

ALTERNATIVE INVESTMENT SOLUTIONS

HEDGE FUND ELEMENTS

ALPS' Monthly Review Package

It is not enough for an investment manager to find an administrator and trust their work alone. With current due diligence practices, it is important for fund management to be able to understand the reporting process an administrator is providing for the fund. For this reason, ALPS has created a Month End Package that not only reports the fund's monthly returns, but provides a transparent reconciliation between the broker's execution and reporting of trades and ALPS' valuation of those trades. Fund management should use the Month End Package against their own "shadow accounting" and how they understand the trades and month's activity should be valued. This will allow a manager to timely detect any errors, and to become confident in the information they are providing to their investors.

In addition to checking the numbers, current auditing standards require that fund auditors review the internal controls established by the investment manager and evaluate the effectiveness of those controls. An important part of those controls is having a process to understand and verify monthly performance valuations. In other words, managers need to establish a review process for the numbers that ALPS provide.

ALPS' "Month End Report." In order to provide a framework and straight forward process for managers to check our work, ALPS provides managers with a monitoring report. The report package provides managers not only a way to verify the monthly performance valuation, but also allows managers to gain a greater understanding of ALPS' internal accounting processes. We expect this report should reduce any confusion regarding the valuation process as it is designed to support the following manager review sequence:

1. Use a global process to estimate fund net return for comparison to ALPS' reported number.
2. Verify that fund assets reported by ALPS reasonably tie to the values reported by brokers.
3. Review income details expressed as percentages so as to highlight unusual values.
4. Review the General Ledger inputs for the month.
5. Review and confirm the accuracy of a table of parameters for investors showing fee rates, ERISA and restricted status.

The Month End Report opens with the Flash report, which gives an overall review of the fund's monthly performance including investor capital balances. At the bottom of the Flash report are multiple fund returns for different investor conditions including net and gross return, FINRA restricted return, and returns with and without management or incentive fees. Some of these return calculations are broken down in following reports. The next tab, "Capital Activity," reports the capital subscriptions and redemptions for each investor. It is important for the manager to review this report carefully and verify that the correct amounts have been reported to the correct investor.

Within the Month End Report, there are five sub-reports in total that help to breakdown the numbers:

- **Gross Performance Attribution & Gross to Net Global Return Recalculation ("Rtrn Details" tab)** - The purpose of this report is to provide a set of portfolio measurements in which the manager can verify the performance of the fund. At the top of the report, the gross performance attribution is a simple analysis of the fund's positions by capturing the long and short performance separately. Below this is the month end exposure giving the gross and net exposure that can be used as a risk metric and can give the manager a sense of performance drivers. The next section of this tab is the return details, the purpose of which is to perform a "back-of-the-envelope" recalculation of the monthly official fund return found on the Flash report. The top portion of the report displays opening capital followed by income and expenses, followed by ending capital. This ending capital amount ties to the next report, Market Value to Partners' Capital Reconciliation. The second half of the report breaks out the percentage affect of various fee items such as the management fee and incentive fee. The "Current period gain/ (loss)" line ties to the Income Details report.
- **Market Value to Partners' Capital Reconciliation ("Broker Rec" tab)** - The purpose of this report is to provide a "big picture" check between the brokerage values and the ALPS fund valuation, highlighting the primary differences, which are normally

ALPS' Monthly Review Package continued

the accruals, fees and intangible assets that are not included at the broker level. The first section of the report shows broker level market value figures, both on a cash basis excluding accruals and on a cash basis including accruals. The remaining sections of the report provide a breakdown of the remaining balance sheet items. Details of these items can be found by examining the General Ledger (a description of this report follows below). The last line of the report, "Total Partners' Capital" will tie to both the Flash Report as well as the previous report, Gross to Net Global Return Recalculation.

- **Income Details ("Income Details" tab)** - This report is similar to an income statement, however, with much more detail. It breaks performance down based on the dollar change as well as percentage change based on each income item. The last line of the report, "Gross Income/Gross Loss", ties back to the previous report, Gross to Net Global Return Recalculation. Note that the percentage figures on the Income Details report really are "back-of-the-envelope." Because fees and incentives are calculated separately for each participant – including the "tracking account" – there can be small differences between a global fund-level estimate and the actual net return.
- **General Ledger ("General Ledger" tab)** - This report gives the detailed double-entry accounting figures for the month. The column headers state the account name while the row headers give the transaction type. By calculating the change in any income/expense account (ending capital minus beginning capital) the figures can all be tied back to the previous report, Income Details.
- **Investor Fee Rates, ERISA & Restriction Status ("Inv Fee Rates" tab)** - This last report displays the way we have coded each investor's unique fee arrangements, ERISA status, and restriction status. It is important for fund management to review these items for accuracy in the event information is incorrect or investor status has changed.

Through the use of these reports, fund management should be able to get a sound understanding of the accruals, income items, balance sheet items, and individual investor standings. It is important to understand that several of these reports are "backing" into returns or dollar figures as a check to the official fund valuation methodology. Small dollar and basis point variances between reports are expected and should be disregarded.

Documenting the Review Process and File Retention

In order to expedite and simplify the annual audit process, ALPS suggest fund management maintain electronic copies of the Month End Reports. The financial controls process would be further perfected if fund management devises a system to document a contemporaneous monthly review of the package and other ALPS-provided reports.

If an investor or fund manager goes through a reasonable due diligence process that requires third-party administration and a reputable independent broker and auditor, assuring that there are reasonable financial controls, and follows a documented review process, risks for fraud and unexpected loss are minimized.

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