

## IS YOUR RIA FIRM IN COMPLIANCE WITH THE SEC CUSTODY RULES?

Now, nearly four years after the U.S. Securities and Exchange Commission issued amendments to Rule 206(4)-(2), they are reporting widespread non-compliance with the commonly referred to "Custody Rule". In March 2013, the Office of Compliance Inspections and Examinations reported that almost one-third of their examinations included custody-related issues. Reported deficiencies come at a cost to the Registered Investment Advisers (RIAs). Remedies include drafting new compliance policies and procedures, changing business practices, and devoting resources to the area of custody compliance. Some deficiencies have resulted in referrals to the SEC's Division of Enforcement.

Why is this relevant in 2014? Recent industry surveys indicate that many RIAs are currently unaware of these regulations and, as such, are potentially non compliant. We are here to help!

### REGULATORY HISTORY

In December 2009, the U.S. Securities and Exchange Commission (SEC) issued amendments to Rule 206(4)-2, which significantly changed the compliance regulations for RIAs. The amended regulation was a direct response to the mercurial rise of fraud and theft of client assets by investment advisers. It is important to note that the "Custody" Rule applies exclusively to investment advisers who are registered with the SEC.

### WHAT IS "CUSTODY"?

"Custody" is generally defined as holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them" (SEC Rule 206(4) 2(d)(2)). Some cited examples of custody reporting deficiencies include: (1) the RIA serving as trustee or granted power of attorney for client accounts; (2) the RIA pays client bills and is authorized to withdraw funds or securities from client accounts; (3) the RIA has access to client usernames or passwords; (4) the RIA has signatory and check writing authority for client accounts; (5) the RIA has receipt of checks made payable to clients. And, of course the most obvious example is where the adviser has physical possession of client assets, such as securities certificates. Do any of these examples fit your situation?

### ANNUAL SURPRISE EXAMS

RIAs having custody are subject to the annual "surprise" examination provision of the Custody Rule. The RIA is required to engage a Public Company Accounting Oversight Board (PCAOB) registered public accounting firm to perform surprise examinations verifying client funds and securities. At the conclusion of the



examination, that Firm files an opinion with the SEC regarding the RIA's compliance with the "Custody Rule".

To better ensure that the RIA receives a "clean opinion", Management must properly plan, implement, and monitor compliance. Have you properly assessed risk and established adequate internal controls over custody?

### **INTERNAL CONTROL REPORTS**

An RIA or a related party acting as a "qualified custodian" who maintains client accounts is required to produce an annual internal control report prepared by a public accounting firm registered with and subject to inspection by the PCAOB. There are two types of annual internal reports. The first is a traditional AICPA SOC One report "Report on Controls Placed in Operation and Tests of Operating Effectiveness". The second is a report on internal control examination performed in accordance with the PCAOB/AICPA attestation standard AT601/SSAE # 10 "Compliance Attestation". Both types of engagement focus on the RIA's internal control and risk assessment policies and procedures. Once again, the RIA's operating procedures must be designed and implemented to comply with the requirements of the "Custody Rule". Are you ready to be tested?

### **WHAT THIS MEANS FOR THE RIA**

RIAs must obtain an understanding of the Rules and whether they apply. If applicable, resources should be dedicated to establish and maintain proper internal control structure over transactions subject to the "Custody Rule". Investment Advisers should evaluate the need to engage legal and compliance "experts" to provide guidance in understanding and implementing compliance requirements.

### **WE CAN HELP**

At BrookWeiner LLC, we can apply our "proven" tools and resources to your "Custody Rule" compliance needs. We are PCAOB registered, inspected and in "good standing". Our qualified "Custody Rule" team is experienced in providing oversight and monitoring capabilities for your RIA practice. We are skilled in the "surprise exam" process and what is required to gain a successful result. Our reputation is founded upon building comprehensive, yet economically-feasible, solutions. Our experienced practice team brings a seasoned approach focused on problem resolution.

Our SOC One and AT 601 engagement "experts" stand ready to help you meet your annual internal control "Custody Rule" reporting requirements. We can help guide you through the process of identifying internal control aspects.

In addition, BW LLC can assist in performing a "readiness" review of your firm's "Custody" practices in preparation for scheduling and conducting the "surprise exam" or internal control reporting.