

## SEC Enforcement Case Summary

### Private Fund Manager Misallocates Expenses to Funds Due in Part to Poor Expense Practices

On January 10, 2025, the Securities and Exchange Commission (**SEC**) settled charges against a private fund manager, its relying adviser, and sole owner for misallocating expenses to two private funds and failing to disclose the resulting conflict of interest. According to the SEC's order, the manager allocated various expenses to the funds that were not authorized under fund governing documents or disclosed in fund offering documents and which benefited the fund manager. Such improper expenses included outsourced financial services, public relations services, and legal fees of the manager. The fund managers either had the private funds pay these expenses directly from fund bank accounts or paid the expenses themselves and then invoiced the private funds for reimbursement.

The funds purportedly paid the salary of a full-time, in-house chief financial officer (**CFO**), who provided services to the managers, after the internal CFO left. The work was performed by two different financial service providers over a period from 2019 through 2023 and represented work that had previously been performed by the full-time CFO. These payments were not authorized under fund governing documents and were not fully and fairly disclosed to investors. The firm further retained a public relations manager to provide strategic communications and public relations services to the manager. These fees were initially paid by the manager. However, in later years the PR provider again provided such services for both fund managers, and the expense was paid by the funds. Finally, the SEC noted several occasions on which the funds paid legal fees for legal work on behalf of the manager.

The SEC faulted the managers for submitting invoices to the funds without taking reasonable steps to ensure the funds owed the money and for approving invoices on behalf of the funds, with generic descriptions, such as (i) invoices for "Various Expenses" or "Expense Reimbursement" (and nothing more); and (ii) invoices "[d]ue to management Co." (and nothing more). The SEC order noted that the firm's owner regularly traveled for work, and many of the expenses he submitted were for legitimate business purposes. However, certain expenses related to personal travel with his wife and other family members and records showed that he charged costs associated with certain of the personal trips to his corporate credit card and improperly allocated these expenses to the fund. The owner relied on his executive assistant and a financial services provider to attempt to reconcile and allocate charges by attempting to match expenses with meetings on his work calendar or contemporaneous email documentation. However, such efforts often occurred months after charges were incurred and sometimes there was not sufficient information to accurately allocate the expense.

The firm agreed to disgorge approximately \$1.8 million, including interest, and pay a \$150,000 penalty to settle the case. This case continues the SEC's theme of focusing on the allocation of expenses to private funds that are not authorized or fully disclosed to investors. Moreover, the case highlights sloppy allocation and reimbursement practices and inadequate policies, procedures and controls to ensure that all expenses are timely and accurately tracked and allocated to the proper parties. We encourage clients to ensure that expense tracking, reimbursement and recordkeeping procedures and practices are designed to ensure that all expenses are documented and allocated properly and according to fund governing documents and disclosures. Potential conflicts related to allocation decisions should be disclosed to fund investors as practices evolve.

**See Summary -** <https://www.sec.gov/enforcement-litigation/administrative-proceedings/ia-6811-s>