MARK-TO-MARKET RESERVE EXPLANATION

This document should be read in conjunction with the Study guide theory and examples on page 14 – 20 and the document "Classification of equity instruments" available on *my*Unisa.

WHAT IS THE MARK-TO-MARKET RESERVE?

- The mark-to-market reserve is the fair value adjustments on equity instruments (financial assets) as per IFRS 9 held at fair value and classified through other comprehensive income.

- The mark-to-market reserve is an equity account therefore the after tax figure should be used (tax taken into account at CGT rate).

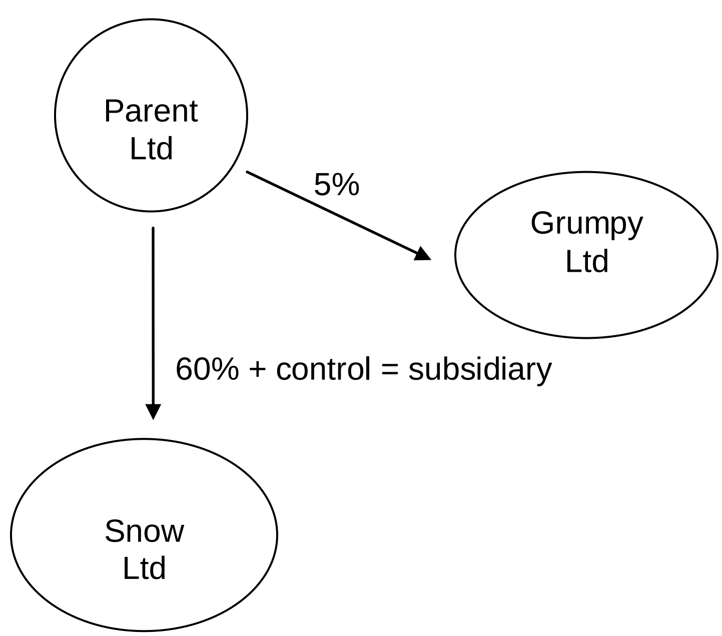
- Example: If a company purchased a share on 1 January 2012, which was trading at R20 per share (fair value) and at year end, 31 December 2012 the share's fair value is R30 per share, the company is required to fair value the share originally recorded at R20 to R30. The investment in the share will be disclosed at R30 in the SFP at year end.

  The fair value adjustment for 2012 will be R30 – R20 = R10.
  The amount which will be disclosed as other comprehensive income in the SP/LOCI is R10 x 81,4% = R8,14.
  The R8,14 will furthermore be disclosed under the mark-to-market reserve column in the SOCIE and SFP at year end 31 December 2012.
  (CGT calculated at 66,6% of normal tax 28%. Therefore 66,6% x 28% = 18,6% effective CGT rate.)

ILLUSTRATION 1:

Extract of the trial balance of the parent at year end:

<u>Mark-to-market reserve as per trial balance:</u>	24 420
- Investment in subsidiary – Snow Ltd	8 140
- Simple investment – Grumpy Ltd	16 280



<u>MARK-TO-MARKET RESERVE IN THE RECORDS OF THE PARENT RELATING TO THE INVESTMENT IN THE SUBSIDIARY, **SNOW LTD**:</u>

- When the parent has an investment in a subsidiary, Snow Ltd, the investment is usually classified as an equity instrument held at fair value through other comprehensive income. See above.

- The fair value adjustment, R8 140 in the records of the parent relating to the investment in the subsidiary, Snow Ltd **<u>will be reversed</u>** at acquisition date when preparing the consolidated financial statements of the group. *Please refer to the study guide examples on page 15 – 20 and the explanation as per "classification of equity instruments" document loaded onto myUnisa.*

- Therefore there will be no fair value adjustment (mark-to-market reserve) relating to the investment in the subsidiary, Snow Ltd in the consolidated financial statements.

<u>MARK-TO-MARKET RESERVE IN THE RECORDS OF THE PARENT RELATING TO THE SIMPLE INVESTMENT, **GRUMPY LTD**:</u>

- If the parent has a simple investment, Grumpy Ltd which is just a normal investment which will not be consolidated in the group statements, the investment can also be classified as an equity instrument held at fair value through other comprehensive income. See above.

- The investment in Grumpy Ltd together with the fair value adjustment, R16 280 in the records of the parent relating to this simple investment, Grumpy Ltd **<u>will remain</u>** just as it is in the parent's records, in the consolidated financial statements. This is because, similar to PPE and any other asset, assets should be included at 100% in consolidated group statements. The simple investment, Grumpy Ltd is just a financial asset in the records of the parent, therefore the investment(asset) and fair value adjustment on the investment will be disclosed in the consolidated statements.

Taking the above into account, the amount that will be disclosed as the mark-to-market reserve in the consolidated financial statements of the group will be R16 280.

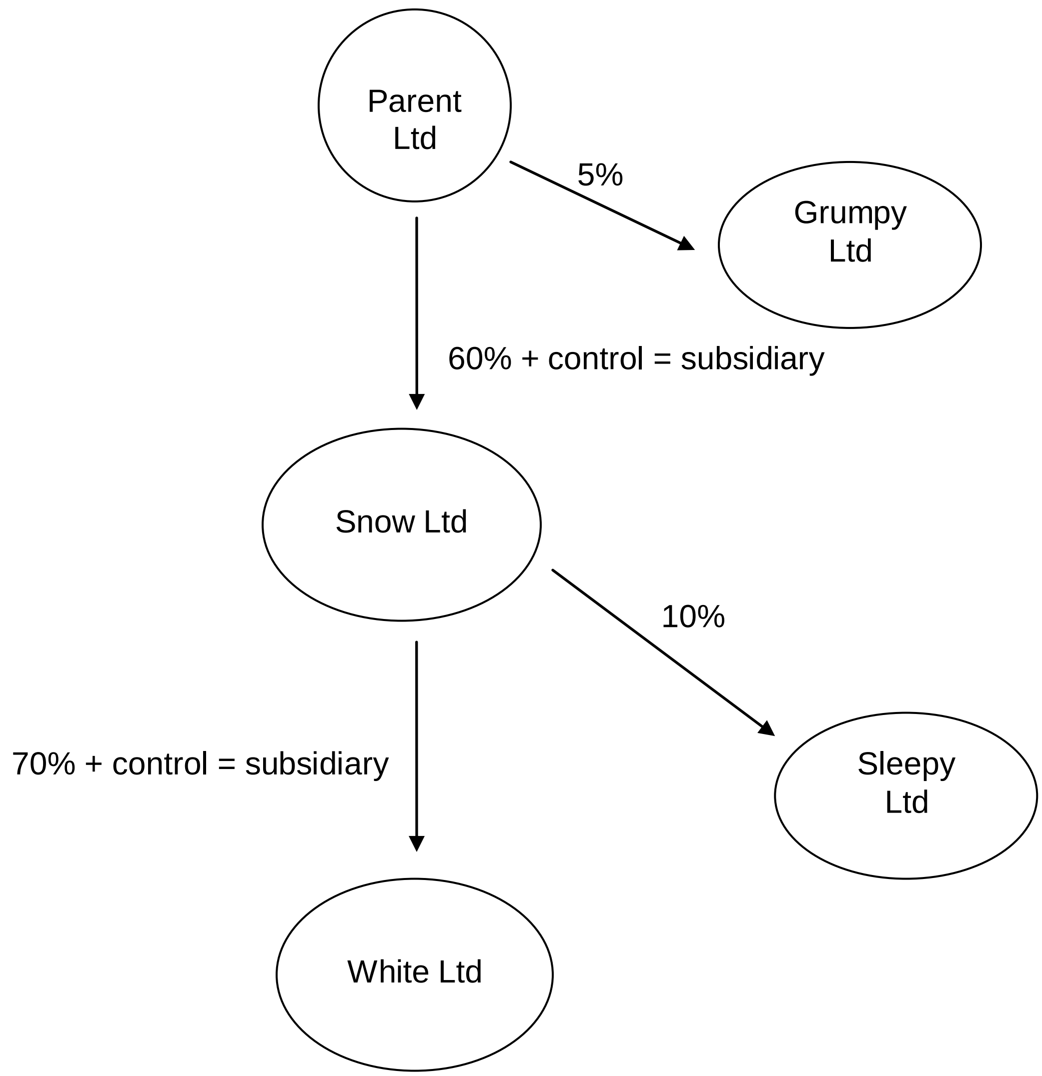
<u>Alternative explanation:</u>

Parent mark-to-market reserve as per trial balance	24 420
- *Elimination of investment in subsidiary – Snow Ltd*	(8 140)
Mark-to-market reserve as per consolidated financial statements	16 280

ILLUSTRATION 2:

Extract of the trial balances at year end:

	Parent Ltd	Snow Ltd
Mark-to-market reserve as per trial balance relating to:	24 420	18 722
- Investment in subsidiary – Snow Ltd	8 140	-
- Simple investment – Grumpy Ltd	16 280	-
- Investment in subsidiary – White Ltd	-	12 210
- Simple investment – Sleepy Ltd	-	6 512



MARK-TO-MARKET RESERVE IN THE RECORDS OF SNOW LTD RELATING TO THE INVESTMENT IN THE SUBSIDIARY, **WHITE LTD**:

- Taking into account what we have learnt in illustration 1, the fair value adjustment of R12 210 in the records of Snow Ltd relating to the investment in the subsidiary, White Ltd **will be reversed** at acquisition date when preparing the consolidated financial statements of the group. *Please refer to the study guide* *examples on page 15 – 20 and the explanation as per the "classification of equity instruments" document loaded onto myUnisa.*

- Therefore there will be no fair value adjustment (mark-to-market reserve) relating to the investment in subsidiary, White Ltd in the consolidated financial statements.

MARK-TO-MARKET RESERVE IN THE RECORDS OF SNOW LTD RELATING TO THE SIMPLE INVESTMENT, **SLEEPY LTD**:

- If Snow Ltd has a simple investment, Sleepy Ltd which will not be consolidated in the group statements, the investment can also be classified as an equity instrument held at fair value through other comprehensive income. See above.

- The investment in Sleepy Ltd together with the fair value adjustment on the investment of R6 512 in the records of Snow Ltd **will remain,** in the consolidated financial statements.

- The investment in Sleepy Ltd will be included at 100% in the consolidated group statements, because similarly to PPE and any other assets, assets of the subsidiary should be included at 100% line-for-line (consolidation) in the consolidated group statements. The simple investment, Grumpy Ltd is just a financial asset in the records of the subsidiary.

- Due to the fact that the mark-to-market reserve is an equity account, the portion attributable to NCI should be accounted for in the consolidated group statements! This will be done in the same way as allocating profits/retained earnings of the subsidiary between the parent and NCI.

Taking the above into account, the amount that will be disclosed as mark-to-market reserve in the consolidated financial statements of the group will be (R16 280 + 3 907 (6 512 x 60%)) = R20 187.

Alternative explanation:

Parent mark-to-market reserve as per trial balance	24 420
Snow Ltd mark-to-market reserve as per trial balance	18 722
- *Elimination of investment in subsidiary – Snow Ltd*	(8 140)
- *Elimination of investment in subsidiary – White Ltd*	(12 210)
- *Allocation of portion of mark-to-market reserve relating to Sleepy Ltd to NCI (6 512 x 40%)*	(2 605)
Mark-to-market reserve as per consolidated financial statements	20 187