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TRANSLATION OF FOREIGN CURRENCY FINANCIAL STATEMENTS (SUMMARY)

When changes in exchange rate occur, it causes assets and liabilities translated at the current exchange rate to change in value from one statement of financial position to the next in terms of the parent company’s reporting currency. These items are also exposed to translation adjustment, and exposure to translation adjustment is referred to as Statement of financial position translation or accounting exposure. A different translation adjustment exists for each of the exposed items. A negative translation adjustment on liabilities, nullifies the positive translation adjustments on assets. When total exposed assets and liabilities through the year are equal, the translation adjustments will result in a null balance. A foreign operation will have a net asset accounting exposure when assets translated at the current exchange rate is greater than the liabilities translated at the same rate and it will have a net liability accounting exposure, when the reverse is the case.

Translation adjustments differ from transaction exposure in that, the former arises from accounting exposure and does not directly result in cash inflows or outflows while the latter gives rise to foreign exchange gains and losses that are eventually realized in cash.

There are four methods of translating foreign currency financial statements:

i. Current/non-current method. The guidelines for this method are: current assets and liabilities are translated at current exchange rate; while non-current liabilities and assets as well as stockholders equity accounts are translated at historical exchange rates. This method has no theoretical basis and is not accepted in the US. It is also not allowed under IFRS.

ii. Monetary/non-monetary method. This method was developed to make up for the lack of theoretical basis in the aforementioned method. In this method, monetary assets (cash and receivables) and liabilities (payables) are translated at current exchange rate while non-monetary assets (inventory, prepaid expenses, non-current assets etc.) & liabilities as well as stockholders equity are translated at historical exchange rate.

iii. Temporal method. In this method the financial statements are prepared in the parent currency as though the foreign subsidiary had actually used the parent currency for the operations. Under this method, assets and liabilities reported on the foreign operations SOFP at historical cost are translated at historical exchange rates to yield an equivalent historical cost in parent currency terms while assets and liabilities reported at current or future value are translated at the current exchange rate to yield an equivalent current value in parent currency terms

iv. Current rate (or closing rate) method. Under this method, a parent’s entire investment in a foreign operation is exposed to foreign exchange risk, and translation of the foreign operations financial statements should reflect this risk. All assets and liabilities of the foreign operation are translated using the current exchange rate while equity accounts are translated at historical exchange rates. This method as well as the temporal method, is required to be used under IAS 21.