The Benefits of Performing Operational Due Diligence on Private Equity – *Paving the Way Ahead*

CORGENTUM

Introduction:

In advance of the upcoming risk management panel at the Opal Private Equity Summit for Institutional Investors Conference in San Francisco, California from March 26-27, Corgentum Consulting, an operational due diligence specialty consulting firm, has put together an exclusive guide for investors highlighting how Limited Partners can incorporate operational due diligence into their risk management process. Specifically, this guide will help private equity investors answer:

- Why Limited Partners should perform operational due diligence on private equity funds

- Why Limited Partners should consider working with an operational due diligence consultants to assist in performing operational due diligence

What is Operational Due Diligence?

Operational due diligence has recently become more of a buzz word in the private equity industry. The term is being more frequently mentioned in reference to alternative investments including private equity. Indeed, private equity investors may have increasingly heard the term mentioned more frequently. Perhaps, one of the reasons for this increased attention has been investors increased focus on private equity fund failures for operational reasons. Also supporting investor interest in operational due diligence has been the increase focus on fraud detection spurred perhaps by recent large scale frauds such as the Madoff scandal. With all of this increased interest, many private equity investors may want to learn more about operational due diligence - but what exactly does this term mean?

Operational due diligence is a due diligence review of a fund that focuses on operational risks. Operational risks can be defined most broadly as a fund's non-investment related risks. Common operational risks can include:

- Valuation policies and processes
- Legal and Regulatory compliance
- Cash Management
- Fund service providers
- Business continuity planning/disaster recovery
- Counterparty management
- Information technology
- Back office and trade operations

Operational due diligence allows for a deep dive into these issues and many others, to ensure that investors are avoiding unnecessary operational risks. Corgentum covers over 20 of these potential risk categories when performing an evaluation on a fund.

Why Should Limited Partners Perform Operational Due Diligence?

Operational risks can lead to big losses:

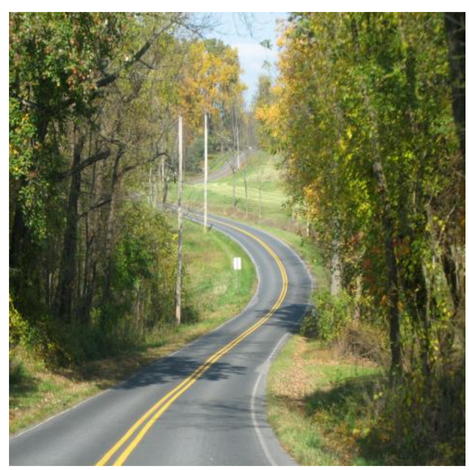
Operational risks can lead to the failures of private equity firms just as easily as they can for hedge funds. Operational risks are typically fat-tailed in nature and can cause total and complete losses for investors. Vetting these risks therefore, should be a crucial part of the overall private equity investing process. A detailed operational due diligence process can assist in detecting these risks and preventing unnecessary losses.

Operational risk is just as important as investment risks:

Private equity operational due diligence has become more common within the last few years and the demand for private equity due diligence is expected to rise in the future. With the higher demand for private equity operational due diligence, it should be discussed how Limited Partners can incorporate operational due diligence into their risk management process.

First of all, we must ask ourselves, why is it important for investors to perform operational due diligence on private equity firms? Private equity funds and hedge funds each contain a number of operational similarities. They are similar to hedge funds in that they both involve operational risks such as, valuation, cash management, information technology, and most importantly to some, the possibility of fraud.

With that said, why would someone think it was important to perform operational due diligence on hedge funds and not private equity funds? It often comes down to the investors tending to focus perhaps too heavily on traditional investment risk management processes. There is no question that mitigating and diagnosing investment risk is an important task to cover when it comes to investing in a private equity fund, but many seem to think that the investigation of the fund stops there. However, it is vital to incorporate operational due diligence into your risk management process.



Government regulation will not protect investors:

The SEC may also play a large part in investor's hesitation to acquire operational due diligence services for private equity funds. Many investors believe that with the new rules and regulations that force firms with over $150 million in assets to register with the SEC, there will be less need for operational due diligence because the SEC will detect any weaknesses that a fund may have. This, however, is not necessarily true. Operational due diligence takes a deeper dive into several categories that the SEC may overlook.

Private equity requires a longer capital lock up so more upfront due diligence on operations is recommended:

Investors which allocate capital to private equity funds are generally making an even longer term commitment of capital then they are with more liquid strategies such as hedge funds. With this longer term commitment, it is arguably even more important that Limited Partners conduct more intensive operational risk review upfront before investing in private equity funds as compared to hedge funds.

Why Should Limited Partners Consider Working with a Due Diligence Consultant?:

Asking the tough questions:

Operational due diligence requires investors to ask the tough questions like, "What is the operational infrastructure of the private equity fund?" The first step is asking the tough questions, but what happens once an investor does? More often than not, investors will ask difficult questions that funds may not always want to answer. Sometimes, even when investors get answers, they do not always know what the answers mean or what to do with them. This is where an operational due diligence provider can come into play. Operational due diligence consultants know what questions to ask and how to get the answers. They are also documenting each of these questions to ensure that each detail is accounted for. It is sometimes helpful for the operational due diligence firm to work alongside the investor to ask the hard questions.

Ensuring risks do not slip through the cracks:

When investors perform operational due diligence, this process also allows investors to get into much more detail that they may not have if they were not working with a third-party specialty

operational risk consultant. According to Corgentum's Managing Partner, Jason Scharfman's new book, *Private Equity Operational Due Diligence: Tools to Evaluate Liquidity, Valuation and Documentation*, the problem is not a matter of whether the investor is capable of obtaining transparency by themselves, but a matter of letting simple operational details fall between the cracks.

When an investor begins the process of reviewing a private equity fund's operational risks, it is easy for an investor to become overwhelmed with information from a fund and miss something. An operational due diligence provider, like Corgentum, is carefully documenting each detail, even what may seem like the simplest ones to an investor. Operational due diligence providers know that the seemingly simple details can add up to uncover potentially large operational risks. An operational due diligence firm can make sure all questions get asked and answered and no operational details which can lead to investor losses will slip through cracks.

Ongoing monitoring:

Another benefit to implementing an operational due diligence provider into your risk management process is that they perform ongoing monitoring. Ongoing monitoring allows updates to be performed on the fund at the discretion of the investor.

A consistent process:

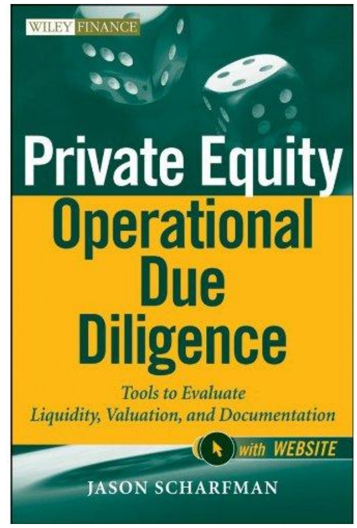
Working with an operational due diligence consultant allows private equity investors to ensure that they perform consistent operational risk reviews. For example, in order to create a consistent practice, the operational due diligence provider can assist in developing an operational due diligence program at an investor's organization. With a program in place private equity investors can then work with the consultant to ensure that certain funds are not under reviewed, and that the same minimum due diligence standards are applied to all funds.

A well documented review:

At the end of an operational due diligence consultant's review, the investor is given a detailed report. In this document , investors can find exactly what they are looking for in regard to operational risk and any other issues or events that may have come up during the due diligence process. The review will explain the level of risk for each section, as well as detailed information explaining why a specific issue poses a risk. Having a process that is documented helps the investor have a detailed written record of not only the operational processes in place at a fund, but also a guide as to what operational risks pose the greatest threats.

Conclusion:

Performing operational due diligence has become a critical part of private equity investing. It is evident that private equity operational due diligence is essential for investors looking to invest in private equity funds. They, like hedge funds, require a deep dive into the operational aspects of a fund- just as one would practice investment due diligence and risk management.
The importance of private equity operational due diligence can also be highlighted in Jason Scharfman's new book, set to be released on April 10, 2012.



The book is entitled *Private Equity Operational Due Diligence: Tools to Evaluate Liquidity, Valuation and Documentation*. It will highlight, in greater detail, the need for operational due diligence on private equity funds. This is just another precautionary tool to ensure that investor's assets are being allocated properly and that the private equity fund is using best practices to ensure the security of the assets.

Additionally, to hear a fuller discussion on the importance of incorporating operational due diligence into the larger private equity risk management process it is encouraged that investor's attend the risk management panel on March 27 at the Opal Private Equity Summit for Institutional Investors Conference in San Francisco, California. At this panel Corgentum's Managing Partner, Jason Scharfman, is anticipated to discuss the following topics:

- the current state of private equity operational due diligence
- trends in limited partner private equity risk management from both investment and operational perspectives
- evaluating latent general partner operational risk exposures
- differences between private equity and hedge funds operational due diligence
- The benefits to limited partners of working with an operational due diligence consultant such as Corgentum, to design a private equity operational due diligence program

About Corgentum Consulting:

Corgentum is an operational due diligence consulting firm that performs operational due diligence reviews of fund managers. Corgentum works with investors, including endowments, fund of funds, pension funds, etc. The core of their work covers private equity, hedge funds, real estate and traditional funds- globally.

Corgentum provides investors with the industry's most comprehensive operational due diligence reviews of hedge funds, private equity funds, real estate funds and traditional funds. Corgentum partners with investors to improve upon the efficiency and effectiveness of the operational due diligence process. Our proprietary due diligence methodologies and innovative original research allows our clients to continually manage and mitigate their operational risk exposures. Corgentum's unbiased and time-tested approach creates a substantial competitive advantage that enhances the risk management functionality of our clients. More information is available at www.Corgentum.com.

Email: info@Corgentum.com
Main Tel. - 201-360-2430