Conundrum I

CASE STUDY – Conundrum I

Introduction:

In our ongoing work with General Partners and Limited Partners we have been invited to provide insight, present case studies and comment at industry conferences, Universities and symposium, some of which we have already shared with you. We have dealt with hundreds of interesting and challenging situations.

Six abridged case scenarios were presented at a recent Bank of America Capital Access Forum. Here are two - the other four will follow in future editions. Perhaps you'll recognize a situation or two or have unfortunately found yourself in these troubling situations with your own "problem children".

If you would like to know more about these situations or have commentary regarding the complex business, legal, financial and ethical issues, please drop us a note or give a call.

The names and fund identities have been changed for all the obvious reasons.

Scenario I

Jess James, a first time GP of the $70 Million Western Golden Opportunity Fund has made a significant mistake in legal paperwork on a transaction. Reparation will cost his portfolio company $40K and the portfolio company involved in the transaction has refused to pay the additional expense as the GP ran the transaction. The governance agreement is silent as to non-transaction oriented legal work. It is not the lawyers fault as the GP made a material, though inadvertent, misrepresentation.

Questions:

1. What obligation does the GP have to relate this problem to the LPs?
2. Should he remain silent and pay the bill, clear it up at the close of the fund or at the time of next audit?
3. What moral, ethical or practical issues should be considered?

Scenario 2

The Susquehanna River Valley Fund, a $60 Million SBIC in its fifth year, had a preliminary meeting with its auditors. It's clear that there are significant issues regarding cash management, segregation of duties and questions regarding records management. The GP is angry at the auditor and does not wish these items be detailed in the management letter. The fund has the obligation of paying all audit costs estimated to be $15K this year. A regional audit firm has been aggressively courting the fund to secure its business. They have said the management issues raised by the incumbent auditor are not appropriate in that they had not previously been raised in past audits and these types of issues are not uncommon. The GP decides to dismiss the incumbent and hire the regional audit firm.

Questions:

1. Does the GP have a responsibility to relate the change in auditing firms to the fund LPs?
2. Does the just fired auditor have any further responsibility?
3. What if any down side is there for the GP for carrying through with the action?

Semaphore
978-794-3366
www.sema4usa.com
info@sema4usa.com