

# C&A Consulting LLC

*Achieving Performance Excellence*

## Win Investors with a SSAE 16 Report

### Improving profits and processes with better controls structures

Are you frustrated with your firm's controls and infrastructure?

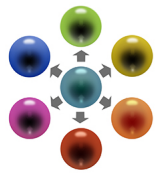
Has it been hindering your ability to raise capital from new investors?

The answer may be to perform an assessment of your control infrastructure and issue a SSAE 16 Report!

Every financial firm that has been in business for a while has experienced operational errors that have disrupted business, introduced serious risks, or created waves of extra work across the firm. In the past, investors may not have been as concerned about the day-to-day operations of a firm. But in today's environment, investors have less tolerance for problems or errors caused by the firm's organizational structure. They consider operational risk as important as investment risk. The lack of a solid control structure can cause a firm to lose both current and potential investors.

After an arduous due diligence meeting with a potential investor, a senior officer might ask: Why is there a fire drill each time an investor performs a due diligence review? Why is it that my back office does not produce meaningful operational and financial statistical reporting? Why does our quarterly investor reporting continually get sent out on the last day of the deadline? These are common questions in our industry and not always easily answered.

Answering these questions requires an analysis of the firm's front to back office processes, organizational structure, and how internal controls support your business model. An assessment will provide your firm with a heat map of the processes that need to be remediated and areas of risk exposure in your internal control framework. Ensuring that your firm has effective front to back office processes with a solid underlying control overlay will reduce the firm's overall risk profile to investors and to regulators. There are other significant benefits including reducing the likelihood of a major reputational event



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caused by an employee, the ability to raise additional capital from new investors and to maintain existing investors, and savings by minimizing operational errors.

Unfortunately, many firms are reactive and not pro-active, and wait until there is an actual operational problem before they spend the time or money to determine where the problem exists. At that point, they also need to worry about the impact on existing and potential investors, in addition to identifying the root of the problem, whether it is the personnel, the organizational structure, the complexity of the products, or the processes.

Investors are requiring more transparency around business practices and processes. In “Principles and Best Practices for Hedge Fund Investors”, a white paper recently issued by the President’s Working Group on Financial Markets, the document forcefully states,

*“The due diligence process should also include an evaluation of the business infrastructure, investment operations, and controls in place to support your decision (to invest in a fund)”.*

One way to provide you and your investors confidence that the firm’s control framework and the processes and procedures are sufficient and functioning properly is to retain a qualified firm to issue a SAS 70/SSAE 16 Report. Most firms retain an auditing firm to attest that the controls framework is sufficient and that the controls in place are adequate and functioning as intended. What was once the exclusive provenance of service providers, this internal control report is gaining favor with hedge funds and private equity firms.

## The SSAE 16 Report

The American Institute of CPAs introduced the SSAE 16 reporting standard, superseding the SAS 70 effective June 2011. The main reasons for this shift are the movement towards a common global accounting standard and the increasing

trend of additional transparency and disclosure. There are some significant differences between the old standard SAS 70 and the new one. This new standard stresses an increased use of narratives surrounding the processes and a physical attestation of the accuracy by the CEO.

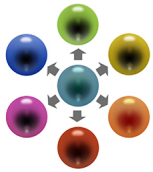
Thoughtful planning is required for those organizations that want to implement SSAE 16. For example, your auditors will have to determine that the control structure that your firm designs is suitable to your business and the inherent risks surrounding your business. Your firm will have to ensure that these controls are working as designed throughout the entire reporting period.

Before deciding whether to go through the expense and management angst of issuing a SSAE 16 SOC report, management should determine if a formalized report such as a SSAE 16 is something that it needs to maintain a competitive advantage in the market place. It should also determine what is involved in preparing the firm for SSAE 16, and estimate how much management time it will take and how much it will cost.

However, even if you feel your firm does not need to issue such a report on internal controls, a thorough review of the control environment and processes is essential in today’s environment.

## Competitive Advantages of SSAE 16

For an alternative investment company, preparing a SSAE 16 report is beneficial to both the firm and its institutional investors. A SSAE 16 SOC report will differentiate a fund from its competitors by providing the investors additional confidence that the internal control structure is designed and working properly. Institutional investors, which are concerned about fulfilling their own fiduciary responsibilities and meeting regulatory requirements, will benefit by receiving this information. Further, the SSAE 16 report will tend to reduce the need for often lengthy due



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diligence discussions related to internal controls and safeguarding of assets by the fund with investors.

The specific focus on the controls over trading and post-trade accounting operations can also provide investors with confidence that funds are investing according to investors' mandates or expectations and that investors are provided with accurate and complete reporting of their investments.

The ability of an alternative investment manager to demonstrate strong internal controls can help differentiate a company from its peers. A SSAE 16 report exhibits that the alternative investment manager is committed to subjecting its controls to examination and reporting by independent auditors. By proactively issuing SSAE 16 reports, alternative investment management companies can take an offensive stance regarding stakeholder demands.

The SSAE 16 report on internal control framework could also be given to regulators before they start an exam. The SSAE 16 along with other documentation (e.g. compliance manual) will provide the examiners with solid evidence of good business practices and good governance.

## Direct Benefits to the Firm

The SSAE 16 has a residual effect of creating efficiencies and improvements in your firm's back office, particularly in areas such as trade processing, valuation and overall operational risk management. For example, C&A discovered that a client's bond accruals were manually performed monthly rather than using the system already in place to automatically calculate them on a daily basis. A small remediation provided the front office with a clearer picture of their cost of capital compared with their revenue.

Just the knowledge that a review is being performed can have positive effects for the company as a whole. C&A has seen staff questioning an inherited process for the first time and working closer with their counterparts in other departments to create a better process and integration between departments. Recent hires embrace such a project and usually have productive insight into how to better manage business flow and risk.

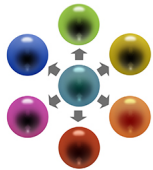
## A Case Study --- How this hedge fund lost investors:

Though their performance was stellar and CEO thought the presentation went well, a second warm prospect passed on investing a substantial amount with the fund manager.

C&A was engaged to perform assessment of the front and back office process and procedures. After our assessment, the CEO was surprised to learn why they failed the due diligence review.

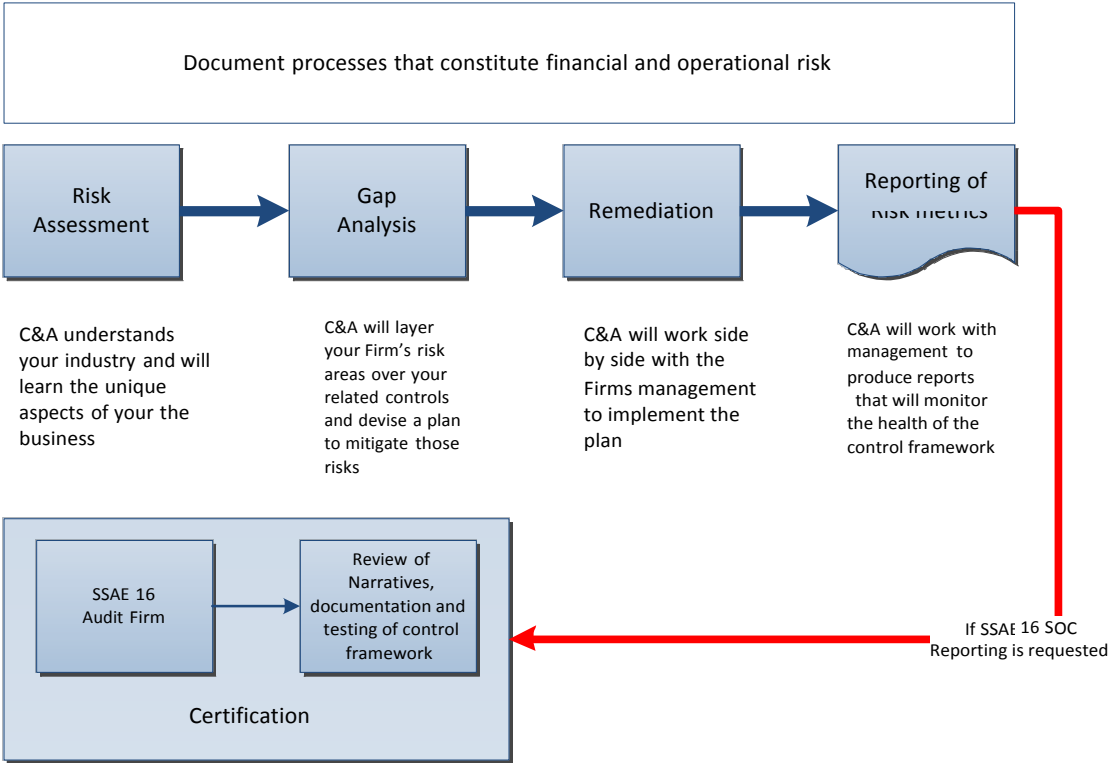
- The philosophy of how the fund conducted business was inconsistent across senior management.
- The CFO was ill-prepared and could not produce the requested reports in a timely fashion.
- The systems used for the operations and accounting were inadequate for the asset classes traded.
- Operations was not able to produce daily reconciliations on cash, FX and positions with its prime brokers.
- The monthly valuation process was inadequate and not well documented.
- Risk reporting was inadequate.
- The entire firm essentially ran on Excel.
- The business continuity plan was inadequate.

With Management's support, C&A was able to remediate these failures.



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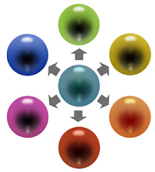
## Analyzing and Documenting the Firm's Processes and Procedures

In performing an assessment of current controls, it is typical to use a software tool to document via flowcharting and narratives the processes and procedures for each area of the firm including front office, middle office and back office functions. Then, a Risk Self Assessment (RSA) is completed to identify key risks to the firm (e.g. controls around the integrity of the general ledger, and reconciliations of cash and positions) and the corresponding mitigating controls. A gap analysis is created and any control deficiencies noted are corrected. A firm should also periodically test the controls to ensure that they are functioning as designed. The flowcharting and narratives of the firm's process and procedures, RSA, and results of the controls testing can all be used as support to demonstrate to investors and regulators of a well controlled environment.

## Establishing an Effective Enterprise Risk Management Integrated Framework

It is essential for a well-run firm to establish an effective Enterprise Risk Management (ERM) Integrated Framework. This includes senior management supporting a well controlled firm environment, communicating the firm's objectives, identifying events that threaten the achievement of the firm's objectives, assessing and addressing risks, undertaking control activities to mitigate risks, communicating information of risk to senior management, and coordinating and monitoring of key risk indicators. The ability of the firm to demonstrate this pro-active stance on risk will help support to investors and regulators that it takes managing risk seriously, and has established an effective comprehensive risk framework.

Not every firm needs to issue a SSAE 16 report to compete or feel comfortable that its controls are



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properly working. But your firm should be thinking about looking at your control environment. You won't get all the benefits of issuing a SSAE 16, but you certainly will have some peace of mind.

## How C&A can help

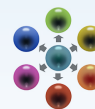
When a company initiates the SSAE 16 process, it is common to begin with a pre-assessment. C&A Consulting can act as an independent third party to review the company's controls and activities to ensure they are functioning appropriately and give advice on how to improve upon them. C&A can also help remediate the findings from the gap analysis. If you decide to retain your independent auditing firm to issue your SSAE 16 Report, and also engage them to perform the pre-assessment review, C&A can help you remediate any noted deficiencies by your auditing firm that would be detrimental to issuing the SSAE 16 Report. Your auditing firm is not permitted because of its inherent conflict to remediate any deficiencies noted in the pre-assessment. Below is a representation flow of what C&A could do for your firm whether you decide a SSAE 16 issued report is right for you.

## C&A Experience

The C&A risk and control staff have decades of experience in performing SAS 70/SSAE 16 pre-assessments. We complement this expertise with a solid financial practice. Our principals and staff

have provided our clients with business insight into the industry and a unique understanding of operational risk and good business practices. We are confident that we can assist your Firm in getting ready for your audit or assessment of your control environment for the ultimate purpose of issuing a SSAE 16.

Contact Mr. Rob Barsky or Mr. Noland Cheng at (646) 233-2112 for a consultation or e-mail either at [rob.barsky@caconsultingllc.com](mailto:rob.barsky@caconsultingllc.com) or [noland.cheng@caconsultingllc.com](mailto:noland.cheng@caconsultingllc.com).



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