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Dear Sir

## **Exposure Draft: SORP for UK Authorised Funds**

Deloitte LLP is pleased to comment on the revised Statement of Recommended Practice for UK Authorised Funds ("the IMA SORP").

In our view the proposed revisions to the IMA SORP are broadly consistent with changes in the regulatory and accounting framework. We have made some comments in cases where we note deviations from the requirements of the new UK financial reporting standards (FRSs 100-103) which may benefit from further consideration.

In the Appendix to this letter we respond individually to the questions raised in the invitation to comment.

We would be happy to discuss our letter and the draft proposals with you. If you have any questions or comments, please contact Jamie Partridge on 0141 314 5956 or [jpartridge@deloitte.co.uk](mailto:jpartridge@deloitte.co.uk).

Yours faithfully



Veronica Poole  
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## **Appendix: Deloitte's responses to questions raised in IMA's invitation to comment**

### **Question 1**

*How many funds do you expect to have significant numbers of instruments that are valued using unobservable inputs?*

We do not expect there to be many such funds (<5%) amongst current UK authorised funds, given that they typically invest in highly liquid investments with an active market. However, as AIFMD may result in a wider range of entities being within scope this may change.

### **Question 2**

*Do you have systems or processes in place to support the IFRS reporting levels?*

Deloitte is commenting as a professional services firm rather than as a holder of funds and this question is therefore not directly relevant to us. In our experience funds and administrators of funds would be expected to have sufficient processes in place to be able to support and extract the information required by the IFRS reporting levels.

### **Question 3**

*Do you agree that the SORP's emphasis justifies the additional disclosure category for unobservable inputs? If not, please explain why.*

Yes, we agree with the additional disclosures which will assist users of the financial statements in understanding the relative subjectivity of fair value measurements and associated risks. The sub-analysis of valuations obtained using other valuation techniques between those using observable inputs and unobservable inputs will aid comparability between funds preparing their financial statements under IFRS and FRS 102. Given that we do not expect many funds to hold significant numbers of instruments valued using unobservable inputs (see Q1 above), we believe that the impact of this additional disclosure requirement will not prove overly onerous.

### **Question 4**

*Do you agree with the generic approach for all authorised funds or should it be more focused on UCITS with non-UCITS funds being dealt with by exception in Appendix III?*

In our view, it would be clearer for readers of the SORP if the body of the SORP provided guidance for UCITS funds, with Appendix III setting out differences for non-UCITS funds.

### **Question 5**

*Do you agree with the integrated approach of using a single set of disclosures to satisfy the regulatory and accounting requirements?*

Our general preference is not to confuse regulatory information, which is generally used by regulators rather than users, and financial reporting requirements. However, in this case we support the integrated approach given:

- the significant degree of overlap between the two categories of disclosure in this case; and
- the fact that the regulatory information is aimed at investors, rather than regulators.

### **Question 6**

*Do you think the SORP should define realised and unrealised gains / losses for non-UCITS funds?*

We believe that a clear definition of such terms may be useful in reducing diversity among market participants because the terms are commonly used in the industry and the AIFMD does not provide a clear definition.

### **Question 7**

*If so, should it use definition A, B or something else?*

We believe that Alternative B is the most appropriate option based on current available guidance within the UK and Europe. Alternative B utilises the definition of realised and unrealised profits from TECH 02/10, which in effect requires consideration of whether they are readily convertible to cash.

We note that this guidance was developed to interpret the reference to realised profits in UK company legislation for the purposes of deciding whether profits of companies may be distributed to shareholders and the European Court or regulator may provide further information on the interpretation as part of AIFMD.

### **Question 8**

*Do you think the proposals will help investors better understand the performance and costs? If not, please suggest how it might be improved.*

Subject to our comments in Q9 below, we agree with the proposals.

### **Question 9**

*Are there any aspects of the proposals that you think will be particularly troublesome to produce?*

In our view funds may find it challenging in practice to obtain the proposed further breakdown of dealing costs into execution and research components. Fund administrators will need to implement systems capable of capturing information at this level. Additional guidance on how to attribute dealing costs between the two components may also be helpful to preparers.

### **Question 10**

*Do you agree with the simplification of the principles for recognising revenue from debt securities?*

We agree with the simplification of revenue recognition on debt securities in principle. However, the current proposals seem to contain some inconsistencies and may not provide adequate guidance in all circumstances (for example 2.36 refers to the coupon interest whereas all other paragraphs refer to expected cash flows; also 2.47 implies that impairment losses may be recognised on such securities but there is no further guidance on how such a loss would be calculated).

If the intention is to approximate amortised cost measurement, a more straight forward solution would be to either replicate or reference the full guidance on amortised cost and to allow the spreading of premiums and discounts (as a component of the amortised cost calculation) on a straight line basis as a practical expedient.

The removal of the guidance relating to the separation of embedded derivatives is consistent with the requirements of Sections 11 and 12 of FRS 102. However, this will make the revenue recognition on such instruments both more volatile and more complex than it is today. This will particularly affect instruments with features that are not measured at amortised cost in their entirety under either FRS 26, or Sections 11 and 12 of FRS 102 (e.g. investments in convertible debt). Retaining guidance on embedded derivatives would be consistent with the desire to simplify revenue recognition and therefore we suggest that, on balance, this should be retained.

#### **Question 11**

*Do you agree with the removal of aggregation?*

Yes, we agree that the segregated liability provisions will render this requirement in the IMA SORP unnecessary and encourage the FCA to consult on the amendment to its COLL in good time for publication of the final SORP.

#### **Question 12**

*What do you think would be the earliest feasible effective date?*

We believe that the proposed effective date of 1 January 2015 is suitable, provided that the IMA SORP is finalised and issued no later than March 2014. We suggest that early adoption of the revised SORP should also be permissible (once it has been finalised and any necessary amendments to the FCA's COLL sourcebook have been made) to enable funds to adopt FRS 102 early, if desired.

#### **Question 13**

*Which requirements need an earlier effective date?*

In our view, all of the requirements should be made effective from 1 January 2015, consistent with the effective date of FRS 102.

The exposure draft proposes that certain requirements should be effective for periods ending on or after 31 March 2014 – in other words, as soon as the revised SORP is in issue. These paragraphs are 2.25A, 2.64A 3.12A, 3.12B and 3.12C and the requirements relating to comparative tables – and broadly stem from changes to FCA rules and the introduction of ACSs. To that end:

- we are not convinced that funds reporting under existing UK GAAP will think to look to the 2014 SORP for accounting requirements. It may be more helpful if these changes are highlighted in a supplementary note for funds that are not planning to adopt FRS 102 early. Indeed, as the The Collective Investment in Transferable Securities (Contractual Scheme) Regulations 2013 came into effect on 5 June 2013, guidance responding to the introduction of ACSs could be required now. If these are included in the 2014 SORP and nowhere else then it will be important for the IMA and/or FCA to communicate their existence to affected funds; and
- the changes dependent on FCA rule change should take effect at the same time as those changes. In the event that these changes cannot be made by 31 March 2014, we would suggest that early adoption of the SORP (and hence of FRS 102) should only be permitted once these changes have been made. This avoids making piecemeal changes to accounting requirements which would introduce needless complexity. We are not aware of significant demand for early adoption of FRS 102 by authorised funds.

## Question 14

*Which requirements should be deferred?*

We do not believe that any requirements should be deferred, although we note that until the FCA has amended COLL as discussed in Question 11 above, the removal of aggregation would not take effect.

## Question 15

*Do you think the proposed SORP satisfies the requirements of FRS 102?*

In general, we consider that the requirements of FRS 102 are satisfied within the proposed SORP for an entity applying the provisions of Section 11 and 12 in full, but we have the following specific comments:

1. FRS 102 allows entities an accounting policy choice over the recognition and measurement requirements to apply for financial instruments. Under this policy choice an entity can choose to apply:
  - the provisions of Sections 11 and 12 in full; or
  - the recognition and measurement provisions of IAS 39 *Financial Instruments Recognition and Measurement* (as adopted for use in the EU) and the disclosure requirements of Sections 11 and 12; or
  - the recognition and measurement provisions of IFRS 9 *Financial Instruments* and IAS 39 (as amended by IFRS 9) and the disclosure requirements of Sections 11 and 12.

If it is the intention that all entities within the scope of the IMA SORP take the first option, this should be explicitly stated. However, if it is the intention to allow entities a free choice, some of the guidance in the IMA SORP may need to be amended, including that related to fair value which would need to be aligned with IFRS 13 for those entities applying IAS 39 or IFRS 9.

Restricting the options available to UK authorised funds would improve comparability between those funds. However, allowing the option to apply IAS 39 or IFRS 9 may improve comparability with funds reporting under IFRS, including comparable funds in other EEA member states.

2. The invitation to comment on the IMA SORP states that “The proposed SORP requires debt instruments to be designated as at fair value through profit or loss”. However:
  - we could not find an explicit requirement in the text of the proposed SORP in respect of debt instruments that are liabilities;
  - whilst the proposed SORP states that, on the asset side, all investments are to be valued at their fair value, it does not explain how this is to be achieved. In the absence of a designation, Sections 11 and 12 would require basic debt instruments to be measured at amortised cost. The requirement to make this designation should be made explicit; and
  - where this is to be achieved by designation, there may be an issue on transition to FRS 102 as (a) such a designation can only be made on initial recognition or

the date of transition to FRS 102 (which may be before the IMA SORP is finalised for some entities) and (b) designation at FVTPL under FRS 26 would not automatically result in continuing measurement at FVTPL under Sections 11 and 12 of FRS 102 following transition. The IMA should consider the need to allow retrospective designation following transition.

3. Compliance with the disclosure requirements set out in the IMA SORP will generally result in full compliance with the disclosure requirements of Sections 11, 12 and 34, but will not do so in all cases. For example, the invitation to comment suggests that the maturity profile of a fund's financial liabilities (as required by paragraph 34.28 of FRS 102) may not be useful information to users of financial statements. If the SORP is suggesting that it may be excluded, even though it is a requirement of FRS 102, it would be helpful if the SORP explained for which classes of funds this information might be immaterial – the only grounds on which an FRS 102 disclosure requirement might be omitted.
4. The disclosure requirement for the names and valuers of investment property to be given in the notes (currently within 2.19) could usefully be moved to 3.86 where the other disclosure requirements for investment property are shown.

#### **Question 16**

*Do you have any other comments on the proposed SORP?*

1. A master-feeder arrangement is defined as “An arrangement whereby a feeder invests at least 85% of its assets in a single master fund is a master-feeder arrangement”. We believe it is worth explaining where the remaining 15% should be invested. From our knowledge of the other guidance available in this respect, we understand that the remaining 15% should be invested in ancillary liquid assets or derivatives for hedging purpose or any other instruments essential for the business of feeder fund.
2. The definition of ‘fair value’ has been removed, yet is still used within the revised SORP. We suggest that the definition of fair value be reinstated. Depending on whether the SORP permits funds to adopt the recognition and measurement requirements of IAS 39 or IFRS 9 (see question 15 above), the definition would need to either:
  - be that in the Glossary to FRS 102 (for funds that are applying the requirements of Sections 11 and 12 in full); or
  - explain that the applicable definition is either that in the Glossary to FRS 102 or that in IFRS 13.
3. Paragraph 2.76 makes a reference to immovable property but it does not seem to be defined anywhere. We suggest that this may mean to refer to “investment property”.

4. Comparative tables: Paragraph 3.12A requires that figures in the comparative table should be expressed “per unit” basis. Although the definition of unit is currently set out in COLL, we suggest that further guidance could be provided as to how the number of units should be calculated for Authorised Contractual Schemes.
5. Above paragraph 3.12C, a requirement has been included to disclose Highest Unit Price or Lowest Unit Price. We suggest that further guidance could be provided for Authorised Contractual Schemes where unit prices are not calculated on a regular basis.
6. Paragraph 3.75 states that generally the authorised fund manager will not be regarded as a related party because it does not control, or have significant influence over, an authorised fund. This may not always be the case and we suggest that it may be more appropriate to require funds to consider the requirements of Section 33 of FRS 102 in determining whether or not the authorised fund manager is a related party based on the facts and circumstances.
7. Appendix III: AIII.5 suggests that disaggregation of the gains or losses into their realised and unrealised components can be shown in the notes. This is out of line with the AIFMD (Article 104) which requires the realised and unrealised components to be disclosed on the face of the income statement.
8. Paragraph 2.4 has been deleted without amendment to paragraph 2.5. In the absence of paragraph 2.4, which deals with the amount at which a transaction should be recognised at, it is not clear what the relevance of consideration is.
9. We believe that the drafting of the opening paragraph of 2.81 is unclear. This paragraph would be clearer if reordered and redrafted as follows:

“A puttable instrument is classified as equity if it meets the conditions set out in paragraph 22.4(a) of FRS 102. As the unitholders of authorised funds 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:

...”