

Case Study

Embracing a New Paradigm in Hedge Fund Administration—Automated Financial Statement Preparation

Exchanging Spreadsheets and Manual Processes for Efficiency and Control

Executive Summary

Annual financial statements provide the basis for year-end hedge fund audits. They are typically large and complex documents, bulging with supporting forms, interconnecting schedules, multipart tables, charts and footnotes. Traditionally these financial statements are prepared using manual processes and spreadsheets. It is a time-consuming method which frequently leads to errors and revisions. Even though many people in and around the industry have spoken of the need for automated solutions to statement preparation, little progress has been made. Until now.

Three years ago, AIS Fund Administration introduced a new, first-of-its-kind automated hedge fund solution. Since that time, AIS Financial Statement Preparation, or AFSP, has emerged as a technology-based service benefiting all parties involved in fund operations and management. A highly flexible, database-sourced solution, it has largely eliminated the need for spreadsheets by mapping data directly from individual general ledger accounts onto the statement's schedules, charts and footnotes for efficient, error-free, straight-thru processing.

AIS, a recognized leader in outsourced support and administration for hedge funds, operates using a service-oriented business model that combines a deep knowledge of hedge fund operations with expertise in applying technology solutions to fund operations and accounting.

The Challenge: The Changing Face of Hedge Fund Financial Reporting

The size of the alternative investment market, as measured by AUM, increased significantly in the first decade of the 21st century. Assets nearly quadrupled from an estimate of just under \$500 billion in 2000, to more than \$2 trillion in 2011.ⁱⁱⁱ A dramatic increase in the use of structured products and derivatives, along with a burgeoning variety of financing instruments employing leverage, dramatically increased the complexity of financial statements

In addition, the financial crisis triggered record redemption requests, causing many funds to “raise the gates” on redemptions. This, along with the Madoff fraud and badly shaken investor confidence, added to the complexity of reporting by increasing the demand for faster, more frequent and more transparent reporting.

A near perfect storm of factors converged to dramatically increase the complexity of preparing hedge fund financial reports. Among them:

- More complex asset classes and their associated fund accounting issues
- The advent of derivatives, structured products and other financing alternatives
- Additional substantiation and footnotes required by regulators. For example, FAS 157/ASC 820 fair value measurements and reporting and FAS 161 derivatives disclosures
- Investor demand for greater transparency and control

The Solution: A First-of-Its-Kind, Automated Financial Statement Preparation Service

As auditing firms began to step away from the preparation of hedge fund financial statements, hedge fund managers turned to AIS to fill the service gap. But AIS initially steered clear. They believed that the highly manual and spreadsheet-intensive methods used in preparing the funds' financial statements meant that they would not be in a position to add any value to the process.

That assessment has now changed. Once AIS was introduced to the Unity Financial Statements software from Confluence, they realized that by integrating the Unity software with their general ledger package, ShadowSuite™, they could develop a database-sourced, automated solution that would reduce, and eventually eliminate, the use of spreadsheets. So, to lessen the burden of manually intensive financial statement preparation while delivering additional business value to their clients, AIS began work on a highly automated, scalable solution. The result has fundamentally changed the way financial statements are processed and prepared.

In 2009, AIS launched AFSP—the AIS Financial Statement Preparation package. A first-of-its-kind automated statement preparation service for alternative investments, AFSP provided an alternative to traditional financial statement preparation.

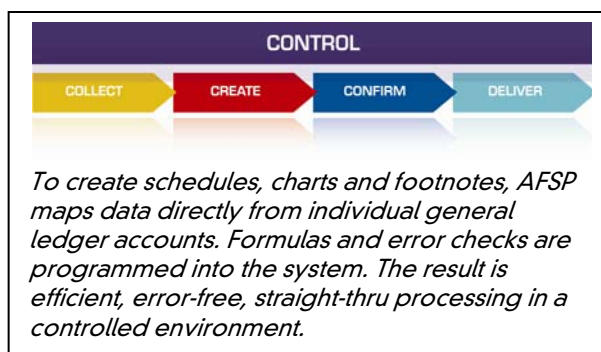
The AFSP package integrates two complementary systems:

- **ShadowSuite**, the AIS general ledger system; and
- Confluence's **Unity Financial Statements** mapping software.

This combination provided the ability to transmit data directly from individual general ledger accounts into the specific charts, tables and footnotes that reside within the Unity Financial Statement templates. Trial balance account and portfolio holdings data are both pre-mapped, formatted and systematically checked for errors. Their output populates a customized Microsoft™ Word template that creates the financial statement. The entire process is sourced with information from a database that is reconciled daily, serving as the fund's official books and records. And AIS has formed a team of professionals solely dedicated to the preparation of financial statements.

ShadowSuite, which is the accounting heart of the AFSP service, is a fully integrated general ledger and portfolio accounting system, designed specifically for the financial markets. It features multi-currency trade capture, mortgage and derivative capabilities and comprehensive portfolio management. However, it is not the typical hedge fund accounting system. Initially designed for the broker/dealer market and for larger institutions, it is a highly scalable, robust application capable of handling all asset classes and even the most complex securities, including derivatives.

Confluence's Unity Financial Statements software and its proprietary Statement Map provide the data mapping tools and reporting components of the AFSP solution. Unity software automates the process of collecting data, creating statements and notes, conforming data



to business rules, and delivering complete financial statements while providing user control across the entire financial reporting process.

Paul Chain, President of AIS Fund Administration, put it this way: “The integration of the Unity software with a robust general ledger package such as ShadowSuite transforms the process from one driven by spreadsheets lacking proper financial controls, into a database-sourced environment with robust financial controls including automated error checks and audit trails. COOs, CFOs, investors, and especially auditors, have responded very positively to this service and its underlying process.”

The Benefits: Scalability, Flexibility, Control, Turnaround and Cost Reduction

Using its AFSP solution, AIS now offers a service that leverages its highly experienced staff and innovative technology solutions to perform efficient and effective financial reporting for hedge fund clients. AFSP affords clients many benefits:

Complete Scalability

AFSP is completely scalable. The reporting process runs on customized Microsoft Word templates. Once they're set up, they can be re-used as required, either when additional funds are added, or to meet more frequent reporting requirements. Changes can be made globally, all at once, rather than spreadsheet by spreadsheet.

Flexibility

Financial statement formats can be customized to fit different clients, different strategies and different audit firms, as well as different data drivers and disclosures. The software underlying AFSP allows AIS staff the flexibility to easily build a variety of made-to-order tables and statements.

Unprecedented Control

From beginning to end, the AFSP service is a database-sourced process, operating within a controlled environment that greatly reduces the need for spreadsheets. Formulas and error checks are programmed into the system, providing straight-thru automated processing. The Unity software maps statements and holdings directly from the general ledger. And a dedicated financial statement preparation team oversees the entire process. As a result, AIS' clients are assured that their financial statements are correct and consistent.

Quick Turnaround

Straight-thru processing means that AFSP can deliver a vastly improved product in less time. Interaction time with the auditor is reduced, along with the number of revisions, resulting in a faster turnaround of the financial statement. ““Before the advent of our AFSP service, our clients' preparation of financial statements for their funds involved numerous drafts, which would often be incomplete or contain inconsistencies, with various tables and statements either unfinished or incorrect,”

“AIS has specific expertise on the operational and financial accounting side of the fund management business. To that, we have added technology and automation to create a true straight-thru processing service. With SEC registration becoming a possible requirement, funds will face stricter requirements for bookkeeping and for preparing bona fide disaster recovery plans. The operational side of the hedge fund business will only grow in complexity. The preparation of financial statements within the alternatives market is a service that requires experience in financial accounting for hedge funds, an understanding of accounting regulations, standards and disclosure requirements and, as importantly, the proper technology which enables an efficient and flexible process within a controlled environment.”

Paul Chain
President
Global Sales & Marketing
AIS Fund Administration

according to Brian Bekiers, AIS Managing Director. "With AFSP we can customize and automate all of our clients' audit checks. Their very first draft becomes a comprehensive set of financials that requires only minimal edits."

Reduced Costs

Fewer errors, along with automated error checks, result in time and staff savings for key stakeholders who use AFSP. COOs and CFOs are relieved of the burden associated with annual financial statement preparation. As a result, they can focus on other critical responsibilities during what is often the busiest time of the year. Auditor time is reduced as well, since there are fewer revision cycles.

Conclusion

AFSP is the first automated financial statement preparation service of its kind, specifically designed for alternative investments. Unlike traditional financial statement preparation processes, AFSP greatly reduces the use of error-prone spreadsheets and manual processes. As a result, AFSP creates significant efficiencies and time savings for fund managers. It provides benefits to auditors by facilitating the audit process. And it helps investors by making it easier for their fund managers to provide them with more frequent unaudited financials.

"AFSP combines the skill of the dedicated professionals at AIS who 'own the process' with the successful integration of ShadowSuite and Unity software," Chain said. "We constantly look at our business from the perspective of fund managers and investors. The feedback from our clients and auditors has been extremely positive. By bringing innovative solutions like AFSP to the table, we have been able to differentiate AIS as a fund administrator."

About AIS

With offices in New Jersey, London, and the Cayman Islands, AIS provides fund administration as well as an outsourced solution for middle- and back-office hedge fund functions. The AIS team is comprised of experts who specialize in the operational and financial accounting issues critical to smooth day-to-day operations of a fund. AIS' offerings include daily reconciliation of trades, positions and cash. Fund managers have access to more than 150 daily reports through AIS*direct*[™] including attribution, financial accounting, operational and daily NAV. All reports are GAAP compliant, audit friendly, and designed with a CFO in mind. AIS' platform is comprehensive, capable of serving all asset classes and strategies. Further information about AIS can be found at www.aisgrp.com.

About Confluence

Founded in 1991, Confluence is a global leader in the automation of fund administration. Confluence helps investment management companies gain unprecedented control by automating every step of the fund administration process — including the collection, creation, confirmation and delivery of investment product data — while maintaining control of the process. Results include lower costs, reduced risk, shorter reporting turnaround times, and the scalability to automate more processes without additional resources. Confluence solutions are currently in use by 40 percent of the leading global investment managers, and more than 60 percent of U.S. mutual funds. For more information, visit www.confluence.com.

ⁱ <http://www.rwbaird.com/bolimages/Media/PDF/Whitepapers/hedge-funds-a-look-back-a-look-ahead.pdf>

ⁱⁱ <http://www.hedgefundresearch.com/index.php?fuse=press&1301697974>