

Woodfield Wire

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

Woodfield's monthly e-newsletter publishes articles about hedge fund-related topics and best practices. To subscribe, please send an email to newsletter@woodfieldllc.com. We welcome your comments and ideas.

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Preparing for and Surviving the Annual Audit

Last week we co-sponsored a networking event hosted by HedgeFundNetworking.com at the Hyatt Regency in Chicago. In preparation for the event we spent a lot of time getting organized and working with the other sponsors involved to ensure the event would go smoothly. It was a great success and the turnout was more than expected. We had a lively mix of industry professionals in attendance and made some good connections.

The following day, during a meeting about the upcoming audit season, I noticed the similarities between preparing a successful networking event and preparing for your fund's annual audit. The whole enterprise hinges on being proactive.

At Woodfield Fund Administration, we don't conduct audits. But we do manage them for our clients (hedge funds, fund of funds, private equity funds, commodity pools, unit investment trusts, real estate funds, and other investment entities). We've helped clients who felt overwhelmed by the process and others who consistently sail through it with ease.

Over the years, we've learned some best practices for preparing for the annual audit:

- **Be proactive.** Because audit firms are dealing with many client audits during the same short window of time, they may need a little prompting to get the process started. For a successful audit, you need to take the first step.
- **Ask your audit firm what they will need.** In late fall, we send a request list to our clients' audit firms, asking when they anticipate conducting the audit, whether there will be a field visit or not, and what is on the PBC (items Prepared By Client) list. If you're working directly with your audit firm, take action early to find out what they need and then supply as much of that information as you can as early as possible.
- **Know the timing.** For investment advisors registered with the SEC, the audit deadline for hedge funds is 120 days from the end of the year; for fund of funds, 180 days. Non-exempt commodity pools must file with the NFA within 90 days, or 120 days for fund of funds. For offshore funds domiciled in the Cayman Islands, the CIMA deadline for filing audited financial statements is 180 days. An automatic 30-day extension is also available from CIMA. For funds that do not fall into one of these categories, there's no specific audit deadline unless self-imposed in the offering documents--usually 90 or 120 days after the end of the year. However, the audit is important to investors, especially in our current environment. The audit also goes hand in hand with the entity's ability to issue K1s, whose timing requirements vary according to the type of entity.

- **Extended-period audits and security counts.** Fund managers who have launched a fund within the last few months may decide to have an extended-period audit done next year. However, if you are an investment advisor registered with the SEC, you are required to have your fund audited annually or have a surprise security count done and/or have all investor assets held by a qualified custodian that independently reports to the fund's investors on a quarterly basis.
- **Organize internal control data.** A key part of the audit will be a review of your policies pertaining to trading and reconciling trades activities. If you work in a mid-sized or large firm, there are probably written procedures in place. Make sure they are up-to-date and that staff members who will talk with the auditors understand them. If your firm doesn't have written procedures, you'll still need to answer questions about internal controls. Make sure you have at least a good set of notes for reference in answering questions.
- **Check in with your staff well before the audit.** When we manage an audit, we meet via conference call or in person with the fund manager and/or audit team to discuss issues from prior years and any specific issues to address this year. If you're managing the audit yourself, check in with the key staff members and refer to any notes in the file regarding issues that arose in past audits. Make sure anyone who will talk with the auditor is well versed in your firm's internal controls.
- **Valuation policies.** Requirements in connection with FAS 157 on fair value of assets may catch some fund managers off guard. Audit firms will obtain from each client specific policies and procedures on how they value their assets. If Woodfield is managing your audit, we will work with you to prepare for this, as well as any new requirements coming in 2010 and beyond. Fund managers are also required to review and understand the work done by their administrator and will be asked to provide proof of this review during the audit process.
- **Prepare the required financial statements.** For our clients, we provide comprehensive draft financial statements for the year to review and deliver to their auditor. If you're preparing the financials yourself, make sure you are on the same page with your auditing firm as to the format and data required to be included.
- **The actual audit.** It is unusual for the auditor to conduct the audit on site, but sometimes there will be a site visit and a walkthrough. There will certainly be phone conversations that focus on questions related to the internal controls. If you have an administrator managing the audit for you, they should answer the vast majority of questions from the auditor, which usually pertain to specific securities transactions identified during the auditor's testing procedures.
- **Wrap-up report.** After the audit, make note of any rough spots that arose in this year's audit process, along with ideas for improvement throughout the year or for the next year's audit, and put them into a file where you can find them next year.

In a nutshell, if you keep things well documented throughout the year and prepare everything in advance of the end of the year, you can pull off a smooth audit and practically enjoy the process.

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About Us

[Woodfield Fund Administration LLC](#) provides third-party accounting and fund administration services to hedge funds, fund of funds, commodity pools, unit investment trusts, real estate funds, family offices and other investment entities. Our clients range from small startup funds with just a few investors to large asset managers with capital in excess of \$1 billion. They choose us because of our focus on accuracy, completeness, timeliness, personal attention, customized services and reasonable cost.

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