foreign Currency Financial Statement.

When talking about the translation of foreign currency we’d firstly discuss the:

**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 exposed to translation adjustment. Statement of Financial Position items translated at historical exchange rates do not change in parent currency value from one Statement of Financial Position to the next. These items are not exposed to translation adjustment.

A foreign operation will have a net asset Statement of Financial Position exposure when 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 exposure exists when liabilities translated at the current exchange rate are greater than assets translated at the current exchange rate. The relationship between exchange rate fluctuations.

**FOREIGN CURRENCY FINANCIAL STATEMENT TRANSLATION METHODS:**

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

i. Current/non-current method,

ii. Monetary/non-monetary method,

iii. Temporal method, and

iv. Current rate (or closing rate) method.

1. **Current/non-current method:**

The rules of these method are, 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. There is no theoretical basis underlying this method. Although once the predominant method, the current/non-current method has been unacceptable in the United States since 1975, has never been allowed under International Financial Reporting Standards, and is seldom used in other countries.

1. **Monetary/Non-monetary Method:**

Under this method, monetary assets and liabilities are translated at the current exchange rates; non-monetary assets, non-monetary 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. Non-monetary assets are assets whose monetary value can fluctuate. They consist of marketable securities, inventory, prepaid expenses, investments, non-current assets, and intangible assets; that is, all assets other than cash and receivables. Monetary liabilities are those liabilities whose monetary value cannot fluctuate over time, which is true for most payables.

1. **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. For example, land carried on the books of a foreign subsidiary should be translated such that it is reported on the consolidated Statement of Financial Position at the amount of parent currency that would have been spent if the parent had sent parent currency to the subsidiary to purchase the land.

1. **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 exchange rate.

ii. Equity accounts are translated at historical exchange rates.

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

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). The translation adjustment arising when the current rate method is used also is unrealized. It can become a realized gain or loss if the foreign operation is sold (for its book value) and the foreign currency proceeds from the sale are converted into parent currency.