

Financial Statements Do's and Don'ts for Private Equity Firms

July 7, 2021



Financial statements are a tool that investors, creditors, and management use as a financial dashboard of the business. It is important that these users find the relevant financial statements easy to understand. In financial reporting, it is strongly advised that the financial statements should present information in a clear and simple manner without omitting useful information.

In order to provide the most transparent financial information to the users, the fund's management, administration firm and audit firm should work together as a team. Identifying proper financial reporting requirements as well as useful financial statement information promptly will be critical to the overall presentation of a fund's audited financial statements.

Let's review some **"Do's and Don'ts"** of key components that go into a private equity fund's preparation of financial statements.

Choose the right basis of accounting for your fund

Cash, Accrual, or Tax Basis – which basis is best for your fund? Users rely on the financial statements to gain an understanding of your fund's financial position and the results of the operations. Regulatory requirements surrounding your fund,

following an established framework (GAAP), or provisions in your organizational documents are just some of the factors to consider when making a choice.

- **Do** seek out the advice of your attorney, administration, or audit firm regarding the proper basis and do so before finalizing your fund documents. Your advisors will be able to guide you through the advantages and disadvantages of each option and provide valuable insights on what could be the right fit for your fund.
- **Don't** choose a methodology solely because what you have seen the most, is the most popular or the least costly to maintain.
- **Don't** deviate from the basis of reporting outlined in your fund documents as this could be problematic. Unless necessary and beneficial, don't contemplate changing your basis at a later date as the process could be costly and time-consuming.

Be consistent in applying valuation methodologies

When it comes to the financial statements of a private equity fund, one of the most critical disclosures relates to the valuation of the fund's underlying portfolio company investments. There must be adequate disclosures and these should include the valuation techniques and inputs used by the fund to measure the fair value of its assets and liabilities, including any judgments and assumptions.

- **Do** make sure your financial statement disclosures align with the policies and procedures the fund has written in the fund agreements.
- **Do** make sure you are following those procedures in practice and not just in documentation alone. The accounting policy on valuation methodologies should be included and discussed in depth in the fund agreement and consistently applied to the fund's investment portfolio.
- **Don't** choose a policy that is too vague or too in-depth that will make it difficult to follow in practice or so complex that it can't be followed. Your valuation policies should be based on real-life practice as well as industry rules and guidance.

Writing the financial statements

Once you have determined the basis of accounting for your fund and you have created and implemented your valuation policy, you can now begin preparing the actual financial statements and disclosures.

- **Do** make sure to have a knowledgeable person in house who can prepare the statements and the disclosures that comprise the financial report. Alternatively, if you have engaged an administration firm to prepare your books and records, make sure they will be able to provide the financial statement preparation and support to complement your accounting and administrative needs. Then make sure you have someone in-house who can review and approve those financial statements.
- **Don't** expect your audit firm to prepare your financial statements.
- **Do** look to your advisors for industry guidance and standard financial statement reporting. Most audit firms have a financial statement guide and disclosure checklists which provide valuable information and samples for both overall presentation and disclosures.
- **Don't** start from scratch if you don't have to.

Getting the basics right

When preparing annual financial statements, there is significant information that must be included both from a financial account perspective as well as a disclosure perspective. All too often, it is the basics that are overlooked.

- **Do** make sure that significant financial accounts that are being presented in the financial statements have corresponding required disclosures. In addition, make sure the disclosures which indicate financial account information agree to the financial statement line items they relate to.
- **Don't** assume everything is correct even if you have engaged an advisor to prepare your financial statements. Take the time to thoroughly review the financial statements and make certain they present the fund's records fairly and accurately.

As the fund manager, you have the responsibility to review and ultimately approve

the financial statements that will be issued. Take the time to understand the required disclosures and how those disclosures best fit your fund. Make sure that all disclosures accurately and fairly represent the fund's performance. Work with your service providers, ask questions and seek out advice. During the planning phase of your audit, discuss with your auditors the draft financial statements so you can avoid surprises such as new or required disclosures including any new accounting standards updates (ASUs) that may affect your fund. Being proactive well in advance of the issuance could alleviate delays when you are trying to finalize your audited financial statements.

For more information on best practices for preparing your financial statements, please contact [Anchin's Emerging Manager Platform team](#) or your Anchin Relationship Partner.