

**ICAI – WIRC Seminar on Mutual Funds,
PMS & Investment Advisory Services**

Sanjay Panse

Senior Partner

S. Panse & Co.,

Chartered Accountants

Coverage

- MF Structure and Legal Entities
- Operations of MF
- Distributable Surplus and Equalization
- Guidance Note of ICAI and Accounting Policies
- PMS Structure and Legal Entities
- PMS – Opportunities for CA's
- Investment Advisory Services and Opportunities

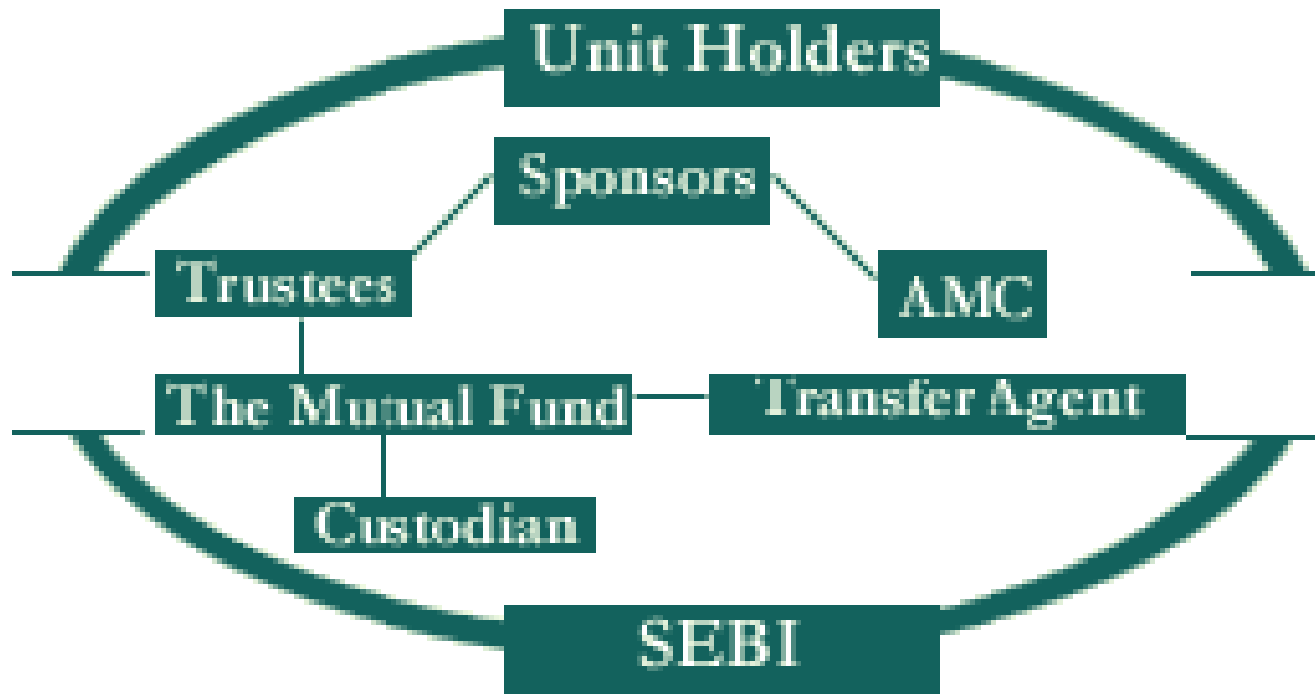
What is Mutual Fund?

- Mutual fund is a mechanism for pooling the resources.
- Issuing units to the investors
- Investing funds in securities
- In accordance with objectives as disclosed in offer document.

How is a Mutual Fund set up?

- Sponsor
- Trustees
- Asset Management Company (AMC)
- 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.

Entities Involved



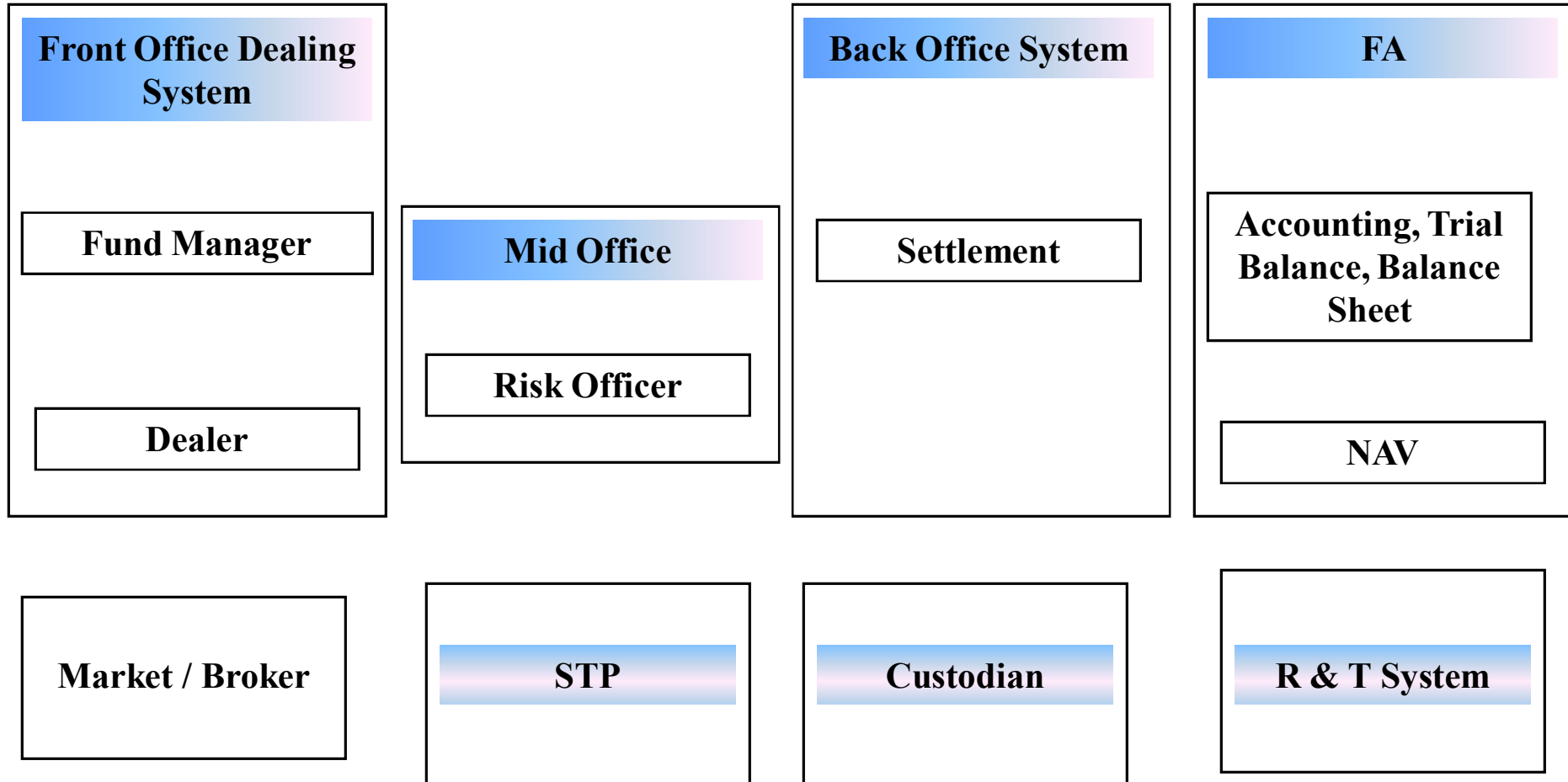
History of Mutual Funds in India

- First Phase – 1964-87
 - Unit Trust of India was the first mutual fund set up in India in the year 1963.
- Second Phase – 1987-1993 (Entry of Public Sector Funds)
 - SBI Mutual Fund was the first non- UTI Mutual Fund established in June 1987 followed by Canbank Mutual Fund (Dec 87),
- Third Phase – 1993-2003 (Entry of Private Sector Funds)
 - Kothari Pioneer (now merged with Franklin Templeton) was the first private sector mutual fund registered in July 1993.
- In 2003 UTI was bifurcated into two separate entities
 - One is the Specified Undertaking of the Unit Trust of India
 - The second is the UTI Mutual Fund Ltd, sponsored by SBI, PNB, BOB and LIC.
- Finally as on November 2013, there are 46 funds, which manage assets of around Rs. 9 lacs crores.

What are the different types of mutual fund schemes?

- Open-ended Fund/ Scheme
- Close-ended Fund/ Scheme (FMP comparison with FD)
- Schemes according to Investment Objective
 - Growth / Equity Oriented Scheme
 - Income / Debt Oriented Scheme
 - Balanced Fund
 - Money Market or Liquid Fund
 - Gilt Fund
 - Index Funds
 - Sector Specific Funds

INVESTMENTS - ENTITIES



What is Net Asset Value (NAV) of a scheme?

- The performance of a particular scheme of a mutual fund is denoted by NAV.
- Mutual funds invest the money collected from the investors in securities markets.
- Net Asset Value is the market value of the securities held by the scheme.
- 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 - Liability Method

Particulars	Amount
Unit Capital (Net Movement)	
Reserve	
Appreciation / Depreciation in Value of Securities	
Income	
Dividend Income	
Interest Income	
Profit & Loss on sale of Equity / Debt/ G-Secs, etc.	
Recurring Expenses	
Income Distribution	
Total NAV	
Total outstanding units as on the day end	
NAV per Unit	

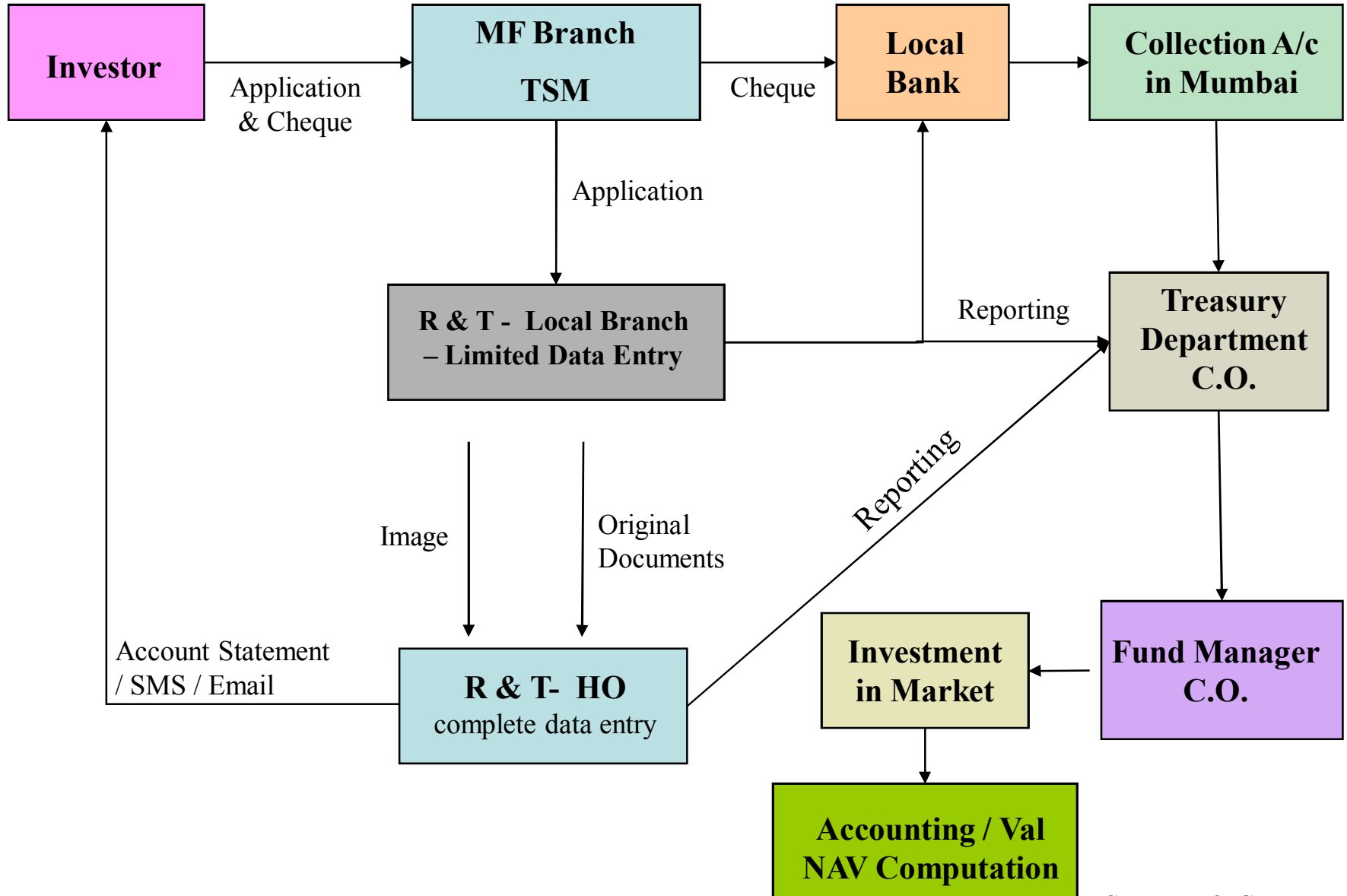
Understanding Unit Capital Movement

- Unit Capital Movement
 - Subscriptions
 - Redemptions
 - Switches

Subscription Process

- Official Receiving Points
- Applications
- Cheques/ Direct Credit instructions
- New Purchase/Additional Purchase
- Role Of R & T Agent

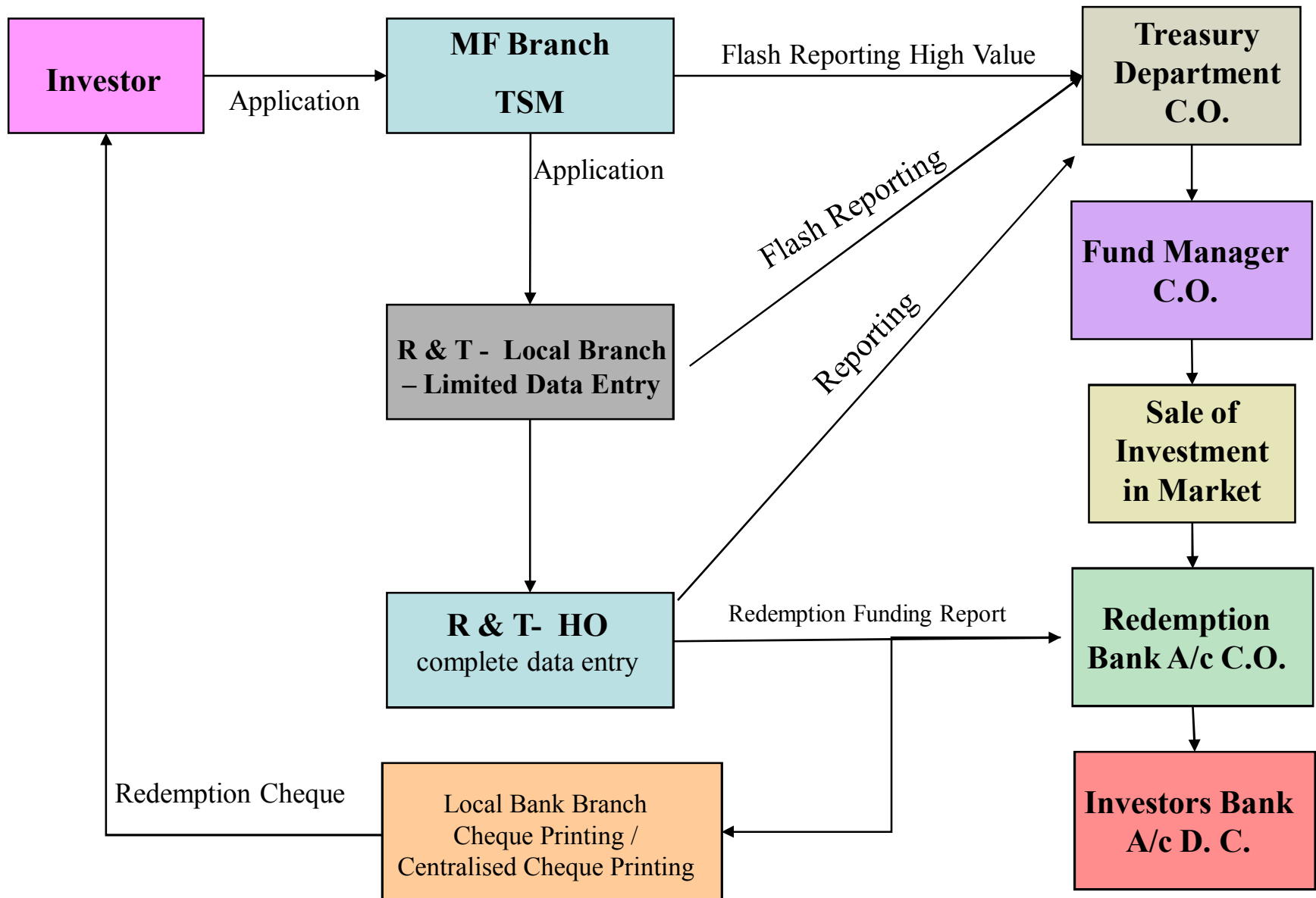
PURCHASE



Redemption Process

- Official Receiving Points
- Applications
- Redemption Cheques
- Direct Credit
- Role Of R & T Agent
- Role Of Banks

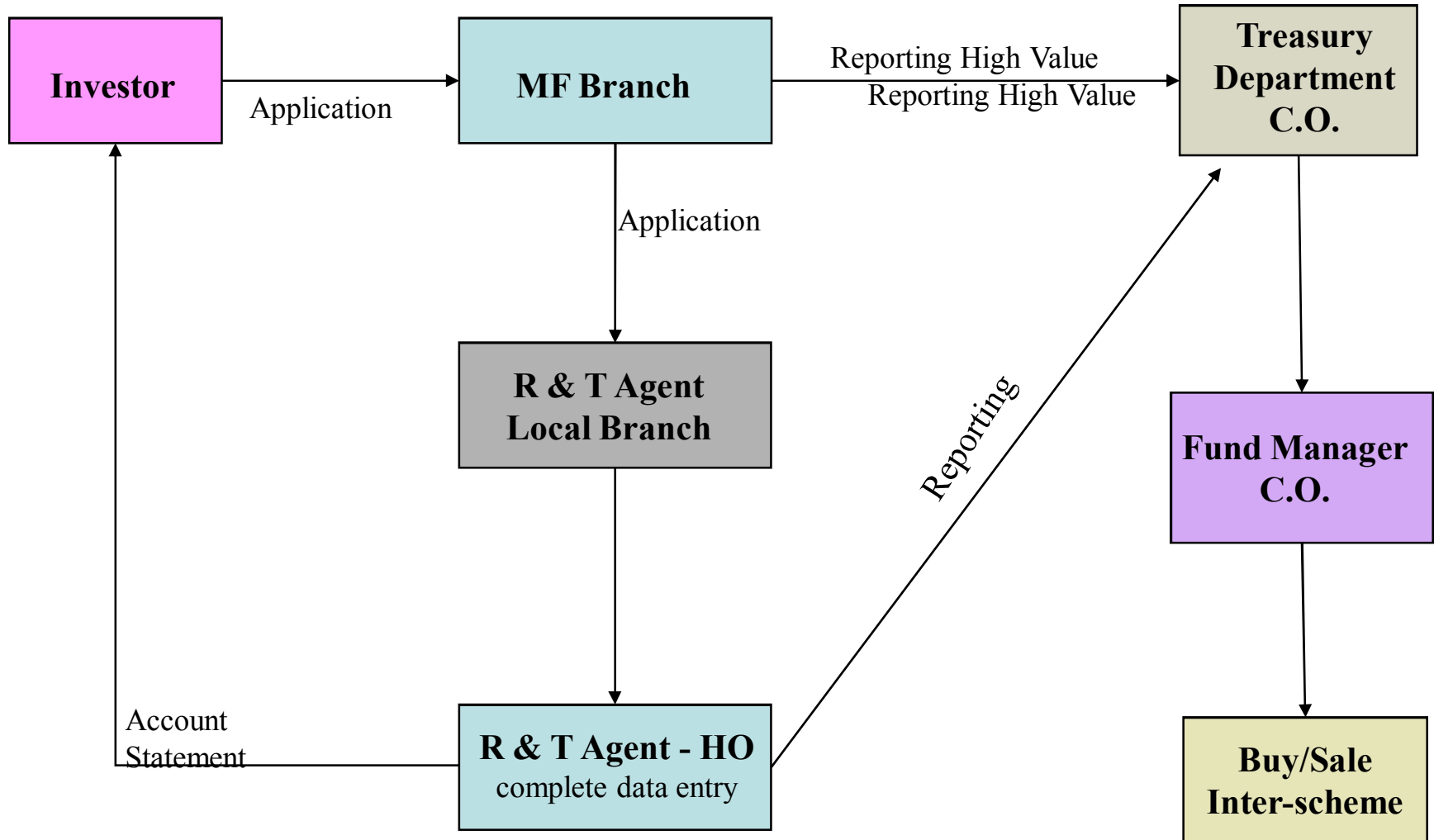
REDEMPTION



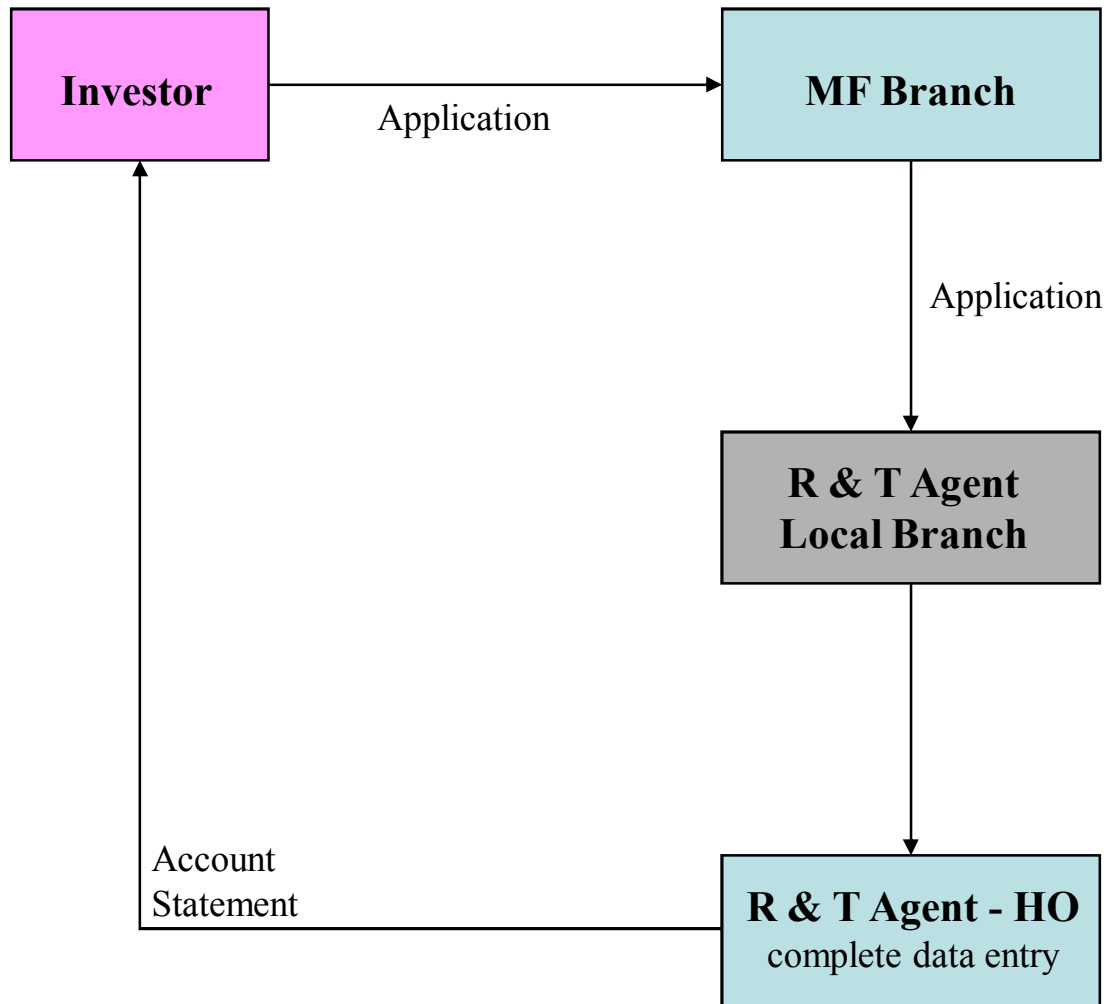
Switch Transactions

- Requests
- Cash Flow
- Role Of Branches
- Role Of R & T Agent

SWITCH



NON FINANCIAL TRANSACTIONS



Financial Statements

Contents of scheme Balance Sheet			
LIABILITIES	₹	ASSETS	₹
Unit Capital		Investments	
Unit Premium Reserve (UPR)		Deposits	
Dividend Equilisation Reserve (EQR)		Other Current Assets	
Appropriation Account (Representing Unrealised Appreciation)			

- **Accounting Policies Part of Regulations**
 - Investments not on Historical Cost
 - Unrealised appreciation / depreciation
- **Valuation**
 - Valuation Committee
 - Documented Valuation Policy, Valuation Methodology & Process
 - Parallel NAV Computation
 - Internal Auditor
 - Statutory Auditor

Financial Statements...contd...

- Distributable Surplus for the purpose of Dividend Declaration
 - Principles
 1. Out of realised gains i.e. not out of unrealised appreciation
 2. Capital not to be returned to Investors as Dividend
- Concepts of UPR & EQR (Circular dated 14th March 2010)
 - Example for Purchase of units by the investor

Purchase of Units	₹
NAV	15
Face Value	10
Unrealised Appreciation	2
Realised Gains	3

Financial Statements... Dividend Declaration

Purchase of Units	₹	100 Units	₹
NAV	15	Chq	1500
Face Value	10		1000
Unrealised Appreciation	2		200
Realised Gains	3		300

Accounting Entries	₹
Unit Capital	1000
Unit Premium Reserve	200
Equalization Reserve	300
Bank Account	1500

- Dividend Equalisation Reserve as visualised in the Regulations and UPR as per SEBI Circular.

ICAI Guidance Note

- No mention of Distributable Surplus
- Fair Value Accounting
- Applicability of Cash Flow
- Need for Revision

Need for Joint Audits

- Large Corpus
- Variety of Schemes
- Every Scheme has a distinct feature
- Impact of valuations practices throughout the year
- Regulatory Compliances
- IRDA

Who is Portfolio Manager?

- Governing Regulations
- SEBI (Portfolio Manager) Regulations, 1993
- “Any person who pursuant to a contract or arrangement with a client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise) the management or administration of a portfolio of securities or the funds of the client, as the case may be.”

Portfolio Manager and Structure

- Therefore Portfolio Manager :
 - Needs to have contract with the client
 - For :
 - Advisory Services
 - Management
 - Administration
 - Of Securities or Funds,
 - Real Estate?
 - Gold and Other Assets
 - Three Types:
 - Discretionary
 - Non Discretionary
 - Advisory

Opportunities for Chartered Accountants

- **Clients to avail PMS**
 - Individual Clients and Equity as Asset Class
 - Need of Expertise
 - High Networth Individuals
 - Experiences of Brokers as Investment Advisor
 - Customization as a Key Element
 - Disclosure of Portfolios
 - Mutual Fund v/s PMS

Opportunities for Chartered Accountants.. Contd...

- Registration
- Audits
- Certification
- Tax Computation
- Contracts and Documentation
- Corporate Governance

Certificate - Re : Disclosure Document

- **Contents of Disclosure Document are certified by Chartered Accountant**
- **Content of the Certificate prescribed by SEBI.**
 - “Disclosures made in the document are true, fair, and adequate to enable the investors to make a well informed decision.”
- **What does Disclosure Document includes**
 - Quantum and manner of fees
 - Details of Portfolio and Risks
 - Related parties transactions
 - Summary of Audited Financial Statements for last 3 years
 - Performance of Portfolio Manager
- **Frequency of Disclosure Document**
 - to be filed every 6 months
 - Or whenever any material change is effected whichever is earlier

Audits of Portfolio Manager

- **Audit under Regulation 20 (2)**
 - “Books of Accounts to be audited yearly
 - To ensure that Portfolio Manager has followed proper accounting methods and procedures
 - Portfolio Manager has performed his duties in accordance with law
- To be submitted within 30 days from 31st March
- Managements comments to be included on observations of Auditors.

Audits of Portfolio Manager.. contd...

- **Audit under Regulation 20 (3)**
 - Portfolio Accounts to be audited annually by CA
 - Certificate to that effect to be given to client along with Portfolio Accounts for the year.
 - Certification content
 - Scope and Methodology
- **Audit under Regulation 20 (4)**
 - Client may appoint CA (of his choice) to audit accounts of Portfolio Manager relating to his transactions.

Audits of Portfolio Manager.. contd...

▪ **Corporate Governance Report**

- Performance measurement along with benchmark indices to be submitted in the periodical report to clients
- Boards of the Portfolio Manager to review performance of the funds for *each client* separately in their meetings
- Boards of the Portfolio Manager to review compliance of Regulations in their meetings
- Compliance Officer to submit quarterly reports on compliance of SEBI Regulations
- Boards of the Portfolio Manager to review redressal of Investors grievances.

Need of Guidance Note

- **Different Accounting Practice across the Industry**
 - Trade Date v/s Settlement Date
 - Principle Stock Exchange and Valuation
 - MTM v/s Historical Cost
 - Impact of Taxation
- Need for Standardization to help performance benchmarking

Investment Advisory Services

- SEBI Regulations
- How different from execution?
- Remuneration

Thank You !