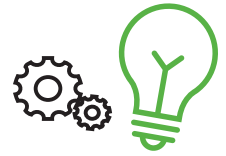


# HOW TO NAVIGATE THE FINANCIAL STATEMENT AUDIT PROCESS



The timely, efficient and successful completion of a financial statement audit for a hedge fund or private equity fund requires an investment manager to understand the key components of the audit process. A manager must also understand his or her responsibilities and be actively involved throughout the entire process. These added responsibilities can be very burdensome and can take time away from tasks where a manager's time may be better spent, such as trading and raising capital.

This guide discusses some key items that managers need to focus on to ensure a smooth and timely audit. It also explains how ALPS Alternative Investment Services (ALPS) helps our clients throughout this challenging process.

## Auditor Selection

The first step in achieving a smooth and successful audit is to ensure you are working with the right auditor. Selecting an auditor who is a good fit for the fund and its manager, and one who will be a long-term adviser are key considerations. Thorough due diligence will help a manager make a good selection.

Some possible interview questions to ask an auditor are:

- Do you understand my business and my strategy? Do you have the appropriate expertise and experience?
- How many alternative investment funds do you audit?
- Are you registered with the Public Company Accounting Oversight Board (PCAOB) and subject to inspection (this is required for managers registered with the SEC who wish to avail themselves of the audit exemption to the SEC's custody rule)?
- Do you have an offshore presence (e.g. funds registered with the Cayman Islands Monetary Authority are required to have a Cayman Islands-based auditor issue the audit opinion for local filing)?
- Do you have the resources to properly service my firm? What is the number of professionals dedicated to the alternative industry? Are practice leaders accessible?
- What kind of support will you offer throughout the year and during the audit process?
- Can you meet my desired timeline?

In addition to the questions above, you should request and contact client references. You should also obtain the opinion of your administrator as they generally have experience working with many auditing firms.

## Communication and Planning

Good communication is key to a successful audit. It is important that all of the fund's service providers work together as a team and understand their respective responsibilities and deadlines. Proper communication and planning should include an initial meeting to introduce all parties and set the general tone and expectations. It should also include on-going meetings to measure the status of the process.

Some items to consider in the planning and on-going meetings are:

- Identifying the responsible individuals and the lines of communication
- Review of the fund's strategy, structure and overall operations
- Financial statement reporting due dates and regulatory due dates
- Timeline for interim and year-end audit testing, including the delivery of audit working papers and draft financial statements to the auditor
- Review of the audit process for the prior year and any issues encountered
- Understand and document each party's respective responsibilities, deliverables and deadlines
- Periodic follow-up meetings to ensure that responsibilities and deadlines are being met, and to identify and correct issues on a timely basis
- After completion of the audit, document any issues encountered and ideas for improvement in next year's audit

## Organization

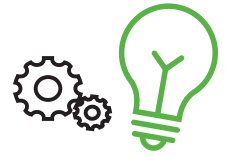
Organization is a key component of an efficient audit process. The organization of the most up-to-date versions of documents such as fund offering memorandums, side letters, agreements and resolutions will help facilitate the auditor's understanding of the fund structure. Additionally, proper documentation of the management company and fund-specific policies and procedures will increase efficiency when addressing auditor requests.

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## *Responsiveness*

During the fieldwork stage the auditor will focus on audit tests such as independent confirmations, sample testing of transactions and analytical reviews. This testing will be accompanied by numerous questions and information requests made to you by your auditor. Some examples are the preparation of confirmation letters, subscription and redemption documents, side letters, valuation support and broker statements. In order to have a smooth audit and assure that the agreed-upon deadlines are met, you must respond to these questions and requests in a timely and thorough manner. This will allow the auditor to continue making progress and meet their deadlines.

## *Accounting Methods and Principles*

Lack of communication with the auditor regarding a fund's accounting methodologies may result in audit delays and unexpected adjustments. Accordingly, it is important to discuss accounting methods used by the fund with the auditor in advance. Items to consider are basis of financial reporting, treatment of organizational costs, valuation methods, and treatment of fund expenses including subsidies. Discussing accounting methods with the auditor in advance of the year-end will help prevent unwanted delays and adjustments. It is desirable for this type of communication to be on-going throughout the year.

Additionally, managers need to stay on top of current and future reporting standards that may affect their fund. While many managers delegate the preparation of the audited financials, they are still required to take an active role in this preparation process. This includes providing input, reviewing and approving them. Accordingly the manager must understand the accounting methods and principles used to prepare them. This will lead to a smoother financial statement preparation process.

## *Draft Financial Statements and Footnotes*

Generally the financial statements issued throughout the year exclude certain information and disclosures required in year-end audited financial statements. This information may include items such as the schedule of investments, footnotes and other financial data. Additionally, certain accounting adjustments or reclassifications may be required to comply with reporting standards. Because the auditor is not allowed to draft or make these adjustments to the financial statements, this responsibility ultimately lies with the manager.

## *How Does ALPS Help Its Clients Navigate the Financial Statement Audit Process*

ALPS' audit liaison department consists of a dedicated team of professionals who help its clients navigate the entire audit process. This team assists clients with the areas identified above including planning, communication, measuring and proactive coordination of the process. This team also helps in areas such as auditor selection, understanding accounting methods and principles, and drafting financial statements in accordance with Generally Accepted Accounting Principles or International Financial Reporting Standards.

ALPS works with all the top audit firms who are focused on the alternative industry including the Big Four.

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