

## CHAPTER 7: NET ASSET VALUE, TOTAL EXPENSE RATIO AND PRICING OF UNITS

### 7.1 Fair Valuation Principles

Fair valuation principles ensure that the assets of a mutual fund scheme are valued accurately and fairly. This is crucial for calculating the Net Asset Value (NAV) of the scheme, which reflects the true value of investors' holdings.

**Market Value:** Assets are typically valued at their current market price. For listed securities, the last traded price on the exchange is considered.

**Illiquid Securities:** For securities that are not frequently traded or are illiquid, AMCs use fair valuation methods prescribed by SEBI to estimate their value.

**Consistency:** Valuation methods should be consistently applied to ensure that NAV calculations are reliable and comparable over time.

Fair valuation ensures transparency and protects investors' interests by providing an accurate measure of their investments.

Quiz Questions:

What is the primary basis for valuing listed securities in a mutual fund's portfolio?

- A. Historical cost
- B. Market value
- C. Book value

Answer: B

How are illiquid securities valued in a mutual fund scheme?

- A. At face value
- B. Using fair valuation methods prescribed by SEBI
- C. At purchase price

Answer: B

### 7.2 Computation of Net Assets of Mutual Fund Scheme and NAV

The Net Asset Value (NAV) is a key metric in mutual fund investments, representing the per-unit value of the scheme's assets.

**Net Assets Calculation:** The total value of the scheme's assets (securities, cash, and other holdings) is calculated. From this, any liabilities (expenses, fees, etc.) are subtracted to determine the net assets.

**NAV Calculation:** NAV is computed by dividing the net assets by the total number of units outstanding.

NAV

=

Total Net Assets

Total Units Outstanding  
NAV=  
Total Units Outstanding  
Total Net Assets

Daily Update: NAV is typically calculated at the end of each trading day to reflect the current value of the scheme.

Accurate computation of NAV ensures that investors' transactions (buying or selling units) are processed at fair value.

Quiz Questions:

What is the formula for calculating NAV?

- A. Total Net Assets / Total Units Outstanding
- B. Total Assets / Total Liabilities
- C. Total Units Outstanding / Total Net Assets

Answer: A

How often is the NAV of a mutual fund typically calculated?

- A. Weekly
- B. Monthly
- C. Daily

Answer: C

### 7.3 Dividends & Distributable Reserves

Dividends in mutual funds are distributions of the scheme's income to its investors. They are declared from the distributable reserves of the scheme.

Distributable Reserves: These are the earnings (income and realized capital gains) that the mutual fund has not yet distributed to investors.

Dividend Declaration: Dividends can be declared periodically (monthly, quarterly, or annually) based on the scheme's performance and income.

Impact on NAV: When dividends are paid out, the NAV of the mutual fund scheme decreases by the amount of the dividend, as it reduces the scheme's assets.

Dividends provide a source of income to investors and reflect the scheme's profitability.

Quiz Questions:

From where are mutual fund dividends declared?

- A. Distributable reserves
- B. Total liabilities
- C. Market value of assets

Answer: A

What happens to the NAV of a mutual fund scheme when a dividend is paid out?

- A. It increases by the dividend amount
- B. It decreases by the dividend amount
- C. It remains unchanged

Answer: B

#### 7.4 Concept of Entry and Exit Load and its Impact on NAV

Entry and exit loads are fees charged by mutual funds when investors buy or sell units, respectively.

Entry Load: A fee charged at the time of investment. It is deducted from the initial investment amount.

Exit Load: A fee charged when units are redeemed before a specified period. It is deducted from the redemption proceeds.

Impact on NAV: Entry loads reduce the amount invested and thus the number of units allotted.

Exit loads reduce the redemption amount received by the investor.

Loads can impact the overall returns from mutual fund investments, and investors should be aware of these costs.

Quiz Questions:

What is an entry load?

- A. A fee charged when investors redeem units
- B. A fee charged when investors purchase units
- C. A fee charged annually

Answer: B

How does an exit load affect the redemption amount?

- A. It increases the redemption amount
- B. It has no effect on the redemption amount
- C. It decreases the redemption amount

Answer: C

#### 7.5 Key Accounting and Reporting Requirements

Mutual funds are required to follow certain accounting and reporting standards to ensure transparency and compliance.

Accounting Standards: Mutual funds follow SEBI-prescribed accounting standards for accurate and consistent financial reporting.

Financial Statements: Mutual funds prepare and disclose financial statements, including balance sheets, income statements, and cash flow statements, providing a comprehensive view of the scheme's financial health.

Regular Reports: AMCs provide regular reports to investors, including annual reports, half-yearly disclosures, and monthly fact sheets, ensuring that investors are informed about their investments.

These requirements help maintain trust and transparency in mutual fund operations.

Quiz Questions:

What do mutual funds follow for accurate and consistent financial reporting?

- A. SEBI-prescribed accounting standards
- B. Arbitrary accounting methods
- C. International accounting standards

Answer: A

Which of the following is regularly provided to investors by AMCs?

- A. Tax returns
- B. Monthly fact sheets
- C. Personal financial statements

Answer: B

#### 7.6 NAV, Total Expense Ratio and Pricing of Units for the Segregated Portfolio

Segregated portfolios are created in mutual funds to separate distressed or illiquid assets from the main portfolio.

NAV of Segregated Portfolio: The NAV for the segregated portfolio is calculated separately, reflecting only the value of the segregated assets.

Total Expense Ratio (TER): The TER for both the main portfolio and the segregated portfolio is calculated separately. This ensures that the costs associated with managing the segregated assets are accurately reflected.

Pricing of Units: Units in the segregated portfolio are priced based on the NAV of the segregated portfolio. Investors holding units in the main portfolio receive proportionate units in the segregated portfolio.

Segregated portfolios help manage distressed assets effectively while protecting the interests of investors in the main portfolio.

Quiz Questions:

What does the NAV of a segregated portfolio reflect?

- A. The value of the main portfolio
- B. The value of the segregated assets

C. The combined value of both portfolios

Answer: B

How are the Total Expense Ratios (TER) calculated for segregated and main portfolios?

A. Combined for both portfolios

B. Separately for each portfolio

C. Not calculated for segregated portfolios

Answer: B