

ACCOUNTING, VALUATION & TAXATION

ACCOUNTING

Mutual Fund Accounting

- Knowledge of MF accounting is very important
- MFs to follow Accounting Policies laid down by SEBI (Mutual Funds) Regulations, 1996
- Separate Balance Sheets are made for each scheme of a MF
- Investments made by the fund appear on Asset side in the Balance Sheet
- Unit holders' subscriptions accounted
 - not as liabilities or deposits
 - but as Unit Capital at Face Value
- All assets of the scheme belong to its Investors

NAV Calculation

- Net Assets = Assets - Liabilities
- Assets = Market value of Investments
+ Receivables + Accrued income +
Other Assets
- Liabilities = Accrued expenses – Payables – Liabilities
- NAV of a Unit = Net Assets of the Scheme
Number of units outstanding

Net Asset Value

- Daily NAV disclosure is mandatory for Open-ended funds
 - Date on which NAV is calculated is called Valuation Date
 - NAV Calculation considers up to date transactions
- Close ended Funds can compute NAV's every week but disclose daily

Disclosing Net Asset Value of a Unit

- All income, expenditure to be accounted upto date of valuation
- Non accrual of small amounts not affecting NAV by more than 1% permitted
- Non-recorded transactions should not affect NAV calculation by more than 2%

Allocation / De-Allocation of Fund Units

- For all valid applications received before the Cut-off time, units are allotted / cancelled based on NAV at the end of the same day
- For valid application received after the cut-off time, units are allotted / cancelled based upon NAV of the next business day
- The above rule does not apply to liquid fund schemes

Cut-off Time

- The cut-off time for all Mutual Fund schemes except liquid fund schemes is 3 pm
- For liquid fund schemes valid application received upto 1 p.m. are allotted units based on NAV of the previous day
- For liquid fund schemes valid application received upto 1 p.m. are allotted units based on NAV of the same day
- NAVs are required to be rounded off upto 4 decimal places for liquid funds & upto 2 decimal places for other funds
- For repurchases under liquid funds the cut-off time is 10 a.m instead of 1 p.m.

Factors affecting Net Asset Value of a Unit

- NAV is affected by 4 of factors:
 - Purchase & sale of investment securities
 - Units sold or redeemed
 - Valuation of all investment securities held
 - Other assets and liabilities

Mutual Fund charges

There are three type of charges

Entry Load

- Distribution Expense

Recurring Expenses

- Expense Ratio

Exit Load

- Back End Load

Entry load

- Charged at the time of investing in Mutual funds
- Paid as distribution expenses to agents
- Entry load is payable only in case the investment is made through an agent
- SEBI abolished any entry load to be collected by AMC's in Aug,09
- Wef August 2011 SEBI allowed AMC's to collect Entry Load in the following manner

Particulars	Investment Amount	Commission Payable
First Time Investor	Less than Rs. 10,000	Nil
	More than Rs. 10,000	Rs. 150
Existing Investor	Less than Rs. 10,000	Nil
	More than Rs. 10,000	Rs. 100

Recurring Expenses

- Also referred as Expense Ratio
- Charged by the AMC for professional portfolio management services provided to the investors
- Operating expenses are calculated on an annualized basis and normally accrued on a daily basis
- Computed NAV is shown after deducting these Recurring Expenses

Maximum Recurring Expenses

SEBI has prescribed the maximum expense that may be charged by the AMC and they are based on the Average Weekly Net Assets of the AMC

Average Weekly Assets	For Equity Funds	For Bond Funds
For first Rs.100 crs	2.50%	2.25%
For next Rs.300 crs	2.25%	2.00%
For next Rs.300 crs	2.0%	1.75%
On the Balance Average Weekly Assets	1.75%	1.50%

Exit Load

- Charged when an investor exits a fund before a specified time frame
- Lower the time frame – the higher would be the exit load
- Also referred as Back-End Load
- Most Mutual Funds charge exit load in the range of 1-3%
- Maximum fees that can be charged by Mutual Funds for premature withdrawal is 7%

Disclosure and Reporting

- Annual Report and Annual Statement of Account is prepared by AMC
- Annual Statement of Account to be audited by an Auditor independent of the Auditor of AMC
- Within 6 months of Accounting year, Fund shall
 - Display the scheme wise annual reports on their website & on AMFI website
 - Mail summary of report to all unit holders
 - Forward to SEBI Annual Audited Accounts, Half yearly Unaudited Accounts, Quarterly Portfolio Statement
 - Publish scheme wise abridged summary of report in newspapers
 - Mail Annual Reports to all unit holders

VALUATION NORMS FOR MUTUAL FUNDS

Valuation Norms for Mutual Funds

- Valuation Norms prescribed by SEBI to protect investors' interests
- Valuation Norms
 - Based upon **fair** portfolio valuation
 - Uniform across all funds
- SEBI
 - Prescribes detailed valuation methodologies in its fund regulations
 - Mandates disclosure of valuation methods used for investor's information

Valuation Norms for Shares

- Valuation of traded shares
 - done on the basis of traded price
 - if not more than 30 days old
- Valuation of thinly traded shares
 - less than 50,000 shares or Rs. 5 lacs or less amount and
 - Done as per SEBI approved Norms
- Valuation of not traded shares
 - done as per SEBI approved valuation norms

Valuation Norms for Shares

- If Thinly traded & Non traded Equity Securities exceed 5% of the total assets of the scheme
 - Independent value should be appointed for valuation
- If Illiquid Securities exceed
 - 15% of net assets for open ended funds
 - 20% of net assets for close ended funds
 - value is taken zero for Securities in excess of 15% 20%

Limit on Illiquid Shares

- Illiquid Share (Non traded, Thinly Traded & Unlisted Equity Shares)
 - not to exceed 20% for Close Ended Fund Assets
 - not to exceed 15% for Open Ended Fund Assets

Valuation Norms for Thinly-traded and Non-traded Shares

Equity Instruments

- Calculate book value per share
- Calculate Fair value per share taking 90% of average of book value and earning value per share
- Calculate earning value per share based upon Average capitalization rate of industry P/E and discount it by 75%. (Latest audited EPS be taken for this purpose)
- If EPS is negative or not available for within previous nine months, it should be taken as zero

Valuation of Traded Debt Securities

- A Debt Security is treated as traded if traded any day during the last 15 days
- Trading can be on a stock exchange or between institutions
- Publicly traded price or private placement price if private placement is within last 15 days is taken as valuation price
- A Debt Security if not traded in last 15 days is called Not Traded or Thinly Traded Debt Security
- Market lot for trading in debt securities is Rs. 5 Crores

Gross Redemption Yield (GRY)

- Gross Redemption Yield (GRY) is also called Yield to Maturity (YTM)
- YTM is the Internal Rate of Return on investment in Bond
- Internal Rate of return is computed based on :
 - i. Coupon Rate
 - ii. Purchase Price
 - iii. Period to Maturity

Gross Redemption Yield (GRY)

- If purchase price is the same as Face Value of Bond
 - YTM will be the same as Coupon Rate
- If purchase price is more than the Face Value
 - YTM will be lower than the Coupon Rate
- If purchase price is less than the Face Value
 - YTM will be more than the Coupon Rate

Calculating Price of Bond with given Ytm An Example

Given data:

Face Value : Rs.1000

Coupon : 10%

Tenure : 5 Years

Interest Payment : Yearly

Yield : 8.72%

Calculate price of the bond

Cash flows under the bond and their present values are as under:

$$\frac{100}{(1+8.72\%)} + \frac{100}{(1+8.72\%)^2} + \frac{100}{(1+8.72\%)^3} + \frac{100}{(1+8.72\%)^4} + \frac{(100+1000)}{(1+8.72\%)^5}$$

Price of the bond = Rs.1050 (By solving the above equation)

TAXATION OF MUTUAL FUNDS

Taxation of MF's and Investors

- Finance Act 1999 radically changed taxation of Dividends received by investors in Mutual Funds
- Mutual Fund as an entity is not taxed since it is a Pass Through Entity.
- Finance Act 1999 made income (dividends) from UNITS totally EXEMPT from tax u/s 10(33) in the hands of all investors
- Income (dividends) distributed by a Debt Fund was made liable to Dividend Distribution Tax at applicable rate
- Open Ended Funds with more than 50% invested in Equity do not pay any Dividend Distribution Tax

Taxation of MF's

- Taxation of Mutual Funds in India can be divided in 2 parts
- Capital Gain (increase in value of investment)
- Dividends (investors receive on regular intervals if they have opted for dividend plans.)

Capital Gains Tax

- Option to pay 20% or 10% lies with investor for each and every security
- 2% surcharge also payable
- Indexation Benefit on Unlisted Bonds not available
- No Capital Gain tax payable if entire Capital gain invested in Capital Gain Bonds of NABARD, NHAI, REC

Capital Gains Tax

- Long Term Capital Gain
(If units held for more than 12 months)

	Individual/ HUF	Domestic Company	NRI*
Equity oriented schemes **	Nil	Nil	Nil
Other than equity oriented schemes	10% without indexation or 20% with indexation whichever is lower + 3% Cess	10% without indexation or 20% with indexation whichever is lower + 5% Surcharge# + 3% Cess	10% without indexation or 20% with indexation whichever is lower + 3% Cess
Without indexation	= 10.300%	= 10.815%	= 10.300%
With indexation	= 20.600%	= 21.630%	= 20.600%

Short / Long Term Capital Gains Tax

- Short Term Capital Gain
(If units held for less than 12 months)

	Individual/ HUF	Domestic Company	NRI*
Equity oriented schemes **	15% + 3% Cess	15% + 5% Surcharge# + 3% Cess	15% + 3% Cess
	= 15.450%	= 16.223%	= 15.450%
Other than equity oriented schemes	30%" + 3% Cess	30% +5% Surcharge# + 3% Cess	30%^ + 3% Cess
	= 30.900%	= 32.445%	= 30.900%

Impact of Dividend Distribution Tax

- Investor pays the tax indirectly, since NAV comes down to the extent of tax paid by the Fund.
- DD Tax bears no relationship to the investor's tax bracket.
- Dividend reinvested is also subject to Dividend Distribution Tax.
- In Growth Plans, Dividend Distribution Tax not applied, since no dividend is distributed.

Tax Implications on Dividend received by Unit holders

Dividend

	Individual/ HUF	Domestic Company	NRI*
Equity oriented schemes	Nil	Nil	Nil
Debt oriented schemes	Nil	Nil	Nil

Tax on distributed income (payable by the scheme) rates

	Individual/ HUF	Domestic Company	NRI*
Equity oriented schemes **	Nil	Nil	Nil
Debt schemes	12.5% + 5% Surcharge + 3% Cess	30% + 5% Surcharge + 3% Cess	12.5% + 5% Surcharge + 3% Cess
	= 13.519%	= 32.445%	= 13.519%
Money market and Liquid schemes	25% + 5% Surcharge + 3% Cess	30% + 5% Surcharge + 3% Cess	25% + 5% Surcharge + 3% Cess
	= 27.038%	= 32.445%	= 27.038%