Investment Companies: Tips on Choosing Auditors and Tax Preparers

Auditors and tax preparers play a vital role in the governance of investment companies. Unlike other service companies, investment companies – including hedge funds, mutual funds, commodity funds, alternative investment funds, and others – are subject to complex government regulations and accounting rules.

Achieving compliance and reducing tax exposure requires a high degree of expertise from a financial services firm. When selecting an auditor and tax preparer for your investment company, recognize you'll be relying on the firm during a time of great uncertainty in the regulatory and taxation realms. The process of finding and hiring a new advisory firm is also time-consuming, and not something you want to repeat in the near future.

Finding a firm with the appropriate credentials and investment company experience will give you the confidence to devote your time on achieving your investment objectives on behalf of clients and shareholders.

A Complex Regulatory and Tax Environment

From an audit perspective, there are requirements from the U.S. Securities and Exchange Commission (SEC) that have to be met annually. The governing documents for many investment companies require an audit to verify the returns on the funds and financial statements are accurate and to minimize the chances for fraud.

In terms of taxes for funds, there are a number of complex challenges to consider. These include the election of certain taxation methods, including mark to market (MTM), 988(a)(1)(B), QEF (qualified electing fund), and PFIC (passive foreign investment companies).

There are also tax implications with regards to reporting capital gains versus ordinary income and the timing and character of reporting gains, losses, and various items of income and deduction. All of these complexities can create increased tax exposure and higher tax payments for investors if not handled by experienced audit and tax experts.

Investment companies that invest in stocks and other exchange-traded instruments can be relatively easy to audit. Auditing alternative investments, which often rely on complex investment strategies, can be more challenging. A financial services firm must have an understanding of the types of alternative investments and strategies, and how to value those investments.

Tips for Selecting an Accounting Firm

It makes sense to consider both large and small firms. Often a mid-size firm will come through with a lower fee while providing more personalized attention to meet your unique needs.

Look beyond cost

While cost is an important part of your decision, it shouldn't be the only factor. Consider the industry expertise offered by each firm, the access your company will have to senior personnel, each firm's reputation, and whether a firm offers any extra services as part of their engagement offerings. The end game is to find a strategic, proactive partner who inspires confidence when dealing with complex tax and regulatory issues.

Choose a firm that specializes in your industry

Financial services firms have different specialties. Make sure to choose a company that specializes in your industry so you can get an expert level of understanding. A firm providing services to your company should have experience assisting with the nuts-and-bolts issues many investment companies must address, as well as specialized areas such as foreign account reporting, foreign partner reporting/withholding, and more.

Consider the broader relationships

During the audit and tax preparation process, the firm interacts with senior management, and becomes deeply acquainted with the internal controls of your company. The firm is in a position to work with you on best practices to meet the needs of all stakeholders – investors, tax authorities, and regulators. That requires a partner with knowledge and a demeanor that can instill respect and confidence inside and outside the organization. It's another reason to engage senior management in the selection process.

Make the case for your company

Everybody wants the best people working on their account. If you feel strongly the firm you want to engage is best suited for your account, let them know how they will benefit from working with you – that you fill a gap in their portfolio of experience or the ease of working with your company, for example.

Don't rush your decision

Don't feel pressured to make a decision immediately after the final presentations. Make sure your management team has enough time to properly review all the candidates and come to a decision as a group. If there's a difference of opinion among group members, go back to the candidates for more information – including how they have addressed issues important to your company.

Taking the time to find a trusted partner to help navigate complex tax methods and regulations will pay off in the long run. They will help develop strategies to find savings and reduce taxes so you can face investors, regulators, and tax authorities with confidence.

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