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15
Years



GUIDE FOR FUND DIRECTORS OVERSEEING THE FINANCIAL STATEMENT CYCLE IN TIMES OF CRISIS



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FOREWORD

In times of crisis, more than ever, the role of Boards is crucial in overseeing the financial statement preparation process and, if applicable, the audit cycle. Boards will undoubtedly be focusing their attention and efforts to guide the business through the crisis, such as the roll out of business continuity plans, in order to weather the storm.

Nevertheless, Boards, Audit Committees where applicable, and Management must still ensure that financial reporting and auditing processes remain robust and as timely as possible amid the crisis situation.

This paper sets out guidance and recommendations of best practice for the Board to consider during times of crisis when seeking to discharge its duty to ensure that complete and accurate financial statements have been prepared in accordance with financial reporting standards and applicable Luxembourg rules and regulations.



Justin GRIFFITHS

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OVERSEEING THE FINANCIAL STATEMENT CYCLE IN TIMES OF CRISIS

As presented in the ILA PRACTICAL GUIDANCE ON FINANCIAL STATEMENTS AND RELATED AUDIT ASPECTS OF INVESTMENT FUNDS IN LUXEMBOURG, investors in investment funds and other stakeholders rely on the soundness of financial reporting in order to assess the creation and protection of shareholder value and the delivery of investment performance. This remains true in times of crisis.

The first step is for the Board to assess the potential impact of the crisis on the financial statement preparation process and, if applicable, on the audit cycle. Will the crisis likely impact the financial statement presentation and disclosures? Has the crisis occurred before or after the financial year end (or interim date) under review? Can legal and regulatory filing deadlines still be met? Does the situation require ad-hoc investor communication?

Although there is no 'one size fits all' approach, the below considerations may assist Fund Boards to navigate the financial statement preparation process and, if applicable, the audit cycle as part of their overall response to a crisis situation:

1. Ensure regular communication to and from Management;
2. Ensure that Management considers the impact of the crisis early and on an ongoing basis as part of the financial reporting planning or status update meetings;
3. Ensure internal controls are being adequately monitored over the preparation of financial statements during the crisis e.g. to address increased fraud and cyber security risks;
4. Enquire of the Fund's service providers and the Auditor about their respective business continuity plans and whether any delays in the production of the financial statements are foreseen;
5. If the financial statements are subject to audit, engage with the Auditor early as part of the audit planning or at an ad-hoc meeting(s) to discuss the likely impact of the crisis on the audit of the financial statements;
6. Pay attention to events that may raise uncertainties about the Fund's (and/or sub-fund) ability to continue as a going concern e.g. increased redemptions, strained fund liquidity or service provider delivery concerns;
7. Prepare for an increase in the application of Management assumptions and estimates, e.g. in the area of asset valuation and stress testing;
8. Expect greater challenge of Management assumptions and estimates by the Auditor;
9. Be alert to the effect of the crisis on the financial statements and potential effect on the audit opinion (if subject to audit);
10. Prepare for a potential increase in significant events, subsequent events and going concern disclosures;
11. Further (or updated) disclosures may be required in the Board and/or investment manager's reports;



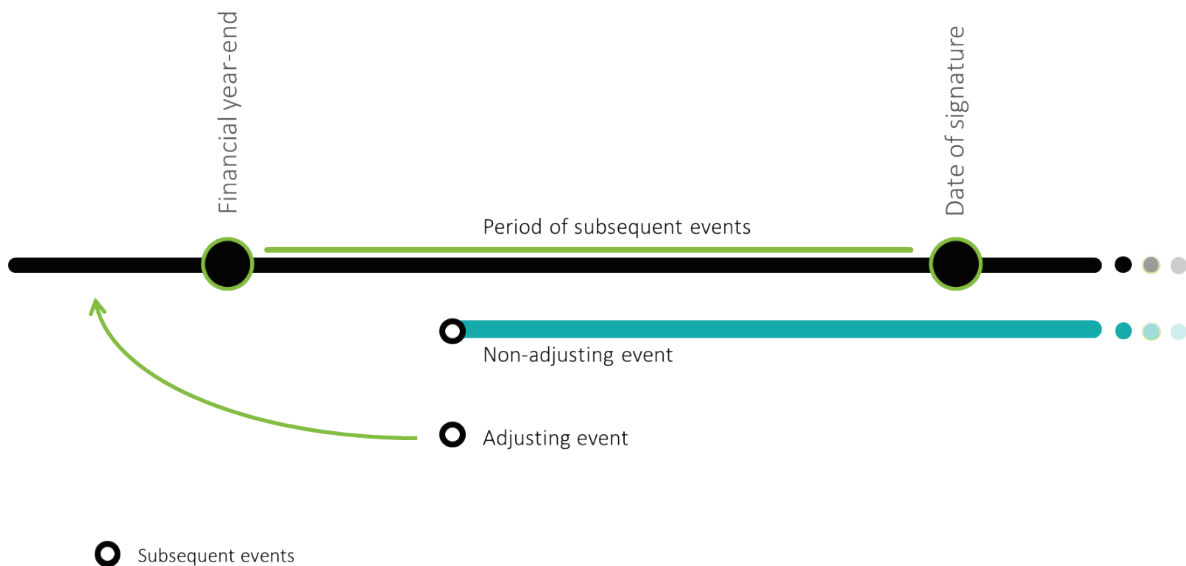
12. Consider any regulatory response to the crisis situation and the impact that it may have on the financial statement preparation process, and if applicable, the audit cycle;
13. Careful consideration of representations in the Auditor's representation letter that address Management's assessment and response to the crisis and its impact on the financial statements. This may require additional comfort to be received from the relevant service providers to the Board;
14. Meeting filing deadlines may be challenging. Boards may need to make tough decisions to delay the issuance of financial statements to ensure appropriate assessments and related disclosures are made as to how the crisis impacts the Fund and its (future) operations. Advance communication with regulatory authorities (including authorities in countries where products are distributed) may be required to request extension of filing deadlines and provide reasons for such delays. Investors should also be appropriately informed;
15. Revised arrangements for approval of the financial statements by the Board and the holding of the shareholder annual general meeting may be necessary e.g. electronic signatures and virtual meetings;
16. Consult resource centers that are made available by industry associations to assist members in dealing with the crisis.


Specific considerations by the Board of particular circumstances and events may include:

Significant events – if the crisis emerged during the financial year, Boards will need to ensure that both qualitative and quantitative disclosures provided by the Fund on the impact of the crisis on its activities, financial situation and future economic performance are adequate and appropriate in view of the applicable financial reporting framework.

Subsequent events – if the crisis emerged after the end of the financial year, Boards will need to consider whether the subsequent events are adjusting or non-adjusting and ensure that the adjustments and/or qualitative and quantitative disclosures provided by the Fund on the impact of the crisis on its activities, financial situation and future economic performance are adequate and appropriate in view of the applicable financial reporting framework.

The diagram below illustrates the distinction between adjusting and non-adjusting subsequent events:





Auditors may need to include a related ‘emphasis of matter’ paragraph in their audit report if the subsequent event is considered essential for the user to understand the impact. Where disclosure is not appropriate, auditors may need to modify their audit opinion accordingly.

A going concern assessment needs to be performed prior to the date on which the financial statements are authorised for issuance (Board approval). This assessment is to be prepared by Management and needs to capture the impact of the crisis on the Fund, taking into account the specifics of the Fund and/or sub-fund(s) in terms of asset classes (valuation), geographical asset exposure and industry exposure. Furthermore, Fund specific factors, such as current (and expected) net redemption levels, disruptions at service provider level and overall investor sentiment, should form part of the going concern assessment.

Auditors will need to include a separate section, with a heading that includes reference to the fact that a material uncertainty related to going concern exists, in their audit opinion if there is a material uncertainty about the ability of the Fund and/or sub-fund(s) to continue as a going concern for the foreseeable future (which is appropriately disclosed). Where disclosure is not appropriate or the Auditor disagrees with Management’s adopted going concern assessment, auditors may choose to modify their audit opinion accordingly.

This guidance should be read in conjunction with existing ILA guidance, including:

- Practical Guidance on financial statement and related audit aspects of investment funds in Luxembourg.
- Audit Committee Guide for Boards of Luxembourg Investment Funds and Management Companies.
- Directors FAQ - Luxembourg Funds and Management Structures.
- Management’s Representation in the Context of an Investment Fund Annual Audit.

These are available on www.ila.lu/publications

SIGNIFICANT EVENTS, SUBSEQUENT EVENTS AND GOING CONCERN CONSIDERATIONS FOR LUXEMBOURG INVESTMENT FUNDS

The following checklist may assist Boards with considerations relating to the impact of significant events, subsequent events and going concern considerations.

1. Crisis arises before (or during) the financial reporting period end under review

Obtain Management's assessment of the impact of the crisis on:

- (i) the operations of the Fund (including related infrastructure such as service providers) as of the balance sheet date; and
- (ii) the NAV calculation; and
- (iii) the financial statements of the Fund currently under review.

Questions that should be asked

- Can the Fund still be operated in accordance with the articles of incorporation/management regulations and the prospectus?
- Have any difficulties been encountered in the fair valuation of instruments held in the Fund's portfolio (e.g. prices from approved pricing vendor no longer available; lack of market information to fair value investments) as of the financial reporting period end?
- Are there any significant valuation write-downs at period end?
- Is there a significant proportion of illiquid and difficult to price securities in the portfolio at period end?
- Has the Fund's NAV calculation(s) been suspended (or intention to suspend) as a result of the difficulties in fair valuing the instruments or for other reasons?
- Is the Fund experiencing any liquidity issues at the Fund or any sub-fund level?
- Have any measures foreseen within the Fund's prospectus (e.g. increased swing pricing factors, NAV suspension and gating/deferred redemptions) been deployed to deal with potential or actual spikes in redemptions?
- What level (% of assets under management) of redemptions has the Fund experienced up to the balance sheet date (over the last month, quarter etc.)?
- Does the Fund have significant exposures to industries or assets that are hit hard by the crisis?
- Has the Fund been required to use any credit facilities (e.g. bank overdraft facilities or committed credit lines) at its disposal?
- Has a decision been made to (or is there any intention to) liquidate the Fund or sub-fund(s)?
- Has the Fund been required to report any related matters to a regulator in the context of its supervision of the crisis?

Impact on financial statements

Based on the above assessment:

- Have Management and/or the Board of Directors of the Fund identified events which impact the presentation and disclosures in the financial statements?
- If yes, have Management accurately and appropriately reflected the impact in the financial statements and relevant disclosures been included to describe the events arising and the effects as a result of the crisis on the Fund?
- If the effects of the crisis continue after the period end, have Management accurately and appropriately reflected the subsequent event disclosures to describe the current and assessed future impact of the crisis on the Fund in the financial statements under review?

Doubts about going concern

Based on the above:

- Have Management and/or the Board of Directors of the Fund identified any events or conditions that may cast significant doubts on the Fund's (or any of its sub-funds) ability to continue as a going concern from the date of assessment to the end of the following financial year of the Fund?
- Have Management accurately and appropriately described the material uncertainty, assumptions made and Management's response to address the material uncertainty in the financial statements currently under review?

If it is concluded that the Fund (or any of its sub-funds) is no longer a going concern, the Board should ensure that Management have adopted the liquidation basis of accounting in preparing the financial statements (related to the respective sub-fund(s)).

2. Crisis arises after the financial reporting period end under review

Obtain Management's assessment of the impact of the crisis on:

- (i) the operations of the Fund (including related infrastructure such as service providers) since the balance sheet date;
- (ii) the NAV calculation; and
- (iii) the financial statements of the Fund currently under review.

Questions that should be asked

- Have any difficulties been encountered in the fair valuation of instruments held in the Fund's portfolio (e.g. prices from approved pricing vendor no longer available; lack of market information to fair value investments) since the financial reporting period end?
- Are there any significant valuation write-downs after the period end?
- Has an assessment been made that the Fund's NAV calculation(s) be suspended as a result of the difficulties in fair valuing the instruments or for other reasons?
- Is the Fund experiencing any liquidity issues at the Fund or any sub-fund level?

- Are there any plans to deploy measures foreseen within the Fund's prospectus (e.g. increased swing pricing factors, NAV suspension, gating/deferred redemptions) to deal with potential or actual spikes in redemptions?
- What level (% of assets under management) of redemptions has the Fund experienced from the balance sheet date to the date of assessment ?
- Does the Fund have any significant exposures to industries or assets that are likely to be hit hard by the crisis?
- Does the Fund have any credit facilities (e.g. bank overdraft facilities or committed credit lines) at its disposal? Have these facilities been utilised as a response to the crisis?
- Has a decision been made to (or is there any intention to) liquidate the Fund or sub-fund(s)?
- Has the Fund been required to report any related matters to a regulator in the context of its supervision of the crisis?

Subsequent events identified

Based on the above:

- Have Management and/or the Board of Directors of the Fund identified any subsequent events (adjusting or non-adjusting) which impact the financial statements but do not give rise to significant concerns on the Fund's ability to continue as a going concern for a period to at least twelve months from the date of approval of the financial statements under review?
- If non-adjusting, have Management accurately and appropriately disclosed the current and future impact of the subsequent events on the Fund in the financial statements under review?
- If adjusting, have Management:
 - Accurately and appropriately adjusted the period end balances;
 - Included accurate and appropriate disclosures to describe the events arising and the adjustments made as a result of the crisis on the Fund in the financial statements under review; and
 - Performed a reconciliation between the financial statement NAV and the originally calculated NAV?

Doubts about going concern

Based on the above:

- Have Management and/or the Board of Directors of the Fund identified events or conditions that may cast significant doubts on the Fund's ability to continue as a going concern from the date of assessment to the end of the following financial year of the Fund?
- Have Management accurately and appropriately described the material uncertainty, assumptions made and Management's response to address the material uncertainty in the financial statements currently under review?

If it is concluded that the Fund is no longer a going concern, the Board should ensure that Management has adopted the liquidation basis of accounting in preparing the financial statements (related to the respective sub-fund(s)).



GENERAL BOARD CONSIDERATIONS - FINANCIAL REPORTING

The following checklist may, in general, assist Boards with respect to processes to be applied in reviewing financial statements and accompanying note disclosures (together, the “financial statements”), reviewing disclosures with respect to new circumstances, and assessing the disclosure of items of significant interest to investors or regulators.

The Board may determine processes to be applied to review the financial statements and accompanying note disclosures, and which of the following activities to incorporate within the review:


- Understanding procedures followed by Management to ensure that the financial statements comply with generally accepted accounting principles and applicable CSSF requirements, including any differences in procedures followed for semi-annual and annual reports to shareholders;
- Reviewing continued appropriateness of accounting policies and disclosure practices and their consistency with industry norms, and any changes made thereto;
- Understanding significant adjustments made to financial statements by Management as part of the period-end accounting and financial reporting process;
- Understanding any uncorrected misstatements identified by Management and/or detected by the Auditor and their effect on the financial statements;
- Reviewing other information accompanying the financial statements in shareholder reports (such as the Report on the Activities of the Fund); and
- Discussing financial statements with Management and Auditors, including obtaining their comments and observations on the timeliness in preparing, and the quality of, draft financial statements.

The Board may also examine whether any required, or desired, disclosures pertaining to any new circumstances have been or should be made, such as:

- Unusual or non-recurring significant transactions;
- Events that may have a significant impact on the Fund’s future operations or its financial statements (for example, launch or closure of new sub-funds, pending or completed mergers of funds and change of service providers); and
- Volatility in markets, caused by credit, currency, or other factors.

The Board should understand any effect on the Fund from circumstances with current significant interest to investors or regulators, and the adequacy of related disclosures, such as:

- Listing on an EU regulated market and related “Public Interest Entity” designation;
- Extended Auditor reporting requirements (“key audit matters”);
- Investments in complex securities (like derivatives and other structured investment vehicles) and corresponding valuation, accounting, and reporting practices;

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- Accounting determinations made in respect of uncertain tax positions taken or expected to be taken;
 - Transactions between the Fund and (i) officers/directors; or (ii) other affiliates/related parties;
 - Securities lending activities;
 - Anti-dilution techniques such as swing pricing;
 - Fee and transaction cost transparency; and
 - The Board may have to consider additional communications/notifications to investors on specific matters.

Finally, the Board should consider these other matters:

- Financial reporting matters for which Auditors require 'special' representations in written representation letters;
- Consistency of disclosures contained in the Directors and/or Investment Managers Report and other non-financial information sections of shareholder reports with the financial statements and the Board's understanding of the Fund and its operations;
- Quality of disclosures in the Directors and/or Investment Managers Report, particularly the extent to which they address the Fund's specific portfolio strategies and security selection during the period; and
- New pronouncements and regulations by standard-setters expected to require changes in accounting policies or disclosures and their anticipated effect(s), including considerations made of early adoption of such pronouncements.

GLOSSARY OF TERMS

Abbreviation or term	Meaning
Adjusting events	Subsequent events that provide evidence of conditions that existed at the date of the financial statements. Those events trigger the adjustment of the primary financial statements.
Audit Committee	An Audit Committee is a committee of the Board of Directors appointed to be responsible for overseeing the financial reporting process. The committee assists the Board of Directors to fulfil its corporate governance and oversight responsibilities in relation to the Fund's financial reporting, internal control system, and internal and external audit functions. Unless there is a separate Board risk committee, its responsibilities may extend to reviewing the investment fund and management company's internal control and risk management systems. Its role is to provide advice and recommendations to the Board within the scope of its terms of reference.
AGM	Annual General Meeting of shareholders
AIF(M)	Alternative Investment Fund (Manager)
Auditor	A Statutory Auditor, who is a member of the IRE and authorised to: <ul style="list-style-type: none"> a) carry out statutory audits; and b) perform any other related engagements delegated exclusively to them by the Luxembourg law on the audit profession.
Board (of Directors)	In the context of a Fund, the Board is an elected group of individuals that represents the investors in the Fund and is the governing body that typically meets at regular intervals to: <ul style="list-style-type: none"> a) determine the Fund's strategic objectives and policies; b) monitor progress towards achieving the objectives and policies; c) appoint the service providers to the Fund; and d) account for the Fund's activities to relevant parties, e.g. investors, regulatory authorities.
CSSF	Commission de Surveillance du Secteur Financier, Luxembourg Regulatory Authority
Emphasis of matter paragraph	A paragraph included in the Auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the Auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

EU-PIE	<p>A Public Interest Entity in the European Union, being:</p> <ul style="list-style-type: none"> • All entities that are both governed by the law of a Member State and listed on a Regulated Market in the EU, as defined in the MiFID; • All credit institutions in the EU, irrespective of whether listed or not; • All insurance undertakings in the EU, regardless of whether they are listed or not and regardless of whether they are life, non-life, insurance or reinsurance undertakings; or • Entities designated by Member States as public interest entities, for instance undertakings that are of significant public relevance because of the nature of their business, their size, or number of employees.
Foreseeable future	<p>The term ‘foreseeable future’ is not defined within ISA 570, but will be determined in accordance with the financial reporting framework applied. Under IFRS for example, IAS 1 <i>Presentation of Financial Statements</i> deems the foreseeable future to be a period of at least 12 months from the end of the reporting period.</p>
Going concern	<p>As per ISA 570 - the financial statements are prepared on the assumption that the Fund is a going concern and will continue its operations for the foreseeable future.</p> <p>General purpose financial statements are prepared using the going concern basis of accounting, unless Management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.</p>
IRE	Institut des Réviseurs d’Entreprises, the Luxembourg Institute of Registered Auditors
ISA	International Standards on Auditing
Key Audit Matters	<p>For EU PIEs, the Auditor’s report is expanded to include information on key audit matters, defined as those matters that, in the Auditor’s professional judgment, were of most significance in the audit of the financial statements of the relevant period.</p>
Management	<p>Management means such personnel who are responsible to perform day to day functions of the business and are also responsible for preparing financial statements. In the context of a Fund this may include the management company, the fund administrator or internal departments tasked with preparing the financial statements.</p>
Management Letter	<p>As part of the Auditor’s duties to inform the CSSF and the Board about significant deficiencies or weaknesses in the Fund’s internal control system, the Auditor issues a management letter detailing the Auditor’s observation, the root cause, the impact and the Auditor’s recommendation. The Board is afforded the opportunity to provide its response to the recommendation raised. If no deficiencies or weaknesses are identified the Auditor issues a “no comment” management letter.</p>
NAV	Net Asset Value



Non-adjusting events	<p>Subsequent events that provide evidence of conditions that arose after the date of the financial statements. Those events do not trigger the adjustment of the primary financial statements but usually require disclosures in the notes to the financial statements.</p> <p>For example a fund may disclose the following for each material category of non-adjusting event after the reporting period:</p> <ul style="list-style-type: none">(a) the nature of the event; and(b) an estimate of its financial effect, or a statement that such an estimate cannot be made.
Subsequent events	<p>As per ISA 560 - Financial statements may be affected by certain events that occur after the date of the financial statements.</p>





OUR MISSION STATEMENT

The mission of ILA is to promote the profession of Directors by developing its members into highly qualified, effective and respected Directors.

In parallel, it will promote best practices in Luxembourg in the field of Corporate Governance of companies and institutions by actively engaging with those institutions charged with the introduction, application and oversight of those Corporate Governance rules and practices. It will achieve this through high quality training, forum discussions, research, publications and conferences.

ILA aims to be the premier interlocutor in Luxembourg on issues affecting Directors.



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