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**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 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.

**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.

1. **Current/Noncurrent Method**

The rules for the current/noncurrent method are as follows: current assets and current liabilities are translated at the current exchange rate; noncurrent assets, noncurrent liabilities, and stockholders’equity accounts are translated at historical exchange rates.

1. **Monetary/Nonmonetary Method**

To remedy the lack of theoretical justification for the current/noncurrent method, Hepworth developed the monetary/nonmonetary method of translation in 1956. Under this method, monetary assets and liabilities are translated at the current exchange rates; nonmonetary assets, nonmonetary liabilities, and stockholders’ equity accounts are translated at historical exchange rates.

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.