Implementing a Private Equity Fund Accounting System

Introduction

Many private equity fund managers use standard general ledger software (Quickbooks, Peachtree or Microsoft Dynamics) to handle fund level accounting and Microsoft Word and Excel to handle capital calls, distributions and partner allocations. The benefit of using these software packages is that they are affordable, highly flexible and easy to use. The challenge with using these programs is that they were not built to handle private equity fund accounting and can be risky, manual and time consuming. A well built and well implemented private equity fund accounting system should save time, reduce risks and produce better and more accessible information.

The purpose of this white paper is to share best practices that we have learned as accountants and administrators while implementing our private equity fund accounting system. It is intended for non-systems professionals who will be managing an implementation.

Is it Worth the Commitment?

Implementing a private equity fund accounting system is a big commitment. You must learn the system, import historical data, configure the system and train the users. The software can be counterintuitive, poorly documented and difficult to use. Therefore, just learning a system can take a lot of time. If you need to add historical data to the system, the time requirements are compounded. Even after a long implementation, we found that it took several quarters post implementation to get the efficiencies we were hoping for.

For us, implementing a system has been well worthwhile. We account for over 100 entities and have been able to boost efficiencies significantly by having a system that can handle routine tasks effectively and efficiently. Our professionals are now able to focus on tasks that add more value.
**Should We Hire Consultant(s) to Implement?**

Almost all vendors offer consultants to set up the fund accounting systems and enter historical data. Consultants will also train you and your staff on how to use the system. We caution against delegating the complete implementation and training to a consultant for two reasons:

It is your data and only your team will know if the information is correct. Most systems implementation specialists are not accountants and might not know which records are important and how to check them. You might want to use the consultant to upload transactions and reduce the workload, but you and your team should be involved in making sure the information is correct.

Your team needs to learn how to use the system. One of the best ways to learn a system is to enter and close a number of periods in a relatively short period of time. The system implementation is the best opportunity you will have to learn this way. In our case, the person in charge of the implementation became our in-house expert.

**Inventory the System’s Capabilities**

Once you have licensed the software, the first thing you need to do is inventory the system’s capabilities. Most software packages will have the following capabilities:

**Base Capabilities:**
- Track partner demographic data including names, addresses, tax id’s
- General Ledger (e.g trial balance and chart of accounts)
- Customer Relationship Management (CRM)
- Capital Call Calculations
- Distribution Calculations (including Waterfall Analysis)
- Notice Creation (capital call notices, distribution notices, other notices)
  (sometimes referred to as mail merge)
- Notice Distribution
- Partner Allocations
- Partner Account Statement Creation
- Investment Accounting
- Performance Calculations (Internal Rate of Return)

**Some systems will have additional capabilities including:**
- Online Reporting
- Portfolio Monitoring
- Deal Management
- Fundraising
- Investor Relations
Choose an Approach

Once you have inventoried the system’s capabilities, you need to decide which modules to implement and how to approach implementation.

There are two approaches we know of:

**Immediate Approach** - The immediate approach prioritizes the modules that will provide the most time savings the soonest. The idea is to get some efficiency out of the system before the system is fully implemented. For example, the system might be used to calculate capital calls and produce capital call notices before the general ledger is implemented.

**Holistic Approach** - With the holistic approach, individual funds are implemented with the focus on getting the system ready for one transition date where all modules are implemented and all users are transitioned over to the new system. Once a fund is implemented, the original system will no longer be used after the transition date as all of its functions will be handled on the new system.

The benefit of the immediate approach is that you can start getting efficiencies out of the system right away. For example, it might not take too much effort to get enough information into the system to create capital call and distribution notices. Depending on how many notices and copies of notices need to be created and distributed, handling capital calls in the new system while using the old general ledger system for everything else might result in an immediate net time savings. Another benefit of the immediate approach is that the users can learn modules one at time. For example, the users might master the capital call function one quarter and partner allocations the next quarter.

The Immediate Approach comes with some inefficiencies: double entry of the same information into the old and new system, reconciling old and new systems, potential adjustments upon implementation of future modules and a delayed full implementation. For example, a user group might decide to implement the partner allocations module first and hold off on implementing the general ledger module until later. The information required to create partner allocations in the new system (capital calls, distributions, income, expense, etc...) are also required to support the general ledger. Therefore, until the general ledger is transitioned from the old system to the new system, the information will need to be entered into both systems. Information in the new system will also need to be reconciled to the old system. When the group later implements the general ledger module of the new system, it may need to correct entries made to feed the allocation module so that they feed the general ledger module properly.

The other challenge with the Immediate Approach is that switching one module at a time can be frustrating and confusing for the user group and delay full implementation of the system. We have seen user groups implement the capital call and allocation modules on a new system, but go for years without implementing the general ledger system.

The main disadvantage with the holistic approach is the longer implementation time. It takes more time to get all of the modules working instead of one module.

The advantage of the holistic approach is that although you might not see immediate efficiencies, the efficiencies will be greater once implemented. For example, if the right system is implemented properly, one capital call transaction will feed the capital call notice, partner allocations and general ledger.
Our Approach

We took the holistic approach in implementing our system. We chose to initially implement all of the Base Capabilities listed above with the exception of the distributions waterfall and performance calculation modules. (We felt that these modules required individualized attention by fund.)

We then chose the first fund to implement. We chose this fund because it had a few years worth of historical information which we could enter to the system and learn from. It also had a structure similar to many of the other funds we account for.

A member of our management team allocated a good portion of his time to implementing this fund and better learning the system. Once he learned the system, he became the firm expert and worked with the rest of the team to implement the other funds.

Lessons Learned

We learned a number of lessons in implementing our system:

It Will Take Longer Than You Expect
We spoke with the software vendor and participated in some training before getting started. However, we learned the most while implementing. In more than one instance, we learned after closing a number of historical periods that there was a better way to handle a type of transaction. We then went back into the prior periods, re-entered the transactions and closed out the periods again. This was a sometimes frustrating but effective way to learn and get the system built for the long term.
Allocate the Resources
It is tempting to hand implementation over to one of your accountants and have them handle it as an extra assignment. As noted above, we do think that it is important for a member of the organization to be in charge of the implementation. We also think that the person who is going to be responsible (especially at the initial stages), should be relieved of other responsibilities allowing him/her time to focus on the implementation. There is just too much learning and work involved in a successful implementation to not make it the prime responsibility of the person in charge.

Manage Expectations
One thing you will find is that everyone in your office will have an opinion on what a private equity system should do. They will also expect it to do those things fairly soon after the system is purchased.

We recommend getting everyone involved in the discussion once the system’s capabilities are inventoried and it is time to decide which modules to implement. A thoughtful and honest discussion upfront may save you some difficult conversations later due to expectations that are incompatible with the implementation plan.

We also recommend explaining to everyone involved that private equity fund accounting systems are industry-specific systems. They are worthwhile to implement because they can do a number of things and create a number of efficiencies for private equity firms that other systems can’t create. However, they take some time to implement and get used to.

Use the System
This may sound obvious, but once the system is implemented, people need to use it. Even after implementation and training, systems take time to get used to. Unless they are reminded and encouraged to do so, accountants will tend to stick with the old procedures. You need to find ways to manage this and convert them to the new system. Once they use the system for a few quarters, the accountants won’t be able to imagine any other way of handling their tasks.

Reports
You might find that the standard reporting provided by the software vendor does not meet your requirements. Many software vendors don’t employ accountants and have difficulties understanding how information should be presented.

The short term solution is for the person charged with implementation to figure out the best way to produce the reports using built-in system reports. This takes some effort, but will be a great help to your staff in the interim before the custom reports are complete.

The longer term solution is to have custom reports built that suit your needs. This can be expensive and time-consuming, but well worth the investment.

Ongoing Development
The development of a private equity accounting system never ends. We are continually developing our system and finding new ways to boost its efficiency and effectiveness. We spend a lot of time discussing the system at our regular meetings and setting priorities to make it work better. We find the more people use and get involved with the system, the more uses they find for it and the more benefits we get out of it.
About the Authors

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Rob is a member at IPS Fund Services. Since 1995, Rob has advised managers on a variety of business and technical issues. He has significant experience with investor allocations, waterfall provisions, financial reporting, and systems implementations. He serves as a technical advisor to managers and attorneys during the fund formation process.

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About IPS

IPS Fund Services (IPS) provides outsourced fund administration and accounting services to small and mid-sized private equity, venture capital, and hedge funds.