

Controls reporting as a response to demand for greater transparency

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In light of the current market turmoil, the recent failures and fraud cases, the pressure on alternative investment providers to disclose their internal risk management and internal controls systems has increased.



Adrian Keller

PricewaterhouseCoopers
(Switzerland)
+41 58 792 23 09
adrian.keller@ch.pwc.com



Dimitri Senik

PricewaterhouseCoopers
(Switzerland)
+41 58 792 23 72
dimitri.senik@ch.pwc.com

In view of the recent turbulence in the financial markets, fraud cases and the resulting lack of confidence, the need for better transparency and controls has become more vital than ever.

Investors consider strong risk management, compliance and transparency to be as important as a good performance track record. While most alternative investment providers report on the investment performance and risk results, only a minority volunteer to inform on further key metrics, such as operational risks and the internal control system around the investment process and back office.

Even before the recent fall in asset values, a 2008 research project from PricewaterhouseCoopers in cooperation with the Economist Intelligence Unit (EIU) concluded that as investments in alternatives had become more deeply embedded in the mainstream asset class mix, so investors increasingly expected higher levels of transparency, disclosure and risk management.

Just before, in January 2008, the UK Hedge Fund Working Group's Hedge Fund Standards, stated that hedge fund managers should explain their approaches to managing risk and their risk frameworks in funds' offering documents, including the risk of breakdowns in internal controls or systems. The US President's Working Group on Financial Markets stated in its report on best practices for the hedge fund industry issued in April 2008, that hedge fund managers should implement and maintain strong internal controls to minimise the risk of loss as a result of operational risk.

Current internal controls reporting initiatives

Controls reporting can provide the desired standardised framework to provide investors with the information required to understand the internal controls environment.

Currently, the most popular globally accepted standard for reporting on controls at a service provider is the Statement on Auditing Standards No. 70 (SAS 70) established by the American Institute of Certified Public Accountants. In November 2008, the US Accounting Standards Board proposed a new Statement on Standards for Attestation Engagements (SSAE) "Reporting on Controls at a Service Organization", which will supersede the current SAS 70 standard.



In addition, the International Auditing and Assurance Standards Board (IAASB) has proposed the new International Standard on Assurance Engagements (ISAE) 3402 “Assurance Reports on Controls at a Third Party Service Organization”, which covers the requirements and principles on an audit of internal controls at a service provider. ISAE 3402 reports can be used for investor communication, as well as in relation to reporting requirements from third-party auditors.

Enhanced transparency in risk management

The above standards are closely related to each other. Both represent initiatives to work towards convergence of the controls reporting standards and to enhance the scope from pure financial reporting objectives to reporting on operational and compliance related matters. The final release of ISAE 3402, as well as the new SSAE, is expected in June 2009.

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Investment Management and Real Estate contacts

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Global Investment Management and Real Estate Leadership Team



Marc Saluzzi
PricewaterhouseCoopers (Luxembourg)
Global Investment Management
and Real Estate Leader
+352 49 48 48 2511
marc.saluzzi@lu.pwc.com



Kees Hage
PricewaterhouseCoopers (Luxembourg)
Global Real Estate Leader
+352 49 48 48 2059
kees.hage@lu.pwc.com



Barry Benjamin
PricewaterhouseCoopers (US)
Americas Investment Management
and Real Estate Leader
+1 410 783 7623
barry.p.benjamin@us.pwc.com



Pars Purewal
PricewaterhouseCoopers (UK)
UK Investment Management
and Real Estate Leader
+44 20 7212 4738
pars.s.purewal@uk.pwc.com



Brendan McMahon
PricewaterhouseCoopers (Channel Islands)
Global IMRE Private Equity Leader
+44 1534 838234
brendan.mcmahon@je.pwc.com



Robert Grome
PricewaterhouseCoopers (Hong Kong)
Asia Pacific Investment Management
and Real Estate Leader
+852 2289 1133
robert.grome@hk.pwc.com



David Newton
PricewaterhouseCoopers (UK)
Global Investment Management
Tax Leader
+44 20 7804 2069
david.newton@uk.pwc.com



Tony Artabane
PricewaterhouseCoopers (US)
Global Hedge Funds Leader
+1 646 471 7830
anthony.artabane@us.pwc.com

If you would like to receive copies of this newsletter or would like further information about PricewaterhouseCoopers Investment Management and Real Estate publications, please contact Denise Cook at denise.cook@uk.pwc.com

Editor: Rupert Bruce

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