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**TRANSLATION OF FOREIGN CURRENCY FINANCIAL STATEMENTS**

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*** ***exposure*** can be contrasted with the ***transaction*** ***exposure*** discussed 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.***

Each item translated at the current exchange rate is exposed to translation adjustment. In effect, a separate translation adjustment exists for each of these exposed items. However, positive translation adjustments on assets when the foreign currency appreciates are offset by negative translation adjustments on liabilities

# **TRANSLATION METHODS**

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

1. Current/noncurrent method,
2. Monetary/nonmonetary method
3. Temporal method
4. Current rate method

# **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. There is no theoretical basis underlying this method.

# **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.

# **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.

# **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.