Dear students

As the semester progresses we have become more aware that students struggle to understand the treatments of the fair value adjustments on the investments in equity instruments (investments in subsidiaries/associates/joint arrangements) and in particular the effect of the Mark-to-market reserve (MTMR).

We would therefore like to take the opportunity to explain the measurement treatment thereof.

**Classification of investments in equity instruments:**

There are two classification criteria of financial assets that are normally used to measure the investments in equity instruments. The investment in a subsidiary/associate/joint arrangement is an equity instrument. The two classification criteria in IFRS 9 are as follows:

1. Equity investments at fair value through profit or loss (See Illustration 1 and 2 of the study guide on pg 15-17) or
2. equity investments at fair value through other comprehensive income (See Illustration 3 and 4 of the study guide on pg 17-20) .

**Equity investments at fair value through profit or loss:**
The fair value adjustment and the tax effect are recognised in the profit or loss section of the statement of profit or loss and other comprehensive income. From there the profit or loss for the period is transferred to the statement of changes in equity in the retained earnings column.

Please see Illustration 1 & 2 in the study guide page 15-17.

**Equity investments at fair value through other comprehensive income:**
The fair value adjustment and the tax effect are recognised in the other comprehensive income section of the statement of profit or loss and other comprehensive income. From there the other comprehensive income for the period is transferred to the statement of changes in equity in the mark-to-market reserve column.

See Illustration 3 & 4 in the study guide page 17-20.

**What is mark-to-market reserve?**
The mark-to-market reserve is the fair value adjustments on investments in equity instruments (financial asset) measured at fair value through other comprehensive income according to IFRS 9.

Fair value adjustments (and the tax effect) on investment in equity instruments at FVTOCI are recognised directly in the other comprehensive income section of the statement of profit or loss and other comprehensive income and transferred from there to the statement of changes in equity in the column called the mark-to-market reserve. Please note that the profit or loss section of the statement of profit or loss and other comprehensive income is transferred to the statement of changes in equity in the retained earnings column.

Please refer to IFRS 9 for more detail on financial assets.

Therefore the investment in the subsidiary/associate/joint arrangement can be classified as an investment in equity instruments at fair value through other comprehensive income in the separate financial records of the parent.

This will result in the investment measured at fair value with fair value adjustments recognised directly in the other comprehensive income section and the balance after tax is transferred to the statement of changes in equity. A mark-to-market reserve and related deferred taxation balances will be recognised in the separate financial statements of the parent.

**Treatment of mark-to-market reserve in the consolidated financial statements of the group:**

In the consolidated financial statements, this mark-to-market reserve should be reversed in order to present accurate financial statements for the group:

- The investment in the subsidiary is required to be at cost on acquisition date as this represents the fair value of the consideration transferred at acquisition date, please refer IFRS 3.37.
- The investment in the associate/joint venture is initially recognised at cost according to the equity method, please refer IAS 28.10.

This is essential to correctly calculate any goodwill/gain on bargain purchase at acquisition date.

For more detail refer to the Group Statements textbook, Volume 1, 14th edition section 4.4 on page 115 and example 4.1 on page 116.

Please note that a mark-to-market reserve in the financial statements of the subsidiary relates to investments in equity instruments that the subsidiary holds and should be treated accordingly. This means if it relates to a simple investment that it should be treated as equity, other comprehensive income of the subsidiary and if it relates to a sub-subsidiary or associate treated as described above.

**Please refer to assignment 3, question 1 for examples on this matter.**

Kind regards,

The lecturers on FAC3704