Accounting for Investments

in Equity Instruments

Worked Example

Ind AS 109 – Accounting for Investments in Equity Instruments

Scenario

The reporting period of HEG Ltd ends on 31 March each year. HEG Ltd makes investment in equity instruments with an intention to keep the shares for their growth potential rather than treat them as part of a trading portfolio. These investments are designed by HEG Ltd at *fair value through other comprehensive income*. On 1 April 20x4, HEG Ltd had the following investment in equity instruments.

Name	Original cost (CU)	Fair value at 1 April 20x4 (CU)
A	240	300
B	220	280
Total	**460**	**580**

On 1 January 20x5, HEG Ltd made another investment in equity instruments (C) for CU 400 and incurred transaction costs of CU 20.

On 1 February 20x5, HEG Ltd sold the investment in A for CU 360. On 31 March 20x5, the fair value of investments in B and C were CU 330 and CU 480 respectively.

During the reporting period ended on 31 March 20x5, HEG Ltd received total dividends of CU 80 from the investments. The rate of tax is 40%. Unrealised gains/(losses) arising on the revaluation of investment of this nature are not taxable/(deductible) *unless* the investment is sold.

What the Standard says

As per **paragraph 5.7.5 of Ind AS 109**, "*At initial recognition, an entity may make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument within the scope of this Standard that is neither* ***held for trading**** *nor* ***contingent consideration***** *recognised by an acquirer in a business combination*…."

* For example, a financial asset is acquired or incurred principally for the purpose of selling it in the near future.

** Usually, it is an obligation of the acquirer to transfer additional equity interests to the former owners of an acquiree as part of the exchange for control of the acquiree if specific future events/conditions are met.

According to **paragraph 4.1.4 of Ind AS 109**, "*At initial recognition, an entity may make an irrevocable election for particular investments in equity instruments (that would otherwise be measured at fair value through profit or loss) to present subsequent changes in fair value in other comprehensive income.*"

Paragraph B5.7.1 of Ind AS 109 states, "….*Amounts presented in other comprehensive income shall not be subsequently transferred to profit or loss. However, the entity may transfer the cumulative gain/(loss) within equity.*"

Paragraph 35 of Ind AS 32 states, "…. *Transaction costs of an equity transaction shall be accounted for as a deduction from equity.*"

If an entity makes an election, as above, it shall recognise in profit and loss dividends from that investment when –

- the entity's right to receive payment of the dividend is established;
- it is probable that the economic benefits associated with the dividend will flow to the entity; and
- the amount of the dividend can be measured reliably.

[Refer paragraph 5.7.6 and 5.7.1A of Ind AS 109]

Investment in Equity Instruments (CU)

Date	Heads of Account	Dr	Cr	Balance
20x4				
Apr 1				580
20x5				
Jan 1	Cash	400		980
Feb 1	Fair value gain [(360 – 300) x 60%]	36		1,016
	Deferred tax liability [(360 – 300) x 40%]	24		1,040
	Cash		360	680
Mar 31	Fair value gain [{(330 – 280) + (480 – 400)} x 60%]	78		758
	Deferred tax liability [{(330 – 280) + (480 – 400)} x 40%]	52		810

For sale of investment in A, the carrying amount of deferred tax liability (in respect of investment in A) is to be transferred from other comprehensive income to profit and loss, ie, CU (360 – 240) x 40% = CU 48. Concurrently, the fair value gain appearing in the Statement of Changes in Equity (in respect of investment in A) is to be transferred to retained earnings, ie, CU (360 – 240) x 60% = CU 72.

Journal

	Account	Dr	Cr
1.	Transaction cost	CU 20	
	Cash		CU 20
2.	Retained earnings	CU 20	
	Transaction cost		CU 20
3.	Deferred tax liability	CU 48	[CU 24 (existing) + CU 24]
	Tax expense		CU 48
4.	Fair value gain	CU 72	
	Retained earnings		CU 72
5.	Cash	CU 80	
	Dividend income		CU 80
6.	Dividend income	CU 80	
	Profit and loss		CU 80

Disclosures

As per **paragraph 8(h)(ii) of Ind AS 107**, the carrying amount of investments in equity instruments designated as such upon initial recognition in accordance with paragraph 5.7.5 of Ind AS 109 shall be disclosed either in the Balance Sheet or in the notes.

As per **paragraph 11A of Ind AS 107**, an entity shall disclose –

- which investments in equity instruments have been designated to be measured at *fair value through other comprehensive income*.
- the reasons for using this presentation alternative.
- the fair value of each such investment at the end of the reporting period.
- dividends recognised during the period, showing separately those related to investments derecognised during the reporting period and those related to investments held at the end of the reporting period.
- any transfers of the cumulative gain or loss within equity during the period including the reason for such transfers.

As per **paragraph 11B of Ind AS 107**, if an entity derecognised above investments, it shall disclose –

- the reasons for disposing of the investments.
- the fair value of the investments at the date of derecognition.
- the cumulative gain or loss on disposal.

As per **paragraph 20 of Ind AS 107**, an entity should also disclose net gains or net losses on investments in equity instruments designated at fair value through other comprehensive income in accordance with paragraph 5.7.5 of Ind AS 109 either in the Statement of Profit and Loss or in the notes.

Fair value measurement in relation to investment in equity instruments

Fair value is a market-based measurement for a particular asset (in this case, investment in equity instruments) – whether it is a single investment or a portfolio of investments.

For some investments, observable market transactions or market information might be available. When a price for an identical investment is not observable, an entity measures fair value using another *valuation technique* [1] that maximises the use of relevant *observable inputs* [2] and minimises the use of *unobservale inputs* [3].

[1] The objective of using a valuation technique is to estimate the price at which an orderly transaction to sell an investment would take place between market participants at the measurement date under current market conditions.

[2] Inputs that are developed using market data, such as publicly available information about actual events or transactions, and that reflect the assumptions that market participants would use when pricing the investment. For example, a qouted price in an active market provides the most reliable evidence of fair value and shall be used without adjustment to measure fair value whenever available.

[3] Inputs for which data are not available and that are developed using the best information available about the assumptions that market participants would use when pricing the investment. Therefore, unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available.

At initial recognition, the transaction price is the price paid to acquire the investment. In contrast, the fair value of the investment is the price that would be received to sell the investment. After initial recognition, when measuring fair value, a valuation technique(s) that uses unobservable inputs, an entity shall ensure that those valuation technqiues reflect observable market data (eg, the price for a similar investment) at the measurement date.

For more such examples, please visit

www.indasedu.com