Guidance Note on

‘Accounting for Investments’ for Local Bodies

Issued by

The Committee on Public and Government Financial Management

The Institute of Chartered Accountants of India

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Introduction and Background:

Local Bodies are an important constituent of our Indian Government System which are responsible for providing basic services to the citizens and development of infrastructure in the area under their jurisdiction. Keeping in view the role of the local bodies in development of a country, it is imperative that the financial management in local bodies be given utmost priority.

Investment decisions are important part of financial management in any entity. Idle funds should be deployed in such a way that returns are increased while balancing the liquidity of the entity. Local Bodies in our country also invest as per the respective applicable statute/ rules/ regulations. From the accounting and financial reporting perspective, it is crucial that the investments done by any entity should be accounted for correctly and properly reflected in the financial statements of an entity. Proper records maintained at the end of the entity also ensure accountability and transparency in its financial operations.

Since efforts are being made by most of the local bodies in the country to move to accrual basis of accounting, ICAI has been making an attempt to provide a robust, updated accrual accounting guidance for them, i.e., Accounting Standards for Local Bodies (ASLBs) which is at par with the International benchmark, i.e. International Public Sector Accounting Standards (IPSASs) which provide accounting guidance for the Government at the International level. ASLBs, that provide accrual- based accounting guidance for various events and transaction of local bodies, are being issued on all subjects relevant to local bodies in India. To avoid complexity, in place of the ASLB corresponding to IPSASs on "*Financial Instruments",* this Guidance Note is being issued which aims to provide accounting guidance to local bodies in respect of Investments made by them.

The Guidance Note is expected to harmonise the diverse practices that are being followed in accounting of investments by local bodies.

Usually, large local bodies have investment guidelines in place. In such case, local body need to follow accounting instructions as per the said statute /policy. In case of inconsistency, if any, with the applicable statute, the provisions of statute will prevail.

This Guidance Note does not deal with investment decisions taken by the entity as to when, how and what type of investment is to be made by the entity. This Guidance Note covers all aspects of investment accounting, i.e., recognition, measurement, presentation & disclosure. This would lead to true and fair presentation of financial statements aligned with the need of all stakeholders.

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The following is the text of the Guidance Note on 'Accounting for Investments' for Local Bodies, issued by the Council of the Institute of Chartered Accountants of India, will be recommendatory in nature in the initial years for use by the Local Bodies. This guidance note will be mandatory for Local Bodies in a State from the date specified in this regard by the State Government concerned.

Objective

1. The objective of this Guidance Note is to provide guidance on accounting for investments[1] including presentation & disclosures in Financial Statements.

Scope

2. This Guidance Note deals with accounting for investments in the financial statements of Local Bodies including ascertaining cost of acquisition of investments, classification of investments, ascertaining carrying value of investments and identifying diminution in value of investments and overall presentation & disclosure of investments.

3. This Guidance Note applies to all the entities described as Local Bodies in the Preface to the Accounting Standards for Local Bodies.

4. This Guidance Note does not deal with:

   a) Recognition of interest, dividends and rentals earned on investments which are covered by ASLB 9, '*Revenue from Exchange Transactions*';

   b) Lease agreements which are covered by ASLB 13, '*Leases*'

   c) Investment Property which are covered by ASLB 16, '*Investment Property*';

   d) Investment in controlled entities covered by ASLB 34, '*Separate Financial Statements*' and ASLB 35, '*Consolidated Financial Statements*'[2];

[1] In India, investments can be made by Local Bodies only in securities or other investments that are permitted by the applicable municipal act/ other relevant statute of the concerned State. This Guidance Note is intended to apply only to items which are material.

[2] This Guidance Note makes a reference to ASLBs 35 ("*Consolidated Financial Statements"*), 37 (*"Joint Arrangements"*) & 40 (*"Entity Combinations"*) and Guidance on 'Financial Instruments' that are yet to be formulated/ issued and the guidance for the same may be obtained from other corresponding pronouncements as per the hierarchy prescribed in paragraph 15 of ASLB 3, 'Accounting Policies, Changes in Accounting Estimates and Errors' that prescribe to consider the

e) Accounting for Investment in Associates & Joint Ventures which are covered by ASLB 36 '*Investment in Associates & Joint Ventures'*;

f) Joint Arrangements covered by ASLB 37, '*Joint Arrangements'*[5];

g) Entity combinations covered by ASLB 40, '*Entity Combination'*[5]; and

h) Changes in the fair value of financial assets (refer Guidance on "financial instruments"[5]).

5. For all investments within the scope of this Guidance Note, the impairment requirements prescribed in ASLB 21, '*Impairment of Non-Cash Generating Assets*' and ASLB 26, '*Impairment of Cash Generating Assets*' will not apply rather the requirement as prescribed in the Guidance Note for diminution in value of investment will apply in that case[3].

Definitions

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

i. Investments are assets held not for operational purposes or for rendering services, i.e., assets other than fixed assets or current assets (e.g., securities, shares, debentures, immovable properties). Assets held as stock-in-trade are not 'investments'.

ii. Short term investments are investments which are readily realisable and are intended to be held for not more than twelve months from the date of investment.

iii. Long term investments are investments other than short term investments.

iv. Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction[4].

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followings in descending order: (a) the most recent pronouncements of the Institute of Chartered Accountants of India, e.g., Accounting Standards and Guidance Notes on Accounting. Such pronouncements also include 'Framework for the Preparation and Presentation of Financial Statements', (b) International Public Sector Accounting Standards issued by International Public Sector Accounting Standards Board, and (c) accepted accounting practices in Local Bodies or in private sector.

[3] This paragraph will have the consequential impact on ASLBs 21 & 26 that will be taken care of at the revision stage of ASLBs.

[4] An arm's length transaction is one between parties that do not have a particular or special relationship that makes prices of transactions uncharacteristic of market conditions. The transaction is presumed to be between unrelated parties, each acting independently.

v. 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.

vi. Government Securities are bonds, notes, and other debt instruments sold by a government to finance its borrowings.

Classification of Investments

7. The investments should be classified based on the maturity profile or nature into short term and long term investments.

8. Short term investments are investments which are readily realisable and are intended to be held for not more than twelve months from the date of investment. Investments other than short term investments can be classified as long term investments, even though they may be readily marketable.

9. The intention of the entity at the time of making investment is to be considered to decide whether the investment is to be classified as short term or long term investments.

10. The short term & long term investments can further be classified in following categories:

- Central Government Securities
- State Government Securities
- Treasury Bills
- Fixed Deposits with Banks
- Equity Shares in Company
- Preference shares in Company
- Debentures & Bonds
- Units of Mutual Funds
- Commercial Papers
- Other Investments

This list is illustrative and not exhaustive.

11. As per ASLB 1, 'Presentation of Financial Statements', long term investments are to be classified as 'Non-Current Assets' and short term investment as 'Current Assets'.

Measurement

Initial Measurement

At the time of Acquisition

12. All investments are initially recognised at Cost.

13. The cost of investments comprises of its purchase price and any other directly attributable cost incurred for acquisition. Directly attributable cost includes:

- Brokerage,
- Transfer & other Fees, and
- Stamp duty & other Taxes & Duties.

For example: Entity acquires equity shares of a company through a broker for Rs. 10,00,000/-, brokerage paid Rs. 10,000/-, then cost of acquisition of investment works out to Rs. 10,10,000/-.

14. If an investment is acquired, or partly acquired, by the issue of securities, the acquisition cost is the fair value of the securities issued (which, in appropriate cases, may be indicated by the issue price as determined by statutory authorities). The fair value may not necessarily be equal to the nominal or par value of the securities issued.

15. 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.

16. Interest and dividends receivables 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, accrued interest (before the acquisition of an interest-bearing investment) is already 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 are declared from pre-acquisition profits, a similar treatment may apply. If it is difficult to make such an allocation except on an arbitrary basis, the cost of investment is normally reduced by dividends receivable only if they clearly represent a recovery of a part of the cost.

17. 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 Income and Expenditure statement. However, 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.

18. The illustrative cases of cost of acquisition to be considered in different situations are as under (this is not an exhaustive list):

Acquisition of Investment	Cost of Acquisition
Government Securities	Purchase cost + directly attributable costs
Interest bearing investments (cum-interest / cum-dividend basis)	Purchase Cost *less* interest/ dividend received from pre-acquisition portion
Equity / Preference Shares	Purchase cost + directly attributable costs
Bonds / Debentures	Purchase cost + directly attributable costs
In exchange of securities issued	Fair Value of securities issued / issue price determined by statutory authorities
In exchange of another asset	Fair value of the asset given up or Fair value of the investment acquired, whichever is more clearly evident.

Subsequent Measurement

19. At each reporting date, the Local Bodies should review the entire investment portfolio, whether short term or long term. Valuation should be done for each category of investment individually and not as a whole.

Short term investments

20. The short term investments are measured at lower of cost or fair value.

21. Valuation of short term investments on overall (or as a whole) basis is not considered appropriate. Entity may have a concern with the value of a category of related short term investments and not with each individual investment, and accordingly the investments may be carried at the lower of cost or fair value computed category-wise (i.e., equity shares, preference shares, convertible debentures, etc.). However, the more prudent and appropriate method is to carry investments individually at the lower of cost or fair value.

22. For short term investments, any decline in fair value and any reversals of such reductions are included in the income and expenditure statement.

Long term investments

23. 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 such decline. Indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment.

24. Long term investments are usually of individual importance to the investing entity. The carrying amount of long term investments is therefore determined on an individual investment basis.

25. Decline in value of long term investment which is other than temporary for a particular investment that the entity holds can be evaluated based on various factors. Illustrative list of factors that may indicate ‘other-than-temporary decline’ include:

- Fair value is significantly below cost.
- Decline in fair value is attributable to specific adverse conditions affecting a particular investment or industry or a geographic area.
- Management does not have both the intent and the ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in fair value.
- Decline in fair value has existed for an extended period of time.
- A security has been downgraded by a rating agency.
- Financial condition of the issuer has deteriorated.
- Dividends have been reduced or eliminated, or scheduled interest payments on securities have not been made or restructured.

If any of the factors exists, the diminution of value of investment should be made.

26. Where there is a decline, other than temporary, in the carrying amounts of long term investments, the resultant reduction in the carrying amount is charged to the income and expenditure statement. 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.

27. Any appreciation in market value of both short term and long term investments over the cost of investments should be ignored. If the appreciation is in respect of investments for which the diminution in value of investment was recorded in earlier years, the value of the said investments should be appreciated by an amount not greater than the diminution in value recorded in earlier years.

For example: Local Body purchased 10,000 equity shares of listed company A Ltd. at Rs. 5,000/- per share. Local Body intends to hold this investment for long term purposes. Market value at cut-off date, i.e., March 31, 2019 was Rs. 4,000/. Then difference between cost of acquisition & market value of Rs. 1,000 will be treated as decline which is temporary in nature and hence no diminution in value is required to be made.

Now, during F.Y. 2019-2020, the investee company has gone in liquidation and liquidation proceedings are underway as at cut-off date of 31st March, 2020. Since, amount that will be recovered on liquidation is yet to be ascertained and there could be possibility that no amount will be recovered and, accordingly, there is decline in value which is other than temporary in nature and hence the diminution in value is required to be made.

28. The carrying amount of investments at reporting date should be:

Type of Investment	Carrying Value
Short term investment	Lower of Cost or Fair Value.
Long term investments	At Cost. Diminution in value is reduced from carrying amount and charged to Income & Expenditure Statement, if there is a decline other than temporary.

Fair Value Measurement

29. A fair value measurement is for a particular investment and therefore, while measuring fair value, an entity should take into account the characteristics of the investment if market participants would take those characteristics into account when pricing the investment at the measurement date. Such characteristics include, for example, the followings:

a. the economic benefit from the investment; and
b. restrictions, if any, on the disposal of the investment.

30. Fair value is a market-based measurement, not an entity-specific measurement. For some investments, observable market transactions or market information might be available. For other investments, observable market transactions and market information might not be available. However, the objective of a fair value measurement in both cases is the same—to estimate the price at which an orderly transaction[5] to sell the investment would take place between market participants[6] at the measurement date under

[5] Orderly transaction is *"a transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such investments; it is not a forced transaction (e.g., a forced liquidation or distress sale)."*

[6] Market Participants *are "buyers and sellers in the principal (or most advantageous) market for the investments who have all of the following characteristics:*

a. They are independent of each other, i.e., they are not related parties as defined in ASLB 20, 'Related Party Disclosures', although the price in a related party transaction may be used as an input to a fair value measurement if the entity has evidence that the transaction was entered into at market terms.
b. They are knowledgeable, having a reasonable understanding about the investment and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary.
c. They are able to enter into a transaction for the investment.

current market conditions (i.e., an exit price at the measurement date from the perspective of a market participant that holds the investment).

31 A quoted market price in an active market provides the most reliable evidence of fair value of an investment. The adjustments to the quoted price may also be required to be made to arrive at fair value depending on various factors such as the volume of investments.

32. If no evidence is available to determine the market value of an investment in an active market, the fair value of the investment may be established by reference to:
    a. other investments with similar characteristics, in similar circumstances and markets. For example, the fair value of an unlisted company's equity shares may be estimated by reference to the market value of unlisted company with similar features for which market evidence is available, or
    b. discounted cash flow projections based on reliable estimates of future cash flows. For example, the fair value of debentures of an unlisted company may be estimated by reference to discounted future cash inflows from interests and redemption of debentures.

33. If there is no market-based evidence of fair value because of the specialised nature of the investment, an entity may need to estimate fair value using, the unobservable inputs such as entity's own data and analysis, information from market participants that is reasonably available.

Disposal of Investments

34. Investments may be held to maturity or may be disposed off before the maturity date. On disposal of an investment, the difference between the carrying amount and the disposal proceeds, net of expenses (such as commission, brokerage etc.), is recognised in the income and expenditure statement.

35. When disposing off 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.

Reclassification of Investments

36. Investments can be reclassified from long term to short term and short term to long term investments depending upon their maturity and intention of the management to hold the investment.

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d. *They are willing to enter into a transaction for the investment, i.e., they are motivated but not forced or otherwise compelled to do so."*

37. Where long term investments are reclassified as short term investments, the short term investments should be recorded at the lower of cost or carrying amount at the date of reclassification.

38. Where investments are reclassified from short term investments to long term investments, the long term investments should be recorded at the lower of cost or fair value at the date of reclassification.

39. The carrying amount of the reclassified investments will be as follows:

Reclassification	**Carrying Amount**
Reclassification of long term investment as short term investment	Lower of cost or carrying amount at the date of reclassification
Reclassification of short term investment as long term investment	Lower of cost or fair value at the date of reclassification

Guidance in case investments are made from specific funds

40. If the investments are made from specific/earmarked funds, then the following treatment is done:

(a) Income from investment should be credited to that specific fund,

(b) Profit on disposal of investments should be credited to that specific fund (or debited in case of loss on disposal), and

(c) Diminution in the value of investment should be debited to that specific fund.

Presentation & Disclosure in Financial Statements

41. Following information should be disclosed in the financial statements in relation to the investments:

a) Accounting policy for determination of carrying amount of investments;

b) Classification of investments as short term investments and long term investments distinctly; further classified into:
   i. Government securities
   ii. Fixed Deposits with Banks
   iii. Shares, debentures or bonds
   iv. Units of Mutual funds
   v. Others—specifying nature.

c) Amounts included in income and expenditure statement for:
    i. Interest & dividends on investments showing separately such income from long term and short term investments. Gross income should be stated, the amount of income tax deducted at source being included under Advance Taxes paid;
    ii. profits and losses on disposal of short term investments and changes in the carrying amount of such investments; and
    iii. profits and losses on disposal of long term investments and changes in the carrying amount of such investments;

d) significant restrictions on the right of ownership, realisability of investments or the remittance of income and proceeds of disposal;

e) the aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments;

f) Investments, after diminution in value of investment should be carried in Financial Statements at the reduced value. Aggregate diminution in value of investments to be disclosed separately.

g) Amount resulting from appreciation in investment, if any to be disclosed separately. (paragraph 27)

h) Previous reclassifications made, if any, in investment to be disclosed along with necessary quantification.

i) Other disclosures as specifically required by the relevant statute governing the entity.

Appendix

Implementation Guidance – Maintenance of Investment Register

This guidance accompanies, but is not a part of, Guidance Note on Accounting for investments.

A Local Body may have investment in variety of securities and to have better control over investments, proper record is required to be maintained. Following is an illustrative list of details to be maintained for each investment:

a. Description of the Investments along with Name of the issuer
b. Distinctive number of certificates/ receipt numbers (if certificates/receipts are available in physical form) along with quantity of investment, i.e., number of shares or bonds or debentures or units held
c. Face value of Investment made
d. Rate of Interest
e. Date of Acquisition of Investment
f. Cost of Acquisition
    a. Purchase Price
    b. Directly attributable cost (such as brokerage, fees, and taxes & duties)
g. Date of Maturity / Redemption/sale of investment
h. Date of receipt of investment proceeds
i. Amount realised on sales/disposal/redemption of Investments
j. Carrying Amount after reducing diminution in value of Investment
k. Other information in remarks:
    a. Market Value of Investment
    b. Interests/ dividend/rentals received on Investment
    c. Diminution in value of Investments
    d. Details of charge / pledged / lien created on such securities
    e. Whether investments have been held in demat account
    f. Gain or loss on disposal of investment

Illustrative Format of Investment Register

Sr. No.	Description of the Investments along with Name of issuer	Distinctive number of certificates/ receipt numbers	Face Value (Rs.)	Rate of Interest (%)	Date of acquisition of investment	Transaction note no.	No of shares/ units	Purchase Price (Rs.)	Directly Attributable cost (e.g. Brokerage, Fees, Duties and Taxes) (Rs.)	Total cost of Acquisition (Rs.)	Date of Maturity / Redemption /sale	Date of receipt of investment proceeds	Amount realised either on sale or maturity of investments	Carrying amount after reducing diminution in Value of Investment	Remarks (such as details regarding Market Value of Investment, Interests/ dividend/rentals received on Investment, Details of charge / pledged / lien created on investments, Whether investments have been held in demat account, Diminution in value of investment, Gain or loss on disposal of investments,)