Ind AS Case Study

The articulation of Profit or Loss and Other Comprehensive Income

INTRODUCTION

This case study aims to illustrate that although Profit or Loss and Other Comprehensive Income are, in substance, two separate statements (they can be shown as a single statement), there is an articulation between the two. Profit or Loss (PL) is the total of income (that should have been received) *less* expenses (that should have been paid), excluding the components of Other Comprehensive Income (OCI), which is the change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners. The articulation of PL and OCI is done through reclassification adjustments, which are amounts reclassified to PL (as realised gains) in the current period that were recognised in OCI (as unrealised gains) in current or previous periods.

The articulation of Profit or Loss and Other Comprehensive Income

REFERENCE

Para 93 of Ind AS 1: *Presentation of Financial Statements* states, "A reclassification adjustment is included with the related component of OCI in the period that the adjustment is reclassified to PL. The amounts may have been recognised in OCI as unrealised gains in the current or previous periods. These unrealised gains must be deducted from OCI in the period in which the realised gains are reclassified to PL to avoid including them in total comprehensive income twice."

CASE STUDY EXAMPLE

Statement of Profit and Loss for the year ended 31 March 20x3 (Extract) (CU)

Revenue		8,700
Cost of sales		3,510
Gross Profit		**5,190**
Other income		150
Administrative expenses		(633)
Distribution expenses		(569)
Other expenses		(1,575)
Accounting Profit		**2,563**
Tax expense –		
Current tax expense (@ 40%)	1,002	
Deferred tax expense	90	
Deferred tax income	(144)	
Deferred tax liability	(12)	
Deferred tax asset	30	966
Profit for the period		**1,597**

No adjustment has been made to the following. A Statement of Profit and Loss and Other Comprehensive Income for the year ended 31 March 20x3 is to be prepared by taking into consideration the following information –

1. Property, Plant and Equipment

Property, Plant and Equipment (CU)

Date	Heads of account	Carrying Amount			Tax Base			Original cost		
		Dr	Cr	Balance	Increase	Decrease	Balance	Increase	Decrease	Balance
20x2										
Apr 1				300			200			320
20x3										
Mar31	Revaluation surplus	24		324		100	100		80	240
	Deferred tax liability	16		340						
	Depreciation		100	240						

2. Employee benefits

Actuarial loss/(gain) on defined benefits retirement benefit plan (CU)

	Plan Liabilities	Plan Assets	Net Pension Liability
Balance bf (1 April 20x2)	3,000	(2,500)	500
Service costs –			
Current service costs	300	–	300
Past service costs	200	–	200
Loss on settlement	100	–	100
Net interest cost (@5%)	150	(125)	25
Benefits paid	(300)	300	–
Contributions paid	–	(500)	(500)
Actuarial loss/(gain) – balancing figure	50	(75)	(25)
Balance cf (31 March 20x3)	**3,500**	**2,900**	**600**

3. Financial asset measured at fair value through other comprehensive income

Investment in Debt Instruments (CU)

Date	Heads of Account	Carrying amount			Tax Base		
		Dr	Cr	Balance	Increase	Decrease	Balance
20x2							
Apr 1				220			200
20x3							
Mar 31	Fair value gain	6		226			
	Deferred tax liability	4		230			
	Cash		230	–		200	–

4. Investment in foreign operation

Investment in Foreign Operation (CU)

Date	Heads of Account	Dr	Cr	Balance
20x2				
Apr 1				1,075
20x3				
Mar 31	Foreign currency translation reserve	105		1,180
	Deferred tax liability	70		1,250
	Cash		1,250	–

Note: The carrying amount of foreign currency translation reserve as on 31 March 20x2 is CU 45 (net of tax).

SOLUTION

1. Property, plant and equipment

There is no taxable/deductible temporary difference, since the accounting depreciation and tax depreciation are the same. Therefore, no deferred tax arises in profit or loss.

The difference between the carrying amount of a revalued asset and its tax base is a taxable temporary difference and gives rise to a *deferred tax liability*. The revalued carrying amount of property, plant and equipment (PPE) will be recovered through use and this will generate taxable income which exceeds the depreciation that will be allowed for tax purposes in future periods.

Journal		
Property, plant and equipment	CU 40	
Revaluation surplus (Other Comprehensive Income)		CU 24
Deferred tax liability (Other Comprehensive Income)		CU 16

A portion of the revaluation surplus in respect of PPE is transferred directly to retained earnings, ie, not through profit or loss. In other words, it is not reclassified to profit or loss. The amount of revaluation surplus transferred is the *net of tax* difference between depreciation based on the revalued carrying amount of PPE (CU 100) and depreciation based on PPE's original cost (CU 80). The amount transferred is: CU (100 – 80) x 60% = CU 12.

Journal		
Revaluation surplus (Statement of Changes in Equity)	CU 12	
Retained earnings (Statement of Changes in Equity)		CU 12

2. Employee benefits

The amount to be recognised in profit or loss for the period in respect of defined benefit plan is the aggregate of the following –

a)	Current service cost	CU 300
b)	Past service cost	CU 200
c)	Loss on settlement	CU 100
d)	Net interest cost	CU 25
		CU 625

A deductible temporary difference arises in PL, and results in a deferred tax asset, when the amount allowed as deduction (ie, benefits paid CU 300) is less than the amount shown as expenses (ie, aggregate of service cost and net interest cost CU 625). The amount of deferred tax asset is = CU (625 – 300) x 40% = CU 130.

Journal		
Deferred tax asset	CU 130	
Deferred tax income		CU 130

Remeasurements of net defined benefit liability, ie, actuarial gains/(losses) arising in the period would be recognised in OCI. The amount is CU 25. The *net of tax* of this amount, ie, CU 25 x 60% = CU 15 will appear in OCI.

Journal

Plan assets	CU 75	
Plan liabilities		CU 50
Remeasurement of defined benefit obligation (OCI)		CU 15
Deferred tax liabilities (OCI)		CU 10

3. Financial asset measured at fair value through Other Comprehensive Income

In the tax jurisdiction in which the entity operates, unrealised gains/(losses) arising on the revaluation of investments of this nature are not taxable (deductible) unless the investment is sold.

The gain on sale of investment in debt instruments is CU 30 (CU 230 – CU 200), which is taxable. In effect, the net gain after tax CU 18 (CU 30 x 60%) is reclassified from OCI to PL. Also, the corresponding deferred tax liability is reclassified from OCI to PL.

Journal

Fair value gain	CU 18	
Profit or loss		CU 18
Deferred tax liability	CU 12	
Tax expense		CU 12

4. Investment in foreign operation

The gain on foreign currency translation is measured through OCI and recognised as foreign currency translation reserve. On disposal of the foreign operation, the cumulative gain on foreign currency translation is to be reclassified from OCI to PL. Also, the cumulative deferred tax liability is to be reclassified from OCI to PL.

Journal

Foreign currency translation reserve	CU 150 (45 + 105)	
Profit or loss		CU 150
Deferred tax liability	CU 100 (30 + 70)	
Tax expense		CU 100

Statement of Profit and Loss and Other Comprehensive Income
for the year ended 31 March 20x3 (Extract)

		(CU)
Revenue		8,700
Cost of sales (3,510 + 100[1])		3,610
Gross profit		**5,090**
Other income		150
Administrative expenses (633 + 600[2])		(1,233)
Distribution expenses		(569)
Other expenses (1,575 + 25[3])		(1,600)
Accounting profit		**1,838**
Tax expense –		
Current tax expense (1,002 – 40[4] – 120[5] + 12[6] + 100[7])	954	
Deferred tax expense	90	
Deferred tax income (144 + 130[8])	(274)	
Deferred tax liability (12 + 12[9] + 100[10])	(124)	
Deferred tax asset	30	676
Profit for the period (*before reclassification adjustments*)		**1,162**
Amount reclassified from Other Comprehensive Income to Profit or Loss –		
Investment in debt instruments	18	
Investment in foreign operations	150	168
Profit for the period (*after reclassification adjustments*)		**1,330**
Other Comprehensive Income (net of tax)		
Items that will not be reclassified subsequently to Profit or Loss		
Revaluation surplus on property, plant and equipment	24	
Remeasurement of defined benefit obligation	15	39
Items that may be reclassified subsequently to profit or loss		
Investment in debt instruments –		
Fair value gain arising during the period	6	
Reclassification adjustments for amounts recognised in profit or loss	(18)	(12)
Investment in foreign operations –		
Exchange differences gain on translating foreign operations during the period	105	
Reclassification adjustment for amounts recognised in profit or loss	(150)	(45)
Total Comprehensive Income		**1,312**

[1] Depreciation on PPE
[2] Aggregate of service costs
[3] Net interest cost
[4] Tax deduction on depreciation
[5] Tax deduction on employee benefits
[6] Taxable amount of gain on sale of debt instruments
[7] Taxable amount of gain on disposal of foreign operation
[8] Deductible temporary difference on employee benefits
[9] Reclassification of deferred tax liability for investment in debt instruments
[10] Reclassification of deferred tax liability for investment in foreign operations