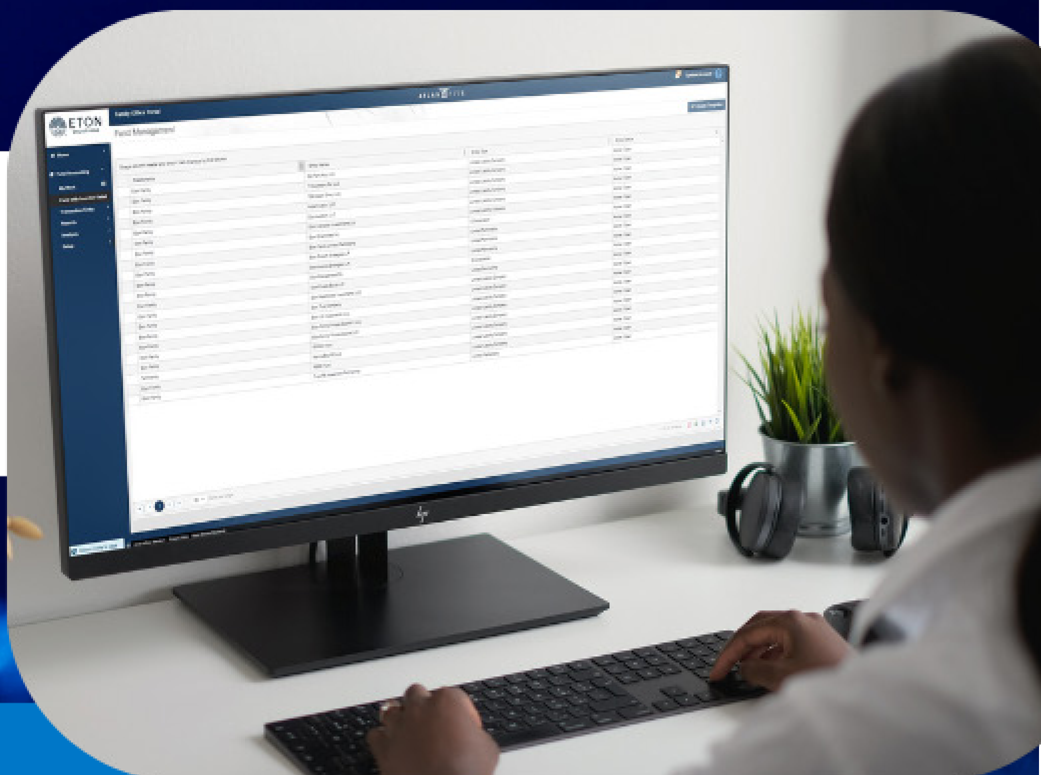
ETON
SOLUTIONS



Maximizing Returns and Mitigating Risks: The Power of Automated Fund Accounting in Private Capital Partnerships

The modern family office faces a flux of challenges ranging from cumbersome regulatory environments to an accelerating flight of capital into a more flexible and sometimes ambiguous asset class known as private capital. Private capital, broadly, is an investment (typically held through private partnerships) that diverts capital away from public assets (e.g., stocks and bonds) and into more focused investment strategies such as private equity, venture capital, and real estate. This migration to a different asset class is challenging family offices to adopt new accounting systems and related processes to manage their changing needs and requirements.

In 2021, the family office industry saw an inflow of 1.2 trillion dollars, ballooning to 9.8 trillion in assets under management[1]. Furthermore, the private equity subset alone increased at 37.7% and accounted for 6.3 trillion of AUM[1]. Privately held partnerships are the vehicle of choice to hold, manage, and invest capital in these private equity assets. These vehicles offer the ability to pool capital, as well as utilize varying mechanisms to return capital and profits not only to investors but also to managing members.

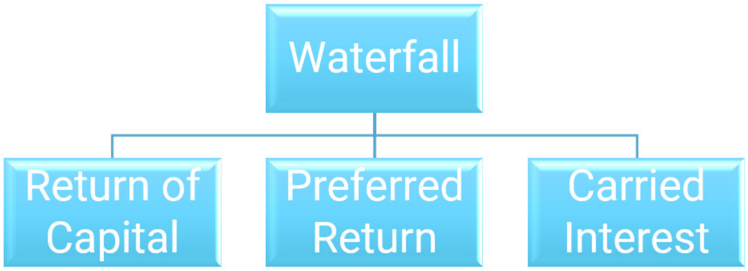
The family office of the future must be able to accommodate the obscure and complex nature of these privately held partnerships. Unfortunately, time and time again, family offices are operationally siloed, making it challenging to build robust internal processes and control frameworks as legal, accounting, and investment professionals are independent and siloed factions within family office operations and workflows.

This obsolete practice of tracking, managing, and documenting the inner workings of privately held partnerships produces diminishing returns. Employees must maintain spreadsheets, capital notices, partnership agreements, and investment performance tracking in separately stored SharePoints, accounting software, or even email. While a well-documented internal control process, standardization of spreadsheets, and internal reviews reduce the risk of error and mismanagement, the cost of maintaining such an expansive framework to minimize but not eliminate erroneous instances can cost the family office more than just the fees leveraged by third-party vendors to document and reclass inconsistencies. The significant investment in cybersecurity to safeguard these processes can accumulate quickly.

Allocations Methodologies

Privately held partnerships are known for their bespoke way of funding and subsequently returning capital and profits to investors. While this flexibility is one of the main attractions of these vehicles, it can also become quite daunting for a siloed family office where non-accountants draft and formalize partnership agreements. The over-legalization of such computations hinders the operations of a family office as the accountants' interpretation quickly turns into dreaded suggestions like 'follow prior year', 'this is how we've always done it', 'that calculation is always provided by a 3rd party' – all of which are prone to errors and additional costs. In its simplest form, private partnership agreements and corresponding allocation methodologies are designed to provide incentives for managing members to produce superior returns on family member wealth. While the structure of such incentives can be open to interpretation for every entity, three general industry approaches are outlined below:

1. Waterfall Method(s): These methods can be used in various combinations and are constructed in a manner that allocates and distributes capital through a defined priority. So long as these priority steps meet certain regulations and economic interest tests (i.e., 704(b): Determination of Distributive Share)



•Return of Capital – Return of initial inflow of cash from investors

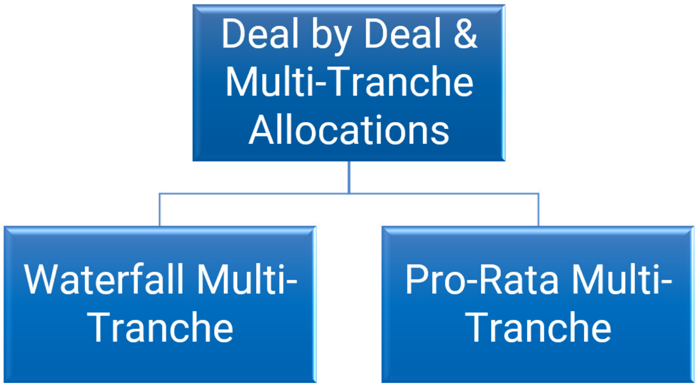
•Preferred Return – Interest earned on initial capital, usually at a compounding or simple rate frequency. Typically, this is between 5-8%, depending on the nature of the partnership agreement

•Carried Interest/Performance Fees (Managing Member (GP) Earnings)

Upon the realization and wind-down of partnerships, managing members and investors must split the proceeds once the 'waterfall' has surpassed steps "a" and "b". The mechanism in which managing members earn their income is referred to as "Carried Interest" or "Performance Fees." Carried interest is the rights for the managing member to earn a stated percent of excess returns on invested capital. The industry standard is the 80/20 rule, where 20% of excess profits are returned to managing members, while 80% is distributed to non-managing members. In addition, a flat performance fee can be charged against excess profits. Both carried interest and performance fees are different mechanisms partnerships can define in partnership agreements to ensure managing members are producing market-lead. ing returns. While each of these components can vary in complexity and priority, the industry utilizes these waterfall steps to ensure investors and managing members are properly incentivized throughout the lifecycle of the partnership.

2. Deal by Deal & Multi-Tranche Allocations: This method allows investors to provide capital for a specific investment while maintaining legal ownership within the partnership, creating a 'deal by deal' and multi-tranche scenario. The main attraction for this methodology is that it can limit exposure to certain asset classes as well as limit overhead as fewer legal entities must be spun up.

While this methodology can also become quite bespoke, two main subsets can be derived within this method:

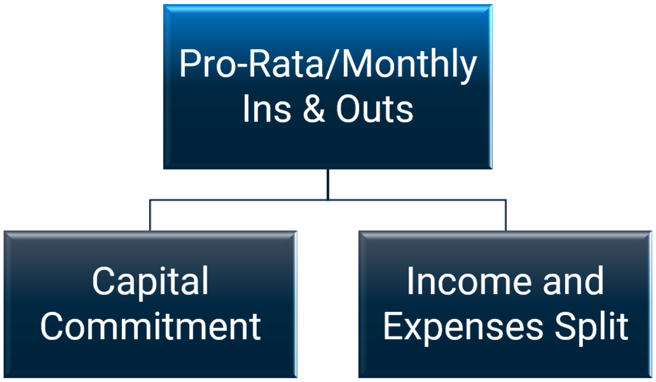


a. Waterfall Multi-Tranche – Like the waterfall method mentioned earlier, these tranches or deals flow through various priority steps to meet and provide incentives. The main benefit of tracking deal by deal with this allocation methodology is that it allows various investment professionals to track each asset within the partnership instead of the partnership as a whole.

This flexibility enables managing members to earn performance fees and carried interest sooner as they can choose to realize various positions at any time. In contrast, at the fund level, it's typically done over the course of 5-7 years.

b. Pro-Rata Multi-Tranche – The simplest form of multi-class, the pro-rata multi-tranche allows a sleeve of ownership between an asset and its ultimate owners. The main attraction of this style is to reduce exposure to certain assets. In addition, the simple relative ownership to the total asset value within a particular sleeve makes it very straightforward.

3. Pro-Rata/Monthly Ins & Outs: This method is the simplest. Putting money into a partnership ensures investor(s) get a relative amount of income or loss based on the performance of underlying assets. As the name suggests, investors get a 'pro-rated' share of that income based on total capital amongst their co-investors. The main attraction of this method is its simplistic nature and relatively low maintenance.

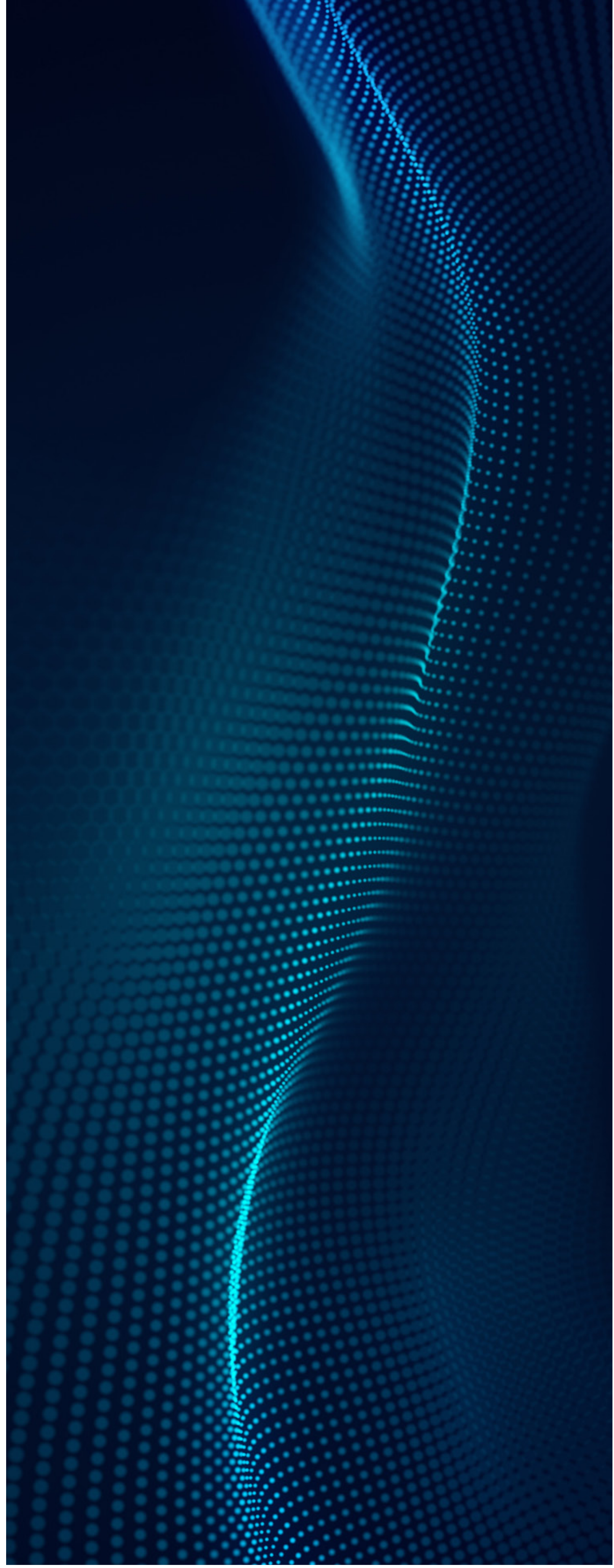


Streamlining Fund Accounting with AtlasFive

AtlasFive was created to streamline and reduce such daunting tasks (such as those mentioned in the allocations section), allowing family office employees to focus on high-impact, highly productive work. Our integrated platform streamlines internal controls, accounting entries, document management, and investment performance tracking and decision-making, ensuring a single source of truth throughout the entire family office. Within our module-based platform, the fund accounting module allows for dual-transaction processing from the fund & investor standpoint and capital record reporting. AtlasFive also automates the various allocation methods documented above. The module interacts with other modules, such as the CRM (Client Relationship Management) module, to maintain a definitive count of legal entities and investor listing. The workflow module ensures proper internal control checkpoints as users can be identified and assigned specific roles dictating certain approvals before key transactions (e.g., cash movements) occur.

From a financial reporting standpoint, AtlasFive allows users to run a trial balance, income statement, and balance sheet in a few clicks compared to feverishly compiling Excel workpapers and manual accounting entries—all while automatically generating investment performance metrics such as IRR. While these features of AtlasFive are the most comprehensive in the marketplace, the additional value of increased visibility and audit trails for transactions across the entire family office, specifically into the computations generating the allocations mentioned in the industry overview, solidifies our standing as the Private Asset Management Award winner for Best Partnership Accounting System in 2022[3].

In closing, our unified, purpose-built data model eliminates the burden of compiling, searching, and sometimes, redoing various components within the lifecycle of privately held partnerships, the backbone of the private capital industry. From the storage of a newly formed partnership agreement to CFO visibility into the various transaction trails, AtlasFive is the most comprehensive SaaS platform for the family office of the future.



About Eton Solutions

Eton Solutions is a software and services company founded to handle the complexities of servicing ultra-high-net-worth families. Created by family office leaders, Eton Solutions' flagship product is AtlasFive®, an integrated platform with over $425 billion in assets under administration that holistically aggregates and manages all your office's data, reporting, and workflow processes. With one source of truth, Eton Solutions leads family offices into the future by maximizing efficiency and minimizing errors and risk. To learn more about Eton Solutions and to request a demo of AtlasFive®, please visit https://eton-solutions.com/.

Sources

1. *Mckinsey Industries Private Markets Annual Review | "Private Markets Rally To New Heights*

2. *The Tax Adviser | "Target or Waterfall Partnership Allocations"*

3. *PR Newswire | "Eton Solutions Recognized as a Family Office Solutions Leader in the 2022 Private Asset Management Awards"*

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