

## **Query No. 28**

**Subject:** *Accounting treatment of investment in erstwhile associate under Ind AS framework.*<sup>1</sup>

### **A. Facts of the Case**

1. A company (hereinafter referred to as ‘the Company’) is a listed company incorporated in the year 1962 and is presently engaged in the business of trading and manufacturing of 3D printing software and defence equipment. The Company had made investments (equity shares) in an associate company (hereinafter referred to as ‘X Ltd.’) in 1970s. However, due to many reasons, associate company was referred to erstwhile Board for Industrial and Financial Reconstruction (BIFR) in 1998-99 and manufacturing operations came to a grinding halt. The matter of revival was pending for several years and finally, a revival package was approved in 2010-11. As the associate company (X Ltd.) was in heavy losses and there was little hope of its revival, the Company made a provision of 100% of its investment in associate company (X Ltd.) in its books. The investment was carried at notional value of Re. 1 for several years. Financials of the Company were prepared under Ind AS compliance for the first time in the accounting year 2016-17. The Company used fair value in its opening Indian Accounting Standard (Ind AS) balance sheet as deemed cost of investment in associate in accordance with paragraph 31 of Ind AS 101, ‘First-time Adoption of Indian Accounting Standards’ which reads as under:

- “31 Similarly, if an entity uses a deemed cost in its opening Ind AS Balance Sheet for an investment in a subsidiary, joint venture or associate in its separate financial statements (see paragraph D15), the entity’s first Ind AS separate financial statements shall disclose:
- (a) the aggregate deemed cost of those investments for which deemed cost is their previous GAAP carrying amount;
  - (b) the aggregate deemed cost of those investments for which deemed cost is fair value; and
  - (c) the aggregate adjustment to the carrying amounts reported under previous GAAP.”

2. The querist has stated that the associate company (X Ltd.) was having negative net worth upto financial year (F.Y.) 2020-21. In financial year 2021-22, associate company (X Ltd.) has made a right offer at premium in which the Company did not participate; therefore, its holding has come down to 19% and it discontinued to be associate of the Company. Now (i.e. in F.Y. 2023-24), the net worth of the erstwhile associate has become positive and there is visibility that it will earn profits in future. In view of turnaround of the erstwhile associate, the management of the Company has decided to value the investment in erstwhile associate at fair value. The management is expecting the fair value of investment around Rs. 40-50 crores subject to valuation by registered valuer against the notional value of Re. 1.

3. Now, the Company wants to measure the investment at fair value through other comprehensive income (OCI) in view of the fact that it is only adjustment of fair value and resultant gain is not available for distribution of dividend or available as free reserve. However,

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<sup>1</sup> Opinion finalised by the Committee on 22.11.2024.

according to the querist, the Company does not fulfil the conditions of paragraph 4.1.2A of Ind AS 109, 'Financial Instruments', which states as follows:

**“4.1.2A A financial asset shall be measured at fair value through other comprehensive income if both of the following conditions are met:**

- (a) the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets and**
- (b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.”**

## **B. Query**

4. In view of above, the querist has sought the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI) as to whether the Company has option to measure investment as at fair value through OCI.

## **C. Points considered by the Committee**

5. The Committee notes that the basic issue raised in the query relates to measurement of investment in the erstwhile associate at fair value through other comprehensive income in the separate financial statements of the Company. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, accounting under the previous GAAP and at the time of transition, compliance with the provisions of Ind AS 101, 'First-time adoption of Indian Accounting Standards', classification as associate and determination of loss of 'significant influence', appropriateness of making provision of 100% of its investment in associate company and presenting the same at notional value of Re. 1, determination of fair value at transition, accounting in the books of X Ltd. (including accounting for right issue), appropriateness of discontinuing to classify X Ltd. as associate company due to decrease in holding, accounting in consolidated financial statements of the Company, application (if any) of the requirements of Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors', etc. The Committee has also not examined that had the Company designated investment as at fair value through OCI immediately on loss of significant influence, how it would have recognised the difference between the carrying amount and fair value, if any, arising as at the date of such designation. The Committee wishes to point out that the opinion expressed hereinafter is in the context of Indian Accounting Standards, notified under the Companies (Indian Accounting Standards) Rules, 2015 as amended from time to time.

At the outset, the Committee notes that the Company used fair value in its opening Indian Accounting Standard (Ind AS) balance sheet as deemed cost of investment in associate in accordance with paragraph 31 of Ind AS 101. Further, the Company has used Re. 1 as the fair value on the date of transition to Ind AS which was also the carrying amount of investment on that date. The Committee has not examined as to whether it is appropriate to measure fair value of the investment at Re. 1 on the date of transition. Further, the Committee wishes to mention that fair value of an investment does not become negative or zero merely due to negative net worth of the investee entity. The same has to be determined as per the requirements of Ind AS 113, 'Fair Value Measurement'.

6. With regard to the issue raised, the Committee notes the following requirements of Ind AS 101:

**“Investments in subsidiaries, joint ventures and associates**

D14 When an entity prepares separate financial statements, Ind AS 27 requires it to account for its investments in subsidiaries, joint ventures and associates either:

- (a) at cost; or
- (b) in accordance with Ind AS 109.

D15 If a first-time adopter measures such an investment at cost in accordance with Ind AS 27, it shall measure that investment at one of the following amounts in its separate opening Ind AS Balance Sheet:

- (a) cost determined in accordance with Ind AS 27; or
- (b) deemed cost. The deemed cost of such an investment shall be its:
  - (i) fair value at the entity’s date of transition to Ind ASs in its separate financial statements; or
  - (ii) previous GAAP carrying amount at that date.

A first-time adopter may choose either (i) or (ii) above to measure its investment in each subsidiary, joint venture or associate that it elects to measure using a deemed cost.”

From the above, the Committee notes that the Company has adopted the cost model under Ind AS 27, ‘Separate Financial Statements’ to account for its investments in associates, X Ltd. in its separate financial statements and on the date of transition, fair value has been used as surrogate for ‘cost’ of such investment. Thereafter in F.Y. 2021-22, investment in X Ltd. discontinued to be an associate and therefore, the same became an investment in equity instruments that needs to be accounted for as per the requirements of Ind AS 109. In this regard, the Committee notes the following requirements of Ind AS 109:

**“4.1.4 A financial asset shall be measured at fair value through profit or loss unless it is measured at amortised cost in accordance with paragraph 4.1.2 or at fair value through other comprehensive income in accordance with paragraph 4.1.2A. However an entity may make an irrevocable election at initial recognition 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 (see paragraphs 5.7.5–5.7.6).”**

**“Investments in equity instruments**

**5.7.5 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 to which Ind AS 103 applies. ...”**

**“Investments in equity instruments and contracts on those investments**

B5.2.3 All investments in equity instruments and contracts on those instruments must be measured at fair value. However, in limited circumstances, cost may be an appropriate estimate of fair value. That may be the case if insufficient more recent information is available to measure fair value, or if there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range.”

From the above, the Committee notes that the investments in equity instruments falling within Ind AS 109 are required to be measured at fair value. The Company may make an irrevocable election to present the subsequent changes in fair value through OCI instead of through profit or loss ***at initial recognition of equity instruments*** as per the requirements of paragraphs 4.1.4 and 5.7.5 of Ind AS 109. To emphasise, the option to measure instrument as at fair value through OCI is available only at the time of initial recognition of equity instruments and not subsequently. Since, in the extant case, after the right issue by X Ltd. in F.Y. 2021-22, X Ltd., was no longer considered to be an associate by the Company, the Company had to apply the requirements of Ind AS 109 for the first time in accounting for its equity investments in X Ltd. in F.Y. 2021-22. In that year, the Company could have irrevocably elected to present the subsequent changes in fair value through OCI (provided it met the conditions of paragraph 5.7.5 of Ind AS 109). However, since it appears from the Facts provided by the querist that the Company did not make such an election in F.Y. 2021-22, that option is not available subsequently in the current reporting period. Therefore, the Committee is of the view that in the extant case, the Company cannot measure investment in equity shares of X Ltd. at fair value through OCI (FVOCI) and it should measure investment in equity shares of X Ltd. at fair value through profit or loss (FVTPL).

**D. Opinion**

7. On the basis of the above, the Committee is of the opinion that the Company should measure investment in equity shares of X Ltd. at fair value through profit or loss (FVTPL) and not at fair value through other comprehensive income (FVOCI), as discussed in paragraph 6 above.

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