



# Barlow Capital Partners

## Pooled Fund Accounting – A Primer (or How the NAV is Not the Whole Story)

*A guide to understanding and calculating the gain or loss on your investment in the Barlow Partners Income and Growth Portfolio*





*In recent conversations with both investors and advisors, we have had many questions regarding the calculation of true gains and losses in the Barlow Partners Income & Growth Portfolio. It is important to remember that the NAV provided by your custodial statements does not necessarily indicate how well your investment is doing. This guide has been created to show you how to incorporate the distributions paid by the Portfolio in calculating your total return.*

**PART I:  
THE DISTRIBUTION CHOICE**

Pooled fund accounting is a Byzantine process at best. Investors contribute money and receive a given number of units based on the Portfolio’s NAV (Net Asset Value) at the time of purchase. The following illustration provides an example of the distribution choice that all investors in the Income and Growth Portfolio need to make and the impacts of each choice on their monthly statements and annual cash flow. But first, let’s examine the fundamentals of pooled investment funds:

**PURCHASING UNITS**

An investor purchases \$1,000 of the BCP Income & Growth (“I&G”) Portfolio on January 1, 2006. The NAV on this date is \$10.00 and he receives 100.000 units in the transaction.

$$\begin{aligned} \text{\# Of Units Purchased} &= \frac{\text{Dollars Invested}}{\text{NAV}} \\ &= \frac{\$1,000}{\$10} \\ &= 100.000 \text{ Units} \end{aligned}$$

**DISTRIBUTIONS AND THE NAV EFFECT**

When the Portfolio pays a distribution, it reduces the Portfolio’s NAV by the amount of capital paid out per unit. This occurs regardless of the method the distribution is received in. Suppose the I&G Portfolio paid out a 5% distribution on March 31. To keep it simple, let’s assume the NAV on this date is unchanged at \$10.00.

$$\begin{aligned} \text{NAV (Pre-Distribution)} &= \$10.00 \\ \text{5\% Distribution} &= \$(0.50) \text{ per unit} \\ \text{NAV (Post-Distribution)} &= \$9.50 \end{aligned}$$

Investors in the I&G Portfolio have the option to receive their quarterly distribution either in cash or in reinvested units. Because calculating your Return on Investment (“ROI”) can be confusing at first, we provide the below formula, used for both distribution methods:

$$\text{ROI} = \frac{\text{Change in NAV} + \$ \text{Distribution}}{\text{Original Book Value}}$$

**INVESTORS RECEIVING CASH DISTRIBUTIONS**

If we continue to use the scenario from our initial example, then an investor who elects to receive their distribution as a cash payment would have the following ROI:

$$\begin{aligned} \text{ROI} &= \frac{(\$9.50 - \$10.00) + \$0.50}{\$10.00} \\ &= 0\% \end{aligned}$$

Although the investor’s return is flat, the value of their position in the I&G Portfolio declines by the distribution amount. Post-distribution, the investor holds \$950.00 in portfolio units (100.000 units @ \$9.50 each) and has \$50 cash in hand.

**INVESTORS RECEIVING REINVESTED UNITS**

The ROI over the three month period is identical for an investor who elects to receive the distribution in reinvested units. The NAV has still declined by \$0.50, and the investor has still received a distribution of \$0.50. This does not show up as a cash transaction in their account statements, but as a DRIP (Dividend Reinvestment Purchase).

Where this method differs from the cash distribution is that there is no change to the value of the investor’s holdings in the I&G portfolio.

As shown earlier, the dollar value of the distribution is \$50. At \$9.50 per unit, this equals 5.263 new units (\$50 / \$9.50). Now the investor owns the original 100 units, plus these new units for a total of 105.263. The investment’s value remains \$1,000 (105.263 x \$9.50).

From the above explanation we can derive a very simple but very important message:

**From a performance perspective, it doesn't matter whether you choose to take the distribution in cash or in reinvested units.**

**PART II:  
THE TAX STORY**

Unfortunately, the story doesn't end here. Revenue Canada gets involved. Because the distributions are taxable outside of RRSPs, CRA allows the ACB or Adjusted Cost Base of the investment to rise by the amount of the distribution. In the previous example, the ACB shown by the account statements would have risen from \$10.00 to \$10.50 post-distribution.

The reason for this bump in the ACB is to avoid double taxation, since the \$0.50 distribution is going to be taxed in the hands of the investor.

Continuing our example, suppose that on April 30, the investor decides to liquidate their position. The investor has received \$0.50 in cash distributions since January 1, and the NAV on April 30 has risen from \$9.50 back to \$10.00. With no increase in the ACB, here is what would happen for tax purposes:

NAV at Liquidation	\$10.00
Units Held at Liquidation	100.000
<b>Liquidation Proceeds</b>	<b>\$1,000</b>
<b>+ Distributions Received</b>	<b>+ \$50</b>
<b>- Original Investment (\$10.00)</b>	<b>- \$1,000</b>
<b>= Taxable Gain</b>	<b>= \$50</b>

However, the investor already incurred a tax liability on the distribution at the time it was received (March 31). When the cost base is adjusted from \$10 to \$10.50, investors are able to avoid double taxation:

<b>Liquidation Proceeds</b>	<b>\$1,000</b>
<b>+ Distributions Received</b>	<b>+ \$50</b>
<b>- Adjusted Cost Basis (\$10.50)</b>	<b>- \$1,050</b>
<b>= Taxable Gain</b>	<b>= \$0</b>

The most important message from this article is this: When you compare the portfolio's NAV against the ACB shown on your monthly account statements, the difference is NOT your ROI. Your ROI is found by taking the change in your NAV since purchase, adding the per unit value of any distributions, and then dividing the sum by your original cost base, not your adjusted cost base.

**PART III:  
YEAR END TAXATION REPORTING**

While it's clear there are tax consequences of receiving periodic income distributions from the I&G Portfolio, the form of this liability is not known with certainty until calendar year-end. This is because the distributions paid by the portfolio to investors can be classified into 4 different categories: Capital Gains, Interest Income, Dividend Income, or Return of Capital. Each of these forms of investment income has a different tax treatment.

At year-end, the manager of the I&G Portfolio looks back over the entire year and allocates its returns to one of the four income sources listed above. Then based on this attribution analysis we must follow CRA guidelines to assign a percentage of the distributions paid to investors from the portfolio into each of the four categories. This information is on the T3 tax slip you receive from us each year, which identifies the amount and type of each income to report on your tax return.

