**Alternative Investment Fund Due Diligence – Better Safe Than Sorry**

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What is an Alternative Fund? It is any fund that invests in assets other than listed stock, listed bonds, and cash. Alternative investment Funds can invest in assets such as real estate, timber, shipping, auto leasing, art, or even tulip bulbs. Due Diligence is the process of doing the required research to make fully informed choices about anything, including an investment. Professional Due Diligence is not a noun, it is a verb. Admittedly this a bit of hyperbole. Why the exaggeration? Because as both a licensed investigator and a Certified Due Diligence Professional, I see the corpses of fund frauds, oversights, and errors, knowing they could have been avoided or prevented.

**Time For Real Tax Cooperation**

**For The Investors Looking In**

Looking on the web and in some books on fund Due Diligence, the first due diligence exercise advocated is rating the fund or looking at the fund's returns and then conducting an in-depth analysis of the fund's returns against other funds in its class. This should be, in fact, the last step as you are looking to buy before you even know what you are buying.

The very first step is to check to see if the fund is duly incorporated, registered as a fund, and if the fund manager is licensed. If they are not, then why bother? My company was hired to conduct a comprehensive due diligence assessment on a fund, and we called back in 30 minutes to advise "don't bother." Why? The fund was incorporated, but not licensed or registered as a fund, and the fund had been operational for nine months!

The next step is to read the prospectus, the subscription agreements, and the investment manager’s agreement. Sales literature and presentations are about sales. It is perfectly acceptable for the material to possess a level of puffery as well as pretty charts and pictures. However, you are investing in a fund that has structure rules, so set the puffery aside, and read. If you can live within the rules and the terms are acceptable, we go on to the next step. The directors, auditors, lawyers, custodians, and administrators of the funds also need to read these agreements every year. As a group, it is their collective duty to compare the contents of the documents against the investment choices and proscribed governance standards. One failed fund we looked at was a fund of funds that stated clearly that no more than 10 per cent of funds would be invested with any manager or in any class of funds for diversification and to avoid a concentration of risk. This sounds reasonable and prudent. The post-mortem indicated the cause of death was caused by the manager breaching the governance limitations agreed upon in the prospectus and investing 90 per cent of the fund with a single manager, who was trading just derivatives, not listed equities as required by the prospectus. Thus, in the end, it was the combination of funds extracted from the directors, auditors, lawyers, custodians, and administrators that made investors whole.

As an investor, one must thoroughly check the background of the investment manager and the directors before investing. The research should be updated at least annually. You might think that this is the job of the lawyer, or the auditors, or the administrator or the custodian, right? You might, but more often then not, they do not look into the investment manager's credentials other than that they are licensed. According to the American Management Association, one in ten resumes contains over claims, exaggerations or outright falsehoods on experience and credentials. Yahoo! CEO Scott Thompson was fired after it was discovered he had lied on his resume. Thompson claimed two 1978 degrees in accounting and computer science from Massachusetts' Stonehill College. Thompson later admitted he had never earned the degree in computer science. One licensed investment manager claimed a CFA certification, and while he had taken the first section of the training, he had never finished. Following up a few years later, I looked at his LinkedIn page. He now had an MBA from Wharton. Nope, that did not check out either. The investment manager had by then over US$1 billion under management. His credentials grew year by year. Even more frightening was a director of a large Wall Street Family of funds who was being sued in three different federal cases for investment fraud totalling some US$75 million. The litigation had been ongoing for three years. Do your homework with annual updates.

Now you have read the documents, checked for licenses and compliance, verified the credentials of the investment manager and the directors, only then is it time to make the substantial investment into analysing returns.

The duty of the fund's directors includes ongoing Due Diligence, matters of governance, as well as oversight and supervision. These functions are vital to the purpose and, thus, the duty of outside directors.  So what is the first thing you look at as an investor? The directors’ fees. If they are being paid US$5,000 or less and or serve on dozens of boards of directors, there may be an issue. US$5,000 is not enough for providing diligence service to the funds. It is the old Russian parable – "If they pretend to pay me, I'll pretend to work for them".