

First Notes

SEBI mandates Ind AS for Mutual Funds

22 March 2022

First Notes on

Financial reporting

Corporate law updates

Regulatory and other information

Disclosures

Sector

All

Banking and insurance

Information, communication, entertainment

Consumer and industrial markets

Infrastructure and government

Relevant to

All

Audit committee

CFO

Others

Transition

Immediately

Within the next three months

Post three months but within six months

Post six months

Forthcoming requirement

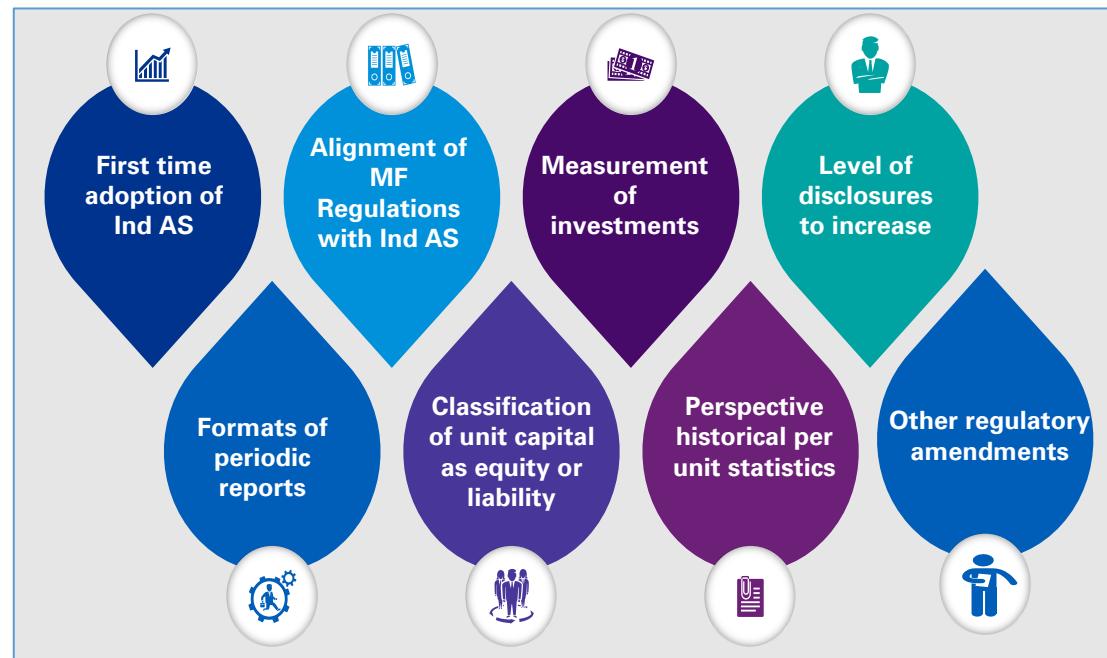
Introduction

The Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 (the MF Regulations) lay down the regulatory framework for operations and functioning of Mutual Funds (MFs). The MF Regulations are amended by SEBI from time to time to enhance transparency and disclosures, to address emerging issues, to protect the interests of investors, and to strengthen the regulatory framework of MFs.

On 25 January 2022, SEBI vide a notification issued the SEBI (Mutual Funds) (Amendment) Regulations, 2022. As per this notification, the financial statements and accounts of MF schemes will be prepared in accordance with Indian Accounting Standards (Ind AS). Additionally, SEBI vide a circular dated 4 February 2022 (the circular) provided certain guidelines on accounting with respect to Ind AS for MFs. The circular also provides specific formats of the financial statements to be prepared for the MF schemes under Ind AS. The requirements of the circular will become applicable from 1 April 2023.

In this issue of First Notes, we have identified key considerations arising from adoption of Ind AS by MFs along with our comments.

Key considerations arising from adoption of Ind AS by MFs are as follows:



¹ SEBI/LAD-NRO/GN/2022/70

² SEBI/HO/IMD-II/DOF8/P/CIR/2022/12

First time adoption of Ind AS

The circular clearly requires the mandatory application of Ind AS by MFs for preparation of the financial statements from 1 April 2023. Accordingly, the first set of the financial statements under Ind AS by MFs shall be for the annual period ending 31 March 2024. MFs will be required to consider the principles laid down in Ind AS 101, *First-time adoption of Indian Accounting Standards*, while drawing up the financial statements for the annual period ending 31 March 2024.

Ind AS 101 requires presentation of an opening balance sheet as at the beginning of the comparative period i.e. 1 April 2022. This date is referred to as the date of transition. All necessary adjustments arising from application of Ind AS are required to be identified and adjusted in the opening balance sheet to the respective assets and liabilities with the corresponding impact to opening retained earning as at 1 April 2022. Accordingly, MFs will be required to maintain two sets of accounting records during the annual period ending 31 March 2023 – one based on Ind AS and another based on the existing MF Regulations.

Alignment of MF Regulations with Ind AS and conflict between Ind AS and MF Regulations

Proviso to clause 50(1A) of the MF Regulations provides that in case there is any conflict between the requirements of Ind AS and the MF Regulations and guidelines issued thereunder, the MFs shall follow the requirements specified under the MF Regulations. The present requirements of the MF Regulations conflict or may potentially conflict with certain requirements of Ind AS e.g. valuation of investments. While certain enabling amendments have been incorporated in the circular but the Eighth Schedule of the MF Regulations remains unchanged, it is unclear whether further amendments shall be introduced by SEBI.

In the absence of any further amendments, the financial statements prepared by MFs may not be in compliance with all the requirements of Ind AS in the areas of conflict. This will require further deliberation amongst various stakeholders to ensure an aligned approach is adopted for the various elements of compliance applicable in context of the financial statements.

Measurement of investments

Presently, MFs are required to measure their investments at fair value on each reporting date. However, the MF Regulations include detailed guidance on the methodology to be applied for such fair valuation for each type of investments (it is captured in the Eighth Schedule of the MF Regulations). For example, for traded equity securities, the valuation is based on the last quoted price at the stock exchange where the respective security is principally traded. While for traded/non-traded debt and money market securities, in practice, valuation is based on the average of the quotes received from the Association of Mutual Funds in India (AMFI) appointed agencies – CRISIL and ICRA. It is important to note that SEBI has not amended the Eighth Schedule.

Under Ind AS, MFs will be required to apply the requirements of Ind AS 113, *Fair Value Measurement*. This may result in the methodology of determining the fair value being different from the approach prescribed as part of the MF Regulations e.g. evaluation of principal and most advantages markets, present value techniques, option pricing models, fair value hierarchy, etc. Accordingly, if MFs are required to follow Ind AS then they will be required to set up processes which first evaluate the appropriate method of determining fair value as per the requirements of Ind AS 113 and then applying the relevant methodology.

Hence, in the absence of further clarifications, it is possible that MFs may continue to follow the investment valuation norms as prescribed in the Eighth Schedule rather than following the principles given under Ind AS.

Further, on initial measurement of investments, MFs presently capitalise transaction costs directly attributable to purchase of such investments e.g. brokerage costs upto a certain threshold. Under Ind AS such costs will be required to be debited through the Statement of Profit and Loss. The circular clarifies this aspect and mentions that such costs would be debited to the Revenue Account.

Level of disclosures to increase

The impact of application of Ind AS would not be restricted to just recognition and measurement related impacts but will also entail inclusion of detailed disclosures as required by Ind AS standards, especially Ind AS 107, *Financial Instruments: Disclosures*. Ind AS also requires extensive information on the nature and extent of risks arising from the exposure to financial instruments and how those risks were managed. MFs should carefully study the extensive disclosure requirements in the Ind AS. This would also require changes to systems and processes to gather relevant information to be disclosed in the financial statements in order to be compliant with the requirements of Ind AS.

Formats of periodic reports

The MF Regulations also require periodic and continual disclosures to SEBI/unitholders. MFs are required to furnish the below mentioned periodic reports to SEBI/unitholders:

- Copies of the duly audited annual statements of accounts including the balance sheet and the profit and loss account for the fund and in respect of each scheme, once a year
- Abridged scheme wise annual report (balance sheet and revenue account)
- A copy of six monthly unaudited accounts
- A quarterly statement of movements in the net assets for each of the schemes of the fund
- A quarterly portfolio statement, including changes from the previous periods, for each scheme.

The circular provides format for annual Ind AS financial statements to be submitted by MFs. Time to time SEBI through various circulars/amendments has prescribed formats for other periodic reports like abridged scheme wise annual report, six monthly unaudited accounts, etc. The circular does not provide any format for the other submissions to be made by MFs. Therefore, in the absence any further clarification, MFs may continue to provide 'other periodic reports' as per the existing formats.

Statement of cash flows

Though the MF Regulations were silent about presentation of statement of cash flows, an opinion³ from the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) required MFs to prepare a statement of cash flows based on the criteria for classification of non-corporate entities for applicability of accounting standards as issued by ICAI.

Under the Ind AS framework, all reporting entities are required to prepare and present statement of cash flows i.e. it does not provide any exemption. The circular also is silent regarding preparation of statement of cash flows and does not prescribe any format for statement of cash flows. In the absence of any clarification from SEBI, MFs should continue to present statement of cash flows based on the requirements of Ind AS 7, *Statement of Cash Flows* which is also in line with the guidance issued by the EAC.

Classification of unit capital as equity or liability

Unit capital represents the net outstanding units at the balance sheet date, thereby reflecting all transactions relating to the period ended on that date. Under the circular, unit capital is presented as a balancing figure under the heading 'Net assets attributable to holder of redeemable units'.

Accounting of unit capital under Ind AS would depend on the nature of the mutual fund scheme (open-ended or close-ended).

In case of an open-ended scheme, unit capital amount is redeemable by the MF at the option of the unit holder at any point in time or can be traded on the stock exchange.

³ Applicability of Accounting Standards to schemes of Mutual Funds – EAC opinion finalised on 30 April 2008

Classification of unit capital as equity or liability (Contd.)

If a scheme is a close-ended scheme, then it is redeemable only at the end of life i.e. on maturity or it can be traded on the stock exchange without any redemption option by the scheme during the lifetime of such a scheme.

Ind AS 32, *Financial Instruments: Presentation* requires an instrument that is redeemable at the option of the holder to be classified as a financial liability. However, Ind AS 32 provides an exemption where certain puttable instruments could be classified as equity when certain conditions are met. Two important conditions to be met are that instrument entitles holder to pro rata share in entity's net assets in the event of entity's liquidation and that the instrument belongs to a class of instruments that is subordinate to all other classes of instruments issued by an entity.

It appears that the condition 'instrument entitles holder to pro rata share in entity's net assets in the event of entity's liquidation' would not be met for open-ended MF schemes, hence unit capital would be classified as a financial liability. While for close-ended MF schemes it is likely that the conditions for exemption would be met, and unit capital would be classified as equity. Entities would need to do a careful evaluation of their facts and circumstances for each scheme of MF to classify unit capital as a financial liability or equity.

It is important to note that Ind AS 32 provides guidance that classification of unit capital as a financial liability does not preclude the use of descriptors such as 'net asset value attributable to unitholders' and 'change in net asset value attributable to unitholders' in the financial statements of an entity that has no contributed equity. Therefore, MFs may use the description (as given in the circular) for unit capital as 'Net assets attributable to holder of redeemable units'.

Perspective historical per unit statistics

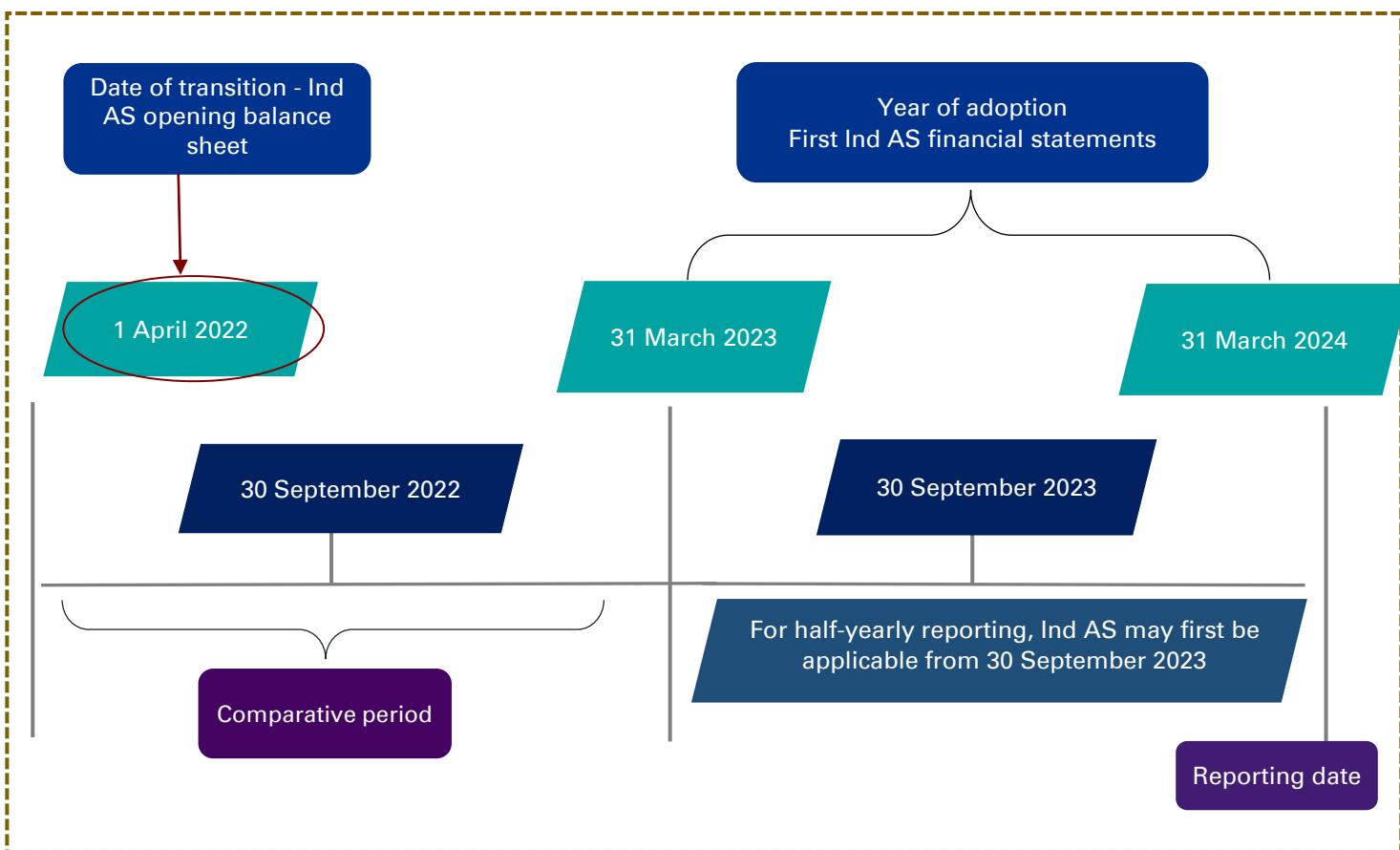
The MF Regulations require disclosure of scheme wise per unit statistics for the past three years. In this regard, the circular provides that the MF schemes may not be mandatorily required to restate the previous years published perspective historical per unit statistics as per requirement of Ind AS for the first two years from first-time adoption of Ind AS. However, MF schemes should furnish following additional information in perspective historical per unit statistics:

- 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. MF Schemes need not quantify those adjustments.

For the financial year 2023-24 following could be the manner of disclosure for perspective historical per unit statistics:

Financial year	31 March 2021	31 March 2022	31 March 2023	31 March 2024
GAAP	Previous GAAP	Previous GAAP	Previous GAAP	Ind AS numbers available as this would be the year of adoption of Ind AS

Timelines on applicability of Ind AS for MF schemes



Other regulatory amendments

- **Authorised signatories:** The balance sheet and the revenue account should be signed by the Chief Executive Officer, Chief Operating Officer/Chief Finance Officer/ such other KMP as designated by Board of AMC who is responsible for preparation of financial statements, Chief Investment Officer, scheme wise fund manager/s, and the Board of Trustees, and reported upon by the Auditors.
- **Approval of financial statements:** The financial statements of the scheme should be approved at a meeting of the Board of Directors (BoD) of the AMC and also at a meeting of the trustees or in the case of a trustee company by the BoD of the trustee company.
- **Brokerage and transaction costs {Regulation 52(6A)(a)}:** Brokerage and transaction cost incurred for the purpose of execution shall be charged to the schemes as provided under Regulation 52 (6A) (a) upto 12 bps and 5 bps for cash market transactions and derivatives transactions respectively. Any payment towards brokerage and transaction costs over and above the said 12 bps and 5 bps for cash market transactions and derivatives transactions respectively may be charged to the Scheme within the maximum limit of Total Expense Ratio (TER) as prescribed under Regulation 52 of the SEBI MF Regulations.
- **Security in default:** If a security is in default beyond its maturity date, then disclosure to this effect shall be provided. Such disclosure shall include details of the security including ISIN, name of security, value of the security considered under net receivables (i.e. value recognised in NAV in absolute terms and as percentage to NAV) and total amount (including principal and interest) that is due to the scheme on that investment. Further, this disclosure shall continue till the value of the security recognised in the NAV is received or for a period of three years from the date of maturity of security, whichever is later.

- **Formats under Ind AS for financial statements:** The SEBI circular prescribes specific formats for Ind AS financial statements to be prepared by the MF schemes.
- **Holding cost of investment:** The MF Regulations have revised the manner of determining the holding cost of investment and gain or loss on sale of investments from average cost to weighted average cost method.
- **Investments acquired or sold:** The investments acquired or sold shall be accounted at transaction price excluding all transaction cost such as brokerage, stamp charges, any charge customarily included in the broker's contract note that are attributable to acquisition/sale of investments. Before amendment, the cost of investments acquired or purchased included brokerage, stamp charges and any charge customarily included in the broker's bought note.
- **Existing regulations:** Some of the existing disclosure requirements as provided in the MF Regulations are reiterated in the SEBI circular such as disclosure of percentage of net average assets, contingent liabilities disclosure, etc. MFs should continue to provide such disclosures in the manner prescribed in the MF Regulations.

Next steps

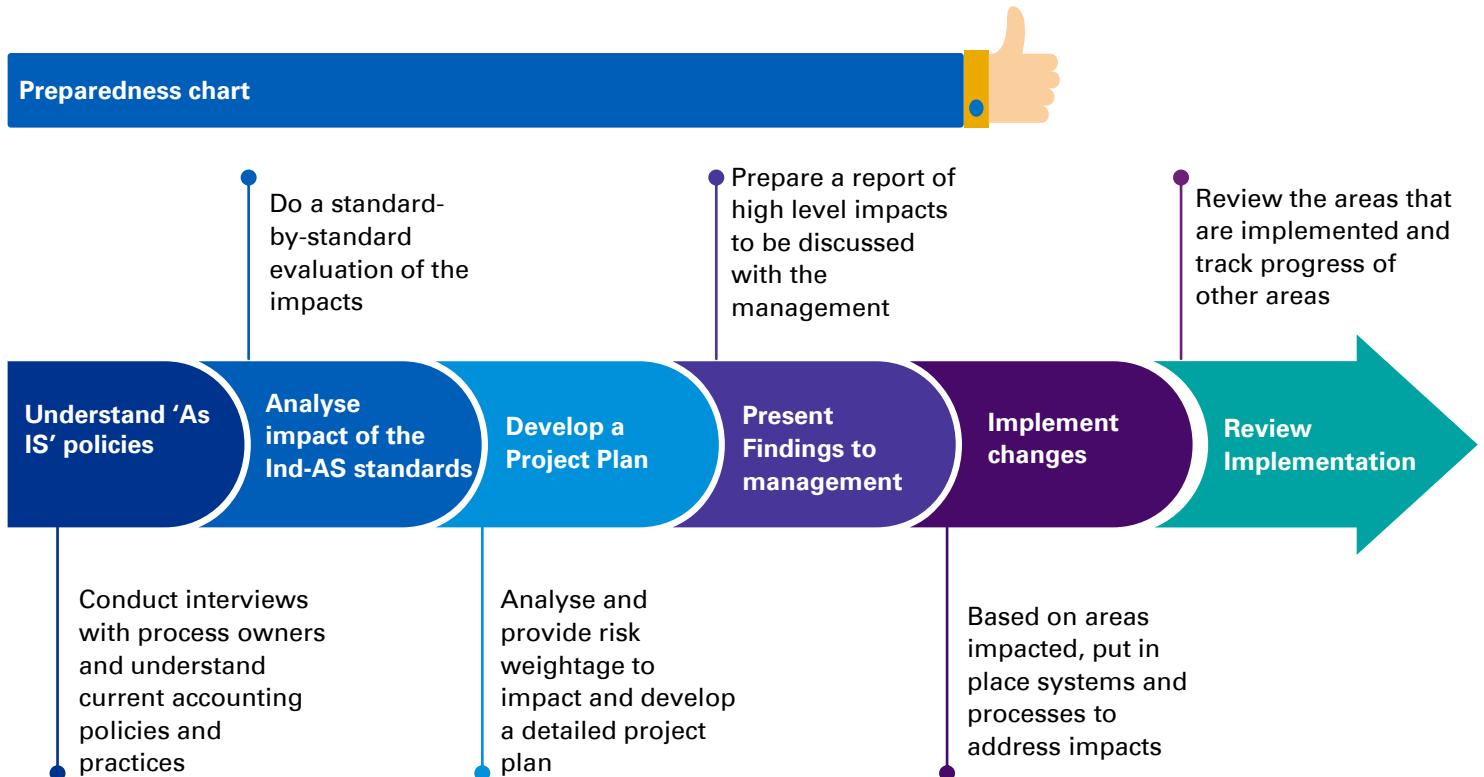
MFs have limited time to gear up for the transition with the date of transition being 1 April 2022. The devil is in the detail. MFs will, therefore, need to invest time and plan the transition to Ind AS.

In addition to the financial reporting impacts, MFs will also have to assess impact on other stakeholders such as investors and analysts.

MFs should immediately undertake a holistic assessment and gear up with a robust implementation plan to deal with a change of this magnitude within the fairly short timelines.



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Missed an issue of Accounting and Auditing Update or First Notes?



Issue no. 67 – February 2022

The topics covered in this issue are:

- The Foreign Contribution (Regulation) Act, 2010 - impact on Not for Profit Organizations
- ESMA identified its priorities in sustainable finance road map 2022-2024 Regulatory updates



SEBI proposes framework for Environmental, Social and Governance (ESG) rating providers

3 March 2022

Recently, climate change and sustainable development concerns have become a priority at global and national level. There has been an increase in the interest of international bodies and financial regulators in examining Environmental, Social and Governance (ESG)-related issues.

SEBI has issued a consultation paper which describes the proposed regulatory framework to regulate ERPs and oversight thereon, periodicity of such disclosure, etc.

The consultation paper is open for comments upto 11 March 2022.

The issue of First Notes aims to provide an overview of the proposed framework issued by SEBI.

Voices on Reporting



VOR quarterly publication for the quarter ended 31 December 2021

Quarterly updates publication (for the quarter ended 31 December 2021) provides a summary of key updates from the Securities and Exchange Board of India (SEBI), the Ministry of Corporate Affairs (MCA), the Institute of Chartered Accountants of India (ICAI) and the Reserve Bank of India (RBI). To access the publication, please click [here](#).

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