

FINANCIAL SERVICES

Statement of Recommended Practice for the financial statements of authorised funds (IMA SORP 2008)



The new SORP document

The IMA SORP 2008, issued on the 10 November 2008, replaces the SORP 2005 and is applicable to accounting periods beginning on or after 1 January 2009. The main changes and areas of particular interest are summarised below.

Contents of reports

The new SORP document

Half-yearly report

The overall presentation within the new SORP document has changed making it easier to read.

Consolidation

The accounting principles and the contents of the report are separated into different sections of the SORP. References to the relevant Accounting Standard/FSA rule and COLL have been made throughout the document.

Income

The illustrative accounts have been removed and the FSA rules are no longer appended.

Derivatives Income

Contents of reports

Risk management policies and risk disclosures

Whilst the portfolio statement still is a mandatory content of the annual and half-yearly reports, respectively, it is no longer part of the financial statements. No changes have been made to the form or content of the portfolio statement and it is still required to agree to the balance sheet total. (IMA SORP 2008 3.5).

Financial instruments

Derivatives

- The annual financial statements should contain (IMA SORP 2008 3.26):
- Statement of total return;
- Statement of changes in net assets attributable to unit holders;
- Balance sheet;
- Statement of cash-flow, unless the authorised fund qualify for exemption; and
- Notes to the financial statements

Effective interest calculation

Statement of cash-flow represents an additional requirement to those of the previous SORP. Authorised funds meeting the following conditions qualify for exemption (IMA SORP 3.50):

- substantially all investments are highly liquid and carried at fair value, considering the nature of the investment and the prevailing market conditions; and
- the entity provides a statement of change in net assets.

A summary of material portfolio changes is no longer a required content of the annual report or the financial statements. (IMA SORP 2008 3.5)

There is a new requirement to calculate and disclose the portfolio turnover with comparatives in the annual and half-yearly report. COLL 4 annex 2R provides guidance for the calculation. (IMA SORP 2008 3.5)

FINANCIAL SERVICES

Statement of Recommended Practice for the financial statements of authorised funds (IMA SORP 2008)

Half-yearly report

There is a new section setting out the required contents of the interim financial statements, which form part of the half-yearly report. (IMA SORP 2008 3.9) The interim financial statements are a condensed version of the annual financial statements and should contain (IMA SORP 2008 3.29):

- Statement of total return;
- Statement of changes in net assets attributable to unitholders;
- Balance sheet; and
- Statement of cash-flow, unless the authorised fund qualify for exemption

There are no specific requirements for notes in the interim financial statements.(IMA SORP 2008 3.32)

Comparative amounts should be provided as follows (IMA SORP 2008 3.30):

- the balance sheet as at the end of the preceding financial year; and
- the equivalent statements for the same half-yearly period of the preceding financial year.

Unless there have been a change during the interim period there should also be a statement that the interim financial statements are prepared on the basis of the accounting policies set out in the most recent set of annual financial statements. (IMA SORP 2008 3.31)

Consolidation

Following the introduction on new rules in December 2007 authorised funds are allowed to invest in overseas real estate via intermediate holding vehicles. This will usually be a wholly owned subsidiary making the fund a parent of a group. A section in the new SORP sets out the principles for preparation of consolidated accounts (2.76-2.80).

Income revenue vs capital (IMA SORP 2008 section 2)

The new SORP makes a distinction between revenue and capital, to be separately disclosed under Income in the Statement of total return.

Revenue includes items such as dividend, interest, fees, rent. Capital is other gains/losses from holding investments, for example revaluation. The appropriate treatment for each item of income is set out in section Income of the new SORP.

Derivatives Income

The treatment of returns on derivatives depends on the nature of the transaction, considering both motives and circumstances. In summary:

- Returns from positions undertaken to protect or enhance capital are capital.
- Returns from positions to generate or protect revenue are revenue.

This represents no change to the existing principle for recognition of returns as income property or capital property. However, the guidance provided in the new SORP has been expanded to reflect the increased diversity of derivative strategies. For example reference is made to situations where positions generate total returns where it will generally be appropriate to apportion between capital and revenue.

FINANCIAL SERVICES

Statement of Recommended Practice for the financial statements of authorised funds (IMA SORP 2008)

(IMA SORP 2008 2.26-2.27)

Risk management policies and risk disclosures

Financial instruments

Authorised fund managers should ensure that suitable narrative and numerical risk disclosures are provided.

The following disclosure requirements were set out in the previous SORP:

- Explanation of the different types of risk arising in connection with financial instruments;
- The significance to the fund;
- Objectives and policies for holding financial instruments; and
- How the risks are managed.

In addition the new SORP sets out the following disclosure requirements (IMA SORP 2008 3.64 – 3.67, 3.78-3.81):

- The procedures used to manage the respective risks;
- Significant changes with regards to risk from the disclosures of previous year and an explanation for the reason;
- Numerical analysis where the exposure of a particular risk is significant, taking into consideration the nature of the investment and the prevailing market conditions.
- If no numerical disclosure is provided on grounds of significance, this needs to be stated.
- The numerical disclosure of interest rate should include the benchmark rates for determining interest payments for floating rate instruments

Derivatives

- The need for disclosure of sensitivity and risk should be proportional to the volume and sophistication of the use of derivatives. The new SORP recommends that disclosures should be made using tools being used as part of the derivative risk management process established by managers to fulfill their regulatory obligation. Methods and assumptions used should be described.
- For sophisticated funds the impact of market changes should be determined by using a value at risk technique or another appropriate robust model.

(IMA SORP 2008 3.82)

The new SORP was developed on the basis that authorised funds will not apply FRS 29 voluntarily. Consequently the requirements of FRS 13 continue to apply.

Should FRS 29 be adopted at a later stage the main addition to the SORP would be to extend the requirement for sensitivity analysis to all types of financial instruments. Most commonly for authorised funds this would require analysis of the impact of changes in interest, exchange rates and market prices.

Effective interest calculation

The principles that interest from debt securities should be calculated using the effective interest rate

FINANCIAL SERVICES

Statement of Recommended Practice for the financial statements of authorised funds (IMA SORP 2008)

calculation by reference to the initial purchase cost is still applicable. However, further guidance has been incorporated into the new

SORP covering situations such as securities with embedded derivatives, denominated in foreign currency, floating rate or variable maturity. (IMA SORP 2008 2.36-2.50).

Specific advice should be obtained before taking action, or refraining from taking action, on any of the subjects covered

LONDON

10 Orange Street
Haymarket
London
WC2H 7DQ

T +44 (0)20 7312 0000
F +44(0)20 7312 0022
E advice@shipleys.com

GODALMING

3 Godalming Business Centre
Woolsack Way
Godalming
Surrey
GU7 1XW

T +44 (0)1483 423607
F +44 (0)1483 426079
E godalming@shipleys.com

SAFFRON WALDEN

Market House
10 Market Walk
Saffron Walden
Essex
CB10 1JZ

T +44 (0)1799 521301
F +44 (0)1799 523854
E saffron@shipleys.com

BIRMINGHAM

2nd Floor
3 Brindley Place
Birmingham
B1 2JB

T +44 (0)121 698 8566
F +44 (0)121 698 8600
E birmingham@shipleys.com



Shipleys is a member of AGN International, a worldwide association of separate and independent accounting and consulting firms.

Registered to carry on audit work and regulated for a range of investment business activities by the Institute of Chartered Accountants in England & Wales.

© Shipleys LLP 2009 02