

The image features a solid blue background on the left side, where the Deloitte logo is positioned. On the right side, there is a photograph of a classical stone column, likely from a government building, set against a clear blue sky. The column is fluted and has a decorative capital. The Deloitte logo consists of the word "Deloitte" in a white, sans-serif font, with a small green dot at the end of the word.

Deloitte.

IFRS for Investment Funds

*More Than Just
Accounting and Reporting*

Audit • Tax • Consulting • Financial Advisory •

Table of Contents

- Industry Views on IFRS for Investment Funds 2
- Other Standard Setting Considerations 2
- Challenges and Opportunities for Investment Funds 3
- Your Roadmap 4
- Technical Accounting Issues for Investment Funds..... 5
- More Than Accounting and Financial Reporting 10
- Smoothing the Transition 12
- Time for Leadership 12
- Resources and Contacts 13

IFRS for Investment Funds

More Than Just Accounting and Reporting

Navigating the challenges and changes presented by the world's capital markets and economies has been difficult, to say the least, over the past 18 months. The investment management industry has not been immune to the uncertainties presented. In light of the current economic uncertainty – as evidenced by unprecedented government intervention throughout the world – it would be a natural response to delay your institution's focus on International Financial Reporting Standards ("IFRS") conversion. You want and need your best minds focused on navigating the daily challenges, not on some future mandate.

However, the movement to IFRS conversion is unlikely to abate and may not be that far in the future. Although the transition or conversion to IFRS is relevant to registered funds (commonly referred to as "mutual funds") and private funds, which include hedge funds and private equity funds (collectively, the "funds" or "investment funds"), the implementation considerations will vary depending upon the nature of the fund and its applicable accounting and reporting requirements. Unlike U.S. Generally Accepted Accounting Principles ("U.S. GAAP") or Securities and Exchange Commission ("SEC") rules, IFRS does not provide industry-specific guidance or standards for investment funds.

Chances are you or someone in your organization are already thinking about IFRS. That's a positive sign because competition is global, and companies strive to produce meaningful financial reporting. Investors, regulators, analysts, and lenders want the ability to compare the strengths and weaknesses of funds registered or domiciled in different countries. IFRS developments over the last year have shifted the discussion from the abstract and distant to the concrete and near-term, despite the current credit crisis.

In late August 2008, the SEC announced plans to issue an IFRS "roadmap" that would include a timetable and appropriate milestones for mandatory transition to IFRS. On November 14, 2008, the SEC issued its proposed IFRS roadmap, outlining milestones that, if achieved, could lead to mandatory transition to IFRS starting in fiscal years ending on or after December 15, 2014. Additionally, the SEC announced plans for specific proposed rule changes that would provide a limited number of U.S. issuers the option of using IFRS in their financial statements for fiscal years ending on or after December 15, 2009. Investment companies; employee stock purchase, savings, and similar plans; and smaller reporting companies, as defined by the SEC, are excluded from the definition of an "IFRS issuer" in the proposed roadmap and therefore would not be eligible to early adopt IFRS. (For the latest news and information on IFRS, visit www.deloitte.com/us/ifrs.)

The SEC's roadmap notes that issuers in specific industries may be subject to various industry guides developed by the SEC's Division of Corporation Finance. The SEC is not proposing any amendments to these guides. Rather, an IFRS issuer that is subject to an industry guide would continue to provide disclosures that satisfy the objective of the guide's disclosure requirements. An IFRS issuer would be required to provide three years of information under IFRS with information provided by U.S. GAAP to cover any earlier years that are required by an industry guide. Although the roadmap excludes investment companies, the SEC's approach to industry guides may be of interest to investment companies.

The challenges highlighted within this document relate to all types of funds, whether mutual funds or private U.S. domiciled investment funds, that convert to IFRS either due to an SEC requirement for registered investment companies, or as a result of an election made by private funds due to investor demands. Public company investment advisors will likely need to address IFRS convergence ahead of investment funds. Registered investment companies are subject to SEC requirements.

The words conversion and convergence sound similar, but have very different meanings. Conversion is the overall transition to a new set of accounting standards; convergence is the rewrite of one accounting standard at a time. Conversion and convergence are separate efforts that may conclude at different points of time. Financial statement preparers may want to follow the standard setting activities of the International Accounting Standards Board ("IASB") and assess whether or not similar standard setting efforts are underway at the Financial Accounting Standards Board ("FASB"). Although the timeline for U.S. public companies to convert to IFRS may occur as early as 2014, the timeline for convergence or changes to existing accounting standards could apply much sooner, and thus change the scope and timing of necessary conversion activities. Also, international investors may wish to invest in funds that report under IFRS, thus causing fund sponsors that currently offer funds that report under U.S. GAAP or other local GAAP to launch funds that apply IFRS.

Industry Views on IFRS for Investment Funds

In part due to the specialized nature of investment company accounting, some industry groups have been less than enthusiastic about the prospect of a shift to IFRS. The level of resistance to IFRS within the investment management industry appears to be stronger than other industries.

In June 2007, the European Funds and Asset Management Association ("EFAMA"), a non-profit association organized to represent European collective investment funds and asset managers, released a paper discussing the application of IFRS to investment funds. The paper noted that most European jurisdictions do not apply IFRS to investment funds. Instead, in most cases, existing national laws require the use of local GAAPs that apply specifically to Undertaking for Collective Investments in Transferable Securities ("UCITS"). The EFAMA Paper describes a number of significant issues in IFRS that must be addressed before IFRS can be meaningfully applied to investment funds. These include, for example: IAS 1 - Comparatives, IAS 7 - Cash Flow Statements, IAS 27 - Consolidation of Subsidiaries, IAS 32 - Classification of Puttable Instruments, IAS 33 - Earnings per Share, and IAS 39 - The Use of Bid Price for Quoted Securities. The EFAMA paper notes support for the convergence process but states that U.S. accounting standards are more appropriate to open-end investment funds than existing IFRS, and that U.S. accounting standards are more in line with current practice in Europe and the rest of the world.

In November 2007, the Investment Company Institute ("ICI"), a national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds, and unit investment trusts, issued a letter to the SEC to comment on the SEC's concept release on allowing U.S. issuers, including investment companies subject to the Investment Company Act of 1940, to prepare financial statements in accordance with IFRS. The ICI recommended that the SEC ensure that there was substantial convergence relating specifically to investment company financial reporting before providing investment companies with the option to produce IFRS financial statements. The ICI stated that the lack of industry guidance would mean that fund financial statements would resemble the financial statements of general corporate entities and thus would be far less meaningful to shareholders.

Additionally, at the 21st annual meeting of the International Investment Funds Association ("IIFA") in November 2007, delegates resolved, on behalf of their member organizations, to support the development of a consistent worldwide regime for investment fund financial reporting that provides meaningful information to investors. In a statement released after the meeting, the IIFA noted that IFRS does not presently provide a satisfactory basis for investment fund financial reporting and is not sufficiently focused on the needs of investors.

To date, the expected response of various regulators to these industry views is unclear. In recent months, regulators' attention has been focused on the credit crisis. The SEC's roadmap states that "considerations at this time with respect to the possible use of IFRS do not include issuers that are investment companies under the Investment Company Act of 1940." However, the SEC is seeking comments on numerous questions raised in the proposed roadmap. Questions include: "Is it appropriate to exclude investment companies and other regulated entities filing or furnishing reports with the Commission from the scope of this Roadmap? Should any Roadmap to move to IFRS include these entities within its scope? Should these considerations be a part of the Roadmap? Are there other classes of issuers that should be excluded from present consideration and be addressed separately?"

Understanding the considerations associated with a conversion to IFRS will help your organization to have an informed view about the benefits and drawbacks of conversion, and enable your organization to determine whether and how to participate in the SEC's comment letter process or in other industry activities related to IFRS.

Other Standard Setting Considerations

The FASB is in the midst of a one-year verification phase of the FASB Accounting Standards Codification. After addressing the issues raised during the constituent feedback process, the FASB is expected to formally approve the Codification as the single source of authoritative U.S. GAAP, other than guidance issued by the SEC. This approval is expected to occur in the summer of 2009. The Codification includes all accounting standards issued by a standard-setter within levels A through D of the current U.S. GAAP hierarchy, including FASB, American Institute of Certified Public Accountants ("AICPA"), Emerging Issues Task Force, and related literature. The Codification does not change GAAP; instead it reorganizes the thousands of U.S. GAAP pronouncements into roughly 90 accounting topics, and displays all topics using a consistent structure. The discussion of U.S. GAAP within this document does not give effect to the Codification.

The IASB is in the process of developing an International Financial Reporting Standard for private entities. The resulting standard is intended to meet user needs while balancing costs and benefits from a preparer perspective. Financial statement preparers should monitor whether their local reporting jurisdictions will require or permit the use of this standard once it has been issued as the guidance may have an impact on non-public investment funds.

Challenges and Opportunities for Investment Funds

Conventional wisdom notwithstanding, an IFRS conversion is not primarily an exercise in reshuffling the chart of accounts, nor is it principally a technical accounting and financial reporting matter. In fact, your company is likely to spend significant amounts of time addressing concerns around tax, valuation, legal and compliance, people, technology, and communications. The impact of consolidation differences will likely have a significant impact on private equity funds and the companies that manage these funds.

Clearly, a great deal of work is involved in shifting to IFRS. Yet, despite these challenges, you may find that the benefits of reporting under IFRS outweigh the costs.

Investment managers often outsource services to multiple third-party administrators which provide fund reporting under accounting standards applicable to the country in which they operate. In such cases, there are significant benefits that can be gained from transitioning all funds to IFRS – including potential for reduced lead time in preparing financial statements, improved controls, reduced personnel costs, and a centralized approach to addressing regulatory reporting issues. Transitioning to a uniform set of standards carries the possibility of enhancing investor/shareholder value.

Consider these factors:

Conversion provides a fresh look at current practices. You may want to consider a fresh look at your accounting policies and other procedures for your fund operations. Conversion to IFRS provides this opportunity.

Conversion can be a catalyst for streamlining the financial reporting process. Moving to IFRS may provoke a reconsideration of the location where financial reporting activities occur and the resources and the process used for such activities.

IFRS offers an opportunity to use principles-based accounting. Many finance professionals have become increasingly frustrated with U.S. GAAP and its voluminous rules for dealing with accounting issues. For a decade or more, finance executives have called for a return to principles-based accounting to help improve financial reporting. Some view IFRS as responsive to that desire (although it may create other potential frustrations and issues for investment funds).

IFRS helps open the doors of the global marketplace. Adopting IFRS may improve access to foreign markets because foreign investors may be more comfortable with or have more confidence in a globally accepted set of accounting standards. Funds can also benefit from improved ability to benchmark with peers and competitors.

Actions for Investment Managers

1. Ask your finance team: Is IFRS the best model for your fund complex? Will you be required or permitted to use IFRS for any of your investment funds? What does this mean for your private equity and hedge fund businesses, which may not be required to convert to IFRS?
2. Understand the needs and preferences of your investors. Do your foreign investors require IFRS reporting to serve your own financial reporting needs? Do your investors perceive IFRS reporting preferential to U.S. GAAP or other accounting conventions?
3. Would IFRS enhance the presentation of your fund performance to your investors and other users of the financial statements? How will adopting IFRS impact financial ratios and other key measurements that investors and creditors utilize?
4. Conduct a competitive analysis. Are your competitors offering funds to investors which report under IFRS? Would it be advantageous to be a leader into this new world of financial reporting? Do you need to adopt IFRS to facilitate comparisons to and benchmarking with your peers?
5. Determine if your service providers are ready. Does your administrator have the information technology systems, infrastructure and IFRS-trained staff to be able to serve your IFRS needs?



Your Roadmap

Whether you plan to charge ahead full steam or take small, measured steps, development of an IFRS implementation roadmap is an important first step. Through this effort, you'll be able to chart the optimal course, determine the pace of your conversion journey, and possibly skirt some detours and potholes. It is important to note that companies may elect to prepare two separate roadmaps, one for the management company and one for the funds, or simply have two components within the same roadmap.

To start, consider gathering answers to a few preliminary questions:

- Have we inventoried our current IFRS reporting requirements, if any?
- How many local generally accepted accounting standards (GAAPs) do our funds currently report under?
- How many of our funds already prepare IFRS financial statements?
- How many of our competitors have converted to IFRS? Is there an expectation that they would switch to IFRS, if given the choice in the U.S.?
- How many of our competitors offer funds to investors which are accounted for in accordance with IFRS? Is that product considered preferential to some investors?
- Do we have a major enterprise resource planning ("ERP") or finance transformation project in the works?
- What is the level of IFRS knowledge within the organization, both domestically and globally?
- Do our people have the skills and mindset to operate using principles instead of rules? How can we train the ones who don't and get the most from the ones who do?
- What would be the impacts on our funds of a possible IFRS requirement in the U.S.?
- Have we assessed the cost and benefits of adopting IFRS?
- Are our third party service providers, such as administrators and custodians, prepared for IFRS?

Of course, your IFRS implementation roadmap will be significantly more detailed than merely addressing these few questions. Given the far-reaching scope of IFRS, the roadmap may assess the potential impact on each department in your organization, including finance, the middle and back office operation functions, human resources, tax, legal, information technology, and investor relations. Other stakeholders may be involved, including the board of directors, audit committee, investors and your external auditor.

By determining your costs, benefits, and timing up front, you can avoid the rushed approach that characterized such initiatives such as the Sarbanes-Oxley Act and the Year 2000 computer issue. A carefully designed roadmap may empower your company and sponsored funds to convert on their own terms. By taking a measured and informed approach, you increase the likelihood of identifying value in an exercise that otherwise may be reactive and solely compliance driven. The value may present itself in the form of reduced costs of implementation, standardization and centralization of reporting activities, greater consistency of accounting policy application, faster close processes, and possibly the transformation of fund operations and administration.

Actions for Fund Operations

- If fund accounting and/or reporting is outsourced, visit your administrator and assess their capabilities. If your administrator is not currently able to offer IFRS reporting, be prepared to work with them to develop a transition plan to IFRS.
- Assess the impact of different consolidation rules on your private funds and other businesses.
- Determine the impact on fund valuation policies and procedures. Are the valuation policies IFRS compliant? What changes will you need to consider to be compliant?
- Determine your resource requirements – internal and external – for a conversion project. Consider the impact of redeploying internal resources.
- Collaborate with your IT team to assess system requirements for reporting under IFRS.

Challenges for Investment Funds

- 1. IFRS 7 Disclosures:** Accumulating relevant data performance analytics on the portfolio for purposes of IFRS 7 disclosures, such as accumulating concentrations of geography or industry, performing sensitivity analyses for interest rate risk and other risks, currency exposure, liquidity exposure, etc., will be challenging.
- 2. Consolidation of Investments:** IFRS guidance for consolidation of investments is very different from the standards applied in the U.S. In all likelihood, many investments that are not consolidated under U.S. GAAP will be consolidated under IFRS. That means private equity funds and other registered investment companies that control investments may have to consolidate. Private equity managers applying IFRS may also be required to consolidate the funds they manage.
- 3. Systems Limitations:** Information Technology ("IT") systems may not have the ability to capture certain information required by IFRS standards. For example, as it relates to trading activities, systems may not be able to separately capture both the costs of securities and related transaction/commission costs. Planning activities should consider the information needs to enable appropriate financial reporting.
- 4. Easy Tasks:** For registered funds, activities as elemental to fund operations as striking a daily net asset value could even be done differently under IFRS. For example, funds may use the last sales price of a security to determine daily net asset value ("NAV"), which is an acceptable approach under U.S. GAAP SEC fair value guidance; however, IFRS requires using the bid price for long positions and ask price for short positions, which is generally only used for securities in the over-the-counter market for funds who report under U.S. GAAP.
- 5. Investor education:** Management needs to be prepared to answer questions from investors and consider proactive communications to ease the risk of misunderstandings by investors about financial reporting.

Technical Accounting Issues for Investment Funds

U.S. GAAP and IFRS differ in key ways, including their fundamental premise. At the highest level, U.S. GAAP is more of a rules-based system, whereas IFRS is more principles-based. This distinction may prove more vexing than it initially appears, because most accounting and finance professionals in the U.S. have been schooled in the rules of U.S. GAAP. The overriding lesson from their years of study and work was this: If you have an issue, look it up. Under U.S. GAAP, voluminous guidance attempts to address nearly every conceivable accounting problem that might arise. And if that guidance doesn't exist, it generally is created. Although IFRS is not without its rules, it is clear that accountants practicing in the United States will have less interpretive guidance to use under IFRS and consequently will be required to use more professional judgment than they are accustomed to, which could prove to be a challenge for some, especially in light of the lack of specific industry guidance under IFRS.

However, it is not simply the dissimilarity between a rules-based approach and a principles-based approach that accounts for the differences between the two sets of standards. The sets of standards differ on a number of points and may significantly affect an investment fund's financial results. Although the extent of these differences is dwindling as a result of convergence, significant differences remain in areas such as consolidation, investment valuation, and master/feeder presentation. For example, IFRS requires funds to consolidate all investments in which they have control. Under IFRS, controlled portfolio companies would be consolidated, rather than reported at fair value as an investment. With the passage of time, it is possible that convergence will lead to a reduced number of differences between IFRS and U.S. GAAP.

Also, as IFRS generally allows for more choices than U.S. GAAP, differences in accounting for similar transactions under IFRS may result. Given that the principles-based approach and more choices may result in differences in accounting for what appear to be similar transactions, robust disclosures are advisable to assist in the comparability and transparency of the financial reporting.

The use of principles-based accounting standards represents a significant change in mindset — one that investment management businesses should be prepared to address. Additional training and consultation will likely be necessary from those with IFRS experience, along with more robust policies and procedures to ensure that any decisions that are made in the IFRS adoption are consistent across the fund complex. There may be several options under IFRS, all of which are acceptable, but the elected policy needs to be disclosed.

Beyond the issue of rules versus principles, IFRS also can pose particular technical accounting challenges to funds. When addressing the technical accounting challenges, investment funds must not lose sight of the effects, potentially significant effects, those changes may have on tax, regulatory, process (including internal controls over financial reporting), and IT.

The tables on the following pages highlight U.S. GAAP/IFRS differences and challenges which are particularly important to funds.

Initial adoption:

Generally, reporting entities must apply initial IFRS adoption rules retrospectively — with some limited exceptions. Any differences resulting from the change in accounting policies upon the initial adoption date of IFRS are recorded directly through retained earnings. One key adoption consideration is that fair value estimates at initial adoption date need to be consistent with estimates made at the same date under U.S. GAAP (after adjustment to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error.

Key Impacts of IFRS Implementation

Technical Accounting	Process and Statutory Reporting	Technology Infrastructure	Organizational Issues
<ul style="list-style-type: none"> • Overall approach to IFRS implementation • First time adoption policy considerations, including reporting dates and use of exemptions • Ongoing policy considerations, including alternatives and approach to “principles” 	<ul style="list-style-type: none"> • Internal controls and processes, including documentation and testing • Management and internal reporting packages • Global reporting packages • Statutory reporting, including “opportunities” around IFRS adoption 	<ul style="list-style-type: none"> • General ledger and chart of account structure, including performance metrics • Global consolidation • Sub-system issues related to configuration and data capture • Capabilities to manage multiple GAAP accounting during transition 	<ul style="list-style-type: none"> • Tax structures • Treasury and cash management • Legal and debt covenants • People issues, including education and training, compensation structures • Internal communications • External and shareholder communications

Selected GAAP Differences that Impact Investment Funds

Potential Differences	IFRS	U.S. GAAP
Industry Specific Guidance	<p>IFRS does not provide specific guidance for registered investment companies or private funds.</p> <p>Where specific guidance does not exist for industry specific issues, investment companies following IFRS must look to other IFRS dealing with similar issues, the Conceptual Framework, standards of other standard-setting bodies and, in certain instances, accepted industry practices.</p>	<p>Specific guidance is available for investment companies, principally through the AICPA's Audit and Accounting Guide for Investment Companies (the "Guide") and Articles 6 and 12 of the SEC's Regulation S-X.</p>
Financial Instruments – Initial Recognition	<p>Securities transactions can be recorded either on a trade date or settlement date basis.</p> <p>When settlement date accounting is applied, an entity recognizes any change in value between the trade date and the settlement date of the asset through profit or loss for assets classified as financial assets at fair value through profit or loss.</p>	<p>Securities transactions for investment funds are recorded on the trade date basis.</p>
Financial Instruments – Classification	<p>Investments are generally classified as trading, or designated at fair value through profit and loss.</p> <p>Subsequent measurement depends on the classification of the investments, although it is generally at fair value through profit and loss.</p> <p>On October 13, 2008, the IASB announced amendments to IAS 39 that would permit the reclassification of some financial instruments. Such reclassifications were already permitted under U.S. GAAP in rare circumstances.</p>	<p>For funds, all investments are accounted for at fair value pursuant to the Guide.</p> <p>Unrealized gains and losses are recognized in the income statement.</p>
Financial Instruments – Fair Value Measurements	<p>Fair value is based on observable market prices or observable market data. If these are not available, transaction price is deemed best evidence of fair value.</p> <p>Investments are fair valued using bid for long positions and ask for short positions (mid can be appropriate when offsetting positions).</p> <p>IAS 39, paragraph 48A establishes the framework for fair value measurements.</p>	<p>Fair value is viewed as an exit price. FASB Statement No. 157, <i>Fair Value Measurements</i>, establishes the framework for fair value measurements including the 3-level hierarchy for disclosures.</p> <p>Investments are fair valued but methods vary and there is no specific prescription for long versus short securities. Last traded price or mid market is common.</p> <p>SEC registered money market funds generally value investments at amortized cost for financial reporting purposes and disclose that amortized cost approximates fair value.</p>
Financial Instruments – Transaction Costs	<p>Transaction costs that relate to investments recorded at fair value through profit and loss are expensed.</p>	<p>Transaction costs are recognized as part of an investment's cost.</p>
Contingent Liabilities	<p>IFRS recognition threshold for contingent liabilities is set at "more likely than not."</p> <p>The lower IFRS recognition threshold could result in more liabilities being recognized.</p>	<p>U.S. GAAP recognizes contingent liabilities when they are probable and reasonably estimable.</p>
Consolidation	<p>Funds are required to consolidate all investments (including other funds and operating companies) over which they have control.</p> <p>Control is defined as "the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities." Control is presumed to exist if a fund holds more than half of the voting power of another entity but may also exist under other circumstances. This definition considers two factors: governance and benefits/risks. Governance relates to the power to make decisions, and may or may not be represented by the presence of voting rights. Benefits/risks relate to consequential economic value arising from the decisions that are made.</p>	<p>Consolidation of operating companies is not appropriate for an investment fund except in the case of operating subsidiaries providing services to the investment fund.</p> <p>If an investment fund is a feeder fund within a "master/ feeder" structure, the master fund should not be consolidated but shown using specific presentation requirements.</p> <p>Additionally, if an investment fund is classified as a fund of funds, it would not consolidate investee funds but show its investments using specific presentation requirements.</p>

Selected GAAP Differences that Impact Investment Funds, Continued

Potential Differences	IFRS	U.S. GAAP
Classification of Investor Ownership	<p>Shareholder interest is currently expressed as a liability when the interest is redeemable by the investor. In addition, IFRS requires that investor capital be split between share capital, premium, and surplus.</p> <p>An amendment to IAS 32, which is effective for annual periods beginning on or after January 1, 2009 (with early adoption permitted) would enable some puttable financial instruments and financial instruments that impose on the issuer an obligation to deliver a pro-rata share of net assets of the entity only on liquidation to be presented as equity. This amendment is expected to result in investment companies presenting their preferred/participating shares as equity.</p> <p>Net assets of open-end investment funds could have zero net assets, impacting contractual calculations such as management fees as management agreements may need to be updated.</p>	Shareholder interest is classified as equity.
Distributions to fund shareholders	Distributions flow through the income statement as financing costs if related instruments are recognized as financial liabilities.	Distributions are recognized as transactions in equity and shown in the statement of changes in net assets.



Financial Statement Presentation and Disclosure Differences for Investment Funds

Potential Differences	IFRS	U.S. GAAP/Investment Company Audit Guide/SEC
Titles and order of financial statements	<ol style="list-style-type: none"> Balance sheets, Statements of changes in equity (or "Statements of changes in net assets attributable to holders of redeemable shares" if there is no equity), Income statements, Statements of cash flows 	<ol style="list-style-type: none"> Statements of assets and liabilities (or net assets), which includes a schedule or condensed schedule of investments, Statements of operations, Statements of changes in net assets or statements of changes of partnership/member capital (depending on structure), Statements of cash flows (may or may not be required under U.S. GAAP)
Comparatives	IFRS requires two years for balance sheets, income statements, statements of changes in equity, and cash flow statements.	Comparatives are not required except for statements of changes in net assets for registered funds.
Financial Highlights	IFRS does not require presentation of financial highlights (per unit results, total return/internal rate of return and income/expense ratios).	<p>Financial highlights are required for each share class for all periods presented in the financial statements for private funds and for the latest five fiscal years for registered funds.</p> <p>The disclosure of financial highlights is required under U.S. GAAP, either as a separate schedule for each permanent class of share which is not a management class or within the notes to the financial statements.</p>
Schedule of Investments	Disclosure of a schedule (or a condensed schedule) of investments is not required. If presented, comparatives are required for all periods presented.	Disclosure of a schedule (or a condensed schedule) of investments is required. This schedule is categorized by type, country, and industry. A full schedule of investments is required for registered funds. Under U.S. GAAP, a condensed schedule of investments or full schedule of investments is required for private funds. A condensed schedule of investments must detail all individual positions and investments greater than 5% of net assets and all investments in any one issuer or underlying greater than 5% of net assets.
Earnings per share ("EPS")	Required for publicly traded funds. The requirement to disclose EPS applies only to those funds whose shares qualify as equity instruments.	Not applicable, as investment funds are excluded from the scope of FASB Statement No. 128.
NAV per share	Not required but it is common practice to disclose NAV per share.	NAV per share is required to be presented on the statement of assets and liabilities and per unit changes in net assets are required to be disclosed in the financial highlights for unitized funds.
Financial Instruments – Disclosure	<p>Separate presentation is required for certain classes of financial assets and liabilities.</p> <p>IFRS prescribe disclosure for financial instruments held by an entity, either individually or as a class. IFRS require significant risk management disclosure.</p>	<p>Like IFRS, separate presentation is required for certain classes of financial assets and liabilities for registered funds. Unlike IFRS, there are no specific presentation requirements for private funds.</p> <p>For derivative financial instruments in private funds, disclose in the schedule of investments the number of contracts, range of expiration dates, and cumulative appreciation/ depreciation if it exceeds 5% of net assets. Also disclose the range of expiration dates and fair value for all other derivatives of a particular underlying which exceed 5% of net assets. For registered funds, disclose all details of each derivatives contract separately.</p>
Cash	<p>Overdrafts may be included in cash balances.</p> <p>The policy should be disclosed in the footnotes, and consistency of policies across the investment complex should be considered.</p>	Overdrafts are generally excluded from cash balances and disclosed separately.
Balance Sheet Format	<p>Classified balance sheet and minimum line items on the face of the balance sheet should be presented.</p> <p>Under both IFRS and U.S. GAAP, classified presentation generally has little relevance since most holdings are current.</p>	<p>Entities may present either a classified or non-classified balance sheet. Items on the face of the balance sheet are generally presented in decreasing order of liquidity.</p> <p>Registered funds should follow SEC regulations.</p>

Financial Statement Presentation and Disclosure Differences for Investment Funds, Continued

Potential Differences	IFRS	U.S. GAAP/Investment Company Audit Guide/SEC
Income Statement Format	IFRS does not prescribe a standard format, although expenditure is presented in one of two formats (function or nature). Certain minimum items are presented on the face of the income statements.	Present as either a single-step or multiple-step format. Expenditures are presented by function. GAAP requires separate presentation of investment income (i.e., dividends and interest) for investment funds. Registered funds should follow SEC regulations.
Realized and Unrealized gains/ (losses) on Investments	IFRS does not specifically address whether the disclosure of net realized gains (losses) and net change in unrealized appreciation (depreciation) should be presented separately for investments which are determined to be fair valued through profit and loss.	Net realized gains (losses) and net change in unrealized appreciation/depreciation should be disclosed separately. There is no requirement to separately break out derivatives.
Statement of Cash Flows – Exemptions, format and method	Required for all funds. Direct or indirect method is permitted. Specific differences in presentation exist versus requirements of U.S. GAAP. For example, interest and dividend income/expense and interest and dividends received/paid are broken out separately on the statements of cash flows.	If certain conditions are met, an investment company may be exempted from presenting a statement of cash flows. The direct or indirect method is permitted.
Authorization of Financial Statements	Disclosure is required on who approved the financial statements and on what date.	No specific requirement.
Risk Reporting	IFRS 7 has robust and specific quantitative and qualitative risk disclosure requirements. IFRS 7 requires disclosures related to the nature and extent of risk exposure of investments including credit risk, liquidity risk, interest rate risk, market risk, and currency risk. For market risks, sensitivity analyses must also be disclosed, either for each market risk or in the aggregate.	Generally more of a focus on qualitative risk disclosures.
Segment Reporting	Required unless an investment fund's shares or debt instruments are not publicly traded.	Not required for funds.



More Than Accounting and Financial Reporting

Without question, IFRS will impact the general ledger and financial statements. But in a relative sense, the accounting and financial reporting may be the easy part. How you handle the nonfinancial aspects of the transition to IFRS may be a far more accurate indicator of your success. Among the areas warranting your attention are human resources, legal and compliance, governance, regulatory, tax, valuation, and technology.

Human Resources: IFRS will likely influence the training, compensation, benefit, and termination practices of managers responsible for the back office activities of funds.

Consider hiring: How many of your finance staff are currently versed in IFRS? (If you don't know, consider adding a personnel inventory to your IFRS road map.) Assuming a talent shortfall, how will you make up the difference? Most U.S. college-level accounting programs are only just now getting their IFRS curriculum established. If you can't recruit in sufficient numbers, can you train existing staff? You'll need a budget and a plan to do so.

Additionally, many funds and investment managers calculate bonuses for top executives and employees based on profits or fund performance. In most cases, reporting under IFRS will likely change that bottom line. Executive and employee compensation plan revisions may be required to smooth over the differences.

Finally, the effect on headcount should be explored. In recent years, many finance functions, within the financial services industry, have been downsizing for reasons of cost and efficiency. Conversion to IFRS may align with this trend, if your company decides to create a shared services center to house the finance function. The rationale is simple: If you previously reported under several – perhaps dozens of – local GAAPs, consolidation to a single standard will mean fewer people are required to handle the financial reporting duties.

Consequently, human resources issues may be a major concern. A conversion project will place increased demands on your personnel, which may come at a time when you are least able to handle it. Unfortunately, personnel reductions resulting from downsizing efforts may mean that the people who could best help with your IFRS efforts are no longer available.

Legal and Compliance/Governance: The ripple effects of conversion to IFRS will surely be felt by your legal and compliance departments. Contracts will need to be examined for possible impact, and some agreements may need to be renegotiated and restructured, which will require the involvement of legal experts. To improve the efficiency of this process, a contract database could be created (if not already in place) to better monitor the IFRS conversion and tracking of effects.

The IFRS conversion may trigger the need to amend contracts in regards to financial accounting information to be supplied. You may have to reword certain sections to address regulatory or third-party requirements to replace U.S. GAAP information with IFRS information.

Your attorneys are already acutely aware that the investment management industry has a propensity for fund mergers, profit-sharing agreements, and other collaborative arrangements. The contractual underpinnings of all these relationships will need to be revisited.

The availability of board and audit committee members with the requisite understanding of IFRS is something that management responsible for fund governance should consider. Audit committee members of registered funds that are currently identified as “financial experts” may be uncomfortable taking responsibility for financial statements prepared under IFRS. Management should consider the willingness of those charged with governance to spend the time needed to learn a new basis of accounting. In the early days of transitioning to IFRS, there may be fewer members willing to serve.

Actions for Legal Counsel

1. Consider how governing agreements, such as those outlining management and incentive fee arrangements, may be impacted by IFRS. Will fee calculations need to be updated to consider different accounting treatment under IFRS?
2. Determine if fund valuation policies contained within your legal documents will require updates. Are the valuation policies IFRS compliant? These changes could have a direct impact on earnings of the advisor, as the base used for asset based fees.
3. Determine which fund governance documents may need to change and what approvals are required.

Regulatory: In an industry like investment management, the thicket of local, national, and international regulatory requirements can trip up even the most sophisticated enterprise. Thus, the prospect of dealing with a transition to IFRS on top of the work associated with the existing collection of regulatory requirements may seem daunting. Yet, paradoxically, the worldwide trend toward IFRS adoption may actually ease compliance burdens.

Certainly, the opportunity to drastically reduce multiple GAAP reporting and coalesce around a single set of standards will provide some relief. The European Union's (“EU”) 2005 conversion to a single set of standards harmonized and simplified compliance, and today there is more cross-border consistency in the application of rules and standards.

But IFRS holds even greater promise of collaboration among various regulatory bodies. The model for this was provided by the Committee of European Securities Regulators (“CESR”), an independent body that works to improve coordination among EU securities regulators. This group, formed in 2001, played an important role in the IFRS conversion effort by bringing together regulators from across the EU to discuss issues, smooth over differences, and reconcile complex points of view.

As other countries across the globe adopt IFRS, the prospect of additional regulatory bodies (such as the SEC) interacting with their counterparts increases. Thus, the movement toward IFRS may ultimately change the regulatory dynamic, forcing regulators to think globally instead of nationally in how they treat these issues.

Tax: The tax considerations associated with a conversion to IFRS, like the other aspects of a conversion, are complex. For investment funds, tax accounting differences are of great significance. However, the impact of a conversion goes beyond these complex matters and also includes matters such as the impact of pre-tax accounting changes on tax methods, the impact on global planning strategies, and the evaluation of the information systems in place to capture all the necessary data. If a conversion to IFRS is approached properly and well in advance of conversion, it has the potential to strengthen the tax function within an organization by providing an opportunity for a detail review of tax matters and processes.

It is important to address the impact that pre-tax accounting differences between IFRS and U.S. GAAP may have on tax methods. The starting point for calculating U.S. taxable income is book income as reported in accordance with U.S. GAAP (Internal Revenue Code §446). Change the starting point, and the tax equation changes. For differences that impact pre-tax accounting methods, an investment fund will need to consider the following questions:

- Is the new financial reporting standard a permissible tax accounting method?
- Is the new book method preferable for tax reporting purposes?
- Is it necessary to file changes in methods of accounting?
- Will there be modifications in the computation of permanent and temporary differences?
- Do planning opportunities exist?

Upon conversion to IFRS, fair value measurements of financial instruments and debt versus equity classification of investments would be of particular interest to an investment fund relating to differences arising in the accounting.

Fair Value

A critical item that remains to be determined is whether the values of positions reported on financial statements will be considered satisfactory as fair market value for purposes of provisions of U.S. income tax permitting mark-to-market accounting. For example, only U.S. GAAP has been determined to be an eligible method and not IFRS under Treasury Regulation §1.475(a)-4. The Internal Revenue Service (“IRS”) is seeking comments on expanding the eligible methods to include IFRS.

Debt versus Equity Classification of Investments

Hybrid instruments, such as those for which the recipient of “interest” is treated as receiving a dividend but for which the payor gets an interest deduction, are common in international planning. Unlike the U.S., some jurisdictions rely heavily on the financial accounting treatment to characterize a financial instrument for tax purposes. A change in the definition of equity arising from a change in accounting standards may unexpectedly eliminate the tax benefits of hybrid instruments since the income may be treated as interest rather than a dividend and thus impact the global tax planning and the effective tax rate.

And don’t forget tax returns. Different countries are moving to IFRS at different times. Even with IFRS in place, many jurisdictions will require a local version of GAAP for tax compliance. The challenge of dealing with myriad global tax regimes isn’t going away soon.

Valuation: Measurements of fair value weave their way through many sections of IFRS, transcending many back office requirements of an investment fund. Legal areas may be affected through debt covenants, partnership or joint venture agreements, investment contracts and fund documentation or even compensation arrangements with employees or management. Estimating, supporting, documenting, and reporting fair value requires a thoughtful process and the allocation of appropriate resources to manage this important aspect of IFRS.

Several areas related to fair value estimates may be considered, including the use of qualified specialists; the determination of proper extent and frequency; careful scoping of the analysis and report; and the development of a detailed policy or standard.

Fair value disclosures in financial statements will likely vary in detail; however, they should include information on valuation methods, assumptions (credit risk, yield curves, volatility, etc.), qualifications of the valuation specialist, and explanations of fair value conclusions.

Technology: IFRS will have wide-ranging impacts at different levels of IT systems architecture. The realignment of information systems will pose a real challenge for IT (along with the rest of the organization). Virtually all applications and interfaces in the system architecture can be affected, from the upstream or source of data to the farthest end of the reporting tools. As such, time and resource needs will likely be significant.

As you plan changes to your IT systems, you will need to take into account external factors such as local and international regulations, fund administrators, and external auditors. This business transformation should not be considered as a one-step project. It may be necessary to implement short-term initiatives strategically designed to institute an effective long-term solution for the organization.

Many companies that adopted IFRS in Europe learned systems lessons the hard way. They chose to put a basic IFRS framework in place without thinking through transaction-level details. Now they’re paying the price. Their systems can’t deliver the detailed information required. They are trapped in a swirl of spreadsheet workarounds to deliver information that could have been automated.

A more effective approach anticipates the need for transaction details while building out high-level systems. That doesn’t mean you take on a gigantic enterprise program all at once. Begin instead by considering an impact assessment and a piloted rollout.

IFRS could require adjustments to financial reporting systems, existing interfaces, and underlying databases to incorporate specific data to support IFRS reporting. A timeline to roll-out XBRL requirements to registered funds has not yet been outlined by the SEC. However, down the road, registered funds may be required to adopt XBRL and “tag” data elements using the accounting methodology required by their jurisdiction.

Actions for Boards of Directors and Audit Committees of Investment Funds

1. Become informed about IFRS. Gain a general overview of the topic through research and/or presentations from external or internal auditors or other resources, such as consultants with IFRS experience.
2. Understand management’s assessment of the impact of IFRS on the funds and the management company, including the benefits and costs of adopting, alignment with strategy and other activities/initiatives, and their plans and proposals related to IFRS.
3. Develop and share with management your perspective on IFRS in order to evaluate adoption and discuss accounting treatments.
4. Understand how management will deal with financial reporting and control risks associated with IFRS.
5. Understand the approach used by management to select an accounting method from among acceptable alternatives. Within IFRS there are often various options management can elect to adopt or are permitted to adopt. Assess the consistency of policies among funds and consider the preferability of various approaches. A change in method after adoption may require a justification that the new approach is preferable.

The Business Case for IFRS

Not everyone is sold on the merits of IFRS. If you find yourself needing to convince others, consider some of these talking points:

- **Global positioning:** “We do business globally; we have global investors; our brand is international; we are expanding into new markets. Our financial reporting should be a reflection of this operational reality.”
- **Potential savings:** “We are currently reporting under multiple standards —U.S. GAAP, local GAAPs, and IFRS. Consolidating to a single reporting standard and eliminating the large number of accounting reconciliations may yield significant savings.”
- **Inevitability:** “IFRS is coming. If we start soon, we can implement a phased, efficient, and orderly process and avoid the chaos that has typified other major projects.”
- **Access to global investors and markets:** “Aligning with the global reporting standard may enable us to register or offer our product in multiple markets and bring our products to the attention of international investors and open up new opportunities.”
- **Internal control:** “Accounting policies and procedures will be refreshed during an IFRS conversion project; the number of financial reporting standards used and reconciliations required will drop dramatically. The net result will likely be improved accuracy and timeliness of financial reporting.”

Smoothing the Transition

If you decide an accelerated IFRS conversion is desirable, here are a few suggestions for smoothing implementation:

Leverage existing projects: If you are already going through — or recently completed — an ERP or finance transformation project, now may be the time to consider IFRS adoption. Recent versions of major ERP systems are designed to accommodate IFRS, which can be mapped in, usually with significant cost savings.

Conduct a trial run: Implementation might be easier if you take a bite-sized approach starting with a single country or reporting entity. Use existing reporting requirements and local country IFRS requirements to your advantage. For example, funds in countries adopting IFRS on a timeline that is more accelerated than the U.S. timeline may be good candidates for your trial run. Learn from this initial conversion exercise, and apply the lessons learned to your global rollout down the road.

Consider shared services centers: IFRS provides a compelling reason for entities responsible for back office activities of funds to establish shared services centers, to potentially consolidate dozens of local GAAPs down to a single reporting standard and concentrate the knowledge of supporting employees in one or more locations.

Strengthen controls: Many investment management companies have operations located across the globe. A decentralized structure can sometimes lead to reduced oversight and weakened controls. IFRS offers the opportunity to implement standardized frameworks and processes to enhance the overall control environment.

Refresh your policies: Conversion to IFRS drives a need to revisit accounting policies. Controls are needed to ensure that multinational locations with decentralized responsibility for the financial records consistently apply IFRS. Documented policies facilitate consistent understanding by members of the global finance organization. As part of the transition exercise this might be accomplished by highlighting differences between historical U.S. GAAP and new IFRS policies.

Time for Leadership

You are in an enviable position, because you possess knowledge that many others in your organization may not: the world is moving towards IFRS; and the initiative involves multiple corporate functions, not solely finance.

So you have a choice: either sit back and wait for it to happen (with all the attendant uncertainty and risk), or mobilize your company in an effort to extract every possible benefit and dodge every avoidable obstacle. For investment funds, there are some unique aspects to a movement to IFRS. Your organization may want to consider increasing its involvement with industry groups in order to help navigate towards a solution that enables the presentation of meaningful information to investors.

By starting now, you will likely spread out your costs, get the jump on your competition, and reel in scarce talent before it vanishes. You can avoid the fire-drill atmosphere that characterizes most last-minute projects. You can improve your processes and systems. You can integrate with other initiatives, such as an ERP upgrade of back office systems of the investment advisor. Most important, you can do it on your own terms, at a pace that suits your company and its circumstances.

Investment management companies are characterized by intensive activity that places major demands on financial and human resources. An IFRS project cannot be a distraction from the primary activities of your business. It must be integrated, coordinated, and aligned. It starts soon with some preliminary questions and a carefully drawn roadmap. And it ends somewhere in the next decade when you report for the first time all funds within a complex under a single unified standard. Whether the journey from here to there is rocky or smooth may be entirely up to you.



Resources

Deloitte has extensive IFRS experience. With thousands of IFRS-experienced professionals in our global network, we provide an array of services related to IFRS and, as a multidisciplinary organization, are positioned to assist companies in addressing a wide range of IFRS issues.

Deloitte offers companies assistance with:

- Evaluating the potential impacts of IFRS
- Assessing readiness for IFRS conversions
- Implementing IFRS conversions, providing support with technical research, project management, and training
- Addressing the implications of IFRS in such areas as tax, finance operations, technology, and valuation

Deloitte's Asset Management Practice:

As global leaders in providing professional services to investment advisors and to entities in the Private Equity, Hedge Fund and Mutual Fund industry, Deloitte works with clients to address a range of critical issues brought on by regulatory changes, competition, globalization, advances in technology, and the changing demands of their customers. Our industry group is comprised of more than 2,500 partners, managers and staff, providing a spectrum of assurance and advisory, tax, enterprise risk, regulatory and consulting services to a broad range of Private Equity, Hedge Fund and Mutual Fund companies. Our clients include investment advisers and administrators from every sector of the industry, including asset managers, broker-dealers, banks, insurance companies, mutual funds, investment partnerships, hedge funds, alternative products, and other money managers.

Deloitte's U.S. Asset Management practice is characterized by the following facts and figures:

- Over 2,500 professionals; more than 500 partners.
- Key practice offices include New York, Boston, Chicago, Kansas City, Dallas, Denver, Los Angeles, San Francisco, Philadelphia and Stamford.
- Independent auditors of more than 4,000 mutual funds, from innovative start-ups to major fund complexes, representing in excess of \$2.2 trillion in assets under management.
- Based on assets under management, Deloitte ranks second among the Big Four professional services firms in mutual fund audit market share.
- Serving as corporate and/or mutual fund auditor for eight of the top 20 U.S. investment management complexes and providing business advisory services to all of the top 20.
- #1 national market share of all private equity buyout funds.
- Named the top firm in Alpha Magazine's 2008 Alpha Awards™ for the Hedge Fund 100 award for four consecutive years (this represents Alpha's most exclusive ranking of the world's largest single-manager hedge fund firms).

Deloitte's Online Resources

For a wealth of online resources related to IFRS, visit www.deloitte.com/us/ifrs. Available materials include newsletters, whitepapers, pocket guides, timelines, webcasts, podcasts, and more.

International Accounting Resources

The IASB provides additional guidance. Visit the IFRS section of www.iasb.org for additional details and copies of the standards.

Contacts

For more information, please contact one of our Asset Management professionals:

IFRS Leadership Team

Patrick Henry
Partner, IFRS Leader
Asset Management Services
Deloitte & Touche LLP
+1 212 436 4853
phenry@deloitte.com

Cary Stier
U.S. Practice Leader, Asset Management Services
Deloitte & Touche LLP
+1 212 436 7371
cstier@deloitte.com

U.S. Asset Management Services Leadership Team

Audit & Enterprise Risk Services

Donna Glass
Partner
Deloitte & Touche LLP
+1 212 436 6408
email: dglass@deloitte.com

Consulting

Adam Broun
Principal
Deloitte Consulting LLP
+1 617 437 2367
abroun@deloitte.com

Tax

Jim Calvin
Partner
Deloitte Tax LLP
+1 617 437 2365
jcalvin@deloitte.com

Financial Advisory Services

Adam Weisman
Partner
Deloitte FAS LLP
+1 212 436 5276
aweisman@deloitte.com

This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this publication.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu, a Swiss Verein, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu and its member firms. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries.

Copyright © 2008 Deloitte Development LLC. All rights reserved.