AS 13 Accounting for investments

Applicability

Mandatory in nature for all enterprises. Notified by Central Government w.e.f. accounting periods commencing on or after 7 December 2006

AS 13 establish accounting principles for investments in the financial statements and related disclosure requirements

This standard does not apply to:

- **Bases for recognition of interest, dividends and rentals earned on investments which are covered by AS 9**
- **Operating or finance leases**
- **Investments of retirement benefit plans and life insurance enterprises and**
- **Mutual funds, venture capital funds and/or the related asset management companies, banks and public financial institutions**

Important terms defined

- **Investments**

  Assets held for earning income by way of dividends, interest, and rentals, for capital appreciation, or for other benefits to investment enterprise. Assets held as stock-in-trade are not investments.

- **Current investment**

  Investment that is readily realisable and intended to be held for not more than one year from the date on which such investment is made

- **Long term investment**

  Investment other than a current investment

Important terms defined *(Continued)*

- **Investment property**

  Investment in land or buildings that are not intended to be occupied substantially for use by, or in the operations of, the investing enterprise

- **Fair value**

  Exchange value in an arm's length transaction between knowledgeable, willing buyer and seller often indicated by market value/net realisable value or in appropriate cases by the issue price determined by statutory authorities

Classification of investments

Current investments	**Nature is similar to that of current assets, common practice is to include them in investments**
Long-term investments	**Nature is similar to that of fixed assets.** ***(Such investments may be readily marketable)***

Investment properties

An enterprise holding investment properties should account for them as long-term investments

Cost of any shares in a co-operative society or a company, the holding of which is directly related to the right to hold the investment property, is added to the carrying amount of investment property.

Securities held as stock-in-trade

Assets held as stock-in-trade are not investments

Shares, debentures and other securities held for sale in the ordinary course of business are disclosed as 'stock-in-trade' under the head 'current assets'

- Cost of stock disposed of such securities should be determined by applying an appropriate cost formula as specified in AS 2, Valuation of Inventories

Cost of investments

Cost of investment includes acquisition charges such as brokerage, fees and duties.

- ***If investment purchased on cum-dividend or cum-interest basis, allocate dividend/interest received between pre-acquisition and post-acquisition periods. Interest/dividend relating to pre-acquisition period represents recovery of cost and should be deducted in arriving at cost.***
- ***If investment acquired by issue of shares/securities, acquisition cost should be fair value of securities issued (may be indicated by issue price as determined by statutory authorities)***

If investment acquired in exchange for another asset, acquisition cost should be determined by reference to fair value of asset given up. Alternatively, fair value of investment acquired may be used, if more clearly evident.

Example

X Ltd. sells a part of its land to Y Ltd., a newly-formed unlisted company, in exchange for 50,000 shares of Y Ltd (face value of Rs 10 each). There are frequent transactions of purchase and sale of land in the area in which the aforesaid piece of land is situated. The market value of land is estimated at Rs 1,00,000/- What would be the acquisition cost of shares?

The acquisition cost of 50,000 shares for X Ltd would be the market value of land given up, i.e. Rs 1,00,000

Cost of investments – Accounting for right shares

When rights shares offered are subscribed for, cost of right shares is added to the carrying amount of the original holding

If rights shares not subscribed for but sold in the market, sale proceeds are taken to the profit and loss account. However, if investments are acquired on cum-rights basis and their market value immediately after becoming ex-rights falls below the cost at which they were acquired, sale proceeds of rights may be applied to reduce the carrying amount of the original holding to market value

Example:

X acquires 100 shares on cum-rights basis for Rs 35,000. He sells rights for Rs 8,000. The ex-right market value of X's holding immediately after the shares becoming ex-right falls to Rs 30,000. In this case Rs 5,000 may be applied to reduce carrying amount of original holding. Rs 3,000 would then be recognised in the profit and loss account.

Carrying amount of investments

Current investments

Investments should be carried in the financial statements at the lower of cost and fair value determined either on an individual investment basis or by category of investment, but not on an overall/global basis

- Any reduction to fair value and any reversals of such reductions are included in the profit and loss statement

Long-term investments

Investments should be carried in the financial statements at cost; provision for diminution shall be made to recognise a decline, other than temporary, in the value of investments, such reduction being determined and made for each investment individually

- Reduction in carrying amount of investments is charged to profit and loss statement. Reduction is reversed only if there is a rise in value or reasons for reduction no longer exists.

Reclassification of investments

If long-term investments are reclassified as current investments, transfers are made <u>at the lower of cost and carrying amount</u> at the date of transfer

If investments are reclassified from current to long-term, transfers are made <u>at the lower of cost and fair value</u> at the date of transfer

Disposal of investments

On disposal of investments, the difference between the carrying amount and disposal proceeds, net of expenses, is recognised in the profit and loss statement

When disposing of a part of the holding of an individual investment, the carrying amount to be allocated to that part is to be determined on the basis of the average carrying amount of the total holding of the investment

Disclosure of investments – Revised Schedule VI

- **The Revised Schedule VI requires Investments to be classified as Current and Non-Current. *AS 13 'Accounting for Investments'* requires to classify Investments as Current and Long-Term.**
- **Accordingly, as per *AS-13*, the assessment of whether an Investment is "Long-term" has to be made with respect to the date of Investment whereas, as per the Revised Schedule VI, "Non-current" Investment has to be determined with respect to the Balance Sheet date.**

Disclosure of investments – Revised Schedule VI

- **Though the Revised Schedule VI clarifies that the Accounting Standards would prevail over itself in case of any inconsistency between the two, it is pertinent to note that AS-13 does not lay down presentation norms, though it requires disclosures to be made for Current and Long-term Investments.**
- **Presentation of all investments in the Balance Sheet should be made based on Current/Non-current classification as defined in the Revised Schedule VI. The portion of long-term investment as per *AS 13* which is expected to be realized within twelve months from the Balance Sheet date needs to be shown as Current investment under the Revised Schedule VI.**

Disclosure of investments – Revised Schedule VI

Revised Schedule VI requires disclosure of *nature of investments* and *mode of valuation, for* example, cost or market value and distinguishing between:

- ✓ **Investment property**
- ✓ **Investment in equity instruments**
- ✓ **Investments in preference shares;**
- ✓ **Investments in Government or trust securities;**
- ✓ **Investments in debentures or bonds;**
- ✓ **Investments in Mutual Funds;**
- ✓ **Investments in partnership firms;**
- ✓ **Other non-current investments (specify nature).**

Disclosure of investments – AS 13

AS 13 requires the following disclosures

accounting policies for determination of carrying amount of investments

classification of investments – current investments and long-term investments

amounts included in profit and loss statement for

- interest, dividends and rentals on investments showing separately such income from long term and current investments
- profit and losses on disposal of current and long-term investments and changes in carrying amount of such investments

significant restrictions on the right of ownership, realisability of investments or remittance of income and proceeds of disposal

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

other disclosures as specifically required by the relevant statute governing the enterprise

Q & A

A company has paid fees to SEBI and merchant bankers, and also incurred certain legal costs and advertisement costs in connection with the acquisition of the shares of another company. Whether such costs would form part of the cost of acquisition of the shares?

Solution

Yes, the fees paid to SEBI and merchant bankers, legal costs and advertisement costs should be treated as a part of cost of acquisition of the shares. AS 13 states "*the cost of an investment includes acquisition charges such as brokerage, fees and duties*". The expression '*such as*' implies that brokerage, fees and duties are merely examples of acquisition charges and that other acquisition charges are also a part of cost of investments.

A company has received incentive for purchase of an investment. Whether such incentive should be deducted from the cost of investments or should it be treated as an income?

Solution

Incentive received in respect of purchase of investments is attributable to their acquisition and is of the nature of a rebate for direct purchase. It should therefore be deducted in arriving at the cost of investment.

A company raised Rs 6 crore as equity capital from its three promoter companies and invested in term deposits. Whether the company is required to disclose in its annual accounts, the utilisation of the money raised by it through equity shares?

Solution

Yes, the company should disclose all unutilised monies out of equity issue to its promoter companies in its balance sheet under the head 'Investments' and/or 'Bank Balances'. Schedule VI to the Companies Act, 1956 requires disclosure of the 'Balance of unutilised monies raised by issue' and it makes no distinction between monies raised by issue of shares to public at large through public issue and monies raised by issue of shares, by way of allotment to promoters.

A company placed its surplus funds in fixed deposits with banks and/or subsidiary companies to earn interest thereon? Whether it would be qualified as an investment?

Solution

Investments are assets held for earning income by way of dividends, interest, and rentals, for capital appreciation, or for other benefits to the investing enterprise. Deposit of surplus funds with banks (other than with the authorised bankers of the company in the normal course of business of company) and or their subsidiaries is an 'investment' for the purposes of section 292(1)(d) of the Companies Act, 1956.

Major differences with the International Financial Reporting Standards

Differences

IFRS	Indian GAAP
Investments should be classified into one of three categories of financial assets: 'financial assets at fair value through profit or loss', 'held-to maturity investments', and 'available-for-sale financial assets' (IAS 39).	Investments should be classified on the long-term and short-term classification.
On initial recognition financial assets in the category at fair value through profit or loss are recognised at fair value. Other financial assets are recognised at fair value plus transaction costs. Subsequent measurement is as below: ▪ financial assets at fair value through profit or loss and available-for-sale financial assets – <u>at fair value</u> ▪ held-to- maturity investments and loans and receivables – <u>at amortised cost using effective interest method</u>	Long-term investments are valued at cost less diminution other then temporary, where as short-term investments would be valued at lower of cost or fair value.

Differences – Investment Property

IFRS	Indian GAAP
IFRS provides detailed guidance on the accounting of investment property. (IAS 40)	There is no detailed standard available under the Indian GAAP. However, limited guidance is available under AS 13.
Investment property is property held to earn rentals or for capital appreciation or both.	Investment property is an investment in land or buildings that are not intended to be occupied substantially for use by, or in the operations of, the investing enterprise.
Investment property is recognised initially at cost; subsequent recognition either by fair value model or by using cost model.	Investment properties are recognised at cost; subsequent recognition also at cost. However, provision for diminution is made to recognise a decline other than temporary.

AS 14 - Accounting for amalgamations

Applicability

Mandatory in nature for all enterprises. <u>Notified by Central Government w.e.f. accounting periods commencing on or after 7 December 2006</u>

AS 14 deals with accounting for <u>amalgamations</u> and the treatment of any resultant goodwill or reserves

Amalgamation is an arrangement whereby a company (transferor company) is amalgamated into another company (transferee company) and loses its existence. It is defined as "an amalgamation pursuant to the provisions of the Companies Act, 1956, or any other statute which may be applicable to companies.

This standard does not deal with cases of business acquisitions.

Important terms defined

- **Transferor company**

  A company which is amalgamated into another company

- **Transferee company**

  A company into which a transferor company is amalgamated

- **Reserve**

  Portion of earnings, receipts/surplus of an enterprise (whether capital or revenue) appropriated for a general/specific purpose other than a provision for depreciation or diminution in the value of assets or for a known liability

- **Consideration**

  Aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company

Important terms defined *(Continued)*

- **Fair value**

  Amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable willing seller in an arm's length transaction

- **Pooling of interests**

  Method of accounting the object of which is to account for the amalgamation as if the separate businesses of the amalgamating companies were intended to be continued by the transferee company. Only minimal changes are made in aggregating the individual financial statements of the amalgamating companies

- **Purchase Method**

  Method of accounting the object of which is to account for the amalgamation by applying the same principles as are applied in the normal purchase of assets

Types of amalgamations

Amalgamation in the nature of merger

Should satisfy all the following conditions:

- ✓ All assets and liabilities of transferor company becomes, after amalgamation, the assets and liabilities of the transferee company
- ✓ Shareholders holding not less than 90% of the face value of equity shares of transferor company become equity shareholders of transferee company
- ✓ Consideration for amalgamation for equity shareholders who agree to become equity shareholders of transferee company is discharged wholly by issue of equity shares, except cash may be paid in respect of fractional shares
- ✓ Business of transferor company is intended to be carried on by transferee company
- ✓ No adjustment is intended to be made to book values of assets and liabilities of transferor company except to ensure uniformity of accounting policies

Types of amalgamations *(Continued)*

Amalgamation in the nature of purchase

- An amalgamation <u>which does not satisfy any one or more of the conditions</u> specified for an amalgamation in the nature of merger
- It is a mode by which one company acquires another company and, as a consequence, the shareholders of the company which is acquired normally do not continue to have a proportionate share in the equity of the combined company, or the business of the company which is acquired is not intended to be continued

Methods of accounting for amalgamations

Amalgamation in the nature of merger	**Accounted for under the pooling of interests method**
Amalgamation in the nature of purchase	**Accounted for under the purchase method**

Pooling of interests method

- Record assets, liabilities and reserves (whether capital or revenue or arising on revaluation) of transferor company at their existing carrying amounts and in the same form as at the date of the amalgamation
- Aggregate the balance of the Profit and Loss Account of the transferor company with the corresponding balance of the transferee company or transfer it to the General Reserve, if any
- Adopt uniform accounting policies following amalgamation in case of conflicting accounting policies at the time of amalgamation. Effect on financial statements of any changes in accounting policies to be reported in accordance with AS 5
- Difference between amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and amount of share capital of transferor company should be adjusted in reserves

Purchase method

- In preparing transferee company’s financial statements, the assets and liabilities of transferor company should be incorporated either:
  - At their existing carrying amounts or
  - Consideration should be allocated to individual identifiable assets/liabilities on the basis of fair values at the date of amalgamation
- Reserves (whether capital or revenue or arising on revaluation) of the transferor company; other than statutory reserves, should not be included in the financial statements of the transferee company
- Where statutory reserves recorded in books of transferee company, corresponding debit should be given to a suitable account head (e.g., ‘Amalgamation adjustment account’. When identity of such reserves no longer required, entry should be reversed.

Purchase method *(Continued)*

- If consideration exceeds the value of net assets of the transferor company
  - recognise excess as ***goodwill arising on amalgamation***

Goodwill to be amortised to income on a systematic basis over its useful life. Amortisation period should not exceed ***five years*** unless a somewhat longer period can be justified

- If value of net assets of transferor company exceeds consideration
  - recognise excess as ***capital reserve arising on amalgamation***

Consideration

Consideration for amalgamation should include any non-cash element at <u>fair value</u>

In case of securities, value fixed by statutory authorities may be taken to be the fair value.

In case of other assets, determine fair value by reference to market value of assets given up (if can be reliably assessed) else value such assets at their respective net book values

If scheme of amalgamation provides for an adjustment to consideration contingent on one or more future events, amount of additional payment should be included only if:

- ✓ ***payment is probable and***
- ✓ ***a reasonable estimate of amount can be made***

In all other cases, adjustment should be recognised as soon as amount is determinable

Treatment of reserves specified in a scheme of amalgamation

Where scheme of amalgamation sanctioned under a statute prescribes the treatment to be given to the reserves of the transferor company after amalgamation, same should be followed.

Where different treatment is prescribed by statute as compared to requirements of AS 14, following disclosures should be made in the first financial statements following the amalgamation:

- **description of accounting treatment given to the reserves and reasons for following different treatment**
- **deviations in the accounting treatment given to reserves as prescribed by the scheme of amalgamation sanctioned under the statute as compared to requirements of AS 14 that would have been followed had no treatment been prescribed by the scheme**
- **the financial effect, if any, arising due to such deviation**

Disclosure for all amalgamations

AS 14 requires following disclosures in the first financial statements following the amalgamation

Names and general nature of business of the amalgamating companies

Effective date of amalgamation for accounting purposes

Method of accounting used to reflect the amalgamation and

Particulars of the scheme sanctioned under a statute

Additional disclosures

AS 14 requires following additional disclosures in the first financial statements following the amalgamation

Pooling of interests method	▪ Description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation ▪ Amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.
Purchase method	▪ Consideration for the amalgamation and a description of the consideration paid or contingently payable ▪ The amount of any difference between the consideration and the value of net identifiable assets acquired, and treatment thereof including the period of amortisation of any goodwill arising on amalgamation

Amalgamation after the Balance Sheet Date

If amalgamation effected after the balance sheet date but before issuance of the financial statements

- **make disclosures as per AS 4**

BUT

- **amalgamation should not be incorporated in the financial statements**

In certain cases, amalgamation may also provide additional information affecting financial statements, e.g., maintain going concern assumption

Q & A

Three companies A, B, C are being merged into another company ‘D’. The amalgamation is in the nature of merger. As per AS 14, difference between amount recorded as share capital issued and the amount of share capital of the transferor company should be adjusted in reserves? What is the nature of ‘reserves’ for purposes of AS 14?

Solution

In order to determine whether reserve should be reflected as capital or general reserve, nature of transaction needs to be examined. Difference in the share capital issued by transferee company on amalgamation and amount of share capital of transferor companies is of capital nature. Accordingly, the difference should be treated as capital reserve.

Company 'S' has estimated the useful life of goodwill arising on amalgamation as 10 years. Whether such goodwill can be amortised over a period of 10 years ?

Solution

AS 14 requires amortisation of goodwill arising on amalgamation over a period of 5 years unless a somewhat longer period can be justified. Useful life of goodwill is a matter of accounting estimate. S should assess whether the estimate of life of 10 years represents a concentrative estimate by taking into account all the relevant factors. Factors used in arriving at useful life of goodwill should be properly documented.

Major differences with the International Financial Reporting Standards

Differences

IFRS	Indian GAAP
Definition of business combination has a wider scope, it includes ▪ purchasing the net assets of another enterprise; or ▪ obtaining control over assets and operations by acquiring the majority of voting power – parent – subsidiary relationship	The standard deals only with amalgamations.
Under purchase method, the acquired identifiable assets, liabilities and contingent liabilities are recognised at fair value.	Under purchase method, the acquired assets and liabilities are recognised at their existing book values or at fair values.
Pooling of interests method not allowed	Liberal use of pooling of interests method

Differences *(Continued)*

IFRS	Indian GAAP
Date of acquisition is the date when acquirer obtains control over the acquired entity or business	Date of acquisition is the appointed date as per court approved scheme
The cost of acquisition is the amount of cash or cash equivalents paid, plus fair value of the other purchase consideration given, including equity instruments issued and the fair value of liabilities assumed plus any cost directly attributable to the acquisition	Consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company (acquirer) to the shareholders of the transferor company (acquiree). While it is required that non-cash elements of consideration should be included at fair value, it is also stated that the value of any securities (forming part of consideration) fixed by statutory authorities may be taken to be their fair value

IFRS	Indian GAAP
Contingent consideration is included in cost of combination at acquisition date if adjustment is probable and can be measured reliably	Same as IFRS
Provides guidance for dealing with situations where initial accounting for a business combination can be determined only provisionally	No guidance is available under the Indian GAAP
Goodwill is not amortised but is tested for impairment at least annually	Goodwill is amortised over a period not exceeding five years unless somewhat longer period can be justified

IFRS	Indian GAAP
Guidance is provided on accounting of reverse acquisition	No guidance is available under the Indian GAAP
When there is negative goodwill, acquirer reassesses the identification and measurement of acquiree's identifiable assets, liabilities and contingent liabilities. Any excess remaining is recognised in the income statement immediately	Reassessment is not required. Negative goodwill is treated as capital reserve
The cost of restructuring an acquired entity is a post-acquisition expense	No guidance is available under the Indian GAAP

Thank you