

Position Statement

Accounting Treatment of Money Market Funds

Summary

The purpose of this note is to provide clarification to corporate investors that the treatment of IMMFA member money market funds in their Financial Statements can be considered as "cash equivalent" in accordance with IAS 7.

However, it remains acceptable for money market funds to be considered as something other than "cash equivalent" when preparing the financial statement.

The interpretation of money market funds should be confirmed with the reporting entity concerned for compliance with internal accounting policies and the relevant external auditor.

Background

Recent changes to International Financial Reporting Standards have resulted in a number of members receiving enquiries from investors in their funds, seeking confirmation that any holdings can continue to be treated as "cash equivalent". The relevant International Accounting Standard relating to the definition and treatment of "cash and cash equivalents" is IAS 7.

There are two fundamentally different styles of money market funds currently operating in Europe, both of which meet the needs of their specific investors. These are often referred to as 'investment-style' institutional money market funds and 'liquidity-style' institutional money market funds.

- (i) 'Investment-style' institutional money market funds have been available in Europe for over 30 years and have the primary investment objective to achieve an 'all-in-return (ie combined capital plus income growth). In many ways they have similar characteristics to short-dated bond funds.
- (ii) 'Liquidity-style' institutional money market funds have operated in Europe for a number of years but gained particular prominence in the late 1990s. Liquidity-style' funds operate on an almost identical basis to funds regulated in the USA by the Securities and Exchange Commission under rule 2a-7 of the Investment Company Act 1940 and known as '2a-7 funds'.

The type of funds provided by IMMFA members fall into the second category. The key features of this type of fund are:

- Constant NAV;
- Same or next day liquidity;
- Maximum Weighted Average Maturity of 60 days;
- Cash equivalent benchmark;
- Investment solely in short term high quality money market instruments;
- Highly diversified (maximum 10% per issuer but in practice lower thresholds apply);
- Highest credit rating for the fund.

These characteristics are published in the fund's prospectus and the financial statements. The IMMFA Code of Practice also requires demonstration of these characteristics.

Standard and interpretations

The International Financial Reporting Standards involved is IAS 7 (Cash Flow Statements) which defines the requirements for an asset to be treated as cash or cash equivalents. It notes that: "Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes". For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition or regular floating interest rate resets. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents, for example in the case of preferred shares acquired within a short period of their maturity and with a specified redemption date.

The Association Française de la Gestion Financière (AFG), the French Asset Management Association, representing investment funds and individual portfolio management, has produced an analysis of the category of coordinated "OPCVM de trésorerie" (ie a UCITS), which has been endorsed by the French Regulator, the Autorité des Marchés Financiers (AMF). This analysis is set out below.

US GAAP clearly defined Money Market Funds (as defined by the US regulator under rule 2a-7) as cash equivalent. Even if no direct link exists between US GAAP and IFRS principles, this evidences that the treatment of Money Market Funds as cash equivalent is also meaningful under US GAAP and corroborates the AMF position.

The AFG/AMF position

This AFG/AMF position sets out a number of criteria whereby French and foreign money market funds can be classified as cash equivalent in compliance with IAS 7. In this analysis, coordinated UCITS have a positive presumption to be classified as cash equivalent, to be validated based on the key criteria as set out in the table below. Other Money Market Funds (ie UCITS with no European passport or other UCITS) may also qualify as cash equivalent in accordance with IAS 7. However, no positive presumption is established and a more specific analysis needs to be performed based on additional financial information. Those criteria are also described in the paper published by the AFG.

<u>Criteria IAS 7</u>	<u>Key Feature</u>	<u>Supporting document</u>
Short term Placement	<ul style="list-style-type: none">• Have a "Monétaire Euro" classification as defined by the AMF• Reference index is a money market index (EONIA; EURIBOR 3 months...)• Recommended average investment maturity < 3 months and may go up to 6 months if other criteria are met.	Prospectus of the UCITS
Highly liquid placement	Daily subscription / redemption possible in the UCITS Underlying investments are valued at market value in accordance with AMF instructions. Disposal is possible at any time and with no impact on their liquidating value.	Prospectus
Easily convertible in cash	The redemption price can be anticipated, given the high liquidity and high correlation with a money market index.	Prospectus and reporting

Low risk of change in value	Linear Fund performance in accordance with underlying reference index.	Prospectus and reporting and financial data provider.
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UCITS sensitivity is always between 0 and 0.5.

No impact on the Fund performance resulting from long term money market rates, equity and exchange markets evolution.

Historical data of the UCITS need to be available to evidence the regular increase in Fund performance.

IMMFA funds

From the perspective of a Liquidity-style' fund and looking at each IAS 7 criteria in turn:

<u>IAS 7 Criteria</u>	<u>Key features</u>	<u>Supporting document</u>
Short-term placement	<p>The fund is informally benchmarked against appropriate treasury benchmarks, typically 7-day LIBID.</p> <p>The fund maintains a weighted average maturity of a maximum of 60 days.</p> <p>The fund's investment policy is to invest in short term instruments to with the objective of maintaining principal while achieving yield.</p>	Prospectus
Highly liquid placement	<p>Same or next day liquidity</p> <p>Underlying investments are valued in accordance with amortised cost methodology and marked to market on at least a weekly basis. Disposal is possible at any time and with no impact on their liquidating value.</p>	Prospectus
Readily convertible to known amounts of cash	<p>The fund's primary investment objective is to maintain the net asset value either constant at par, or at the value of the investors' initial capital plus earnings. This is defined as no deviation greater than 0.5%. The fund operates internal control policies to ensure that this value is maintained.</p> <p>The fund operates on the basis of amortised cost valuation with regular mark to market valuations.</p> <p>The redemption price can be anticipated, given the correlation of performance with appropriate treasury benchmarks benchmark.</p>	Prospectus and reporting

Subject to an insignificant risk of changes in value

The fund invests in highly rated issuers with a maturity or residual maturity of 397 days or with similar regular yield adjustments.

Prospectus and reporting and financial data provider.

The fund is well diversified with an investment per issuer of a maximum of 10%.

The fund has been awarded the highest credit ratings and least volatile risk ratings by the independent credit rating agencies. The ratings are Aaa/MR1+ from Moody's, AAA/V-1+ from Fitch and AAAm from Standard & Poors. The market risk/volatility rating (eg MR1) uses a scale from 1- indicating the lowest volatility to 10- indicating the highest. A "+" modifier is appended to the market risk rating to indicate constant NAV funds.

Conclusion

We consider that IMMFA style funds meet the IAS 7 criteria and can be considered as "cash equivalent". **Corporations should discuss how money market funds are reported within the financial statements with the reporting entity concerned for compliance with internal accounting policies and the relevant external auditor.**