

Professional recommendation with regards to the application of the CSSF Circular 2002/81 named «External audit guidelines – Undertakings for Collective Investment».

This recommendation has been adopted by the June 28, 2004 IRE General Assembly and re-adopted by the June 12, 2007 General Assembly.

A. INTRODUCTION

The purpose of this recommendation is to give guidance to the UCI auditor responsible (the “fund auditor”) for the preparation of the long form report required under Circular 02/81 (“the Circular”).

Circular 02/81 extends the scope of the fund auditor's work from the audit of the annual report on the financial statements drawn up in accordance with Schedule B to the Law of March 30, 1988, and the law of December 20, 2002, to encompass a critical description of the fund's organization and a review of the way the fund operates, including the fund's procedures and relationships with the central administration, the custodian bank, management company and other intermediaries (such as investment managers and distributors).

The fund auditor is required to issue two reports:

- an audit report on the fund's financial statements (section II of the Circular);
- a long form report (“rapport sur la révision de l'activité de l'OPC”) (section III of the Circular).

When issuing an audit report on the financial statements of a fund in compliance with ISA 700, the fund auditor should refer to the appropriate IRE standards on Auditing and recommendations, as applicable.

B. SCOPE OF THE WORK OF THE FUND AUDITOR

The long form report covers:

- aspects in relation with the fund's organization and its service providers, as described in the section III.B.1 of the Circular (central administration, custodian bank, management company and other intermediaries);
- aspects specific to the fund under review (e.g. fund's transactions, internet, investor's complaints) as described in the sections III.B.2, III.B.3 and III.B.4 of the Circular;
- follow up of previous year weaknesses (section III.B.5) and a general conclusion (section III.B.6).

The long form report is issued for the exclusive use of the board of directors of the fund, or of the fund's management company, and of the CSSF.

Section III. B of the Circular contains the minimum information requirements to be detailed in the long form report.

The fund auditor should consider the scope of the work necessary to produce the long form report, particularly in light of the fact that the Circular envisages the fund auditor's use of and reference to reports issued by other auditors of the service providers to the fund (the “Controls” report).

A non-exhaustive list of such types of reports is as follows:

- ISA 402 type B,
- SAS 70 type 2,
- A report produced specifically for the purpose of fulfilling the requirements of the Circular (see further guidance in section 1.1.1 and 1.2.1 and comments hereafter).

When using such reports the auditor of the fund should make sure the activities of his fund fall within the scope of such reports. Otherwise, any requirements of 1.1.2.1 and 1.1.2.2 that are not within the scope of the reports used should be evaluated and reviewed separately by the fund auditor.

Professional recommendation with regards to the application of the CSSF Circular 2002/81 named «External audit guidelines – Undertakings for Collective Investment».

It should be noted that a long form bank report strictly complying with the requirements of the Circular CSSF 01/27 and related IRE audit recommendations neither covers all areas required by the Circular 02/81 nor provides sufficient information to the fund auditor to enable him to assess the scope and results of the work done by the other auditor. Notwithstanding the preceding, the long form bank report may be used as a basis for the preparation of a controls report for instance by the service provider's auditor using the present recommendation as guidance.

The fund auditor should consider whether the Controls report which he intends to refer to may be obtained and utilized as such reports could be restricted as to use (e.g. to management, the service organization, its auditor and, sometimes, its customers).

Having read this (these) reports, the fund auditor shall also ensure that the scope of the Circular 02/81 is either covered by the scope of the controls report(s) or by his own report. The fund auditor is not responsible for the content and conclusion of the report(s), as produced by other auditors, to which he is referring. However, the summary conclusion of the report(s) referred to by the fund auditor should be attached as an appendix to the long form report.

In those instances where the report(s) do not cover the scope of the Circular specificities of the fund for the long form report, the fund auditor will need to undertake himself further appropriate audit work and procedures to ensure fulfilment of the requirements of the Circular.

Where some functions have been delegated to several parties, the fund auditor is required to comment on the procedures for co-ordination and general oversight of the fund's affairs.

C. TERMS OF ENGAGEMENT

The (separate) audit engagement letter must cover the following points:

- the fund auditor's extended responsibility as per the Circular;
- the fund auditor's limitation of responsibility in case other reports are referred to;
- the board of directors' responsibility for obtaining access to the central administration or depository bank (collectively "the service providers") records, providing certain required information and approving the report.

In case a separate engagement letter is issued for the Circular 02/81, the standard audit engagement letter must however include a reference to this separate letter.

D. PROCEDURES AND REPORT

1. Fund organization

This section of the long form report should provide a description of the organization of the fund including but not limited to, the central administration, depository bank, investment adviser and other intermediaries. This description should be sufficient to understand the fund's organization (e.g. central administration and bank depository located in Luxembourg) as well as its applicable legal framework (e.g. the law of March 30, 1988 relating to UCIs, as amended; the law of December 20, 2002 concerning UCIs and modifying the law of February 12, 1979, as amended; etc). The description should clearly indicate to which law the fund is subject to and whether grand-fathering clauses, as per the provisions of the law of December 20, 2002, apply to the fund.

1.1 Central administration

This section addresses the procedures and controls at the central administration and should include the fund auditor's negative assurance over the proper functioning of such procedures and controls.

Professional recommendation with regards to the application of the CSSF Circular 2002/81 named «External audit guidelines – Undertakings for Collective Investment».

1.1.1. Fund auditor's use of a report issued by an auditor of the central administration

The Circular identifies two situations where the work of another auditor may be referred to in the fund long form report: 1) a specific report on a credit institution or financial sector professional (acting as central administration) prepared by an auditor of such, or 2) an “UCI controls report” defined as a report prepared in accordance with ISA 402 type B, SAS 70 type 2 or an equivalent audit standard.

The following should be considered when making reference to the work of another auditor:

- i. The fund auditor should be provided with a copy of the report(s) that will be referred to in the context of preparing his long form report, and the fund auditor should pay attention to the acceptable usage of such report(s).

For example, a bank long form report, prepared in accordance with the CSSF Circular 01/27, is prepared solely for the use of the bank’s board of directors and the CSSF; it is not prepared for the fund’s board of directors or the fund auditor.

- ii. Determine if sufficient information is provided – with respect to procedures, controls and testing - to cover the requirements of 1.1.2.1 and 1.1.2.2. Such information should at least include the following:
 - detailed description of all relevant internal procedures and controls existing at the administrative agent;
 - level and type of tests performed to evaluate the consistent application of such procedures and controls and the results of the testing performed;
 - scope of the work performed by the other auditor to confirm its relevance for the fund audited.

When using reports the auditor of the fund should make sure the activities of his fund fall within the scope of such reports. Otherwise, any requirements of 1.1.2.1 and 1.1.2.2 that are not within the scope of the reports used should be evaluated and reviewed separately by the fund auditor

- iii. Determine that the scope of the work used covers the operations of the fund over the appropriate period and, if it does not, whether there have been substantial changes to the operating environment that must be taken into consideration. The fund auditor should satisfy himself that the service provider has put in place a continuous process for having its operations reviewed annually and reported on without interruption during the period covered.
- iv. The summary conclusion of the report(s) referred to by the fund auditor should be attached as an appendix to the long form report.

1.1.2. Audit tests and procedures conducted by fund’s auditor

The fund auditor should request the board of directors to obtain authorization from the central administration to carry out the requirements in sections 1.1.2.1. and 1.1.2.2.

1.1.2.1. Assessment of procedures

The fund auditor should indicate whether or not the central administration maintains a procedures manual describing the tasks that the central administration performs on behalf of the fund as prescribed by the provisions of Chapter D of IML Circular 91/75 (as well as any eventual specific authorizations granted by the CSSF).

In addition and in relation to the following specific procedures, the fund auditor should provide negative assurance concerning the adequacy of such specific procedures. Where such specific procedures are performed by multiple parties, the fund auditor must also indicate whether or not appropriate coordination and monitoring procedures have been put in place.

Procedures to be covered relate to anti-money laundering, valuation of securities, compliance, net asset value calculation, shareholder activity and trade processing.

Professional recommendation with regards to the application of the CSSF Circular 2002/81 named «External audit guidelines – Undertakings for Collective Investment».

For purposes of determining whether or not the above procedures are adequate, the following non-exhaustive criteria should be considered:

- Procedures are clearly documented and comprehensive;
- Procedures are relevant in the circumstances;
- Documented procedures are updated regularly (for changes in Luxembourg laws and regulations);
- Controls are performed regularly;
- Monitoring controls are in place and utilized appropriately.

Considering the type and complexity of the fund, and based on the information gathered during the normal course of his work, the fund auditor should state whether anything has come to his attention indicating that human resources of the central administration appear to be inadequate.

1.1.2.2. Information Technology

The fund auditor should obtain a brief description of the central administration's IT systems. This description should principally include all software components by function as well as the location of outsourced functions.

Functions should be determined depending on the central administration system infrastructure. A non exhaustive list of functions includes:

- NAV calculation and accounting;
- Share registrar system;
- Reconciliation systems;
- Financial reporting system.

Based on relevant information obtained during the audit, the fund auditor should state whether he has indications leading him to consider that the IT systems are not adequate to support the fund's operations, specifically with regards to the volume of transactions in the fund, pooling applications, and multi-manager applications, where applicable. He should also identify any major IT systems changes and report on any significant migration problems.

Where the accounting system is not adapted to record certain types of investments, the fund auditor must be provided with the central administration's procedures and controls for manual accounting entries.

The fund auditor should also assess whether or not the IT systems of the central administration comply with section III.1 of Chapter D of IML Circular 91/75 (as well as any specific authorizations granted by the CSSF).

In addition, the fund auditor should be provided with and include a description of the central administration's business continuity plan.

The fund auditor must detail any significant weaknesses in the procedures and controls noted above and, if applicable, refer to its management letter.

1.2 Depository Bank

This section addresses the procedures and controls at the depository bank and should include the fund auditor's negative assurance over the proper functioning of such procedures and controls.

1.2.1. Fund auditor's use of a report of an auditor of the depository bank

The Circular identifies two situations where the work of another auditor may be referred to in the fund long form report: 1) a specific report on a credit institution prepared by an auditor of such, or 2) an "UCI controls report" defined as a report prepared in accordance with ISA 402 type B, SAS 70 type 2 or an equivalent audit standard. The following should be considered when referencing the work of another auditor:

Professional recommendation with regards to the application of the CSSF Circular 2002/81 named «External audit guidelines – Undertakings for Collective Investment».

- i. The fund auditor should be provided with a copy of the report(s) that will be referred to in the context of preparing his long form report, and the fund auditor should pay attention to the acceptable usage of such report(s).

For example, a bank long form report, prepared in accordance with the CSSF Circular 01/27, is prepared solely for the use of the bank's board of directors and the CSSF; it is not prepared for the fund's board of directors or the fund auditor.

- ii. Determine if sufficient information is provided – with respect to procedures, controls and testing - to cover the requirements of 1.2.2.1, 1.2.2.2 and 1.2.2.3. Such information should at least include the following:
 - Detailed description of all relevant internal procedures and controls existing at the depositary bank;
 - Level and type of tests performed to evaluate the application of such procedures and controls and the results of the testing performed;
 - Scope of the work performed by the other auditor to confirm its relevance for the fund audited.

When using reports the auditor of the fund should make sure the activities of his fund fall within the scope of such reports. Otherwise, any requirements of 1.2.2.1 and 1.2.2.2 and 1.2.2.3 that are not within the scope of the reports used should be evaluated and reviewed separately by the fund auditor

- iii. Determine that the scope of the work used covers the operations of the fund over the appropriate period and, if it does not, whether there have been substantial changes to the operating environment that must be taken into consideration. The fund auditor should satisfy himself that the service provider put in place a continuous process for having its operations reviewed annually and reported on without interruption during the period covered.
- iv. The summary conclusion of the report(s) referred to by the fund auditor should be attached as an appendix to the long form report.

1.2.2. Audit tests and procedures conducted by fund's auditor

The fund auditor should request the board of directors to obtain authorization from the depositary bank to carry out the requirements in sections 1.2.2.1, 1.2.2.2 and 1.2.2.3.

1.2.2.1. Assessment of procedures

The fund auditor should indicate whether or not a manual of procedures exists and is relevant to the fund's activity and legal structure. He will also describe the correspondent bank network and its monitoring.

A manual of procedures should at least include the following depositary bank activities:

- 1) Safekeeping and supervision of assets;
- 2) Supervision and monitoring control of operations;
- 3) Day-to-day administration for a fund;
- 4) Specific supervision exercised due to the fund's legal nature, i.e. for mutual funds.

Where necessary, the fund auditor should describe the segregation of duties between central administration and custodian responsibilities.

The fund auditor must detail any significant weaknesses in the procedures and controls in relation to the correspondent bank network and , if applicable, include such weaknesses in the Management Letter.

1.2.2.2. Information Technology

A brief description of the depositary bank's IT systems in relation to the fund's activity should be obtained and included in the long form report. The fund auditor should also identify any major IT systems changes and report eventual migration problems.

Professional recommendation with regards to the application of the CSSF Circular 2002/81 named «External audit guidelines – Undertakings for Collective Investment».

Based on relevant information obtained during the audit, the fund auditor should state whether nothing has come to his attention indicating that the IT systems and IT staff to support such systems are not adequate, to support the fund's operations.

1.2.2.3. Results of reconciliations

The fund auditor must confirm whether or not there are adequate (see criteria under section 1.1.2.1) procedures to reconcile the investment holdings, transactions, contracts and commitments recorded in the funds records and those recorded in the bank depository records (note that if this reconciliation is performed by the central administration, this requirement should be covered in section 1.1.).

The results of the reconciliations examined during the audit and specifically relating to the fund are detailed in section 2.7 of this report.

1.3 Relationship with management company

This section deals with all the functions exercised by the fund's management on its behalf. The fund auditor shall review the related contractual arrangements in order to assess whether these functions are reflected in the respective contracts. It is not the fund auditor's responsibility to verify the legal validity of such contracts.

The fund auditor shall:

1. Be provided with a description of the management company's activities during the period under review, which shall be included in the long form report.
2. Obtain from the central administration and/or the board of directors the list of all functions exercised by the management company and indicate the related contractual arrangements.
3. Assess the control procedures in place to ensure compliance with applicable Luxembourg laws (and regulations) of all functions identified (make reference to paragraph 1.1.1 or 1.1.2 for any functions already reported on in those sections).
4. Describe in detail any major problems for which the fund auditor becomes aware of.

1.4 Relationship with other intermediaries

This section deals with arrangements the fund has concluded with any intermediaries other than its central administration, depository bank and management company. These intermediaries encompass for instance the investment manager / adviser, the distributors, tax representatives, external investment compliance advisers, valuation providers, securities lending agents / principals or any other person or service company to which the fund has delegated, on a contractual basis, any of its responsibilities towards its investors or third parties.

The fund auditor shall:

1. Be provided by the board of directors, an exhaustive list of all significant arrangements in place, which shall be included in the long form report.
2. By way of representations obtained from the board of directors, assess whether any major problems related to these intermediaries have upset the fund's activity for the period under review. If applicable, these will be described in detail.

In order to determine whether a significant problem has occurred, the fund auditor shall consider if such problem has affected:

- the fair treatment of investors ;
- significantly the determination of the NAV ;
- the timely subscriptions / redemptions of the fund's units / shares ;
- the compliance with the fund's investment objectives and restrictions.
- the compliance with applicable regulations by fund and/or intermediaries.

Professional recommendation with regards to the application of the CSSF Circular 2002/81 named «External audit guidelines – Undertakings for Collective Investment».

2. Controls of the fund's operations

2.1 Anti-money laundering

1. The fund auditor has to verify compliance with relevant Circulars issued in the context of anti-money laundering and in particular the Circulars IML 94/112, BCL 98/153, CSSF 00/21, CSSF 01/40, and CSSF 02/78, the fund auditor will use the existing IRE checklists to the extent possible. As new Circulars are issued in this context, the fund auditor will mention in the report the list of applicable Circulars used as guidance/reference for his work.
2. The description and/or procedures provided by the central administration shall:
 - a) describe the central administration's process and determine whether the identification is carried out by itself and/or by intermediaries ;
 - b) in the case where intermediaries are involved, the description provided by the central administration should include :
 - bi) the controls carried out by the central administration in accepting such intermediaries (member of GAFI countries, etc...) ;
 - bii) the systematic procedures implemented by the Central Administration in order to ensure respect of the conditions for equivalent identification controls;
 - c) the monitoring controls applied on abnormal transactions.
3. The fund auditor will be provided with a chart of the (contractual) distribution channels of the OPC shares / units which should:
 - a) state whether country of distributor's domicile is a full GAFI member;
 - b) state regulatory status of the fund's distributors (subject or not to an equivalent supervision / affiliate of a regulated entity);
 - c) if a) and b) are not applicable, the report must contain a concise description of the distributors concerned (i.e. by type / by country);
 - d) describe any specific undertaking given to the CSSF in this context.
4. In order to comment on the appropriate monitoring of unusual transactions, the fund auditor should receive from the central administration:
 - a) a description of the controls implemented by the central administration (including specific automated controls), of the system for identifying abnormal transactions and monitoring the "Black lists" published by the Parquet, and of the controls on redemptions ;
 - b) access to the diligence documentation gathered in relation with intermediary/distributor approval and access to investors account opening documentation.
5. In order to test the effectiveness of the controls over proper identification of subscribers, the fund auditor shall :
 - a) determine the scope of the testing and the selection method, taking into consideration risks identified and covering all distribution categories FATF vs Non-FATF distributor, direct investor;
 - b) describe the sample selected and determine the relevant coverage reached ;
 - c) report results from the tests performed (testing must include verification of compliance with procedures described in 2 b) above).

Professional recommendation with regards to the application of the CSSF Circular 2002/81 named «External audit guidelines – Undertakings for Collective Investment».

6. In case the fund auditor decides to refer to a report issued by another auditor for the purposes of fulfilling the requirements described in points 4 and 5 above, the fund auditor will :
- a) ensure that this report covers all aspects relevant to the fund he audits and, if applicable, complete its coverage by additional audit steps carried out using the above guidelines ;
 - b) give the references of such report, indicating the name of the auditor and date of the report.

Such information should at least include the following:

- Detailed description of all relevant internal procedures and controls existing at the service organization;
- Level and type of tests performed to evaluate the consistent application of such procedures and controls and the results of the testing performed;
- Scope of the work performed by the other auditor to confirm its relevance for the fund audited.

When using such reports the auditor of the fund should make sure the activities of his fund fall within the scope of such reports. Otherwise, any requirements of 1.1.2.1 and 1.1.2.2 that are not within the scope of the reports used should be evaluated and reviewed separately by the fund auditor

2.2 Valuation methods

The board of directors shall provide to the fund auditor the current written procedures and valuation rules. Based on these and on information gathered during the course of his audit work, the fund auditor shall comment on such procedures and rules and describe any exceptions noted.

Considering the activity of the fund, the auditor shall assess the scope of tests needed to determine whether these transactions have been carried out on an arm's length basis and report any exceptions.

2.3 Monitoring of the risk management system

The board of directors shall provide a description of the systems and controls in place to monitor and manage the investment policy and restrictions and other related risks to which the fund is exposed.

The board of directors shall indicate or confirm in writing to the fund auditor whether all or part of the responsibility for the monitoring and/or operation of the risk management system has been delegated to one or more third or related parties during the reporting period and shall, where necessary, obtain all the necessary details from these parties for the fund auditor to perform his obligations under Circular 02/81.

The fund auditor will state in his report which person, entity or entities (internally or externally) is responsible for each of the major risks to which the fund is exposed. The long form report shall also specify the frequency of the controls. Where the board of directors delegates one or more functions, the board's procedures and controls for monitoring such functions shall also be described.

Based on above information and representations received from the board, the fund auditor shall indicate whether, as a minimum, the risk control system implemented by the board covers, or is applicable in respect of credit risk/counter-party risk, market risk, settlement risk, exchange risk, and, where appropriate, interest rate risk, liquidity risk and risks in respect of derivative instruments.

The fund auditor shall limit his review to those monitoring controls performed at the level of the board or at the level of the management of the fund. However, he has no responsibility to verify procedures and controls carried out by other parties (e.g. asset managers).

Professional recommendation with regards to the application of the CSSF Circular 2002/81 named «External audit guidelines – Undertakings for Collective Investment».

2.4 Specific controls

The board of directors shall provide the fund auditor with a list of all instances of material NAV computation errors and active non-compliance with investment objectives and restrictions for which the amount of compensation and amount payable to an investor did not exceed the limits provided for in Circular 02/77. The fund auditor shall ensure this list encompasses all instances which came to his attention during his audit work.

The fund auditor shall obtain representations from the board of directors that all material NAV errors and active breaches have been disclosed to him and ensure all diligences required by CSSF 02/77 are carried out.

Where there have been no material NAV errors or active breaches, the fund auditor should explicitly mention this in the long form report.

2.5 Statement of net assets and profit and loss account

Under this section, the fund auditor will comment on the various elements of the statements of net assets and of operations combined. As part of normal audit, it is expected that the fund auditor will check, on a subfund basis, the existence and accuracy of financial statement captions and disclosures, and determine the consistent application of accounting principles.

For the purposes of his comments on the financial statements, the fund auditor will therefore in principle not comment on each position for each sub-fund, but rather highlight material items, if applicable.

Specifically, the long-form report should:

- 1 State whether based on his audit work any “window dressing” activities have been discovered as being carried out by the fund. In such a case, the fund auditor should report on his findings, extending his testing where necessary.
- 2 Provide data in respect of portfolio and securities turnover. The fund auditor will state whether, based on portfolio rotation, transaction costs and investment style, any “churning” may be suspected.
- 3 Report any exceptions discovered during the testing of performance fees.
- 4 Include any transactions that are deemed, in the judgment of the fund auditor, not to have been carried out at an arm’s length basis or any expenses that materially disagree with the terms of the underlying contractual arrangements.
- 5 Include a description of the nature of soft commissions or other similar arrangements. The fund auditor has no responsibility to ensure the completeness of the information provided by the board of directors.

2.6 Publication of the NAV

The board of directors shall provide details to the fund auditor of the procedures and controls in place to ensure that the publication requirements, per the current prospectus and Luxembourg law, are being met. This should include details of any delegation of responsibility in this respect to third or related parties or any designated internal member of management of the fund.

The fund auditor should report non-compliance with publication requirements per the prospectus and Luxembourg law that the fund auditor becomes aware of during the course of the audit.

2.7 Results of reconciliations

As part of the annual audit procedures and in relation to the accounting/custody reconciliation performed at the fund’s period end, the fund auditor should indicate whether or not the results of the audit of the accounting/custody reconciliation were satisfactory.

Professional recommendation with regards to the application of the CSSF Circular 2002/81 named «External audit guidelines – Undertakings for Collective Investment».

In the case where significant and unjustified reconciling differences exist, the fund auditor should describe such reconciling items and, when possible, provide an understanding of why such reconciling items cannot be explained.

3. Internet

This section only requires a description of the nature of Internet usage.

The board of directors shall provide a description of the type of Internet usage in respect of the fund's activities in respect of the distribution and marketing under its direct responsibility. Instances where the fund is sold/marketed via the Internet by intermediaries do not fall under the scope of this paragraph.

4. Investor complaints

The board of directors shall provide the fund auditor with necessary information concerning complaints received by the central administration in Luxembourg.

If no such complaints have been received, then such fact shall be stated in the long-form report.

The fund auditor is not responsible to make any judgment based on the number of investor complaints reported.

5. Follow up of previous years

The fund auditor will follow up on serious weaknesses which were reported in the previous years' long form report or management letter.

6. Conclusion

The fund auditor will conclude on the work he has performed (and not on work carried out by other auditors to whose controls reports he is referring) and summarise any significant findings resulting from his work. Such conclusion will either be positive or negative, depending on the nature of the work carried out (for detailed guidance, refer to the points D.1 to D.5 to this recommendation).