



Translating foreign currency financial statements: Methods and challenges

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Abstract

The globalization of business has intensified the need for accurate and consistent translation of foreign currency financial statements. Multinational corporations (MNCs) often face significant challenges in consolidating financial results across jurisdictions where operations are conducted in diverse currencies. This paper investigates the major methods of translation, including the current rate method, temporal method, and monetary/non-monetary method, alongside the challenges of exchange rate volatility, regulatory divergence, and investor interpretation. A review of existing literature highlights gaps, particularly in the treatment of translation during global crises and the limited exploration of emerging technologies in this field. The findings underscore the need for harmonization between IFRS and US GAAP, improved disclosure practices, and the adoption of advanced technological solutions to enhance transparency and comparability in financial reporting.

Keywords: Foreign currency translation, current rate method, temporal method, ifrs, us gaap, exchange rate volatility, translation risk, financial reporting

Introduction

Foreign currency translation is crucial for international financial reporting in the global economy. Multinational corporations maintain financial statements in local currencies, which must be translated into the parent company's reporting currency for consolidation. This process ensures adherence to accounting standards, improves comparability, and provides reliable information for stakeholders. Despite accounting standards like IAS 21 and ASC 830, practical difficulties persist in implementation.

This study explores the impact of translation on financial statement accuracy and interpretation, highlighting how exchange rate fluctuations can affect earnings, performance metrics, investor perceptions, and financial stability. It also highlights the strategic importance of foreign currency translation in tax planning, investment decisions, and stakeholder trust, providing insights for improving international financial reporting reliability.

Introduction to the Area of the Study

This study focuses on foreign currency translation in international accounting and financial management. Various methods, including current rate, temporal, and monetary/non-monetary, have been developed over time to address translation needs. The selection of a method is a crucial accounting decision that can impact reported results and market interpretations.

The study explores topics like comparability, harmonization of standards, and cross-border investment analysis, addressing regulatory frameworks but also addressing strategic and policy-level challenges faced by multinational corporations due to foreign exchange volatility, hyperinflation, and differing economic conditions.

Literature Review

(Alhammedi, (2024) ^[8] "Foreign exchange rate risk by Alhammedi, M. H., Almansoori, M. A., Alnuaimi, M. A., & Nobanee, H. (2024) ^[8]."

This study investigates foreign exchange rate risk, as well as its causes, effects, and how to manage these risks. It

considers the specific impact on multinational corporations, investors, and (and overall economies), while exploring the impact on cash flows, asset values, and competitiveness. The authors suggest integrated approaches that involve various operational, financial, and strategic decisions. (Rajan, (2025) ^[7]

"A Comparative Analysis of Reported Earnings and Information Quality: IFRS and US GAAP. In Navigating Business through Essential Sustainable Strategies" by Rajan, L., & Shenoy, S. (2025) ^[7]

This study explores whether there are differences between IFRS and US GAAP for both reported earnings and the quality of the information, demonstrating that accounting conventions influence transparency, comparability, and investor decision making. IFRS permits flexibility and US GAAP permits uniformity, although uniformity may also limit flexibility in complicated transactions, making accounting conventions important for global stakeholders. (Bonini, (2016) ^[6].

"Do firms hedge translation risks?" by Bonini, S., Dalocchio, M., Raimbourg, P., & Salvi, A. (2016) ^[6]."

This research examines the ways in which firms manage foreign currency translation risk as part of the process of consolidating financial statements. The researchers discovered that while several firms focus on transaction and economic exposures to foreign currency risk, translation risk can have a significant impact on earnings, financial position, and the perception of investors. (Rajan, (2025) ^[7]

This study looks at the effect of the translation of International Financial Reporting Standards (IFRS) into other languages on professional judgments and financial decision making. They argue that clear translations, revisions, and training programs for practitioners are necessary for maintaining the intended meaning and minimizing potential misinterpretations within a multinational context. (Adams, (2021) ^[1].

"Fx transaction and translation risk" by Adams, P., & Verdelhan, A. (2021) ^[1]"

This study distinguishes foreign exchange transaction risk from translation risk, both risks that multinational firms

encounter when dealing with foreign exchange. Transaction risk arises from actual cash flows, while translation risk refers to the process of converting a foreign subsidiary's financial statements into the currency of the parent company for reporting purposes. Translation risk can create significant volatility in earning, balance sheet value, and investor attitude. (Savić, (2019)^[2].

“The key issues in the translation of the financial statements of multinational companies by Savić, B., Obradović, N., & Milojević, I. (2019)^[2]”

This study provides insight into the issues that multinational entities face with the translation of financial statements to a single reporting currency. The article identifies the need to designate a functional currency, the management of fluctuations in exchange rates, the application of various translation methods, and adherence to international legislation including IFRS and US GAAP. (Bogicevic, (2013)^[3].

“Accounting implications of foreign currency transactions translation and hedging by Bogicevic, J. (2013)^[3]”

This paper discusses the accounting ramifications of translating foreign currency transactions and using hedging strategies for risk management. It describes the way that various translation methods can affect financial statements; specifically, earnings and equity reported in the financial statements. The role of forward contracts, options, and swaps were all illustrated to lessen uncertainty and to help organizations provide reliable financial information to both internal and external users, as they typically operate in a multinational environment. (Manda, (2025)^[4].

“Exchange Rate Volatility. Monetary Dynamics and Socio-Economic Development in Emerging Economies” by Manda (2025)^[4]”

This study examines the significance of exchange rate fluctuations on the monetary research functions and socio-economic development implications in emerging economies. In addition to monetary and fiscal measures to combat adverse exchange rate fluctuations, the study argues for the emergence of coherent national public policy frameworks, as well as improved corporate forecasting, hedging, and reporting.

Methods of Translating Foreign Currency Financial Statements

- a. **Current Rate Method:** This method involves translating assets and liabilities at the current exchange rate, while equity items are translated at historical rates. Income statement items are translated at the exchange rates prevailing on transaction dates. The resulting translation adjustment is recorded in Other Comprehensive Income (OCI) under IFRS and a separate equity component under US GAAP. This method provides up-to-date valuation of assets and liabilities but can create equity volatility due to frequent exchange rate changes.
- b. **Temporal Method:** Assets and liabilities are translated based on their valuation basis, with monetary items translated at the current exchange rate, non-monetary items at historical rates, and income statement items at the rate in effect at the transaction. This aligns accounting treatment of assets and liabilities with their valuation basis but can be complex and distort comparability if historical rates differ significantly from current ones.

- c. **Monetary / Non-Monetary Method:** The current rate is used to translate monetary items like cash, loans, and receivables, while non-monetary items like land and inventory are translated at historical rates. Income statement items are translated based on the nature of underlying assets and liabilities. This method offers a logical framework for separating sensitive items but can understate or overstate values during inflationary or volatile conditions.

- d. **Closing Rate Method:** The closing rate method, like the current rate method, involves translating assets and liabilities at the closing rate, often used under IFRS for subsidiaries with different functional currencies.

Challenges in Translating Foreign Currency Financial Statements:

- a. **Exchange Rate Volatility:** Exchange rate fluctuations can cause significant translation gains or losses, affecting reported earnings and equity, causing confusion for investors due to their unreflected operational performance.
- b. **Translation Exposure (Accounting Exposure):** Translation exposure can distort profitability in companies, as consolidated financial statements may show changes solely due to translation, even when no actual cash flow occurs, particularly in volatile or hyperinflationary economies.
- c. **Disclosure Challenges:** Firms often fail to disclose translation methods, exchange rates, and currency sensitivity, leading to transparency issues that can damage investor trust.
- d. **Operational Costs and Complexity:** Translation management necessitates advanced accounting systems and expert knowledge, which can be costly and complex for smaller firms with limited resources.

Objectives of the research

- To investigate the main techniques for translating financial statements in foreign currencies.
- To determine challenges that multinational firm's encounter when implementing these strategies.
- To examine how reported earnings and financial positions are affected by changes in exchange rates.
- To contrast the translation methods of US GAAP and IFRS.
- To point out any gaps in the body of knowledge and offer suggestions for better methods.

Research Methodology

Problem Statement of the Research

Even with well-defined accounting systems, international firms nevertheless face challenges with foreign exchange translation. Exchange rate volatility can affect actual business performance by introducing artificial variations into consolidated financial results and causing translation risk. Selecting a translation method adds even more complexity because different approaches might produce wildly different results.

Inconsistencies between IFRS and US GAAP pose challenges for corporations with cross-border reporting

obligations, increasing compliance costs and reducing comparability for global investors, thereby posing a serious problem for transparent and reliable financial reporting.

Research Gap

Translation methods and risks are extensively researched, but areas like financial crises and pandemics have been underexplored. The potential of emerging technologies like artificial intelligence, blockchain, and big data analytics to tackle translation challenges is also not widely studied.

The gap in empirical evidence on the practical impact of IFRS and US GAAP on global investors and corporations is significant, reducing the effectiveness of policymaking and accounting reforms and requiring further investigation.

Relevant Research Questions

What are the basic approaches to translating foreign currency financial statements under IFRS and US GAAP? What are the biggest problems that global organizations encounter when implementing various translation methods? How does the volatility of exchange rates impact translation adjustments and reported earnings? What role do accounting standards play in assuring the uniformity and comparability of internationally translated financial statements? How may technology (such as ERP systems and AI-driven accounting software) help to simplify translation practices? What changes to present accounting rules can be suggested to address unresolved translation issues?

Significance of the Research Gap and Reasons for Investigating It

Research gaps in international financial reporting are crucial for improving reliability and consistency. Exploring translation practices during crises can develop resilient guidelines for transparency. Evaluating technology's role could revolutionize translation, reduce errors, enhance efficiency, and promote trust in reported figures.

Reliable translation practices benefit accounting professionals, investors, regulators, and policymakers by reducing compliance costs, improving global market comparability, and enhancing investor confidence. Investigating these gaps contributes to stronger corporate governance, financial stability, and stakeholder trust in interconnected economies.

Results and Discussions

In our random sampling survey method, we have 9 respondents in the age range of 18–60, with most respondents (around 78%) in the age group of 18-25, most of the students pursuing various academic streams, and rest of the people aged 25 and above. Most of the respondents (around 89%) affirmatively replied that the current rate method provides a more realistic picture of financial position as compared to the temporal method. Most of the respondents (approx.44%) responded that they would consider the current rate method as the most practical method for multinational companies whereas others provided mixed responses.

Most of the respondents (approx.56%) affirmatively agreed that various subsidiary companies required various translation methods whereas others provided mixed responses. Most of the respondents (approx.89%) strongly believed that translation adjustments should be separately

disclosed from operational earnings. Respondents gave an equal response (33.3% each) that volatility in exchange rates creates significant problems in financial reporting whereas others provided mixed responses. Respondents gave an equal response (33.3% each) that volatility in exchange rates creates significant problems in financial reporting whereas others provided mixed responses.

Most of the respondents (approx.78%) affirmatively replied that exchange rate volatility has significant impacts on reported earnings than on cash flows whereas the remaining were unsure. Most of the respondents (approx. 56%) affirmatively agreed that volatility in exchange rates can significantly impact reported earnings more than actual cash flows whereas others provided mixed responses. Most of the respondents (approx.78%) affirmatively agreed that more detailed disclosures on translation impacts would improve transparency whereas others provided neutral responses when asked about their views on this.

Most of the respondents (approx.78%) affirmatively replied that unified global standards should be implemented for translation practices. Most of the respondents (approx.67%) affirmatively replied that ERP or AI-based accounting tools simplify the translation processes whereas the others were not sure about this. Respondents gave an equal response (44.4% each) that enhanced disclosures would improve investor understanding of translation effects whereas others provided mixed responses.

Findings, Summary and Conclusion

Findings of the study

The two most common methods are the current rate method and the temporal method.

IFRS and US GAAP both employ these methods, albeit in slightly different ways.

Companies frequently find it challenging to determine which functional currency their subsidiaries will use. Exchange rate fluctuations can have a significant impact on reported profits and assets, even if real company performance remain same.

Investors may become confused by these translation impacts and believe that changes in business operations, rather than currency fluctuations, are the reason for changes in profits. Many businesses don't employ enough hedging techniques to mitigate the risk of translation.

To guarantee consistency as well as reliability in financial reporting, better policies and procedures are required.

Summary of the Study

The study explores the challenges of translating foreign currency financial statements using current rate and temporal methods, as per IFRS and US GAAP. Issues include exchange rate volatility, functional currency decisions, hyperinflation, and accounting standards differences. Translation effects can distort results, confuse investors, and create comparability issues. Existing literature mainly focuses on technical processes, but there is a lack of practical problems and decision-making in managing translation risk.

Conclusion of the Study

The study highlights the challenges multinational companies face in reporting foreign currency translation, despite IFRS and US GAAP guidance. They struggle with consistency and investor communication, especially in volatile or high-

inflation economies. The gap between theory and practice is evident, and improving disclosures, consistency, and management practices is crucial for transparent financial reporting.

Recommendations based on conclusions

- Utilize risk management approaches such as forward contracts, options, and natural hedging to lessen your exposure to the volatility in currencies.
- Increase transparency in financial statement disclosures by making a clearer distinction between operational performance and translation effects.
- Reinforce IFRS and US GAAP standards on management of hyperinflationary conditions and identification of functional currencies.
- Encourage the finance teams' training and awareness-building to create greater consistency in applying translation procedures.
- Minimize differences between IFRS and US GAAP requirements to increase global comparability.
- Increase research on practical issues and investor views on practical behaviour to help bridge the gap between theory and practice.

Annexure

- Do you think the Current Rate Method provides a more realistic picture of financial position compared to the Temporal Method?
- Which method do you consider most practical for multinational corporations? (Current Rate / Temporal / Monetary-Non-Monetary / Other)
- Different subsidiaries require different translation methods.
- Do you believe translation adjustments should be disclosed separately from operational earnings?
- Exchange rate volatility creates significant problems in financial reporting.
- Do you think exchange rate volatility has more impact on reported earnings than on cash flows?
- Exchange rate changes affect reported earnings more than actual cash flows.
- More detailed disclosure on translation effects would improve transparency.
- Should there be a unified global standard for translation practices?
- Do you think ERP or AI-based accounting tools simplify translation processes?
- Enhanced disclosure would improve investor understanding of translation effects.

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