CHAPTER 12

MUTUAL FUNDS

LEARNING OUTCOMES

After studying this chapter, you will be able to:

- Learn the definition of Mutual Funds and their history
- Comprehend with the regulations governing mutual funds in India
- Familiarize with the types of mutual funds
- Compute the net asset value (NAV) of mutual funds
- Understand the requirements for the annual report and annual statement of accounts of the schemes and the Mutual Funds

<u>Note</u>: This chapter is also discussed in Paper 2: Strategic Financial Management of Final Course Study Material. In Advanced Accounting Paper, students should emphasize upon accounting aspects of Mutual Funds only. Strategic Financial Management Paper deals with financial aspects of mutual funds.

CHAPTER OVERVIEW

In India, **Mutual Funds** are regulated by SEBI (Mutual Funds) Regulations, 1996. According to the SEBI (Mutual Funds) Regulations, 1996, a 'mutual fund' means a fund established in the form of a trust to raise monies through the sale of units to the public under one or more schemes for investing in securities including money market instruments or gold or gold related instruments or real estate assets.

A mutual fund should be registered with SEBI.

Types of Mutual Funds

On the basis of Structure- The mutual fund schemes can be classified as open ended and close ended. The open-ended schemes permit entry by subscription or exit by sale of units on a continuous basis. Close-ended scheme means any scheme of a mutual fund in which the period of the maturity of the scheme is specified.

On the basis of Investors Objectives - In terms of investment objectives, mutual fund schemes can be classified as the growth funds and income funds.

Mutual funds sell their shares to public and redeem them at current Net Asset Value (NAV) which is calculated as under –

$$\frac{\text{Total market value of all MF holdings - All MF liabilities}}{\text{Unit size}}$$

The **net asset value of a mutual fund** scheme is basically the per unit market value of all the assets of the scheme.

Every mutual fund is required to prepare in respect of each financial year an annual report and annual statement of accounts of the schemes and the fund as specified in Eleventh Schedule of SEBI (Mutual Funds) Regulations, 1996.

1. INTRODUCTION

A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The money thus collected is then invested in capital market instruments such as shares, debentures and other securities. The income earned through these investments and the capital appreciation realized is shared by its unit holders in proportion to the number of units owned by them.

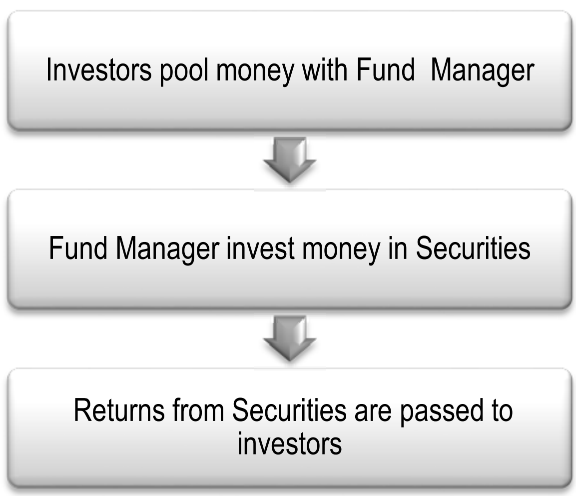
Different investment avenues are available to investors. Mutual funds also offer good investment opportunities to the investors. Like all investments, they also carry certain risks. The investors should compare the risks and expected yields after adjustment of tax on various instruments while taking investment decisions.

Investments in securities are spread across a wide cross-section of industries and sectors and thus the risk is reduced. Diversification reduces the risk because all stocks may not move in the same direction in the same proportion at the same time. Mutual fund issues units to the investors in accordance with quantum of money invested by them. Investors of mutual funds are known as unitholders.

The profits or losses are shared by the investors in proportion to their investments. The mutual funds normally come out with a number of schemes with different investment objectives which are launched from time to time. A mutual fund is required to be registered with Securities and Exchange Board of India (SEBI) which regulates securities markets before it can collect funds from the public.

As per section 2(q) of Securities and Exchange Board of India (SEBI) (Mutual Funds) Regulations, 1996, "Mutual Fund" means a fund established in the form of a trust to raise monies through the sale of units to the public or a section of the public under one or more schemes for investing in securities, including money market instruments or gold or gold related instruments or real estate assets.

The following flow chart describes broadly the working of a mutual fund:



2. HISTORY OF MUTUAL FUNDS IN INDIA AND ROLE OF SEBI IN MUTUALFUNDS INDUSTRY

Unit Trust of India was the first mutual fund set up in India in the year 1963. In early 1990s, Government allowed public sector banks and institutions to set up mutual funds. In the year 1992, Securities and exchange Board of India (SEBI) Act was passed. The objectives of SEBI are to protect the interest of investors in securities and to promote the development of and to regulate the securities market.

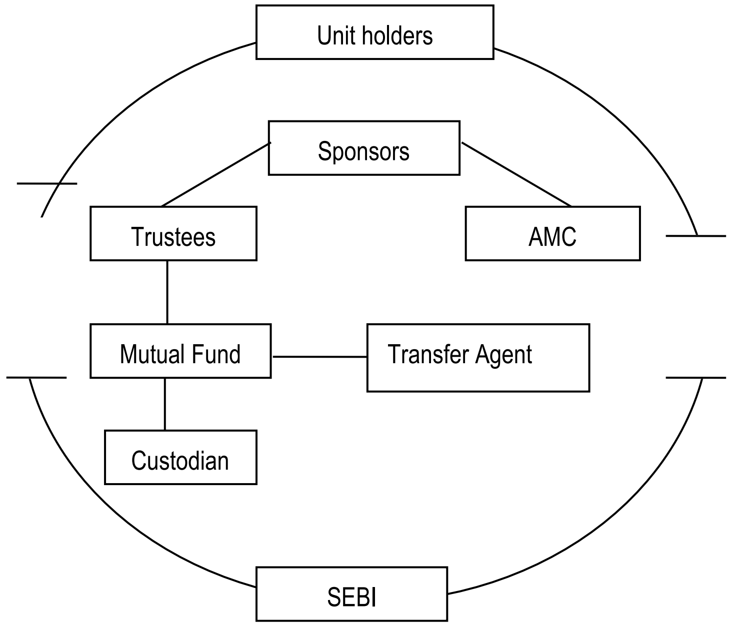
As far as mutual funds are concerned, SEBI formulates policies and regulates the mutual funds to protect the interest of the investors. SEBI notified regulations for the mutual funds in 1993. Thereafter, mutual funds sponsored by private sector entities were allowed to enter the capital market. The regulations were fully revised in 1996 and have been amended thereafter from time to time. SEBI has also issued guidelines to the mutual funds from time to time to protect the interests of investors.

All mutual funds whether promoted by public sector or private sector entities including those promoted by foreign entities are governed by the same set of Regulations. There is no distinction in regulatory requirements for these mutual funds and all are subject to monitoring and inspections by SEBI. The risks associated with the schemes launched by the mutual funds sponsored by these entities are of similar type.

3. ORGANISATION OF MUTUAL FUNDS

In India, mutual funds are regulated by SEBI (Mutual Funds) Regulations, 1996. A mutual fund is set up in the form of a trust, which has sponsor, trustees, asset management company (AMC) and custodian. The trust is established by a sponsor or more than one sponsor who is like promoter of a company. The trustees of the mutual fund hold its property for the benefit of the unitholders. Asset Management Company (AMC) approved by SEBI manages the funds by making investments in various types of securities. Custodian, who is registered with SEBI, holds the securities of various schemes of the fund in its custody. The trustees are vested with the general power of superintendence and direction over AMC. They monitor the performance and compliance of SEBI Regulations by the mutual fund.

SEBI Regulations require that at least two thirds of the directors of trustee company or board of trustees must be independent i.e. they should not be associated with the sponsors. Also, 50% of the directors of AMC must be independent. All mutual funds are required to be registered with SEBI before they launch any scheme.



“Asset management company” means a company formed and registered under the Companies Act, 1956 or 2013 and approved as such by the Securities and Exchange Board of India to manage the funds of a mutual fund.

“Unit” means the interest of the unit holders in a scheme, which consists of each unit representing one undivided share in the assets of a scheme;

Money market instruments provide for borrowers' short-term needs and give needed liquidity to lenders. Money market instruments include commercial papers, commercial bills, treasury bills, Government securities having an unexpired maturity up to one year, call or notice money, certificate of deposit, usance bills, and any other like instruments as specified by the Reserve Bank of India from time to time.

4. NET ASSET VALUE (NAV) OF A SCHEME

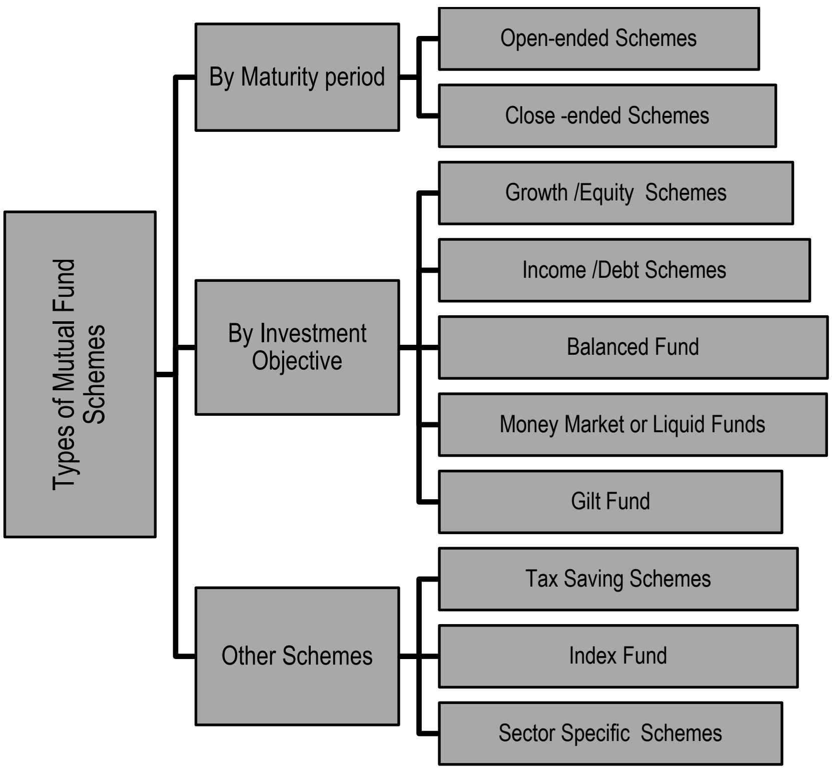
The performance of a particular scheme of a mutual fund is denoted by Net Asset Value (NAV).

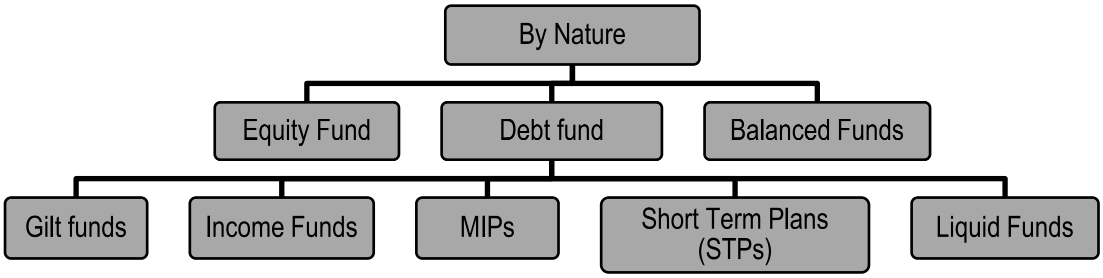
Mutual funds invest the money collected from the investors in securities markets. In simple words, Net Asset Value is the market value of the securities held by the scheme. Since market value of securities changes every day, NAV of a scheme also varies on day to day basis. The NAV per unit is the market value of securities of a scheme divided by the total number of units of the scheme on any particular date.

For example, if the market value of securities of a mutual fund scheme is Rs. 200 lakhs and the mutual fund has issued 10 lakhs units of Rs. 10 each to the investors, then the NAV per unit of the fund is Rs.20. NAV is required to be disclosed by the mutual funds on a regular basis - daily or weekly - depending on the type of scheme.

5. TYPES OF MUTUAL FUND SCHEMES

Wide variety of Mutual Fund Schemes exists to cater to the needs of the investors. There are over hundreds of mutual funds scheme to choose from. The charts given below will give an overview of various types of schemes:





All the above mentioned schemes have been discussed in brief in the succeeding paragraphs.

<u>By Maturity Period</u>

A mutual fund scheme can be classified into open-ended scheme or close-ended scheme depending on its maturity period:

1. Open - Ended Schemes: An open-end fund is one that is available for subscription and repurchase all through the year. These do not have a fixed maturity. Investors can conveniently buy and sell units at Net Asset Value ("NAV") related prices which are declared on a daily basis. The key feature of open-end schemes is liquidity.

2 Close - Ended Schemes: These schemes have a pre-specified maturity period. One can invest directly in the scheme at the time of the initial issue. Depending on the structure of the scheme there are two exit options available to an investor after the initial offer period closes. Investors can transact (buy or sell) the units of the scheme on the stock exchanges where they are listed. The market price at the stock exchanges could vary from the net asset value (NAV) of the scheme on account of demand and supply situation, expectations of unit holder and other market factors. Alternatively some close-ended schemes provide an additional option of selling the units directly to the Mutual Fund through periodic repurchase at the schemes NAV; however one cannot buy units and can only sell units during the liquidity window. SEBI Regulations ensure that at least one of the two exit routes is provided to the investor.

3. Interval Schemes: Interval Schemes are that scheme, which combine the features of open-ended and close-ended schemes. The units may be traded on the stock exchange or may be open for sale or redemption during pre-determined intervals at NAV related prices.

By Investment objective

A scheme can also be classified as growth scheme, income scheme, or balanced scheme considering its investment objective. Such schemes may be open-ended or close-ended schemes as described earlier. Such schemes may be classified mainly as follows:

1. Equity fund: The aim of growth funds is to provide capital appreciation over the medium to long- term. Such schemes normally invest a major part of their corpus in equities. Such funds have comparatively high risks. These schemes provide different options to the investors like dividend option, capital appreciation, etc. and the investors may choose an option depending on their preferences. The investors must indicate the option in the application form. The mutual funds also allow the investors to change the options at a later date. Growth schemes are good for investors having a long-term outlook seeking appreciation over a period of time. The Equity Funds are sub-classified depending upon their investment objective, as follows:

- Diversified Equity Funds
- Mid-Cap Funds
- Sector Specific Funds
- Tax Savings Funds (ELSS)

Equity investments are meant for a longer time horizon, thus Equity funds rank high on the risk-return matrix. Growth Schemes are also known as equity schemes. The aim of these schemes is to provide capital appreciation over medium to long term. These schemes normally invest a major part of their fund in equities and are willing to bear short-term decline in value for possible future appreciation.

- **Income Schemes**: Income Schemes are also known as debt schemes. The aim of these schemes is to provide regular and steady income to investors. These schemes generally invest in fixed income securities such as bonds and corporate debentures. Capital appreciation in such schemes may be limited.
- **Balanced Schemes:** Balanced Schemes aim to provide both growth and income by periodically distributing a part of the income and capital gains they earn. These schemes invest in both shares and fixed income securities, in the proportion indicated in their offer documents (normally 50:50).
- **Money Market Schemes**: Money Market Schemes aim to provide easy liquidity, preservation of capital and moderate income. These schemes generally invest

in safer, short-term instruments, such as treasury bills, certificates of deposit, commercial paper and inter-bank call money.

2. **Debt funds:** The objective of these Funds is to invest in debt papers. Government authorities, private companies, banks and financial institutions are some of the major issuers of debt papers. By investing in debt instruments, these funds ensure low risk and provide stable income to the investors. These funds are not affected because of fluctuations in equity markets. However, opportunities of capital appreciation are also limited in such funds. The NAVs of such funds are affected because of change in interest rates in the country. If the interest rates fall, NAVs of such funds are likely to increase in the short run and vice versa. However, long term investors may not bother about these fluctuations. Debt funds are further classified as:

- **Income Funds**: Invest a major portion into various debt instruments such as bonds, corporate debentures and Government securities.
- **Monthly Income Plans (MIPs)**: Invests maximum of their total corpus in debt instruments while they take minimum exposure in equities. It gets benefit of both equity and debt market. These scheme ranks slightly high on the risk-return matrix when compared with other debt schemes.
- **Short Term Plans (STPs)**: Meant for investment horizon for three to six months. These funds primarily invest in short term papers like Certificate of Deposits (CDs) and Commercial Papers (CPs). Some portion of the corpus is also invested in corporate debentures.
- **Liquid Funds**: Also known as Money Market Schemes, These funds provide easy liquidity and preservation of capital. These schemes invest in short-term instruments like Treasury Bills, inter-bank call money market, CPs and CDs. These funds are meant for short-term cash management of corporate houses and are meant for an investment horizon of 1 day to 3 months. These schemes rank low on risk-return matrix and are considered to be the safest amongst all categories of mutual funds.

3. **Balanced funds:** As the name suggest they, are a mix of both equity and debt funds. They invest in both equities and fixed income securities, which are in line with pre-defined investment objective of the scheme. These schemes aim to provide investors with the best of both the worlds. Equity part provides growth and the debt part provides stability in returns. They generally invest 40-60% in equity and debt instruments. These funds are also affected because of fluctuations in share prices in the stock markets. However, NAVs of such funds are likely to be less volatile compared to pure equity funds.

4. Money Market or Liquid Fund: These funds are also income funds and their aim is to provide easy liquidity, preservation of capital and moderate income. These schemes invest exclusively in safer short-term instruments such as treasury bills, certificates of deposit, commercial paper and inter-bank call money, government securities, etc. Returns on these schemes fluctuate much less compared to other funds. These funds are appropriate for corporate and individual investors as a means to park their surplus funds for short periods.

5. Gilt Funds: These funds invest exclusively in government securities. Government securities have no default risk. NAVs of these schemes also fluctuate due to change in interest rates and other economic factors as is the case with income or debt oriented schemes.

By Other Schemes

1. Tax Saving Schemes: Tax-saving schemes offer tax rebates to the investors under tax laws prescribed from time to time. Under Sec. 80C (2) of the Income Tax Act, contributions made to any notified Equity Linked Savings Scheme (ELSS) are eligible for deduction. Pension schemes launched by the mutual funds also offer tax benefits. These schemes are growth oriented and invest pre-dominantly in equities. Their growth opportunities and risks associated are like any equity-oriented scheme.

2. Index Schemes: Index schemes attempt to replicate the performance of a particular index such as the BSE Sensex or the NSE 50. The portfolio of these schemes will consist of only those stocks that constitute the index. The percentage of each stock to the total holding will be identical to the stocks index weightage. And hence, the returns from such schemes would be more or less equivalent to those of the Index.

3. Sector Specific Schemes: These are the funds/schemes which invest in the securities of only those sectors or industries as specified in the offer documents. e.g. Pharmaceuticals, Software, Fast Moving Consumer Goods (FMCG), Petroleum stocks, etc. The returns in these funds are dependent on the performance of the respective sectors/industries. While these funds may give higher returns, they are riskier compared to diversified funds. Investors need to keep a watch on the performance of those sectors/industries and must exit at an appropriate time.

6. FUND OF FUNDS (FOF) SCHEME

A scheme that invests primarily in other schemes of the same mutual fund or other mutual funds is known as a FoF scheme. An FoF scheme enables the investors to achieve greater diversification through one scheme. It spreads risks across a greater universe.

7. LOAD OR NO-LOAD FUND

A Load Fund is one that charges a percentage of NAV for entry or exit. That is, each time one buys or sells units in the fund, a charge will be payable. This charge is used by the mutual fund for marketing and distribution expenses. Suppose the NAV per unit is Rs.10. If the entry as well as exit load charged is 1%, then the investors who buy would be required to pay Rs.10.10 and those who offer their units for repurchase of the mutual fund will get only Rs.9.90 per unit. The investors should take the loads into consideration while making investment as these affect their yields/returns. However, the investors should also consider the performance track record and service standards of the mutual fund which are more important. Efficient funds may give higher returns in spite of loads.

A no-load fund is one that does not charge for entry or exit. It means the investors can enter the fund/scheme at NAV and no additional charges are payable on purchase or sale of units.

8. FREQUENTLY USED TERMS

Net Asset Value (NAV): Net asset value is the market value of the assets of the scheme minus its liabilities. The per unit NAV is the net asset value of the scheme divided by the number of units outstanding on the valuation date.

Sale Price (SP): It is the price you pay when you invest in a scheme; also called offer price. It may include a sales load.

Repurchase Price: It is the price at which units under open-ended schemes are repurchased by the Mutual Fund. Such prices are NAV related.

Redemption Price: It is the price at which close-ended schemes redeem their units on maturity. Such prices are NAV related.

Sales Load: It is a charge collected by a scheme when it sells the units. Also called 'Front-end' load. Schemes that do not charge a load are called 'No Load' schemes.

Repurchase or 'Back-end' Load: It is a charge collected by a scheme when it buys back the units from the unit holders.

The Association of Mutual Funds in India (AMFI): The Association is dedicated to developing the Indian Mutual Fund Industry on professional, healthy and ethical lines and to enhance and maintain standards in all areas with a view to protecting and promoting the interests of mutual funds and their unit holders.

9. SEBI GUIDELINES FOR MUTUAL FUNDS IN INDIA

Application for registration An application for registration of a mutual fund shall be made to the Board in Form A by the sponsor.

Furnishing information

The Board may require the sponsor to furnish such further information or clarification as may be required by it.

Eligibility criteria

(a) For the purpose of grant of a certificate of registration, the applicant has to fulfill the following, namely, the sponsor should have a sound track record and general reputation of fairness and integrity in all his business transactions;

Explanation: For the purposes of this clause "sound track record" shall mean the sponsor should,-

(i) be carrying on business in financial services for a period of not less than five years; and the net worth is positive in all the immediately preceding five years; and the net worth in the immediately preceding year is more than the capital contribution of the sponsor in the asset management company; and

(ii) the sponsor has profits after providing for depreciation, interest and tax in three out of the immediately preceding five years, including the fifth year.

(b) applicant is a fit and proper person

(c) in the case of an existing mutual fund, such fund is in the form of a trust and the trust deed has been approved by the Board;

(d) the sponsor has contributed or contributes at least 40% to the net worth of the asset management company;

Provided that any person who holds 40% or more of the net worth of an asset management company shall be deemed to be a sponsor and will be required to fulfill the eligibility criteria specified in these regulations;

(e) the sponsor or any of its directors or the principal officer to be employed by the mutual fund should not have been guilty of fraud or has not been convicted of an offense involving moral turpitude or has not been found guilty of any economic offence.

(f) appointment of trustees to act as trustees for the mutual fund in accordance with the provisions of the regulations;

(g) appointment of asset management company to manage the mutual fund and operate the scheme of such funds in accordance with the provisions of these regulations;

(h) Appointment of a custodian in order to keep custody of the securities and carry out the custodian activities as may be authorized by the trustees.

The Board may register the mutual fund and grant a certificate in Form B on the applicant paying the registration fee as specified.

Trust Deed to be registered under the Registration Act

A mutual fund shall be constituted in the form of a trust and the instrument of trust shall be in the form of a deed, duly registered under the provisions of the Indian Registration Act, 1908 (16 of 1908) executed by the sponsor in favour of the trustees named in such an instrument.

Approval of the Board for appointment of trustee

No trustee shall initially or any time thereafter be appointed without prior approval of the Board. The existing trustees of any mutual fund may form a trustee company to act as a trustee with the prior approval of the Board.

Rights and obligations of the trustees

The trustees and the asset management company shall with the prior approval of the Board enter into an investment management agreement. The trustees shall ensure before the launch of any scheme that the asset management company has;-

(a) systems in place for its back office, dealing room and accounting;

(b) appointed all key personnel including fund manager(s) for the scheme(s) and submitted their bio-data which shall contain the educational qualifications, past experience in the securities market with the trustees, within 15 days of their appointment;

(c) appointed auditors to audit its accounts;

(d) appointed a compliance officer to comply with regulatory requirement and to redress investor grievances;

(e) appointed registrars and laid down parameters for their supervision;

(f) prepared a compliance manual and designed internal control mechanisms including internal audit systems;

(g) specified norms for empanelment of brokers and marketing agents.

The trustees shall ensure that an asset management company has been diligent in empanelling the brokers, in monitoring securities transactions with brokers and avoiding undue concentration of business with any broker.

Each trustee shall file the details of his transactions of dealing in securities with the Mutual Fund on a quarterly basis.

The trustees shall be accountable for, and be the custodian of, the funds and Trustees shall exercise due diligence as under:

1. The Trustees shall be discerning in the appointment of the directors on the Board of the asset management company.
2. The trustee shall ensure that the trust property is properly protected, held and administered by proper persons and by a proper number of such persons.
3. The trustee shall ensure that all service providers are holding appropriate registrations from the Board or concerned regulatory authority.
4. The Trustees shall arrange for test checks of service contracts.
5. Trustees shall immediately report to Board of any special developments in the mutual fund.
6. The Trustees shall: obtain internal audit reports at regular intervals from independent auditors appointed by the Trustees.
7. Obtain compliance certificates at regular intervals from the asset management company.
8. Hold meeting of trustees more frequently to review the operation of the AMC function and auditor's report in order to take appropriate action.

10. ANNUAL REPORT

Every mutual fund or the asset management company is required to prepare in respect of each financial year an annual report and annual statement of accounts of the schemes and the fund as specified in Eleventh Schedule to the SEBI (Mutual Funds) Regulations, 1996.

As per Regulation 51, the financial year, for all the schemes, shall end as of March 31st of each year.

The scheme wise Annual Report of a mutual fund or an abridged summary thereof shall be mailed to all the unit holders as soon as may be but not later than four months from the date of closure of the relevant accounts year.

According to Eleventh Schedule, the annual report shall contain –

(i) Report of the board of Trustees on the operations of the various schemes of the fund and the fund as a whole during the year and the future outlook of the fund;

(ii) Balance Sheet and Revenue Account in accordance with paras 2, 3 and 4, respectively of this Schedule;

(iii) Auditor's Report in accordance with paragraph 5 of this Schedule;

(iv) Brief statement of the Board of Trustees on the following aspects, namely:-

(a) Liabilities and responsibilities of the Trustees and the Settlor;

(b) Investment objective of each scheme;

(c) Basis and policy of investment underlying the scheme;

(d) If the scheme permits investment partly or wholly in shares, bonds, debentures and other scrips or securities whose value can fluctuate, a statement on the following lines:

"The price and redemption value of the units, and income from them, can go up as well as down with the fluctuations in the market value of its underlying investments in securities or fair value in underlying real estate asset, as the case may be."

(e) Comments of the Trustees on the performance of the scheme, with full justification.

(v) Statement giving relevant perspective historical 'per unit' statistics in accordance with paragraph 6 of this Schedule;

(vi) Statement on the following lines:

"On written request, present and prospective unit holders /investors can obtain copy of the trust deed, the annual report [at a price] and the text of the relevant scheme."

11. RESTRICTION ON INVESTMENTS

As per Seventh Schedule to the SEBI (Mutual Funds) Regulations, 1996, a mutual fund scheme shall not invest more than ***10%*** of its NAV in debt instruments issued by a single issuer which are rated not below investment grade by a credit rating agency authorised to carry out such activity under the Act. Such investment limit may be extended to ***12%*** of the NAV of the scheme with the prior approval of the Board of Trustees and the Board of asset management company. Provided that such limit shall not be applicable for investments in government securities and money market instruments.

1. A mutual fund scheme shall not invest more than 10% of its NAV in unrated debt instruments issued by a single issuer and the total investment in such instruments shall not exceed 25% of the NAV of the scheme. All such investments shall be made with the prior approval of the Board of Trustees and the Board of asset management company.
2. No mutual fund under all its schemes should own more than ten per cent of any company's paid up capital carrying voting rights.
3. Transfers of investments from one scheme to another scheme in the same mutual fund shall be allowed only if, -

   (a) such transfers are done at the prevailing market price for quoted instruments on spot basis.

   [Explanation - "spot basis" shall have same meaning as specified by stock exchange for spot transactions.]

   (b) the securities so transferred shall be in conformity with the investment objective of the scheme to which such transfer has been made.
4. A scheme may invest in another scheme under the same asset management company or any other mutual fund without charging any fees, provided that aggregate inter scheme investment made by all schemes under the same management or in schemes under the management of any other asset management company shall not exceed 5% of the net asset value of the mutual fund.
5. Every mutual fund shall buy and sell securities on the basis of deliveries and shall in all cases of purchases, take delivery of relevant securities and in all cases of sale, deliver the securities.

   Provided that a mutual fund may engage in short selling of securities in accordance with the framework relating to short selling and securities lending and borrowing specified by the Board.

   Provided further that a mutual fund may enter into derivatives transactions in a recognized stock exchange, subject to the framework specified by the Board.

Provided further that sale of government security already contracted for purchase shall be permitted in accordance with the guidelines issued by the Reserve Bank of India in this regard.

6. Every mutual fund shall, get the securities purchased or transferred in the name of the mutual fund on account of the concerned scheme, wherever investments are intended to be of long term nature.
7. Pending deployment of funds of a scheme in securities in terms of investment objectives of the scheme a mutual fund may invest them in short term deposits of scheduled commercial banks.
8. No mutual fund [scheme] shall make any investment in;
   (a) any unlisted security of an associate or group company of the sponsor; or
   (b) any security issued by way of private placement by an associate or group company of the sponsor; or
   (c) the listed securities of group companies of the sponsor which is in excess of 25% of the net assets.
9. No mutual fund scheme shall invest more than 10 per cent of its NAV in the equity shares or equity related instruments of any company.

   Provided that, the limit of 10 per cent shall not be applicable for investments [in case of] index fund or sector or industry specific scheme.
10. A mutual fund scheme shall not invest more than 5% of its NAV in the unlisted equity shares or equity related instruments in case of open ended scheme and 10% of its NAV in case of close ended scheme.
11. A fund of funds scheme shall be subject to the following investment restrictions:
    a. A fund of funds scheme shall not invest in any other fund or funds scheme;
    b. A fund of funds scheme shall not invest its assets other than in schemes of mutual funds, except to the extent of funds required for meeting the liquidity requirements for the purpose of repurchases or redemptions, as disclosed in the offer document of fund of funds scheme.

12. COST OF INVESTMENTS

According to Ninth Schedule of SEBI (Mutual Fund) Regulations, 1996, cost of investments acquired or purchased should include brokerage, stamp charges and any charge customarily included in the broker's bought note. In respect of privately placed debt instruments any front – end discount offered should be deducted from the cost of the investment.

As per the Eleventh Schedule of the SEBI Regulations, in respect of all interest – bearing investments, income must be accrued on a day-to-day basis as it is earned. Therefore, when such investments are purchased, interest paid for the period from the last interest due date upto the date of purchase must not be treated as a cost of purchase but must be debited to Interest Recoverable Account. Similarly, interest received at the time of sale for the period from the last interest due date upto the date of sale must not be treated as an addition to sale value but must be credited to Interest Recoverable Account.

In determining the holding cost of investments and the gains or loss on sale of investments, the "average cost" method must be followed. As per Regulation 51A, the exit load charged, if any, shall be credited to the scheme.

13. INVESTMENT VALUATION NORMS

Eight Schedule of the SEBI (Mutual Fund) Regulations, 1996 states the Investment Valuation Norms. NAV of a scheme is determined by dividing the net assets of the scheme by the number of outstanding units on the valuation date.

1. Traded Securities:-

(i) The securities shall be valued at the last quoted closing price on the recognized stock exchange.

(ii) When the securities are traded on more than one recognised stock exchange, the securities shall be valued at the last quoted closing price on the stock exchange where the security is principally traded. It would be left to the asset management company to select the appropriate stock exchange, but the reasons for the selection should be recorded in writing. There should however be no objection for all scrips being valued at the prices quoted on the stock exchange where a majority in value of the investments is principally traded.

(iii) Once a stock exchange has been selected for valuation of a particular security, reasons for change of the exchange shall be recorded in writing by the asset management company.

(iv) When on a particular valuation day, a security has not been traded on the selected stock exchange, the value at which it is traded on another stock exchange may be used.

(v) When a security is not traded on any stock exchange on a particular valuation day, the value at which it was traded on the selected stock exchange or any other stock exchange, as the case may be, on the earliest previous day may be used provided such date is not more than sixty days prior to the valuation date.

2. 'Non-traded Securities':-

(i) When a security is not traded on any stock exchange for a period of thirty days prior to the valuation date, the scrip must be treated as a 'non-traded' scrip.

(ii) Non-traded securities shall be valued "in-good faith" by the asset management company on the basis of appropriate valuation methods based on the principles approved by the Board of the asset management company.

[For example, non-traded debt and money market securities of short term maturities, as may be specified by the Board from time to time, may be valued on amortization basis provided that such valuation shall be reflective of the fair value of the securities and all investors are treated fairly.]

Such decision of the Board must be documented in the Board minute and the supporting data in respect of each security so valued must be preserved. The methods used to arrive at values "in-good faith" shall be periodically reviewed by the trustees and reported upon by the auditors as "fair and reasonable" in their report on the annual accounts of the fund. For the purpose of valuation of non-traded securities, the following principles should be adopted:-

(a) Equity instruments shall generally be valued on the basis of capitalization of earnings solely or in combination with the net asset value, using for the purposes of capitalization, the price or earning ratios of comparable traded securities and with an appropriate discount for lower liquidity;

(b) Debt instruments shall generally be valued on a yield to maturity basis, the capitalization factor being determined for comparable traded securities and with an appropriate discount for lower liquidity;

(c) Investments in call money, bills purchased under rediscounting scheme and short term deposits with banks shall be valued at cost plus accrual; other money market instruments shall be valued at the yield at which they are currently traded. For this purpose, non-traded instruments that is instruments not traded for a period of seven days will be valued at cost plus interest accrued till the beginning of the day plus the difference between the redemption value and the cost spread uniformly over the remaining maturity period of the instruments; Government securities will be valued at yield to maturity based on the prevailing market rate.

(d) In respect of convertible debentures and bonds, the non-convertible and convertible components shall be valued separately. The non-convertible component should be valued on the same basis as would be applicable to a debt instrument. The convertible component should be valued on the same basis as would be applicable to an equity instrument. If, after conversion the resultant equity instrument would be traded pari passu with an existing instrument which is traded, the value of the latter instrument can be adopted after an appropriate discount for the non-tradability of the instrument during the period preceding the conversion. While valuing such instruments, the fact whether the conversion is optional should also be factored in;

(e) In respect of warrants to subscribe for shares attached to instruments, the warrants can be valued at the value of the share which would be obtained on exercise of the warrant as reduced by the amount which would be payable on exercise of the warrant. A discount similar to the discount to be determined in respect of convertible debentures (as referred to in sub-paragraph (d) above) must be deducted to account for the period which must elapse before the warrant can be exercised;

(f) Where instruments have been bought on ₹ repo' basis, the instrument must be valued at the resale price after deduction of applicable interest upto date of resale. Where an instrument has been sold on a ₹ repo' basis, adjustment must be made for the difference between the repurchase price (after deduction of applicable interest upto date of repurchase) and the value of the instrument. If the repurchase price exceeds the value, the depreciation must be provided for and if the repurchase price is lower than the value, credit must be taken for the appreciation.

3. Until they are traded, the value of the "rights" shares should be calculated as:

$$Vr = n/m \times (Pex - Pof)$$

where Vr = Value of rights

n = no. of rights offered

m = no.of original shares held

Pex = Ex-rights price

Pof = Rights Offer Price

Where the rights are not treated pari passu with the existing shares, suitable adjustment should be made to the value of rights. Where it is decided not to subscribe for the rights but to renounce them and renunciations are being traded, the rights can be valued at the renunciation value.

Value of Gold:

The gold held by a gold exchange traded fund scheme shall be valued at the AM fixing price of London Bullion Market Association (LBMA) in US dollars per troy ounce for gold having a fineness of 995.0 parts per thousand, subject to the following:

(a) adjustment for conversion to metric measure as per standard conversion rates;

(b) adjustment for conversion of US dollars into Indian rupees as per the RBI reference rate declared by the Foreign Exchange Dealers Association of India (FEDAI); and

(c) Addition of-

  (i) transportation and other charges that may be normally incurred in bringing such gold from London to the place where it is actually stored on behalf of the mutual fund; and

  (ii) notional customs duty and other applicable taxes and levies that may be normally incurred to bring the gold from the London to the place where it is actually stored on behalf of the mutual fund. Provided that the adjustment under clause (c) above may be made on the basis of a notional premium that is usually charged for delivery of gold to the place where it is stored on behalf of the mutual fund. Provided further that where the gold held by a gold exchange traded fund scheme has a greater fineness, the relevant LBMA (London Bullion Market Association) prices of AM fixing shall be taken as the reference price under this sub-paragraph.

If the gold acquired by the gold exchange traded fund scheme is not in the form of standard bars, it shall be assayed and converted into standard bars which comply with the good delivery norms of the LBMA and thereafter valued in terms of sub-paragraph (1).

All expenses and incomes accrued upto the valuation date shall be considered for computation of net asset value. For this purpose, while major expenses like management fees and other periodic expenses should be accrued on a day to day basis, other minor expenses and income need not be so accrued, provided the non-accrual does not affect the NAV calculations by more than 1%.

Any changes in securities and in the number of units be recorded in the books not later than the first valuation date following the date of transaction. If this is not possible given the frequency of the Net Asset Value disclosure, the recording may be delayed upto a period of seven days following the date of the transaction, provided that as a result of the non-recording, the Net Asset Value calculations shall not be affected by more than ***1%***.

In case the Net Asset Value of a scheme differs by more than 1%, due to non-recording of the transactions, the investors or scheme/s as the case may be, shall be paid the difference in amount as follows:

(i) If the investors are allotted units at a price higher than Net Asset Value or are given a price lower than Net Asset Value at the time of sale of their units, they shall be paid the difference in amount by the scheme.

(ii) If the investors are charged lower Net Asset Value at the time of purchase of their units or are given higher Net Asset Value at the time of sale of their units, asset management company shall pay the difference in amount to the scheme. The asset management company may recover the difference from the investors.

Thinly traded securities as defined in the guidelines shall be valued in the manner as specified in the guidelines issued by the Board.

The aggregate value of illiquid securities as defined in the guidelines shall not exceed 15 per cent of the total assets of the scheme and any illiquid securities held above 15 per cent of the total assets shall be valued in the manner as specified in the guidelines issued by Board.

14. MARKING INVESTMENTS TO MARKET

For the purposes of the financial statements, mutual funds shall mark all investments to market and carry investments in the balance sheet at market value. However, since the unrealized gain arising out of appreciation on investments cannot be distributed, provision has to be made for exclusion of this item when arriving at distributable income.

15. PRICING OF UNITS

As per Regulation 49 of the SEBI (Mutual Funds) Regulations, 1996:

(1) The price at which the units may be subscribed or sold and the price at which such units may at any time be repurchased by the mutual fund shall be made

available to the investors.

(2) The mutual fund, in case of open ended scheme, shall at least once a week publish in a daily newspaper of all India circulation, the sale and repurchase price of units.

(3) While determining the prices of the units, the mutual fund shall ensure that the repurchase price is not lower than 93% of the Net Asset Value and the sale price is not higher than 107% of the Net Asset Value.

Provided that the repurchase price of the units of a close ended scheme shall not be lower than 95% of the Net Asset Value:

Provided further that the difference between the repurchase price and the sale price of the unit shall not exceed 7% calculated on the sale price.

(3A) Where a mutual fund repurchases units in a close ended scheme launched prior to the commencement of the SEBI (Mutual Funds) (Amendment) Regulations, 2009 which fulfils the conditions mentioned in sub-regulation (3B), it shall deduct an amount representing proportionate initial issue expenses or part thereof remaining unamortized, from the repurchase proceeds.

Explanation:

The term —proportionate initial issue expenses or part thereof remaining unamortised refers to such proportion of the expenses of the scheme as are attributable to the units being repurchased.

(3B) The conditions referred to in sub-regulation (3A) are the following:

(a) the scheme is launched after the commencement of the Securities and Exchange Board of India (Mutual Funds) (Second Amendment) Regulations, 2006 and prior to commencement of the Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2008;

(b) initial issue expenses in respect of the scheme are accounted in the books of accounts of the scheme in accordance with Tenth Schedule.

(3C) The amount recovered under sub-regulation (3A) shall be credited to the unamortized initial issue expenses of the scheme.

(4) The price of units shall be determined with reference to the last determined Net Asset Value as mentioned in sub-regulation (3) unless,

(a) the scheme announces the Net Asset Value on a daily basis; and

(b) the sale price is determined with or without a fixed premium added to the future net asset value which is declared in advance.

16. LIMITATION ON FEES AND EXPENSES ON ISSUE OF SCHEMES

As per Regulation 52 of SEBI (Mutual Funds) Regulations, 1996, all expenses should be clearly identified and appropriated in the individual schemes. The asset management company may charge the scheme with investment and advisory fees which shall be fully disclosed in the offer document.

In addition to the above, the asset management company may charge the scheme with certain recurring expenses as mentioned in sub regulation 4 of Regulation 52.

Any other expense shall be borne by the asset management company or trustee or sponsors.

The total expenses of the scheme excluding issue or redemption expenses, whether initially borne by the mutual fund or by the asset management company, but including the investment management and advisory fee shall be subject to the following limits:—

(a) in case of a fund of funds scheme, the total expenses of the scheme including weighted average of charges levied by the underlying schemes shall not exceed 2.50 per cent of the daily net assets of the scheme.

(b) in case of an index fund scheme or exchange traded fund, the total expenses of the scheme including the investment and advisory fees shall not exceed one and one half percent (1.5%) of the daily net assets;

(c) in case of any other scheme-

(i) on the first ₹ 100 crores of the daily net assets 2.5%;

(ii) on the next ₹ 300 crores of the daily net assets 2.25%;

(iii) on the next ₹ 300 crores of the daily net assets 2.0%;

(iv) on the balance of the assets 1.75%:

In addition to the limits specified above, the following costs or expenses may be charged to the scheme, namely -

(a) brokerage and transaction costs which are incurred for the purpose of execution of trade and is included in the cost of investment, not exceeding 0.12 per cent in case of cash market transactions and 0.05 per cent in case of derivatives transactions;

(b) expenses not exceeding of 0.30 per cent of daily net assets, if the new inflows from such cities as specified by the Board from time to time are at least -

(i) 30 per cent of gross new inflows in the scheme, or;

(ii) 15 per cent of the average assets under management (year to date) of the scheme,

whichever is higher:

(c) additional expenses, incurred towards different heads mentioned under sub regulations (2) and (4), not exceeding 0.20 per cent of daily net assets of the scheme

Any expenditure in excess of the limits specified shall be borne by the asset management company or by the trustee or sponsors.

17. ACCOUNTING POLICIES FOR INVESTMENT IN SECURITIES

As per Regulation 50(3) of SEBI (Mutual Funds) Regulations, 1996, the Asset Management Companies are required to follow the accounting policies and standards specified in the Ninth Schedule of the Regulations so as to provide appropriate details of the scheme-wise disposition of the assets of the fund at the relevant accounting date and the performance during that period together with information regarding distribution or accumulation of income accruing to the unitholder in a fair and true manner.

Following accounting policies shall be followed by Mutual Funds for the preparation of accounts:

a. For the purposes of the financial statements, mutual fund shall mark all investments to market and carry investments in the balance sheet at market value. However since the unrealized gain arising out of appreciation on investments cannot be distributed, provision has to be made for exclusion of this item when arriving at distributable income.

b. Dividend income earned by a scheme should be recognized, not on the date the dividend is declared, but on the date the share is quoted on an ex-dividend basis. For investments which are not quoted on the stock exchange, dividend income must be recognised on the date of declaration.

c. In respect of all interest-bearing investments, income must be accrued on a day to day basis as it is earned. Therefore when such investments are purchased, interest paid for the period from the last interest due date up to the date of purchase must not be treated as a cost of purchase but must be debited to Interest Recoverable Account. Similarly, interest received at the time of sale for the period from the last interest due date up to the date of sale must not be treated as an addition to sale value but must be credited to Interest Recoverable Account.

d. In determining the holding cost of investments and the gains or losses on sale of investments, the "average cost" method must be followed.

e. Transactions for purchase or sale of investments should be recognised as of the trade date and not as of the settlement date, so that the effect of all investments traded during a financial year are recorded and reflected in the financial statements for that year. Where investment transactions take place outside the stock market, for example, acquisitions through private placement or purchases or sales through private treaty, the transaction should be recorded, in the event of a purchase, as of the date on which the scheme obtains in enforceable obligation to pay the price or, in the event of a sale, when the scheme obtains an enforceable right to collect the proceeds of sale or an enforceable obligation to deliver the instruments sold.

f. Bonus shares to which the scheme becomes entitled should be recognised only when the original shares on which the bonus entitlement accrues are traded on the stock exchange on an ex-bonus basis. Similarly, rights entitlements should be recognised only when the original shares on which the right entitlement accrues are traded on the stock exchange on an ex-rights basis.

g. Where income receivable on investments has accrued but has not been received for the period specified in the guidelines issued by the Board, provision shall be made by debiting to the revenue account the income so accrued in the manner specified by guidelines issued by the Board.

h. When in the case of an open-ended scheme units are sold, the difference between the sale price and the face value of the unit, if positive, should be credited to reserves and if negative is debited to reserve, the face value being credited to Capital Account. Similarly, when in respect of such a scheme, units are repurchased the difference between the purchase price and face value of the unit, if positive should be debited to reserves and, if negative, should be credited to reserves, the face value being debited to the capital account.

i. In the case of an open-ended scheme, when units are sold an appropriate part of the sale proceeds should be credited to an Equalization Account and when units are repurchased an appropriate amount should be debited to Equalization Account. The net balance on this account should be credited or debited to the Revenue Account. The balance on the Equalization Account debited or credited to the Revenue Account should not decrease or increase the net income of the fund but is only an adjustment to the distributable surplus. It should therefore be reflected in the Revenue Account only after the net income of the fund is determined.

j. In a close-ended scheme which provide to the unit holders the option for an early redemption or repurchase their own units, the par value of the unit has to be debited to Capital Account and the difference between the purchase price and the par value, if positive, should be credited to reserves and, if negative, should be debited to reserves. A proportionate part of the unamortized initial issue expenses should also be transferred to the reserves so that the balance carried forward on that account is proportional to the number of units remaining outstanding.

k. The cost of investments acquired or purchased should include brokerage, stamp charges and any charge customarily included in the broker's bought note. In respect of privately placed debt instruments any front-end discount offered should be reduced from the cost of the investment.

l. Underwriting commission should be recognised as revenue only when there is no devolvement on the scheme. Where there is devolvement on the scheme, the full underwriting commission received and not merely the portion applicable to the devolvement should be reduced from the cost of the investment.

m. In case of real estate mutual fund scheme, investments in unlisted equity shares shall be valued as per the norms specified in this regard.

18. ACCOUNTING POLICIES FOR DIRECT INVESTMENT IN REAL ESTATE ASSET

A real estate asset that is held by a real estate mutual fund scheme shall be valued at fair value. Where a portion of the real estate asset is held to earn rentals or for capital appreciation and if the portions can be sold or leased separately, the real estate mutual fund scheme shall account for the portions separately.

Initial Recognition

A real estate mutual fund scheme shall recognise a real estate asset if (a) it is probable that the future economic benefits that are associated with the real estate asset will flow to the real estate mutual fund scheme; and (b) the cost of the asset can be measured reliably.

A real estate mutual fund scheme shall evaluate all its real estate asset costs including those incurred initially to acquire a real estate asset and those incurred subsequently to add to, replace part of, or service a real estate asset, at the time they are incurred. Provided that a real estate mutual fund scheme shall not recognise in the carrying amount of a real estate asset the costs of the day-to-day servicing of such an asset and such costs shall be recognised in the revenue account as incurred.

A real estate mutual fund scheme may acquire parts of real estate assets through replacement. For example, the interior walls may be replacements of original walls. Under the recognition principle, a real estate mutual fund scheme shall recognise in the carrying amount of a real estate asset, the cost of replacing part of an existing real estate asset at the time that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced shall be derecognised.

The real estate asset shall be recognized on the date of completion of the process of transfer of ownership i.e. the date on which the real estate mutual fund scheme obtains an enforceable right including all significant risks and rewards of ownership.

Measurement at Initial Recognition

A real estate asset shall be measured initially at cost. Such cost shall comprise purchase price and any other directly attributable expenditure such as professional fees for legal services, registration expenses and asset transfer taxes.

If the payment for a real estate asset is deferred, its cost is the cash price equivalent. A real estate mutual fund scheme shall recognise the difference between this amount and the total payments as interest expense over the period of credit.

A real estate mutual fund scheme may acquire one or more real estate assets in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The cost of such a real estate asset shall be measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired real estate asset shall be measured in this manner even if a real estate mutual fund scheme cannot immediately derecognize the asset given up. If the acquired real estate asset cannot be measured at fair value, its cost shall be measured at the carrying amount of the asset given up.

A real estate mutual fund scheme determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction.

For the purpose of determining whether an exchange transaction has commercial substance, the real estate mutual fund scheme-specific value of the portion of the real estate mutual fund scheme's operations affected by the transaction should reflect post-tax cash flows.

If the real estate mutual fund scheme is able to determine reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident.

Subsequent Measurement

After initial recognition, a real estate asset held by a real estate mutual fund scheme shall be measured at its fair value. A gain or loss arising from a change in the fair value of the real estate asset shall be recognised in the Revenue Account for the period in which it arises. The gain that arises from the appreciation in the value of real estate asset is an unrealised gain and thus the same cannot be distributed.

Where the fair value of the asset is not reliably determinable on a continuing basis, a real estate mutual fund scheme shall measure that real estate asset at cost as per Revised Accounting Standard 10 (Revised AS 10). The residual value of the real estate asset shall be assumed to be zero. The real estate mutual fund scheme shall apply Revised AS 10 until disposal of the investment asset. In determining the fair value of the real estate asset, it shall be ensured that there is no double-counting of assets or liabilities.

Explanation:

(a) equipment such as lifts or air-conditioning is often an integral part of a building and is generally included in the fair value of the real estate asset, rather than recognised separately as asset, plant and equipment.

(b) if an office is leased on a furnished basis, the fair value of the office generally includes the fair value of the furniture, because the rental income relates to the furnished office. When furniture is included in the fair value of real estate asset, a real estate mutual fund scheme shall not recognise that furniture as a separate asset.

(c) the fair value of real estate asset shall exclude prepaid or accrued operating lease income, because the real estate mutual fund scheme would recognise it as a separate liability or asset.

(d) The fair value of real estate asset held under a lease reflects expected cash flows (including contingent rent that is expected to become payable). Accordingly, if a valuation obtained for an asset is net of all payments expected to be made, it will be necessary to add back any recognised lease liability, to arrive at the fair value of the real estate asset for accounting purposes.

Where a real estate mutual fund scheme expects that the present value of its payments relating to a real estate asset (other than payments relating to recognised liabilities) will exceed the present value of the related cash receipts it shall apply AS 29, Provisions, Contingent Liabilities and Contingent Assets to determine whether to recognise a liability and, if so, how to measure it.

To determine the fair value of a real estate asset in accordance with the above-mentioned paragraphs, a real estate mutual fund scheme is required to use the services of two independent and approved valuers having recent experience in category of the real estate asset being valued and use the lower of the two valuations.

For accounting for rental income on real estate asset, AS 19, Leases, shall be followed. Such income shall be accrued on a daily basis, till the currency of the lease agreements.

Where the rental income receivable by a real estate mutual fund scheme in respect of real estate asset, has accrued but has not been received for the period specified by the Board. Further, provision shall be made by debiting to the revenue account the income so accrued in the manner as may be specified by the Board.

Derecognition of Real Estate Asset

A real estate mutual fund scheme shall derecognise a real estate asset on disposal or when the asset is permanently withdrawn from use and no future economic benefits are expected from its disposal.

In determining the date of disposal for real estate asset by way of sale, a real estate mutual fund scheme shall apply the criteria in AS 9, Revenue Recognition, for recognising revenue from the sale of goods and consider the related guidance AS 9, Revenue.

Gains or losses arising from the disposal or retirement of real estate asset shall be determined as the difference between the net disposal proceeds and the carrying amount of the real estate asset and shall be recognised in the Revenue Account in the period of the disposal or retirement.

The consideration receivable on disposal of a real estate asset is to be recognised initially at fair value. In particular, if payment for a real estate asset is deferred, the consideration received is recognized initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent should be recognised as interest revenue over the period of credit.

19. CONTENTS OF BALANCE SHEET AND REVENUE ACCOUNT

The annual report of a mutual fund consists of (a) Balance Sheet (b) Revenue Account (c) Report of the Board of Trustees (d) Auditor's Report and (e) Brief statement of the Board of Trustees on specified matters.

Contents of Balance Sheet

(i) The Balance Sheet shall give scheme wise particulars of its assets and liabilities. It shall also disclose, *inter alia*, accounting policies relating to valuation of investments and other important areas.

(ii) If investments are carried at costs or written down cost, their aggregate market value shall be stated separately in respect of each type of investment, such as equity shares, preference shares, convertible debentures listed on recognized stock exchange, non-convertible debentures or bonds further differentiating between those listed on recognised stock exchange and those privately placed.

(iii) The Balance Sheet shall disclose under each type of investment the aggregate carrying value and market value of non-performing investments. An investment shall be regarded as non-performing if it has provided no returns in the form of dividend or interest for a period specified in the guidelines issued by the Board.

(iv) The Balance Sheet shall indicate the extent of provision made in the Revenue Account for the depreciation/loss in the value of non-performing investments. However if the investments are valued at marked to market, provisions for depreciation shall not be necessary.

(v) The Balance Sheet shall disclose the per-unit net asset value (NAV) as at the end of the accounting year.

(vi) As in case of companies, the Balance Sheet shall give against each item, the corresponding figures as at the end of the preceding accounting year.

(vii) The notes to the balance sheet should disclose the following information regarding investments:-

(a) all investments shall be grouped under the major classification given in the balance sheet;

(b) under each major classification, the total value of investments falling under each major industry group (which constitutes not less than 5% of the total investment in the major classification) shall be disclosed together with the percentage thereof in relation to the total investment within the classification;

(c) a full list of investments of the scheme shall be made available for inspection with the Asset Management Company;

(d) the basis on which management fees have been paid to the Asset Management Company and the computation thereof;

(e) if brokerage, custodial fees or any other payment for services are paid to or payable to any entity in which the Asset Management Company or its major shareholders have a substantial interest (being not less than 10% of the equity capital), the amounts debited to the revenue account or amounts treated as cost of investments in respect of such services shall be separately disclosed together with details of the interest of the Asset Management Company or its major shareholders;

(f) aggregate value of purchases and sales of investments during the year and expressed as a percentage of average weekly net asset value;

(g) where the non-traded investments which have been valued "in good faith" exceed 5% of the NAV at the end of the year, the aggregate value of such investments; and

(h) movement in unit capital should be stated.

An example of the manner in which the movement in unit capital may be disclosed is given below:

	No. of units	(₹ in lakhs)
Balance as on 1st April, 2016	1250,00,000	12,500.00
Units sold during the year	127,50,000	1,275.00
Units repurchased during the year	(15,40,000)	(154.00)
	1362,10,000	13,621.00

(i) the name of the company including the amount of investment made in each company of the group by each scheme and the aggregate investments made by all schemes in the group companies of the sponsor;

(j) if the investments are marked to market, the total income of the scheme shall include unrealised depreciation or appreciation on investment. There should be disclosure and unrealised appreciation deducted before arriving at the distributable income in the following manner, e.g.

	₹ in lakh	*₹ in lakh*
Net income as per Revenue Account	100	
Add: Balance of undistributed income		
as at 1st April, 2016 brought forward	20	120
Less: Unrealised appreciation on investments		
As on 31st March, 2017	30	
As on 1st April, 2016	15	(15)
		105
Less: Distributed to unit holders	80	
Transfer to reserve	5	(85)
		20

(viii) Provisions for doubtful deposits, doubtful debts and for doubtful outstandings and accrued income shall not be included under provisions on the liability side of the balance sheet, but shall be shown as a deduction from the aggregate value of the relevant asset.

(ix) Disclosure shall be made of all contingent liabilities showing separately underwriting commitments, uncalled liability on partly paid shares and other commitments with specifying details.

Contents of Revenue Account

(i) The Revenue Account shall give scheme wise particulars of the income, expenditure and surplus of the mutual fund. These particulars shall contain information enumerated in Annexure 2 of Eleventh Schedule of SEBI (Mutual Funds) Regulations, 1996.

(ii) If profit on sale of investments shown in the Revenue Account includes profit/loss on inter-scheme transfer of investments within the same mutual fund the aggregate of such profit recognised as realised, shall be disclosed separately without being clubbed with the profit/loss on sale of investments to third parties.

(iii) Unprovided depreciation in value of investments representing the difference between their aggregate market value and their carrying cost shall be disclosed by way of a note forming part of the Revenue Account. Conversely, unrealised profit on investment representing the difference between their aggregate market value and carrying cost, shall be disclosed by way of note to accounts. The Revenue Account shall indicate the appropriation of surplus by way of transfer to reserves and dividend distributed. However, if investments are marked to market, depreciation may not be provided.

(iv) The Revenue Account shall indicate the appropriation of surplus by way of transfer to reserves and dividend distributed.

(v) The following disclosures shall also be made in the revenue accounts:

(a) provision for aggregate value of doubtful deposits, debts and outstanding and accrued income;

(b) profit or loss in sale and redemption of investment may be shown on a net basis;

(c) custodian and registrar fees;

(d) total income and expenditure expressed as a percentage of average net assets, calculated on a weekly basis.

The layout of Balance sheet and Revenue account as per SEBI regulation is given as an annexure at the end of the chapter.

20. EVALUATION OF MUTUAL FUNDS

Mutual funds sell their shares to public and redeem them at current Net Assets Value (NAV) which is calculated as under –

$$\frac{\text{Total market value of all MF holdings - All MF liabilities}}{\text{Unit size}}$$

The net asset value of a mutual fund scheme is basically the per unit market value of all the assets of the scheme.

To illustrate this better, a simple example will help.

Scheme name	:	XYZ
Scheme size	:	₹ 50,00,00,000 (Rupees Fifty crores)

Face value of units	:	₹ 10
No. of units	:	5,00,00,000
		$\frac{\text{Scheme size}}{\text{Face value of units}}$
Investments	:	In shares
Market value of shares	:	₹ 75,00,00,000 (Rupees seventy five crores)

$$= \frac{\text{Market value of investments}}{\text{No. of units}} = \frac{₹\ 75,00,00,000}{5,00,00,000} = ₹\ 15$$

Thus, each unit with face value of ₹ 10 has a market value of ₹ 15.

Simply stated, NAV is the value of the assets of each unit of the scheme, or even simpler value of one unit of the scheme. Thus, if the NAV is more than the face value (₹ 10), it means your money has appreciated and *vice versa*.

NAV also includes dividends, interest accruals and reduction of liabilities and expenses, besides market value of investments. The Net Asset Value (NAV) is the value of net assets under a mutual fund scheme. The NAV per unit is NAV of the scheme divided by number of units outstanding. NAV of a scheme keep on changing with change in market value of portfolio under the scheme. The day of valuation of NAV is called the valuation day.

As per Regulation 48 (2) of SEBI (Mutual Funds) Regulations, 1996, NAV of the scheme shall be calculated on daily basis.

Illustration 1

Sparrow Holdings is a SEBI Registered Mutual Fund which made its maiden N.F.O (New Fund Offer) on 10th April, 2016 at ₹ 10 face value per unit. Subscription was received for 90 lakhs units. An underwriting arrangement was also entered into with Affinity Capital Markets Ltd., that agreed to underwrite the entire NFO of 100 lakh units on a commission of 1.5%.

Out of the monies received ₹ 892.50 lakhs was invested in various capital market instruments. The marketing expenses for the N.F.O amounted to ₹ 11.25 lakhs. During the financial year ended March 2013 the Fund sold securities having cost of ₹ 127.25 lakh (FV ₹ 54.36 lakhs) for ₹ 141.25 lakhs. The fund in turn purchased securities for ₹ 130 lakhs. The management expenses of the fund are regulated by SEBI stipulations which state that the same shall not exceed 0.25% of the average funds invested during the year. The actual amount spent towards management expenses was ₹ 2.47 lakhs of which ₹ 47,000 was in arrear. The dividends earned on the investments held amounted to ₹ 2.51 lakhs of which a sum of ₹ 25,000 is yet to be collected. The fund distributed 80% of realized earnings. The closing market value of the portfolio was ₹ 1120.23 lakhs.

You are required to determine the closing per unit NAV of the fund.

Solution

Calculation of Closing per unit of NAV of the fund

	₹ *in lakhs*
Net Assets of Sparrow holding	
Closing cash balance (W.N.2)	79.99
Closing Market Value of Investments	1,120.23
Accrued Dividends (collectable)	0.25
	1,200.47
Less: Current Liabilities	
Outstanding Management Fee (payable)	(0.47)
Closing Net Assets (A)	1,200.00
Units outstanding (in lakhs) (B)	100.00
NAV per unit (A/B)	12.00

Working Notes:

		₹ *in lakhs*
1. Computation of opening cash balance		
Proceeds of NFO in full including underwriters commitment		1000.00
Less: Initial Purchase of Securities		(892.50)
		107.50
Less: Underwriting Commission	15.00	
Marketing Expenses	11.25	(26.25)
Opening Cash Balance		81.25
2. Computation of Closing cash balance		
Opening bank balance (W.N.1)		81.25
Add: Proceeds from sale of securities	141.25	
Dividends received on investment	2.26	143.51
		224.76
Less: Cost of Securities purchased	130.00	
Management Expenses (W.N.3)	1.76	
Capital Gains Distributed ₹ (141.25 - 127.25 x 80%)	11.20	
Dividends Distributed ₹ (2.26 x 80%)	1.81	(144.77)

Closing cash balance		79.99
3. Computation of Management Expenses Chargeable		
Actual Expense Incurred [A]		2.47
Opening Investment Made	892.50	
Closing Funds Invested (892.50 - 127.25 + 130)	895.25	
Total	1,787.75	
Average Funds Invested (1,787.75/2)	893.875	
0.25% of Average Funds Invested [B]		2.23
Lower of A or B		2.23
Less: Amount unpaid		(0.47)
Management expenses paid		1.76

Illustration 2

Calculate the year-end NAV of the Mutual Fund scheme on the basis of the information given below:

(i) UTI launched a new Fund scheme for ₹ 6,000 crore.

(ii) Underwriting Commission is 1% of the fund shared equally by SBI, PNB, Syndicate Bank and UTI Bank.

(iii) The Fund was launched on 1.4.2016 with a face value of ₹ 1000 per unit.

(iv) Underwriting Commission was paid in full.

(vi) Management Expense was allowed by SEBI @ 1% of the Fund raised. However, during the year management expense was of ₹ 45 crore only. The management decided to defer the payment of ₹ 5 crore to the next financial year.

(vii) On 1.5.2016, the total fund received was invested after deduction of underwriting commission and ₹ 100 crore to meet the day to day management expenses. The investment fund received yielded 10% interest per annum. The interest was received for 3 quarters and the interest of last quarter is yet to be received. The interest realized in cash has been distributed to the unit holders @ 80%. The financial year runs from April to March. The quarter starts from the date of investment i.e. 1.5.2016.

Solution

Calculation of Net Asset Value of a fund

		₹ in crores
Total Assets:		
Investment (6,000 - 60 -100)	5,840.00	

Add: Closing Cash Balance (Refer W.N.)	147.60	
Add: Interest for two months due to be received $\left(5,840 \times 10\% \times \frac{2}{12}\right)$	97.33	6,084.93
Less: Outstanding Management Expenses		(5.00)
Total value of the fund		6,079.93

$$\text{No. of Units} = \frac{₹\ 6,000 \text{ crores}}{1,000} = 6 \text{ crore units}$$

$$\text{NAV per unit} = \frac{₹\ 6079.93 \text{ crores}}{6 \text{ crore}} = ₹\ 1,013.32 \text{ per unit}$$

Working Note:

Calculation of year-end cash/bank balance of the fund

		₹ in crores
Cash received during the year for the fund		
Sale of units		6,000
Add: Interest for 3 quarters on investment $\left(5,840 \times 10\% \times \frac{9}{12}\right)$		438
		6,438
Less: Underwriting commission	60	
Management expenses paid in cash	40	
Investment	5,840	
Dividend paid (438 x 80%)	350.40	(6,290.40)
		147.60

21. DISPOSAL OF INVESTMENTS

The profit/loss arising on the disposal of investment is the difference between the selling price and the cost. The profit arising on disposal of investment is recognised fully in the Revenue Account.

The loss on disposal of investment is recognised fully in the Revenue account, if the investments are sold in the same year in which they are purchased. However, if an investment is sold in any year subsequent to year of purchase, loss on disposal is charged first against provision for depreciation to the extent of balance available, and the balance of loss, if any, should be charged directly to the Revenue Account.

Illustration 3

The investment portfolio for a mutual fund scheme includes 10,000 shares of A Ltd. and 8,000 shares of B Ltd. acquired on 30.10.2016. The cost of A Ltd's shares is ₹ 20 while that of B Ltd's shares is ₹ 30. The market values of these shares at the end of 2016-17 were ₹ 19 and ₹ 32 respectively. Show important accounting entries in books of the fund in the accounting year 2016-17.

Solution

	₹ 000	*₹ 000*
31.10.16 Investment in A Ltd's Shares Dr.	200	
Investment in B Ltd's Shares Dr.	240	
To Bank		440
(Being purchase of A Ltd., 10,000 shares @ ₹ 20 and 8000 shares of B Ltd., @ ₹ 30 each)		
31.3.17 Revenue A/c Dr.	10	
To Provision for Depreciation		10
(Being market value of A Ltd depreciated for ₹ 1 each for 10,000 shares)		
31.3.17 Investment in B Ltd's Shares Dr.	16	
To Unrealised Appreciation Reserve		16
(Being 8000 shares of B Ltd., appreciated @ ₹ 2 each per share on the closing date)		

Illustration 4

In the previous example, suppose that shares of both of the companies were disposed off on 31.05.16 realizing ₹ 18.50 per A Ltd's share and ₹ 33.50 per B Ltd's share. Show important accounting entries in books of the fund in the accounting year 2016-17.

Solution

Date	*Particulars*	*₹ 000*	*₹ 000*
1.4.16	Unrealised Appreciation Reserve Dr.	16	
	To Investment in B Ltd. Shares		16
	(Being 8,000 shares of B Ltd., appreciated @ ₹ 2 each per share on the closing date has been reversed at the beginning of the next year)		

31.5.16	Bank Account Dr. Loss on disposal of Investment Dr. To Investment in A Ltd. Shares (Being ₹ 2,00,000 of A Ltd., shares sold for ₹ 1,85,000 and Loss incurred ₹ 15,000)	185 15	 200
	Provision for Depreciation Dr. Revenue A/c Dr. To Loss on disposal of Investment (Earlier depreciation provision provided being reversed on disposal of total shares of A Ltd. and the balance amount debited to Revenue Account)	10 5	 15
	Bank Account Dr. To Investment in B Ltd. shares To Revenue A/c (Being 8,000 shares of B Ltd. sold @ ₹ 33.50 accounted on the trade date since this is a regular transaction in the business)	268	 256 12

Illustration 5

A fund purchased 10,000 debentures of a company on June 1, 2016 for ₹ 10.7 lakh and further 5,000 debentures on Nov 1, 2016 for ₹ 5.45 lakh. The debentures carry fixed annual coupon of 12%, payable on every 31 March and 30 September. On Feb 28, 2017 the fund sold 6,000 of these debentures for ₹ 6.78 lakh. Nominal value per debenture is ₹ 100.

Show Investment in Debentures A/c in books of the fund.

Solution

Investment in Debentures A/c

		₹ *Lakh*			₹ *Lakh*
June 1, 2016	To Bank	10.70	June 1, 2016	By Interest Recoverable (Note 1)	0.20
Nov 1, 2016	To Bank	5.45	Nov 1, 2016	By Interest Recoverable (Note 2)	0.05
Feb 28, 2017	To Interest Recoverable	0.30	Feb 28, 2017	By Bank	6.78

	(Note 3)				
Feb 28, 2017	To Profit on disposal (Note 4)	0.12	Mar 31, 2017	By Balance c/d	9.54
		16.57			16.57

Working Notes:

Note 1: 10,000 x 100 x 12/100 x 2/12 = ₹ 0.20 Lakhs

Note 2: 5,000 x 100 x 12/100 x 1/12 = ₹ 0.05 Lakhs

Note 3: 6,000 x 100 x 12/100 x 5/12 = ₹ 0.30 Lakhs

Note 4: Cost of investments (per unit) = [(10,70,000 -20,000)+(5,45,000– 5,000)]/15,000 units

= [10,50,000+ 5,40,000]/15,000 = ₹ 106

Cost of investments sold = ₹ 106 x 6,000 = ₹ 6,36,000

Sale proceeds = ₹ 6,78,000 - ₹ 30,000(interest) = ₹ 6,48,000

Profit = ₹ 6,48,000 - ₹ 6,36,000 = ₹ 12,000

22. RECOGNITION OF DIVIDEND INCOME

Dividend income earned by a scheme should be recognized, not on the date the dividend is declared, but on the date the share is quoted on an ex-dividend basis. For investments which are not quoted on the stock exchange, dividend income must be recognized on the date of declaration.

Where income receivable on investments has accrued but has not been received for the period specified in the SEBI guidelines, the income accrued should be debited to Revenue A/c as provision.

Bonus shares to which the scheme becomes entitled should be recognized only when the original shares on which the bonus entitlement accrues are traded on the stock exchange on an ex-bonus basis. Similarly, rights entitlements should be recognized only when the original shares on which the right entitlement accrues are traded on the stock exchange on an ex-rights basis.

23. DATE OF RECOGNITION OF TRANSACTIONS

For investments in securities

Transaction for purchase or sale of investments should be recognized as of the trade date and not as of the settlement date, so that the effect of all investments traded during a financial year are recorded and reflected in the financial statements for that year. Where investment transactions take place outside the stock market, for example, acquisitions through private placement or purchases or sales through private treaty, the transaction should be recorded in the event of a purchase, as of the date on which the scheme obtains in enforceable obligation to pay the price or, in the event of a sale, when the scheme obtains an enforceable right to collect the proceeds of sale or an enforceable obligation to deliver the instruments sold.

(a) In case open– ended scheme units are sold, the difference between the sale price and the face value of the unit, if positive, should be credited to reserves and if negative be debited to reserves, the face value being credited to Capital Account. Similarly, when in respect of such a scheme, units are repurchased, the difference between the purchase price and face value of the unit, if positive should be debited to reserves and, if negative, should be credited to reserves, the face value being debited to the capital account.

(b) In the case of an open – ended scheme, when units are sold, an appropriate part of the sale proceeds should be credited to an Equalisation Account and when units are repurchased, an appropriate amount should be debited to Equalisation Account. The net balance on this account should be credited or debited to the Revenue Account. The balance on the Equalisation Account debited or credited to the Revenue Account should not decrease or increase the net income of the fund but is only an adjustment to the distributable surplus. It should, therefore, be reflected in the Revenue Account only after the net income of the fund is determined.

(c) In a close – ended scheme which provide to the unit holders the option for an early redemption or repurchase of their own units, the par value of the unit has to be debited to Capital Account and the difference between the purchase price and the par value, if positive, should be credited to reserves and, if negative, should be debited to reserves. A proportionate part of the unamortized initial issue expenses should also be transferred to the reserves so that the balance carried forward on that account is proportional to the number of units remaining outstanding.

(d) Underwriting commission should be recognized as revenue only when there is no devolvement on the scheme. Where there is devolvement on the scheme, the full underwriting commission received and not merely the portion applicable to the devolvement should be reduced from the cost of the investment.

For investments in real estate assets

In a real estate mutual fund scheme which provides to the unit holders the option for an early redemption or repurchase of their own units the par value of the unit shall be debited to Capital Account and the difference between the purchase price and the par value, if positive, should be debited to reserves and, if negative, shall be credited to reserves.

24. DIVIDEND EQUALISATION

New investors are not entitled to any share of the income of a mutual fund scheme which arose before they bought their units. However, at the end of each distribution period the fund management allocates the same amount from the income of the fund to each unit. To compensate for this, an equalisation payment is added to the cost of new units. This is the amount of income that has arisen up to the date of purchase of the unit. Because these payments are included in the amount available for distribution they are effectively repaid to the purchaser. The purchaser's dividend voucher at the end of the first distribution period should show the amount of the returned equalisation payment. This payment is not income. It should not be treated as capital distribution. It is a return of the initial price paid and it should, therefore, be deducted from the price paid when computing the chargeable gain on eventual disposal.

Illustration 6

On 1.4.2016 a mutual fund scheme had 9 lakh units of face value ₹ 10 outstanding. The scheme earned ₹ 81 lakh in 2016-17, out of which ₹ 45 lakh was earned in first half-year. 1 lakh units were sold on 30.09.16 at NAV of ₹ 60. Show important accounting entries for sale of units and distribution of dividend at the end of 2016-17.

Solution

Allocation of earnings

	Old unit holders (9 lakh units) (₹ Lakh)	*New unit holders (1 lakh units) (₹ lakh)*	*Total earning (₹ Lakh)*
First half-year (₹ 5.00 per unit)	45.0	Nil	45.0
Second half-year (₹ 3.60 per unit)	32.4	3.6	36.0
	77.4	3.6	81.0
Add: Equalisation payment recovered			5.0
Total available for distribution			86.0

Note: Equalisation payment = ₹ 45 lakh / 9 lakh = ₹ 5 per unit.

Distribution of earning per unit

	Old unit holders ₹	*New unit holders* ₹
Dividend distributed	8.60	8.60
Less: Equalisation payment		(5.00)
Net distributed income	8.60	3.60

Journal Entries

Date			*₹ lakh*	*₹ lakh*	
30.09.16	Bank	Dr.	65		1 lakh x ₹ 65
	To Unit Capital			10	1 lakh x ₹ 10
	To Reserves			50	1 lakh x ₹ 50
	To Dividend Equalisation			5	1 lakh x ₹ 5
31.03.17	Dividend Equalisation	Dr.	5		
	To Revenue A/c			5	
31.03.17	Revenue A/c	Dr.	86		
	To Bank			86	10 lakh x ₹ 8.60

SUMMARY

- In India, mutual funds are regulated by SEBI (Mutual Funds) Regulations, 1996. According to the SEBI (Mutual Funds) Regulations, 1996, a 'mutual fund' means a fund established in the form of a trust to raise monies through the sale of units to the public under one or more schemes for investing in securities including money market instruments. A mutual fund should be registered with SEBI.
- **Types of Mutual Funds:**
  - **On the basis of Structure**- The mutual fund schemes can be classified as open ended and close ended. The open-ended schemes permit entry by subscription or exit by sale of units on a continuous basis.
  - **On the basis of Investors Objectives** - In terms of investment objectives, mutual fund schemes can be classified as the growth funds and income funds. The growth funds invest major parts of their corpus in equity instruments and hence are exposed to comparatively higher risks.

- Mutual funds sell their shares to public and redeem them at current **Net Asset Value** (NAV) which is calculated as under –

$$\frac{\text{Total market value of all MF holdings - All MF liabilities}}{\text{Unit size}}$$

- Every mutual fund or the asset management company is required to prepare in respect of each financial year an annual report and annual statement of accounts of the schemes and the fund as specified.
- Net asset value of a mutual fund scheme is basically the per unit market value of all the assets of the scheme.

TEST YOUR KNOWLEDGE

MCQs

1. In XYZ mutual fund scheme, for the determination of the per unit net asset value, all the assets of the scheme are taken at
   (a) Book value
   (b) Market value
   (c) Current value
2. "Open ended scheme" means a scheme of mutual fund
   (a) which permits entry by subscription or exit by sale of units on a continuous basis.
   (b) in which the period of maturity of the scheme is specified.
   (c) in which the amount to be redeemed is not mentioned.

Theoretical Questions

Question 1

What do you mean by "Net asset value" (NAV) in case of mutual fund units?

Question 2

A Mutual Fund has launched a new scheme "All Purpose Scheme". The Mutual Fund Asset Management Company wishes to invest 25% of the NAV of the Scheme in an unrated debt instrument of a company Y Ltd. which has been paying above average returns for the past many years. The promoters of the company seek your professional advice in light of the Regulations of SEBI. Will the position change in case the debt instruments of the company Y Ltd are rated?

Practical questions

Question 1

Investors Mutual Fund is registered with SEBI and having its registered office at Pune. The fund is in the process of finalizing the annual statement of accounts of one of its open ended mutual fund schemes. From the information furnished below, you are required to prepare a statement showing the movement of unit holders' funds for the financial year ended 31st March, 2017.

	₹ '000
Opening Balance of net assets	12,00,000
Net Income for the year (Audited)	85,000
8,50,200 units issued during 2016-2017	96,500
7,52,300 units redeemed during 2016-2017	71,320
The par value per unit is ₹ 100	

Question 2

On 1.4.2016, a mutual fund scheme had 18 lakh units of face value of ₹ 10 each was outstanding. The scheme earned ₹ 162 lakhs in 2016-17, out of which ₹ 90 lakhs was earned in the first half of the year. On 30.9.2016, 2 lakh units were sold at a "NAV" of ₹ 70.

Pass Journal entries for sale of units and distribution of dividend at the end of 2016-17.

Question 3

A Mutual Fund raised 100 lakh on April 1, 2017 by issue of 10 lakh units of ₹ 10 per unit. The fund invested in several capital market instruments to build a portfolio of ₹ 90 lakhs. The initial expenses amounted to ₹ 7 lakh. During April, 2017, the fund sold certain securities of cost ₹ 38 lakhs for ₹ 40 lakhs and purchased certain other securities for ₹ 28.20 lakhs. The fund management expenses for the month amounted to ₹ 4.50 lakhs of which ₹ 0.25 lakh was in arrears. The dividend earned was ₹ 1.20 lakhs. 75% of the realized earnings were distributed. The market value of the portfolio on 30.04.2017 was ₹ 101.90 lakh.

Determine NAV per unit.

Question 4

The investment portfolio of a mutual fund scheme includes 5,000 shares of X Ltd. and 4,000 shares of Y Ltd. acquired on 31-12-2015. The cost of X Ltd.'s shares is ₹ 40 while that of Y Ltd.'s shares is ₹ 60. The market value of these shares at the end of 2015-16 were ₹ 38 and ₹ 64 respectively. On 30-06-2016, shares of both the companies were disposed off realizing ₹ 37 per X Ltd's share and ₹ 67 per Y Ltd's share. Show important accounting entries in the books of the fund for the accounting years 2015-16 and 2016-17.

ANSWERS/ SOLUTIONS

MCQs

[1. (b); 2.(a)]

Theoretical Questions

Answer 1

The net asset value of a mutual fund scheme is basically the per unit market value of all the assets of the scheme. Simply stated, NAV is the value of the assets of each unit of the scheme, or even simpler value of one unit of the scheme. Thus, if the NAV is more than the face value (₹ 10), it means your money has appreciated and vice versa. NAV also includes dividends, interest accruals and reduction of liabilities and expenses besides market value of investments. NAV is the value of net assets under a mutual fund scheme. NAV per unit is NAV of the scheme divided by number of units outstanding. NAV of a scheme keeps on changing with change in market value of portfolio under the scheme.

Net Asset Value (NAV) is calculated as under:

$$\frac{\text{Total market value of all Mutual Fund holdings - All Mutual Fund liabilities}}{\text{Unit size}}$$

Answer 2

The Seventh Schedule of SEBI (Mutual funds) Regulations, 1996 states that a mutual fund scheme shall not invest more than 10% of its NAV in unrated debt instruments issued by a single issuer and the total investment in such instruments shall not exceed 25% of the NAV of the scheme. All such investments shall be made with the prior approval of the Board of Trustees and the Board of Asset Management

Company. It also states that a mutual fund scheme shall not invest more than 10%* of its NAV in debt instruments issued by a single issuer which are rated not below investment grade by an authorised credit rating agency. Such investment limit may be extended to 12% of the NAV of the scheme with the prior approval of the Board of Trustees and the Board of Asset Management Company.

Accordingly, (i) If the debts instruments of Y Ltd. are unrated then Mutual Fund Asset Management Company (AMC) cannot invest more than 10% of its NAV in those instruments.

(ii) If the debts instruments of Y Ltd are rated, even then, Mutual Fund Asset Management Company cannot invest more than 12% of its NAV in those instruments. Therefore, investment of 25% of its NAV of the scheme in debts instrument of Y Ltd. by Mutual Fund Asset Management Company is not permissible as per the SEBI (Mutual Fund) Regulations, 1996.

Practical Questions

Answer 1

Statement showing the Movement of Unit Holders' Funds for the year ended 31st March, 2017

	(₹ '000)
Opening balance of net assets	12,00,000
Add: Par value of units issued (8,50,200 × ₹ 100)	85,020
Net Income for the year	85,000
Transfer from Reserve/Equalisation fund (Refer working note)	15,390
	13,85,410
Less: Par value of units redeemed (7,52,300 × ₹ 100)	(75,230)
Closing balance of net assets (as on 31st March, 2017)	13,10,180

Working Note:

Particulars	Issued	Redeemed
Units	8,50,200	7,52,300
	₹ 000	₹ 000
Par value	85,020	75,230

* Amended as per SEBI (Mutual Fund) (Amendments) Regulations, 2016 w.e.f 12.02.2016

Sale proceeds / Redemption value	96,500	71,320
Profit transferred to Reserve / Equalisation Fund	11,480	3,910
Balance in Reserve / Equalisation Fund (Issued & Redeemed)	15,390	

Answer 2

Allocation of Earnings	Old Unit Holders [18 lakhs units] ₹ in lakhs	New Unit Holders [2 lakhs units] ₹ in lakhs	Total ₹ in lakhs
First half year (₹ 5 per unit)	90.00	Nil	90.00
Second half year (₹ 3.60 per unit)	64.80	7.20	72.00
	154.80	7.20	162.00
Add: Equalization payment recovered	-	-	10.00
Total available for distribution			172.00
Equalization Payment -₹ 90 lakhs ÷18 lakhs = ₹ 5 per unit			
		Old Unit Holders ₹	New Unit Holders ₹
Dividend distributed		8.60	8.60
Less: Equalization payment		-	(5.00)
		8.60	3.60

Journal Entries

			(₹ in lakhs)
30.9.2016	Bank A/c Dr.	150.00	
	To Unit Capital		20.00
	To Reserve		120.00
	To Dividend Equalization		10.00
	(Being the amount received on sale of 2 lakhs unit at a NAV of ₹ 70 per unit)		

31.3.2017	Dividend Equalization	Dr.	10.00	
	To Revenue A/c			10.00
	(Being the amount transferred to Revenue Account)			
30.9.2017	Revenue A/c	Dr.	172.00	
	To Bank			172.00
	(Being the amount distributed among 20 lakhs unit holders @ ₹ 8.60 per unit)			

Answer 3

	₹ in lakhs	₹ in lakhs	
Opening bank balance [₹ (100 – 90 - 7) lakhs]	3.00		
Add: Proceeds from sale of securities	40.00		
Dividend received	1.20	44.20	
Less: Cost of securities	28.20		
Fund management expenses [₹ (4.50–0.25) lakhs]	4.25		
Capital gains distributed [75% of ₹ (40.00 – 38.00) lakhs]	1.50		
Dividends distributed (75% of ₹ 1.20 lakhs)	0.90	(34.85)	
Closing bank balance		9.35	
Closing market value of portfolio		101.90	
		111.25	
Less: Arrears of expenses		(0.25)	
Closing net assets		111.00	
Number of units			10,00,000
Closing Net Assets Value (NAV)			₹ 11.10

Answer 4

Accounting Entries in the books of fund

			₹	₹
31.12.2015	Investment in X Ltd.'s shares A/c (5,000 x ₹ 40)	Dr.	2,00,000	
	Investment in Y Ltd.'s shares A/c (4,000 x ₹ 60)	Dr.	2,40,000	

	To Bank A/c			4,40,000
	(Being investment made in X Ltd. and Y Ltd.)			
31.3.2016	Revenue A/c [5,000 x ₹ (40-38)]	Dr.	10,000	
	To Provision for Depreciation A/c			10,000
	(Being provision created for the reduction in the value of X Ltd.'s shares)			
31.3.2016	Investment in Y Ltd.'s shares A/c [4,000 x ₹ (64-60)]	Dr.	16,000	
	To Unrealised Appreciation Reserve A/c			16,000
	(Being appreciation in the market value of Y Ltd.'s shares transferred to Unrealised Appreciation Reserve A/c)			
01.04.2016	Unrealised Appreciation Reserve A/c	Dr.	16,000	
	To Investment in Y Ltd.'s shares A/c			16,000
	(Being last year's unrealised appreciation reserve balance reversed at the beginning of the current year)			
30.6.2016	Bank A/c (5,000 x ₹ 37)	Dr.	1,85,000	
	Loss on disposal of Investment A/c	Dr.	15,000	
	To Investment in X Ltd.'s shares A/c (5,000 x ₹ 40)			2,00,000
	(Being shares of X Ltd. disposed off at a loss of ₹ 15,000)			
30.6.2016	Provision for Depreciation A/c	Dr.	10,000	
	Revenue A/c	Dr.	5,000	
	To Loss on disposal of Investment A/c			15,000
	(Being net loss on disposal of X Ltd.'s shares charged to revenue account)			
30.6.2016	Bank A/c (4,000 x ₹ 67)	Dr.	2,68,000	
	To Investment in Y Ltd.'s shares A/c (4,000 x ₹ 60)			2,40,000
	To Revenue A/c			28,000
	(Being shares of Y Ltd. disposed off at a profit of ₹ 28,000)			

ANNEXURE

ABC MUTUAL FUND

Address

Abridged Balance Sheet as at

____

Rupees in Lakhs

		Scheme A		Scheme B		Scheme C	
		As at Current Year	**As at Previous Year**	**As at Current Year**	**As at Previous Year**	**As at Current Year**	**As at Previous Year**
	LIABILITIES						
	Unit Capital						
	Reserves & Surplus						
	Unit Premium Reserves						
	Unrealised Appreciation Reserve						
	Other Reserves						
	Loans & Borrowings						
	Current Liabilities & Provisions						
	Provision for doubtful Income/Deposits						
	Provisions						
	Total						
	ASSETS						
	Investments						
	Listed Securities:						
	Equity Shares						
	Preference Shares						

	Equity Linked Debentures						
	Other Debentures & Bonds						
	Securitized Debt Securities						
	Securities Awaiting Listing:						
	Equity Shares						
	Preference Shares						
	Equity Linked Debentures						
	Other Debentures & Bonds						
	Securitized Debt Securities						
	Unlisted Securities						
	Equity Shares						
	Preference Shares						
	Equity Linked Debentures						
	Other Debentures & Bonds						
	Securitized Debt Securities						
	Government Securities						
	Treasury Bills						
	Commercial Paper						
	Certificate of Deposits						
	Bill Rediscounting Units of Domestic Mutual Fund						
	Foreign Securities						
	Deposits						
	Other Current Assets						
	Cash & Bank Balance						
	CBLO/Reverse Repo Lending						

	Others						
	Deferred revenue						
	Expenditure (to the extent not written off)						
	Total						

Notes to Accounts-Annexure I

ABC MUTUAL FUND

Address: Abridged Revenue Account for the Year/Period ended

		Scheme A		**Scheme B**		**Scheme C**	
		As at Current Year	**As at Previous Year**	**As at Current Year**	**As at Previous Year**	**As at Current Year**	**As at Previous Year**
	INCOME						
	Dividend						
	Interest						
	Reaslied Gain/(Loss) on Foreign Exchange Transactions						
	Realised Gains/(Losses) on Inter scheme sale of investments						
	Realized Gains/(Losses) on External sale/redemption of investments						
	Realised Gains/(Losses) on derivative Transactions						
	Other Income[1]						
	Expenses[2]						
	Management fees						
	Service tax on Management fees						

	Transfer agents fees and expenses						
	Custodian fees						
	Trusteeship fees						
	Commission to Agents						
	Marketing & Distribution expenses						
	Audit fees						
	Other operating expenses						
	(B)						
	NET REALISED GAINS/(LOSSES) FOR THE YEAR PERIOD (A-B=C)						
	Change in Unrealised Depreciation in value of investments (D)[3]						
	NET GAINS/(LOSSES) FOR THE YEAR PERIOD (E=(C-D)						
	Change in unrealized appreciation in the value of investments (F)[4]						
	NET SURPLUS/(DEFICIT) FOR THE YEAR/PERIOD (E+F=G)						
	Add: Balance transfer from Unrealised Appreciation Reserve						
	Less: Balance transfer to Unrealised Appreciation Reserved						
	Add: /(Less): Equalisation						

	Total						
	Dividend appropriation						
	Income distributed during the year/Period						
	Tax on income distributed during the year/period						
	Retain Surplus (Deficit) carried forward to Balance sheet						

Notes to Accounts:

1. Provide details of significant items indicating nature & corresponding amount in Notes to accounts
2. State in the notes to accounts that expenses other than management fee is inclusive of service tax where applicable.
3. Unrealised Depreciation to be computed by each asset category and shown on an aggregated basis. This should take into account change in unrealised depreciation for the year/period and write back of unrealised depreciation provided in the previous year end.
4. Unrealised Appreciation to be computed by each asset category and shown on an aggregated basis. This should take into account change in unrealised appreciation for the year/period and write off of unrealised appreciation provided in the previous year end.

Notes to Accounts - Annexure to the Abridged Balance Sheet and

Revenue Account for the Year / Period ended _

1. Investments:-

   1.1. Note confirming that Investments of the Schemes are registered in the name of the Trustees for the benefits of the Schemes Unitholders.

   1.2. Open Position of derivatives (outstanding market value & % to Net Assets as of the Year end).

   1.3. Investments in Associates and Group Companies: Provide details of issuer, nature of instruments, amount, aggregate investments by all schemes.

   1.4. Open position of Securities Borrowed and / or Lend by the scheme.

1.5. Details of NPA: Aggregate market value and provision thereof.

1.6. Aggregate Unrealised Gain / Loss as at the end of the Financial Year / Period and percentage to net assets.

1.7. Aggregate Value of Purchase and Sale with Percentage to average assets.

1.8. Non-Traded securities in the portfolio: Provide Aggregate Value of Equity, Debt & Money Market Instruments and percentage to net assets.

2. Details of Transaction with Associates under regulation 25(8).

   Provide details of name of associate, nature of payment and amount

3. "Large Holdings in the Scheme (i.e. in excess of 25% of the net assets). Provide details of No. of Investors and total holdings by them in percentage terms."

4. Unit Capital movement during the year ended / period ended. Planwise details of movement in units - opening, subscription, redemption, closing. Indicate plan wise face value of units.

5. Prior Year Comparison - a suitable statement that prior year figures have been reclassified wherever necessary to conform to current years' presentation.

6. Contingent Liability. Provide details of nature and amount.

Guidance Note: Provide corresponding previous year/period figures for all the above disclosures.