TOPIC - 8

(CHAPTER 9 OF ICAI)

INVESTMENT ACCOUNTS

INTRODUCTION

Investments are assets held by an enterprise for earning income by way of-

- dividends,
- interest,
- rentals, and
- for capital appreciation.

Investment Accounting is done as per AS 13, *Accounting for Investments* which deals with accounting for investments in the financial statements and related disclosure requirements except:

(i) Bases for recognition of interest, dividends and rentals earned on investments

(ii) operating or financial leases

(iii) investment of retirement benefit plans and life insurance enterprises

(iv) mutual funds, etc.

Note: Assets held as Stock-in-trade are not 'Investments'.

CLASSIFICATION OF INVESTMENTS

The investments are classified into two categories as per AS 13, *viz.*, Current Investments and Long-term Investments.

Current Investments

- A 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.

  Example: A Ltd. acquired 1,000 shares of B Ltd. on 1st April, 20X2 with an intention to hold them for a period of 15 months. Suggest the classification of such investment (in accordance with AS 13) as on 31st March, 20X3.

Investment in 1,000 shares is not a current investment because it is intended to be held for more than one year from the investment date even though the remaining period as on the reporting date may be less than one year.

- **The carrying amount** for current investments is the lower of cost and fair value.
- **Fair Value** is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction. Under appropriate circumstances, market value or net realisable value provides an evidence of fair value.
- **Market Value** is the amount obtainable from the sale of an investment in an open market, net of expenses necessarily to be incurred on or before disposal.
- Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss.

Long-term Investments

- A long-term investment is an investment other than a current investment.
- Long term investments are usually carried at cost.
- If 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 reduction in carrying amount is charged to the statement of profit and loss.
- 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.

COST OF INVESTMENTS

1. The cost of an investment includes acquisition charges such as brokerage, fees and duties.
2. 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.

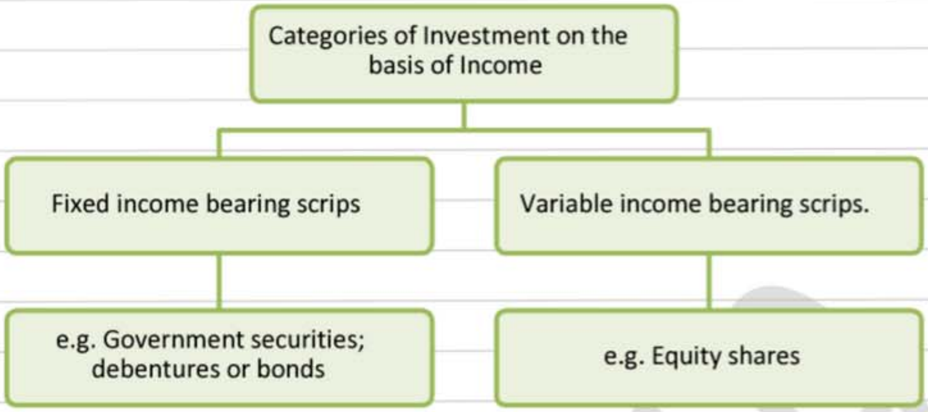
   The fair value may not necessarily be equal to the nominal or par value of the securities issued.

   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 or the fair value of the investment acquired, whichever is more clearly evident.

Type of acquisition	Cost of investments
Cash/ bank	Cash price including charges such as brokerages, fees and duties
Issue of shares/ other securities	Fair value of securities issued
In exchange for another asset	Fair value of asset given up or fair value of investment acquired, whichever is more clearly evident

3. A separate Investment Account should be made for each scrip purchased.

The scrips purchased may be broadly divided into two categories, viz



The entries in Investment Account for these two broad categories of scrips will be made as under:

(i) **Fixed income Bearing Securities:** These refer to securities having fixed return of income. Investment in Government securities or debentures comes under this category.

Transaction for fixed income bearing securities may occur on following basis:

(a) Ex-interest basis

(b) Cum- interest basis

In case the transaction is on 'Ex-interest' basis, the amount of interest accrued to the date of transaction has to be paid in addition to the price of security.

The following entries are made in the books of Purchaser:

Investment Account	Dr.	(With the price settled on ex-interest basis)*
Interest accrued Account To Bank A/c	Dr.	(Accrued interest till the date of transaction)**
		(With total amount paid)

* This amount will appear in Capital Column of 'Investment A/c'.

**This amount will appear in Income Column of 'Investment A/c'.

In case the transaction is on cum-interest basis, a part of purchase price is related to the interest accrued from the date of the last interest paid to the date of transaction Hence, in this case, the cost of investment has to be calculated by subtracting the amount of accrued interest from the Purchase Price.

The following entries are made in the books of Purchaser

Investment Account	Dr.	(With the price settled on cum-interest *less* Interest Accrued)*

Interest accrued Account To Bank A/c	Dr.	(Accrued interest till the date of transaction)** (With total amount paid)

* This amount will appear in Capital Column of 'Investment A/c'.

**This amount will appear in Income Column of 'Investment A/c'.

When the interest amount is actually received, it is entered in the Income Column credit side. The net effect of these entries will be that the amount credited to the income will be only the interest arising between the date of purchase and the one on which it next falls due.

Note:

(a) Interest amount is always calculated with respect to nominal value (par value/ nominal value).

(b) In case the quotation does not specify whether it is ex-interest or cum-interest, the same will be treated as ex-interest quotation as per the general practice

(ii) Variable Income Bearing Securities: These refer to securities having variable return of income. Investment in equity shares comes under this category. The following points should be noted with respect to investment in equity shares:

(a) dividends from investments in shares are not recognised in the statement of profit and loss until a right to receive payment is established;

(b) the amount of dividend accruing between the date of last dividend payment and the date of purchase cannot be immediately ascertained.

In the following way the information is incorporated in the books of investor at the time of purchase:

Investment Account To Bank A/c	Dr.	(With the entire purchase price)* (With total amount paid)

* This amount will appear in Capital Column of 'Investment A/c'.

The adjustment with respect to dividend is made when the dividend is actually received as under:

Bank A/c To Investment A/c To Investment A/c	Dr.	(with total dividend received) (with the amount of dividend for the period for which the investor did not hold the share)* (with the amount of dividend for the post – acquisition period)**

*This amount will appear in Capital Column of 'Investment A/c'.

**This amount will appear in Income Column of 'Investment A/c'.

- The important point with respect to investment in equity shares is that the amount of dividends for the period, for which the shares were not held by the investor, should not be treated as revenue receipt but they should be treated as capital receipt, i.e., when dividends on equity shares are declared from pre-acquisition profits, the amount of such dividend received by the investor is entered on the credit side in the capital column, so as to reduce the acquisition cost.
- If it is difficult to make an allocation between pre and post-acquisition periods except on an arbitrary basis, the cost of investment is normally reduced by dividends receivable, only if they clearly represent recovery of part of the cost.

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

> *If rights are not subscribed for but are sold in the market, the sale proceeds are taken to the statement of profit and loss.*

Right shares	Accounting
When right shares offered are subscribed	Cost of right shares should be added to carrying amount of the original holding.
If rights are not subscribed for but are sold	Sale proceeds should be taken to statement of profit and loss (refer note below for an exception).

Note: 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.

For *e.g.*, Mr. X acquires 200 shares of a company on cum-right basis for` 50,000. He subsequently receives an offer of right to acquire fresh shares in the company in the proportion of 1:1 at ` 110 each. X subscribes for the right issue. Thus, the total cost of X's holding of 400 shares would amount to ` 72,000 (50,000 + 22,000).

Suppose, he does not subscribe but sells the rights for ` 15,000. The ex- right market value of 200 shares bought by X immediately after the rights falls to ` 40,000. In this case out of sale proceeds of ` 15,000, ` 10,000 may be applied to reduce the carrying amount to the market value `40,000 and` 5,000 would be credited to the profit and loss account.

5. Where an investment is acquired by way of issue of bonus shares, no amount is entered in the capital column of investment account since the investor has not paid anything.

DISPOSAL OF INVESTMENTS

- On disposal of an investment, the difference between the carrying amount and the disposal proceeds, net of expenses is recognised in the profit and loss statement.
- When a part of the holding of an individual investment is disposed, the carrying amount is required to be allocated to that part on the basis of the average carrying amount of the total holding of the investment.

In respect of shares, debentures and other securities held as stock-in-trade, the cost of stocks disposed of may be determined by applying an appropriate cost formula (*e.g.*, first-in, first-out (FIFO), average cost, etc.). These cost formulae are the same as those specified in AS 2, *Valuation of Inventories*.

(i) *Fixed Income Bearing Securities* In case the transaction is on 'Cum- interest basis', the amount of accrued interest from the date of last payment to the date of sale is credited in the income column and only the sale proceeds, net of accrued interest (from the date of last payment to the date of sale), is credited in the capital column of investment account.

In case the transaction is on 'Ex-interest' basis, entire sale proceeds is credited in the capital column and the amount of accrued interest from the date of last payment to the date of sale, separately received from the buyer will be taken to the credit side of the income column of investment account.

(ii) *Variable Income Bearing Securities* In case of these securities, the entire amount of sale proceeds should be credited in the capital column of investment account, unless the amount of accrued dividend can be specifically established.

The entries in the books at the time of sale of investments will be just the reverse of the entries passed for their acquisition.

Particulars	Value in 'capital' column of investmen	
	Purchase	Sale
Transaction on ex-interest basis	Purchase price of investment, i.e., no impact of interest accrued upto the date of transaction	Entire sale proceeds from investments, i.e., no impact of accrued interest (from the date of last payment to the date of sale)
Transaction on cum-interest basis	Purchase price of investment *less* accrued interest upto the date of transaction	Sale proceeds, net of accrued interest (from the date of last payment to the date of sale)

STUDENTS NOTES

CLASS WORK QUESTION from ICAI MODULE

Question 1

In 20X1, M/s. Wye Ltd. issued 12% fully paid debentures of ` 100 each, interest being payable half yearly on 30th September and 31st March of every accounting year.

On 1st December, 20X2, M/s. Bull & Bear purchased 10,000 of these debentures at ` 101 cum-interest price, also paying brokerage @ 1% of cum-interest amount of the purchase. On 1st March, 20X3 the firm sold all of these debentures at ` 106 cum-interest price, again paying brokerage @ 1 % of cum-interest amount. Prepare Investment Account in the books of M/s. Bull & Bear for the period 1st December, 20X2 to 1st March, 20X3.

Question 2

On 1.4.20X1, Mr. Krishna Murty purchased 1,000 equity shares of ` 100 each in TELCO Ltd. @ ` 120 each from a Broker, who charged 2% brokerage. He incurred 50 paise per ` 100 as cost of shares transfer stamps. On 31.1.20X2, Bonus was declared in the ratio of 1: 2. Before and after the record date of bonus shares, the shares were quoted at ` 175 per share and ` 90 per share respectively. On 31.3.20X2, Mr. Krishna Murty sold bonus shares to a Broker, who charged 2% brokerage.

Show the Investment Account in the books of Mr. Krishna Murty, who held the shares as Current assets and closing value of investments shall be made at Cost or Market value whichever is lower.

Question 3

Mr. X purchased 500 equity shares of ` 100 each in Omega Co. Ltd. for ` 62,500 inclusive of brokerage and stamp duty. Some years later the company resolved to capitalise its profits and to issue to the holders of equity shares, one equity bonus share for every share held by them. Prior to capitalisation, the shares of Omega Co. Ltd. were quoted at ` 175 per share. After the capitalisation, the shares were quoted at ` 92.50 per share. Mr. X. sold the bonus shares and received at ` 90 per share.

Prepare the Investment Account in X's books on average cost basis.

Question 4

On 01-04-20X1, Mr. T. Shekharan purchased 5,000 equity shares of ` 100 each in V Ltd. @ ` 120 each from a broker, who charged 2% brokerage. He incurred 50 paisa per ` 100 as cost of shares transfer stamps. On 31-01-20X2 bonus was declared in the ratio of 1: 2. Before and after the record date of bonus shares, the shares were quoted at ` 175 per share and ` 90 per share respectively. On 31-03-20X2, Mr. T. Shekharan sold bonus shares to a broker, who charged 2% brokerage.

Show the Investment Account in the books of T. Shekharan, who held the shares as Current Assets and closing value of investments shall be made at cost or market value whichever is lower.

Question 5

On 1^{st} April, 20X1, Rajat has 50,000 equity shares of P Ltd. at a book value of ` 15 per share (nominal value ` 10 each). He provides you the further information:

(1) On 20^{th} June, 20X1 he purchased another 10,000 shares of P Ltd. at ` 16 per share.

(2) On 1^{st} August, 20X1, P Ltd. issued one equity bonus share for every six shares held by the shareholders.

(3) On 31^{st} October, 20X1, the directors of P Ltd. announced a right issue which entitles the holders to subscribe three shares for every seven shares at ` 15 per share. Shareholders can transfer their rights in full or in part.

Rajat sold $1/3^{rd}$ of entitlement to Umang for a consideration of ` 2 per share and subscribed the rest on 5^{th} November, 20X1.

You are required to prepare Investment A/c in the books of Rajat for the year ending 31^{st} March, 20X2.

Question 6

On 1.4.20X1, Sundar had 25,000 equity shares of 'X' Ltd. at a book value of ` 15 per share (Nominal value ` 10). On 20.6.20X1, he purchased another 5,000 shares of the company at `16 per share. The directors of 'X' Ltd. announced a bonus and rights issue. No dividend was payable on these issues. The terms of the issue are as follows:

Bonus basis 1:6 (Date 16.8.20X1)

Rights basis 3:7 (Date 31.8.20X1) Price ` 15 per share

Due date for payment 30.9.20X1

Shareholders were entitled to transfer their rights in full or in part. Accordingly, Sundar sold 33.33% of his entitlement to Sekhar for a consideration of ` 2 per share.

Dividends: Dividends for the year ended 31.3.20X1 at the rate of 20% were declared by X Ltd. and received by Sundar on 31.10.20X1. Dividends for shares acquired by him on 20.6.20X1 are to be adjusted against the cost of purchase.

On 15.11.20X1, Sundar sold 25,000 equity shares at a premium of ` 5 per share. You are required to prepare in the books of Sundar.

(1) Investment Account

(2) Profit & Loss Account.

For your exercise, assume that the books are closed on 31.12.20X1and shares are valued at average cost.

Question 7

On 1st January 20X1, Singh had 20,000 equity shares in X Ltd. Nominal value of the shares was `10 each but their book value was ` 16 per share. On 1st June 20X1, Singh purchased 5,000 more equity shares in the company at a premium of ` 4 per share.

On 30th June, 20X1, the directors of X Ltd. announced a bonus and rights issue. Bonus was declared at the rate of one equity share for every five shares held and these shares were received on 2nd August, 20X1.

The terms of the rights issue were:

(a) Rights shares to be issued to the existing holders on 10th August, 20X1.

(b) Rights issue would entitle the holders to subscribe to additional equity shares in the Company at the rate of one share per every three held at ` 15 per share-the whole sum being payable by 30th September, 20X1.

(c) Existing shareholders were entitled to transfer their rights to outsiders, either wholly or in part.

(d) Singh exercised his option under the issue for 50% of his entitlements and the balance of rights he sold to Ananth for a consideration of ` 1.50 per share.

(e) Dividends for the year ended 31st March, 20X1, at the rate of 15% were declared by the Company and received by Singh on 20th October, 20X1.

(f) On 1st November, 20X1, Singh sold 20,000 equity shares at a premium of ` 3 per share.

The market price of share on 31-12-20X1 was ` 14. Show the Investment Account as it would appear in Singh's books on 31-12-20X1 and the value of shares held on that date.

Question 8

The following transactions of Nidhi took place during the year ended 31st March 20X2:

1st April	Purchased ` 12,00,000, 8% bonds at ` 80.50 cum-interest. Interest is payable on 1st November and 1st May.
12th April	Purchased 1,00,000 equity shares of ` 10 each in X Ltd. for ` 40,00,000
1st May	Received half-year's interest on 8% bonds.
15th May	X Ltd. made a bonus issue of three equity shares for every two held. Nidhi sold 1,25,000 bonus shares for ` 20 each.

1st October	Sold ` 3,00,000, 8% bonds at ` 81 ex-interest.
1st November	Received half-year's bond interest.
1st December	Received 18% interim dividend on equity shares (including bonus shares) in X Ltd.

Prepare the relevant investment account in the books of Nidhi for the year ended 31st March, 20X2.

Question 9

Smart Investments made the following investments in the year 20X1-X2:

12% State Government Bonds having nominal value `100

Date	Particulars
01.04.20X1	Opening Balance (1200 bonds) book value of ` 126,000
02.05.20X1	Purchased 2,000 bonds @ ` 100 cum interest
30.09.20X1	Sold 1,500 bonds at ` 105 ex interest

Interest on the bonds is received on 30th June and 31st Dec. each year.

15.04.20X1	Purchased 5,000 equity shares @ ` 200 on cum right basis Brokerage of 1% was paid in addition (Nominal Value of shares ` 10)
03.06.20X1	The company announced a bonus issue of 2 shares for every 5 shares held
16.08.20X1	The company made a rights issue of 1 share for every 7 shares held at ` 250 per share. The entire money was payable by 31.08.20X1.
22.8.20X1	Rights to the extent of 20% was sold @ ` 60. The remaining rights were subscribed.
02.09.20X1	Dividend @ 15% for the year ended 31.03.20X1 was received on 16.09.20X1
15.12.20X1	Sold 3,000 shares @ ` 300. Brokerage of 1% was incurred extra.
15.01.20X2	Received interim dividend @ 10% for the year 20X1 –X2
31.03.20X2	The shares were quoted in the stock exchange @ ` 220

Prepare Investment Accounts in the books of Smart Investments. Assume that the average cost method is followed.

Question 10

Mr. Brown has made following transactions during the financial year 20X1-X2:

Date	Particulars
01.05.20X1	Purchased 24,000 12% Bonds of ` 100 each at ` 84 cum-interest. Interest is payable on 30th September and 31st March every year.
15.06.20X1	Purchased 1,50,000 equity shares of ` 10 each in Alpha Limited for ` 25 each

	through a broker, who charged brokerage @ 2%.
10.07.20X1	Purchased 60,000 equity shares of ` 10 each in Beeta Limited for ` 44 each through a broker, who charged brokerage @2%.
14.10.20X1	Alpha Limited made a bonus issue of two shares for every three shares held
31.10.20X1	Sold 80,000 shares in Alpha Limited for ` 22 each.
01.01.20X2	Received 15% interim dividend on equity shares of Alpha Limited.
15.01.20X2	Beeta Limited made a right issue of one equity share for every four shares held at ` 5 per share. Mr. Brown exercised his option for 40% of his entitlements and sold the balance rights in the market at ` 2.25 per share.
01.03.20X2	Sold 15,000 12% Bonds at ` 90 ex-interest
15.03.20X2	Received 18% interim dividend on equity shares of Beeta Limited. Interest on 12% Bonds was duly received on due dates.

Prepare separate investment account for 12% Bonds, Equity Shares of Alpha Limited and Equity Shares of Beeta Limited in the books of Mr. Brown for the year ended on 31st March, 20X2.

Question 11

A Limited purchased 5,000 equity shares (nominal value ` 100 each) of Allianz Limited for ` 105 each on 1st April, 20X1. The shares were quoted cum dividend. On 15th May, 20X1, Allianz Limited declared & paid dividend of 2% for year ended 31st March, 20X1. On 30th June, 20X1 Allianz Limited issued bonus shares in ratio of 1:5. On 1st October, 20X1 Allianz Limited issued rights share in the ratio of 1:12 @ 45 per share. A Limited subscribed to half of the rights issue and the balance was sold at ` 5 per right entitlement. The company declared interim dividend of 1% on 30$^{th}$ November, 20X1. Right shares were not entitled to dividend. The company sold 3,000 shares on 31$^{st}$ December, 20X1 at ` 95 per share. The company A Ltd. incurred 2% as brokerage while buying and selling shares.

You are required to prepare Investment Account in books of A Ltd for the year ended 31st March, 20X2.

Question 12

On 1st April, 20X1, XY Ltd. has 15,000 equity shares of ABC Ltd. at a book value of `15 per share (nominal value ` 10 per share). On 1st June, 20X1, XY Ltd. acquired 5,000 equity shares of ABC Ltd. for ` 1,00,000. ABC Ltd. announced a bonus and right issue.

(1) Bonus was declared, at the rate of one equity share for every five shares held, on 1st July 20X1.

(2) Right shares are to be issued to the existing shareholders on 1st September 20X1. The company will issue one right share for every 6 shares at 20% premium. No dividend was

payable on these shares.

(3) Dividend for the year ended 31.3.20X1 were declared by ABC Ltd. @ 20%, which was received by XY Ltd. on 31st October 20X1.

XY Ltd.

- Took up half the right issue.
- Sold the remaining rights for `8 per share.
- Sold half of its shareholdings on 1st January 20X2 at ` 16.50 per share.

  Brokerage being 1%.

You are required to prepare Investment account of XY Ltd. for the year ended 31st March 20X2 assuming the shares are being valued at average cost.

Question 13

The following information is presented by Mr. Z (a stock broker), relating to his holding in 9% Central Government Bonds.

Opening balance (nominal value) ` 1,20,000, Cost ` 1,18,000 (Nominal value of each unit is ` 100).

1.3.20X1	Purchased 200 units, ex-interest at `98.
1.7.20X1	Sold 500 units, ex-interest out of original holding at ` 100.
1.10.20X1	Purchased 150 units at `98, cum interest.
1.11.20X1	Sold 300 units, ex-interest at `99 out of original holdings.

Interest dates are 30th September and 31st March. Mr. Z closes his books every 31st December. Show the investment account as it would appear in his books . Mr. follows FIFO method.

Question 14

Mr. Purohit furnishes the following details relating to his holding in 8% Debentures (` 100 each) of P Ltd., held as Current assets:

1.4.20X1	Opening balance – Nominal value ` 1,20,000, Cost ` 1,18,000
1.7.20X1	100 Debentures purchased ex-interest at ` 98
1.10.20X1	Sold 200 Debentures ex-interest at ` 100
1.1.20X2	Purchased 50 Debentures at ` 98 cum-interest
1.2.20X2	Sold 200 Debentures ex-interest at V 99

Due dates of interest are 30th September and 31st March.

Mr. Purohit closes his books on 31.3.20X2. Brokerage at 1% is to be paid for each transaction. Show Investment account as it would appear in his books. Assume FIFO method. Market value of 8% Debentures of P Limited on 31.3.20X2 is ` 99.

Student Notes:-

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