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Difference of Gain and Loss on Currency Translation and Conversion

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Abstract

This article discusses the advantages and disadvantages of translation and conversion of currency. Foreign currency translation is the process of reporting financial information from one currency to another. Foreign currency transactions take place on the spot, forward, or swap markets. Currencies bought or sold on the spot generally have to be delivered as soon as possible, that is, within 2 working days. Foreign currency translation is carried out to prepare joint financial reports. Translation is simply a change in monetary units, just as a balance sheet expressed in British pounds is restated into its US dollar equivalent. No physical exchange takes place, and no related transaction occurs as if a conversion were made.

Introduction

Translation is not the same as the physical conversion or exchange of one currency to another. Translation is simply a change in monetary units, as a balance sheet expressed in British pounds is restated in its US dollar equivalent. No physical exchange takes place, and no related transaction occurs as if a conversion were made.

Balances in foreign currencies are translated into domestic currency equivalents based on foreign exchange rates, namely the price of one unit of one currency which is expressed in another currency (Ahmed, 2015; Mehrling, 2013). The currencies of major trading nations are bought and sold in global markets. Connected via sophisticated telecommunication networks, market participants include banks and other currency intermediaries, businesses, individuals and professional traders.

Foreign currency transactions take place on the spot, forward, or swap markets. Currencies bought or sold on the spot generally have to be delivered as soon as possible, that is, within 2 working days. The spot market rate is influenced by many factors, including differences in inflation rates between countries, differences in national interest rates and expectations of the direction of future exchange rates. Transactions in the forward market are agreements to exchange a certain amount of currency into another currency at a future date. Quotations in the forward market are stated at a discount or premium from the spot rate.

A swap transaction involves a spot purchase and a forward sale or a spot sale or a forward purchase, of a currency at the same time. Investors often take advantage of swap transactions to take advantage of higher interest rates in a foreign country, while at the same time protecting themselves against unfavorable movements of foreign exchange rates. In connection with the above, this paper will discuss the differences in translation and conversion between foreign currencies, the form of terms in currency translation, the differences in foreign currency translation gains and losses.

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Differences in Translation and Conversion between Foreign Currencies

Foreign currency translation is the process of reporting financial information from one currency to another. Foreign currency translation is carried out to prepare joint financial reports that provide reports to readers of information about the company's operations globally, taking into account the foreign currency financial statements of the subsidiary against the foreign currency of the parent company. Foreign currency translation is the process of restating financial information from one currency to another (Pinto, 2002; Pinto, 2005; Holt, 2011).

Three additional reasons for foreign currency translation, namely recording foreign currency transactions, taking into account the effect the company has on currency translation, communicating with foreign shareholders. Currency transactions can take place directly on the spot market, forward market, or swap market. The spot market rate is influenced by various factors, including differences in inflation rates between countries, differences in national stocks, and expectations regarding the direction of the next currency rate. This exchange rate is direct or indirect. The exchange rate on the forward market is an agreement to translate a fixed number of currencies for the future. Transactions in the forward market receive a discount or premium from the spot market, or as a false rate on the forward market. Exchange rate swap transactions involve simultaneous spot buying and forward selling, or spot selling and currency forward buying.

Foreign currency translation is the process of restating financial information from one currency to another. Meanwhile, conversion between foreign currencies is the physical exchange from one currency to another. The difference is, translation is simply a change in the monetary unit, for example, at a rate expressed in British pounds it is restated in its US dollar equivalent value. No physical exchange takes place, and no associated transactions take place. Conversion, on the other hand, allows for physical exchanges to take place and related transactions to take place.

Foreign currency balances are translated into domestic currency equivalents based on foreign exchange rates, namely the price of one unit of one currency expressed in another currency (Huefner et al., 1989). The currencies of major trading nations are bought and sold in global markets. Connected via sophisticated telecommunication networks, market participants include banks and other currency intermediaries, businesses, individuals and professional traders.

Foreign currency transactions take place on the spot, forward, or swap markets. Currencies bought or sold on the spot generally have to be delivered as soon as possible, that is, within 2 working days. The spot market rate is influenced by many factors, including differences in inflation rates between countries, differences in national interest rates and expectations of the direction of future exchange rates. Transactions in the forward market are agreements to exchange a certain amount of currency into another currency at a future date. Quotations in the forward market are stated at a discount or premium from the spot rate.

A swap transaction involves a spot purchase and a forward sale or a spot sale or a forward purchase, of a currency at the same time. Investors often take advantage of swap transactions to take advantage of higher interest rates in a foreign country, while at the same time protecting themselves against unfavorable movements of foreign exchange rates. An example of a translation such as a country previously expressed in British pounds could be expressed in its US dollar equivalent. This restating process is called translation. An example of

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conversion such as a US citizen on vacation will convert dollars into local currency if he will buy local products in the local currency.

Conversion between foreign currencies is the physical exchange from one currency to another. Where the translation is simply the change in monetary units, for example, in a statement expressed in British pounds, it is restated into the equivalent value of US dollars. No physical exchange takes place, and no associated transactions take place. Conversion, on the other hand, allows for physical exchanges to take place and related transactions to take place (Bowen & Jones, 1986; Allee, 2008).

Development of Translation Accounting in Foreign Currency Translation

Translation accounting practices have evolved over time in response to the increasing complexity of multinational operations and changes in the international monetary system. To provide some historical perspective on the current status of translational accounting, here is a brief narrative of financial reporting initiatives in the United States that represents experiences in other countries.

Before 1965

The Accounting Research Bulletin then encourages the use of the now-non-current method. Profits or losses on transactions are directly included in profits. Net transaction gains or losses are offset during the period. Meanwhile, net transaction losses are deferred in postponement of the balance sheet and used to write off future translation losses.

1965 - 1975

ARB allows certain exceptions to current-non-current methods in certain circumstances. Inventories can be translated at historical rates. Long-term debt arising from the purchase of long-term assets can be translated at the current exchange rate. Any accounting differences resulting from the restatement of debt are treated as part of the cost of assets. Translating all debt and receivables in foreign currencies based on current exchange rates is allowed after Accounting Principle Board Opinion No. 6 issued in 1965.

1975 - 1981

The FASB issued the controversial FAS No.8 in 1975, changing US practice and the practice of foreign companies using US GAAP by requiring the use of the temporal translation method. Deferral of translation gains and losses is no longer permitted and should be recognized in profit during periods of exchange rate changes.

Parties support the theoretical basis used, while others criticize it for the distortions it can cause in reported company profits. FAS No.8 causes accounting results that are not in accordance with economic reality. The yo-yo effect of FAS No.8 on company profits has generated concern among executives of a number of companies who are reported to be more volatile than domestic company profits and will thus depress share prices of multinational companies. They are concerned that reported corporate profits will appear. more volatile when compared to the profits of domestic companies and thus depress the company's share price.

1981 - present

The FASB reconsidered FAS No.8 and after going through many public meetings and two interim drafts, published Statement of Financial Accounting Standards No.52 in 1981.

Terms in Foreign Currency Translation

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Conversion, is the exchange of a currency into another currency. Current rate, is the exchange rate in effect at the date of the relevant financial statement. The position of net assets at risk is the excess of assets measured in or denominated in foreign currency and translated using the current exchange rate of the liabilities measured or denominated in foreign currency and translated using the current exchange rate. A forward exchange contract is an agreement to exchange currencies of different countries using a specific exchange rate (forward rate) on a certain date in the future. The functional currency is the main currency used by a company in carrying out business activities. Usually the currency is the currency of the country where the company is located. Historical exchange rate, is the exchange rate of foreign currency that is used when an asset or liability in foreign currency is purchased or occurs. Reporting currency, is the currency used by the company in preparing financial statements. Spot rate, is the exchange rate for immediate currency exchange. Translation adjustments, are adjustments arising from the process of translating financial statements from the functional currency of a company into the reporting currency.

The glossary of foreign currency translation terms includes attributes, quantitative characteristics of an item that are measured for accounting purposes. For example, historical costs and replacement costs are attributes of an asset. Conversion, the exchange of one currency into another currency. Current exchange rate, the exchange rate in effect at the relevant financial statement date. Discount, when the next exchange rate is lower than the current rate. The position of net assets at risk, excess assets that are measured in or denominated in foreign currency and translated using the current exchange rate of the liabilities measured or denominated in foreign currency and translated using the current exchange rate.

Foreign currency, a currency other than the currency used by a country, a currency other than the reporting currency used by the company. Financial statements in foreign currency, financial statements that use foreign currency as the unit of measurement. Foreign currency transactions, transactions (namely the sale or purchase of goods or services, or loans or trade receivables) with terms stated in currencies other than the company's functional currency. Foreign currency translation, the process of expressing amounts denominated or measured in one currency into another currency using the exchange rate between the two currencies.

Foreign operations, an operation that produces financial statements that (1) are combined or consolidated or calculated based on the equity method in the reporting company's financial statements and (2) are prepared in a foreign currency other than the reporting company reporting currency. Forward exchange contact, an agreement to exchange currencies of different countries using a specific exchange rate (forward rate) on a certain date in the future. The functional currency, the main currency used by a company in conducting its business activities, and in generating or using its cash.

Historical exchange rate, the exchange rate of foreign currency used at the time an asset or liability denominated in foreign currency is purchased or incurred. Local currency, the currency of a certain country that is used; reporting currency used by a domestic or foreign operation. Monetary items, the obligation to pay or the right to receive a fixed number of currency units in the future. Reporting currency, the currency used by the company in preparing financial statements. Settlement date, the date when a debt is paid by a collectible account. Spot rate, the exchange rate for currency exchange in immediate time. Transaction date, the date when a transaction is recorded in the accounting records of the reporting company. Translation adjustments, adjustments arising from the process of translating financial statements from the functional currency of a company into the reporting currency.

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The unit of measurement, the currency used to measure assets, liabilities, income and expenses.

Three translation rates used to translate foreign currency balances against domestic currencies are the current exchange rate; the exchange rates in effect at the date of the financial statements. Historical rates; currency translation that applies when assets denominated in currencies are first acquired or when liabilities denominated in foreign currencies first appear. Average exchange rate; ordinary or weighted average values at either historical or current exchange rates.

Difference of Profits and Disadvantages of Foreign Currency Translation

If the local currency point of view is used (the point of view of a local company), it is not necessary to include translation adjustments in current income. Including translation gains and losses in profit will distort the original financial relationship and may mislead users of the information. Translation gains or losses should be treated from the perspective of the local currency as an adjustment to owner's equity.

If the reporting currency of the parent company is the unit of measurement for translated financial statements (parent company point of view), it is advisable to recognize translation gain or loss as soon as possible (Louis, 2003). The parent company point of view sees an offshore subsidiary as an extension of its parent company. Translation gains and losses reflect increases or decreases in foreign investment equity in domestic currency and must be recognized (Bazaz & Senteney, 2001; Ahern et al., 2015).

Foreign Currency Translation Gains and Losses

Adjunct

Changes in the value of the domestic currency equivalent of the net assets of foreign subsidiaries are not realized and have no effect on local currency cash flows generated from foreign entities. Translation adjustments should be accumulated separately as part of consolidated equity.

Deferral and Amortization

Deferring translation gains or losses and amortizing these adjustments during the useful life of the related balance sheet items, especially those related to debt, will be deferred = cash is amortized over the life of the related fixed assets, i.e. charged to profit in the same manner as depreciation expense or deferred and amortized over the remaining period of the loan as an adjustment to interest expense.

Partial Suspension

Translation gains and losses are recognizing losses as soon as possible after they occur, but recognizing gains only after they are realized, this is simply because they are gains, still ignoring changes in exchange rates.

Not Suspended

Recognize translation gains and losses in the income statement as soon as possible. However, incorporating translation gains and losses in current year earnings introduces a random element to earnings which can result in very significant fluctuations in earnings if there are changes in exchange rates. These translation gains and losses reflect increases or decreases in investment equity in domestic currency and must be recognized.

Conclusion

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Foreign currency translation is the process of reporting financial information from one currency to another. Foreign currency translation is carried out to prepare joint financial reports that provide reports to readers of information about the company's operations globally, taking into account the foreign currency financial statements of the subsidiary against the foreign currency of the parent company. Foreign currency translation is different from foreign currency conversion. Translation is simply a change in monetary units, just as a balance sheet expressed in British pounds is restated into its US dollar equivalent. No physical exchange takes place, and no related transaction occurs as if a conversion were made. Sometimes it is difficult to distinguish between conversion and translation therefore it is important to know the theory in order to differentiate in practice. If the local currency point of view is used (the point of view of a local company), it is not necessary to include translation adjustments in current income. Including translation gains and losses in profit will distort the original financial relationship and may mislead users of the information. Translation gains or losses should be treated from the viewpoint of the local currency as an adjustment to owner's equity.

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