How often have you thought: “We never seem to get ahead”? There are always new issues or challenges facing our back office. Whether it comes from investors, regulators or internal requests, more often than not, it creates a fire-drill mentality. Are there better ways? Of course there are. Remember the Seven Habits of Highly Effective People by Stephen Covey? Habit one was “be proactive.”

Think of all the new expenses you had to allocate over the last five years. Some of these expenses weren’t even contemplated when you formed your last fund. You now need to decide how your firm allocates these expenses, and based on the results of this survey, there doesn’t seem to be a standard approach.

A practical and helpful tool that fund managers have employed is an expense allocation policy. Under the Investment Advisors Act of 1940, registered investment advisors (RIAs) have a fiduciary duty to act in the investors’ best interests. RIAs need to ensure that they do not breach this duty by improperly allocating expenses to funds and investors. Having an expense allocation policy that has been approved by the LPAC helps in this effort. The policy should be tailored to your firm, disclosed to investors, and consistently followed. Even if you are not an RIA today, most investors would like you to run the firm with that same fiduciary approach.

The expense allocation policy is more principles-based than rules-based and can streamline how a company handles new expenses, avoids unnecessary legal costs and internal distractions and helps with efficiently running the firm. A policy also avoids the trap of “case by case” decisions which could lead to hindsight scrutiny by investors and regulators. Here is some step-by-step advice on how to be proactive and not let expenses overwhelm the resources of the firm, or become a potential weak spot for future fundraising efforts:

**Step one**
Develop policy to address allocation of expenses that are not contemplated by, or are not clear, in your existing funds’ LPAs, and communicate this policy and procedures to all investors in all funds. Older funds’ LPAs are not as thoroughly documented as regulators or investors expect today.

Use this opportunity to clarify a consistent position for all funds and include new industry issues (eg, allocation of vendor discounts). To the extent that the new policy and procedures are in conflict with specific sections of any existing fund’s LPA, highlight and carve out those expenses in the exhibit to the policy for each fund. Involve LPAC members, investment managers, and the CFO and CCO in the decision-making process.

The general rule for most expenses is that they are allocated to the entities benefiting from them. For example, most agree that accounting and investor communications are beneficial to the fund, so many managers are allocating those costs accordingly.
**Step two**

Look at anything that has come up recently in the industry even if it doesn’t apply to you today. For example:

- New insurance policies (eg, cybersecurity)
- New technology applications
- Specialized service providers and consultants
- Regulatory and compliance costs (if recently registered, or planning to register, or for keeping up with the constantly changing regulatory landscape)

The use of specialized service providers or consultants is increasing as our industry matures. For example, we have started to see more environmental, social, and corporate governance service providers since the UN issued its Principles for Responsible Investment. Having a proactive ESG strategy and reporting can help both the firm and its investors. When the decision to use an ESG consultant was the firm’s, 70 percent of the respondents in the survey said it was a management company expense. But, if an investor required the ESG consultant, 50 percent of the respondents said that would change the allocation, making it either a fund expense or an expense charged to a specific investor.

**Step three**

For any new funds, add a provision to the LPA for the allocation of expenses not contemplated at the time of the agreement. The expense policy and procedures of the firm will determine the allocation of these expenses. Also, establish procedures for addressing expense allocations that do not clearly fit within the policy. Review and update the expense policy at least annually.

**Step four**

Ensure that you have proper documentation in place for expense allocations. Document the calculation of the allocation of expenses in accordance with your policy and the required approvals. If it is a new type of expense, ensure that the documentation includes the rationale for the allocation methodology as well as the required approvals. There are a variety of applications available that can assist in the allocation and documentation for record keeping purposes.

**Step five**

Make certain that you are in compliance with your expense allocation policy and procedures. Educate members of your firm and service providers, such as your fund administrator, to ensure that they understand how expenses should be allocated. On a test basis, periodically conduct a review of the allocation of expenses for historical transactions to ensure that you are in compliance with your policy and procedures.

So, yes, there are better ways. Having an expense allocation policy and procedure will save you a lot of time and money in the long run. Think of how relieved your auditors and regulators will be if they can follow a consistent policy across all funds. You might hear that some fund managers like the flexibility of not having to go through and create or clarify the firm’s expense policies. This flexibility comes at a great cost, one that might not be apparent until it’s too late (eg, SEC fines or a failed fundraise). Call us if you need any encouragement. We’d be happy to share some motivational success stories as well as best practices that we see at firms that have robust policies and procedures in place. ■

--

Anne Anquillare is co-founder and chief executive of PEF Services. Launched in 2002, PEF provides high touch fund administration solutions for alternative investments. Anne has been an active member in the private equity industry since 1993 and has served as general partner of Walden Capital Partners, a growth capital fund licensed in 1996.

---

### When you bring in technology-driven systems for the following, who covers the costs?

<table>
<thead>
<tr>
<th>Service</th>
<th>Management firm</th>
<th>Fund</th>
<th>Split between fund and firm</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valuation databases</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investor portal</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fund accounting</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Data retention</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Portfolio and risk management</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CRM</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trading platforms</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: pfm

“*This article was originally published in private funds management in October 2016*”
Profile
PEF Services provides high quality, high touch Fund Administration solutions supported by senior professionals with extensive experience in alternative investments. PEF has a 15-year track record of delivering cost-effective solutions to Funds and General Partnerships, including Buyout, Venture, Real Estate, Special Purpose Vehicles, Mezzanine, Credit, SBIC, and Fund of Funds. The firm’s LP Administration Solutions Group (LPAS) focuses solely on meeting the unique administration and data needs of limited partners investing in illiquid alternative assets. In partnering with PEF, firms increase operational efficiency, reduce and control operating costs, improve focus on core capabilities, and gain access to experts in private capital back office operations. For more information please visit www.pefservices.com.

Our Differentiators
Everything we do from technology development through service delivery is designed to reward the trust our clients place in us. As a service provider, we are acutely focused on operational excellence in the work we do for our clients. More specifically, we are disciplined, focused, and highly effective in supporting our clients with a wide range of fund services and related consulting. All our relationships start by putting together an underlying plan to accomplish each of our client’s goals, and we then focus relentlessly on execution, ensuring that every step of the fund administration process is handled with precision. We pitch in and contribute in every way we can, and we generate creative ideas while focusing on the granular back office details required by our clients. While the needs of each client differs, we help each firm achieve their goals by solving complex problems with the same intensity and sophistication that you bring to bear regarding your portfolio of investments. The justification for our business is simple – we must exceed the capabilities of our competitors and the expectations of our clients.

Our Services
We partner with firms and funds of all sizes to provide customized back office and accounting solutions that increase operational efficiency of the Fund, ensure its daily operations run smoothly, and drastically reduce operational risk. Our team works with you to comply with all accounting and reporting requirements mandated by your Partnership Agreement.

Put PEF Services to work for you:
• Fund Accounting
• Financial Reporting
• Capital Management
• Investor Services
• Consulting Services
• LP Administration
• Administration and Compliance
  SEC & SBA
  AML/KYC

Our Technology
PEF Services has consistently invested in technology since day one. The result is an outstanding IT team of developers and quality assurance professionals who have extensive alternative investment experience.

We have developed Proprietary web-based applications customized for private fund financial reporting, investor communications and data management. These applications facilitate the collection of data, simplify compliance and streamline the financial reporting function. These applications, PEFOnline and Investor Library, are continuously updated and improved upon based on feedback from our clients and the demands of the market.
Turn your back office into a Center of Excellence

Upgrade the quality, breadth and depth, and timeliness of your investor information

Private Capital firms come to PEF Services to reduce compliance risk, improve investor relations, and eliminate the staffing and training challenges associated with back office fund administration.

We have an exceptional, 15-year track record delivering cost effective solutions to private capital funds of all types and sizes, including:

- Buyout
- Debt
- Distressed
- Fund of Funds
- Mezzanine
- Real Estate
- Venture

Our Center of Excellence approach means we build a plan that is unique to the needs of your firm and fund. Our team then goes to work every day to ensure your success.

Put PEF Services to work for you:

- Financial Reporting
- Books and Records
- Capital Management
- Investor Services
- Technology
- Consulting Services
- Administration & Compliance
  — SEC & SBA
  — AML/KYC

www.pefservices.com