Institutional Investor's

alpha

The Definitive Source for Everything Hedge Funds

Top Accounting Firms

RANK 2016	RANK 2015	COMPANY
1	4	PricewaterhouseCoopers
2	1	EisnerAmper
3	2	Ernst & Young
4	8	Grant Thornton International
5	–	Marcum
6	3	Deloitte Touche Tohmatsu
7	7	RSM
8	5	KPMG

CLIMBING TO THE TOP

Performance isn't the only factor that determines how well a firm fares in our annual Hedge Fund Report Card — but it's by far the most important.

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ALPHA AWARDS: **ACCOUNTANTS**

WHEN BIGGER ISN'T BETTER

IT WAS ONE of the biggest mergers of accounting and audit firms in the U.S. in years, and one that had significant implications for the accounting lineup that caters to the hedge fund industry. In May 2014, KPMG, one of the Big Four global accounting firms, announced it was buying regional powerhouse Rothstein Kass, a New Jersey–based firm that had fought its way to the top ranks of hedge fund accountants, in part thanks to its aggressive courtship of smaller and emerging managers.

At the time, London-based research firm Preqin said the merger would dramatically reshuffle the leadership ranks in hedge fund accounting, propelling KPMG to the top of the heap of firms that provide global audit services, by at least one measure: number of funds served. Preqin said the merger would immediately give KPMG 26 percent of the hedge fund market, putting it ahead of the previous leaders, Ernst & Young, which had 21 percent, and PricewaterhouseCoopers, with 20 percent.

How's the merger working out so far? Judging from the latest Alpha Awards ranking of accounting firms, and anecdotal comments, KPMG has faced some challenges in keeping all those Rothstein clients happy. KPMG not only slips in the ranking, it lost former Rothstein managers to other firms.

KPMG sinks three places to eighth in this year's Alpha Awards ranking. (Rothstein was No. 6 a year ago.) KPMG finishes behind the other Big Four firms and four midsize outfits. KPMG's decline is one of several shifts in this year's ranking. First-place firm PricewaterhouseCoopers edges out last year's winner, EisnerAmper, a midsize firm that drops to second place. PwC soars to No. 1 from a fourth-place finish last year. Ernst & Young slips to No. 3 from second place last year. Another midsize firm, Grant Thornton International, surges to fourth place from eighth last year, followed by midtier Marcum in fifth. Another Big Four firm, Deloitte Touche Tohmatsu, falls to sixth from last year's third-place finish, while RSM (which before October was known as McGladrey) comes in seventh. No. 8 KPMG rounds out the list. To determine the Alpha Awards, we surveyed more than 425 hedge fund firms, asking them to rate the quality of service they received from their accounting firms over the past year in five categories: Audit, Client Service, Hedge Fund Expertise, Regulatory & Compliance and Tax.

PwC's situation this year is the reverse of KPMG's. The firm not only shows improved popularity in the Alpha Awards ranking, it has gained new hedge fund business thanks to its rival's merger. "We have picked up several large clients and expect more opportunities created by the KPMG-RK transaction," says Michael Greenstein, U.S. and global leader of alternative investments for PwC.

The firm isn't alone in snatching up former Rothstein clients. EisnerAmper says it too has gained clients as a result of the merger.

KPMG acknowledges that some managers have left for other firms since the merger but says the losses have been minor. Former Rothstein Kass chief operating officer Christopher Mears, who is now national leader for asset management audit operations at KPMG, says more than 90 percent of his former firm's managers stayed on. Rothstein reportedly had more than 1,100 hedge fund clients before the merger; losing 10 percent of that total translates to 100 hedge funds that may have jumped ship. KPMG reportedly had about 900 hedge fund clients before the merger.

> "I knew I was never going to be an important client to a Big Four firm, but I would always be an important client to Grant Thornton."
> *Grant Thornton client*

Some of the Rothstein managers who left after the merger may be major clients, but more are likely to be smaller managers who might not feel the same love from a giant firm like KPMG that they enjoyed at a smaller one like Rothstein. "The reality is that in the emerging-manager space, Rothstein Kass took everything on," Mears says. "If a guy launched with $5 million and in three or four years was still at $5 million, Rothstein would deal with it." That sort of client may not feel as comfortable at KPMG. But Mears adds that KPMG is far from abandoning small managers and remains committed to emerging funds.

The KPMG merger continues a trend toward concentration of hedge fund accounting at a few firms, which in turn mirrors the growing concentration of assets among the biggest managers. Preqin says the top 10 percent of the 5,000-plus single-manager hedge funds it tracks control 90 percent of the assets in the sample. Globally, some 8,000 hedge funds hold about $3 trillion in assets.

When Boston-headquartered hedge fund consultant NEPC recently polled some 250 managers who controlled nearly $1 trillion in assets about their accounting services, 91 percent said they used a Big Four firm for their funds. Of those who responded to the survey, 85 percent managed $1 billion or more, and 38 percent ran more than $10 billion.

In the NEPC survey the concentration of business among the Big Four left just 9 percent for all other firms, and most of that went to a few midsize firms, including three on this year's *Alpha* list: EisnerAmper, Grant Thornton and McGladrey. "The movement we are seeing is away from smaller organizations to the Big Four firms," says NEPC chief compliance officer William Bogle IV.

This year's Alpha Awards champ, PwC, also can boast about winning the annual revenue game. The firm edges out Deloitte to claim the highest global revenue for the most recent year: $35.4 billion,

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compared with second-place Deloitte's $35.2 billion. PwC employs 208,000 worldwide.

The firm can attribute some of its success in hedge fund accounting to the increasing complexity and scope of that business, particularly for the largest managers. What those mega-billion-dollar managers require these days is an accounting firm that can not only perform an audit on time but also make accurate valuations of complicated investments that may be scattered around the globe. All of that works in favor of a Big Four firm like PwC, with a global reach and a broad talent pool.

"Hedge fund managers want to work with a firm that has a deep understanding of products and strategies, as well as a depth and breadth of skills," Greenstein says. "They want to have access to experts who can deliver business- and industry-specific knowledge, whether it is new asset classes, products, markets or ongoing challenges in tax and regulatory compliance." Greenstein has been with the firm for more than 25 years and has been alternative-asset leader since 2010.

One area of the hedge fund industry that has gotten extra attention at PwC is audit, Greenstein says. The firm has worked to simplify the audit process by investing in technology to help drive efficiency and allow quicker delivery. PwC is working to help managers use data developed in the audit process to gain insights that might be used elsewhere, providing a bonus to clients.

Top Firms by Aspects of Service

RANK 2016	RANK 2015	COMPANY
Audit		
1	4	PricewaterhouseCoopers
2	1	EisnerAmper
3	2	Ernst & Young
4	–	Grant Thornton International
5	3	Deloitte Touche Tohmatsu
Client Service		
1	4	PricewaterhouseCoopers
2	1	EisnerAmper
3	–	Marcum
4	–	Grant Thornton International
5	3	Ernst & Young
Hedge Fund Expertise		
1	4	PricewaterhouseCoopers
2	1	EisnerAmper
3	–	Grant Thornton International
4	2	Ernst & Young
5	–	Marcum
Regulatory & Compliance		
1	4	PricewaterhouseCoopers
2	1	EisnerAmper
3	2	Ernst & Young
4	–	Grant Thornton International
5	3	Deloitte Touche Tohmatsu
Tax		
1	2	PricewaterhouseCoopers
2	–	Marcum
3	1	EisnerAmper
4	3	Ernst & Young
5	–	Grant Thornton International

All of that global knowledge and expertise, however, comes at a cost, and smaller managers or those with simpler strategies may not need the extra bells and whistles. For those managers a firm like No. 2 EisnerAmper fits the bill.

One EisnerAmper client, a manager with a straightforward strategy, says he once shopped the Big Four firms but found he could get what he needed at EisnerAmper for less. He says he has never regretted his choice and in fact feels that his access to top accountants is probably better than what he might get from a Big Four firm with a client roster of big-name managers.

"Eisner has tremendous customer service," the manager says. "Sometimes I need an answer immediately, and the ability to pick up the phone and just dial the tax or audit partner and get a response back immediately is key. I don't think I could get that in a big firm."

Eisner boasts 1,200 hedge fund clients. Its annual revenue of $305 million is a fraction of that of a Big Four firm, as is its workforce of 1,300. The firm's financial services group is its largest, with 250 professionals.

To try to keep pace with larger firms, Eisner has been expanding its head count and geographic reach, adding offices in Miami and Los Angeles and launching a global network of independent firms and connections in Ireland and the Cayman Islands. It has beefed up its cybersecurity advisory effort, not just to respond to its clients' needs and compliance issues but also to keep pace with larger firms that are putting extra focus on that area. Peter Cogan and Chris Bekmessian cochair Eisner's financial services business that focuses on hedge funds; both have spent their entire careers with the firm.

Eisner's challenge is to make itself look more like a Big Four firm without losing the personal touch its clients crave. The fact that it remains near the top of the *Alpha* rankings indicates that clients are satisfied. "I have worked at funds where we used bigger firms," says one client. "I don't miss it."

Eisner's appeal to smaller funds has helped it retain its position as one of the most-liked firms in the Alpha Awards. But Big Four firms are hardly ceding the small-manager business, especially the emerging-manager field.

"One area of focus where we continue to invest is in the start-up market," says Natalie Deak Jaros, hedge funds market co-leader for the Americas at Ernst & Young.

Although EY retains an interest in emerging managers, much of its hedge fund attention is focused on larger firms.

In the U.S., EY insists that it is No. 1 in terms of clients served — at least, those big enough to register with the Securities and Exchange Commission, which requires hedge funds with more than $150 million in assets to file. EY says it audits about 40 percent of all SEC-registered hedge funds and hopes to grow that number.

Jaros is not surprised by the continuing concentration of hedge fund clients and assets with the Big Four because those firms all view the industry as an important business and devote money and talent to ensuring they don't lose their edge. She points out that most of the largest hedge fund clients at EY have been with the firm since their inception.

"I think this is still a niche business," Jaros says. "You need to understand the nature of the business and be willing to invest in this niche. Not all firms are willing to do that, so the concentration doesn't surprise me."

EY has more than 211,000

employees worldwide, including 15,000 in its asset management business, which includes hedge funds. Global revenue for its most recent year was $28.7 billion, third among the Big Four. Jaros, who has been an EY partner since 2006, shares the title of hedge fund co-leader with Michael Serota.

Grant Thornton enjoys one of the biggest jumps in the Alpha Awards ratings, climbing to No. 4 from eighth place last year. Though it is considered a midsize firm, it is much larger and more of a global player than either EisnerAmper is or Rothstein Kass was.

Grant Thornton had global revenue last year of about $4.7 billion and total employment of 40,000, including more than 450 professionals who focus on hedge funds. But it retains the small-firm ambience that its smaller clients appreciate.

One hedge fund client with less than $1 billion under management and a straightforward long-short equity strategy says he gets the quality expertise he needs from Grant Thornton, plus a personal touch.

"I knew I was never going to be a mega-billion-dollar hedge fund," the client says. "So I knew I would never be an important client to a Big Four firm. But I felt that I would always be an important client to Grant Thornton. And the fees would be significantly less."

The U.S. and the U.K. account for more than half of Grant Thornton's revenue and most of its hedge fund business. For the past four years, Michael Patanella has led the firm's U.S. hedge fund practice, which represents about 350 hedge funds with a combined $150 billion in assets. Part of what makes the firm attractive is the access to top partners — including himself — that Patanella provides.

"It is a personal relationship with him," the client says. "I can call him on a Sunday afternoon if I need to. He is accessible and responsive."

Fifth-place finisher Marcum has been developing a niche in hedge funds and maintains efforts aimed at smaller managers, including programs for emerging managers and hedge fund start-ups. The hedge fund practice is part of the firm's alternative-investment group, which has more than 50 professionals and has been headed by Beth Wiener since Marcum's founding in 2000. The firm has 1,500 employees in offices around the U.S., Grand Cayman and China.

Although the next-ranked firm in the Alpha Awards, Deloitte, trails rival PwC in revenue, it has the largest workforce in the accounting field: 225,000. Deloitte's overall hedge fund leader is Patrick Henry, who serves as head of investment management. Edward Dougherty leads the hedge fund practice in the U.S.

Order of Importance to Clients

RANK 2016	RANK 2015	ASPECT
1	1	**Audit**
2	2	**Hedge Fund Expertise**
3	4	**Client Service**
4	3	**Tax**
5	5	**Regulatory & Compliance**

RSM (formerly McGladrey), No. 7 in the Alpha Awards, exhibits many of the same qualities as Grant Thornton. It is also an upper-midtier firm, with $4.4 billion in global revenue and 37,500 employees. John Hague leads the financial accounting practice. Firm partner Alan Alzfan heads the hedge fund audit unit, while partner Richard Nichols runs the hedge fund tax practice.

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> *Michael Greenstein, Pricewaterhouse-Coopers*

No. 8-ranked KPMG has enjoyed a boost in revenue and hedge fund clients thanks to the Rothstein Kass merger. Its U.S. revenue grew by 9.8 percent in its fiscal year ended in September 2015, the first full year after the merger.

KPMG reported global revenue of $24.4 billion last year, and though that was below the previous year's $24.8 billion, the firm says that when the figure is expressed in local currencies rather than in dollars, it had a global revenue increase of 8.1 percent.

KPMG has about 174,000 employees, including 600 professionals who work on hedge fund accounts. Robert Mirsky, the global hedge fund leader, relocated from London to New York in 2014 and has helped shepherd the Rothstein merger along, working with Steve Mena, the former Rothstein managing partner who now leads the U.S. hedge fund practice.

Though moving from a small regional firm to a big multinational accountant may prove challenging for some smaller hedge fund firms affected by the merger, some larger managers may welcome the change. One KPMG client, now a multi-billion-dollar manager, hired Rothstein Kass years ago, when the fund was a small start-up. An executive in that firm has heard some mixed reviews of the merger from other managers but says his own experience has been positive.

"We don't think we have lost any attention or level of service since the transition," he says. "My biggest concern was that responsiveness might be impacted. Our team has been pretty happy with KPMG."

If KPMG can expand that sentiment over the next year, maybe it can regain its footing in the Alpha Awards as well.

— Irwin Speizer