

## **Accounting for Investments**

FRS 25 *Accounting for Investments* was issued by the CCDG in January 2003 and consequential amendments were made in July 2004 and March 2005.

This Standard is operative for financial statements covering periods beginning on or after 1st January 1988.

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Financial Reporting Standard 25 *Accounting for Investments* (FRS 25) is set out in paragraphs 1-51. All the paragraphs have equal authority. FRS 25 should be read in the context of the *Preface to the Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. FRS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

# FINANCIAL REPORTING STANDARD FRS 25

## Accounting for Investments

### Foreword

This Financial Reporting Standard should be read in the context of this foreword:

#### Investment Properties

##### paragraph 4

- i. For the purpose of this Standard, but subject to the exceptions in paragraph ii below, an investment property is an interest in land and/or buildings:
  - (a) in respect of which construction work and development have been completed; and
  - (b) which is held for its investment potential, any rental income being negotiated at arm's length.
- ii. The following are exceptions from the definition:
  - (a) A property which is owned and used by an entity for its own purposes is not an investment property, for example, a hotel or a warehouse.
  - (b) A property let to, and occupied by, another group company is not an investment property for the purposes of its own financial statements or the group financial statements.
- iii. Investment properties may be held by an entity which holds investments as part of its business such as an investment trust or a property investment company. Investment properties may also be held by an entity whose main business is not the holding of investments.

#### Changes in Carrying Amount of Investments

##### paragraph 32

- iv. For the purpose of this Standard, the term "same investment" should be interpreted as "same class of investments". "Same class of investments" means a category of investments which have a similar nature or function in the operations of the reporting enterprise.
- v. Paragraph iv does not apply to the long-term business of insurance companies where changes in value are dealt with in the relevant fund account.

### Scope

- 1. This Standard should be applied in the accounting for and disclosure of investments.**
- 2. Enterprise should account for investments in accordance with paragraphs 8 to 44 of this Standard, unless they are specialised investment enterprises in which case they may account for investments in accordance with paragraph 45 of this Standard.**
3. This Standard does not deal with —
  - (a) the bases for recognition of interest, royalties, dividends and rentals earned on investments (see FRS 17 *Leases* and FRS 18 *Revenue*);

- (b) investments in subsidiaries (see FRS 27 *Consolidated and Separate Financial Statements*);
- (c) investments in associates (see FRS 28 *Investments in Associates*);
- (d) investments in joint ventures (see FRS 31 *Interests in Joint Ventures*);
- (e) goodwill, patents, trademarks and similar assets;
- (f) finance leases as defined in FRS 17;
- (g) investments of retirement benefit plans and life insurance enterprises; and
- (h) investments in financial assets to which FRS 39 *Financial Instruments: Recognition and Measurement* applies.

## Definitions

### 4. The following terms are used in this Standard with the meanings specified:

***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.***

***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.***

***An investment is an asset held by an enterprise for the accretion of wealth through distribution (such as interest, royalties, dividends and rentals), for capital appreciation or for other benefits to the investing enterprise such as those obtained through trading relationships. Inventories as defined in FRS 2 Inventories, are not investments. Property, plant and equipment as defined in FRS 16 Property, Plant and Equipment, (other than investment properties) are not investments.***

***An investment property is an investment in land or buildings that are not occupied substantially for use by, or in the operations of, the investing enterprise or another enterprise in the same group as the investing enterprise.***

***A long-term investment is an investment other than a current investment.***

***Market value is the amount obtainable from the sale of an investment in an active market.***

***Marketable means that there is an active market from which a market value (or some indicator that enables a market value to be calculated) is available.***

## Forms of Investments

5. Enterprises hold investments for diverse reasons. For some enterprises, investment activity is a significant element of operations<sup>[1]</sup>, and assessment of the performance of the enterprise may largely, or solely, depend on the reported results of this activity. Some hold investments as a store of surplus funds and some hold trade investments in order to cement a trading relationship or establish a trading advantage.

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<sup>[1]</sup> Enterprises for which investment activity is a significant element of operations, such as insurance companies and some banks, are often subject to regulatory control. The Preface to Financial Reporting Standards provides that Financial Reporting Standards do not override local regulations governing the issue of financial statements.

6. Some investments are represented by certificates or similar documents; others are not. The nature of an investment may be that of a debt, other than a short or long-term trade debt, representing a monetary amount owing to the holder and usually bearing interest; alternatively it may be a stake in an enterprise's results, such as an equity share. Most investments represent financial rights, but some are tangible — such as certain investments in land or buildings and direct investments in gold, diamonds or other marketable commodities.
7. For some investments, and active market exists from which a market value can be established. For such investments, market value is an indicator of fair value. For other investments, an active market does not exist and other means are used to determine fair value.

## **Classification of Investments**

8. ***An enterprise that distinguishes between current and long-term assets in its financial statements should present current investments as current assets and long-term investments as long-term assets.***
9. ***Enterprises that do not distinguish between current and long-term investments in their balance sheets should nevertheless make a distinction for measurement purposes and determine the carrying amount for investments in accordance with paragraphs 19 and 23 of this Standard.***
10. Most enterprises present balance sheets that distinguish current assets from long-term assets in accordance with FRS 1 *Presentation of Financial Statements*. Current investments are included in current assets. The fact that a marketable investment has been retained for a considerable period does not necessarily preclude its classification as current.
11. Investments held primarily to protect, facilitate or further existing business or trading relations, often called trade investments, are not made with the intention that they will be available as additional cash resources and are thus classified as long-term. Other investments, such as investment properties, are intended to be held for a number of years to generate income and capital gain. They are therefore classified as long-term assets even though they may be marketable.
12. Some enterprises choose not to distinguish between current and long-term assets, and others may be required by regulations to adopt a balance sheet format that makes no distinction. Many such enterprises operate in the financial field, such as banks and insurance companies. Although such enterprises do not intend to realise their assets in current operations, they usually regard many of their investments as being available for the purposes of their current operations if required.
13. However, such enterprises may have investments properly regarded as long-term assets, for example a bank may hold shares in a leasing company.
14. Many such enterprises therefore analyse their investments and attribute carrying amounts to them according to whether their characteristics are those of current investments or long-term investments.

## **Cost of investments**

15. The cost of an investment includes acquisition charges such as brokerages, fees, duties and bank fees.
16. 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 and not their nominal or par value. 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. It may be appropriate to consider the fair value of the investment acquired if it is more clearly evident.

17. Interest, royalties, dividends and rentals receivable in connection with an investment are generally regarded as income, being the return on the investment. However, in some circumstances, such inflows represent a recovery of cost and do not form part of income. For example, when unpaid interest has accrued before the acquisition of an interest-bearing investment and is therefore included in the price paid for the investment, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods; the pre-acquisition portion is deducted from cost. When dividends on equity securities are declared from pre-acquisition profits a similar treatment applies. If it is difficult to make such an allocation except on an arbitrary basis, the cost of an investment is normally reduced by dividends receivable only if they clearly represent a recovery of part of cost.
18. The difference between the acquisition cost and redemption value of an investment in debt securities (the discount or premium on acquisition) is usually amortised by the investor over the period from acquisition to its maturity so that a constant yield is earned on the investment. The amortised discount or premium is credited or charged to income as though it were interest and added to or subtracted from the carrying amount of the security. The resulting carrying amount is then regarded as cost.

## Carrying Amounts of Investments

### Current Investments

**19. Investments classified as current assets should be carried in the balance sheet at either:**

- (a) **market value; or**
- (b) **the lower of cost and market value.**

***If current investments are carried at the lower of cost and market value, the carrying amount should be determined either on an aggregate portfolio basis, in total or by category of investment, or on an individual investment basis.***

20. Opinions differ on the appropriate carrying amount for current investments. Some maintain that, for financial statements prepared under the historical cost convention, the general rule of lower of cost and net realisable value is applicable to investments; and since most current investments are marketable, the carrying amount is the lower of cost and market value. Supporters of this method of determining carrying amount claim that it provides a prudent balance sheet amount and does not result in recognising unrealised gains in income. They also claim that fortuitous swings in stock market prices, which may reverse, are not brought to account merely as the result of the choice of a particular balance sheet date.
21. Others argue that, since current investments are a readily realisable store of wealth, or a cash substitute, it is appropriate to value them at fair value, usually market value. The enterprise is not concerned with the cost of such items but with the cash it could raise by disposing of them. Investments are distinguished from inventories because they can generally be sold without effort, whereas it would normally be inappropriate to recognise profit on sale of inventories before the sale was assured. Each investment is dispensable by the business - for example an equity investment could be sold and the proceeds re-invested in a bank deposit account without detriment to the business - and therefore it is appropriate to report it at market value. Supporters of market value also argue that reporting investments at historical cost allows management to recognise income at its discretion, since selected investments can be sold and immediately repurchased and the resulting profit reported in income, although such transactions have not changed the enterprise's economic position.

22. In general, the concern of an enterprise is with the overall value of its current investment portfolios, and not with each individual investment, since the investments are held collectively as a store of wealth. Consistent with this view, investments carried at the lower of cost and market value are valued on an aggregate portfolio basis, in total or by category of investment, and not on an individual investment basis. However, some argue that the use of the portfolio basis results in losses being offset against unrealised gains.

### **Long-term Investments**

**23. Investments classified as long-term assets should be carried in the balance sheet at either:**

- (a) cost;**
- (b) revalued amounts; or**
- (c) in the case of marketable equity securities, the lower of cost and market value determined on a portfolio basis.**

***If revalued amounts are used, a policy for the frequency of revaluations should be adopted and an entire category of long-term investments should be revalued at the same time.***

***The carrying amount of all long-term investments should be reduced to recognise a decline other than temporary in the value of the investments, such reduction being determined and made for each investment individually.***

24. Long-term investments are usually 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. Indicators of the value of an investment may be obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. Risk and the type and extent of the investor's stake in the investee are also taken into account. Restrictions on distributions by the investee or on disposal by the investor may affect the value attributed to the investment.
25. Many long-term investments are of individual importance to the investing enterprise. The carrying amount of long-term investments is therefore normally determined on an item-by-item basis. However, in some countries, marketable equity securities classified as long-term investments may be carried at the lower of cost and market value determined on a portfolio basis. In these cases, temporary reductions and reversals of such reductions are included in equity.
26. Reductions for other than a temporary decline in the carrying amounts of long-term investments are charged in the income statement unless they offset a previous revaluation (see paragraph 32). Reductions in carrying amount may be reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exist. However, in some countries reductions in the carrying amount are not reversed.

### **Revaluations**

27. Sometimes long-term investments are revalued to fair value. In the interests of consistency, a policy for the frequency of revaluation is adopted and all long-term investments are revalued at the same time or, at the minimum, an entire category is revalued.

### **Investment Properties**

**28. An enterprise holding investment properties should either —**

- (a) treat them as property in accordance with FRS 16 Property, Plant and Equipment;**  
**or**

**(b) account for them as long-term investments.**

29. Some enterprises elect to account for investment properties as long-term investments. Other enterprises prefer to account for and charge depreciation on investment properties under their accounting policy for property, plant and equipment, in accordance with FRS 16.
30. Enterprises that account for investment properties as long-term investments consider that changes in their fair value, usually market value, are more significant than their depreciation. The properties are therefore revalued periodically on a systematic basis. Where fair values are recognised in the carrying amount, any changes in carrying amount are accounted for in accordance with paragraph 32. Where such fair values are not recognised in the carrying amount, they are disclosed.

## **Changes in Carrying Amount of Investments**

**31. An enterprise that carries current investments at market value should adopt, and consistently apply, a policy for accounting for increase or decreases in carrying amount which should either —**

**(a) be recognised as income or expense; or**

**(b) be accounted for in accordance with paragraph 32 of this Standard.**

**32. An increase in carrying amount arising from the revaluation of long-term investments should be credited to owners' equity as a revaluation surplus. To the extent that a decrease in carrying amount offsets a previous increase, for the same investment, that has been credited to revaluation surplus and not subsequently reversed or utilised, it should be charged against that revaluation surplus. In all other cases, a decrease in carrying amount should be recognised as an expense. An increase on revaluation directly related to previous decrease in carrying amount for the same investment that was recognised as an expense, should be credited to income to the extent that it offsets the previously recorded decrease.**

## **Disposals of Investments**

**33. On disposal of an investment the difference between net disposal proceeds and the carrying amount should be recognised as income or expense. If the investment was a current asset carried on a portfolio basis at the lower of cost and market value, the profit or loss on sale should be based on cost. If the investment was previously revalued, or was carried at market value and an increase in carrying amount transferred to revaluation surplus, the enterprise should adopt a policy either of crediting the amount of any remaining related revaluation surplus to income or of transferring it to retained earnings. This policy should be applied consistently in accordance with Financial Reporting Standard FRS 8 Accounting Policies, Changes in Accounting Estimates and Errors.**

34. Any reduction to market value of current investments carried at the lower of cost and market value on a portfolio basis is made against the cost of the portfolio in aggregate; individual investments continue to be recorded at cost. Accordingly the profit or loss on sale of an individual investment is based on cost; however the aggregate reduction to market value of the portfolio needs to be assessed.

35. When disposing of part of an enterprise's holding of a particular investment, a carrying amount must be allocated to the part sold. This carrying amount is usually determined from the average carrying amount of the total holding of the investment.

## Transfers of Investments

**36. For long-term investments re-classified as current investments, transfers should be made at:**

- (a) the lower of cost and carrying amount, if current investments are carried at the lower of cost and market value. If the investment was previously revalued, any remaining related revaluation surplus should be reversed on the transfer; and**
- (b) carrying amount if current investments are carried at market value. If changes in market value of current investments are included in income any remaining related revaluation surplus should be transferred to income.**

**37. Investments re-classified from current to long-term should each be transferred at the lower of cost and market value, or at market value if they were previously stated at that value.**

## Switches of Investments in a Portfolio

38. An enterprise with significant investment activity typically maintains a portfolio of investments in which it trades constantly. In doing so, the enterprise seeks to improve the quality and yields of its portfolio of investments. On disposing of a particular investment, funds released are available for reinvestment or may remain as the cash element of the investment portfolio.

39. In view of the constant changes in investments in such a portfolio, different opinions are held as to the appropriate accounting treatment on disposal of a particular investment:

- (a) some maintain that an excess or deficiency of net sale proceeds over carrying amount represents a realised profit or loss, which should be recognised in income immediately;
- (b) others argue that the disposal merely reflects an adjustment of the constituents of the portfolio, representing no value increase or decrease since it is only a substitution of one investment for another, and that therefore no profit or loss should be reflected in income; and
- (c) a few advocate a middle course, whereby the difference between net sale proceeds and cost is amortised to income over a given period.

40. Alternative (a) is the preferred method. Alternative (b) is appropriate only when the market value basis is used and changes in market value are included in income, since the adjustments to market value will already have been accounted for. Alternative (c) is inappropriate because it fails to recognise the whole of the profit or loss in the period in which it arises.

## Income Statement

**41. The following should be included in income:**

- (a) investment income arising from —**
  - (i) interest, royalties, dividends and rentals on long-term and current investments;**
  - (ii) profits and losses on disposal of current investments;**
  - (iii) unrealised gains and losses on current investments carried at market value, where that policy is adopted under paragraph 31 of this Standard; and**

- (iv) **reductions to market value and reversals of such reductions required to state current investments at the lower of cost and market value;**
  - (b) **reductions of the carrying amount for other than a temporary decline in value of long-term investments, and reversals of such reductions; and**
  - (c) **profits and losses on disposal of long-term investments, calculated in accordance with paragraph 33 of this Standard.**
42. Some enterprises that carry current investments at market value on the grounds that they are a store of freely disposable wealth recognise any gains or losses in market value as an element of income to be accounted for in the income statement along with profits and losses on disposals. However, in some countries such gains are not permitted to be included in income and are credited direct to owners' equity and accounted for in the same way as revaluation surplus on long-term investments.
43. If current investments are carried at the lower of cost and market value, any reductions to market value and any reversals of such reductions are included in the income statement along with profits and losses on disposals.
44. Any reductions in carrying amount for other than a temporary decline in value of long-term investments, and reversals of such reductions, and profits and losses on disposal of long-term investments, are included in income and presented in accordance with FRS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

## **Specialised Investment Enterprises**

45. ***Specialised investment enterprises which are prohibited from distributing profits on the disposal of investments may exclude from income changes in value of investments, whether realised or not, provided they carry their investments at fair value. Such enterprises should include in the financial statements a summary of all the movements in value of their investments for the period.***
46. In certain countries, there are specialised investment enterprises whose main business is the holding of a portfolio of marketable securities as an investment vehicle for their individual shareholders. These enterprises carrying their investments at fair value, usually market value, because this is the most appropriate basis in the circumstances. They regard realised profits and losses on their investments as being the same in substance as unrealised gains and losses and therefore account for them in the same way. They disclose a summary of all the movements in the value of their investments for the period.
47. The constitutions of these enterprises prohibit the distribution as dividends of profits on disposal of investments and require a distinction to be drawn between income arising from interest and dividends and the gains or losses arising on the disposal of the investments. Hence these enterprises exclude from income all changes in value of investments whether or not they are realised.

## **Taxes**

48. Accounting for tax consequences resulting from the application of this Statement is dealt with in accordance with FRS 12 *Income Taxes*.

## **Disclosure**

49. ***The following should be disclosed:***

- (a) ***the accounting policies for —***
  - (i) ***the determination of carrying amount of investments;***
  - (ii) ***the treatment of changes in market value of current investments carried at market value; and***
  - (iii) ***the treatment of a revaluation surplus on the sale of a revalued investment;***
- (b) ***the significant amounts included in income for —***
  - (i) ***interest, royalties, dividends and rentals on long-term and current investments;***
  - (ii) ***profits and losses on disposal of current investments; and***
  - (iii) ***changes in value of such investments;***
- (c) ***the market value of marketable investments if they are not carried at market value;***
- (d) ***the fair value of investment properties if they are accounted for as long-term investments and not carried at fair value;***
- (e) ***significant restrictions on the realisability of investments or the remittance of income and proceeds of disposal;***
- (f) ***for long-term investments stated at revalued amounts —***
  - (i) ***the policy for the frequency of revaluations;***
  - (ii) ***the date of the latest revaluation; and***
  - (iii) ***the basis of revaluation and whether an external valuer was involved;***
- (g) ***the movements for the period in revaluation surplus and the nature of such movements; and***
- (h) ***for enterprises whose main business is the holding of investments an analysis of the portfolio of investments.***

50. The following disclosures may be provided to assist a reader's understanding of the financial statements:

- (a) an analysis of long-term investments by category;
- (b) the directors' assessment of the fair value of investments that are not marketable;
- (c) where investments are not marketable, the method of assessing value used for comparison with cost, where applicable;
- (d) the amount of any previous revaluation surplus which related to the investments disposed of during the year and which has been previously distributed or converted into share capital; and
- (e) details of any single investment which represents a significant proportion of the reporting enterprise's assets.

## **Effective Date**

***51. This Financial Reporting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1988.***