

TRENDS IN HEDGE AND P/E DUE DILIGENCE

THE IMPORTANCE OF ANALYSIS AND JUDGMENT IN “ODD”



ODD BRIEF #117

OPERATIONAL
DUE DILIGENCE:
ARE YOU RECEIVING
‘VALUABLE ANALYSIS’?

When conducting operational due diligence, the process and the procedures are key to meeting compliance requirements and vetting the validity of the investment manager. However, it is the individual analysis and professional judgment of the due diligence personnel that has historically set groups apart. In the end, all investment companies have operational risks, but the alpha in ODD is deciding where to draw the line on the “assurance” opinion.

In 2020, many fiduciary allocators are now outsourcing their ODD in order to obtain independent opinions, new insight, and critical expertise. There is nonetheless a current debate over what ODD is, and whether it is purely an operational check-up to see if there are accounting systems and cash reconciliations in place, or whether it is truly an assessment on the business and the integrity of the internal control framework and staff. In PRISM’s view, it needs to be both. PRISM’s goal is to provide its clients with analysis and greater color on the funds and managers it reviews. Only a thorough review of the middle and back office operations, coupled with a trained eye to assess fraud risk can provide investors with assurance over operational, structural, and business

risks. Reviewing and understanding the internal control environment is critical to assessing whether the people and processes in place are sufficient to lower the likelihood of fraud or large operational errors. However, first and foremost, investors are conducting ODD to gain assurance that the managers they invest in are not fraudulent or bad actors. In order to assess this, one must realize that there are varying forms of fraud. The lighter forms of fraud start with transparency and assessing whether the manager is providing a commercial level of information, or are they misleading investors in some way. This can be a challenging task without a complex process, knowledgeable interviewing techniques, and extensive experience reviewing private fund investment managers.

Once all of the due diligence vetting procedures are completed, it is the analysis and individual judgment applied to the operational due diligence opinions that make the difference in the end. It is always difficult to provide a qualified opinion, but it is necessary in order to protect investors and counterparties from an unacceptable amount of operational risk that can result in irreversible financial and reputation damage.

Hedge fund and private equity operational due diligence since 2009.

PRISM LLC

WWW.PRISMALTERNATIVES.COM

CONTACT: LAURI HAAS • 1-424-302-0165 • INFO@PRISMALTERNATIVES.COM