

# AN INTRODUCTION TO FUND ACCOUNTING

## 2-Day Workshop

### BACKGROUND

Managers, Administrators and Depositaries all have responsibilities for ensuring that funds are fairly and accurately priced. They face increasing challenges and complexity due to the asset classes being invested into and the range of shareclasses being made available. Asset illiquidity has been a particular challenge in the last year, causing Managers to revisit their fair valuation and dilution policies.

At the same time, there are increased expectations for cost efficiency, improved risk management and control processes, for improved governance and delivery of process efficiency.

### OBJECTIVES

The purpose of this two day workshop is to give delegates a thorough understanding of the key elements of the Fund NAV calculation and of shareclass accounting. In addition, delegates will gain an appreciation of the key risks involved and also of the key controls that should be in place and how they can detect and prevent from costly error.

There is also a focus on the need for efficient processes and effective governance and oversight to meet the needs of Boards, Managers, Trustees, Auditors and other stakeholders.

### CONTENTS

- Introduction to Fund Valuation
- Difficult to Price Securities
- Dilution Levies and Swinging Pricing
- Shareclass Accounting
- Effective Risk Control Environments
- Effective Yield
- Performance Fees
- Fair Valuation Techniques
- Derivatives
- Pricing Errors
- Taxation
- Report & Accounts

### 1. INTRODUCTION TO FUND VALUATION

In our first session we introduce all the elements that go to making up the net asset valuation (NAV) of the fund and the challenges faced as regards fair and accurate valuation. This includes:

- Key components of the NAV
- Income and Expense accruals
- Taxation
- Dual and Single Pricing
- Forward pricing principles
- Valuation point and frequency
- FSA expectations on the control environment

### 2. DIFFICULT TO PRICE SECURITIES

Managers need to have robust controls over the fair and accurate valuation of difficult to price securities. This has been a particular challenge in the past year as previously liquid asset classes suffered from illiquid and lack of price transparency. Here we consider how the Manager can effectively respond to these challenges.

- Identifying difficult to price securities
- Techniques for valuing illiquid debt instruments
- Illiquid, suspended and unquoted securities
- Asset backed and mortgaged backed securities
- OTC Derivatives
- Key controls and oversight arrangements

### 3. DILUTION LEVIES AND SWINGING PRICING

Single priced funds can experience a dilution effect from investor dealing. To combat this, Managers need to develop effective responses in the form of dilution levy or dilution adjustments (single swinging pricing). In this session, we consider how dilution occurs and the steps Managers should take to prevent dilution.

- How dilution occurs
- Dilution levies vs. dilution adjustments
- Developing an effective dilution policy
- Dealing fairly with institutional and retail investors
- Dilution as a protection from market timing

#### 4. SHARE CLASS ACCOUNTING

Multiple share class refers to different classes of share or unit in a fund. Share classes include income distribution shares, accumulation shares, institutional and retail shares. Each share class will have a unique characteristic such as a different fee structure or distribution policy. In this session we explain using the accounting treatment required for multiple shareclasses.

- Why different shareclasses
- Apportionment of capital and income
- Monitoring for shareclass price divergence
- Currency hedging at class level
- Controls over shareclass accounting

#### 5. EFFECTIVE CONTROL ENVIRONMENTS

In this session, we consider the key risks in the fund accounting process and the control arrangements that Managers should have in place in order to have assurance that funds are fairly and accurately priced. This sessions will enable Managers to benchmark their own arrangements against best practice. This includes:

- Controls over valuation of individual securities
- Controls over Income and Expense Accruals
- Tax balances
- Daily Fund level checks
- Higher level periodic checks

#### 6. EFFECTIVE YIELD

For periods beginning on or after 1 January 2007 funds are required to account for income from bonds on an “effective yield” basis, although Managers may choose to distribute income on either an “effective yield” basis or “coupon basis.”

- Key features of effective yield accounting
- The choice between effective yield basis or coupon basis for distributions
- Illustrative calculations
- Practical challenges with effective yield

#### 7. PERFORMANCE FEES

A properly designed performance fee should be of benefit to the manager and to investors but ill-conceived structures can achieve the exact opposite and incur significant administrative complexity and cost. In this session we consider how Managers can address these challenges and opportunities, including:

- Approaches to calculating performance fees
- The use of target benchmarks and hurdle rates
- Internal procedures and controls to support performance fees
- Clear and simple explanations for investors
- Expectations of Depositories
- Alternatives to performance fees

#### 8. FAIR VALUATION TECHNIQUES

There are numerous scenarios when FVP may need to be applied, including where the markets invested into are closed at the time the fund is valued, market suspensions, holidays, corporate activity and default. Managers need to have robust systems and controls to enable fair valuation of the funds. We consider a number of issues, including:

- When Fair Value Pricing may be needed
- Why FVP is required and how it protects investors
- Approaches to applying Fair Valuation
- International best practice on fair valuation
- Controls and governance over FVP
- Developing your FVP Policy
- Avoiding the need to FVP

#### 9. DERIVATIVES

Derivatives cause particular challenges as regards fund accounting, often requiring manual process and work-arounds which in turn bring their own risks. Here we consider these challenges and responses to these challenges. This includes:

- Trade capture, processing and data maintenance
- Marking to Market vs. Marking to Model
- The impact of liquidity on pricing
- Using pricing models
- Key controls and Regulator’s expectations re. derivatives pricing
- Accounting for derivatives as capital or income, depending on motive and circumstances.

#### 10. PRICING ERRORS

The Regulations provide for the compensation of material pricing errors. This can often be a complex exercise, which places strain on outsourced relationships and where the internal administrative costs far exceed the actual costs of compensation payable. In this session, we consider how pricing errors may arise and how they need to be resolved. This includes:

- Examples of how pricing errors can arise

- Key controls for early identification of errors
- Processes for resolution of pricing errors
- Compensation calculations
- Regulatory requirements – materiality, de-minimis and FSA reporting

## 11. TAXATION

Tax is a key element of the fund NAV. It is also a key element of the decision on where to domicile the fund and goes to the core of the competitiveness of the UK industry. In this session, we consider the provisions for the taxation of funds and the taxes applicable to authorised funds. This includes:

- The Investment Management Exemption, Tax Bulletin 60 and BN 26, 2009
- Taxes applicable to UK authorised funds
- SDRT, CGT, Income Tax, Withholding tax and VAT
- UK vs Ireland and Luxembourg
- Recent and upcoming taxation developments
- UCITS IV and the tax obstacles to be addressed

## 12. REPORT AND ACCOUNTS

The IMA Statement of Recommended Practice (SORP) for the financial statements of authorised funds applies to the annual and half-yearly reports of all authorised funds and compliance is required by the Financial Services Authority's (FSA's) Collective Investment Schemes (COLL) sourcebook.

In this session we consider the requirements of the SORP including in respect of:

- Contents of long and short form reports
- Guidance for recognising income from bonds
- Derivatives
- Risk disclosures
- Upcoming IFRS developments

## 13. THE ROLE AND EXPECTATIONS OF DEPOSITARIES

The Depositary has an oversight role in respect ensuring that funds are fair and accurately priced. They have also specific duties. Here we consider the role of the depositary in a number of elements of und accounting, including:

- Review of Managers system and control arrangements
- OTC Derivative Valuation
- Pricing errors
- Dilution Policies
- Fair Valuation of Assets

## 14. GOVERNANCE OF FUND ACCOUNTING

Service level agreements (SLAs) govern the day to day operations of an outsourcing arrangement. Management Information (MI) allows the governance team to monitor performance and compliance and to identify emerging risks and trends. This session considers the key features of effective governance frameworks and how to effect operational change. This includes:

- Identifying the key SLAs from a risk management perspective
- Which SLAs should be included in the MI pack
- The use of Key Risk Indicators (KRIs)
- The use of KRIs and Key Performance Indicators (KPIs) in relationship management
- The use of penalties and service credits

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## WORKSHOP LEADER

The course will be led by Darren Burrows, a Director at Funds-Axis. Darren is a qualified Chartered Accountant and Funds Expert with a comprehensive working knowledge of fund and shareclass accounting and strong familiarity with a number of leading fund accounting platforms.

Darren has supported large scale fund amalgamations and mergers, transitions of fund accounting platforms and outsourcing initiatives. He has supported Managers and Administrators in benchmarking and enhancing their fund accounting systems, controls and processes as well as supporting significant pricing error re-work projects.

Recent work has focused on governance over fund accounting arrangements and process re-engineering. This has included SLA development and re-engineering and development of service credit regimes in respect of outsourced fund accounting arrangements.

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## OTHER FUNDS-AXIS COURSES

- **Introduction to Fund Administration**
- **UCITS III, Derivatives and Eligible Assets**
- **TCF for Asset Managers**
- **Operational Risk for Asset Managers**
- **Introduction to UCITS III**
- **ICAAP, Liquidity and Reverse Stress Testing**
- **UCITS III and Hedge Funds**