
01 : Consolidation is around the corner

02 : Anti-Money Laundering – a Hot Topic

03 : US GAAP clarifies
the definition of “fair value”

04 : Augentius update

TECHNICAL

Consolidation is around the corner

Much has been discussed about the consolidation issues for the Private Equity community when complying fully with IFRS, specifically IAS 27 (Consolidated and Separate Financial Statements). Few would deny that the historic practice of adopting UK GAAP as modified and agreed with the auditors created great flexibility in determining whether or not private equity funds should consolidate their investments. In the US, such funds are typically dealt with under the 'investment company' guidelines, disclosing their portfolio at fair value.

However, with the convergence of UK and US GAAP on IFRS, along with expected increased investor demand for full GAAP financials, some would argue that the days of opting out of consolidation may be numbered.

In a bid to clarify its own rules, the IASB has issued a consultation paper as the first step toward replacing IAS 27 in the second half of 2009.

If the consultation paper is adopted in its current form, the new IFRS would unequivocally require private equity funds to consolidate their holdings in the same way as companies. The IASB has clearly taken a view that “the information needs of users are best served by financial statements that consolidate investments under the control of the reporting entity.”

The paper categorically states that investment companies such as private equity and venture capital funds should be included in the scope of the proposed standard. It does though draw a distinction between the proposed treatments for general partners (GPs) and for private equity funds.

Private equity funds

The proposed standard is based on a controlling entity approach, whereby if a parent “has a controlling interest in another entity when it has exclusive rights over that entity's assets and liabilities which give it access to the benefits..., it would be required to consolidate that investment.”

In the event that the private equity fund does not satisfy the conditions to control the business but instead maintains a significant involvement, new disclosures would be required in the fund's financial statements.

The key disclosures would cover:

- Aggregated assets and liabilities of the investments;
- Concentrations of assets and maturities of liabilities; and
- Conditions that would result in the fund having control over the investments.

General Partners

The consultation paper may be interpreted to mean that general partners acting on behalf of the other partners in managing a fund

would not be required to consolidate such, on the basis that the GP is acting as an “agent” for others and neither controls nor owns the fund. Although not explicitly referred to in the paper, one might assume that even where the GP has control over the investment, consolidation would still not be required as the GP is “looking after” the investment for the ultimate owners.

Far enough?

Whilst the implications for GPs may be straightforward, the treatment for PE funds is less so. The flexibility for fund partnerships may remain for as long as they are unlisted, and able to agree format and content of financial reports with their investors through the funds' legal agreements. It would take pressure from investors to force PE funds to prepare fully compliant IFRS statements.

Many in the PE community are of the opinion that the IASB should permit a carve-out for private equity or VC funds as has been seen in other jurisdictions. Based on decisions reported to date, this appears unlikely – the full extent of the changes remain to be seen in the exposure draft to be published later this year.

MORE INFO

To discuss the potential impact of the changes on your business, please contact Ian Kelly on 020 7397 5465 or at ian@augentius.com



Ian Kelly
Chief Operating Officer



TECHNICAL

Anti-Money Laundering – a Hot Topic

Deterring money laundering remains high on the global agenda. The Private Equity community in the UK was issued with a “warning” on this matter from the FSA (the UK regulator) in a letter dated 8 August 2005, sent to all Private Equity firms. Since that date we have seen a new set of rules in the form of the Third Anti-Money Laundering Directive applied across the European Union and elsewhere. New legislation to ensure conformation was introduced into the UK, Guernsey and Jersey during 2007/08. [Links to the various legislation/handbooks appear at the end of this article].

The possibility of a Private Equity or a Property Fund being used to assist with money laundering and terrorist financing poses many risks for General Partners/Managers, including:

- criminal and disciplinary sanctions
- civil action against the partnership as a whole and individual partners
- reputational damage leading to a loss of business

The new legislation did away with many of the standardised rules and practices of the past and introduced a risk-based approach, whereby the risks relating to each LP must be identified, assessed and mitigated. If you know your investors well, as most GPs and Advisors do, you will be better placed to assess risks and spot suspicious activities. Private Equity and Property Fund managers have advantages over many of their contemporaries within the financial services sector – their funds are generally closed-ended and there is normally a relatively small number of investors – but that does not mean that this is a subject that can be ignored and it should regularly appear on board meeting agendas.

What to do?

Gone are the days when the collection of certified copy passports and gas bills would

suffice. Regulators are looking for more. “Identification”, “mitigation” and “monitoring” should be the watchwords:

- **Identification** of the level of risk and exposure of each LP to money laundering
- **Mitigation** of the said risks and exposures through appropriate controls
- **Monitoring** conformance to legislation, adherence to controls and procedures, re-assessment and possible reclassification of identified risks, maintenance of documentary evidence and provision of advice to management

Many investors in the Private Equity and Property asset classes readily fall into low risk groups – institutional investors in the forms of insurance companies, pension funds and the like – but others constitute higher risk and need to be identified as such. PEPs (Politically Exposed Persons) must be identified, the appropriate files created and checks carried out. For medium to high risk individuals, in addition to the usual KYC documentation, sources of funds and wealth etc. need to be determined.

Funds would be strongly advised to set up a simple matrix of investors, classified into low, medium and high risk individuals or entities, with the respective due diligence levels required for each, categorised for the individual investors as necessary.

This is not a one-off exercise. The file cannot be set up at the outset of the fund and then left to gather dust for the next ten years of the fund's life.

There must be regular monitoring of files. Has anyone become a PEP who previously wasn't? Has anyone received a criminal record since the fund was set up – meaning that the money invested could actually be proceeds of crime? All these checks may be carried out without necessarily needing to



Kerry-Anne Morley
Managing Director (Guernsey)



Suzanne Meecham
Legal Director

refer or otherwise inconvenience investors. Systems, databases and the like will all allow the GP to run checks on a regular basis, and are process driven, as a matter of course, by administrators.

Ignore at your peril

Regulators have made it very clear that they will take firm action against organisations lacking effective systems and controls. Experience has shown that they are not afraid to levy fines and penalties where they consider organisations to be failing in their duty.

It is important that GPs dedicate proper resources to this aspect of Compliance, have documented procedures and then ensure that reviews are carried out on a regular basis – again with written evidence that this has been done.

Failure to do so could have catastrophic effects on the firm as a whole.

MORE INFO

Links to Legislation/Guidance Notes:

UK

http://www.fsa.gov.uk/Pages/About/What/financial_crime/money_laundering/3mld/index.shtml

Jersey

http://www.jerseyfsc.org/anti-money_laundering/regulated_financial_services_businesses/aml_cft_handbook.asp

Guernsey

http://www.gfsc.gg/UserFiles/File/CFC/20071215_AML_Handbook.pdf

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US GAAP clarifies the definition of “fair value”



Glyn Thomas
Associate Director
(Special Projects and Training)

Fair value is not a novel concept in financial accounting. US GAAP has long required investment companies to report their portfolio at fair value, and IFRS (with which we are all converging) uses the principle in around twenty different accounting standards. There are audit standards prescribing how to test fair values, and industry bodies such as PEIGG and IPEV have created useful guidelines on measures appropriate to our sector.

Despite this, the standards themselves have included limited guidance on valuation methods and traditionally GPs were happy to take a prudent approach – using their acquisition cost, or a recent round of financing, as a proxy for fair valuation.

What's new for 2008 year-ends?

The FASB issued FAS 157, Fair Value Measurements around two years ago, though many funds will only be preparing their first audited financials under the standard for December 2008. FAS 157 is principles-based (like IFRS) and while it still lacks industry-specific guidance, it is more prescriptive in how fair value is to be determined and disclosed.

What impact?

The main thrust of FAS 157 is:

- A more specific definition of fair value (the exit price);
- Clarification on the use of certain valuation methods in certain situations; and
- New disclosures on the drivers of asset valuations.

Carrying investments at acquisition cost in a rising market was a conservative approach that had arguably enabled firms to ignore current valuation drivers for longer than their investors might like. The historic price paid for an asset is not necessarily what you would expect to receive from a buyer going forward. It may be an indicator, but is no longer the obvious basis for valuing one's holdings.

The new standard is clear on what it does not permit. It does not, for instance, allow transaction costs to be included in the valuation. Nor should one discount valuations of listed holdings on the basis of the size of a holding (i.e. 25 million shares is 'worth' 25 million x 1 share, even though you may move the market when trying to sell them). Such clarifications are likely to be frustrating for PE managers who feel they understand their real value but have to fall in line with a new standard – and calculate the effect on their opening balance sheet.

Uncertain times are no excuse

The impact of the credit crunch brings its own challenges. How does one determine a palatable fair value when listed investments are experiencing such volatility? In this environment, a push toward reflection of a current 'exit price' – when investments are held for the medium term and not in an active market – is understandably meeting some resistance.

Funds cannot however shy away from increasing calls for accuracy and transparency, in particular from corporate and institutional investors who have their own fair value reporting obligations. FASB's Valuation Resource Group clarified recently that

fund-of-funds investors should not simply rely on a reported NAV to assess their fair values; such entities may need to become even more demanding in the information sought from GPs to allow them to draw their own conclusions.

With reduced deal activity, other factors such as quality of reporting will become more of a differentiator between GPs.

Sharing the burden

Compared to a 'cost' regime, fair valuation figures should really be led from the front office investment process. It will be important for firms to reflect the unique factors relevant to the investment in their valuation model, using several techniques to corroborate an implied value. The back office reporting team however, has a role in policing a structured approach to drive consistency, reliability and efficiency.

But one thing is for certain

Funds need to get it right. The combined effect of the market dislocation and the new standard will lead to one certainty – managers should expect their auditors to apply even more rigour than usual in challenging investment values. This does not need to be a painful process, but firms should use the third quarter as an opportunity to review their approach – and the documentation thereof – for a 'no surprises' reporting season at year-end.

MORE INFO

To discuss the potential impact of the changes on your business, please contact Glyn Thomas on 020 7397 5473 or at glyn@augentius.com



TECHNICAL

Augentius is named as "Top Rated" Administrator



Ian Kelly
Chief Operating Officer

Augentius has been named as the "Top Rated" Private Equity fund administrator in London by Global Custodian magazine. This is a massive achievement for Augentius.

Global Custodian has been carrying out high quality industry surveys throughout the Fund Administration, Custody and Banking sectors for over 10 years. It has developed sophisticated processes and utilises client survey responses to accurately assess the service levels delivered by a service provider. Whilst scoring highly throughout the survey, it particularly identified Investor/LP reporting and Technology as being real strengths for Augentius.

"We are extremely grateful to all the clients who participated in the survey" said Barry Carroll, Senior Partner. "This is a real achievement for us and a reflection on all the hard work invested in our business and our clients. It has always been our objective to be considered as the best Private Equity/Property administrator by Quality and this is recognition of the hard work of all concerned, but we won't be stopping here!"

"We are constantly striving to enhance and improve our service levels to clients" said Ian Kelly, Chief Operating Officer. "We have recently invoked performance measurement across the whole of the business and are measuring our performance against KPIs (Key Performance Indicators). These are then shared with clients as we continue to constantly strive to improve performance levels. As the business continues to grow it is imperative that we continue to deliver a high quality of service."

Exam Success

Augentius actively supports all its staff through professional qualifications, particularly Accountancy and Company Secretarial exams. Our summer 2008 results for ACCA and CIMA students showed continued improvement with an 81% success rate.

"It was particularly satisfying to see six of our students complete their final exams to qualify as full accountants" said James Watts, Head of Onshore Client Services, London. "We have seen a number of staff who joined us as part-qualified accountants progress through to completing their professional qualification with us. Not only have they progressed educationally, but have also been able to develop their careers within Augentius. One of our newly qualified accountants will shortly be heading off to New York to work in our office there", he said. "It's great for us to be able to give people opportunities such as this. We work hard to help our staff grow. In addition to paying for exams and training courses, we support our staff with study leave and other facilities, along with the internal and external training courses organised by our training function."

Meet the Team Ian Kelly, Chief Operating Officer

Ian was one of the original team of seven that sat at One Mitre Square in the very very early days of Ansbacher Fund Services. He joined Ansbacher in August 2002 and was very quickly thrown into the deep end

by being sent out to the Bahamas for two weeks to close the office and transfer the existing Hedge Fund clients to alternative providers! He was involved in the creation of Ansbacher Fund Services from the outset and has been instrumental in its development from the very beginning.

An accountant by trade, Ian had substantial experience in the Fund Administration business prior to joining us, working on numerous fund types, structures and jurisdictions. In his previous roles, Ian had combined his accounting knowledge with a systems approach culminating in the design, creation and implementation of a number of financial services accounting systems.

By the time the MBO came around, Ian was heading up our London Client Services team and in October 2007 he was appointed Chief Operating Officer, responsible for all Operations and the delivery of Client Services for our European offices. He leads and guides our European operations.

Given greater flexibility under the new ownership structure post MBO, Ian has been fostering a business structure and approach that continues to focus on quality and that will support the company and its clients as they continue to grow. He is keen to create ever increasing value, pushing the boundaries of the traditional outsourcing relationship and has been instrumental in the development of Key Performance Indicators across the business. Ian has also been instrumental in the development of our in house Training Team.



MORE INFO

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