Ind AS
Worked Example

Reclassification Adjustment:
Concept of Vertical Consistency

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Reclassification Adjustment – Concept of Vertical Consistency

Introduction

One of the qualitative characteristics of financial statements included in Conceptual Framework is consistency. The objective of consistency is to stop entities using whichever method suits their best interests in a particular reporting period. Consistency makes possible a comparison of accounting figures over a period of time. Once chosen, an accounting basis should not be changed unless it is necessary to confirm to the conservatism concept, which is paramount. In financial reporting, consistency is reflected in financial statements in three different ways –

Vertical consistency

The consistency within a given set of financial statements at a specified date and for a specific time.

Horizontal consistency

The intra-firm consistency between different reporting periods. The financial statements of a reporting period must be prepared on the basis that the figures stated are consistent with those of earlier periods.

Third dimensional consistency

The inter-firm consistency between entities in similar industry or trade. It refers to the use of similar measurement concepts and procedures for related items by different entities in the same industry.

What the standard says

As per **paragraph 7** of Ind AS 1 *Presentation of Financial Statements*, “Reclassification adjustments are amounts reclassified to profit or loss in the current period that were recognised in other comprehensive income in the current or previous periods.” Therefore, through reclassification, a relationship is established between profit and loss and other comprehensive income. For example, reclassification adjustment –

- arises on disposal of a foreign operation.
- does not arise from changes in revaluation surplus of a foreign operation.

A vertical consistency is maintained when unrealised gains (recognised in other comprehensive income in the current or previous periods) are deducted from other comprehensive income in the period in which the realised gains are reclassified to profit and loss to avoid including them in total comprehensive income **twice.**

Refer **paragraph 93** of Ind AS 1.

Question

The profit for the period (before reclassification adjustment) of Drake Ltd for the reporting period ended 31 March 20x5 is CU 2,879. Drake Ltd has an investment in foreign operation. The following information is provided in regard to that –

1. Investment in Foreign Operation

Date	Heads of Account	Carrying amount			Tax Base		
		Dr	Cr	Balance	Increase	Decrease	Balance
20x4							
Apr 1				2,500			2,000
20x5							
Mar31	Revaluation surplus	240		2,740			
	Deferred tax liability	160		2,900			
	Gain on Exchange difference	60		2,960			
	Deferred tax liability	40		3,000			
	Cash		750	2,250		500	1,500

2. Statement of Changes in Equity for the Reporting Period ended 31 March 20x5 (Extract)

	Investment in Foreign Operation	
	Revaluation surplus	Exchange difference
Balance bf	180	120
Recognised through other comprehensive income	240	60
Transferred to –		
Retained earnings	(105)	–
Profit and loss	–	(45)
Balance cf	**315**	**135**

3. Deferred Tax Liability (Extract)

	Investment in Foreign Operation	
	Revaluation surplus	Exchange difference
Balance bf	120	80
Recognised through other comprehensive income	160	40
Reclassified through profit and loss	(70)	(30)
Balance cf	**210**	**90**

An extract of Profit and Loss and Other Comprehensive Income is to be prepared. The income tax rate on gain of disposal of foreign operation is 40%.

Solution

Journal

		Dr	Cr
1.	Investment in foreign operation	CU 400	
	Revaluation surplus		CU 240
	Deferred tax liability		CU 160
2.	Investment in foreign operation	CU 100	
	Gain on exchange difference		CU 60
	Deferred tax liability		CU 40
3.	Cash	CU 750	
	Investment in foreign operation		CU 750
4.	Revaluation surplus [(CU 180 + CU 240) x (CU 750 ÷ CU 3,000)]	CU 105	
	Retained earnings		CU 105
5.	Gain on exchange difference [(CU 120 + CU 60) x (CU 750 ÷ CU 3,000)]	CU 45	
	Profit and loss		CU 45
6.	Deferred tax liability (CU 70 + CU 30)	CU 100	
	Tax expense		CU 100

Statement of Profit and Loss and Other Comprehensive Income (Extract) CU

Profit for the period (*before reclassification adjustment)*		2,879
Gain on exchange difference reclassified		45
Profit for the period (*after reclassification adjustment)*		2,924
Other Comprehensive Income		
Items that will not be reclassified subsequently to profit and loss		
Revaluation surplus on foreign operation	400	
Deferred tax liability @ 40%	(160)	240
Items that may be reclassified subsequently to profit and loss		
Gain on exchange difference on foreign operation	100	
Deferred tax liability @ 40%	(40)	60
Reclassification adjustment for amounts recognised in profit and loss		(45)
Total Comprehensive Income		**3,179**

Note – *Revaluation surplus of CU 105 is to be transferred to retained earnings.*