Investment Management Association

Statement of Recommended Practice

Financial Statements of UK Authorised Funds

May 2014

Contents

Statement by the Financial Reporting Council

The aim of the Financial Reporting Council (FRC) is to promote high-quality corporate governance and reporting to foster investment. In relation to accounting standards applicable in the UK and Republic of Ireland the FRC's overriding objective is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs. In particular industries or sectors, clarification of aspects of those standards may be needed in order for the standards to be applied in a manner that is relevant and provides useful information to users of financial statements in that industry or sector.

Such clarification is issued in the form of Statements of Recommended Practice (SORPs) by bodies recognised for this purpose by the FRC. The IMA has confirmed that it shares the FRC's aim of high-quality financial reporting and has been recognised by the FRC for the purpose of issuing SORPs for UK Authorised Funds.

In accordance with the FRC's *Policy and Code of Practice on SORPs* the FRC carried out a limited scope review of the SORP focusing on those aspects relevant to the financial statements.

On the basis of its review, the FRC has concluded that the SORP has been developed in accordance with the FRC's *Policy and Code of Practice on SORPs* and does not appear to contain any fundamental points of principle that are unacceptable in the context of present accounting practices or to conflict with an accounting standard.

8 May 2014

Financial Reporting Council

1. Introduction

1.1 Statements of Recommended Practice (SORPs) are recommendations on accounting practices for specialised industries or sectors. They supplement Financial Reporting Standards (FRS) and other legal and regulatory requirements in the light of the special factors prevailing or transactions undertaken in a particular industry or sector.

1.2 The Financial Reporting Council (FRC) has approved the Investment Management Association (IMA) for the purposes of issuing recognised SORPs for UK authorised funds. This arrangement requires the IMA to follow the FRC's code of practice for the production and issuing of SORPs. The code of practice provides the framework to be followed by the IMA for the development of SORPs, but does not entail a detailed examination of the proposed SORP by the FRC. However, a review of limited scope is performed.

1.3 The recommendations of this SORP are not an alternative for referring to the relevant regulations and FRS. For convenience signposts are provided to the relevant regulations. The SORP should be read in conjunction with the FRC Statement "SORPs: Policy and Code of Practice", any rules and regulations relating to authorised funds that are in force, and the law relating to these matters. The recommendations of this SORP have been arrived at after consideration of all laws, regulations and FRS issued before 31 July 2013.

1.4 Financial statements prepared in accordance with this SORP should comply with all applicable FRS and FRC Abstracts. The SORP does not reflect the full detail of the relevant FRS. The full standards should be applied in order for the financial statements to give a true and fair view of the results and financial position of an authorised fund. Where standards issued after this SORP contain requirements that conflict with this SORP, the requirements of the relevant standard shall prevail.

1.5 The comparative table in Appendix A identifies the charges and direct transaction costs incurred by the fund and has been developed to improve transparency and better meet investors' needs. Forthcoming EU legislation contains further requirements for the disclosure of charges and costs, including transaction costs. Once finalised, implementation of this legislation may lead to further disclosure requirements and enhancements to the comparative table.

1.6 FRS 100 allows entities a choice of preparing financial statements in accordance with FRS 102 or EU-adopted IFRS. SORPs are applicable when the financial statements are prepared in accordance with FRS 102. Regulations require the financial statements of authorised funds to be prepared in accordance with this SORP. Therefore, if the requirements of EU-adopted IFRS conflict with the requirements of this SORP, it will be necessary to apply FRS 102 in order to fulfil the regulatory requirement of compliance with this SORP. **COLL 4.5.7R** **COLL 4.5.8R**

Objective

1.7 The objective of this SORP is to provide recommendations for the preparation of the financial statements of all authorised funds. In addition to providing standard interpretations of accounting standards and other legal and regulatory requirements in so far as they relate to authorised funds, this SORP establishes principles for determining the nature of items of income as revenue or capital for the purposes of both distribution and taxation.

Scope

1.8 This SORP applies to the annual and half-yearly reports of all UK authorised funds. Notwithstanding that SORPs describe "recommended" practice; compliance with this SORP is required by the Financial Conduct Authority's (FCA's) Regulations.

Date from which effective

1.9 This SORP was issued by the IMA in May 2014 and supersedes the previous SORP for authorised funds. The recommendations of this SORP are applicable to accounting periods beginning on or after 1 January 2015. Earlier application is permitted providing that FRS 102 is applied at the same time.

Responsibilities

1.10 The directors of an open-ended investment company must prepare an annual report and a half-yearly report for each accounting period of the company. Where the company's first annual accounting period is less than 12 months, a half-yearly report need not be prepared for any part of that period. **OEICR 66 R**

1.11 The annual report of an open-ended investment company must contain the financial statements of the company and the auditor's report in respect of the accounts. **OEICR 67 R**

1.12 The authorised fund manager must, for each annual and half-yearly accounting period, prepare a short report and a long report. Where the first annual accounting period is less than 12 months, a half-yearly report need not be prepared. **COLL 4.5.3 R**

1.13 The authorised fund manager of an authorised fund that is a qualified investor scheme must prepare a report in respect of each annual and half-yearly reporting period. Where the first annual accounting period is less than 12 months, a half-yearly report need not be prepared. **COLL 8.3.5 R**

1.14 The directors of an open-ended investment company must lay copies of the annual report before the company in general meeting where general meetings are held. **OEICR 66 R**

1.15 The annual and half-yearly long reports must be signed in accordance with paragraph 3.4.

Definitions

1.16 Unless otherwise defined the terms used throughout this SORP are used with the meaning specified in FRS 102.

1.17 *Authorised fund*

- A unit trust scheme which is authorised by an authorisation order under section 243 of FSMA;
- An open-ended investment company incorporated by an authorisation order under regulation 14 of the OEIC Regulations; or
- A contractual scheme which is authorised by an authorisation order under section 261D of FSMA.

1.18 *Authorised fund manager*

The authorised corporate director (ACD) of an open-ended investment company (OEIC), the manager of an authorised contractual scheme (ACS) or the manager of an authorised unit trust scheme (AUT).

1.19 *Collective investment scheme (scheme)*

Any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income.

1.20 *Counterparty risk*

The risk of loss resulting from the fact that the counterparty to a transaction may **FCA** default on its obligations prior to the final settlement of the transaction's cash flow.

1.21 *Debt securities*

Government and public securities, debentures, debenture stocks, loan stocks, **FCA** bonds, certificates of deposit and any other instrument creating or acknowledging indebtedness.

1.22 *Depositary*

- The trustee of an authorised unit trust scheme;
- The person to whom is entrusted the safekeeping of the property of an open-ended investment company;
- The person holding the property of an authorised contractual scheme for the participants.

1.23 *Direct transaction costs*

Fees and commissions paid to agents, advisers, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Direct transaction costs do not include any difference between the quoted bid and offer prices or internal administrative or holding costs.

1.24 *Fiscally transparent entity*

An entity, regardless of its domicile or legal form, that is fiscally transparent as regards the taxation of income.

1.25 *Functional currency*

The functional currency is the currency of the primary economic environment in which the fund operates. Generally a fund's net asset values and unit prices are calculated, in accordance with COLL 6.3, in the functional currency notwithstanding that unit prices might be translated into another currency for dealing purposes. Where the valuation currency is different to the base currency, this must be stated in the prospectus.

1.26 *Fund*

A standalone authorised fund or an individual sub-fund of an authorised fund that is an umbrella.

1.27 *Income*

Income is the economic return generated from investment activities and encompasses both revenue and capital gains/losses. Revenue includes items such as dividends, interest, fees, rent and equivalent items. Capital gains/losses arise, for example, from the revaluation of investments.

1.28 *Instrument constituting the fund*

In relation to an OEIC, the instrument of incorporation, in relation to an authorised contractual scheme, the contractual scheme deed and in relation to an authorised unit trust, the trust deed.

1.29 *Liquidity risk*

The risk that a position in a fund's portfolio cannot be sold, liquidated or closed out at limited cost in an adequately short timeframe and that the ability of the scheme to comply with its obligations to redeem units is thereby compromised. **FCA**

1.30 *Market risk*

The risk of loss resulting from fluctuation in the market value of positions in a fund's portfolio attributable to changes in market variables such as interest rates, foreign exchange rates, equity and commodity prices or an issuer's credit worthiness. **FCA**

1.31 *Master-feeder arrangement*

An arrangement whereby a feeder invests at least 85% of its assets in a single master scheme.

1.32 *Non-UCITS fund*

An authorised fund that is not a UCITS.

1.33 *Qualified investor scheme (QIS)*

Qualified investor schemes are authorised funds which may be sold only to sophisticated investors and accordingly have a more relaxed set of rules governing their operation. **COLL 8.1.4 G**

1.34 *Units*

The rights or interests of the participants in a collective investment scheme.

The term unit, and derivations thereof, have been used throughout this SORP for the sake of simplicity. This should not preclude an OEIC from using the term share or shareholder in situations where it is more appropriate.

2. Accounting

2.1 Authorised funds are schemes whereby contributions from investors are pooled and managed together with the aim of spreading investment risk and generating an investment return for investors. The instrument constituting the fund may provide for different classes of unit. However, where this is the case the assets and liabilities of the authorised fund remain as one pool and are not separately owned by any individual unit class.

Assets and liabilities

2.2 Authorised fund managers applying FRS 102 should apply the provisions of sections 11 and 12 of FRS 102 in full.

Recognition

2.3 Transactions should be recognised when a legally binding and unconditional right to obtain, or an obligation to deliver, an asset or liability arises.

2.4 Amounts receivable and payable should be recorded for transactions awaiting settlement between the trade date and the settlement date. Amounts outstanding for purchases and sales with the same broker should not be offset unless so required by paragraph 2.9.

2.5 Investment property transactions should be recognised at total cost including transaction costs.

2.6 Accrued interest purchased and sold on interest-bearing securities should be excluded from the cost of these securities and recognised in revenue.

2.7 Transactions denominated in a foreign currency should be translated using the exchange rate prevailing on the date of the transaction.

2.8 Assets should be recognised when it is probable that an inflow of economic benefits will arise. Contingent assets, including potential recoveries of overseas withholding taxes, should not be recognised unless it becomes virtually certain that an inflow of economic benefits will arise.

2.9 Assets and liabilities should not be offset unless offsetting is required. Offsetting is required by paragraphs 11.38A and 12.25A of FRS 102 when a right to set off is legally enforceable and there is an intention to settle the asset and liability on a net basis or simultaneously.

2.10 Securities on loan should continue to be recognised and any collateral held in respect of such loans should not be recognised.

Valuation

2.11 Authorised fund managers perform regular valuations of authorised funds for the purpose of determining the dealing price of units. For most authorised funds this is done daily at a regular valuation point during the day. The methodology for valuing the investments and other assets and liabilities for pricing purposes is laid down in the instrument constituting the fund[1]. **COLL 6.3.3 R**

[1] Valuation guidance in COLL 6.3.6 G establishes the principles to be followed by authorised fund managers.

2.12 For the purposes of the financial statements all investments are to be valued at their fair value[1] as at the balance sheet date. In an active market the fair value of long positions is the quoted bid price and fair value of short positions is the quoted offer price. The fact that a market is closed due to normal business hours at the time the fair value is determined does not cause an otherwise active market to be regarded as inactive. Where, in view of exceptional circumstances, for example the suspension of the market, the last quoted price is not used and a valuation technique is used instead, the notes should describe clearly the basis of valuation and the reasoning behind it in accordance with paragraph 3.101.

2.13 For derivatives, fair value is the price that would be required to close out the contract at the balance sheet date. A contract is closed out by another contract that eliminates any further exposure to market movements or market risk. The income and expenditure relating to a derivative are generally required to be offset so that the risks and rewards are properly matched.

2.14 Fair value is normally determined by reference to quoted prices from reputable sources; that is the market price. If the authorised fund manager believes that the quoted price is unreliable, or if no recent price exists, a valuation technique is used whereby fair value is the authorised fund manager's best estimate of a fair and reasonable value for that investment arrived at in accordance with the instrument constituting the fund. The notes should include adequate details about the basis of the valuation, and a statement on how the authorised fund manager reached the valuation in accordance with paragraph 3.101. This statement should make it clear that the intention of the valuation was to estimate fair value. **COLL 6.3.6 G**

2.15 Foreign currency assets and liabilities should be translated using the exchange rate prevailing on the balance sheet date.

2.16 For the purposes of the financial statements it is acceptable to use the prices and the portfolio holdings determined at the last valuation point of the accounting period, rather than perform an additional valuation, provided the authorised fund manager is satisfied that the resultant portfolio valuation would not be materially different from a valuation carried out at close of business on the balance sheet date. The precise valuation point should be disclosed in the notes.

2.17 Investments are valued at their fair value and are shown on the balance sheet excluding any element of accrued interest. Accruals should be included at realisable value.

2.18 Where a fund invests in another collective investment scheme operated by the same authorised fund manager, holdings should be valued at cancellation price for dual priced funds and at the single price for single priced funds.

2.19 Where a fund invests in other operators' collective investment schemes, holdings should be valued at bid price for dual priced funds and at the single price for single priced funds. Valuation should take into account any agreed rate of redemption charge.

2.20 A feeder in a master-feeder arrangement should not consolidate the master but should instead carry the master at fair value.

[1] It will often be the case that the valuation for the financial statements is different to the valuation for determining unit dealing prices.

2.21 Investment properties should be valued and disclosed at fair value excluding the value of any guarantees or incentives.

2.22 Qualifying money market fund valuations are performed daily on an amortised cost basis. As an exception to paragraph 2.12, it is acceptable to value a qualifying money market fund's holdings on an amortised cost basis. **COLL 6.3.13 R**

Income

Revenue and capital

2.23 Income encompasses both revenue and capital gains/losses. For authorised funds it is necessary to distinguish revenue from capital for the purpose of determining the distribution.

2.24 Revenue includes items such as dividends, interest, fees, rent and equivalent items. Capital is the return, positive or negative, from holding investments other than that part of the return that is revenue. Returns should be recognised as revenue or capital in accordance with their economic substance. Subject to this principle, the following sections of this SORP provide guidance on the items that should be recognised as revenue and those that should be recognised as capital.

2.25 The distribution for the period is determined by taking the revenue, deducting the expenses and taxation and making such other adjustments as the authorised fund manager considers appropriate and in accordance with FCA rules.

2.26 Revenue should be recognised when earned.

2.27 If it is expected that revenue receivable at the balance sheet date will not be received, a provision should be made for the relevant amount.

Fiscally transparent entities

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

Derivatives

2.29 The treatment of the returns from derivatives[1] depends upon the nature of the transaction. Both motives and circumstances are used to determine whether returns should be treated as capital or revenue. In making such determinations it is expected that the authorised fund manager will consult with the investment manager, the auditors and the depositary. Where positions are undertaken to protect or enhance capital, and the circumstances support this, the returns are capital. Similarly where they are for generating or protecting revenue, and the circumstances support this, the returns are revenue. Where positions generate total returns it will generally be appropriate to apportion such returns between capital and revenue to properly reflect the nature of the transaction.

2.30 For returns on an option or derivative with the characteristics of an option: if, when entered into, such an instrument has the immediate effect of generating a

[1] In order to maintain consistency with the definition of a derivative in the tax rules (section 576 of the Corporation Tax Act 2009), paragraphs 2.29 and 2.30 apply to derivatives as defined in FRS 102 and to instruments that would be defined as derivatives but for their high initial net investment.

capital loss, for instance it is written "in the money", then generally it would be the case that all returns, including premiums received, would be regarded as being capital in nature. However, if there is no immediate capital loss generated, circumstances can support the treatment of the premium as revenue notwithstanding that any future losses may be treated as capital.

Dividends

2.31 In the case of quoted equity shares, and non-equity shares, dividends should be recognised as revenue when the security is quoted ex-dividend (i.e. when the price quoted falls to reflect the value of the dividend concerned). In the case of unquoted equity shares, dividends should be recognised when declared, and the amount at which the securities are shown in the balance sheet should reflect any such declared dividend.

2.32 Application of the accruals concept means that a return (whether in respect of dividends, in respect of redemption, or otherwise) on a non-equity share (such as a preference share) should, in principle, be recognised and accrued on a time-apportionment basis. However, because of the practical difficulties arising from the requirement to undertake daily valuations for pricing purposes (such as the lack of availability of pricing information that achieves an accurate allocation between capital and revenue for these shares), this is impractical for authorised funds. Therefore, returns from non-equity shares should be recognised on the same basis as equities.

Stock dividends

2.33 For certain securities, the holder may receive a dividend in the form of shares rather than cash. Generally the value of the shares to be received will approximate to the amount of the cash dividend (an 'ordinary' stock dividend), any small difference being attributable to the movement of the share price between the dividend declaration and the shares being quoted ex dividend. In certain cases an enhancement may be offered such that the value of the shares significantly exceeds the cash dividend (an 'enhanced' stock dividend).

2.34 In the case of an ordinary stock dividend, the whole amount should be recognised as revenue, on the basis of the market price of the shares on the date they are quoted ex dividend. In the case of an enhanced stock dividend, the value of the enhancement, calculated as the amount by which the total fair value of the shares on the date they are quoted ex dividend exceeds the cash dividend, is capital.

Special dividends, share buy-backs and additional share issues

2.35 Whether a special dividend, share buy-back or additional share issue is revenue or capital depends on the facts of each particular case. It is likely that where the receipt of a special dividend results in a significant reduction in the capital value of the holding, then the special dividend should be recognised as capital so as to ensure that the matching principle is applied to gains and losses. Otherwise, the special dividends should be recognised as revenue.

Income from collective investment schemes

2.36 Income arising from collective investment schemes (other than fiscally transparent schemes) should be recognised as revenue when the units are priced ex-distribution (i.e. when the unit price falls to reflect the value of the distribution concerned). Where sufficient relevant and reliable information about that income has been obtained, recognition may be before that date. Where an amount is reported in lieu of a distribution, for example, where the units are held in an accumulation form, the amount reported should be recognised as revenue.

2.37 Any equalisation element should be regarded as a return of capital regardless of any alternative treatment that may be permitted in determining the distribution.

2.38 Where an estimate of the amount to be received or reported is made in accordance with paragraph 2.36, any difference between the estimate and the actual amount shall be recognised in the period when the information about the actual amount becomes available.

2.39 Where a feeder accrues revenue on a holding whose distribution includes equalisation, the equalisation received from the master should not form part of the income property. When the feeder sells units of the master, the proceeds should be regarded as realising any income accrual in respect of the units sold.

Zero dividend preference shares

2.40 Zero dividend preference shares carry no entitlement to dividends but give the holders a preferential right to receive a repayment of capital and a premium from the capital reserves of an investment company. Accordingly, the returns should be recognised as capital.

Interest from debt securities

2.41 The revenue arising from a debt security comprises the coupon interest and the difference between the purchase price and the expected maturity price. The total revenue recognised on a debt security should be spread over its expected remaining life at a constant rate or amount having regard to the guidance in this SORP.

2.42 Generally, a consistent methodology will be chosen for all debt securities with similar characteristics. However, a different methodology may be more appropriate for debt securities with certain characteristics, for example, index-linked bonds. The method or methods used should be disclosed in the accounting policies.

2.43 Some instruments are structured such that the economic substance may be closely tied to an underlying indicator. The accounting treatment should follow the economic substance. If, for example, an instrument's returns have the characteristics of equity returns, the instrument should be treated as equity.

2.44 When a distressed security is purchased, the purchase cost reflects incurred credit losses. Where significant, such incurred credit losses should be taken into account when estimating cash flows so as to ensure that revenue is recognised at an appropriate rate, that is, a rate that is not significantly different to reasonable commercial expectations.

2.45 For securities with variable maturity terms, such as callable bonds, the spreading of the premium or discount should be on the basis of the most likely maturity date and value. For the holder of a security this is usually the date with the worst yield to maturity, although other factors, such as the reputation of the issuer, may also be relevant. It should be assumed that issuers and holders of securities will behave rationally.

2.46 For sinking bonds, the spreading of the premium or discount should take account of the expected repayment profile.

2.47 For securities with floating rates, it is acceptable to recognise revenue on the basis of the revised coupon rate and the original amortisation schedule. Changes in the maturity value calculated by reference to inflation shall be regarded as revenue.

2.48 For securities such as stepped bonds, where the interest rate changes over the remaining period to the expected maturity date, an adjustment should be made to ensure that the recognition of the total revenue for each distribution period is determined in a way to result in a reasonably consistent rate or amount for each period.

2.49 Where the circumstances of the debt security change so that the original assumptions regarding the expected cash flows are no longer valid, an appropriate adjustment should be made so that the future revenue recognition has regard to the improving or deteriorating outlook for the debt security. Such an adjustment should ensure that interest continues to be recognised at an appropriate rate.

2.50 When an existing security becomes impaired, or a distressed security recovers, the loss, or gain, due to the change in its fair value should be recognised as capital.

2.51 Where an event occurs that makes the receipt of future coupon payments and maturity proceeds uncertain and it is considered prudent to both cease daily income accruals and provide against previous accruals, then the maximum provision that should be made against revenue in the current period is the coupon accrual and amortisation arising since the last ex coupon date. Where there is no ex coupon date, for instance the instrument is a zero coupon debt security, then generally the preceding distribution period end date should be substituted for the ex coupon date. Where amounts in respect of previous coupons are due but not paid then consideration should also be given to providing against these in which case any provision would be recorded as an expense in the current period.

Other income

Other interest

2.52 Bank and other interest should be recognised as revenue on an accruals basis.

Underwriting commission

2.53 Underwriting commission should be recognised when the issue takes place, except where the fund is required to take up all or some of the shares underwritten, in which case an appropriate proportion of the commission received should be deducted from the cost of those shares.

2.54 Underwriting commission should be recognised as revenue except for the proportion that is deducted from the cost of shares, which is capital.

Rent

2.55 Rent (excluding amounts for services such as insurance and maintenance) should be recognised on a straight-line basis over the lease term, unless either:

- another systematic basis is representative of the time pattern of the lessee's benefit from the property, even if the receipt of payments is not on that basis; or

- the payments to the lessor are structured to increase in line with expected general inflation (based on published indexes or statistics) to compensate for the lessor's expected inflationary cost increases. If payments to the lessor vary according to factors other than inflation, then this condition is not met.

2.56 Lease incentives should be treated as a reduction to rent and recognised in accordance with paragraph 2.55 over the lease term on a straight-line basis, unless another systematic basis is representative of the time pattern over which the lessor's benefit from the leased asset is diminished.

2.57 Where lease incentives were recognised initially under a previous SORP, any residual benefit or cost associated with those lease incentives may continue to be amortised on a straight-line basis over the period of the lease or, if shorter, up to the first rent review date.

2.58 Where rent is subject to negotiation, the previous rent may continue to be charged by the landlord pending the conclusion of such negotiations. In this situation the authorised fund manager should include the best estimate of the market rent that will become due over the entire new period.

2.59 Rent should be recognised as revenue.

Stock lending fees

2.60 Net fees receivable arising from stock lending activities should be recognised as revenue on an accruals basis.

Fee rebates

2.61 Where a fund invests in other collective investment schemes, fee rebates (including trail or renewal commissions) should be recognised on an accruals basis.

2.62 Where it is the policy of the underlying scheme to charge its fees to capital in determining its distribution, the fund should generally recognise such rebates as capital. Otherwise the fund should recognise such rebates as revenue.

Tax on revenue

2.63 Revenue should be stated net of irrecoverable tax credits. In cases where revenue is received after the deduction of withholding tax, the revenue should be shown gross of taxation, and the tax consequences should be shown within the tax charge.

Guaranteed funds

2.64 Where a premium is paid to a third party for a guarantee, the accounting treatment follows the nature of the transaction. Where the nature of the guarantee is to limit or cap the expenses of the fund, any receipt from the third party should be shown as a deduction against expenses rather than income. Any such deduction should be disclosed in the notes. The cost of the premium should be recognised in the statement of total return over the period to which the guarantee relates. The treatment of any recoveries from third parties follows the treatment of the premium. Because there will be instances where professional judgement will be required and other factors might have to be taken into account (for example the ability of third parties to honour their guarantees), there should be sufficient narrative disclosure in the notes to enable the user properly to understand the nature of the receipt.

2.65 Where a third party guarantees to protect investments, the income and expenditure should be dealt with in capital; where it guarantees to protect revenue, the income and expenditure should be dealt with in revenue.

Expenses

2.66 Expenses should be recognised when incurred.

2.67 Where a fund invests in a fiscally transparent entity, the expenses incurred by the entity should be recognised as expenses by the fund.

2.68 Charges arising as a result of investment transactions for the scheme, such as handling charges levied by custodians, should be recognised on an accruals basis as deductions from capital. **COLL 6.7.11 G**

2.69 Costs incurred in relation to aborted transactions should be charged against revenue regardless of any alternative treatment that may be permitted in determining the distribution.

2.70 All other expenses, including performance fees and interest on borrowing should be charged against revenue regardless of any alternative treatment that may be permitted in determining the distribution. **COLL 6.7.11 G**

2.71 Where an authorised fund incurs costs in pursuing a claim, but the outcome is uncertain, those costs should be charged as expenses as they are incurred. In determining the distribution, such expenses should be offset to capital until such time as an economic benefit is crystallised. The expenses should then be matched to the benefits either as deductions against revenue or as part of capital, as appropriate.

VAT

2.72 To the extent that a fund is able to recover VAT it should not be included in income or in expenditure. Irrecoverable VAT should be included as part of the relevant cost.

Taxation

2.73 In general, the tax accounting treatment should follow that of the principal amount, with charges or reliefs allocated using the marginal basis regardless of any alternative treatment that may be permitted in determining the distribution. Under the marginal basis, tax charges or reliefs are allocated to capital or revenue to the extent that there remains a liability to corporation tax after relief has been made for all expenses attributed directly to revenue and capital. In calculating how much tax relief should be allocated, revenue expenses are matched first against taxable income arising in revenue, and tax deductible capital expenses are matched first against taxable income arising in capital. Tax relief should be allocated to capital only to the extent that expenses in capital (if any remain after offsetting these expenses against taxable income in capital) are required to reduce or eliminate taxable profits. Similarly, tax relief should be allocated only to revenue to the extent that expenses in revenue (if any remain after offsetting these expenses against taxable income in revenue) are required to eliminate taxable profits. The fact that a fund is not in an overall taxpaying position is not, in itself, a reason not to allocate tax relief on expenses.

2.74 For example, a fund with £100 of taxable income and £120 of relievable expenses, £50 of which are offset to capital, would take full relief for the £70 of expenses borne by revenue before allocating relief of £6 (being £100 less £70 = £30 at 20%) to capital.

2.75 Overseas withholding tax suffered net of expected recoveries under any relevant double tax treaty, to the extent that a valid claim is or is expected to be made, should be separately disclosed in the financial statements. In addition, there may be a large amount of overseas taxation recoverable under double tax treaties. There may often be a significant time lag between the receipt of the overseas dividend net of taxation and the receipt of the tax refund. Whether the distribution should assume that all tax claims would be recovered in full will depend on the circumstances and recovery experience in respect of the investments and territories involved. If provision is considered necessary, owing to significant uncertainty as to receipt, this should be deducted from the amount receivable and disclosed as part of overseas taxation. The estimated expense of recovering the taxation should also be provided for and included within expenses.

2.76 Where an authorised fund opts to pay an interest distribution, the amount paid out or, for accumulation units, reinvested is allowed as a deduction against the fund's taxable profit for the period. However, except where an interest distribution is paid gross to unitholders, it will nevertheless be a responsibility of the fund to deduct income tax at source at the appropriate rate on payment of the interest distribution to the unitholders. Tax withheld on interest distributions should be shown as part of "distributions payable" and not as part of the liability to corporation tax, since it will be settled from amounts transferred to the distribution account.

Deferred tax

2.77 Deferred tax should be recognised in respect of timing differences that have originated but not reversed by the balance sheet date in accordance with paragraph 29.6 of FRS 102. Deferred tax assets should be recognised to the extent that, on the basis of all available evidence, it is regarded as more likely than not that they will be recovered. Deferred tax should be measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

2.78 Deferred tax assets are realised only as a reduction of a tax payment, which will normally be more than 12 months into the future. Realisation is contingent on the crystallisation of future taxable profits. Credits arising from the recognition of deferred tax assets should not form part of the distribution until the period in which the tax liability is reduced. Therefore, in determining the distribution, the benefit of taxable losses should be included only to the extent that taxable profits have arisen in the period under consideration.

Consolidation

2.79 Authorised funds do not report under the Companies Act and therefore are exempted from the requirement to prepare consolidated financial statements by paragraph 9.3(g) of FRS 102. However, authorised funds that hold investment property through intermediate holding vehicles (IHVs) should prepare consolidated financial statements that include the authorised fund and the IHVs that it controls. The consolidation should be prepared in accordance with the procedures set out in section 9 of FRS 102.

Classification of units

2.80 A puttable instrument is classified as equity if it meets the conditions set out in paragraph 22.4(a) of FRS 102. As unitholders have the right to sell units back to the issuer, fund units are puttable instruments. They will therefore be classified as equity instruments if, and only if, they meet all three of the following conditions:

- the fund is a stand-alone fund or is the sole sub-fund of an umbrella;
- the fund has only a single class of units; and
- the fund is not obliged to distribute by way of cash (where, for example, only accumulation units are in issue) any part of the total return to unitholders.

All other fund units are classified as financial liabilities.

Schemes of arrangement

2.81 Where an authorised fund is the transferee in a scheme of arrangement, it is the acquirer for the purposes of section 19 of FRS 102 and should apply the purchase method when accounting for the scheme of arrangement.

3. Reports

3.1 The authorised fund manager of an authorised fund that is not a qualified investor scheme (QIS) must, no more than four months after the end of each financial year, make available and publish the annual long report and, no more than two months after the end of the first six months of each financial year, make available and publish the half-yearly long report. **COLL 4.5.14 R**

3.2 The authorised fund manager of an authorised fund that is not a QIS must publish annual and half-yearly short reports in the timescales applicable in paragraph 3.1. The contents of the short report[1], which must be consistent with the long report, are not within the scope of this SORP. **COLL 4.5.13 R**

3.3 The authorised fund manager of a QIS must, within a reasonable time period after the end of each relevant accounting period, make available and publish the annual report and half-yearly report. The annual report must be made available no later than six months after the end of the financial year. **COLL 8.3.5 R** **FUND 3.3.3 R**

3.4 Annual and half-yearly long reports, including reports prepared under paragraph 3.3, should be signed in accordance with the Financial Conduct Authority's Regulations and dated. The date shall be construed as the date on which the financial statements were authorised for issue. **COLL 4.5.8B R** **COLL 8.3.5E R**

Annual reports

3.5 Annual reports on authorised funds which are umbrella funds must contain: **COLL 4.5.7 R**

- Authorised fund manager's report[2]
- Statement of the authorised fund manager's responsibilities
- Depositary's report[3]
- Auditors' report[4]
- For each sub-fund:
  - Comparative table for each class of units[5]
  - Annual financial statements, including the distribution table (audited)

3.6 Annual reports on authorised funds which are not umbrella funds, or are individual sub-funds of an umbrella fund, must contain the same items as umbrella funds. **COLL 4.5.7 R**

3.7 The authorised fund manager must ensure that the financial statements referred to in paragraphs 3.5 and 3.6 give a true and fair view of the net revenue, the net capital gains or losses and the financial position of the fund as at the end of the period. This is achieved by complying with this SORP and with relevant accounting standards. **COLL 4.5.7 R**

[1] The contents of the short report are defined in COLL 4.5.5 R.
[2] The authorised fund manager's report must contain the items set out in COLL 4.5.9 R (or COLL 8.3.5C R for a QIS). To the extent that this information is the same for each sub-fund, it may be presented once for the umbrella as a whole. However, it must be given for each sub-fund where it varies from that given in respect of the umbrella as a whole.
[3] The depositary's report must contain the items set out in COLL 4.5.11 R (or COLL 8.3.5D R for a QIS).
[4] The authorised fund manager must ensure that the auditors' report includes the all the matters set out in COLL 4.5.12 R.
[5] The information required in the comparative table is defined in COLL 4.5.10 R and should be prepared in accordance with appendix A.

3.8 In addition to complying with the requirements for umbrella funds, the authorised fund manager may prepare further annual long reports for any one or more individual sub-funds of an umbrella fund. Paragraph 3.63 does not apply to any such annual long reports. **COLL 4.5.7 R**

Half-yearly reports

3.9 Half-yearly reports on authorised funds which are umbrella funds must, subject to paragraph 3.12, contain: **COLL 4.5.8 R**

- Authorised fund manager's report[1]
- For each sub-fund:
  - Number of units in circulation and net asset value per unit[2]
  - Interim financial statements

3.10 Half-yearly reports on authorised funds which are not umbrella funds, or are individual sub-funds of an umbrella fund, must contain the same items as umbrella funds. **COLL 4.5.8 R**

3.11 In addition to complying with the requirements for umbrella funds, the authorised fund manager may prepare further half-yearly long reports for any one or more individual sub-funds of an umbrella fund. **COLL 4.5.8 R**

3.12 The authorised fund manager of an authorised fund that is a QIS may choose whether the half-yearly report is prepared for the umbrella as a whole, or for each individual sub-fund, or both. **COLL 8.3.5B R**

Portfolio statement

3.13 A list of all a fund's investments is required as part of the authorised fund manager's report in both the annual and half-yearly reports. **COLL 4.5.9 R**

3.14 The total net assets in the portfolio statement should agree to the balance sheet total.

3.15 The portfolio statement is a list of all the investment assets and liabilities in a fund's portfolio. For each investment[3] it should show the following information:

- Security name
- Amount held
- Value determined in accordance with paragraphs 2.11 to 2.22
- Percentage of the net assets

3.16 The investments should be analysed by category using the most appropriate criteria in the light of the investment policy of the fund, for example economic, geographical or currency. The percentage that each category represents of the total net assets should be shown.

[1] The authorised fund manager's report must contain the items set out in COLL 4.5.9 R (or in COLL 8.3.5C R for a QIS). To the extent that this information is the same for each sub-fund, it may be presented once for the umbrella as a whole. However, it must be given for each sub-fund where it varies from that given in respect of the umbrella as a whole.
[2] UCITS Directive article 69.4.
[3] This information is not required for investment properties which should be shown in accordance with paragraph 3.21.

3.17 Comparative percentages for each category (but not for each security) should be given for the end of the preceding financial year in order to indicate changes in the composition of the portfolio during the period.

3.18 If a fund invests in more than one class of asset (for example, bonds and equities) and asset class is not a category used in presenting the portfolio statement, the split between each asset class should be made clear at the foot of the portfolio statement. Such an analysis is not recommended if a single asset class represents more than 95% of the total value of the net assets.

3.19 The portfolio statement should distinguish between those securities admitted to official stock exchange listing, securities traded on another regulated market, recently issued securities[1] and other securities[2].

3.20 The net value of each derivative position should be shown in the portfolio statement.

3.21 The value and percentage of each individual investment property need not be shown in the portfolio statement. 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. Where this presentation is adopted, details of individual properties should be given within each band and the percentage of the total net assets that each band represents should be shown.

3.22 UCITS schemes are required to show changes in the composition of the portfolio during the period. For authorised funds this requirement is satisfied by the inclusion of all of the following:

- Portfolio statement comparatives (paragraph 3.17)
- Total purchases and sales (paragraph 3.37)
- Description of the material changes in portfolio composition as part of the review of investment activities

Financial statements

3.23 The requirements for the contents of financial statements where the fund units are all classified as financial liabilities are set out in paragraphs 3.26 to 3.102 inclusive. Where fund units are classified as equity in accordance with paragraph 2.80, these paragraphs should be amended in accordance with appendix B. Where these paragraphs provide a format for the layout the items identified are required where applicable.

3.24 The AIFMD level 2 Regulation imposes additional requirements for the content and format of the financial statements of non-UCITS funds. Appendix D provides additional guidance in order to take account of the need to ensure the financial statements of non-UCITS funds applying these regulations remain consistent with the requirements of FRS 102 and this SORP.

3.25 Where an authorised fund is required to produce consolidated financial statements, both the consolidated and the individual primary statements required in paragraphs 3.26 or 3.29 should be presented. Where appropriate consolidated and individual notes should be presented to support the figures in the primary statements.

[1] Recently issued securities of the type referred to in COLL 5.2.8 R (3)(e).
[2] Other securities of the type referred to in COLL 5.2.8 R (4).

Annual financial statements

3.26 A complete set of annual financial statements should contain:

- Statement of total return
- Statement of change in net assets attributable to unitholders
- Balance sheet
- Statement of cash flows[1]
- Notes to the financial statements

3.27 The statements above should be presented with equal prominence. There is no prescribed order in which these statements should be presented; however, the statement of total return and the statement of change in net assets attributable to unitholders should be presented on the same page, thereby providing unitholders with a summary of the principal features of the fund's results for the period.

3.28 Comparative information should be shown for all items in the annual financial statements, unless permitted otherwise. The corresponding amounts should be the amounts for the preceding financial year.

Interim financial statements

3.29 Interim financial statements are a condensed version of annual financial statements and should contain:

- Statement of total return
- Statement of change in net assets attributable to unitholders
- Balance sheet
- Statement of cash flows[1]

3.30 Comparative information should be shown for all items in the interim financial statements. The corresponding amounts for the balance sheet should be the amounts as at the end of the preceding financial year and the equivalent amounts for the same half-yearly period in the preceding financial year for all other statements.

3.31 Interim financial statements should include a statement that they are prepared on the basis of the accounting policies set out in the most recent set of annual financial statements. Where it is known that an accounting policy change will be made in the annual financial statements, the change should be implemented in the interim financial statements rather than deferred to year end. The nature of each change and the reasons for it should be disclosed.

3.32 There are no specific requirements for notes in the interim financial statements.

Contents of financial statements

Statement of total return

3.33 The statement of total return includes the items to be included in a profit and loss account in accordance with the requirements of Part 1 of Schedule 1 of the

[1] A statement of cash flows is not required where the conditions in paragraph 7.1A FRS 102 are met.

company accounts regulations[1] and modified in accordance with the provisions of section A of that Part.

3.34 The statement of total return summarises the results of the management of the fund and should show at least the following line items, unless otherwise permitted by this SORP:

Income		
Net capital gains/(losses)		X
Revenue	X	
Expenses	(X)	
Interest payable and similar charges	(X)	
Net revenue/(expense) before taxation	XX	
Taxation	(X)	
Net revenue/(expense) after taxation		XX
Total return before distributions		XX
Distributions		(X)
Change in net assets attributable to unitholders from investment activities		XX

3.35 The financial statements should be prepared in the base currency as defined in the instrument constituting the fund. Where the base currency differs from the functional currency, all exchange differences resulting from translation to the base currency should be separately disclosed in the statement of total return.

Net capital gains/(losses)

3.36 The notes should include an appropriate analysis of this figure and should distinguish amounts relating to derivatives and non-derivatives. Foreign exchange gains/(losses), except for those arising on investments, should be disclosed separately in the notes.

Transaction costs

3.37 Transaction costs form part of net capital gains/losses. For purchases and for sales the total before and after direct transaction costs should be disclosed in the notes.

3.38 Total purchases and sales and associated direct transaction costs should be analysed for each significant asset class[2], with significant *in specie* transfers and corporate actions disclosed separately. The analysis should include disclosure of the amount of each type of direct transaction cost together with the percentage each represents of the relevant principal purchase or sale amount.

3.39 Purchases and sales of cash schemes as part of a daily sweep to manage liquidity should be excluded from the disclosures required by paragraphs 3.37 and 3.38.

3.40 The total of each type of direct transaction cost should be stated, expressed as a percentage of the fund's average net asset value.

3.41 Explanations should be given to enable users of the financial statements to understand the nature of transaction costs and how they arise for different types

[1] The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.
[2] Derivatives should be included at the settlement amount of the contract.

of investments. This should include explanations of where there are indirect transaction costs or transaction costs incurred by underlying schemes which do not form part of the direct transaction cost disclosures.

3.42 The average portfolio dealing spread, including the effect of foreign exchange, should be stated as at the balance sheet date. This spread is the difference between the values determined respectively by reference to the bid and offer prices of investments expressed as a percentage of the value determined by reference to the offer price. Where the authorised fund manager believes the spread on the balance sheet date is not representative of the typical spread throughout the year, this fact should be disclosed.

Revenue

3.43 The notes should include an appropriate analysis of this figure and should distinguish amounts relating to derivatives and non-derivatives.

Stock lending and repurchase agreements

3.44 Fees earned from stock lending and repurchase agreements are included in revenue on a net basis. The notes should disclose the gross fees and related direct and indirect expenses. The identity of the recipient(s) of these expenses and their relationship to the authorised fund manager or the depositary should be disclosed.

3.45 Disclosure should 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.

Expenses

3.46 Each type of expense (excluding transaction costs which are disclosed in accordance with paragraphs 3.37 and 3.38) should be shown in the notes with an analysis that shows the expenses payable to each of the authorised fund manager and associates, the depositary and associates and other third parties.

3.47 Where there is directly or indirectly any fee sharing between the authorised fund manager, the depositary or an affiliate of either, this must be disclosed with the relevant details.

3.48 Where performance fees are charged, the basis of the charge should be disclosed. Where there are known circumstances that may affect future performance fees, this information should be disclosed in the notes.

Interest payable and similar charges

3.49 Dividends payable on short positions should be included in this line item and disclosed separately in the notes. Where this line item contains only interest payable and the amount is not material it may be combined and disclosed under expenses.

Taxation

3.50 A fund's total tax charge should be disclosed and comprises corporation tax, tax on capital gains and tax withheld on revenue but should not include tax withheld by the fund on distributions on behalf of unitholders.

3.51 The notes should include an analysis of the fund's total tax charge for the period distinguishing between current and deferred tax. The current tax charge should show separately the domestic and foreign tax, any adjustments relating to prior periods and any relief under double taxation treaties.

3.52 The notes should disclose the amount of corporation tax that would arise on the net revenue before taxation at the standard rate for UK corporation tax for authorised funds. This amount should be reconciled to the fund's total tax charge for the period.

3.53 The deferred tax provision at the start and the end of the period and the movement in the year should be stated in the notes.

3.54 The amount of any deferred tax asset that has not been recognised should be disclosed in the notes together with the circumstances in which the asset would be recovered.

Distributions

3.55 The amount and type of each distribution payable in respect of the period should be disclosed. Where there is a material difference between net revenue after taxation shown in the statement of total return and the total amount of the distributions, a reconciliation of the difference should be included in the notes. It is expected that the authorised fund manager's report should explain the investment strategy, the result of which has led to this material difference.

Statement of change in net assets attributable to unitholders

3.56 The statement of change in net assets attributable to unitholders reconciles the opening and closing net assets attributable to unitholders. It presents the impact of transactions with unitholders in addition to the results of the management of the fund and should show at least the following line items, unless the amount is nil for both the current and preceding period:

Opening net assets attributable to unitholders		X
Amounts receivable on issue of units	X	
Amounts payable on cancellation of units	(X)	
		XX
Dilution levy/adjustment		X
Stamp duty reserve tax		X
Change in net assets attributable to unitholders from investment activities		X
Retained distributions on accumulation units		X
Unclaimed distributions		X
Closing net assets attributable to unitholders		XX

Additional line items should be presented for other significant amounts.

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

Balance sheet

3.58 The balance sheet is presented in accordance with the requirements of Part 1 of Schedule 1 of the company accounts regulations[1] and modified in accordance with the provisions of section A of that Part.

3.59 The balance sheet presents the financial position and should show at least the following line items, unless the amount is nil for both the current and preceding period:

Assets:	
Fixed assets:	
Tangible assets:	
Land and buildings	X
Property under construction	X
Investments	X
Current assets:	
Debtors *	X
Cash and bank balances *	X
Total assets	XX
Liabilities:	
Investment liabilities	X
Provisions for liabilities *	X
Creditors	
Bank overdrafts	X
Distribution payable	X
Other creditors *	X
Total liabilities	XX
Net assets attributable to unitholders	XX

* For annual financial statements these items should be analysed further in the notes.

Statement of cash flows

3.60 Authorised funds qualify for exemption from the need to prepare a statement of cash flows if they meet all the following conditions:

- substantially all of the entity's investments are highly liquid;
- substantially all of the entity's investments are carried at fair value; and
- the entity provides a statement of change in net assets.

3.61 When assessing the criteria for exemption from the need to prepare a statement of cash flows the authorised fund manager should consider both the nature of the investments and the prevailing market conditions.

3.62 Authorised funds that do not qualify for exemption should prepare a statement of cash flows in accordance with section 7 of FRS 102.

[1] The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

Notes to the financial statements

3.63 In case of an umbrella fund, the information in the notes may be presented once for the umbrella as a whole provided that the financial statements of each sub-fund contain appropriate cross-references.

Basis of preparation

3.64 Where the financial statements have been prepared in compliance with FRS 102, a statement that this is the case should be given. The title of this SORP and whether the financial statements have been prepared in accordance with it should be stated. In the event of a departure from this SORP, the financial statements should include the disclosures required by paragraph 6 of FRS 100.

Accounting policies

3.65 A summary of the significant accounting policies should be given in accordance with section 8 of FRS 102, together with a description of the judgements made by the authorised fund manager, the key assumptions and the other key sources of estimation uncertainty. Details of any changes from the previous period should also be disclosed.

Distribution policies

3.66 A description of the distribution policies that are material in the context of the distribution should be given detailing, in particular, policies relating to adjustments to net revenue after taxation in determining the distribution together with a statement explaining the consequential impact on the value of capital. Where policies are specific to each class this should be disclosed. Details of any changes from the previous period should also be disclosed.

3.67 Ordinary stock dividends are recognised as revenue in the first instance. The policy for ordinary stock dividends should state whether or not they form part of the distribution.

3.68 The distribution policy[1] should be stated and where the policy is to increase the distribution by disregarding the effect of amortisation a statement explaining the consequential impact on the value of capital should be included.

3.69 The distribution policy[2] should be stated where that policy is designed to contribute to the preservation of the unit value in real terms.

3.70 Expenses, including performance fees, are charged against revenue in the first instance unless they are recognised in accordance with paragraph 2.68. Where the policy is to partially or fully offset expenses against capital in order to determine the distribution, the distribution policy should be disclosed together with a statement explaining the consequential impact on the value of capital.

3.71 Where a transfer is made between the revenue and capital of the same class it is acceptable not to take into account marginal tax relief in determining the distribution. This policy should be disclosed.

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[1] COLL 6.8.3 R permits transfers to be made such that distributions are determined disregarding the effect of amortisation, provided that the resultant distribution is not less than if those transfers had not been made.

[2] COLL 6.8.3 R permits funds whose policy is to invest predominantly in index-linked securities to make transfers in respect of index-linked gilt-edged securities in order to exclude from the distribution the amount attributable to the change in the Retail Prices Index during the period.

3.72 Where income arises to an authorised fund from other collective investment schemes any equalisation is recognised as capital in the first instance. The distribution policy of the fund should state whether or not this equalisation forms part of its distribution.

3.73 The distribution policy for qualifying money market funds should be stated and should explain the impact that maintaining the value of such a fund has on the distribution.

3.74 Where consolidated financial statements are produced, the distribution policy should state whether the distribution is determined based on the authorised fund's individual net revenue after taxation or on that of the consolidated group.

Risk management policies

3.75 FRS 102 requires disclosures that enable users of the financial statements to evaluate the nature and extent of credit risk, liquidity risk and market risk arising from financial instruments and how those risks are managed. Regulations require authorised fund managers to establish, implement and maintain an adequate and documented risk management policy for identifying, measuring and managing all risks to which the fund is or might be exposed. This SORP recommends integrated risk disclosures using the elements of the regulatory risk management policy to satisfy the requirements of paragraphs 34.23 to 34.30 of FRS 102.

COLL 6.12
FUND 3.7
AIFMR 38-45

3.76 Authorised funds are designed to generate returns for investors in the form of changes in the fair value of their investment. To achieve this they create and manage exposure to market risk and regulations require other risks to be fully mitigated. Where an authorised fund is exposed to credit risk in the form of an issuer's credit quality, this is measured and managed as part of the exposure to market risk. The residual exposure to credit risk is measured and managed as counterparty risk. The authorised fund manager should ensure that suitable narrative and numerical risk disclosures in respect of market risk, credit risk and liquidity risk are provided by the permanent risk management function.

3.77 For each type of risk that arises the disclosures should include a description of:

(a) the exposures to risk and how they arise;

(b) its objectives, policies and processes for managing the risk and the methods used to measure the risk; and

(c) any changes in (a) or (b) from the previous period.

3.78 Where the exposure to a particular type of risk is significant a numerical analysis of that risk is required. When assessing the significance of a particular risk the authorised fund manager should consider both the nature of the investments and the prevailing market conditions. Where disclosure is not given on the grounds of significance, it should be stated that this is the case.

Market risk

3.79 FRS 102 requires a sensitivity analysis for each type of market risk (eg interest rate risk, currency risk, other price risk) to be provided. Where exposure is measured and managed using a value-at-risk approach, the requirements of FRS 102 in respect of market risk should be satisfied by applying 3.80. Where value-at-risk techniques are not used, the disclosures required by paragraphs 3.81 to 3.84 should be made.

3.80 Where value-at-risk is used the lowest, the highest and the average utilisation of the value-at-risk limit calculated during the financial year should be given. The model and inputs used for calculation (calculation model, confidence level, holding period, length of data history) should be disclosed and explained in order to aid an understanding of these disclosures. Where relative value-at-risk is used, information on the reference portfolio should be given.

3.81 For funds employing significant leverage, the level of leverage[1,2] employed during the period should be disclosed with sufficient explanation to aid an understanding of the disclosure.

3.82 For funds with a significant exposure to currency risk the net exposure to the principal foreign currencies should be disclosed. Net exposure should take into account any instruments used to hedge against the foreign currencies.

3.83 For funds with a significant exposure to interest rate risk an analysis showing separately the value of investments at fixed interest rates, at variable interest rates and those that are non-interest bearing should be disclosed. The values disclosed should take into account any instruments used to hedge against changes in interest rates.

3.84 For funds where a significant proportion of the portfolio is invested in debt securities, an analysis of the credit quality of the portfolio should be given using the credit ratings or, as a minimum, showing the proportion of the portfolio that is invested in unrated securities and the proportion in securities that are below investment grade. The disclosure should reflect the impact of derivative positions on the risk profile.

Credit risk

3.85 FRS 102 requires disclosure of the exposures to credit risk, details of any collateral held and other techniques used to mitigate credit risk and information about the credit quality of the investments held. Additional disclosures are required where possession is taken of collateral held. The requirements of FRS 102 in respect of credit risk should be satisfied by the disclosures made in accordance with paragraphs 3.45, 3.77, 3.84 and 3.86.

3.86 Disclosure should be given in the notes of the exposure[3] to each counterparty obtained through the use of derivatives and the nature and value of collateral held or pledged in respect thereof, analysed by asset class.

Liquidity risk

3.87 FRS 102 requires disclosure of a maturity analysis for financial liabilities. Where substantially all a fund's liabilities are its units, it will normally be sufficient to deal with liquidity risk by narrative disclosure in accordance with paragraph 3.77.

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[1] For UCITS, leverage should be calculated as the sum of the net asset value and the incremental exposure generated through the use of derivatives (calculated in accordance with the commitment approach (CESR/10-788)) divided by the net asset value.

[2] For non-UCITS funds, leverage should be calculated as the exposure (calculated in accordance with the commitment method (AIFMR article 8)) divided by the net asset value.

[3] This exposure should be calculated in accordance with COLL 5.2.11B R

Other information in the notes

Commitments, contingent liabilities and contingent assets

3.88 A provision should be recognised when the entity has a present obligation (legal or constructive) as a result of a past event, it is probable that a transfer of economic benefits will be required to settle the obligation, and a reliable estimation can be made of the amount of the obligation.

3.89 Where an authorised fund has a commitment, for example, where it may be called upon to subscribe for shares pursuant to an underwriting, placing or similar agreement, and the existence of an obligation will be confirmed only by the occurrence of one or more future events not wholly within the authorised fund's control, the aggregate commitments should be disclosed. Such future events could include the passing of certain resolutions by the issuing company.

3.90 A contingent liability should not be recognised but, unless the possibility of a transfer of economic benefits is remote, should be disclosed with a brief description of the nature of the contingent liability and, where practicable, an estimate of its financial effect, an indication of the uncertainties relating to the amount or timing of any outflow and the possibility of any reimbursement.

3.91 A fund may have a commitment with respect to partly paid and nil paid shares. Even though it may be intended to sell these shares before the calls become due, a possible obligation exists, and the aggregate commitment on partly paid and nil paid shares should be disclosed.

3.92 Contingent assets usually arise from unplanned or other unexpected events that give rise to economic benefits. An example is a claim that an entity is pursuing through legal processes, where the outcome is uncertain.

3.93 A contingent asset, including a potential recovery of overseas withholding taxes, should not be recognised in the financial statements unless it becomes virtually certain that an inflow of economic benefits will arise. If an inflow is probable, the contingent asset should be disclosed with a brief description of its nature and, where practicable, an estimate of its financial effect.

3.94 Whilst contingent assets should not be recognised in the financial statements they may be recognised, on a proportional or otherwise appropriate basis, for the purposes of determining the dealing prices of units. Where the bases of recognition are different, disclosure should be given in the notes explaining the reasons for the differences.

Related parties

3.95 The authorised fund manager should identify any related parties and make the disclosures required by section 33 of FRS 102. Generally, neither the authorised fund manager nor the depositary will be regarded as a related party because their relationship to the authorised fund does not meet the conditions in paragraph 33.2(b) of FRS 102.

Unitholders' funds

3.96 The price of a unit is determined by reference to the proportional share of the net asset value attributable to each unit class. Where there are different unit classes, the price of units will reflect the terms and conditions of each class, but it is not necessary to analyse each class in the financial statements. The different rights and terms attaching to each unit class, including the rights on winding-up and the policy for allocating taxation and distributable income, should be summarised in the notes to the financial statements, unless they are disclosed elsewhere in the report.

3.97 A reconciliation of the opening and closing numbers of units of each class should be given showing the number of units issued, cancelled and converted during the period. This reconciliation need not be presented for prior periods.

Distribution table

3.98 A table showing the distribution rate per unit for each distribution relating to the period for every class of unit is required. The table should distinguish between group 1 and group 2 units, and should be analysed to show:

- Gross revenue *
- Income tax *
- Net revenue
- Equalisation
- Distribution

* These items are required only for funds that withhold income tax on their distributions.

Events after the balance sheet date

3.99 In accordance with section 32 of FRS 102, the nature and financial effect of each significant category of non-adjusting events should be disclosed. An example of such an event is an abnormally large change in the fair value of investments between the balance sheet date and the date the accounts are signed.

Fair value disclosure

3.100 An analysis of the portfolio in accordance with the fair value hierarchy should be disclosed in the notes. This should show separately the value of investment assets and liabilities valued on the basis of a quoted price for an identical asset in an active market, the price of a recent transaction for an identical asset or an alternative valuation technique. The value determined by valuation techniques that rely significantly on assumptions and non-observable market data should be disclosed separately to those using observable market data. Additional guidance is provided in appendix C.

3.101 When a valuation technique is used, the assumptions applied in determining the fair value should be disclosed. This disclosure should reflect the extent to which the authorised fund manager has exercised judgment in quantifying the inputs to the valuation technique in order to determine fair value.

Investment property disclosure

3.102 The following disclosures should be made for investment properties:

- the methods and significant assumptions applied in determining the fair value of investment property;

- the name and qualifications of the valuer;

- the existence and amounts of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal;

- contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements; and

- a reconciliation between the carrying amounts of investment property at the beginning and end of the period, showing separately:

  - additions
  - disposals;
  - net gains or losses from fair value adjustments; and
  - other changes.

This reconciliation need not be presented for prior periods.

APPENDIX A – Comparative table

This appendix forms an integral part of the SORP.

A.1 A comparative table is required for each unit class covering each of the last three financial years or, if less than three, each financial year since launch. For classes launched during a period the charges and costs figures should be apportioned on an appropriate basis. All figures should be expressed "per unit" unless specified otherwise.

A.2 The comparative table summarises the financial highlights and should show, in a single table for each unit class, the following amounts:

Illustrative performance of a unit in issue throughout the period

Change in net assets per unit	
Opening net asset value per unit	X
Return before operating charges*[1]	X
Operating charges[2]	(X)
Return after operating charges*[3]	XX
Distributions on income units[4]	(X)
Closing net asset value per unit[5]	XX
Retained distributions on accumulation units[4]	X
* after direct transaction costs[6, 7] of:	X
Performance	
Return after charges[8]	X.X%
Other information	
Closing net asset value (£'000)	X
Closing number of units	X
Operating charges[9, 10]	X.XX%
Direct transaction costs[7, 11]	X.XX%
Prices	
Highest unit price	X
Lowest unit price	X

A.3 The direct transaction costs figures in the comparative table of a feeder in a master-feeder arrangement should take account of the master's direct transaction costs.

A.4 Explanations should be given in order to aid an understanding of the disclosures in the comparative table and should include reference to the matters required by paragraph 3.41.

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[1] The "return before operating charges" is calculated as the "return after operating charges" plus the "operating charges".

[2] The ex-post figure for the financial year and otherwise calculated in accordance with CESR/10-674 and expressed by reference to the average of the number of units in issue at each valuation point during the financial year.

[3] The "return after operating charges" is calculated as the "closing net asset value per unit" plus the "distributions" minus the "opening net asset value per unit".

[4] Delete as appropriate.

[5] Closing net asset value per unit should correspond to the balance sheet total.

[6] Total direct transaction costs expressed by reference to the average of the number of units in issue at each valuation point during the financial year.

[7] Direct transaction costs may be stated after deducting, in the case of single-priced funds, the proportion of the amounts collected from dilution adjustments or dilution levies that relates to direct transaction costs and, in the case of dual-priced funds, the amounts collected in relation to direct transaction costs added to, or subtracted from, the valuations by virtue of COLL 6.3.6 G (4).

[8] The "return after charges" is calculated as the "return after operating charges" per unit divided by the "opening net asset value per unit".

[9] The ex-post figure for the financial year and otherwise calculated in accordance with CESR/10-674.

[10] Any performance-related fee for the financial year should be disclosed separately.

[11] Total direct transaction costs expressed by reference to the average of the net asset values at each valuation point during the financial year.

APPENDIX B – Presentation for funds with units classified as equity

This appendix forms an integral part of the SORP.

The text embedded in the body of the SORP should be amended in accordance with this appendix where a fund's units are assessed as equity, having regard to the conditions in paragraph 2.80, rather than financial liabilities.

B.1 In paragraphs 3.26, 3.27, 3.29 and in the heading above paragraph 3.56, replace "Statement of change in net assets attributable to unitholders" with "Statement of change in unitholders' funds".

B.2 In paragraphs 3.34 and 3.56, replace "Change in net assets attributable to unitholders from investment activities" with "Change in unitholders' funds from investment activities".

B.3 In paragraph 3.56, replace the first sentence with "The statement of change in unitholders' funds reconciles the opening and closing net assets."

B.4 In paragraph 3.56, replace "Opening net assets attributable to unitholders" with "Opening net assets" and replace "Closing net assets attributable to unitholders" with "Closing net assets".

B.5 In paragraph 3.59, replace "Net assets attributable to unitholders" with "Net assets" and add a line item "Unitholders' funds" below "Net assets".

APPENDIX C – Illustrative application of fair value disclosures

This appendix forms an integral part of the SORP.

C.1 Fair value based on a quoted price for an identical instrument in an active market will generally include equities, some highly liquid bonds and exchange traded derivatives.

C.2 Fair value based on the price of a recent transaction for an identical instrument will generally include holdings in other schemes.

C.3 Fair value based on a valuation technique using observable market data will generally include evaluated pricing techniques using inputs such as quoted prices for similar instruments, interest rates, yield curves or credit spreads.

C.4 Fair value based on a valuation technique that relies significantly on non-observable market data will include values not primarily derived from observable market data.

C.5 The disclosures required by paragraph 3.100 may be presented as follows:

Valuation technique	Assets	Liabilities
	£'000	£'000
Quoted prices for identical instruments in active markets	X	X
Prices of recent transactions for identical instruments	X	X
Valuation techniques using observable market data	X	X
Valuation techniques using non-observable data	X	X
	XX	XX

C.6 In preparing these disclosures, consideration should be given to other guidance including that issued by the IMA.

APPENDIX D – Additional guidance for non-UCITS funds

This appendix forms an integral part of the SORP.

The FCA's Investment Funds Sourcebook (FUND), which implements the AIFM Directive, and the AIFMD level 2 Regulation (AIFMR) contain specific requirements in respect of the annual reports of non-UCITS funds. This appendix provides guidance on applying these requirements in a manner that is consistent with the requirements of FRS 102. References to articles in this appendix refer to AIFMR unless otherwise specified.

D.1 FUND requires the financial statements to be prepared in accordance with the accounting standards of the Member State in which a non-UCITS fund is domiciled.

D.2 Article 103 states the general principles of materially relevant, reliable, comparable and clear in respect of the information provided in the annual report. Authorised fund managers should have regard for the needs of investors to be able to compare authorised funds regardless of whether they are established as UCITS or non-UCITS funds.

D.3 Article 104 specifies the elements and underlying line items that should be included in the financial statements of a non-UCITS fund but permits these to be modified to the extent necessary to ensure consistency with national accounting standards and the instrument constituting the fund and compliance with national legislation.

D.4 Article 104 specifies a balance sheet line item for cash and cash equivalents[1]. FRS 102, by application of the Companies Act formats, requires cash at bank and in hand to be shown. This conflict should be resolved by including an additional line item for cash equivalents in the balance sheet.

D.5 Article 104 specifies separate income and expenditure account line items for realised gains, unrealised gains under income and realised losses and unrealised losses under expenses. FRS 102 requires a single line item for net gains or net losses, including changes in fair value and this SORP refers to this line item as net capital gains/losses. In order to ensure the financial statements comply with FRS 102 and to maintain consistency of presentation with UCITS, this conflict should be resolved by including a single line item for net capital gains/losses in the statement of total return and disaggregating net gains or losses into their realised and unrealised components in the notes. It should be explained that, where realised gains/losses include gains/losses arising in previous periods, a corresponding loss/gain is included in unrealised gains/losses.

D.6 For the purpose of paragraph D.5, realised gains/losses on investments should be calculated as the proceeds from disposal less the book cost.

D.7 Article 104 specifies separate income and expenditure account line items for investment advisory or management fees and other expenses. This SORP refers to a single line item for expenses with further analysis in the notes. In order to maintain consistency of presentation with UCITS, the SORP presentation generally will be sufficient to satisfy the information requirements of article 104.

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[1] Cash equivalents are defined in article 7(a) as "highly liquid investments held in the base currency of the AIF, that are readily convertible to a known amount of cash, are subject to an insignificant risk of change in value and provide a return no greater than the rate of a three-month high quality government bond".

D.8 Article 105 specifies the minimum contents of the investment manager's report.

D.9 Article 106 deals with material changes to the information made available to investors before they invested.

D.10 Article 107 specifies the information to be disclosed in the annual report in respect of the remuneration paid by the authorised fund manager to its staff.

D.11 Articles 108 and 109 specify information that should be disclosed as part of the periodic reporting to investors at the same time as the annual report is made available. The disclosures should include:

- the risk profile including an outline of the measures to assess the sensitivity of the portfolio to the most relevant risks, and a description of any actual or expected breaches of the risk limits and the remedial measures taken (article 108.4);
- An outline of the main features of the risk management systems employed and any changes thereto together with the anticipated impact of the change (article 108.5);
- the actual utilisation of leverage calculated on both a gross and a commitment basis (article 109.3); and
- an overview of any special arrangements for managing liquidity and the percentage of assets subject to such special arrangements (article 108.2).

Authorised fund managers should consider the overlap between these requirements and the requirements in paragraphs 3.75 to 3.87 of this SORP. It is acceptable to add to these SORP requirements in order to achieve compliance with FUND and AIFMR.

APPENDIX E – Laws, regulations and accounting standards

At the time the SORP was issued the following laws, regulations and accounting standards were relevant to the financial statements of authorised funds.

Laws and regulations

Financial Services and Markets Act 2000 (FSMA)
An Act to make provision about the regulation of financial services and markets.

Part XVII deals with powers of incorporation and authorisation and defines the types of entity that are authorised funds and the parties involved their operation.

Open-Ended Investment Companies Regulations 2001 (OEICR)
Regulations, made under FSMA, governing the establishment, carrying on, and regulation of open-ended investment companies (OEICs).

Part II deals with powers of incorporation and authorisation. Part III deals with the responsibilities of the directors of an OEIC, including in respect of reports.

Collective Investment Schemes Sourcebook (COLL)
Part of the FCA's regulatory handbook, this specialist sourcebook provides the detailed framework within which authorised funds operate.

Section 4.5 deals with an authorised fund manager's responsibilities in relation to reports and accounts. Chapter 6 deals with operating duties and responsibilities of the parties involved in operating an authorised fund.

Investment Funds Sourcebook (FUND)
Part of the FCA's regulatory handbook, this specialist sourcebook provides the detailed framework within which funds operate.

FUND has been created as part of the implementation of the AIFM Directive and it is expected that FCA will incorporate the requirements of COLL into FUND in due course.

Commission Delegated Regulation (EU) No 231/2013 (AIFMR)
European Commission Regulations, made under the AFIM Directive, with regard to exemptions, general operation conditions, depositaries, leverage, transparency and supervision.

Section 1 of Chapter V deals with the requirements for annual reports.

Accounting standards

FRS 100 Application of Financial Reporting Requirements
This standard sets out the applicable financial reporting framework for entities preparing financial statements that are intended to give a true and fair view. It specifies the statements that should be made regarding compliance with the SORP.

FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland
This standard sets out the financial reporting requirements applicable to financial statements that are intended to give a true and fair view of an entity's financial position and financial performance for the period.

All sections of FRS 102 are applicable to authorised funds and the following sections are the most likely to be relevant:

Section 3: Financial Statement Presentation
This section explains fair presentation of financial statements, what compliance with this FRS requires, and what constitutes a complete set of financial statements.

Section 4: Statement of Financial Position
This section sets out the information that is to be presented in a statement of financial position and how to present it.

Section 5: Statement of Comprehensive Income and Income Statement
This section requires an entity to present its total comprehensive income for a period – ie its financial performance for the period - in one or two financial statements. It sets out the information that is to be presented in those statements and how to present it.

Section 8: Notes to the Financial Statements
This section sets out the principles underlying information that is to be presented in the notes to the financial statements and how to present it.

Section 10: Accounting Policies, Estimates and Errors
This section provides guidance for selecting and applying the accounting policies used in preparing financial statements. It also covers changes in accounting estimates and corrections of errors in prior period financial statements.

Sections 11 and 12: Financial Instruments
Section 11 and 12 together deal with recognising, derecognising, measuring and disclosing financial instruments (financial assets and financial liabilities).

Section 21: Provisions and Contingencies
This section applies to all provisions (ie liabilities of uncertain timing or amount), contingent liabilities and contingent assets except those provisions covered by other sections of this FRS.

Section 22: Liabilities and Equity
This section establishes principles for classifying financial instruments as either liabilities or equity and deals with the accounting for compound financial instruments.

Section 29: Income Tax
This section covers accounting for current, deferred and value added taxes.

Section 30: Foreign Currency Translation
This section prescribes how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a presentation currency.

Section 32: Events after the End of the Reporting Period
This section defines events after the end of the reporting period and sets out principles for recognising, measuring and disclosing those events.

Section 34: Specialised Activities
This section sets out additional financial reporting requirements for financial institutions.

Section 35: Transition
This section sets out requirements for entities applying this FRS for the first time.

The following sections of FRS 102 may also be relevant to some authorised funds:

Section 7: Statement of Cash Flows
This section sets out the information that is to be presented in a statement of cash flows and how to present it.

Section 9: Consolidated and Separate Financial Statements
This section sets out the circumstances where consolidation is required and the consolidation procedures that should be followed.

Section 14: Investments in Associates
This section applies to accounting for investments in associates.

Section 15: Investments in Joint Ventures
This section applies to accounting for investments in joint ventures.

Section 16: Investment Property
This section applies to accounting for investments in land or buildings that meet the definition of investment property and some property interests held by a lessee under an operating lease that are treated like investment property.

Section 20: Leases
This section covers accounting for leases.

Section 25: Borrowing Costs
This section specifies the accounting for borrowing costs.

Section 33: Related Party Disclosures
This section requires an entity to include in its financial statements the disclosures necessary to draw attention to the possibility that its financial position and profit or loss have been affected by the existence of related parties and by transactions and outstanding balances with such parties.

The following standards are not likely to be relevant to authorised funds.

FRS 101 Reduced Disclosure Framework
This standard sets out disclosure exemptions for the individual financial statements of subsidiaries of parents that apply EU-adopted IFRS.

FRS 103 Insurance Contracts
This standard sets out the accounting requirements for insurance contracts.

Other guidance

FRC Statement: SORPs: Policy and code of practice
This statement provides guidance on the policy for recognition of a SORP-making body and the process of developing and issuing a SORP.