GARBA JAFIYADA

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INTERNATIONAL ACCOUNTING

SUMMARY ON TRANSLATION OF FOREIGN CURRENCY FINANCIAL STATEMENTS.

Foreign currency translation is the accounting method in which an international business translates the results of its foreign subsidiaries into its domestic currency so that they can be recorded in the books of account. This is a key aspect of financial statement consolidation process and the processes includes:

1. Determine the functional currency of the foreign entity.
2. Remeasure the financial statements of the foreign entity into the reporting currency of the parent company.
3. Record gains and losses on the translation of currencies.

When translating the financial statements of an entity for consolidation purposes into the reporting currency of a business. Translate the financial statements using the following rules:

For assets and liabilities, translation is done using the current exchange rate at the balance sheet date for assets and liabilities. For items of the income statement, translation of revenue, expenses, gains and losses is done using the exchange rate as of the dates when those items were originally reorganized.

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, Statement of Financial Position exposure, and translation adjustments can be summarized as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | | **Foreign Currency** | |  |
| **Statement of Financial Position Exposure**. | **Appreciates** | | **Depreciates** | |
| Net Assets | Positive Translation adjustment | | Negative Translation adjustment | |
| Net Liabity | Negative Translation adjustment | | Positive Translation adjustment | |

**METHODS OF TRANSLATION**

* Current/Noncurrent method
* Monetary/Nonmonetary method
* Temporal method
* Current rate/Closing rate method

Current/Noncurrent method

The basic rules for this method are: current Asseets and liabilities are translated using the current exchange rate;noncurrent asset, noncurrent liabilities and stockholders’ equity accounts are translated at historical exchange rates.

Monetary/Nonmonetary method

This is used when the foreign operations are highly integrated with the parent company. The method translates monetary items such as cash and accounts receivable using the current exchange rate and translates the nonmonetary assets and liabilities including inventories and property using historical exchange rate.

Temporal Method

This is also known as the historical method and is applied to adjust income-generating assets on the balance sheet and related income statements items using historical exchange rates from the transaction dates or from the date that the company last assessed the fair market value of the account.

Current rate/ Closing rate method

Under this method of translation, most items of financial statements are translated at the current exchange rate. The assets and liabilities of the business are translated at the current exchange rate. Since this can lead to volatility associated with changes in the exchange rate, gains and losses associated with this translation are reported on a reserve account instead of the consolidated net income account.