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SAS 70: Meeting the Industry Standard

Increased regulation and corporate governance, coupled with heightened levels of investor concern, has resulted in money management firms experiencing a rise in internal control-related inquiries from clients, auditors, boards, and other interested parties. In response to these inquiries, many leading money management firms have proactively undertaken initiatives aimed to strengthen and formalize their internal control environment.

What is a SAS 70?

SAS 70 is an in-depth examination of an organization's internal control by auditors under the AICPA's Statement on Auditing Standards No. 70 ("SAS 70"), as amended, which culminates in a report suitable for distribution to clients and their auditors. SAS 70 has long established its prominence as the industry standard for demonstrating an organization's internal control related to the services they are providing to others. This prominence is evident with the SEC's recent recognition of SAS 70 as an important mechanism for investment advisors to demonstrate their internal control.

Recent SAS 70 Proposal

On May 20, 2009, to strengthen protection of client assets, the SEC proposed changes to the investment advisor custody rules under 206(4)-2. A significant part of the proposed amendment is to require investment advisors whose client assets are not maintained with an independent qualified custodian (i.e. custodian other than the advisor or related person) to obtain a Type 2 SAS 70 related to custody of such assets.

Industry Usage

In the money management industry, investment management SAS 70's were initially used as a tool to support an audit of financial statements for their institutional clients. However, more recently, SAS 70 has evolved and is viewed more broadly by the marketplace. Besides providing information in a consistent format to institutional clients and their auditors, SAS 70 often serves as a risk management tool providing an independent examination of the money manager's controls. SAS 70s are often requested from fund advisors, boards, internal audit, and operational risk functions, as well as senior management.

Prior to embarking on a SAS 70 examination, service organizations commonly undertake a SAS 70 readiness review to determine if their organization has the appropriate controls and documentation in place to move forward with a SAS 70 examination.

MMI SAS 70 Survey

In conjunction with Deloitte & Touche LLP, the Money Management Institute (“MMI”) developed a survey on SAS 70, which was provided to MMI members for response. The objective of the survey was to obtain and understand the benefits, trends, and use of SAS 70 reports in the money management industry; the survey results were tabulated for analysis.

Survey Results and Trends

SAS 70 reports have changed from being considered just an auditor-to-auditor communication to a relevant and frequently requested report issued to meet clients’ expectations. Approximately 90% of the respondents had previous familiarity with SAS 70 reports, with over 80% having a moderate to greater understanding of the SAS 70 reports and the standard. Approximately 40% of the respondents indicated that over the past three years there has been at least moderate increase in the number of SAS 70 requests, while 20% of the respondents indicated that the growth in SAS 70 requests has been significant.

There is a growing trend for organizations to engage in a SAS 70 examination to respond to the multitude of requests by providing information about the nature of their services and their internal control environment. Respondents have indicated that over 60% of their clients have requested a SAS 70 from their organization. As part of their due diligence process, over 70% of prospective clients have inquired if a SAS 70 report is available at the investment manager. Almost 65% of respondents believe that a SAS 70 would be beneficial for their organization to meet the requests of clients and over 75% of believe that the SAS 70 report would be beneficial for the organization to understand and evaluate their internal control environment.

A SAS 70 report can be issued as a Type 1 or Type 2 report. A Type 1 SAS 70 provides an examination on the description of controls and the design of the service providers’ controls as of a specific point of time. A Type 2 SAS 70 report includes the elements of a Type 1 examination, and also includes tests of the operating effectiveness of the service providers’ controls covering a specified period of time (typically not less than 6 months and no greater than 12 months). Organizations have responded to SAS 70 requests from their clients; greater than 35% of the respondents indicated that their organizations issue a SAS 70. Since Type 1 reports are typically produced in the first year of report issuance, approximately 50% of the respondents indicated that if their organization issues a SAS 70 report, the report is a Type 2 report or multiple reports are issued for their organization.

SAS 70 Benefits

Although SAS 70 reports require an investment in time and resources, in the long run money managers are finding the investment worthwhile. Over 80% of respondents indicated that their organization is currently performing internal control assessments, including operational and information technology areas, which are typically found in a SAS 70. In addition to clients and their auditors, respondents have indicated that over 50% of reports are being received by other parties (e.g. Board of Directors, Chief Compliance Officer, etc.). Below are a few examples of the benefits of SAS 70 and current trends in utilizing SAS 70 reports:

- Clients request SAS 70s as part of their due diligence procedures over 3rd party asset managers
- Board of directors and fund advisors execute and review SAS 70 reports as part of their internal monitoring process
- Asset managers and fund advisors are issuing SAS 70 reports to meet market requests and demands; their clients expect a similarly strong control environment at their 3rd party asset managers.

Conclusion

Requests for SAS 70 continue to increase as it is viewed as a valuable tool in the asset management industry. As a globally recognized standard, SAS 70 has allowed organizations to produce a single report that is useful for their global clients. Providing SAS 70 reports has been viewed positively for organizations as they continue to meet their client expectations and demands as well as striving to have a competitive advantage in the marketplace.