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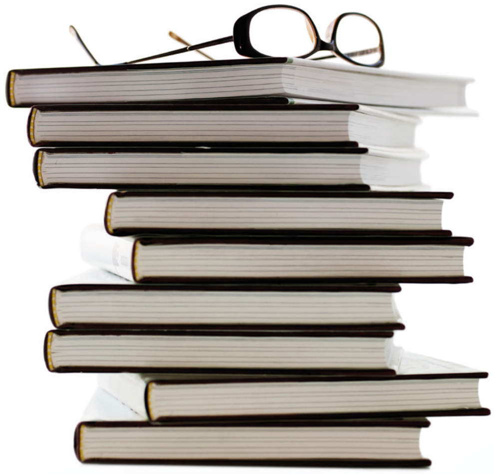
IMA SORP May 2014



An update

Introduction

On 14 May 2014, the Investment Management Association ("IMA") issued a revised Statement of Recommended Practice: Financial Statements of UK Authorised Funds ("the new SORP"). The revisions to the previous SORP were prompted by a number of changes to the accounting and regulatory framework within which authorised funds operate.

The new SORP is applicable for accounting periods beginning on or after 1 January 2015 with early adoption permitted.

Highlights

- No requirement for aggregated financial statements.
- New comparative tables for each share class.
- Effective interest method for calculating revenue on debt securities no longer mandatory.
- New disclosure requirements for transaction costs.
- Additional reporting requirements for non-UCITS funds under the Alternative Investment Fund Managers Directive (AIFMD).
- Extended fair value and investment property disclosures.

Accounting

Authorised Fund Managers will need to:

- apply Section 11 "Basic Financial Instruments" and Section 12 "Other Financial Instruments Issues" of FRS 102 in full; and
- be satisfied that the resultant portfolio valuation is not materially different from a valuation carried out at close of business on the balance sheet date if the valuation point is not consistent with the year end.

Fixed Interest securities

The new SORP does not require the effective interest method for calculating revenue from debt securities, instead this can be accounted for based on coupon, adjusting for any premium or discount on market price on purchase, spread over the life of the asset. For sinking bonds, the spreading of the premium or discount should take account of the expected repayment profile.

Consistent methodology should be applied for all debt securities with similar characteristics. However, for more complex debt instruments where there is a more appropriate alternative methodology, this should be applied and disclosed in the accounting policies.

Adjustments should be made for the following:

- stepped bonds to ensure a relatively stable rate of revenue across the life of the asset; and
- expected cash flows as a result of debt security changes should be made to ensure that interest flows from the asset at an "appropriate rate".

Other accounting changes

Where a fund invests in a fiscally transparent entity, the revenue earned by the entity should be recognised as revenue by the fund.

Tax withheld on interest distributions should be shown as part of "distributions payable" rather than within "other creditors" as previously stated.

Authorised funds holding investment property through intermediate holding vehicles should prepare consolidated financial statements in accordance with section 9 of FRS 102 that include the authorised fund and the intermediate holding vehicles (IHVs) that it controls.

On 14 May 2014, the Investment Management Association ("IMA") issued a revised Statement of Recommended Practice: Financial Statements of UK Authorised Funds ("the new SORP").

Reporting

Aggregated financial statements

There is no longer a requirement for either the annual or half yearly reports to contain aggregated financial statements.

The comparative table

The new SORP has introduced new comparative tables to summarise financial highlights for each share class. The table is required for each share class for each of the last three financial years, or if less than three, each financial year since launch. For share classes that have been launched during the year, the charges and costs figures should be apportioned on an appropriate basis.

Key changes include the requirement to show a reconciliation of the change in net assets per unit and disclose the performance return after charges.

Investments

The new SORP requires that an analysis of the portfolio in accordance with the fair value hierarchy should be disclosed in the notes showing separately the value of investment assets and investment liabilities, disclosure of the valuation techniques and the assumptions used.

The four levels of fair value hierarchy are as follows:

- quoted prices for identical instruments in active markets;
- prices of recent transactions for identical instruments;
- valuation techniques using observable market data; and
- valuation techniques using non-observable data.

The new SORP also requires the following new disclosures in respect of investment properties:

- methods and significant assumptions;
- name and qualifications of valuer;
- existence and any restrictions on the realisability of investment property;
- contractual obligations; and
- reconciliation between carrying amounts at the beginning and end of the period.

Transaction costs

There are new requirements for transaction costs as follows:

- total purchases and sales and associated direct transaction costs should be analysed for each significant asset class with significant in specie transfers and corporate actions disclosed separately;
- the total of each type of direct transaction cost should be stated, expressed as a percentage of the fund's average net asset value;
- explanations should be given to enable users of the financial statements to understand the nature of the transaction costs and how they arise for different types of investments; and
- the average portfolio dealing spread, including the effect of foreign exchange, should be stated as at the balance sheet date.

Other reporting changes

The statement of total return has a new heading of "interest payable and similar charges" replacing the current heading of "finance costs: interest".

There is now a requirement to disclose the recipient(s) of stock lending and re-purchase agreements within expenses and their relationship to the Authorised Fund Manager or Depositary.

Disclosure should also be given in the notes of an analysis by counterparty of the value of securities on loan or subject to a repurchase agreement at the balance sheet date, and the nature and value of collateral held in respect thereof, analysed by asset class.

Dividends payable on short positions should now be included under "interest payable and similar charges". Should the "interest payable and similar charges" contain only interest, it is now permitted to include this within the expenses figure.

There are new balance sheet headings of "fixed assets", "current assets" and "other creditors" with the requirement to disclose "total other assets" and "total other liabilities" being removed.

FRS 102 requires a sensitivity analysis for each type of market risk, and there are additional requirements for credit risks which requires disclosure to be given in the notes of the exposure to each counterparty obtained through the use of derivatives and the nature and value of collateral held or pledged, analysed by asset class.

Where distribution policies are specific to each share class, this should be disclosed. In addition, where marginal tax relief is not taken into account when determining the distribution, this should also be disclosed.

There is no longer a requirement for either the annual or half yearly reports to contain aggregated financial statements.

There is now a requirement to disclose the recipient(s) of stock lending and re-purchase agreements within expenses and their relationship to the Authorised Fund Manager or Depositary.

Alternative Investment Fund Managers Directive (AIFMD)

The AIFMD level 2 Regulation imposes additional requirements for the content and format of the financial statements of non-UCITS funds. The guidance included in Appendix D of the new SORP ensures that the financial statements of non-UCITS funds remain consistent with the requirements of FRS102 and the IMA SORP. The key points are as follows:

- a line item for cash and cash equivalents should be added to satisfy the FRS 102 requirements;
- including a single line item for net capital gains/losses in the statement of total return and disaggregating the net gains or losses into their realised and unrealised components in the notes addresses the requirements of FRS 102;
- SORP presentation is considered appropriate with reference to income and expenditure; and
- articles 105, 106, 107, 108 and 109 specify further information that should be disclosed in order to comply with the AIFMD. It is considered acceptable to add these to the SORP requirements in order to achieve compliance with the FCA's Investment Funds Sourcebook ("FUND") and AIFMD.

Other minor changes

Revenue

The new SORP highlights the following:

- revenue from collective investment schemes (other than fiscally transparent schemes) are to be recognised as revenue on ex-distribution date; and
- where there is relevant and reliable information, recognition is allowed before the priced ex-distribution date.

Differences between estimates and actual revenue should be recognised as soon as this information becomes available.

Expenses

Expenses from a fiscally transparent entity should be recognised in line with other expenses of the fund.

The new SORP states that aborted transaction costs should be charged against revenue.

The total expense ratio ("TER")/ongoing charges figure ("OCF") disclosure is now covered as part of the new comparative tables as discussed earlier.

There is no requirement to disclose the total finance costs.

The new SORP requires rent to be recognised on a straight line basis unless there is a more representative basis which reflects the lessee's benefit from the property, or there is an inflationary element in the rent payment schedule.

Currency

Where the base currency differs from the functional currency, all exchange differences from translation to the base currency should be separately disclosed in the statement of total return.

Foreign exchange gains and losses must be disclosed separately in the net capital gains/(losses) note.

Fair value disclosures

Fair value disclosure should be excluding guarantees and incentives.

Weekly procedures are no longer required to ensure that valuations don't differ from a valuation performed on a mark to market basis. There is also no requirement to ensure that the amortised cost isn't significantly different to the fair value disclosure.

Other

The new SORP highlights that the treatment in determining distributions is irrelevant for the purposes of tax accounting treatment.

There is now a requirement for qualified investor schemes (QIS), as well as authorised funds, to prepare a comparative table.

The value and percentage of each individual investment property need not be shown in the portfolio statement but as a minimum, properties should be shown in valuation bands. The width of each band should not be more than 5% of the total net asset value.

In the case of single priced funds, amounts receivable on the issue of units and amounts payable on cancellation should be stated at the mid-market price. Dual priced funds may make an equivalent disclosure.

There is no requirement to show derivatives separately either in the notes or on the face of the balance sheet.

If the financial statements have been prepared under FRS 102, disclosure to this effect is required.

Where marginal tax relief is not taken into account when determining the distribution, this should be disclosed.

There is no requirement to disclose transactions with the AFM and depositary as related party transactions.

The AIFMD level 2 Regulation imposes additional requirements for the content and format of the financial statements of non-UCITS funds.

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