

Responsibilities of Plan Sponsors for Alternative Investments

Alicia Schmidt, Principal

Michele Chalmers, Engagement Director



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About CliftonLarsonAllen

- A professional services firm with three distinct business lines
 - Wealth Advisory
 - Outsourcing
 - Audit, Tax, and Consulting
- 3,600 employees
- Offices coast to coast
- Our Employee Benefits Group's 30 principals and 300 professionals audit more than 2,000 plans across the country and provide consulting services for hundreds more.



Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC.

Speaker Introductions



- **Alicia Schmidt, CPA, Principal**

- Principal at CliftonLarsonAllen in the Benefit Services Group and the Pacific Northwest regional leader for employee benefit plan services.
- Specializes in audit, tax, and operational and compliance matters impacting employee benefit plans.
- Has over 10 years of employee benefit plan audit experience, including audits of single, multiple-, and multi-employer employee benefit plans, including defined benefit and defined contribution pension plans, health and welfare plans, and other tax-exempt organizations.



- **Michele Chalmers, Engagement Director**

- An engagement director with CliftonLarsonAllen in the Benefit Services Group and is the leader of the employee benefit plan practices for the Maryland and Washington DC offices.
- Has over 14 years of experience in public accounting, specializing in providing assurance and consulting services to plan sponsors of various employee benefit plans including 401(k), 403(b), 401(a), 11-k, profit sharing, money purchase pension, employee stock ownership, defined benefit, and health and welfare plans.
- Functions as the engagement principal on over 150 plans and is responsible for developing and implementing the firm wide employee benefit plan audit approach and the related training.

Learning Objectives

- Be able to identify an alternative investment in your plan
- Understand due diligence steps prior to investment
- Understand fiduciary responsibility under ERISA
- Understand ongoing monitoring procedures
- Understand financial statement reporting and disclosures
- Understand potential tax issues



Does Your Plan Have Alternative Investments?

What are Alternative Investments?

- Definition
 - Do not have readily determinable fair value price
 - ◇ Investment not listed on any national exchanges or markets for which quoted market prices are not available from sources such as financial publications or exchanges
- Characteristics
 - Less liquidity, generally have redemption restrictions
 - Prevalent in defined benefit plans to improve return over long term
 - In DC plans, generally CCTs and PSA accounts however can include others, particularly with self-directed accounts

How to Identify an Alternative Investment?

- Security name
- Internet search
- Review investment agreements
- Review audited financials
- Review 5500
- Discuss with investment manager or investment consultant
- Review custodial/trust statement
 - Compare price from statement to market data



Due Diligence



Should You Invest in Alternatives?

- Does the plan have the ability to hold the investment long-term?
- Is the fund marked to market?
- Does it fit the plan's investment strategy and portfolio?

Due Diligence Steps

- Conduct face-to-face meetings with the investment firm's management team
- Conduct on-site visits, including back office and operational due diligence
- Evaluate the investment strategy, process and portfolio
- Review the historical performance and attribution analysis (audited, if possible)
- Review the valuation procedures

Due Diligence Steps (Continued)

- Request and maintain the following documents:
 - Offering Memorandum
 - Legal Agreements
 - Pitch Books
 - Information Requests
 - Financial Statements (preferably Audited)
 - Form ADV (used by advisors to register with SEC as investment advisors)

Due Diligence Steps (Continued)

- Solicit information regarding the team/firm from knowledgeable third parties
- Perform reference checks
- Perform third-party background checks on senior professionals
- Review and negotiate legal agreements
- Document due diligence steps and approval in minutes



Ongoing Monitoring

Fiduciary Responsibilities

- Acting solely in the interest of plan participants and their beneficiaries and with the exclusive purpose of providing benefits to them
- Carrying out their duties prudently
- Following the plan documents
- Paying only reasonable plan expenses
- Selection of investment options & diversification
- Monitoring the investment option performance and compliance with investment policy

Procedures for Alternative Investments

- Holding regular meetings with the investment firm's management team
- Perform an annual on-site visit
- Review fund communications, such as quarterly shareholder letters
- Review the audited financial statements of the fund
- Review SOC 1 report (if available)

Procedures for Alternative Investments

- Compare performance to benchmark and expected returns
- Compare cash returns to previously reported market values
- Review portfolio holdings on a regular basis
- Conduct review if investment strategy changes
- Review press reports
- Monitor size of assets under mgmt in specific strategies and throughout the whole plan
- Appropriate controls for proper fair value reporting

Valuation Best Practices

- Established, comprehensive, and documented valuation policies and procedures
- Policies identify the methodologies for valuing each type of financial instrument
- Valuation determined in accordance with established procedures
- Policies and procedures are reviewed regularly
- Plan management ensures high level of independence in application of valuation policies and procedures

Valuation Best Practices (Continued)

- Request and review, if available, the valuation of portfolio holdings for reasonableness
- For custodial assets, reconcile with the custodian's pricing
- Compare the Plan's statements of value received as of the fund's year-end to the value based on the fund's audited financial statements and follow-up on significant discrepancies
- Establish an investment committee and maintain minutes



Financial Reporting

Plan Management Responsibilities

- Appropriate controls in place for proper fair value measurement
- Maintain a continuously updated detail listing of alternative investments by type or by manager
- Review the most recent audited financial statements of each alternative investment
 - Verify basis of accounting
 - Review accounting policies pertaining to the valuation of alternative investments
 - Audit firm and the type of opinion

Plan Management Responsibilities

- Compare investment balances report by investment manager to general ledger
- Determine level of ownership of each alternative investment
- Perform and document assessment of risk of material misstatement related to valuation of alternative investments
- Formal investment policy approved by committee
- Oversight of all investments and compliance with investment policies
 - Establish an investment committee

ASC 820 Fair Value Measurements and Disclosure

- Level 1
 - Inputs are unadjusted quoted market prices
- Level 2
 - Inputs derived principally from or corroborated by observable market data (or quoted prices for similar assets), etc.
- Level 3
 - Inputs are unobservable and significant to the fair value measurement

ASC 820 Fair Value Measurements and Disclosure

- Alternative investments are either Level 2 or 3
- Dependent upon ability to redeem investment at NAV in the near term at measurement date
 - To meet criteria for level 2, the reporting entity need not have submitted a previous redemption request
 - Redemption period of 90 days or less generally considered near term

ASC 820 Fair Value Measurements and Disclosure

Level 3 Investments

- Reconciliation from opening balances to closing balance, disclosing separately the following changes:
 - Total gains and loss recognized in earnings and the line items in the statement of changes in net assets where recognized
 - ◇ Further required to disclose unrealized gains/loss
 - Purchases, sales, issuances, settlements (each disclosed separately)
 - Transfers into or out of level 3, reason for transfer, and the plan's policy for determining when transfers have occurred

ASC 820 Fair Value Measurements and Disclosure

Level 3 Investments Example Reconciliation

Level 3 Assets
Year Ended December 31, 20X1

	<i>Guaranteed Investment Contract</i>
Balance, beginning of year	\$660,000
Realized gains/(losses)	5,000
Unrealized gains/(losses) relating to instruments still held at the reporting date	40,000
Purchases	835,000
Sales	(25,000)
Transfers in and/or out of level 3	—

ASC 820 Fair Value Measurements and Disclosure

Significant Unobservable Inputs Used in Level 3 Fair Value Measurements (Not applicable when subject to ASU 2009-12)

— Quantitative Information about Significant Unobservable Inputs Used in Level 3 Fair Value Measurements

The following table represents the Plan's level 3 financial instruments, the valuation techniques used to measure the fair value of those financial instruments, and the significant unobservable inputs and the ranges of values for those inputs.

Instrument	Fair Value	Principal Valuation Technique	Unobservable Inputs	Range of Significant Input Values	Weighted Average
Guaranteed investment contract	\$1,515,000	Discounted Cash Flow	Swap Yield Rates Duration Payout Date Payout Percentage	1.749 - 2.707 2.3 - 2.7 6/28/13 - 12/31/13 33% - 100%	Y%

- Also required to disclose narrative on valuation procedures

FASB ASU 2009-12

- Required disclosures (by major class) for non-readily marketable investments valued at NAV or equivalent
 - Fair value as of report date
 - Unfunded commitments
 - Redemption frequency
 - Redemption notice period
 - Restrictions on withdrawal (if any)
 - Investment objective
- Information can be obtained from investment manager, investment manager agreement, and/or audited financials



Tax Issues

Common Source of UBI: Alternative Investments

- Investment in partnerships – the activities conducted by the partnership flow through to the exempt organization (plan) and retain the same character
- Often generate UBI
 - 990T Filing
- Schedule K-1 & footnotes must be reviewed in its entirety to determine whether UBI is generated
- Be aware that most states also tax UBI
- Additional foreign filing requirements – Forms 926, 5471, FBAR, etc...



Alicia Schmidt, CPA

Principal

alicia.schmidt@CLAconnect.com

425-250-6065

Michele Chalmers

Engagement Director

michele.chalmers@CLAconnect.com

410-308-8170



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CLAconnect.com



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