

# Authorised investment funds technical release

October 2011

## What's new in financial reporting for 2011?

In this latest technical release we summarise some of the main financial reporting developments for 2011 which affect authorised funds. Following the implementation of the 2010 SORP, this year sees fewer changes to accounting requirements. Compared to the on-going changes within the regulatory regime, the general UK accounting environment continues to be relatively static, and it is likely to remain largely that way until the debate on the future of UK GAAP reaches a final conclusion.

There are however some financial reporting changes arising from the implementation of UCITS IV, and the transition to the reporting funds regime will continue to affect UK funds investing in offshore funds. Looking further ahead, there have been some unexpected twists and turns with the ASB's proposals for UK GAAP and these plans have again been deferred.

### Funds investing in offshore funds

In our view one of the principal financial reporting issues in the coming year will relate to the implementation of HMRC's reporting funds regime. The distributor status regime was replaced by equivalent reporting fund rules from 1 December 2009, and although there were transitional arrangements in place, some offshore funds have started to report income and their number will grow as the transitional provisions continue to unwind. UK funds investing in offshore funds will therefore need to make sure that they are accounting for income reported by funds in the new regime. Some offshore funds may also report equalisation.

The IMA has published guidance which indicates that reported income should be accounted for not later than the date when the reporting fund makes its report available to investors. This gives some flexibility to funds wishing to account for the income on an estimated basis and then adjust this when reported income is known, where the manager considers that the circumstances warrant this approach.

Other funds may consider it appropriate to bring the income into account when it is reported.

Following recent changes to tax regulations, it is possible for a fund with a holding in a non-reporting fund to choose to compute 'deemed' reportable income, in order that the holding may be treated as if it were a reporting fund. Whilst a fund investing in offshore reporting funds will record reported income as revenue (following the SORP), in our view deemed reportable income on a non-reporting fund will, following COLL, be reflected instead as a distribution adjustment in the financial statements. Deemed reportable income is however likely to arise relatively rarely in practice.

So far as UK Funds Investing in Non-Reporting Offshore Funds are concerned, the risk of such a fund inadvertently becoming a FINROF for tax purposes has reduced somewhat following HMRC's decision to raise the threshold for automatic FINROF status from 20% to 50%. Nonetheless failure to identify where a fund has become, or has invested in, a FINROF could still harbour tax provisioning pitfalls.

### COLL changes – UCITS IV

UCITS IV had to be implemented into UK law and regulation by 1 July 2011. Whilst this has resulted in extensive new material being introduced into COLL, relatively little of this affects financial reporting. Changes to UCITS fund reports include:

- disclosure of the new synthetic risk and reward indicator (SRRI) and any changes to this;
- disclosure of the new ongoing charges figure (OCF), which replaces the TER in both annual and half yearly reports.

These changes coincide with the introduction of the new key investor information document (KIID) which contains similar disclosures. The disclosures will apply also to certain non-UCITS retail schemes, where the manager has applied to

the FSA for consent to produce a NURS KIID (an equivalent document to the UCITS KIID).

There are additional, more specific, reporting changes following the introduction of UCITS master/feeder structures. COLL is largely silent on the form and content of master and feeder accounts and this will be something for the SORP to address. COLL does however require that UCITS feeder funds must disclose how the reports of master funds can be obtained and must disclose the aggregate charges of the overall structure. COLL also states that the manager of a feeder must file copies of the annual and half yearly long reports of the master with the FSA and must provide these to investors when requested. COLL does not consider any of the accounting ramifications in relation to situations where consolidated accounts may be required and again this is a matter where there will need to be further consideration given. The IASB are currently consulting on a possible consolidation exemption for investment entities under IFRS and if this goes ahead, something similar may come onto the agenda for UK GAAP.

### **COLL changes – termination accounts**

Following the completion of its consultation on termination reports, the FSA's proposals to introduce termination accounts for unit trusts (to align them with OEICs) did not go ahead. However, with effect from 6 March 2011 the timescale for completing OEIC termination accounts or final unit trust accounts has been extended from two months to four months.

### **The future shape of UK GAAP**

The surprise package of the summer has been the announcement by the ASB that it plans to significantly revise its proposed model for UK GAAP. Until now, the plan had been that publicly accountable entities, including authorised funds, would be required to follow IFRS and that this would take effect from 2013.

Changes in the political climate have significantly altered the apparent UK appetite for extending IFRS to entities beyond those for whom it is obligatory under EU law, and this has brought about an eleventh hour reprieve. The ASB has announced that it intends to remove the proposed requirements for publicly accountable entities, and this would leave such entities to follow the so called FRSME (Financial Reporting Standard for Medium-sized Entities). In general, this would mean that the further application of IFRS to entities in the UK would be a matter to be determined by company law and regulatory bodies (for example listing authorities or the FSA).

Subject to this, the ASB is faced with the situation that the FRSME may have to be applied by many entities for which it was never intended, including authorised funds. The

new focus of the ASB's project is therefore to identify areas where the FRSME will need to be enhanced or upgraded. Another possibility is that, in order to keep the FRSME manageable, some of the tailoring could be dealt with by the SORP. SORPs can be expected to remain supplementary to accounting standards in any revised framework, but given the relatively basic nature of the FRSME, suddenly the role of SORPs appears to become more critical in the eyes of the ASB. Ironically, it is only two years since the ASB had proposed their abolition.

The FRSME itself is largely based on the IASB's IFRS for SMEs, which is in turn a simplified version of full IFRS. Broadly speaking it embodies IFRS measurement principles but contains only around 10% of the disclosure requirements applicable under full IFRS. Financial instruments disclosure is therefore one of the principal areas where the ASB believes that the FRSME will need to be expanded and this is currently under consideration. These disclosures will be based on existing IFRS 7. Whilst one hopes that these will have regard more to the basic principles of IFRS 7 rather than the detail, it remains to be seen as to how this will play out.

In view of the amount of work required to redraft the FRSME, the ASB will issue a revised exposure draft of its proposals towards the end of 2011 or early in 2012. The effective date of any changes has therefore been pushed back from 1 July 2013 to 1 January 2014, although even this revised timetable is challenging as it would require the final standards to be published by the end of June 2012 in order for it to be achieved.

### **Contact us**

If you would like to discuss any of the matters raised in this release further, please contact one of our authorised funds experts listed below.



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