AS 13 – Accounting of Investments

Applicability

Accounting for Investments is issued in 1993 and is a mandatory accounting standard applicable to all level of enterprises as it is a measurement as well as a disclosure standard. Though, an old Accounting Standard, it is observed that the implications of this standard is high when it comes to recognition of profits / loss arising from sale of investments as well as when the carrying value of Investments are ascertained at year end.

Issue 1 :

Which Investments are covered under AS 13, Accounting for Investments?

☞ As per AS 13, Investments are assets held by an enterprise for earning income by way of dividends, interests and rentals, for Capital appreciation, or for other benefits to the investing enterprise. Assets held as stock-in-trade are not 'Investments'.

Investments in shares, debentures, bonds, etc held for the purpose as referred to in above are considered as Investments.

Similarly, investments in land or building that are not intended to be occupied substantially for use by, or in the operation of the investing enterprise is covered under AS 13 as Investment Property.

Issue 2 :

AS 13, Accounting for Investments does not deal with which situations?

☞ AS 13, does not deal with :

(a) The bases of recognition of interest, dividend and rentals earned on investments, which are covered by AS 9 on Revenue recognition.

(b) Operating or finance leases,

(c) Investments of retirement benefit plans and life insurance enterprises and

(d) Mutual funds and venture capital funds and /or the related asset management companies, banks and public financial institutions formed under a central or state government Act or so declared under the Companies Act, 1956.

Thus, disclosures and valuation of investments held by life insurance enterprises, Mutual Funds, banks, etc. will be made as per provisions of the respective act governing them and not as per AS 13.

Issue 3 :

What is difference between Current Investments and Stoke-in-Trade ? Should Stock-in-Trade also be disclosed under Investments ?

☞ Any asset held for earning income by way of dividends, interest and rentals for capital appreciation or for other benefits are considered as investments. Current Investment is an investment that is by its nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made.

Whereas for example shares, debentures and other securities held for sale in the ordinary course of business are not investments but 'stock-in-trade' and disclosed under the head 'Current assets'.

Issue 4 :

Premium Investments Ltd. is an investment company. On each buy and sell, along with purchase price of the equity share, it also pays brokerage, service tax and securities transaction tax. Premium Investments Ltd. at the time of purchase and sell considers only purchase price as Investments and debits profit and loss account for the brokerage, service-tax and securities transaction tax. Is the treatment given by Premium Investments Ltd. in accordance with AS 13 ?

☞ As per AS 13, the cost of an investment includes acquisition charges such as brokerage, fees and duties. Thus, transaction costs such as fees and commission paid to agents, advisers, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties that are directly attributable to the acquisition and disposal of an Investment should be included in the cost of investment.

Thus, accounting treatment followed by Premium Investments Ltd. is not in consonance with the requirements of AS 13. Premium Investments Ltd. should include such cost incurred as part of investment cost, irrespective of the tax implications.

Issue 5 :

High Returns Ltd., purchased 10,000 cum-dividend units of Fair Growth Mutual Fund at Rs.25 per unit. The units carry a dividend of Rs.8 per unit. High Returns Ltd. received Rs.80,000 as dividend which is credited to profit and loss account. Investments in balance sheet is shown at Rs.2,50,000. Is accounting treatment given by High Returns Ltd. correct?

☞ As per AS 13, when unpaid dividend has accrued before the acquisition of dividend bearing investment, the same is included as price paid for investment. The subsequent receipt of dividend is allocated between pre-acquisition and post-acquisition periods. The pre-acquisition portion is deducted from the cost.

Accordingly, High Returns Ltd., will be required to deduct Rs.80,000 (being dividend on equity declared from pre-acquisition profits) from cost of investments of Rs.2,50,000. Thus, investments will be shown at Rs.1,70,000 and not at Rs.2,50,000. Dividend received, will not be credited to profit and loss account, as the investments were purchased cum-dividend.

Issue 6 :

Miracle Investments Ltd. purchased cum-right 10,000 equity shares of A Ltd. at Rs.100 per share. A Ltd. has declared a rights issue of 1:1 at Rs.20 per share. Miracle Investments Ltd. instead of subscribing the rights, sells 10,000 rights shares in the market at Rs.50 per share and thus earns a profit of Rs.5,00,000. In its balance sheet, it accounted investments in A Ltd. at Rs.10,00,000 and showed profit on sale of investment of Rs.5,00,000 in its profit and loss account. Is accounting treatment adopted by Miracle Investments Ltd. appropriate?

☞ As per AS 13, where the investments are acquired on cum-right basis and the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, it may be appropriate to apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value.

Thus, Miracle Investments Ltd. should reduce the cost of investments by Rs.5,00,000 instead of showing profits of Rs.5,00,000.

Similarly, if Miracle Investments Ltd. preferred to subscribe 10,000 equity shares of A Ltd. at Rs.20 per share, then the cost of the right shares should be added to the carrying amount of the original holding. In this case, 20,000 equity shares of A Ltd. should be valued at Rs.12,00,000 showing an average purchase price of Rs.60 per share and not to be valued at Rs.100 and Rs.20 separately.

Issue 7 :

Unreliable Investments Ltd. is holding following securities as current investments at the balance sheet date.

Equity Shares	No. of Shares	Cost	Market Value
A Ltd.	5,000	2,50,000	3,00,000
X Ltd.	1,000	80,000	1,00,000
Z Ltd.	10,000	10,00,000	9,50,000
	(a)	**13,30,000**	**13,50,000**
Debentures			
M Ltd.	1,000	1,00,000	1,05,000
O Ltd.	5,000	5,50,000	4,50,000
	(b)	**6,50,000**	**5,55,000**
	(a) + (b)	**19,80,000**	**19,05,000**

Unreliable Investments Ltd., has made a provision for diminution in value of current investments of Rs.75,000 as at the balance sheet date, comparing total cost of Rs.19,80,000 as against market value of Rs.19,05,000. Is diminution in value of current investments of Rs.75,000 made by Unreliable Investments Ltd. in compliance of AS 13 ? What provision for diminution in value of investments be required if the investments were considered as long term investments ?

☞ The carrying amount for current investments is the lower of cost and fair value. As per AS 13, two options are available of comparing cost with fair value. The more prudent and appropriate method is to carry investments individually at the lower of cost and fair value. Alternatively, investments may be carried at the lower of cost and fair value computed category-wise i.e. equity shares, preference shares, convertible debentures, etc. AS 13, donot permit valuation of current investments on overall (or global) basis.

Unreliable Investments Ltd. has two options, either to value lower of cost and fair value individually or at the most category wise but not on global basis.

Thus, Unreliable Investments Ltd. can value current investments individually. In that case, diminution for equity will come to Rs.50,000 and for debentures to Rs.1,00,000. If it opts to value category wise, diminution for equity will be Rs.Nil, whereas for debentures a diminution of Rs.95,000 will have to be provided. Provision of Rs.75,000 made by Unreliable Investments Ltd. is not appropriate.

If the above investments were considered as long term investments, than carrying amount would differ. Long term investments are 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. The carrying amount of long-term investments is determined on an individual investment basis. Value of investment are obtained by reference to market value, the investee's assets and results, the expected cash flows, type and extent of the investor's, stake, etc.

Thus, Unreliable Investments Ltd. will value its long term investments at cost unless the decline in value is other than temporary. If O Ltd. is not a healthy company and that the chances of full redemption are weak, than provision of Rs.1,00,000 may be called for as a diminution in value of long term investment.

Issue 8 :

Quick gains Ltd., is an investment company. It holds following shares of R Ltd as long term investments.

No. of Shares	Cost
1,000	5,00,000
800	4,80,000
1,200	8,40,000
1,500	11,50,000
4,500	**29,70,000**

The above shares were purchased on different dates over the past two years. Quick gains Ltd. has sold 2,000 equity shares of R Ltd. for total value of Rs. 17,00,000. Quick gains Ltd. reported a profit of Rs.5,80,000 on sale of long term investments. Is the Profit computed by Quick gains Ltd. in consonance with the requirements of AS 13 ?

☞ As per AS 13, when disposing of a part of 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.

Thus, Quick gains Ltd., need to work out the average carrying amount of investments at the time of sale. The average carrying amount for 4,500 equity shares in R Ltd. comes to Rs.660. As against this average cost, the sale proceeds is Rs.850 per equity share giving a net profit of Rs.190 per share. Total profit on sale of 2,000 equity shares at the rate of Rs.190 per share will come to Rs.3,80,000 and not Rs.5,80,000 as accounted by Quick gains Ltd.

However, the situation would be different, if the shares in R Ltd. were treated as stock-in-trade. In that case as per AS 2, the cost of stocks disposed of is determined by applying an appropriate cost formula e.g. first-in-first out or average cost. The profit computed by Quick gains Ltd. would be correct, if the company had treated R Ltd. shares as stock-in-trade and had followed FIFO method for its valuation.

Issue 9 :

Prima Products Ltd. has its registered office in a building, which is a co-operative society. As per the bye-laws, Prime Products Ltd. is allotted certain shares in the co-operative society towards the property. Prime Products Ltd. has shown, the property under fixed assets whereas shares in co-operative society are shown under Investments. Is the accounting treatment given by Prime Products Ltd. proper ?

☞ As per AS 13, the 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 the investment property.

Conversly, if any property is held as fixed asset, than the cost of any shares in a co-operative society or a company, the holding of which is directly related with the fixed asset, is added to the value of the fixed asset and not shown separately as Investment.

Prime Products Ltd. would be advised to club the value of shares in co-operative society with the value of property under the head fixed assets. The particulars of investments in co-operative society be disclosed by way of foot-note to the schedule of fixed assets.

Issue 10 :

Fair Investments Ltd., a listed company, is in investments of infrastructure projects. The company initially gives infrastructure Companies, advance money to be converted into equity later on. Fair Investments has borrowing and utilizes such borrowings also for advancing. In its financial statements, Fair Investments Ltd., adds interest paid on such borrowings to advances and when shares are allotted (at par) by the infrastructure companies, capitalises the entire advance towards equity along with interest. So what actually happens, that though equity are issued at PAR, the shares are capitalsed as if Premium is paid on those shares as it includes interest element. Is the treatment given by Fair Investments Ltd. correct ?

☞ As per AS 13, cost of investment includes acquisition charges such as brokerage, fees and duties. Meaning thereby AS 13 is silent as to whether interest on such advances, which are towards equity, can be included. Hence, AS 16, dealing with borrowing cost will have to be referred to. As per AS 16, a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

In this case, what Fair Investments Ltd. acquires is equity in infrastructure companies. The nature remains the same but the entities are different i.e. Investment in equity by Fair Investments and creation of asset by infrastructure companies. The borrowings are made by Fair Investments Ltd. and not by infrastructure companies. Further, Infrastructure companies will not be capitalising any interest on borrowings made by Fair Investments Ltd. They will show and issue equity capital of only that amount received by them from Fair Investments Ltd. Thus, Fair Investments Ltd., cannot be said to have created asset taking substantial period of time. In short, advance for equity cannot be said to have given rise to a qualifying asset. Accordingly, Fair Investments Ltd. will have to write off the interest in its profit and loss account in the year of payment, irrespective of the fact that advances for equity shares still remains in its financial statements at the year end.

Issue 11 :

Toyhonda Ltd. is in manufacture of Automobiles. It has equity investments in various auto ancillary units. In its balance sheet it has shown these as investments, whereas dividend received from them is shown as dividend and whenever sales are made, profit or loss is shown as profit or loss on sale of investments. Is Toyhonda Ltd., following the disclosure requirements of AS 13 ?

☞ As per AS 13, Investments have to be classified as long term and Current Investments. Toyhonda Ltd. will have to segregate Investments into long term and current investments for the purpose of disclosure under " Investments ". Further AS 13, also requires dividends, interest and rentals on investments to be separately shown as income from long term and current investment. Thus, Toyhonda Ltd. will have to show dividend income received from investments either as long term or short term depending upon the classification of investments made in balance sheet. Further, profits and losses on disposal of long term and current investments have also to be shown separately. Thus, on disposal of investments, profits / losses from long term investments will have to be shown separately and profits / losses from short term investments also will have to be shown separately.

Issue 12 :

Prime Investments Ltd. has equity investments in A Ltd. as follows :

Date	Qty.	Amount
05-10-99	5,000	5,00,000
10-12-02	5,000	Bonus
10-01-04	3,000	5,40,000
	(a)	**10,40,000**

Prime Investments Ltd. sold 8,000 equity shares of A Ltd. on 10/01/2005 at Rs.250 per equity share aggregating to Rs.20,00,000. Prime Investments Ltd. showed a profit of Rs.15,00,000 in its profit and loss account as Profit on sale of long term Investments. Is profit computed by Prime Investments correct ?

☞ As per para 22 of AS 13, 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.

Hence, when shares are sold subsequently, the average price should be considered and not on specific identification method. The actual profits would come to Rs.13,60,000 considering average purchase price of Rs.80 per share.

It is very important to note that the accounting treatment in case of accounting of investments is completly different from the Indian Income Tax Act and one should not be guided by the taxation laws as to its accounting.

Accounting Policies relating to Investments of selected Companies are as under:

1. Reliance Industries Limited (2004-05)

Current investments are carried at the lower of cost and quoted / fair value, computed category wise. Long term Investments are stated at cost. Provision for diminution in the value of long-term investments is made only if such a decline is other than temporary in the opinion of the management.

2. Larsen & Toubro Limited (2004-05)

Current investments are carried at lower of cost or market value. The determination of the carrying costs of such investments is done on the basis of specific identification. Long-term investments (including interests in Joint Ventures which are in the nature of Jointly Controlled Entities) are carried at cost, after providing for any diminution in value, if such diminution is of a permanent nature.

3. Tata Steel Limited (2004-05)

Long term investments are carried at cost less provision for permanent diminution in value of such investments. Current investments are carried at lower of cost and fair value. When investments is made in partly convertible debentures with a view to retain only the convertible portion of the debentures, the excess of the face value of the non-convertible portion over the realisation on sale of such portion is treated as a part of the cost of acquisition of the convertible portion of the debenture.