ACCOUNTING FOR INVESTMENTS

According to the Accounting Standard (AS-13), Investments are assets held by an enterprise for earning income by way of dividends, interest, and rentals, for capital appreciation, or for other benefits to the investing enterprise. Assets held as stock-in-trade are not 'investments'. Table 13.1 shows investments as % of total assets of some of the well know companies of India.

Table 13.1			
Investment as % of total assets as on 31st March 2006			
Reliance Communications Ltd.	78%	Tata Consultancy Services Ltd.	26%
H C L Technologies Ltd.	73%	Dr. Reddy'S Laboratories Ltd.	21%
Zee Entertainment Enterprises Ltd.	60%	Infosys Technologies Ltd.	10%
Bajaj Auto Ltd.	59%	A C C Ltd.	6%
Hero Honda Motors Ltd.	53%	Cipla Ltd.	1%

Investments can be broadly divided into two categories: Current Investments and Long Term Investments

A *current investment* is an investment that is by its nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made.

A *long term investment* is an investment other than a current investment.

Investments and Accounting Equation

When company purchases investments, either cash goes down or a corresponding liability is created.

Example 13.1

Table 13.2 shows the assets and corresponding sources of ABC ltd.

Table 13.2					
Accounting Equation before the purchase of Bonds of XY					
Loan +	Profit +	Capital =	Cash+	Stock +	Plant
50,000	20,000	150,000	90,000	30,000	100,000

If the company uses cash to acquire 12% Bonds of XYZ ltd. worth of Rs. 30,000, the new accounting equation will be as shown by the table 13.3.

Table 13.3						
Accounting Equation of ABC						
Loan +	Profit +	Capital =	Cash+	Stock +	Plant+	12% Bonds
50,000	20,000	150,000	60,000	30,000	100,000	30,000

Or Acquired for cash but takes a specific loan.

If the company takes a loan to acquire 12% Bonds of XYZ ltd worth of Rs. 30,000, the new accounting equation is shown by table 13..4

Table 13.4							
Accounting Equation of ABC							
New Loan +	Loan +	Profit +	Capital =	Cash+	Stock +	Plant+	Bonds
30,000	50,000	20,000	150,000	90,000	30,000	100,000	30,000

Table 13.5 shows the accounting equation when the company receives interest on bonds: Rs. 3000.

Table 13.5							
Accounting Equation of ABC							
New Loan +	Loan +	Profit +	Capital =	Cash+	Stock +	Plant+	Bonds
30,000	50,000	23000	150000	93000	30000	100000	30000

Table 13.6 shows the accounting equation when the company sells the above investments at a premium of 50% for cash.:

Table 13.6							
Accounting Equation after the sale of investments at a profit							
New Loan +	Loan +	Profit +	Capital =	Cash+	Stock +	Plant+	Bonds
30,000	50,000	38000	150000	138000	30000	100000	0

- Cash = 93,000 + 45,000 = 138,000
- Profit = 23,000+15,000 = 38,000

When the company sells the above investments for 25000, the accounting equation will be as follows:

Table 13.7							
Accounting Equation after the sale of investments at loss							
New Loan +	Loan +	Profit +	Capital =	Cash+	Stock +	Plant+	Bonds
30,000	50,000	18,000	150,000	118,000	30,000	100,000	0

- Cash = 93,000 + 25,000 = 118,000
- Profit = 23,000 - 5,000 = 18,000

Investments and Financial Statements

According to the AS-13, the financial statements of a company should disclose the following:

a. the accounting policies for the determination of carrying amount of investments;

b. the amounts included in profit and loss statement for:

   i. interest, dividends (showing separately dividends from subsidiary companies), and rentals on investments showing separately such income from long term and current investments. Gross income should be stated, the amount of income tax deducted at source being included under Advance Taxes Paid;

   ii. profits and losses on disposal of current investments and changes in carrying amount of such investments;

   iii. profits and losses on disposal of long term investments and changes in the carrying amount of such investments;

   iv. the aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments.

Let us take an example to understand the impact of investments on the financial statements.

Example: 13.2

On 1st April 2005, Altd started business with a capital of Rs.100,000 Immediately used the money to purchase the following:

- 2000 10% Bonds of Rs. 10 at a premium of 50%. Interest is received annually 31st March.

Table 13.8 shows the impact of above transactions relating to investments on the financial statements for the year ending on 31st March 2006

Table 13.8

Cash Flow Statement		**Income Statement**		**Balance Sheet as on 31st March 2006**	
Receipts		Incomes		Source	
Capital	100,000	interest	2,000	Capital	100,000
Interest	2,000			Profit	2,000
Total Receipts	102,000				**102,000**
Payments		Expenses	0	Assets	
Purchase of Bonds	30,000			Bonds	30,000
Total Payments	30,000			Cash	72,000
CIH	**72,000**	Profit	**2,000**		**102,000**

Example: 13.3

On 1st April 2005, Altd started business with a capital of Rs.100,000. Used the money to purchase the following:

- On 1st January 2006, purchased 2000 10% Bonds of Rs. 10 at a premium of 50%. Interest is received annually on 31st December.

Table 13.9

Cash Flow Statement			Income Statement			Balance Sheet as on 31st March 2006	
Receipts			Incomes			Source	
Capital	100,000		interest	600		Capital	100,000
Interest	0					Profit	600
Total Receipts	100,000						**100,600**
Payments			Expenses	0		Assets	
Purchase of Bonds	30,000					Bonds	30,000
						Accrued Interest	600
Total Payments	30,000					Cash	70,000
CIH	**70,000**		Profit	**600**			**100,600**

Classification of Investments

Investments are classified as long term investments and current investments. Current investments are in the nature of current assets, although the common practice may be to include them in investments.

Further classification of current and long-term investments should be as specified in the statute governing the enterprise. In the absence of a statutory requirement, such further classification should disclose, where applicable, investments in:

- Government or Trust securities
- Shares, debentures or bonds
- Investment properties
- Others—specifying nature.

Cost of Investments

As per the AS-13, the cost of an investment includes acquisition charges such as brokerage, fees and duties.

Example: 13.4

ABC ltd. acquires 50 shares of MindTree Consulting through ICICI Direct.com. Cost information were as follows:

- Price of share: Rs. 784
- Brokerage: 75p for every Rs .100
- Service tax; 12.5%

Table 13.10 shows the cost of these investments as per AS-13.

Table 13.10	
Cost of Investment	
No of shares	50
Price	784
	39,200
Brokerage	294
Service Tax	36.75
Total Cost	39530.75

Acquisition of Investments in exchange of shares

According to AS-13, if an investment is acquired, or partly acquired, by the issue of shares or other securities, the acquisition cost is the fair value of the securities issued (which, in appropriate cases, may be indicated by the issue price as determined by statutory authorities). The fair value may not necessarily be equal to the nominal or par value of the securities issued.

Example: 13.5

Table 13.11 shows the assets and sources of ABC ltd as on 31st March 2006

Table 13.11			
Balance Sheet of ABC ltd			
Capital	50,000	Cash	20,000
Reserves	20,000	Stock	100,000
Loans	50,000		
	120,000		120,000

ABC ltd acquires 1000 shares (of Rs. 10) of XYZ ltd by issuing 100 shares (of Rs. 10) at a market price of 150. The investment should be valued at Rs. 15,000 and the balance sheet after the acquisition of the investment will be as follows (Table 13.12) :

Table 13.12			
Balance Sheet of ABC ltd after acquiring the shares			
Capital	51,000	Cash	20,000
Share Premium	14,000	Stock	100,000
Reserves	20,000	Shares of XYZ	15,000
Loans	50,000		
	135,000		135,000

- Cash Flow Statement: no effect
- Income Statement: no effect

Workings

- *Cost of the investment = 100 * 150 = 15,000*
- *Nominal value of shares issued = 100 * 10 = 100*
- *Share premium = 100 * 140 = 14,000*

In exchange of other assets

Similarly, if an investment is acquired in exchange, or part exchange, for another asset, the acquisition cost of the investment is determined by reference to the fair value of the asset given up. It may be appropriate to consider the fair value of the investment acquired if it is more clearly evident.

Income from investments

Interest, dividends and rentals receivables in connection with an investment are generally regarded as income, being the return on the investment.

Example: 13.5

Table 13.13			
Balance Sheet of ABC ltd after acquiring the shares			
Capital	101,000	Cash	20,000
Share Premium	14,000	Stock	100,000
Reserves	70,000	Shares of XYZ (10)	35,000
9% Loans	70,000	12% Bonds	100,000
	255,000		255,000

Transactions during the year:

- Dividend received = 25% on the face value. Market price of the shares at the time of the purchase = 35.
- Received interest on 12% bonds
- Purchased shares of MP ltd. = 1000 shares of Rs. 5 at Rs. 20
- Interest on loan due but not paid.

Table 13.14					
Cash Flow Statement		**Income Statement**		**Balance Sheet as on 31st March 2006**	
Opening Cash	20,000	Incomes		Capital	101,000
Dividend	2,500	interest	12,000	Share Premium	14,000
Interest	12,000	Dividend	2,500	Reserves	78,200
Total Receipts	34,500	Less		Loans	70,000
				Interest due	6,300
Payments		Expenses	6300		269,500
				Cash	14,500
				Stock	100,000
Shares	20,000			Shares of XYZ	35,000
				12% Bonds	100,000
Total Payments	20,000			Shares	20,000
CIH	**14,500**	Profit	**8,200**		**269,500**

Carrying Amount of Investments

AS-13 also provides guidelines for valuing investments, both short and long term investments.

Current Investments

According to the AS-13, current investments should be shown in the balance sheet at

- Cost, or
- Fair value
  Which ever is less

According to AS-13, in respect of investments for which an active market exists, market value generally provides the best evidence of fair value. The valuation of current investments at lower of cost and fair value provides a prudent method of determining the carrying amount to be stated in the balance sheet.

For current investments, any reduction to fair value and any reversals of such reductions are included in the profit and loss statement.

Example: 13.6

Following balance sheet shows the assets and sources of ABC ltd. as on 1st January 2007

Table 13.15

Balance Sheet of ABC ltd. As on 1st January 2007			
Capital	51,000	Cash	20,000
Reserves	34,000	Stock	100,000
12% Loans	100,000	Shares of Reliance Petroleum	65,000
	185,000		185,000

- Reliance Petroleum shares were bought at Rs. 65.

During the last quarter of 2006-07, the company sold 50% of the stock for 80,000. No other expenses. Price of Reliance Petroleum touched Rs. 110 as on 31st March 2007. financial statements as at the end of the last quarter.

Table 13.16

Income Statement		Cash Flow Statement		Balance Sheet of ABC ltd. As on 31st March 2007	
Sales	80,000	Opening Cash	20,000	Capital	51,000
less		Receipts		Reserves (37,000+27000)	61,000
COGS	50,000	Sales	80,000	Loans	100,000
Interest	3,000		100,000		**212,000**
Total Expenses	53,000	Payments		Cash	97,000
		Interest	3,000	Stock	50,000
				Shares of Reliance Petroleum	65,000
Profit	**27,000**	Closing CIH	**97,000**		**212,000**

Note: Observe that though the shares of Reliance Petroleum are now Rs .110, still the balance sheet shows the shares at the cost price i.e. 65.

Long-term Investments

According to the AS-13, long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long term investment, the carrying amount is reduced to recognise the decline. Indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. The type and extent of the investor's stake in the investee are also taken into account. Restrictions on distributions by the investee or on disposal by the investor may affect the value attributed to the investment.

Where there is a decline, other than temporary, in the carrying amounts of long term investments, the resultant reduction in the carrying amount is charged to the profit and loss statement. The reduction in carrying amount is reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exist.

Example: 13.7

Table 13.17 shows the assets and sources of ABC ltd. as on 1st April 2006

Table 13.17			
Balance Sheet of ABC ltd as on 1st April 2006			
Capital	51,000	Cash	20,000
Reserves	34,000	Stock	100,000
Loans	50,000	Shares of XYZ	15,000
	135,000		135,000

ABC acquired the shares for Rs. 15,000, however on 31st March 2007, the market value of the shares reduced to Rs. 13,500.

- If the investment in XYZ is treated as a short-term investment, the investment will continue to appear at the cost i.e. Rs 15,000
- If the investment in XYZ is treated as a long-term investment and the change in price is
- If the investment is XYZ is treated as a long-term investment and the change in the price is permanent in nature, then balance sheet should show the investment at 13,500 and the loss of Rs.1500 is transferred to the income statement. Table 13.18 shows the balance sheet and income statement, ignoring other incomes and expenses (including interest)

Table 13.18

Balance Sheet of ABC ltd as on 31st March 2006			
Capital	51,000	Cash	20,000
Reserves	32,500	Stock	100,000
Loans	50,000	Shares of XYZ	13,500
	133,500		133,500

Income Statement	
Income	0
Less	
Expenses	0
Decrease in the value of investment	1,500
Loss	1,500

Disposal of Investments

On disposal of an investment, the difference between the carrying amount and the disposal proceeds, net of expenses, is recognized in the profit and loss statement.

Example: 13.8

Table 13.19 shows the assets and the sources of ABC ltd. as on 1st April 2006

Table 13.19			
Balance Sheet of ABC ltd as on 1st April 2006			
Capital	51,000	Cash	20,000
Reserves	34,000	Stock	100,000
12% Loans	50,000	Shares of XYZ	15,000
	135,000		135,000

Transactions during the year

- Sold 50% of the stock at 80,000 for cash
- Interest paid
- Sold shares of XYZ for 28,000

Table 13.20					
Income Statement		Cash Flow Statement		Balance Sheet	
Sales	80,000	Receipts		Capital	51,000
COGS	50,000	Opening Cash	20,000	Reserves	71,000
Gross Profit	30,000	Sales	80,000	Loans	50,000
Profit on Shares	13,000	Sale of Shares	28,000		**135,000**
PBIT	43,000		128,000	Cash	122,000
Interest	6,000	Payments		Stock	100,000
		Interest	6,000	Shares of XYZ	15,000
Profit	**37,000**	Closing CIH	**122,000**		**135,000**

Workings:

- Profit on sale of shares = 28,000 – 15,000 =13,000
- Profit on sale of shares has been calculated by deducting the cost of purchase from the sale proceeds of the shares..

Impact on Bonus on the Cost of Investment

When a company receives bonus shares on its investment, the number of shares increase and there will be a corresponding decrease in cost per share.

Example: 13.9

Altd acquired 500 shares of XYZ for Rs. 50000 on 1st April 2005. On 1st January 2006, XYZ issues bonus shares in the ratio 2:1 So A ltd will received 1000 shares.

Cost per share for ALtd. after the bonus issue will be Rs. 50,000 divided by1500 shares. Cost per share, therefore, reduces from Rs.100 to Rs. 33.33

Following table shows bonus issue by some of the well known companies of India

Table 13.21		
Bonus Issue		
Name of company	Ratio	Announcement Date
Tata Steel	1 to 2	6/7/2004
HLL	1 to 1	2/22/1998
Hindalco	1 to 1	5/28/2005
Greaves Cotton	1 to 2	4/30/1995

1 to 2: Tata Steel issued one share for every two shares held by the shareholders

Investment in Fixed Income Bearing Investments

Fixed income bearing securities are those which commit a fixed percentage of return to the investor. Such investments include; government bonds, bonds or debentures issued by different corporate entities. Some of the popular features of such investments are as follow:

- Interest rate of fixed
- Interest is paid on the due dates (normally half-yearly or annual)
- Redeemable after a specific period
- Interest for the period is payable, to the person whose name appears on the Register, irrespective of the period of actual holding.

Such investments can be bought at *ex-interest* or *cum-interest* price.

- Cum-interest price includes interest for the period. The total money payable will be equal to the price multiplied by the number of share. Therefore to determine the cost of the scrip one has to deduct the interest from the price
- Ex-interest price excludes interest for the period

Some of the important items required for maintaining the investment accounts by a company;

- Price: At which the securities are bought and sold.
- Money payable: Money payable is the quantity purchased or sold multiplied by the price.
- Cost value
- Nominal value
- Interest

Example: 13.9

Following are the transactions of ABC ltd. during the year 2005-06

- Started business with cash 100,000.
- Purchased 1st June: 1000 12% Bonds of A ltd of Rs. 10 at 15 ex-interest. Interest payable annually on 31st December
- 1st October: 2000 12% Bonds of Rs. 10 at 20 cum-interests. Interest payable annually on 31st December

Table 13.22 shows the investment accounting of ABC ltd.

Table 13.22											
12% Bonds											
Date		No.	NV	CV	Interest	Date		No	NV	CV	Interest
1.06.05	Cash	1,000	10,000	15,000	500	31.12.05	interest received				3,600
1.10.05	Cash	2,000	20,000	38,200	1,800						
						31.03.06	Closing balance	3,000	30,000	53,200	900
31.03.06	To Income Statement				2,200						
		3,000	30,000	53,200	4,500			3,000	30,000	53,200	4,500

Working notes

a) 1st June: (Ex-interest transaction)
   - Nominal Value (NV) = 1000 *10 = 10,000
   - Price (ex interest) = 15
   - Cost Value (CV) = Price = 15*1000 = 15,000
   - Interest = for five months on the NV = 12% of 10,000 = 500
   - Money payable = Price + Interest = 15,000 + 500 = 15,500

b) 1st October (cum-interest transaction)
   - NV = 2000 *10 = 20,000
   - Price (ex interest) = 20 *2000 = 40,000
   - Interest = for nine months on the NV = 12% of 20,000 for nine months = 1800
   - CV = Price –Interest till date= 40,000 – 1800 = 38,200
   - Money payable = Price = 40,000

c) 31st December (date of interest)
   - Interest on 30,000 for 12 months
   - Interest = 12% of 30,000 = 3600

d) 31st March (date of closing the books)
   - NV = 3000 *10 = 30,000
   - Interest = for three months on the NV = 12% of 30,000 for three months = 900
   - CV = The balancing figure = 53,200

Table 13.23 shows the financial statements for the year ending March 2006

Table 13.23

Income Statement		Cash Flow Statement		Balance Sheet as on 31 March 06	
Incomes		Receipts		Capital	100,000
Interest	2,200	capital	100,000	Profit	2,200
		Interest	3,600		
Total	2,200	Payments			**102,200**
		Bonds	15,000	Cash	48,100
Expenses	0	Bonds	38,200	Bonds	53,200
		Interest	2,300	Accrued interest	900
Profit	**2,200**	CIH	**48,100**		**102,200**

Example: 13.10

Refer to example 13.9. Transactions During 2006-07

- On 1st July sold 500 bonds at 20 ex-interest.
- No other transactions during the year

Table 13.24

12% Bonds

Date		No.	NV	CV	Interest	Date		No	NV	CV	Interest
1st April	Balance	3,000	30,000	53,200	900	1st July	Sale	500	5000	10000	300
1st July	Profit of sale			2,500		31st Dec	Interest received				3,000
						31st Mar 06	Closing balance	2,500	25,000	45,700	750
31st Mar	To Income Statement				3,150						
		3,000	30,000	55,700	4,050			2,500	25,000	45,700	4,050

Working Note

1st July 2006: Sale of 500 bonds at 20 ex-interest

- NV = 500 *10 = 5,000
- Price (ex interest) = 20 *500 = 10,000
- Interest = for six months on the NV = 12% of 5,000 for six months = 300
- CV = Price =10,000
- Money payable = Price + Interest = 10,000 +300 = 10,300
- Profit on sale = CV at the time of sale – CV at the time of purchase
- CV at the time of purchase has been determined using FIFO assumption as follows:
- Profit = Rs. 10,000 – Rs. 7500 = 2,500

31st December (interest for 12 months on the unsold investments)

- NV = 2500 *10 = 25,000
- Interest = for 12 months on the NV = 12% of 25,000 = 3000

31st March (date of closing the books)

- NV = 2500 *10 = 25,000
- Interest = for three months on the NV = 12% of 25,000 for three months = 750
- CV = The balancing figure = 45,700

Table 13.25 shows the financial statements for the year ending March 2007

Table 13.25

Income Statement		Cash Flow Statement		Balance Sheet	
Incomes		Opening Balance	48,100	Capital	100,000
Interest	3,150	sale	10,300	Profit	7,850
Profit on Sale	2,500	Interest	3,000		
		Total	61,400		**107,850**
				Cash	61,400
		Payments	0	Bonds	45,700
				Accrued interest	750
Profit	**5,650**	CIH	**61,400**		**107,850**

Disclosure

The following disclosures in financial statements in relation to investments are appropriate:—

(a) the accounting policies for the determination of carrying amount of investments; the amounts included in profit and loss statement for:

(i) interest, dividends (showing separately dividends from subsidiary companies), and rentals on investments showing separately such income from long term and current investments. Gross income should be stated, the amount of income tax deducted at source being included under Advance Taxes Paid;

(ii) profits and losses on disposal of current investments and changes in carrying amount of such investments;

(iii) profits and losses on disposal of long term investments and changes in the carrying amount of such investments;

Accounting policies

Infosys

Trade investments are the investments made to enhance the Company's business interests. Investments are either classified as current or long-term based on the management's intention at the time of purchase. Current investments are carried at the lower of cost and fair value. Cost for overseas investments comprises the Indian Rupee value of the consideration paid for the investment. Long-term investments are carried at cost and provisions recorded to recognize any decline, other than temporary, in the carrying value of each investment.

Cipla

Investments

Long term investments are stated at cost, less any provision for permanent diminution in value. Current investments are stated at lower of cost and fair value.

Dr. Reddy'S Laboratories Ltd.

Long-term investments are carried at cost less any other-than-temporary diminution in value, determined separately for each individual investment.
Current investments are carried at the lower of cost and fair value. The comparison of cost and fair value is done separately in respect of each category of investment.

Bajaj Auto

a) Investments other than fixed income securities, are valued at cost of acquisition, less provision for diminution as necessary.

b) Fixed income securities are from this year, carried at cost, less amortisation and provision for diminution as considered necessary. See Note 9 (c).

c) Investments made by the Company are of a long-term nature. Hence diminutions in value of quoted Investments are generally not considered to be of a permanent nature, except current investments representing fixed income securities with a maturity less than 1 year are stated at cost adjusted for amortisation and diminution as considered necessary.

d) The management has laid out guidelines for the purpose of assessing likely impairments in investments and for making provisions based on given criteria. Appropriate provisions are accordingly made which in the opinion of the management are considered adequate.

Hero Honda

Current investments are stated at lower of cost and fair value. Long term investments are stated at cost less provision for permanent diminution, if any.