Financial Reporting Brief
August 2016

Irish Funds Financial Reporting Working Group

Executive summary

In this brief, the Irish Funds Financial Reporting Working Group (FRWG) provide an update on changes in financial reporting and regulatory disclosure requirements as relevant to investment funds.

The following are the key developments covered in this edition:

- UCITS Requirements
- AIFMD Requirements
- Securities Financing Transactions Regulations 2016
- Companies Act 2014

UCITS requirements

There have been recent updates to the UCITS regulations through Central Bank UCITS Regulations - SI 420 (2015) and UCITS V - SI 143 (2016) that impact the financial reporting disclosures in annual and semi-annual financial statements. We also reference the recent issue of Consultation Paper CP105 'Consultation on amendments to the Central Bank UCITS Regulations'.

Central Bank UCITS Regulations (SI 420 of 2015)

Effective 1 November 2015, the Central Bank of Ireland issued a new set of regulations relating to Irish domiciled UCITS, their management companies and their depositaries titled "Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Undertakings for Collective Investment in Transferable Securities) Regulations 2015".

Requirements for UCITS funds

Schedule 7 and 8 of SI 420 set out the annual and semi-annual reporting requirements. The requirements are consistent with the most recent UCITS Notices with the exception of the following changes or new requirements.

1. Balance Sheet: change of category heading from Collective Investment Schemes' to 'Investment Funds' (half-yearly and annual report).
2. General description on the use of FDIs and of the use of efficient portfolio management (EPM) techniques and instruments.
3. New requirement to identify 'counterparties to OTC derivatives shall be identified in the annual / half-yearly report, in the same section in which open financial derivative positions are identified.'
4. Leverage disclosure for Absolute VaR appears to be no longer required, only required for relative VaR under SI 420 (annual report only).
5. Connected Party terminology changed to Connected Person, definition of Connected Person revised to a mean 'a management company or depositary of a UCITS; and the delegate or sub-delegates of such a management company or depositary (excluding any non-group company sub-custodians appointed by a depositary); and any associated or group companies of such a management company, depositary, delegate or sub-delegate'.
6. New requirement to include details of any distributions out of capital (half-yearly and annual report).
7. New requirement to include details of all sub-investment managers engaged by the investment manager to act in relation to the UCITS (half-yearly and annual report).

Requirements for UCITS management companies and depositaries

SI 420 introduces a new requirement for management companies and depositaries to submit separate interim management accounts for the second six months of the financial year. The requirement for full-year audited accounts remains. The new requirement applies to financial reporting periods commencing 1 November 2015.

CP105 'Consultation on amendments to the Central Bank UCITS Regulations'

CP105 was published recently by the Central Bank of Ireland and is looking for specific feedback on recent amendments to the Central Bank UCITS Regulations, particular feedback on the current level of disclosure around financial derivative instruments in semi-annual and annual reports. The IF Financial Reporting Working Group will prepare and submit a response over the coming weeks, deadline for a response is 25 August 2016. CP105 is available at:

www.centralbank.ie/regulation/marketsupdate/Documents/160602%20_Consultation%20Paper%20Final.pdf

UCITS V - (European Union (Undertakings for Collective Investment in Transferable Securities) (Amendment) Regulations 2016 - SI 143 of 2016)

Transposed into Irish Law on 21 March 2016. Para 18 of SI 143 amended regulation 89 of the Principal UCITS Regulations to introduce a disclosure requirement for remuneration related information for UCITS managers similar to that already required under AIFMD.

"(3A) The annual report shall include-

(a) the total amount of remuneration for the financial year, split into fixed and variable remuneration paid by the management company and by the investment company to its staff, and the number of beneficiaries, and where relevant, any amount paid directly by the UCITS itself, including any performance fee,
(b) the aggregate amount of remuneration broken down by categories of employees or other members of staff as referred to in paragraph (3) of Regulation 24A,
(c) a description of how the remuneration and the benefits have been calculated,
(d) the outcome of the reviews referred to in subparagraphs (c) and (d) of paragraph (1) of Regulation 24B including any irregularities that have occurred, and
(e) a description of material changes made to the adopted remuneration policy."

Effective date
In respect of annual financial reporting periods that end on or after 18 March 2016, disclosure to be included on a best efforts basis depending on the availability of remuneration related information over the first full annual performance period of the UCITS management company, explaining the basis for any non-disclosure.

AIFMD requirements

The FRWG completed a review of the AIFMD Financial Reporting Disclosures Guidance Paper previously issued in January 2014 to determine whether updates were required to reflect the latest industry practice for such disclosure requirements.

The FRWG concluded that the considerations and recommendations in the paper remain relevant and in line with latest industry practice. Therefore no revision to the paper is considered necessary at this point in time.

This AIFMD Financial Reporting Disclosures Guidance Paper is available for Irish Funds member firms to access at:

http://www.irishfunds.ie/regulatory-technical/aifmd

Securities Financing Transactions Regulation

The EU Securities Financing Transactions Regulation (SFTR) came into effect on 12 January 2016. The aim of SFTR is to improve the transparency of securities financing transactions (SFTs) in the shadow banking sector, giving regulators (including ESMA and national regulators) access to information to enable them to monitor the risks in this sector.

SFTR contains new rules to enhance transparency which supplement the requirements of the UCITS Directive and the AIFMD. In particular, UCITS managers and AIFMs will need to supplement their existing periodic reports to investors with detailed information on the use of SFTs and total return swaps.

SFTs are defined in the SFTR to include repurchase transactions, securities or commodities lending or borrowing, buy-sell back transactions or sell-buy back transactions and margin lending transactions.

The requirements under SFTR and associated implementation dates vary depending on the requirement, summary below.

Year	Requirement	Effective date
2016	UCITS and AIFs constituted after 12 January 2016 to make disclosures in related offering documents	From 12 January 2016
	Disclosure on collateral re-use (applies to all transaction types where collateral is received from an EU counterparty, not just SFTs)	From 13 July 2016
2017	UCITS and AIFs constituted before 12 January 2016 to make disclosures in related offering documents	From 13 July 2017
	Requirement for UCITS and AIFs to make disclosures in financial statements (refer to Appendix 1 for detail)	From 13 January 2017
2018	Mandatory daily reporting of SFT transactions to trade repositories (similar to EMIR in relation to derivatives)	2018/2019 (estimated)

Financial reporting impact

The specific information to be provided in the periodic financial statements of UCITS and AIFs is set out in Section A of the Annex to SFTR. A summary of the specific requirements of Section A are set out overleaf. Some of the disclosures are partially covered through existing GAAP or other regulatory requirements, however most of the requirements would be considered new. We will provide more clarity on the local industry understanding of the disclosures over the coming months as relevant parties interpret the requirements.

We would recommend that a detailed review is performed on theses specific requirements to establish where the information can be sourced in time for disclosure in 2017 and also the ability to report comparative information (if applicable).

Effective date

The disclosure requirements need to be implemented from 13 January 2017 although the regulation is not clear on whether the requirements apply for financial reporting periods ending from this date or otherwise. Clarification is to be sought and will be confirmed at a later date.

Section A of the Annex to SFTR – *Information to be provided in the UCITS half-yearly and annual reports and AIF's annual report*

Disclosure	**Detail**	**Impact to disclosures under existing GAAP or regulatory requirements**
Global Data	- The amount of securities and commodities on loan as proportion of total lendable assets defined as excluding cash and cash equivalents. - The amount of assets engaged in each type of SFT or total return swap, expressed as an absolute amount (in the collective investment undertaking's currency) and as a proportion as proportion of the collective investment undertaking's assets under management (AUM)	New requirement Extension of existing requirement
Data on collateral reuse	- Share of collateral received that is reused, compare to the maximum amount specified in the prospectus or in the disclosure to investors. - Cash collateral reinvestment returns to fund	New requirement New requirement
Concentration data	- 10 largest collateral issuers across all SFTs and total return swaps (breakdown of volumes of the collateral securities and commodities received per issuer's name) - Top 10 counterparties of each type of SFT and total return swap separately (name of counterparty, gross volume of outstanding transactions)	New requirement Extension of existing requirement
Safekeeping of collateral received by the collective investment undertaking as part of SFT's and total return swaps	- Number and names of custodians and amount of collateral held in safekeeping by each of the custodians.	New requirement
Aggregate transaction data for each type of SFT and total return swaps according to new categories	- Type and quality of collateral - Maturity tenor of collateral broken down into following maturity buckets (< 1 day, 1 day to 1 week, 1 week to 1 month, 1 month to 3 months, 3 months to 1 year, > 1 year, open maturity) - Currency of collateral - Maturity tenor of SFTs and total return swaps broken down by 7 maturity buckets (< 1 day, 1 day to 1 week, 1 week to 1 month, 1 month to 3 months, 3 months to 1 year, > 1 year, open transactions) - Country in which counterparties are established. - Settlement and clearing (eg. tri-party, central counterparty, bilateral)	New requirement

Safekeeping of collateral granted by collective investment scheme as part of SFTs and total return swaps	- The proportion of collateral held in segregated, pooled or other accounts.	New requirement
Data on return and cost for each type of SFT and total return swap	- broken down between the collective investment undertaking, the manager of the collective investment undertaking and third parties (eg. agent lender) in absolute terms and as a % of overall returns generated by that type of SFT and total return swap	New requirement

Companies Act 2014

The Irish Companies Act 2014 (the "Act") introduced key changes to the content of the Directors' Report which are effective for the first time for financial years beginning on or after 1 June 2015. The following is an overview of the three key changes:

- Directors' compliance statement (Section 225 of the Act);
- Audit committee statement (Section 167 of the Act); and
- Audit information statement (Section 330 of the Act)

Directors' compliance statement

The directors of certain Irish incorporated companies are required by Section 225 of the Act to include in the Directors' Report a statement to acknowledge that they are responsible for securing the company's compliance with its **relevant obligations**, and confirm the three specific things outlined in the Section have been done.

Scope

Covered:	***Excluded:***
PLCs	Small/medium companies
Large companies:	Unlimited companies
Private Limited Companies	Investment companies*: Non UCITS/AIF
DACs	
Guarantee companies	
S110 companies	
UCITS*	

*The Act states that investment companies are exempt from the Directors' compliance statement ("DCS") requirement, however the definition of an investment company (Section 1386 of the Act) does not include a company to which the UCITS Regulations apply.

The thresholds for Large Limited Companies are:

(a) its balance sheet total for the year exceeds−(i) subject to *subparagraph (ii)*, €12,500,000; or
(ii) if an amount is prescribed under *section 943 (1)(i)*, the prescribed amount;
And
(b) the amount of its turnover for the year exceeds−
(i) subject to *subparagraph (ii)*, €25,000,000; or
(ii) if an amount is prescribed under *section 943 (1)(i)*, the prescribed amount.

Relevant obligations

Directors must be satisfied that the company has appropriate structures/arrangements to secure material compliance with relevant obligations. The relevant obligations are all of **the company's Irish tax obligations as well as a number of company law provisions** (where failure to comply is a Category 1 or 2 offence, a serious Market Abuse offence or a serious Prospectus offence). Regulatory requirements such as the UCITS or AIFMD Regulations are NOT within scope of this requirement.

Measures to Demonstrate Compliance
The three measures identified to demonstrate compliance with "relevant obligations" are as follows:

- Preparation of "Compliance Policy Statement"
- Implementation of structures which in the Directors' opinion are designed to secure material compliance
- Review, during the relevant financial year, of the structures put in place

Actions to be taken
The suggested actions to be taken in order to demonstrate compliance and enable the directors to make the appropriate attestation in the Directors' Report of the financial statements are:

- draw up a compliance policy statement setting out appropriate (in the directors' opinion) policies regarding compliance with relevant obligations
- put appropriate arrangements and structures in place to secure material compliance
- conduct a review, during the period, of the arrangements and structures

Each director who fails to comply with this section of the Act shall be guilty of a category 3 offence.

- Implications - Category 3 offence
- Class A fine: not exceeding €5k
- Imprisonment not exceeding 6 months

Directors' compliance statement
The requirement can be simply stated – including a statement in the Directors' Report:

- acknowledging responsibility for securing compliance with relevant obligations, and
- confirming that certain things have been done (or providing explanations for things not done).

These obligations follow the "comply or explain" principle.

Example of Directors' compliance statement wording

"The directors acknowledge that they are responsible for securing the company's compliance with the relevant obligations as set out in section 225 of the Act.

The directors confirm that:
1) A compliance policy document has been drawn up that sets out policies, that in our opinion are appropriate to the company, respecting compliance by the company with its relevant obligations
2) appropriate arrangements or structures are in place that are, in our opinion, designed to secure material compliance with the company's relevant obligations, and
3) during the financial year, the arrangements or structures referred to in (2) have been reviewed

[If the above has not been done the directors must specify the reason why it has not been done.]"

Compliance policy statement

While preparation of a compliance policy statement is required, there are no guidelines specifying what should be included in the statement. For organisations with less complex transactions and affairs, the compliance policy statement is likely to be a comparatively straightforward and simple document. The compliance policy statement for more complex organisations, where the scale of potential tax and company law compliance risks is greater and more diverse, will need to be more elaborate.

Points of consideration and feedback received

Points of consideration	Feedback received
Is the investment company/management company in scope?	The DCS requirement does not apply to investment companies however the exclusion of UCITS plcs from the definition of an investment company in the Act means that the exemption from the DCS does NOT apply to UCITS plcs. This point was not always clear. The legislation contains a potential carve out for UCITS plcs on the basis that a ministerial order is passed exempting them from the provisions of section 225 of the Act. Irish Funds are seeking for the legislation to be amended so as to exclude UCITS funds from the scope, however no such ministerial order has been passed to date and there is no indication that an order will be passed in the near future. Where a management company has a balance sheet over €12.5m and turnover over €25m Irish limited companies it must also address the requirement for a directors' compliance statement, in their reports on the financial statements for periods beginning on or after 1 June 2015. The legislation also contains a potential carve out for s110 companies on the basis that a ministerial order is passed exempting them from the provisions of section 225 of the Act. However, no such ministerial order has been passed to date and there is no indication that an order will be passed in the near future. As such, s110 companies are currently in scope.
What is the year end of the investment company/management company (effective date accounting period starting on 01/06/15)? Have DCS and relevant obligation been addressed within the expected timeframe?	It is noted that the requirement is to fully comply and have procedures in place and the relevant review performed during the financial year/period (therefore is expected to be completed by the financial year/period end date). As a result in a number of cases, particularly for May 2016 year ends, remedial actions are taking place with retrospective reviews being performed in the

	period between the financial year/period end date and the financial statements release. However it is noted that this is not fully compliant with the requirements and any instances of non-compliance must be explained in the DCS in the financial statements. Furthermore it is not clear what the response of the regulator will be in such instances or how the requirement will be enforced.
Has responsibility for compliance with the Directors Compliance Statement been assigned to a specific team/person or group (legal firm/Tax firm/Directors/external consultant/internal auditors)?	A wide range of responses has been received on this matter. Depending on the specific outsourced model of each entity, different parties are being assigned responsibility for demonstrating compliance to the directors. Also this is ultimately driven by the Directors' view on this matter and from the feedback received to date, it is likely that Directors will refer to one or more service providers in order to be satisfied that the company has appropriate structures in place to secure material compliance with the relevant obligations.
Has a matrix of 'relevant obligations' been compiled and reviewed to identify the obligations that apply to the fund/company?	From the responses received it appears that the fact that the relevant obligations refer solely to relevant Irish company law and tax law is not always clear as often a wider range of relevant law/regulation/tax is initially considered to be in scope. From the feedback received for a number of entities the following approach is being applied: • Assembling a listing of all relevant obligations • Reviewing and identifying the obligations that apply to the entity • Allocating responsibilities
Has a compliance policy statement been drafted – can existing policies be leveraged?	A wide range of responses has been received on this matter. This is primarily due to the variety of policies and procedures in place for each type of entity in scope. However the vast majority of the feedback received suggests that a specific compliance policy document is being drafted. For funds this document tends to be quite short and refers back to existing policies and procedures in place where feasible.
Is discussion taking place with the relevant service providers - Administrator, Investment Manager, Tax Advisor, Legal advisor given the outsourced model of funds?	From the feedback received it is noted that discussion is taking place with different parties depending on the specifics of the entities in scope and their outsourced model. It is noted that the requirement refers to compliance with relevant Irish company law and tax law. On this basis, depending on the specific outsourced model of each entity, different parties are taking a more active role in demonstrating compliance. Again this

	discussion and its timing depend on the approach of the individual Directors and the entity's financial year/period end.
Is discussion taking place with the preparers of financial statements?	Although the financial reporting requirement per se is quite clear when full compliance is taking place, it is noted that a "comply or explain" principle applies. On this basis additional communication and discussion is expected to take place in cases where disclosure of explanations will be required.
Have the directors agreed what is required in order to provide them with sufficient comfort to sign the DCS?	A wide range of responses has been received on this matter. On this basis early engagement with directors is essential for a smooth process. From the responses received it appears that at times there is lack of clarity in relation to the work currently performed by the different service provider and if the work performed to date is adequate and sufficient to demonstrate to directors that appropriate structures are in place to secure material compliance. It is ultimately up to the Directors as to the level of comfort they require to include and sign the DCS.
How will the arrangements/structures in place to secure compliance with the relevant obligations be documented?	This will depend on the procedures and policies already in place. Also compliance policy statements are being/have been drafted. The legislation does not require that the arrangements/structures/procedures are documented. However in practical terms, many directors will require evidence of same and their testing in order to give them sufficient comfort to sign the DCS.
Who will carry out the review of these arrangements/structures during the financial year/period?	The legislation does not state who must carry out the review. A number of different responses has been received on this matter suggesting that there are different views from directors' as to what party should review the arrangements and structures in place. For many companies, the review will be carried out internally or by the directors themselves whereas other companies may seek independent assistance to carry out the review.

Audit Committee Statement

Requirement

Section 167 (2) of the Act requires the board of directors of a large* company to either establish an audit committee or decide not to establish such a committee. The director's report should include their decision, and where they choose not to establish a committee, they must disclose their reason for not doing so. Failure of a director to do so can lead to a category 3 offence.

Other requirements under Section 167

- Members of the audit committee shall include at least one independent non-executive director of the large company.
    - That director must not have (or had in the preceding 3 years) a material business relationship with the large company, or hold/held a position of employment with that company.
    - That director must have competence in accounting or auditing.
- Statutory auditors will report to the audit committee on material weaknesses in internal controls in relation to the financial reporting process.
- Make recommendations to the board of directors of a large company in relation to the appointment of statutory auditors.

Responsibilities of an audit committee

- Monitoring of the financial reporting process
- Monitoring of the effectiveness of the large company's systems of internal control, internal audit and risk management.
- Monitoring of the statutory audit of the large company's statutory financial statements, and
- Review and monitoring of the independence of the statutory auditors and in particular the provision of other services to the large company.

Scope

Section 1387 of the Act provides and exemption for investment companies to comply with the Audit Committee requirements, however as the definition of an investment company under Section 1386 does not include UCITS or Section 110 entities, these entities are in scope for this requirement. Related to this, section 115 (10)(b) of SI 312 of 2016 (the EU Audit Directive) provides and exemption from audit committees for public-interest entities (PIE) therefore leaving Non-PIE UCITS in scope. However SI 312 of 2016 does not make reference to the Act. The thresholds referred to below do not apply to PLCs, therefore all non-listed UCITS PLCs are in scope of the requirement.

**Large company, defined as a company that:*

A. In the most recent financial year of the company and the financial year immediately preceding that, meets the following criteria:

I. Balance sheet total of that company exceeds for the year

i. €25,000,000 subject to clause (ii)

ii. If an amount is prescribed under section 945 (1)(k), the prescribed amount

And

II. The amount of turnover of that company exceeds for the year

i. €50,000,000 subject to clause (ii)

ii. If an amount is prescribed under section 945 (1)(k), the prescribed amount

B. A company which has one or more subsidiary undertakings, where the combination of the company and all those undertakings meet the criteria set out in paragraph A.

Audit information statement

Section 330 of the Act introduces a requirement for a statement within the Directors' report to the effect that, in the case of each of the directors who are directors at the time the report is approved:

- so far as the director is aware, there is no relevant audit information of which the company's statutory auditors are unaware, and
- the director has taken all the steps that he or she ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that the company's statutory auditors are aware of that information.

"Relevant audit information" is defined as information needed by the company's statutory auditors in connection with preparing their report.

Measures to demonstrate compliance
A director is regarded as having taken all the steps that he/she ought to have taken as a director in order to make him/herself aware of any relevant audit information and to establish that the company's statutory auditors are aware of that information if he/she has:

- made such enquiries of his or her fellow directors and of the company's statutory auditors for that purpose, and
- taken such other steps (if any) for that purpose as are required by his or her duty as a director of the company to exercise reasonable care, skill and diligence.

Consequences of a false statement
Where a Directors' report containing the statement required by Section 330 is approved by the Board but the statement is false, every director of the company who knew that the statement was false or was reckless as to whether it was false, and failed to take reasonable steps to prevent the report being so approved, shall be guilty of a category 2 offence.

Caveat - Section 330 is not intended to be read as reducing in any way the statutory and professional obligations of the statutory auditors in relation to them forming their audit opinion.

Scope
There are no provisions in Sections 1002 or 1387 of the Act disapplying Section 330 to Investment Companies. Therefore this new requirement applies to all investment companies.

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