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Dear Sirs

Invitation to comment on the Exposure Draft: SORP for UK Authorised Funds

Thank you for the opportunity to comment on the Exposure Draft for the revision of the Statement of Recommended Practice – Financial Statements of UK Authorised Funds ("the SORP ED/AF SORP").

We support the proposals in general with some specific areas of comment in this letter and in our responses to the Invitation to Comment questions are set out in Appendix 1.

We thank the SORP Working Party members and, in particular, the contribution by Mark Sherwin in delivering, for the industry, the proposals in the SORP ED.

We consider that there is an extensive range of stakeholders with an interest in the AF SORP, much wider than investors and fund managers, including: the Financial Conduct Authority ("FCA"), as the regulator of authorised funds ("AFs"); and HM Revenue & Customs ("HMRC") for whom the AF SORP is crucial to the taxation of investors in UK AFs. In addition HMRC uses the basis of accounting in the AF SORP to guide the reportable amount of in excess of 20,000 offshore fund share classes sold to UK investors. The point is that the AF SORP's utility extends considerably beyond financial reporting by UK AFs. The latest ED seeks to extend its scope, compared to prior AF SORPs, further into areas of regulation and investor information.

Accordingly, in commenting on the changes and proposals in the SORP ED we acknowledge that that this document, developed by the Investment Management Association ("IMA") for users, elects to go substantially further than solely recommending the application of FRS 102 for UK AFs. It has become and is further expanded into a multipurpose tool for the industry with a combination of financial reporting recommendations, regulatory, taxation, and investment performance requirements and reflecting to an extent the interconnected nature of these in authorised funds. For this reason we consider it important that the AF SORP identifies

for each paragraph the reference source be it: FRS 102; law and regulation; or industry guidelines/best practice.

It is also important that the AF SORP accurately reflects the substantially reduced text of FRS102 compared to the standards it replaces; consideration could be given to a text review to ensure the revised AF SORP is consistent with FRS 102 rather than its predecessor reporting standards.

We note that the SORP ED has elected to expand the AF SORP's role in the areas of regulation and investor reporting. That inevitably presents a challenge regarding the future maintenance/amendment of the AF SORP. Regulation and investor reporting will change to a different timetable to the FRC amending FRS 102 and that will necessitate the AF SORP having to be revised for reasons other than changes in relevant financial reporting requirements.

It is unclear how oversight of this will be delivered since revision of SORPs follows a due process set by the FRC and is expected when relevant financial reporting standards are amended. Does the IMA envisage a process of revising the AF SORP for changes in regulation or investor reporting? What role would the FRC have?

Accounting for debt securities

Our understanding is that FRS 102 has not diverged from an expectation that the interest return on debt securities is accounted for using the Effective Interest Rate ("EIR") method. FRS 102 remains consistent with FRS 26, though using reduced text. Since debt securities are held, and returned are recognised, at FVTP&L we accept that the "split" between capital and revenue may be considered presentational to accounting standards but is clearly a very significant matter to AFs, their revenue and distributions, and the taxation of investors.

It is certainly helpful that AFs have options in determining the interest revenue return from debt securities and in this regard we support that the SORP allows for the straight line amortisation of cash flows. However, we suggest it should be clear to preparers and users that this is an option that sits alongside accounting for debt using the EIR method and current EIR method and accounting systems can be retained. The approach adopted would be clear from the fund's accounting policy for debt securities.

Since UK domiciled funds have for some years run accounting systems to account for debt using the EIR method and allocate interest revenue using that method many would see change as costly with limited benefit. Rather, it appears, the greater benefit of the SORP ED's recommendation in this area is that straight line amortising of cash flows is often the accounting policy in offshore funds marketed in the UK with reporting fund share classes, including UCITS domiciled in the two principle European fund centres of Luxembourg and Ireland. The new option helps offshore fund reporting share classes to arrive at the "reportable amount" for UK investors without the need to consider adjustments in arriving at reportable amounts of revenue between straight line amortisation of cash flows and the EIR method.

It would be helpful if the AF SORP was clear that compliance with FRS 102 may be delivered by either method and for the IMA to confirm that current systems delivering the EIR method do not have to be amended.

Both methods have the same challenge with respect to identifying the expected cash flows to determine interest revenue, particularly where sub-investment grade debt or debt instruments with more complex features are acquired. Industry guidance will remain useful and we consider there is benefit in the existing IMA guidance documents (July 2006, May 2007 and February 2009) being consolidated and updated to support the revised AF SORP.

The composite role of the AF SORP

As noted, the AF SORP exists to deliver much more than the recommended practice for the industry in its application of FRS 102 to AFs. Its stakeholders expect it to deliver more than accounting and financial reporting, extending to the rules and options for distributions; regulation including risk management and reporting and a variety of information disclosures for investors; facilitating the taxation of investor returns as well as the fund; and now provision of proposed changes and additional information for investors on performance and charges on a share class basis via the AF SORP rather than regulation.

In meeting to the expectations of the stakeholders the content should be clearly flagged so as not to be confused with fund accounting. It will benefit all users for the AF SORP to identify the origin of its recommendations be they from FRS 102; FCA COLL; ESMA guidelines; EU legislation and regulation; or industry guidance.

This is also relevant to the many offshore fund share classes seeking to comply with the accounting principles of the AF SORP in determining the amount to be reported to investors. These offshore funds will not need to meet the disclosure requirements; the distribution rules; and certain law and regulation; or industry guidance, and paragraph identification will assist users.

Accounting policies and distribution policies

It would be useful if the AF SORP could be clear as to where its guidance relates to a fund's distribution policy as opposed to an accounting policy.

The current approach by AFMs is, typically, to combine in a single note the accounting and distribution policies and this increases the potential for confusion between the two.

The AF SORP could recommend that any note comprising both accounting and distribution policies sufficiently differentiates between the two, for example using separating headers.

Our specific responses to the invitation to comment questions are in the appendix to this letter; however we make the following additional comments:

1 Discontinuing the requirement for the aggregated financial statements

We support this proposal.

It is recognised that the aggregate is a construct that has never had utility for investors but that, while the concept of contagion existed, albeit highly remote, there could be argued that creditors of an OEIC may have found utility in the aggregation of sub-funds.

There has also been some confusion for umbrella unit trusts as to the need for an aggregation and this change should eliminate that.

We agree that once an umbrella OEIC is operating as a protected cell company the aggregate could be dispensed with provided that FCA COLL has been amended. The FCA should acknowledge that all OEICs are constituted as a legal entity but where they operate with segregated compartments/cells/funds that the entity is not required to prepare financial statements. The FCA's consultation on amending COLL should also address any issues arising from the Open-Ended Investment Companies Regulations 2001.

The FCA could also clarify that when a series of trusts are set up under a common trust deed this does not create an overarching trust; each trust is legally distinct and "ring-fenced" by the trustee and should be reported separately to unitholders. The trusts should not be aggregated in the annual report but may be bound in a single document for the efficient delivery of the annual reports and financial statements of the trusts.

Since the FCA is on the SORP Working Party, we understand that it is minded to consult and make amendment in 2014.

We raise a more general point with this approach, since the appearance is that the SORP ED is initiating rather than following what should have been a regulatory change that the FCA addressed when introducing the protected cell regime ("PCR").

There is a risk that this and other changes proposed in the SORP ED (e.g. the new comparative tables) are not addressed in the same way by a changes in COLL or that the change of COLL is delayed. The AF SORP could need to be revised after publication.

In summary, while the industry is right to represent to the FCA that it should revise COLL, the AF SORP should follow not lead the change and should limit itself to accounting and financial reporting and directly related efficiencies. Other disclosures should be dealt with through the amendment of COLL and where appropriate, FCA approved industry guidance.

2 New comparative tables of performance and charges

We support the principle and goals of the additional disclosures; however, as discussed above we do not consider the AF SORP is the most appropriate place for these recommendations. It should be FCA COLL Rules supported by FCA approved industry guidance.

If the new comparative tables remain within the AF SORP, we think that more reassurance would be provided if the comparative tables were subject to some form of attestation. However for that to happen there would need to be an agreed approach to performing the calculations codified so that auditors could refer to them as a basis of preparation in their report. That guidance would also enhance consistency of calculation improving comparability. For that reason we believe that the IMA should consult on and provide relevant industry guidance prior to implementation.

We support the IMA in seeking to improve the quality and relevance of information provided to investors to connect performance and the costs of delivering that performance on a share class basis.

It is increasingly important, with the advent of funds with many share classes, that the investor is able to access the information relevant to his/her investment in one place in a clear and relevant format. For the investor in a share class, it could be considered that the fund's audited financial statements are now simply a backdrop to the share class performance and charges.

We consider that all the information required for the comparative tables can be generated from existing data however to do this systematically as opposed to using a manual work-around will take some time to deliver. Systematic delivery of these tables is not expected to be in place at fund administrators by 1 April 2014. While that should not be a reason to delay implementation it will initially increase the time, cost and process risk management to deliver these new tables.

Clearly the FCA must amend COLL to affect these disclosures and the approach adopted does leave the AF SORP exposed to future events outside the direct control of the IMA.

This has additional relevance since costs and charges and their disclosure are the subject of a FCA review which it has said will take the remainder of 2013. The conclusions of that FCA work may colour its expectations of disclosures and widen its consultation and expectations on future disclosures. A wider scope FCA consultation on fund charges and disclosure may mean that the current proposals need to be amended or the FCA's agreement to these tables is delayed. This could present a significant challenge given the due process for amending a SORP.

One of the headline messages at the asset management conference on 30 October was that the FCA was concerned at the use of investors money spent on brokerage commissions being used for services that should be paid for by the manager from its charges. The disclosure expectations of the FCA after it completes its review and consults may not be delivered by the current proposed table on in 3.12C. Embedding this in the AF SORP rather than in COLL as it is at present means the AF SORP could have to be amended.

On balance, therefore, we consider that these new comparative tables would be better dealt with through FCA consultation; FCA Guidance and, if appropriate, FCA approved industry guidance delivered in parallel with revision of COLL.

That should not necessarily delay implementation of enhanced disclosures; indeed it could deliver the industry proposal sooner and would retain greater flexibility in the future. Future flexibility is particularly pertinent as the FCA and European Commission continue to explore the disclosure of performance, charges to investors and what investors' money is used to purchase.

3 Accounting for investments in fiscally transparent entities (tax transparent funds) ("FTEs")

We agree that the investment of a feeder fund into a fiscally transparent master fund should be on the basis proposed in paragraphs 2.25A and 2.64A. A feeder fund will have a feeder-master agreement which means the feeder will have a right and access to receive the information required to deliver the accounting recommendation.

However, an AF may invest in a diversified pool of assets including other funds and those other funds could be FTEs. Investment in an FTE does not establish the right to require the FTE to provide the information to support the recommendations of 2.25A and 2.64A.

Accordingly, we do not consider that all investments in FTEs will be capable of accounting for revenue as earned (2.25A) and expenses as they arise (2.64A) in the FTE (a "look through" basis for revenue and expense recognition).

If "look through" were to be required for revenue and expenses for all investments in FTEs this could constrain the available investments for AFs and/or disproportionately increase the costs of administration of investments in FTEs.

The proposed paragraphs 2.25A and 2.64A should be subject to the judgement of the manager taking into account the cost and capacity to obtain and recognise revenue and expenses as they arise in the FTE. The actual manner by which certain FTEs meet the tax information requirements of UK investors including funds also varies and certain information provision meets taxation requirements but is not at the level of detail or frequency envisaged by the SORP ED.

Authorised fund managers ("AFM") perform due diligence on all assets to determine the characteristics of the asset and how it will be taxed in ownership by the fund. The accounting should not be required to follow the tax treatment of an asset. Deferred tax and tax provisioning supports differential treatment of items for accounting and taxation and this should be allowed for in the case of investments in FTEs. Accordingly, paragraphs 2.25A and 2.64A should only apply where the FTE is a master fund in a master-feeder structure, otherwise their application should be for the judgement of the AFM taking into account available information and cost/benefit and assessing the impact on the tax provision and any requirement for deferred tax.

4 Accounting for debt securities

We support that the AF SORP should allow for the option of straight line amortisation of the expected cash flows on a debt security but not exclude use of the effective interest method as explained above.

5 Defining realised and unrealised gains and losses

We understand the rational of the AF SORP defining realised and unrealised gains and we appreciate the difficulty of the SORP working party in reaching a firm conclusion.

An initial reaction could be support proposal "B" that for securities that meet "conditions" regarding ready realisation into cash should be treated as "realised/realisable" gains. However while that may meet the Companies Act definition we have difficulties with this in that the proposal appears to restrict the "unrealised/not readily realisable" gains to securities valued using unobservable inputs.

The proposal to limit unrealised amounts to asset values which depend on unobservable inputs appears too narrow and unrealised/not readily realisable gains should include assets that cannot be readily converted into cash. Property would be a prime example but it could apply to a range of assets that have constraints on liquidity including investments in funds and derivatives.

This requirement to determine the liquidity of an asset presents an administrative burden. We are concerned that unless there is more guidance there will be inconsistency in what is reported as realised and unrealised.

Of course such guidance exists under the Companies Act but that has been prepared for the purpose of determining distributable profits which is not relevant to UK AFs which are not permitted to distribute gains and losses whether realised or not.

In addition option B would seem to move away from the generally accepted definition of a realised gain by investors and tax authorities. While the UK tax authorities do not tax the capital gain on a unit whether realised or unrealised this is not the case universally and while the UK financial accounting cannot be expected to meet multiple tax reporting requirements there is a concern that a change from the traditional definition of realised and unrealised to "realised and readily realisable" versus "unrealised and not readily realisable" could be confusing for investors and not accord with their expectations or those of certain tax authorities.

So while there are some merits in B there are also complexities, operational costs and a significantly greater risk of different interpretation and therefore inconsistent treatment.

Unless there is guidance in the AF SORP including objective measures of "readily realisable into cash" which would have to be considered for each asset then there will be inconsistency and potential misunderstanding for investors between that which is reported as a "realised/realisable". Without full and objective guidance on the operation of option B and

assessment of the costs of option B, we consider the traditional basis of recognition of gains and losses, option A, as preferable.

If there are any aspects of this letter you would like to discuss please contact Gareth Horner (gareth.horner@kpmg.co.uk 0131 527 6951) or Paul Taylor (paul.taylor@kpmg.co.uk 0207 311 5116).

Yours faithfully

KPMG LLP

Appendix 1: KPMG responses to the questions raised in the invitation to comment

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Q1 *How many funds do you expect to have significant numbers of instruments that are valued using unobservable inputs?*

We observe a very low proportion of assets by number and value with unobservable inputs in the valuation technique for UCITS and NURS. The QIS fund is a different case, but this fund type remains only about 1% of Authorised Funds. However, to support a wide range of assets the AF SORP should reflect that such assets are eligible and arise.

Q2 *Do you have systems or processes in place to support the IFRS reporting levels?*

As auditors, our observation is that fund administrators have established systems to meet the valuation levels set by IFRS.

Q3 *Do you agree that the SORP's emphasis justifies the additional disclosure category for unobservable inputs? If not please explain why.*

Yes. It is clearly relevant to an investor the extent to which the valuation of assets uses unobservable inputs determined by the Authorised Fund Manager. It is important and appropriate to separately identify these assets from assets valued using observable inputs.

Q4 *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?*

We agree with the generic approach. There should be consistency as far as possible between UCITS and non-UCITS, in particular since for UK AFs both UCITS and NURS are established, operated and regulated in a comparable manner for retail investors.

Q5 *Do you agree with the integrated approach of using a single set of disclosures to satisfy the regulatory and accounting requirements?*

We agree this approach because the Authorised Fund owes its existence to regulation. Therefore it is reasonable that while going beyond FRS 102 a composite recommendation that addresses both regulation and financial reporting disclosures is the appropriate approach, and that this delivers a cohesive report of risks and management of those risks consistent with the nature of the AF and the manner it was distributed to/acquired by the investor.

Q6 *Do you think the SORP should define realised and unrealised gains/losses for non-UCITS funds?*

We do not see the need for separating realised and unrealised gains, however consequent upon the AIFMD realised and unrealised gains will need to be reported for AIFs and approximately 20% of UK AFs are AIFs (the vast majority being NURSs with a small number of QISs). The AF SORP should support that with definitions; however, as discussed above, it appears that the definition of an unrealised gain is too narrowly drawn if this is restricted to assets valued using unobservable inputs.

Q7 *If so, should it use definition A, B or something else?*

As discussed in our letter above we see some merits in B, however, we do not see that ICAEW Tech 02/10 has direct relevance since UK AFs are not permitted to distribute gains whether assessed as realised or not. In addition, unless there is clarity as to "readily realised into cash" through definition and objective guidance we are concerned that option B could overstate the realised gains on less liquid assets and have inconsistency in its application.

We are also concerned that option B could increase fund costs without benefits.

In absence of expanding the definition and recommended practice around option B and an assessment of the cost/benefit it would be preferable to use option A. This may be less than ideal but would be more consistently understood and applied and is expected to have lower incremental costs in existing systems.

Q8 *Do you think the proposals will help investors better understand the performance and costs? If not, please suggest how it might be improved.*

These disclosures should provide useful information for an investor that has held a unit throughout the period.

The means of an investor receiving/obtaining this information is, however, beyond the scope of the AF SORP. Clearly the requirement of the FCA is for delivery of the Short Report, and even in that case the FCA has yet to decide on the required distribution of the Short Report to units held in nominee accounts. The FCA will need to consult on how this information will be included in its Short Report which is outside the scope of the AF SORP.

The general commentary is that these disclosures may typically be brought to the attention of investors through the website of the manager; platforms and comparison sites etc.

The use of pence per unit alone without percentages may make it harder for investors to compare units between funds with different unit prices.

Q9 *Are there any aspect of the proposals that you think will be particularly troublesome to produce?*

There should not be as all the information exists or can be calculated from available data. As we note in our letter the concerns are:

i. This requires FCA approval and amendment of COLL at a time that coincides with a more general examination by the FCA of costs and charges and the use of brokerage commissions. Recent announcements by the FCA indicate it may come up with proposals that necessitate further consideration of what is proposed after the AF SORP has been reissued. Taking these proposals outside the AF SORP and back into the COLL Rules where the existing comparative tables reside would remove this problem.

ii. The European Commission has initiatives such as PRIPs which may see the demise of the KIID and amendment of the OCF.
These factors support our concern that the AF SORP is not be the ideal place for implementing regulatory disclosures, particularly when one has regard to the FRC's due processes for delivery of SORP revisions.
FCA COLL amendment supported by industry guidance reviewed by the FCA could be a better and more flexible approach.

iii. Wherever specified, the new comparative tables should be supported by industry guidance and worked examples to achieve consistent and comparable application from the outset.

iv. In our discussions, there is a concern that the unit performance "*Total return before charges*" is a balancing figure.

v. While the table of operating charges will include the "*charges made in underlying schemes*" and so agree to the OCF in the KIID (provided this is on an ex-post basis), then this would not agree to the "Operating charges" in the table above. Guidance could assist achieving consistency in this area.

vi. We consider that there could be a variety of interpretations and variation in the "*Amounts recovered on units issued and cancelled*" in the fund level table of transaction costs. The footnote indication of "*relevant proportions*" could be inconsistently interpreted. It has even been suggested that, depending on this adjustment, a negative transaction costs total could arise. The SORP ED does not express sufficiently clearly that the adjustment should not include market spread – this may seem obvious but differing assumptions could materially distort the resultant reduction. The industry should develop guidance and worked examples including dealing with areas such as; market spread; in specie transactions; conversions and switches; dilution levies and dilution adjustments.

Q10 *Do you agree with the simplification of the principles for recognising revenue from debt securities?*

Yes, provided this is an option and not the only permitted approach. However, the SORP ED does appear to imply that FRS 102 no longer supports the effective interest method which is not the case. FRS 102 11.14(a) is clear. That the recommendation of the SORP allowing for straight line amortisation of cash flows as an option to deliver the separation of the returns between revenue and capital is reasonable provided this is alongside the option of the effective interest method and enable the existing EIR method systems to continue to be used.. Please see our comment in the letter above.

Q11 *Do you agree with the removal of the aggregation?*

Yes, please see our comment in the letter above.

In addition it should be a condition that the PCR regime has been adopted by the umbrella OEIC, while the vast majority of umbrella OEICs will have adopted the PCR regime and given notice to the FCA by 21November 2013, an AFM could apply for an extension to 21 November 2014 or beyond in specified circumstances.

Q12 *What do you think is the earliest feasible effective date?*

Reflecting that the IMA expects to issue the revised AF SORP towards the end of March 2014, the earliest required date should be 1 January 2015, aligned with FRS 102. Early adoption should be an option.

However, the AF SORP combines certain disclosures arising from regulation with financial reporting and certain regulatory disclosures required in financial statements are already in force, in effect, the AF SORP is catching up. Accordingly, those disclosures, already subject to ESMA guidelines and Q&A and IMA/DATA guidance, must be adopted to the regulatory timetable not a timetable prescribed by the AF SORP.

This multiple disclosure role has become an inherent feature of the AF SORP, with it recommending both accounting and regulatory requirements. Inevitably regulations will arise that must be adopted without AF SORP revision and this will depend on the IMA (and DATA) continuing to provide guidance on a public rather than member only basis.

Q13 *Which requirements need an earlier effective date?*

No financial reporting requirements should have an earlier date imposed than that of FRS 102. In umbrella structures any adoption, including early adoption, should be consistent across all sub-funds of the umbrella.

The IMA seeks an early application date for the new comparative tables, and it has proposed accounting periods ending after 31 March 2014. While it is important that the industry takes the initiative on high quality, relevant and comparable disclosures on performance and all charges, with the AF SORP unlikely to be issued in final until March 2014 this presents a challenge for implementation. In addition the FCA must consult and amend COLL for these new comparative tables which will take time as it has due process to follow.

We do not consider there is information that cannot be generated from the pricing; dealing; and accounting records but these tables will require systems developments to generate the tables "systematically" and that could require some time and cost by fund administration. In the intervening period the use of spreadsheets or other processes to generate the tables may be more time consuming with greater cost.

These factors would suggest that the adoption of the new comparative tables may have to be deferred to a date that the FCA agrees them and has consulted and revised the COLL sourcebook, and, prospectively, the FUND sourcebook. Both the COLL to FUND integration project and the FCA review of charges and use of brokerage commissions may delay the FCA's amendment of COLL and therefore the adoption of new comparative tables.

Q14 *Which requirements should be deferred?*

None.

Q15 *Do you think the proposed SORP satisfies the requirements of FRS 102?*

The AF SORP cannot satisfy all the requirements of FRS 102 which is a much more wide ranging document. FRS 102 should remain the primary reference document.

Q16 *Do you have any other comments on the proposed SORP?*

Please see out comments in the letter above, particularly regarding the accounting for Fiscally Transparent Entities ("FTEs").

We would have preferred to have seen the removal of the paragraphs 2.70 and 2.71 since the marginal relief paragraphs reflected when capital and revenue were quite distinct. The two new sentences at the end of paragraph 3.60 help as regards distributions not being artificially distorted by marginal relief between revenue and capital, if these paragraphs are retained, it could help users if a connection is made between paragraphs 2.70/2.71 and the expanded paragraph 3.60.