

**Securities and Exchange Board of India (‘SEBI’) issues guidelines for Indian Accounting Standards (‘Ind AS’) accounting for Asset Management Companies (‘AMC’) and Mutual Fund (‘MF’) schemes**

# Introduction

## 1. Introduction

Mutual fund industry in India dates back to 1963, when Unit Trust of India was formed at the initiative of the Government of India. With the entry of numerous mutual fund players and several products across the asset classes, the industry has come a long way. The Mutual Fund Industry's Assets under Management <sup>1</sup>('AUM') has grown from INR 22.20 trillion as on 28 February 2018 to INR 39.46 trillion as on 28 February 2023, i.e., around 2-fold increase in a span of 5 years.

## 2. Measurement of investments

<sup>2</sup>Currently, there are 43 AMC's operating in India which are regulated and governed by the SEBI (Mutual Funds) Regulations, 1996.

## 3. Classification of unit capital issued as liability or equity

The financial statements for mutual fund schemes comprising Balance Sheet, Revenue Account and the Cash Flow Statement are required to be in conformity with the accounting policies and standards specified in the Ninth Schedule to the SEBI (Mutual Fund) Regulations, 1996 as amended.

## 4. First-time adoption of Ind AS

On 25 January 2022, SEBI mandated the AMC's and Mutual Fund Schemes to prepare financial statements in accordance with Ind AS with effect from 01 April 2023.

## 5. Impact on the Total Expense Ratio (TER)

Additionally, vide circular dated 4 February 2022 ('the circular'), SEBI has specified the requirements for preparation of the opening balance sheet as on the date of transition and the comparatives as per Ind AS along with the additional information required as part of the detailed disclosures. SEBI has also prescribed the format in which the financial statements of the mutual fund schemes shall be prepared.

## 6. Distributable Surplus

As part of this issue, we have articulated the key aspects pertaining to implementation of Ind AS by mutual funds.

## 7. Enhanced Disclosures

<sup>1</sup> Association of Mutual Funds in India (url : <https://www.amfiindia.com/indian-mutual>)

## 8. Perspective historical per unit statistics

<sup>2</sup> Association of Mutual Funds in India (url : <https://www.amfiindia.com/amfi-members-details>)

## 9. Presentation changes

## 10. Next Steps

# Measurement of investments

## 1. Introduction

Currently, mutual funds follow the investment valuation norms laid down as per the Eighth Schedule of SEBI (Mutual Funds) Regulations, 1996. The Eighth Schedule provides guidance on aspects such as principles of fair valuation along with guidelines for traded and non-traded securities. While mutual funds have been mandated to adopt Ind AS, SEBI has not amended the Eighth Schedule.

## 2. Measurement of investments

With the adoption of Ind AS by Mutual Funds, the classification of investments will be driven by Ind AS 109- Financial Instruments and fair valuation will be driven by Ind AS 113- Fair Value Measurement. This may result in inconsistency while measuring investments as per the MF Regulations and Ind AS.

## 3. Classification of unit capital issued as liability or equity

For instance, the SEBI regulations require valuation of traded equity instruments to be done as per last quoted price on the stock exchange where the scrip is principally traded. In case of debt and money market instruments, valuation is in practice is done on average of quotes received from AMFI appointed agencies.

## 4. First-time adoption of Ind AS

Under Ind AS, investments will need to be first classified in accordance with Ind AS 109 and valued based on principles provided by Ind AS 113. Accordingly, mutual funds may need to revisit practices followed to determine fair value whilst applying Ind AS 113 e.g., determining principal and most advantageous market for quoted financial instruments, determining appropriate valuation technique and assumptions for estimating fair value of unquoted financial instruments.

## 5. Impact on the Total Expense Ratio (TER)

## 6. Distributable Surplus

Furthermore, Ind AS 113 stipulates fair value hierarchy disclosures that categorizes inputs used in valuation techniques into three levels. The fair value hierarchy categorizes such inputs into Level 1, Level 2 and Level 3, wherein Level 1 comprises quoted prices in active markets for identical assets and liabilities; Level 2 inputs are other than quoted prices included in Level 1 and Level 3 are unobservable inputs.

## 7. Enhanced Disclosures

## 8. Perspective historical per unit statistics

With regard to the initial measurement of investments, SEBI vide circular has amended the Mutual Fund Regulation and requires the transaction cost of investment to be charged to Revenue Account instead of the current requirement of capitalizing the same to the cost of investment. This is aligned with Ind AS 109 for financial assets measured at Fair Value through P&L ('FVTPL').

## 9. Presentation changes

## 10. Next Steps

Further, clause 50(1A) of the Mutual Fund Regulations, 1996 states in case of conflict between the requirements of Ind AS and the SEBI regulations, the MFs shall follow the requirements specified under the SEBI regulations. Thus, in the absence of further amendments to the Eight Schedule, the MF's may continue to apply the valuation norms as per the Eight Schedule. This may result in a sub-optimal outcome as alignment in guidelines relating to measurement of fair value with Ind AS 113 is critical for implementation of Ind AS by mutual funds.



# Classification of unit capital issued as liability or equity

## 1. Introduction

Under Ind AS, the classification of unit capital issued as a financial liability or equity would depend on whether the mutual fund scheme is an open-ended scheme or a close-ended scheme. The circular requires unit capital to be presented separately as net assets attributable to the holder of redeemable units i.e., as the difference between total assets and total liabilities.

## 2. Measurement of investments

## 3. Classification of unit capital issued as liability or equity

An open-ended fund or scheme is one which offers units for sale without specifying any duration for redemption. Accordingly, units are redeemable by the scheme at the discretion of investors, or such units can be traded on the stock exchange. A close-ended scheme means any scheme of a mutual fund in which the period of maturity of the scheme is specified or can be traded on the stock exchange without any redemption option by the scheme.

## 4. First-time adoption of Ind AS

As per Ind AS 32, Financial instruments - Presentation, a financial instrument redeemable at the option of the holder is required to be classified as a financial liability. However, puttable instruments are classified as equity subject to specified conditions being fulfilled i.e., the instrument entitles the holder to a pro-rata share of net assets in the event of the entity's liquidation and the instrument belongs to a class of instruments subordinate to all other classes of instruments issued by the entity.

## 5. Impact on the Total Expense Ratio (TER)

## 6. Distributable Surplus

Accordingly, the unit capital of an open-ended scheme will not meet the aforesaid conditions and will be classified and presented as financial liability. The unit capital of a closed-ended scheme may meet the conditions required to be fulfilled to be classified as equity by exception.

## 7. Enhanced Disclosures

## 8. Perspective historical per unit statistics

## 9. Presentation changes

## 10. Next Steps





# First-time adoption of Ind AS

SEBI requires mutual funds to mandatorily adopt Ind AS with effect from 1 April 2023.

Accordingly, as part of the first set of Ind AS financial statements, mutual funds will need to prepare the following:

- Opening balance sheet as on the transition date of 1 April 2022
- Comparative financial statements for the year ended 31 March 2023
- Financial statements for the year ending 31 March 2024

The financial statements of the mutual fund schemes shall be prepared as per the formats prescribed in Annexure A of the Circular dated 4 February 2022. The format of the balance sheet prescribed in Annexure A is the order of liquidity- based presentation consistent with requirements of Ind AS 1- Presentation of Financial Statements.

Further, the preparation of Ind AS financial statements for the year ending 31 March 2024 will be driven by Ind AS 101, the First-time adoption of Ind AS. The accounting adjustments arising from the first-time adoption of Ind AS will need to be recognized in retained earnings as on 1 April 2022.

## Impact on the Total Expense Ratio (TER)

All costs for running and managing a mutual fund scheme are collectively referred to as Total Expense Ratio ('TER'). In India, TER is fungible i.e., there is no limit on any particular type of allowed expense as long as the TER is within the limits as prescribed under Regulation 52 of SEBI Mutual Fund Regulations.

As per the SEBI circular, transaction cost of investment shall be charged by the mutual fund scheme to Revenue account instead of the current practice of capitalization. This will have a direct impact on the management fees which the schemes pay to the AMC's for their services as the Fund will have to manage the TER so that it remains within the prescribed limits.

Hence, this accounting change in the books of mutual fund schemes will have a direct impact on the top line of the AMCs.

### 1. Introduction

### 2. Measurement of investments

### 3. Classification of unit capital issued as liability or equity

### 4. First-time adoption of Ind AS

### 5. Impact on the Total Expense Ratio (TER)

### 6. Distributable Surplus

### 7. Enhanced Disclosures

### 8. Perspective historical per unit statistics

### 9. Presentation changes

### 10. Next Steps

# Distributable Surplus

Mutual fund schemes can distribute realized profits. In the case of discounted instruments, mutual fund schemes will need to assess if full fair value change should be presented as such or should fair value change be split between interest and residual fair value. It seems Mutual Fund Schemes may have to make an accounting policy choice in this context which should be consistently followed.

## 1. Introduction

## 2. Measurement of investments

## 3. Classification of unit capital issued as liability or equity

## 4. First-time adoption of Ind AS

## 5. Impact on the Total Expense Ratio (TER)

## 6. Distributable Surplus

## 7. Enhanced Disclosures

## 8. Perspective historical per unit statistics

## 9. Presentation changes

## 10. Next Steps

# Enhanced Disclosures

With the adoption of Ind AS, all the detailed quantitative and qualitative disclosures required by Ind AS will become applicable to mutual funds. It is expected that disclosures required by Ind AS 107 on the nature of risks arising from exposure to financial instruments along with information (quantitative and qualitative) on how such risks are managed will need to be provided in the financial statements.

Further, the circular also requires mutual funds to provide detailed disclosures for securities in default. Such disclosure covers information such as ISIN, name of security, the value of security considered in NAV, and the amount due to the scheme (principal and interest). Such information has to be disclosed till the value of security recognized in NAV is received or 3 years from the date of maturity of such security, whichever is later. These disclosures will require extensive details and mutual funds will need to ensure adequate processes and controls are in place to provide reliable information in notes to financial statements as such disclosures will also be subject to audit.



# Perspective historical per unit statistics

## 1. Introduction

The Mutual Fund Regulation requires disclosure of scheme-wise per unit statistics of the past 3 years. However, on the adoption of Ind AS, mutual funds may not be mandatorily required to restate the previously published perspective historical per unit statistics as per requirements of Ind AS for the first two years from the first-time adoption of Ind AS. However, mutual fund schemes shall provide the following additional information in perspective historical per unit statistics:

## 2. Measurement of investments

## 3. Classification of unit capital issued as liability or equity

- Label the previous Generally Accepted Accounting Principles (GAAP) information prominently as not being prepared in accordance with IND AS; and
- Disclose the nature of the adjustments that would be required to make it comply with IND AS. Mutual Funds schemes need not quantify those adjustments.

## 4. First-time adoption of Ind AS

## 5. Impact on the Total Expense Ratio (TER)

# Presentation changes

## 6. Distributable Surplus

The circular prescribes the format of the financial statements of the Mutual Fund Schemes. A comparison of the prescribed format as against the current format as per Eleventh Schedule of the SEBI (Mutual Fund) Regulation is discussed below.

## 7. Enhanced Disclosures

## 8. Perspective historical per unit statistics

## 9. Presentation changes

## 10. Next Steps

### Contents of scheme wise Balance Sheet (Indian GAAP)

#### Liabilities

- Unit Capital
- Reserves and Surplus
- Borrowings
- Current Liabilities and Provision

#### Assets

- Investments
- Deposits
- Other Current Assets
- Fixed Assets

Current presentation followed by the Mutual Fund Schemes as per the requirements of ninth schedule of the SEBI (Mutual Funds) Regulations 1996

## Contents of scheme wise Balance Sheet (Ind AS)

Assets	
	<b>Financial Assets</b>
<ul style="list-style-type: none"> <li>• Cash and cash equivalents</li> <li>• Balances with Banks</li> <li>• Derivative financial instruments</li> <li>• Receivables</li> <li>• Investments</li> <li>• Other financial Assets</li> </ul>	
	<b>Non-Financial Assets</b>
<ul style="list-style-type: none"> <li>• Investment property</li> <li>• Other non-financial assets</li> </ul>	
Liabilities	
	<b>Financial Liabilities</b>
<ul style="list-style-type: none"> <li>• Derivative financial instruments</li> <li>• Payables</li> <li>• Borrowings</li> <li>• Other Financial Liabilities</li> </ul>	
	<b>Non- Financial Liabilities</b>
<ul style="list-style-type: none"> <li>• Provisions</li> <li>• Other Non-financial Liabilities</li> </ul>	

Unlike the format prescribed by ninth schedule of the SEBI (Mutual Fund) Regulation 1996, the revised Balance Sheet format will lead to the following key presentation changes:

- The current / non-current classification has been replaced by the presentation based on order of liquidity
- “Unit Capital” and “Reserves and Surplus” is presented as a balancing figure under the heading “Net assets attributable to holder of redeemable units”
- Real estate assets shall now be presented under “investment property”
- Bank balance, Cash and cash equivalents, Derivatives will be presented as a separate line item on the face of the balance sheet
- Deposits will be presented as part of the schedule “Balances with banks”

- 1. Introduction
- 2. Measurement of investments
- 3. Classification of unit capital issued as liability or equity
- 4. First-time adoption of Ind AS
- 5. Impact on the Total Expense Ratio (TER)
- 6. Distributable Surplus
- 7. Enhanced Disclosures
- 8. Perspective historical per unit statistics

### 9. Presentation changes

### 10. Next Steps





## Contents of scheme wise Revenue Account (Indian GAAP)

### 1. Introduction

### 2. Measurement of investments

### 3. Classification of unit capital issued as liability or equity

### 4. First-time adoption of Ind AS

### 5. Impact on the Total Expense Ratio (TER)

### 6. Distributable Surplus

### 7. Enhanced Disclosures

### 8. Perspective historical per unit statistics

### 9. Presentation changes

### 10. Next Steps

#### Income

- Dividend
- Interest
- Rental income
- Profit on sale/redemption of investments in securities
- Profit on inter scheme transfer/sale of investments
- Profit on sale of real estate assets
- Other income

#### Expenses

- Provision for depreciation in the value of investments in securities
- Provision for outstanding accrued income considered doubtful
- Provision for doubtful deposit and current assets
- Loss on sale/redemption of investment in securities
- Loss on sale of real estate investment properties
- Loss on inter scheme transfer/ sale of investment
- Management fee
- Trusteeship fee
- Staff cost
- Office and administrative expenses
- Registration and local charges
- Commission to Agents
- Publicity expenses
- Audit fees
- Legal and title search fee
- Insurance and security expenses
- Advisory fees in respect of real estate investment asset
- Other operating expenses
- Depreciation of fixed assets
- Custodian fee
- Registration fee

Current presentation followed by the Mutual Fund Schemes as per the requirements of ninth schedule of the SEBI (Mutual Funds) Regulations 1996

## Contents of scheme wise Revenue Account (Ind AS)

- 1. Introduction
- 2. Measurement of investments
- 3. Classification of unit capital issued as liability or equity
- 4. First-time adoption of Ind AS
- 5. Impact on the Total Expense Ratio (TER)
- 6. Distributable Surplus
- 7. Enhanced Disclosures
- 8. Perspective historical per unit statistics
- 9. Presentation changes
- 10. Next Steps

Income (A)
<ul style="list-style-type: none"> <li>Interest income</li> <li>Dividend income</li> <li>Rental income</li> <li>Gain on fair value changes</li> <li>Gain on sale/ redemption of investments</li> <li>Others (to be specified)</li> </ul>
Expense (B)
<ul style="list-style-type: none"> <li>Finance costs</li> <li>Fees and commission expenses</li> <li>Loss on fair value changes</li> <li>Loss on sale/ redemption of investments</li> <li>Others (to be specified)</li> </ul>
Surplus/deficit for the reporting period (A-B)

Unlike the format prescribed by ninth schedule of the SEBI (Mutual Fund) Regulation 1996, the revised Revenue Account format will lead to the following key presentation changes:

- Grouping together information about items measured similarly such as
  - Gain/ loss on fair value changes for assets measured at fair value
  - Gain/loss on sale/ redemption of investments
  - Interest, Dividend, finance cost, fees and commission
- The other income/ expenses will be parked in "Others"



# Next Steps

## Governance



### 1. Introduction

### 2. Measurement of investments

The circular requires financial statements of the scheme to be approved at a meeting of trustees or in the case of a trustee company by the Board of Directors of the trustee company.

### 3. Classification of unit capital issued as liability or equity

As mutual funds will be implementing Ind AS for the first time, it will be important for the AMC to proactively engage with trustees or the Board of Directors of the trustee company. Accordingly, it will be important for the Chief Financial Officer ('CFO') of the AMC to determine the impacts of Ind AS for the schemes.

### 4. First-time adoption of Ind AS

The circular also requires the balance sheet and revenue account to be signed by the Chief Executive Officer ('CEO'), CFO, and such other key management personnel designated by the Board of AMC, Chief Investment Officer ('CIO'), scheme-wise fund managers and Board of Trustees. This will call for a detailed project plan for seamless implementation of Ind AS.

### 5. Impact on the Total Expense Ratio (TER)

## Business considerations



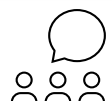
### 6. Distributable Surplus

AMCs will need to engage with analysts to bring them up to speed on potential impacts arising from the implementation of Ind AS.

### 7. Enhanced Disclosures

### 8. Perspective historical per unit statistics

## People



### 9. Presentation changes

AMCs will need to upskill personnel involved in the preparation of financial statements and familiarize them with the requirements of Ind AS.

### 10. Next Steps

## Investor Education



The SEBI guidelines require mutual funds to prepare financial statements in accordance with Ind AS. As detailed in the previous section, there are several financial reporting considerations including differences relating to presentation of various financial statement captions in the balance sheet and revenue account. AMCs will need to initiate Investor Education initiatives so as to familiarize them with the changes stipulated by SEBI guidelines including key differences between financial reporting practices followed hitherto and those applicable now under Ind AS.

# A TEAM THAT YOU CAN TRUST TO DELIVER



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