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Investment Management Operations: Reconciliation

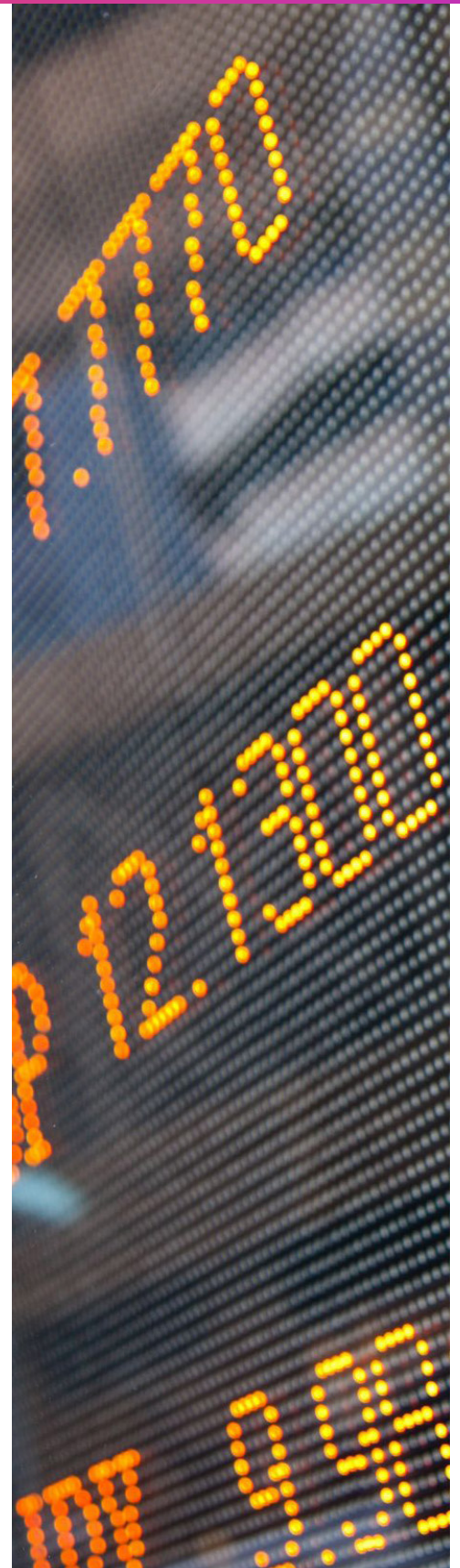
WHAT DOES IT MEAN FOR an account to be fully reconciled? As the asset management industry continues its move into a new era of increased competition and margin compression, investment management middle and back offices are burdened to supply an operating platform that supports complex and global assets, simply and inexpensively.

Increasing the complexity of operations is the number of parties that may be participating in account recordkeeping. Custodians, fund accountants, and of course the investment management firms, have recordkeeping responsibilities, each with different purposes. So, a basic question regarding any investment management operating platform is: “What does it mean for a record to be considered fully reconciled?”

First, a brief discussion of the varied parties’ purposes in recordkeeping. IBOR, or Investment Book of Records, refers to investment data used to supply accurate information to the front office in support of an investment management process. This includes what a manager may trade, such as intraday share positions and pending transactions. IBOR is distinguished from data used in support of back-office operations, commonly known as Accounting Book of Records (ABOR). ABOR supports back-office business functions and includes data for such needs as daily NAVs, regulatory reporting, fund administration, and transfer agency services. Managers must reconcile to a custodian’s records, but most do not need the fund administration information found in ABOR. Archer recently coined the term Custodian Book of Records (CBOR), representing the data being provided to the IRS by the custodian. This includes income, as well as realized gains and losses.

At its most basic, reconciliation will account for discrepancies between two sets of records. For investment managers, this typically means reconciling a custodian’s records to the manager’s IBOR. Investment managers maintain records for performance measurement and trade order management purposes, as well as client support. It cannot be assumed that one set of records is “correct” and the other “incorrect” because the veracity of each is determined by their underlying purpose. A custodian’s records are dominated by their need to account for accurate cash and settlement of securities. An investment manager’s records must focus on accurate trading and performance measurement. In effect, both are correct when viewed individually, but can conflict when compared one to the other because they often have separate, competing goals. A custodian’s records often reflect settlement date, whereas a manager’s must have a trade-date focus.

Further complications are added with the presence of a fund accountant, whose ABOR must be adequate to strike an NAV; investment managers often desire to reasonability test the fund accountant’s ABOR against the investment management firm’s IBOR. Simply matching IBOR to portions of CBOR, or conducting a reasonability test of ABOR, does not ensure compliance with current standards. Because



of both the importance of accurate performance presentation and regulatory scrutiny, it is not an exaggeration to say that reconciliation is the foundation of a manager's data integrity.

When reasonability testing of ABOR is needed, data points in addition to positions, transactions and cash are required. These include: Local Pricing of Global Securities; Local Market Value of Global Securities; and Local Accrued Income of Global Securities. As there are an abundance of pricing and local value sources, and given the absence of a global 'market close,' the investment industry has not yet established a standard for fair value NAV pricing, which poses a challenge for Investment managers attempting to reasonability test fund accountants whose 'best efforts' practices differ.

Technology is available to significantly automate the reconciliation and reasonability test processes. At a minimum, there are at least two requirements for this automation: an accounting system that corrects errors through the automatic reprocessing of all relevant transactions,

and highly customizable data exchanges with custodians and fund accountants. These capabilities allow processors to focus on true discrepancies, like position breaks, and to ignore the "false" breaks caused by accounting and / or policy differences. Additionally, the reconciliation process can be further simplified when the IBOR system is able to intelligently apply reconciliation adjustments at a global level.

Archer has the ability to reconcile a single investment account against multiple sources, in an automated fashion.

Because of the increased complexity of fund accountant reasonability testing, one might expect an increased need to adjust records.

However, an IBOR platform capable of highly customized interfaces that simulate - but do not match - fund accountants' records provide for a best-efforts check on fund accountant data. Comparison of shares and cash at the account level, rolled up to the portfolio level, is essentially the same for reconciling to custodian and comparing to fund accountants. Calculating and comparing pricing and accrual information at the portfolio level, and subscriptions and redemptions at the account and the portfolio level, however, requires a

complete understanding of the fund accountant's practices in this area. Once understood, the comparisons can be automated, false breaks can be identified, and reasonability testing can occur in advance of settlement.

In essence, being "fully reconciled" for successful investment managers means that their records reflect their needs by accurately accounting and adjusting for differences with custodians and / or fund accountants. With flexible technology and customized interfaces, this can be achieved on a daily basis through a highly automated process, placing less strain on human resources while providing other benefits.

When a highly automated reconciliation process is driven by an intuitive user interface, the result is an intelligent workflow that supports data integrity simply and efficiently. While data accuracy is a paramount concern, the timeliness and accessibility of the data across a firm is of equal importance for both cost efficiency and customer support. Given the ever-increasing compliance and regulatory demands the investment management industry faces, timely, accurate and accessible data will continue to be a hallmark of successful firms.

Archer provides institutional investment managers the tools needed to maintain proper oversight of ABOR providers with reconciliation of cash, positions, and accruals as well as reasonability testing of fair market value pricing.