



Investment Adviser Audits: Are You Ready?

Under Section 204 of the federal Investment Advisors Act of 1940 (the "IAA"), all records of a registered investment adviser are subject to examination by the SEC staff. State regulated investment advisers are subject to similar requirements under state laws and regulations. State and SEC audits differ on one crucial element, frequency. Ohio maintains a two year schedule for investment adviser audits, but the exam cycle for SEC registered investment adviser firms is about once every 3-5 years.

SEC Inspections

There are generally three types of inspections conducted by the SEC's Office of Compliance, Inspections and Examinations, or their state counterparts. These include examinations of high-risk investment advisers (generally selected based on information in regulatory filings or past examinations); special purpose reviews (which seek information about specific areas of concern within the financial services industry); and cause examinations (generally based on a complaint or a tip). The fact that an adviser is being examined is not made public.

How to Prepare

Preparation for an examination should start well before the firm receives an examination letter, i.e., the firm should have a culture of compliance that includes self-examination and should operate every day as if an exam were scheduled for the next one. That includes knowledge and comfort with the rules and regulations applicable to the firm and a periodic internal risk assessment of the firm's operating procedures. It also includes retaining knowledgeable advisers and consultants and making use of their expertise.

Conclusion

It is recommended that firms conduct a mock audit regularly. This can be accomplished using either internal personnel or outside counsel or consultants. Many firms examine specific areas of compliance periodically during the year and have their outside counsel or consultant conduct the mock audit. Carlile Patchen & Murphy can assist in conducting mock audits or getting your firm ready if the knock comes at the door.

