(Withdrawn as AS 30 became recommendatory from April 1, 2009)

GN(A) 13 (Issued 2000)

Guidance Note on Accounting for Investments in the Financial Statements of Mutual Funds

Foreword

Mutual Funds have assumed greater significance in recent years as major players in the capital market of the country. As the funds of a large number of investors are involved in Mutual Funds, protection of their interest through periodic dissemination of information including the financial information is of paramount importance. The Securities and Exchange Board of India have prescribed regulations containing accounting principles to be followed by Mutual Funds for the preparation of their financial statements which provide that for the purpose of financial statements investments shall be marked to market. Regulations, however, prescribe that till necessary Guidance Note is issued by the Institute, investments may continue to be valued at cost with the market value being shown separately. Pursuant to this, the Institute has issued this Guidance Note on Accounting for Investments in the Financial Statements of Mutual Funds.

I wish to place on record my deep appreciation of the Research Committee for preparing this Guidance Note.

I am confident that this Guidance Note would go a long way in ensuring adoption of healthy accounting practices by Mutual funds and will be of immense use to the members and others concerned.

New Delhi
December 14, 2000

G. Sitharaman
President

(Withdrawn as AS 30 became recommendatory from April 1, 2009)

Preface

Mutual Funds act as a major catalyst towards development of the capital market in an economy. In India also, this role of Mutual Funds has attained recognition in recent years. In order that the Mutual Funds play their role in a more effective manner, it is important that they are managed efficiently so that the common investor of the Mutual Funds is not affected adversely. In this context, the Securities and Exchange Board of India – the principal regulator of the capital market in the country – has laid down various regulations to regulate Mutual Funds for investor's protection. One of the regulations provides that the Institute of Chartered Accountants of India, being a premier accounting body in the country, should provide guidance in respect of accounting for investments in the financial statements of Mutual Funds. Accordingly, the Research Committee of the Institute decided to prepare the "Guidance Note on Accounting for Investments in the Financial Statements of Mutual Funds", which has been issued under the authority of the Council.

This Guidance Note deals with issues related to forms of investments and cost of investments and provides guidance on the accounting treatment of depreciation and appreciation when investments are marked to market and accounting for disposal of investments.

It is my pleasure to place on record our deep appreciation of Shri Sanjay Panse, a member having expertise in this area, who helped us in preparing the basic draft of this Guidance Note.

I am confident that this Guidance Note will prove to be of immense use to the members and others concerned.

New Delhi
December 12, 2000

Bhavna G. Doshi
Chairperson
Research Committee

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GN(A) 13 (Issued 2000)

Guidance Note on Accounting for Investments in the Financial Statements of Mutual Funds

INTRODUCTION

1. The Securities and Exchange Board of India (Mutual Funds) Regulations, 1996, (hereinafter referred to as 'the Regulations') have prescribed accounting policies to be followed by mutual funds for the preparation of their financial statements which, inter alia, require that "for the purpose of all financial statements, all investments shall be marked to market and investments shall be carried out in the balance sheet at market value. However, till necessary guidance notes are issued by the Institute of Chartered Accountants of India to their members, in the above matter, investments may be continued to be valued at cost, with the market value shown separately and the reconciliation statement for the changes in investments valued in the two different ways, shall be provided" [Clause 2(i) of Eleventh Schedule to the Regulations].

2. Clause (a) of the Ninth Schedule to the Regulations, prescribing Accounting Policies and Standards, also provides as below:

> "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 unrealised 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."

3. Accounting Standard (AS) 13 on 'Accounting for Investments', issued by the Institute of Chartered Accountants of India, does not apply to accounting for investments in the financial statements of mutual funds. This Guidance Note is being issued primarily with the objective of providing guidance on accounting for investments in the financial statements of mutual funds, where they are marked to market, as stipulated in the above requirements of the Regulations.

4. This Guidance Note does not apply to Unit Trust of India (UTI) in view of the fact that UTI is governed by the provisions of Unit Trust of India Act, 1963, and Rules framed thereunder.

(Withdrawn as AS 30 became recommendatory from April 1, 2009)

FORMS OF INVESTMENTS

5. Regulation 43 of the Regulations, prescribes that the moneys collected under any scheme of a mutual fund should be invested only in money market instruments or in the capital market or in privately placed debentures or securitised debts. If mutual fund collects money under any money market scheme of a mutual fund, the money collected is to be invested only in money market instruments in accordance with the directions issued by the Reserve Bank of India in this regard. A mutual fund can also, in the case of securitised debts, invest in asset backed securities but the fund is precluded from investing in mortgage backed securities. The investments that a mutual fund can make are subject to the investment restrictions specified in the Seventh Schedule to the Regulations.

CLASSIFICATION OF INVESTMENTS

6. The Regulations do not require classification of investments into any categories, such as current and long term. Annexure 1A of the Eleventh Schedule to the Regulations, which prescribes the contents of scheme-wise Balance Sheet, requires separate disclosure of investments into the following types:

(i) Equity shares;

(ii) Preference shares;

(iii) Privately placed debentures/bonds;

(iv) Debentures and Bonds listed/awaiting listing on the recognised stock exchange;

(v) Calls paid in advance;

(vi) Term Loans;

(vii) Central and State Government Securities (including treasury bills);

(viii) Commercial Paper;

(ix) Others.

It may be noted that item (vi), i.e., term loans was meant to cover such transactions permitted before the Regulations came into force.

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COST OF INVESTMENTS

7. As per clause (k) of the Ninth Schedule to the Regulations, 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 debt instruments any front-end discount offered should be reduced from the cost of the investment." Clause (c) of the said Schedule requires that when interest-bearing 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." In case of investments which carry right to dividend, the cost of investment is reduced by dividends only if they clearly represent a recovery of a part of the cost, e.g., where dividends are passed on by the broker at the time of giving delivery either by giving separate cheque along with the scrips or through credit in his bill. This could arise where (a) the fund has bought shares on cum-dividend basis but delivery is after time limit of book closure of dividend, or (b) Non-Pari Passu (NPP) shares are delivered, i.e., contract was for purchase of old shares, but NPP shares are delivered. National Securities Depository Limited (NSDL) transaction charges and custodian transaction charges identifiable with respect to a particular transaction, are considered as cost of investments. However, such charges which are not identifiable with respect to a particular transaction are not considered as cost of investments.

CARRYING AMOUNT AND THE TREATMENT OF DEPRECIATION AND APPRECIATION WHEN INVESTMENTS ARE MARKED TO MARKET

8. The market value of investments should be determined on the basis of investment valuation norms prescribed in the Eighth Schedule to the Regulations.

9. The basic objective of marking the investments to market, in a mutual fund, is to arrive at the current net asset value of the units. It is felt that this basic objective would be met if the investments are marked to market for balance sheet purposes. Further, as per the existing generally accepted accounting principles in India, unrealised profit is not considered for arriving at the profit (loss) for the period concerned. The recommendations on accounting for investments in the financial statements of mutual funds contained in the following paragraphs are based on the aforesaid principles.

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10. The investments should be marked to market on the balance sheet date. The provision for depreciation in the value of investments should be made in the books by debiting the Revenue Account. The provision so created should be shown as a deduction from the value of investments in the balance sheet. However, unrealised appreciation should be directly transferred to the Unrealised Appreciation Reserve, i.e., without routing it through the Revenue Account with the corresponding debit to the Investments Account. It is recommended that the Unrealised Appreciation Reserve should be reversed at the beginning of the next accounting year.

11. Clause 2(i) of the Eleventh Schedule also provides that "where the financial statements are prepared on a mark to market basis, there *need not be* a separate provision for depreciation". However, keeping in view 'prudence' as a factor for preparation of financial statements and correct disclosure of the amount of depreciation on investments, it is recommended that the gross value of depreciation on investments should be reflected in the Revenue Account rather than the same being netted off with the appreciation in the value of other investments. In other words, depreciation/appreciation on investments should be worked out on an individual investment basis or by category of investment basis, but not on an overall (or global) basis for the entire investment portfolio.

DISPOSAL OF INVESTMENTS

12. The profit/loss arising on the disposal of investment would be the difference between the selling price and the cost. The profit arising on disposal of investment should be recognised fully in the Revenue Account. The amount of loss on the disposal of investment should also be recognised fully in the Revenue Account, if it has been sold in the same year in which it was purchased or if no provision was created for depreciation in the value of investment. However, if the investment is sold in the subsequent year(s) and provision was created as on the last balance sheet date for depreciation in the value of investment, the loss should be charged against the said provision to the extent of balance available in the said account and the balance of loss, if any, should be charged directly to the Revenue Account.

DISCLOSURE

13. Accounting policy for valuation of investments should be disclosed as required by Annexure 1A of the Eleventh Schedule to the Regulations.