Accounting Treatment of Dividend Declared by Mutual Fund in Debt Fund Scheme under Dividend Re-Investment Plan

A. Facts of the Case
1. A company (hereinafter referred to as 'the company') is a Maharatna Central PSU engaged in mining of coal having touched a production of 452 million tonnes during the 2012-13 fiscal year. The company is a direct holding company of nine subsidiaries out of which eight are registered in India and the ninth one is registered in Mozambique. Two of its direct subsidiaries have further three and two sub-subsidiaries, respectively. Further, there are few joint ventures and associate companies which also form part of the group accounts. The consolidated turnover of the company for the year 2012-13 was ₹88,281 crore with profit before tax of ₹24,979 crore. The main object of the company is to produce or otherwise engage generally in the production, sale and disposal of coal and its by-products.

2. The querist has stated that the company and its subsidiaries have surplus funds which are invested in bank Fixed Deposits (FDs) as well as in mutual funds (debt fund scheme). While the bank Fixed Deposits are shown under the Note 'cash & bank balance', the investment in mutual fund is shown under the Note 'current investments' in the balance sheet. The term of the mutual fund is dividend re-investment plan which signifies that the dividend accruing on daily basis of Net Assets Value (NAV) of the scheme as on the date of declaration of dividend, results into increase in the number of total units held by the company.

Accounting Policy:

3. As per annual accounts of the company, the significant accounting policies with respect to investments and recognition of dividend income are reproduced below:
   
   Note–33
   5.0 Investments:

   “Current investments are valued at the lower of cost and fair value as on the balance sheet date. Investments in mutual fund are considered as current investments. Non-current investments are valued at cost.”

   11-2 Dividend:
   “Dividend income is recognised when right to receive is established”.

4. Practice being followed:
   The valuation of the mutual funds is done on NAV basis and any dividend earned and re-invested over and above the initial investment is credited to the mutual fund account by increase of appropriate number of units at the NAV as on that date. (A copy of typical mutual fund accounts statement as an illustration to the above method has been supplied by the querist for the perusal of the Committee).
   The terms and conditions of the mutual funds are subject to market risk. A copy of the disclaimer clause issued by the mutual funds managers in this respect has also been supplied by the querist for the perusal of the Committee.

5. As already stated above, the initial investment in mutual fund for which the direct cash outflow took place is shown under the note 'Current Investments' in the balance sheet. The increase in number of units by way of dividend and the resultant increase in valuation thereby are not recognised either as income or as increased valuation of investment as on the balance sheet date on the ground that the same has not been realised and that investments are valued at cost. The dividends are recognised only in the period in which the initial investment along with additional units allotted due to reinvestment of dividend declared on a daily basis are redeemed and realised.
Treatment as described hereinabove is based on the logic that since investments in mutual funds are subject to market risks and there is no certainty that the dividend incomes by way of units at NAV (which is reckoned at the NAV value of the initial investment) shall be ultimately realised upon redemption.

As per the disclosure requirement of Accounting Standard (AS) 13, ‘Accounting for Investments’, the NAV value/market value of the investment along with the increased number of units received due to conversion of dividend are however disclosed at fair value of unquoted investment. An illustration has also been supplied by the querist as Note-14, current investment (unquoted at cost) from the annual accounts of the company (standalone) for the perusal of the Committee.

(Emphasis supplied by the querist.)

Thus, the company is following a very conservative method of not recognising the income till ultimate realisation thereof by way of redemption and at the same time, disclosing the fair value of investment (in mutual funds) as per the requirements of AS 13.

6. Issue raised:
Statutory auditor of one of the subsidiary companies is of the view that the dividend declared is credited to the mutual fund account of the company and thereafter the number of units held by the company is increased by additional units following conversion of such dividend amount into units at NAV of the scheme. Thus, the dividend declared and reinvested in the scheme should be recognised as revenue income on the balance sheet date as per Accounting Standard (AS) 9, ‘Revenue Recognition,’ notified under the Companies (Accounting Standards) Rules, 2006 (hereinafter referred to as the ‘Rules’).

B. Query
7. In the above background, the querist has sought the opinion of the Expert Advisory Committee as to whether the dividend declared on daily basis and credited in the form of additional units in the mutual fund account under debt fund dividend re-investment plan should be recognised as revenue income as on the date of balance sheet in the final accounts of the company even if the same has not been redeemed/encashed. If yes, the value at which such recognition is to be made.

or

The present conservative practice of the company of not recognising the dividend declared and re-invested in the mutual fund – dividend re-investment plan on the balance sheet date due to non-encashment of such additional units be continued.

C. Points Considered by the Committee
8. The Committee notes that the basic issue raised in the query relates to the timing of recognition of dividend income which has been declared on mutual fund units of debt fund dividend re-investment plan, which is classified by the company as a current investment. The Committee has, therefore, considered only this issue raised by the querist in paragraph 6 above and has not examined any other issue(s) that may be contained in the Facts of the Case, such as, accounting for fixed deposits, classification of investments, disclosure requirements under AS 13, accounting policy as adopted for valuation of current investments and long-term investments, etc.

9. The Committee notes from the Facts of the Case that the company invests in the debt fund scheme of the mutual funds and has opted for dividend reinvestment plan wherein the dividend declared by the mutual fund on daily basis is reinvested in the additional units of the same scheme. The querist has raised the issue with respect to timing of recognition of such dividend declared by the mutual fund which is received by the company in the form of additional units of mutual fund. For recognition of such dividend, the Committee notes the following paragraph of AS 9, notified under the Rules:

“13. Revenue arising from the use by others of enterprise resources yielding interest, royalties and dividends should only be recognised when no significant uncertainty as to measurability or collectability exists. These revenues are recognised on the following bases:

...
(iii) Dividends from investments in shares: when the owner’s right to receive payment is established.”

In view of the requirements of AS 9 referred to above, the Committee notes that dividend income should be recognised at the time when the unit holder’s right to receive the payment thereof is established. The Committee is of the view that the right to receive is established when dividend is declared. In the extant case, the Committee notes from the Facts of the Case that dividend is declared on daily basis and credited to the account of the company, which is represented by units determined on the basis of NAV per unit under initial investment of the units. This is reflected in the mutual fund account statement of the company. The Committee also notes from the Dividend Policy under one of the Schemes in the Key Information Memorandum, which is provided by the querist for the perusal of the Committee, that such reinvestment option was available in respect of a liquid fund wherein payout option on periodic basis was also available. Thus, dividend was realisable both in cash or in kind, i.e., in the form of units of the fund as per the option exercised by the investor. The Committee is further of the view that nature of dividend would not change due to opting for reinvestment of dividend. Change in the value of reinvested units as a function of market price is a separate risk from the risk of investor’s right to receive the dividend. Accordingly, the Committee is of the view that the present practice of the company to defer the dividend declared and re-invested in the mutual fund scheme till the actual redemption of units and realisation of cash is not correct, rather it should be recognised as and when right to receive the dividend is established.

10. As regards the value at which dividend and investment should be recognised, the Committee is of the view that revenue from dividend should be recognised at the value of dividend received. Similarly, investments should be recognised at the issue price on the date of acquisition of each unit of mutual fund. With regard to any decline in the value of investments occurring subsequently due to market risks involved in mutual fund, viz., fluctuations in the NAV vis-a-vis interest rates, etc., the Committee is also of the view that since current investments are carried at lower of cost and fair value, such decline/impairment in value of investment would be recognised while valuing the investments at the reporting date.

D. Opinion

11. Based on the above, the Committee is of the opinion that the dividend declared on daily basis and credited in the form of additional units in the mutual fund account under debt fund dividend re-investment plan should be recognised as revenue income as and when the right to receive is established, as discussed in paragraph 9 above. As regards the value at which dividend and investment should be recognised, refer to paragraph 10 above.

| 1 | The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute. |
| 2 | The Opinion is based on the facts supplied and in the specific circumstances of the querist. The Committee finalised the Opinion on January 22-23, 2014. The Opinion must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of Opinion by the Committee. |
| 3 | The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in thirty two volumes. A CD of Compendium of Opinions containing thirty two volumes has also been released by the Committee. These are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur. |
| 4 | Recent opinions of the Committee are available on the website of the Institute under the head ‘Resources’. |
| 5 | Opinions can be obtained from EAC as per its Advisory Service Rules which are available on the website of the ICAI, under the head ‘Resources’. For further information, write to eac@icai.in. |