

# Woodfield Wire

AN E-NEWSLETTER FOR HEDGE FUND MANAGERS  
AND OTHER INDUSTRY PROFESSIONALS

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## Type II SAS 70: What Is It and Why Should Your Fund Administrator Have One?

Unless you're a service auditor or your company has undergone a service audit, the term "SAS 70" may not mean much to you. But the SAS 70 and its subsequent version (the SSAE 16; more on that below) are becoming increasingly important in our industry. Knowing a little more about them can benefit you. In this issue we'll explain why.

### What is a SAS 70?

SAS 70 is the term used for an audit performed according to the Statement on Auditing Standards (SAS) No. 70, Service Organizations, an internationally recognized auditing standard developed by the American Institute of Certified Public Accountants (AICPA). The standard provides guidelines for a third party to audit a service organization's controls and safeguards, including controls over hosting and processing data belonging to the organization's customers.

### Evaluating Fund Administrators

Thanks to increased regulation, the growing institutionalization of the client pool for investor funds, the growing complexity of managing a hedge fund, and investor wariness in a post-Madoff world, the number of full-service fund administrators has burgeoned.

As a result, if you are a fund manager, you have a wider range of choices today than ever before for firms that provide this crucial function. The choice of the right administrator has an impact on the amount of time you need to spend on administration-related issues, your ability to grow, your relationship with your investors and most importantly, your ability to raise capital.

Unfortunately, many managers are not well equipped to evaluate the relative merits of different fund administrators. That's why it is of real value to ask:

### Does the administrator have a Type II SAS accreditation covering all aspects of its operations from a well-known accounting firm?

In a SAS 70, a public accounting firm audits the internal controls of a professional service organization. At the end of the audit, the service auditor issues a report called the "Service Auditor's Report" that describes each internal control and the degree to which the service organization adhered to that control. For example, if the administrator claims that it has a process through which a fund's accounting reports are reviewed by upper management to insure quality, the auditor will confirm that

documented procedures are in place and that the administrator follows them consistently. Any breakdowns in the procedures are also noted in the report.

But not all SAS 70s are of equal value. A Type I audit contains only a *listing* of the controls the organization claims are in place. With a Type II audit, the auditor actually tests to make sure they are in place and adhered to. Most observers feel that a Type I report is of little value; you want to make sure your administrator has a Type II report.

Also, and this is very important, many administrators include only some of their processes in the SAS 70. Many people are unaware that auditors only audit the processes and functions that service organizations instruct them to audit for the SAS 70. Consequently, some administrators only cover their accounting processes in their SAS 70, while others have the auditor review all aspects of their operations, including critical functions like AML (anti-money laundering), financial controls, physical and logical security measures and other vital functions. You want to make sure your administrator's SAS 70 covers all controls, policies and procedures that will relate to your business. This will be evident from reading the SAS 70 Report; the functions audited will be listed in the report along with the auditor's findings.

### In a Nutshell

There are several reasons why you want your administrator to have a Type II SAS 70. First, it will make your annual audit easier and possibly cheaper. If your administrator has a Type II SAS 70, then your auditor can rely on certain aspects of the administrator's work without further investigation.

More importantly, the SAS 70 will give your investors and potential investors the ability to assess the processes and controls that are in place to insure that they can rely on the administrator to protect them.

To an ever-increasing extent, institutional and other large investors are requiring that administrators have a comprehensive Type II SAS 70 audit. If your administrator doesn't have one it may affect your ability to raise money from these investors.

### One More Wrinkle

A new standard with slightly different requirements, the **SSAE 16** (Statement on Standards for Attestation Engagements No. 16), will supersede the SAS 70 for any audits completed for periods ending on or after June 15, 2011. This change is a result of the need for more uniform reporting in today's increasingly global economy and regulatory environment. The new audit will be very similar to the SAS 70 and will serve the same purpose as the SAS 70 for you and your investors.

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