

**INVESTMENT ADVISER
COMPLIANCE PROGRAM
ANNUAL REVIEWS**

By

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This paper is an updated version of a Q&A on this topic originally prepared in 2005.

SEC rules require investment advisers not only to establish and implement compliance policies and procedures, but to review them as well. This Q&A addresses some of the key issues pertaining to compliance program reviews.

1. **How Often Must an Adviser's Compliance Program be Reviewed?**

Advisers are required to review their compliance program at least annually. (See Advisers Act Rule 206(4)-7(b).) Because a compliance review is required at least annually, it is often referred to as an "annual review" or an "annual compliance review." However, the SEC Staff has made it clear that advisers are also expected to conduct an interim review of their compliance programs, between annual reviews, when developments or changes warrant. The kinds of developments or changes that may warrant an interim review include those listed under Question 5 below, in cases where it would not be prudent to wait until the next annual review to ensure that the adviser's compliance program remains effective. In addition, certain aspects of an adviser's compliance "review" – such as monitoring and testing for compliance with specific requirements -- are best implemented on an on-going basis, as discussed more under Question 6 below.

2. **When During the Year Must the Annual Compliance Program Review be Completed?**

SEC rules do not dictate a particular time of year for an adviser to conduct its compliance program review. In determining which time of year may be most suitable for them, advisers should ask questions such as:

- When does the adviser's fiscal year end? Are the adviser's financial statements audited at year-end? It might be more efficient to integrate an annual compliance program review into other review-type procedures the adviser would be undertaking at year-end anyway.
- What are the needs of the adviser's clients? For example, does the adviser manage an investment company where the fund board will be asking the adviser for compliance information as part of the fund's own compliance review, where it might therefore be important for the adviser's review to be relatively current?
- Is a "SAS 70" or "SOP 07-2" report going to be prepared or issued on the adviser's operations or are outside auditors or consultants going to be brought in to do any assessments?
- What are the availability and workload capacity of the adviser's personnel to conduct a complete compliance program review at various times during the year?
- What do the adviser's own policies and procedures say about a compliance review? Advisers should always adhere to their own program requirements, and many compliance policies and procedures are drafted with specific provisions stating how often and when they must be reviewed and updated.

3. **What is the Purpose of the Compliance Program Review?**

The purpose of the compliance program review is twofold, to determine:

- the adequacy of the adviser's compliance policies and procedures, and
- the effectiveness of their implementation.

4. **What Basic Steps Should an Adviser Follow to Conduct a Compliance Program Review?**

Because advisers and their businesses vary so widely, there is no “one size fits all” approach to conducting a compliance review. However, advisers would be wise to plan their approach in advance and incorporate at least the following basic steps:

STEP 1. Consider compliance developments. Identify and consider the developments that have occurred since the date of the last review -- such as violations, deficiency letters, industry scandals and the other matters listed in Question 5 below -- which bear on whether the adviser’s program is adequate and effective or whether changes are warranted.

STEP 2. Update the risk assessment. A well-designed compliance program should focus resources on those areas where the adviser is at greater risk for having a compliance problem or having conflicts of interest arise. Accordingly, each adviser should define the appropriate contours of its compliance program by conducting a risk assessment that identifies those areas of risk pertinent to its particular business. That risk assessment should be updated at least annually to determine whether changes to its compliance program are warranted in light of any new or changed risks that may have come into play. Excellent materials are publicly available to help advisers conduct and update their risk assessment, including a Risk Assessment Guide, Questionnaire and Identification Chart put out by the Investment Adviser Association. (See the “Other Resources” section at the end of this paper.)

STEP 3. Consider the results of compliance monitoring and testing. Instead of gauging the effectiveness of their compliance programs by simply waiting for problems to arise, advisers should proactively monitor and test their programs. A robust compliance program will include monitoring and testing in various areas on an on-going basis throughout the year. On-going testing not only reduces the risk that compliance problems will go uncorrected for extended periods of time but also avoids the practical burden that would result from leaving all the testing to be accomplished at once as part of a compliance review. The results of monitoring and testing will be an important measure in assessing whether an adviser’s program is adequate and effective or whether changes are warranted. Monitoring and testing is discussed more fully under Question 6 below.

STEP 4. Update existing policies and procedures. Advisers should periodically re-read all of their existing policies and procedures, page by page, line by line, to determine whether they need to be changed or updated. The SEC Staff continues to identify advisers not following their own written procedures as one of the most common deficiencies they find upon inspection. If nothing else, the annual compliance review should include re-reading all existing policies and procedures to make sure they are consistent with the adviser’s actual practice.

STEP 5. Memorialize the review. In contrast to investment company CCOs who are required by SEC rules to prepare a written report of their annual compliance review, adviser CCOs are not required under the Advisers Act rules to produce a written report of their review. However, the Advisers Act books and records rules (see Rule 204-2(a)(17)(ii)) require advisers to preserve any records the adviser

does make documenting the annual review, even if the adviser chooses not to produce a written “report” of the review. Records documenting the annual review must be kept in an easily accessible place for a period of not less than 5 years from the end of the fiscal year during which the last entry was made on the record, the first 2 years in an appropriate office of the adviser.

Moreover, as a practical matter, the SEC Staff expects advisers to document the compliance review in some fashion, and they will request to see that documentation in an examination. Advisers unable to provide adequate written documentation of their compliance reviews risk being found deficient and subjected to closer Staff scrutiny or more frequent SEC inspections. Specific suggestions on memorializing a compliance review are included under Question 12 below.

5. **What Issues Should be Considered When Assessing Whether a Compliance Program is Adequate and Effective?**

As a minimum, these issues should be considered as part of a compliance program review:

- Any compliance matters that arose since the last review.
Examples might be:
 - Breaches, exceptions, deviations, failure, violations, glitches, confusion or close calls experienced in the adviser’s operations or with respect to a client account.
 - Results of any compliance monitoring and testing conducted by the adviser (see Question 6).
 - Deficiency letters received from the SEC or other regulatory body following inspection.
 - Employee warnings, sanctions or disciplinary actions.
 - Client complaints or lawsuits or enforcement actions implicating compliance.

- Any changes in the business activities of the adviser or its affiliates.
Examples might be:
 - Acquisitions, divestitures or restructurings that changed the scope or nature of the adviser’s business, the scope or nature of its clientele or the ownership or affiliations of the adviser.
 - Business lines, products or services added to or dropped from the adviser’s operations.
 - Changes in the adviser’s key personnel, offices or infrastructure (such as computer systems).

- Any changes in the law or regulatory developments that might suggest a need to revise the policies or procedures.
Examples might be:
 - New guidance issued by the SEC on regulatory issues.
 - Public speeches and statements from the SEC Staff and Commissioners (available on the SEC’s website) addressing compliance-related issues.
 - Common areas of deficiency identified by the SEC Staff in a “ComplianceAlert” letter (also available on the SEC’s website).
 - Tips or guidance made available by the SEC Staff at national and regional CCO outreach seminars.

- Recent SEC and state enforcement proceedings suggesting areas of particular compliance and enforcement concern, such as custody (such as the Madoff debacle), insider trading, valuation of securities, books and records, etc.

6. **How Can an Adviser Measure the “Adequacy” and “Effectiveness” of its Compliance Program?**

One of the most concrete ways for an adviser to measure whether a specific policy or procedure is effective is to proactively monitor or test whether the adviser and its personnel are in compliance with it. Every well designed compliance program aimed at preventing violations should include monitoring and testing designed to detect violations, in order to make sure that the program is working as intended. What kind of monitoring and testing an adviser should do, and how often, depends on each adviser’s compliance program. Examples of the methods an adviser might use to monitor and test for compliance are listed on Appendix A at the end of this paper. In some areas of operation, advisers might choose to monitor or test daily, others weekly, monthly, quarterly or annually, and still others, on an ad hoc basis. Adviser may also choose to do the testing themselves, or may choose to outsource some or all of their testing to third-party vendors. Indeed, industry surveys have shown that roughly one-third of the responding advisers indicated that they rely on an outside vendor to conduct some or all their compliance testing. (See the 2007 Investment Management Compliance Testing Survey referenced under “Other Resources” at the end of this paper.)

In any event, monitoring and testing for compliance on an on-going basis avoids the work overload and practical risk that would result from monitoring and testing only sporadically, or that would result from waiting until an annual compliance review to do all the specific testing of procedures at once. Indeed, having an on-going system for monitoring and testing is a key element to having an efficient and robust compliance system in operation throughout the year. Fortunately, most advisers seem to have taken that point to heart. In a survey, over half of the advisers responding indicated that they conduct at least some testing on an on-going, “rolling” basis. (See the 2007 Investment Management Compliance Testing Survey referenced under “Other Resources” at the end of this paper.)

7. **What is This “Forensic” Testing We Keep Hearing About?**

There has been a lot of buzz about the need for advisers to do “forensic” testing of their compliance procedures, in addition to “transactional” testing that focuses on whether one particular transaction is proper. Although the term “forensic test” is not defined in SEC rules or guidance, the Staff has used the term to mean a test with three characteristics:

- First, it provides a real test that does more than simply repeat things the adviser already does.
- Second, it helps answer the question: what am I missing? In other words, it covers new material to test and validate the material the adviser usually works with.
- Third, it adds current value, meaning it can be used as part of the everyday compliance program.

(Lori Richards, Director of the SEC’s Office of Compliance Inspections and Examinations, Remarks Before the National Society of Compliance Professionals National Membership Meeting, Washington, DC, October 25, 2005.)

Forensic testing will often involve looking beyond one individual transaction for compliance and instead looking at trends, patterns or statistics over time that may help to reveal hidden issues or violations that are not evident when one transaction is reviewed in isolation. For example,

analyzing brokerage over a specified period by comparing the adviser's actual execution costs to the execution costs of a peer group benchmark is one type of "forensic test" an adviser might use to help assess compliance with its policy to seek best execution. Numerous other examples of forensic testing are included among the various tests listed on Appendix A at the end of this paper.

Just like transactional testing, forensic testing can be done on an on-going basis throughout the year. However, because forensic testing often involves looking at trends, patterns or statistics over a period of time, some forensic tests will be more effective if conducted only on a periodic basis at key points in time. For this reason, advisers might find themselves doing more forensic testing in conjunction with the annual compliance review than at other times during the year.

8. **Are Adviser CCOs Legally Required to Do the Compliance Program Review Themselves?**

No. CCOs may delegate tasks to personnel inside their firm or to outside consultants or vendors to assist in a compliance review. However, since the adviser's CCO is responsible under SEC rules for "administering" the adviser's compliance program, it could easily be expected that the CCO would be held responsible for making sure the compliance review is conducted as well, as part of overall program administration. In practice, that means if other personnel or outsiders are tasked to complete certain steps in the review, the CCO should nonetheless remain apprised of and involved in the overall effort.

9. **Should an Attorney or Law Firm Conduct the Compliance Review in Order to Protect the Results from Disclosure?**

Some speculate that having an attorney conduct an adviser's compliance program review would shield from disclosure to the SEC or anyone else any problems that might be discovered during the course of the review, due to protections afforded by the attorney-client privilege and/or work product doctrine. However, several factors suggest that the attorney-client privilege and work product protections might not be available even if the review were conducted by an attorney. Among them are assertions made by the SEC Staff to the effect that:

"All reports required by [SEC] rules are meant to be made available to the Commission and the Commission staff and, thus, they are not subject to the attorney-client privilege, the work-product doctrine, or other similar protections." (Adopting Release No. IA-2204, n. 94)

Although this assertion was made in reference to compliance review reports prepared by a fund CCO for a fund board under Rule 38a-1 (the fund compliance rule), it could be applied by analogy to the results of an adviser compliance review conducted under Rule 206(4)-7 (the adviser compliance rule). Although the Staff's position has not yet been tested in court, it seems to stake out their view of the matter and suggests that if an entire compliance review report were successfully shielded from disclosure to the Staff, the Staff might then take the position that the adviser failed to meet applicable regulatory requirements because the Staff could not verify by inspecting available documentation that the required review had indeed been adequately conducted. The Staff might also view the adviser as less than forthcoming and cooperative and therefore perceive it as a higher risk, potentially putting the adviser on a shorter cycle for SEC examination.

Another argument suggests that the attorney-client privilege might not apply in that context anyway. An attorney's engagement might be deemed to lack a necessary element for the privilege to apply, if it were not undertaken for the purpose of providing legal advice to the adviser but rather for the purpose of fulfilling the adviser's regulatory duty to conduct a compliance program review. This issue is even more acute if the adviser utilizes in-house counsel to conduct the review and it is unclear whether the individual is conducting the review in their role as counsel or in a business role as the CCO or another member of management. A similar problem could arise under the work product doctrine, which under classic interpretations would not apply if the engagement is not undertaken in connection with or in anticipation of litigation. Again, it remains to be seen whether any of these arguments would bear weight in any given case, but they suggest that using an attorney to conduct the regulatory review for the purpose of shielding the results from disclosure might not be as successful as expected.

As a separate matter, however, note that the objections to applying the attorney-client privilege or work product doctrine in the context of a regulatorily required compliance review would not exist if an attorney were instead engaged to conduct a compliance review in a different context, such as a "mock SEC audit" undertaken to assess whether an adviser's compliance program meets legal standards, completely aside from a compliance review called for by Rule 206(4)-7. There, the engagement would not be undertaken to fulfill a regulatory requirement but rather to obtain legal advice about whether the adviser's compliance program is legally sufficient, presumably disarming the potential objection to the attorney-client privilege applying in that case. Moreover, an engagement in that context might well be undertaken in anticipation of litigation – particularly if it is prompted by a problem having come to light – in that case disarming the potential objection to the work product doctrine applying as well. This suggests that using a lawyer to help assess a compliance program can still be a useful strategy for advisers, but with a greater chance of protection from disclosure when undertaken as a supplement to and not a substitute for the regulatorily required review.

Advisers looking for a more economical approach to conducting the regulatorily required review might well use their own compliance personnel rather than an attorney to spearhead the task. Then, if a specific issue is discovered in the course of the review, the adviser could at that point consider engaging an attorney to investigate and provide advice concerning that specific issue. This approach would allow the adviser to make a record of the overall review available for Staff inspection, but offer a better chance of shielding from disclosure those specific, narrow matters referred to counsel, using the attorney-client privilege or other applicable protection.

Looking beyond the traditional attorney-client privilege and work product doctrine, some advisers are considering the prospect of shielding their compliance reviews from disclosure using another privilege known as the "critical self-analysis privilege" (or "self-evaluation privilege"). This type of privilege has been recognized in other circumstances – perhaps most notably to shield medical "peer reviews" – on the theory that the benefits derived from frank and candid self-analysis outweigh the benefits of disclosing the analysis to an opposing or potentially opposing party. The "critical self-analysis privilege" has far from universal acceptance, however. Not all states or courts recognize the privilege or apply it in all circumstances. Some courts treat it as a common law privilege, while others treat it as a statutory privilege that does not exist absent legislative action. In certain cases, the privilege is applied only in private litigation and not to shield the results of an internal review from government regulators, particularly if the review is mandated by law. Moreover, even when applied, the privilege may be used only to shield from disclosure the analysis and not the underlying facts. Despite these limitations, a "critical self-analysis" privilege might be available in some cases.

Still other advisers seem willing to waive privileges and make their compliance reviews available to the SEC upon inspection, but are nonetheless concerned about the review getting into the hands of competitors, private plaintiffs or the media through other means, for example, through a request made to the SEC under FOIA (the Freedom of Information Act, the federal “open records” law). Concerned about relying on potentially available, self-executing exemptions from FOIA disclosure, these advisers are taking extra steps to request “confidential treatment” for any compliance reports or related materials that wind up in the SEC’s records in the course of an inspection or otherwise. That way, if a FOIA request is made for those materials, at least the adviser will have the chance to argue why the materials (or portions of it) should not be disclosed on the basis of applicable exceptions under FOIA. Although it is not yet known how protected compliance reviews will be from FOIA disclosure, cautious advisers routinely take steps to request confidential treatment of sensitive materials provided to the Staff in an inspection. More information on seeking confidential treatment is available at the links listed under “Other Resources” at the end of this paper.

Lastly, wholly aside from the question of whether an adviser can shield a compliance review from disclosure using the attorney-client privilege or another available protection, there is a question of whether the adviser will want to assert those protections in any given case. More frequently in recent years, advisers and others have been waiving those types of protections either as a gesture of their “cooperation” with investigators or prosecutors (in the expectation or hope of getting less harsh treatment in return) or in order to fulfill a specific condition to settlement imposed by an opposing party. Although the practice of pressuring targets to waive those protections in a federal investigation has attracted substantial criticism from the American Bar Association and other widely respected organizations, the practice of some regulatory agencies, including the SEC, has reportedly not substantially changed.

10. **What Should be Done if a Compliance Review Reveals a Weakness or Violation?**

Advisers should be prepared in the event a compliance review reveals a weakness in their compliance controls or perhaps even reveals an actual compliance violation. At that point, a red flag is waving that an adviser must resolve with due speed. Because of the wide variety of problems that might be encountered, there is no uniform road map that should be followed in every case. However, whenever a weakness or violation is discovered, an adviser should formulate an action plan by considering all relevant issues, including the following:

- Should outside counsel be engaged to investigate specific issues or violations and provide legal advice, in an engagement intended to be protected by the attorney-client privilege?
- What can be done to enhance procedures and eliminate the discovered weakness?
- Has any client been harmed due to the weakness or violation and, if so, in what way, how much and for how long?
- What can be done to make any harmed client whole?
- Which personnel were involved in the situation and what were their role, responsibility and level of culpability?
- Should involved personnel be terminated, put on leave or reassigned pending resolution of the issue?
- What should the adviser’s clients be told about the issue and when?
- Should the adviser “self-report” to the SEC or its primary regulators or otherwise contact authorities about the issue?
- Must or should the adviser or its clients disclose the matter publicly, in SEC filings or otherwise and, if so, when?

- Should the adviser's or client's fidelity bond carrier or E&O insurance carrier be notified of the problem, in order to preserve a possible claim under those policies? (Failure to notify a carrier of potential claims in a timely fashion may void otherwise available coverage.)
- Should the adviser engage the services of a public relations firm to assist with outside contacts and relations?
- Must or should a contingency be booked on the financial statements of the adviser and/or any affected clients?

Minor problems would typically be expected to engender a less full-scale response than larger or more serious problems. However, even minor problems should be viewed in context to see whether a pattern is developing that suggests a more serious problem may exist.

11. **Would a CCO Necessarily Be Personally Liable if a Compliance Violation Occurs on Their Watch?**

Great concern has been expressed that simply by virtue of their position, CCOs could be held personally responsible for compliance violations committed by someone else in their organization on, for example, a "failure to supervise" theory. For that theory to work full bore, more or less everyone in the organization would have to be viewed as under the CCO's "supervision" in some sense, at least as to compliance matters. Unfortunately, the SEC has raised the specter of exactly that, by defining a "supervisor" in past failure to supervise cases as any person who under the relevant facts and circumstances has the requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue. See, e.g., *In the Matter of John H. Gutfreund, et al.*, 51 S.E.C. 93, 113, Exchange Act Release No. 31554 (Dec. 3, 1992). That definition poses considerable concern when read alongside statements in the Adopting Release for the compliance rules, where the SEC says:

"An adviser's [CCO] should be competent and knowledgeable...and... empowered with full responsibility and authority to develop and enforce appropriate policies and procedures for the firm. Thus, the compliance officer should have a position of sufficient seniority and authority within the organization to compel others to adhere to the compliance policies and procedures." (Adopting Release No. IA-2204, at II.C.1., emphasis added)

Under the *Gutfreund* definition, then, would a CCO who has the requisite authority and influence that the Adopting Release says they should have be viewed as "supervising" everyone in the firm and therefore be potentially subject to a "failure to supervise" claim as a result of any compliance violation committed in the firm?

Despite *Gutfreund*, the SEC Staff says that the answer to that question is 'No.' The Adopting Release says that the CCO designation does not in and of itself carry supervisory responsibilities and that, therefore, a CCO would not necessarily be subject to a sanction for failure to supervise other firm personnel. In public remarks, the SEC Staff has reiterated this view, calling it a "myth" that every CCO has accountability for all violations. (Bob Plaze, Associate Director of the SEC's Division of Investment Management at the CCO Outreach National Seminar in Washington, DC, November 8, 2005.) Rather, according to the Staff, the cases where CCOs have been pursued by the SEC for compliance failures are where either:

- the CCO has some other role in the organization in addition to being CCO, and it is in that other role where the individual has gotten into trouble, or

- the CCO is held accountable for participating in, facilitating or covering up a fraud or compliance failure -- in other words, for being personally involved in the violation in some way.

So far, SEC cases have tended to bear this out. See, for example, In the Matter of CapitalWorks Investment Partners, LLC and Mark J. Correnti, Investment Advisers Act of 1940 Release No. 2520 (June 6, 2006) (settled administrative proceeding), where the SEC found that the adviser willfully violated the compliance rule by failing to adopt any procedures that could have prevented false statements from appearing in the adviser's RFP responses, which statements served as the basis for separately alleged fraud violations. In that case, the SEC also pursued personally the firm's head of compliance -- who was also the adviser's head of marketing -- asserting that he had willfully aided and abetted the firm's violations. Another case tending to bear this out is SEC v. The Nutmeg Group LLC, Randall Goulding and David Goulding, et al., USDC ED IL (Case No. 09CV1775) (filed March 23, 2009), in which the SEC charged an adviser along with several officers personally, including the CCO, for various violations stemming from a scheme they allegedly conducted, in which they misappropriated client assets, made misrepresentations to clients, failed to comply with custodial obligations and violated books and records requirements.

Note, however, that CCOs can and have been held personally liable for an adviser's failure under Rule 206(4)-7 to merely establish and implement a compliance program reasonably designed to prevent violations, even in the absence of actual violations resulting from that failure. See, for example, In the Matter of Consulting Services Group, LLC, and Joe D. Meals, Release Nos. IA-2669 and 34-56612 (October 4, 2007), which sends the message that the CCO bears some measure of personal responsibility for ensuring that the adviser's compliance program meets the Rule 206(4)-7 standards, wholly aside from whether the program actually prevents violations in practice.

There are sound reasons why CCOs should not be "automatically" liable – under any theory – just because a compliance violation has occurred somewhere in the organization. Without doubt, the CCO would be among those who come under scrutiny in the wake of a violation when tough questions are being asked about how and why the violation occurred. But saddling CCOs with strict liability for violations would be counterproductive to recruiting good, qualified individuals to serve as CCOs and thereby weaken the overall regulatory aim of protecting clients. In short, CCOs should not risk liability for violations in which they were not personally involved and which were committed by a person they do not supervise. A compliance violation by itself is not evidence that the CCO failed to meet a regulatory responsibility. Human frailty being what it is, slip-ups will occasionally occur in any organization, including one with a reasonably designed, implemented and administered compliance program. The SEC Staff has even acknowledged that in compliance "everyone hits bumps in the road" and that the compliance rules call for "reasonable" policies and procedures, not "perfect" policies and procedures. (Lori Richards, Director of the SEC's Office of Compliance Inspections and Examinations, Remarks Before the National Society of Compliance Professionals National Membership Meeting, Washington, DC, October 25, 2005.) Moreover, all too often violations are committed by individuals bent on working the system to their advantage no matter what, who may do everything possible to hide their wrongdoing. CCOs diligently fulfilling their responsibilities would become nothing more than insurers if held responsible for violations in those cases.

Note also that even an adviser CCO who does have supervisory responsibilities over other individuals in their firm may have an affirmative defense to a "failure to supervise" claim stemming from a violation committed by someone under their supervision, so long as the adviser had an adequate compliance program in place. This is because Section 203(e)(6) of the Advisers Act says that a person will not be deemed to have failed to reasonably supervise another person if:

- procedures were established that would reasonably be expected to prevent and detect, insofar as practicable, any such violation by the other person;
- a system was in place for applying the procedures; and
- the supervising person had reasonably discharged their supervisory responsibilities in accordance with the procedures and had no reasonable cause to believe the procedures and system were not being complied with.

12. **What Documentation Should be Maintained of a Compliance Program Review?**

As previously mentioned, adviser CCOs are not required by SEC rules to produce a written report memorializing their compliance review, in contrast to fund CCOs who must prepare a written report for the fund board. Nonetheless, the SEC Staff expects advisers to document the compliance review and can be expected to request that documentation in an examination. Fortunately, the vast majority of advisers seem to understand this point. According to an industry survey, only 3.1% of the responding advisers indicated that they did not document their annual review. Among the ways that surveyed advisers documented their annual review were:

- a lengthy written report (45.6%)
- a short memorandum (37.4%)
- informal notes (summarizing tests) (30.4%)
- workpapers (evidencing tests) (48.7%) and/or
- other (13.9%).

(See the 2007 Investment Management Compliance Testing Survey referenced under “Other Resources” at the end of this paper. Note that more than one response could be checked.)

Prudence would suggest that advisers create written documentation to memorialize, at a minimum:

- what period was covered by the review,
- what steps were taken in the process,
- who undertook those steps,
- what was found generally in each of the various areas or operations reviewed, for example, whether issues or problems were found and the general nature of those matters,
- what follow-up was taken thereafter on specific items found or changes recommended.

Some have described the review process as “iterative” or “cyclical,” meaning that by following the documentation, one can understand what reviews were done, what was found, and what was done in response, period after period, over and over in an iterative or cyclical way.

Documentation might take many different forms, including:

- copies or lists of the specific policies and procedures that were reviewed (the adviser’s Compliance Manual would be a logical place to start);
- documents reflecting the risk assessment or inventory of risks considered or updated in the course of the review (the SEC is likely to ask for this specifically when they come to inspect);
- data, surveys, analyses or other information gathered to assess the adviser’s policies and procedures (these might be materials commissioned by the adviser or publicly available information gathered by or for the adviser);
- results of compliance monitoring and testing conducted during the course of the year (good recordkeeping to keep track of prior testing will be helpful here);

- results of additional transactional or forensic testing conducted in the course of the review (now is the time to catch up in any area when monitoring or testing remains to be completed);
- notes from or summaries of interviews conducted with employees or others in the course of the review (interviews with personnel using a “show me” line of questioning can be a valuable source of information on how the firm’s policies and procedures are actually being implemented in practice; similarly, interviews using a “what would you do if” line of questioning may help to identify personnel who may not completely understand what their compliance responsibilities are and where additional training would be beneficial);
- copies or summaries of reports from auditors, consultants, service providers or others that may be used as part of the review (audit reports from accountants, SAS 70 reports, SOP 07-2 reports, legal compliance review reports, etc.);
- copies of compliance attestations or certifications that were gathered and relied on as part of the review (from service providers, sub-advisers or the adviser’s own personnel);
- summaries or copies of regulatory updates or developments that were considered in conjunction with the annual review (SEC enforcement cases, legal or compliance newsletters or articles, etc.);
- compliance summaries or reports prepared for the adviser’s management or others at the conclusion of the review (this might include a more formal written report the adviser’s CCO would produce for management).

As previously noted, under the SEC’s adviser books and records rules, any records that are created to document the adviser’s compliance program review must be maintained and preserved in an easily accessible place for not less than 5 years from the end of the fiscal year during which the last entry was made on the record. During the first 2 years, the record must be maintained in an appropriate office of the adviser.

Adequate documentation is a prudent course in today’s environment where some regulators take the view that “if it isn’t in writing, it didn’t happen.” At the same time, there will be an unavoidable tension inherent in creating documentation that is sufficient to meet regulatory expectations but which nonetheless avoids creating a “roadmap” for subsequent claims or litigation. As a result, documentation should be prepared with appropriate care understanding that it might well become subject to SEC inspection and/or public disclosure in connection with a lawsuit or otherwise. Of course, any documentation intended to be protected by the attorney-client privilege, work product doctrine or confidential treatment rules should be conspicuously marked as such and appropriately limited in distribution.

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Other Resources:

Compliance Programs of Investment Companies and Investment Advisers (the compliance rule “Adopting Release”), SEC Release Nos. IC-26299, IA-2204 (December 17, 2003):
<http://www.sec.gov/rules/final/ia-2204.htm>

Assessing the Adequacy and Effectiveness of a Fund’s Compliance Policies and Procedures, Investment Company Institute whitepaper (December 2005):
http://www.ici.org/pdf/rpt_05_comp.pdf

Remarks of Gene Gohlke (OCIE) and Bob Plaze (Division of Investment Management) at the CCO Outreach National Seminar for CCOs (November 8, 2005), concerning CCO accountability for compliance violations (archived webcast): <http://www.connectlive.com/events/ccoutreach/>

Remarks of Lori Richards, Director of the SEC's Office of Compliance Inspections and Examinations, Before the National Society of Compliance Professionals National Membership Meeting (October 25, 2005): <http://www.sec.gov/news/speech/spch102605lr.htm>

Risk Assessment Guide, Questionnaire and Identification Chart, prepared by the Investment Adviser Association:
<http://www.investmentadviser.org/eweb/dynamicpage.aspx?webcode=PubDoc-RiskAssesment>

Securities and Exchange Commission Confidential Treatment Procedure Under Rule 83 (17 CFR 200.83) at <http://www.sec.gov/foia/confcreat.htm>, concerning seeking confidential treatment under FOIA.

"Independence of the Legal Profession: Attorney-Client Privilege, Work Product, and Employee Legal Protections," American Bar Association Governmental Affairs Office at <http://www.abanet.org/poladv/priorities/privilegewaiver/>.

ComplianceAlert Letters from the SEC Staff to all Adviser/Fund CCOs, at <http://www.sec.gov/info/iaiccco/iaiccco-compliancealerts.htm>

SEC CCO Outreach program and materials: <http://www.sec.gov/info/iaicccoutreach.htm>

Investment Management Compliance Testing Survey, Summary Reports (2007, 2008 and 2009), prepared by ACA Compliance Group, Investment Adviser Association, IM Insight and Old Mutual (US) Holdings Inc.:
http://www.investmentadviser.org/eweb/dynamicpage.aspx?webcode=PN_RB

Speech by SEC Staff: Strengthening Examination Oversight: Changes to Regulatory Examinations, by Lori A. Richards, Director, Office of Compliance Inspections and Examinations, U.S. Securities and Exchange Commission, at the SIFMA Compliance and Legal Division St. Louis Regional Seminar, The New World of Compliance and Legal (June 17, 2009): <http://www.sec.gov/news/speech/2009/spch061709lar.htm>

APPENDIX A
METHODS FOR MONITORING AND TESTING
ADVISER COMPLIANCE

Caveat: *Following is a list of methods that an investment adviser might use to monitor or test for compliance in various operational areas. The list does not constitute a comprehensive or complete adviser compliance program or compliance review, nor does it include every method available to monitor or test in the operational areas noted. Moreover, some of the methods listed may not apply to or be appropriate for some advisers since advisers and their businesses vary significantly from firm to firm. Therefore, the list should not be used as a checklist, but rather only as a resource or discussion tool to provide ideas for possible testing methods.*

Note that this list includes methods for monitoring or testing compliance, not steps for “doing” compliance. In other words, it is not a list of compliance procedures but rather a list of methods that might be used to test whether procedures already in place at an advisory firm are adequate and effective to achieve compliance.

In most cases, this list does not attempt to address the question of when or how frequently these tests should be run. Those questions must be answered by each adviser based on its own compliance program and needs. Note also that these tests are often undertaken by using spot checking or statistical sampling techniques rather than attempting to test every single case.

Portfolio Management

--Review holdings in client accounts at key points in time, to make sure they reflect securities and techniques consistent with applicable restrictions, investment guidelines, client mandates, etc.

--Review quarterly compliance checklists that portfolio managers have completed, to make sure all securities in relevant portfolios are within applicable restrictions, investment guidelines, client mandates, etc.

--Review all exceptions generated by firm’s trade management/compliance software (which monitors trades proposed in relevant accounts relative to account restrictions), to make sure any impermissible securities, concentration, techniques or positions were avoided or corrected.

--Monitor manual overrides of automated trade management restrictions to make sure circumstances were appropriate to permit an override.

--Calculate various risk metrics (e.g., alpha, beta, various volatility measures) on client accounts for relevant periods and compare them to known benchmarks, to make sure they are consistent with client mandates and suitability issues.

--Calculate relevant percentages on holdings in accounts (how much in various market cap ranges, stocks/bonds/cash, sector and industry concentration, issuer diversification, foreign vs. domestic, etc.) at various points in time, including between reporting periods, to make sure they are consistent with investment guidelines, client mandates, risk disclosures, etc., and that portfolio manager is not engaged in “window dressing.”

--Monitor inflows and outflows to and from relevant accounts, for evidence of market timing (if a mutual fund) or suspicious or unexplained activity (e.g., anti-money laundering issues).

--Surveil communications of personnel with access to portfolio information (e.g., postal mail, email and/or recorded phone conversations), to make sure (among other things) they are not engaging in insider trading or divulging private client or portfolio information in any unauthorized manner.

--Analyze the performance of accounts that consistently beat their benchmarks over time to find out what the performance is attributable to, to make sure that it is attributable to securities, transactions and techniques that are appropriately disclosed and are within the investment guidelines for those accounts.

--Interview key personnel using a "what would you do if" line of questioning to make sure they recognize potential compliance violations and know what to do in response -- for example, what would you do if you received a request from a third party for information about a specific security held in some of your client accounts, what would you do if you were asked by the press for a comment on X, what would you do if an employee at a client asked you to make an unusual trade in the client's account, etc.?

--Compare the performance of client accounts with the performance of employees' personal accounts to see if there are questionable discrepancies.

--Review trading to make sure no securities appearing on a "restricted list" were traded during restricted period.

--Monitor for contra-trades in a particular security on the same day in different accounts (such as one client account buying a security on the same day another account is selling the same security), to make sure there are appropriate justifications for each of the trades in light of each account's own investment parameters.

Trading Practices / Brokerage

--Review a list of what market centers (broker-dealers, exchanges, ECNs, etc.) client trades are being directed to for execution over time and the commission dollars being paid to each, to see whether there are any issues with best execution, directed brokerage or the like.

--Compare any patterns of brokerage placement against logs or reports of gifts/entertainment received from those brokers.

--Compare any patterns of brokerage placement against lists of brokers with whom the adviser's portfolio management or trading personnel have familial relationships or other relationships that may pose conflicts of interest.

--Analyze brokerage placement in light of client referrals received from brokers, to see whether there are inappropriate or undisclosed commission or other trade arrangements in exchange for client referrals.

--Compare actual commission rates to approved or contractual rates, paying particular attention to any commission overrides or rate increases.

--Compare commission rates on trades executed through any affiliated broker-dealer with commission rates on trades executed through non-affiliated brokers.

- Commission a report by outside consultants (such as ITG Plexus) analyzing adviser's trade quality and execution costs, to help monitor best execution.
- Compare execution price of each equity trade against the NBBO (national best bid and offer) for that security, to help monitor trade quality.
- Compare adviser's equity trading costs against peer group costs using VWAP (volume weighted average price) as a benchmark, to help monitor best execution.
- Check documentation supporting any contemporaneous dealer quotations available for fixed-income securities (3 or more where available), to help monitor best execution for those trades.
- Monitor TRACE (Trade Reporting and Compliance Engine) System data from FINRA if trading in corporate bonds, to help monitor for execution quality.
- Check soft dollar arrangements, to make sure that they have been approved (evidenced by initials or approval memo) by head of trading and/or CCO.
- Check soft dollar allocations, to make sure they are all going to arrangements that appear on a "master" approved soft dollar arrangements list.
- Compare soft dollar research and execution budgets against actual broker-dealer allocations.
- Check soft dollar statements received from participating soft dollar brokers against firm's records, to make sure that they agree.
- Check firm's records on soft dollar/hard dollar "mixed use" allocations, to make sure they are being maintained properly and that allocations appear justified, accurate and consistent.
- Check with broker-dealers as to whether any soft dollar, reallowance, rebate, or other payment arrangements are in place with regard to commissions or trade executions, between the broker-dealer and the adviser, the client/fund, or other parties.
- Analyze all trading errors that occurred over a period of time, to see if they reveal a pattern suggesting an underlying problem needs to be addressed or that procedures need to be changed, etc.
- Check records supporting trading error corrections or adjustments, to make sure they are consistent with firm's procedures on trade error correction and applicable SEC guidance.
- Inspect adviser (or fund) cash journals for any non-recurring or special payments to or from broker-dealers, which among other things may indicate cash adjustments for trading errors.
- Review trading activity in client accounts in the period immediately leading up to a reporting period end (for example, quarter end), to see if the portfolio manager is engaged in window dressing or portfolio pumping or is in appropriately attempting to fulfill soft dollar commitments.
- Review trading activity and turnover in client accounts for any unusual increases in the number of trades in a given period, which may be evidence of improper churning or other inappropriate trading activity.

--Analyze the performance of all client accounts being run with the same investment style to see whether any are outliers (meaning performance significantly different than the rest of the group) and, if so, looking into why, to make sure that it is not due to cherrypicking or an unfair allocation of trading opportunities.

--Review cross-trades between client accounts conducted over a specified period, to make sure that they were conducted in accordance with applicable restrictions, that any necessary consents were obtained in a timely fashion, that all appropriate disclosures were made, that prices received were reasonable in relation to available market prices, etc.

--Monitor for contra-trades in a particular security on the same day in different accounts (such as one client account buying a security on the same day another account is selling the same security), to avoid inadvertent cross-trades.

--Identify any trades with affiliated broker-dealers that might be viewed as principal trades.

--Check client files for clients with directed brokerage arrangements, to make sure where appropriate that clients have received disclosures concerning how directed brokerage can impact firm's ability to achieve best execution ("Bailey" disclosures).

--Check block (aggregated, bunched) trades to make sure that no accounts were inappropriately left out of a block trade.

--Check allocations of partially filled orders among client accounts and proprietary accounts over a specified period, to make sure they were allocated in a fair and equitable manner and in accordance with firm's policies and procedures and any relevant disclosures. Pay particular attention to any allocations made by overriding automated systems.

--Check allocations of securities purchased in IPOs and any purchased in the immediate aftermarket for the same security, to make sure they were allocated in accordance with firm's policies and procedures.

--Review trades that are the most profitable over a specified period, as measured by parameters defined and consistently applied by the adviser, to make sure there are no suspicious patterns of accounts, managers, brokers or other involved parties.

--For advisers trading on behalf of registered funds, analyze whether any of the fund's selling brokers are getting a disproportionate share of the fund's brokerage, which might be evidence that fund share sales are still being taken into consideration in placing brokerage in violation of the SEC's ban on directed brokerage in exchange for distribution.

--Review documentation created upon placement and execution of trades in client accounts, to make sure all records are being kept as called for by the Advisers Act books and records rules as they relate to trade orders (for example Rule 204-2(a)(3)).

Proprietary and Personal Trading / Code of Ethics

--Review list of firm access persons, to make sure that it is being updated as necessary.

--Monitor all initial, quarterly and annual transactions reports (or duplicate statements and confirms) received from access persons, to make sure they are all received in a timely fashion and do not reveal any improper trading activity (including compliance with all Code of Ethics

requirements, such as black-out periods, short-swing transaction restrictions, IPO and limited offering pre-approvals, no trading in securities while on “restricted list” or “watch list,” etc.).

--Monitor reports received from covered personnel quarterly and annually as to their accounts and securities holdings, to make sure all reports are received in a timely fashion and that any accounts in which they have an interest are treated as “proprietary accounts” when appropriate.

--Compare information on employees’ confirms and account statements with the holdings and transactions reports submitted to check for discrepancies or concerns.

--Compare employees’ trading pre-approval forms with their accounts statements and confirms to ensure that they traded only on the terms and in the time frame approved.

--Compare employees’ personal trades with client trades to see if any patterns or concerns emerge (front running, improper principal trading, etc.).

--Consider whether any securities, trades or opportunities taken by employees should have been offered to clients.

--Compare new securities holdings reported by employees against publicly available reports of new IPOs to make sure that no employees bought shares in an IPO inconsistent with the firm’s policies or procedures.

--Look at the gifts log over time, to see if a particular person or firm has been the sender or recipient of an unusual number of gifts from any advisory firm personnel.

--Review employee expense reports to identify any unusual expenditures or patterns involving gifts or entertainment.

--Send an anonymous gift to a firm employee to see whether the gift is declined or reported consistent with firm policies and procedures.

--Obtain from the adviser’s most commonly used broker-dealers a log of any gifts the broker-dealer or its personnel have received from the adviser or its personnel, to make sure that gift giving is being done and reported consistent with firm’s policies and procedures.

--Monitor certifications/acknowledgments requested from all personnel annually (acknowledging receipt of and adherence to Code of Ethics and/or Compliance Manual), to make sure they are all received and are signed.

--Check any trading or other transactions between proprietary accounts and client accounts over a specified period, to make sure they were authorized, proper consents were obtained and proper disclosures made, etc.

--Check any waivers or exceptions permitted under the adviser’s Code of Ethics, to make sure that (i) appropriate documentation exists justifying the waiver/exception and memorializing the process by which the waiver or exception was granted and (ii) waivers and exceptions have not been granted authorizing conduct that is inconsistent with the law.

Insider Trading

--Test trading patterns in client accounts around news stories, to see if any suspicious patterns suggest access to inside information. (Software systems are available today that can help to automate this process.)

--Test trading patterns in employees' personal accounts around news stories, to detect any suspicious patterns.

--Review circumstances surrounding any unusually profitable trades in client accounts.

--Review circumstances surrounding any unusually profitable trades in employees' personal accounts.

--Surveil employee communications with (emails, phone calls, IMs) key clients and contacts who are more likely to be privy to inside information, such as broker-dealers, investment bankers, research analysts, consultants, lobbyists, other investment advisers, insiders at public companies, etc.

Regulatory Filings -- Form ADV, Form 13F, Schedule 13G, etc.

--Check Form ADV disclosures against SEC form requirements, item by item, to make sure disclosures are up-to-date and accurate.

--Check client files, to make sure ADV Part II was offered to each client in writing at least annually and that any requests for Part II were fulfilled in a timely fashion.

--Check personnel records on any employees who are "Investment Adviser Representatives," to make sure that they have proper licenses (e.g., FINRA/NASAA administered exams) or qualifications (CFA, CFP, ChFC, etc., if used as a substitute), proper forms on records (e.g., U-4), proper state registrations/notice filings, etc.

--Check client files, to make sure that clients reside only in states where state adviser/IAR registration or notice filing requirements have been met (or that exemptions still apply).

--Check disclosures in Part 1 of Form ADV against similar disclosures in Part II of Form ADV, to make sure they are complete and consistent.

--Check disclosures in Part 1 and Part II of Form ADV against related disclosures appearing elsewhere (any firm brochure the adviser may use, any client-specific materials or RFPs, the SAI of any mutual fund clients, etc.), to make sure they are complete and consistent.

--Check EDGAR filings, to make sure that adviser's Form 13F was filed in a timely fashion.

--Check account holdings to see whether any exceed filing triggering thresholds (e.g., 5% or 10% of an issuer's outstanding securities), to make sure that appropriate SEC filings (Schedule 13G, 13D, Hart-Scott-Rodino, etc.) have been made if so.

Safeguarding Client Assets

--Arrange for and review results of audit of client accounts conducted by independent auditor pursuant to Advisers Act Rule 206(4)-2 (for advisers who are subject to the "surprise audit" rule).

--Where feasible, arrange for custodian of client assets to send monthly or quarterly account statements directly to client, showing account balances, holdings, valuations and activity.

--Check with clients that custodian is in fact sending account statements to clients directly as expected.

--Review reconciliations of custodian statements showing client assets against adviser's records of same, to make sure they agree with adviser's internal records and records of client. Check for any indications that reconciliations are being manipulated, such as unexplained "plug" numbers, stale items, patterns or anomalies that are not explained. Pay particular attention to any statements that are not reconciled in a timely fashion.

--Review any withdrawals or transfers from client accounts within control of adviser personnel, to make sure they are appropriate and documentation of compliance with internal approval and control procedures exists.

--For advisers self-custodying or using a related person as custodian, check holdings and trade confirms obtained from higher up the custody chain, such as with prime brokers, depositories, OTC counterparties or other independent sources.

--Verify any account names and addresses on client account statements sent by adviser with same information used for custodian confirms.

--Review for consistency any account statement sent to clients by custodian directly, as compared to account information supplied to client by adviser.

--Make sure clients are informed that they should be checking their own account statements and confirms routinely and know who to contact at the adviser (preferably the CCO or other "independent" personnel) if questions or discrepancies arise.

Books and Records

--Compare a list of SEC-required books and records to a list of the types of books and records being kept by adviser (on-site or through storage service companies), to make sure that appropriate records are being created, maintained and preserved in all required areas.

--Randomly request from IT/records department or storage service company retrieval of specified historical records (among those required or expected to be retained, including email), to make sure they still exist and can be retrieved in a timely and accurate fashion.

--Review documentation on client accounts opened during the preceding period, to ensure that all appropriate documentation has been filled out, received, signed, delivered, etc. (advisory agreement, privacy notice, Part II of ADV, disclosures, tax forms, AML documentation, etc.).

--Check emails being "deleted" by firm personnel but retained on the firm's servers, to make sure personnel are not attempting to delete emails that constitute required books and records.

--Surveil incoming and outgoing email of adviser personnel for potential violations, inappropriate communications or unauthorized use of email system. (Relatively inexpensive email surveillance software is available to assist in this process.)

--Check client files or firm records of any client to whom regulatory documents are being delivered electronically, to make sure they have provided informed consent to electronic delivery and that evidence exists of their ability to receive electronic deliveries.

Marketing / Solicitors

--Review documents, websites or files containing any marketing materials, sales literature, advertisements or other sales-type materials used during a specified period, to make sure that materials are consistent with internal policies and applicable legal requirements and reflect any required approvals (initials, etc.).

--Check files pertaining to any solicitors acting on behalf of the firm, to make sure proper signed agreements are in place containing all appropriate undertakings by the solicitor.

--Contact clients referred to the firm by a solicitor during a specified period, to make sure the solicitor provided only materially accurate and complete approved materials to the client, delivered any required disclosures in a timely fashion, obtained client's consent to or acknowledgement of any required materials/disclosures, etc.

--Obtain from and review a periodic compliance certification from all third-party solicitors, attesting that they have adhered to adviser's requirements, legal requirements, etc.

--Check third-party solicitor registrations and disciplinary records on available databases (IAPD, WebCRD, state securities commissions, etc.).

--Recalculate account or composite performance for specified periods, to confirm the accuracy of any data used in marketing or client materials or provided to investment manager databases.

--Perform an attribution analysis of performance on model portfolios or key accounts to determine what performance is attributable to, to make sure that any appropriate disclosures about how performance was achieved are being made, that the appropriate index is being used as a benchmark and that any material differences between the account and the index are being disclosed.

--Check emails or communications sent from visitors to adviser's website or to a "general info" email address, to make sure they are being routed to the correct individuals and handled appropriately.

Valuing Assets / Assessing Advisory Fee

--Compare valuations of client assets as shown on statements sent to clients to an independent source for valuations, to make sure they agree.

--Compare values assigned to various securities in all accounts holding that securities, to ensure consistency of valuations across accounts or supportable variations.

--Check pricing or valuation exception reports for stale pricing, unusual price fluctuations or other potential pricing problems.

--Review pricing overrides made by portfolio managers, sub-advisers, Boards of Directors, or others, for reasonableness and support.

--Review "fair value" assigned to any client assets where market prices are not readily available, to make sure valuation used for fee calculation and other purposes was done in accordance with applicable methodology and back-up documentation for valuation has been preserved.

--Compare valuations on any portfolio securities that were "fair valued" for any purpose against the next available trade price of those securities, to monitor the accuracy of the fair valuation used and help to determine whether the methodology needs refinement. (Software is available today to assist with fair valuation of securities.)

--Recalculate advisory fees charged on client accounts over a specified period, to make sure calculation was done correctly, breakpoints were applied correctly and statements accurately reflected charges.

Privacy / Data Security

--Test accessibility to client files/records from various computers using authorized and unauthorized methods, to make sure that unauthorized persons cannot access such information. (Advisers can do this internally or hire a computer security consultant to conduct these tests.)

--Check file drawers, cabinets and rooms that are supposed to be locked, to make sure unauthorized persons do not have access.

--Monitor desk areas of employees in firm, to see whether confidential client information or computer passwords are readily visible or accessible to unauthorized persons.

--Check client files, to make sure that a copy of adviser's Privacy Notice has been provided to clients initially and at least annually.

--Re-read the adviser's Privacy Notice to make sure that privacy practices and procedures are consistent with the adviser's representations on how data is handled.

Business Continuity / Disaster Recovery Plan

--Randomly test, without prior notice, availability of licensed seats/stations at any off-site recovery center that adviser has contracted for, to make sure that all services expected are indeed available.

--Randomly request retrieval of specified computer files or records from any back-up or "mirrored" computer system, to make sure records actually exist and would be accessible in case of emergency.

--Practice a premises evacuation drill or continuity plan simulation, to make sure employees know what to do and that key personnel know how to stay in contact if a real evacuation emergency were to arise.

--Conduct a "table-top" exercise simulating a business disruption or disaster, to make sure key personnel have talked through what to do.

--Interview key personnel about the adviser's business continuity/disaster recovery plan, to make sure that they would know what to do if various situations were to arise, including a Katrina-like or 911-like disaster in adviser's area.

Compliance Attestations / Certifications

--Review compliance attestations/certificates received from key service providers to identify any potentially relevant issues or concerns regarding their compliance for adviser or adviser's client accounts.

--Review compliance attestations/certificates received from adviser's personnel, to make sure they have read and understand updated Compliance Manual and to identify any potentially relevant issues or concerns regarding their compliance for adviser or adviser's client accounts.

--Review any consultant reports (such as SAS 70 reports from an auditing firm) certifying as to the description of adviser's compliance controls and/or testing the controls.

Proxy Voting / Class Action Settlements

--Review client account files to make sure client has signed appropriate documents (for example, advisory agreement or separate document) acknowledging whether or not adviser will be voting proxies on securities in client's account.

--Review client account files to make sure client has signed appropriate documents acknowledging whether adviser or not will be handling proofs of claims in class action lawsuits pertaining to securities in client's account.

--Check each incoming proxy against firm's records, to make sure holdings information agrees.

--Check proxy files to make sure incoming proxies were voted and were voted consistently with firm's proxy voting policy or, if not, that an acceptable explanation for why not was created and maintained in the files.

--Check the list of proxy votes recorded by an adviser on behalf of its client accounts (for example Form N-PX for a mutual fund client) over a specified period, to make sure the proxies were in fact voted as indicated in the record.

--Obtain explanation for any changes in proxy policies applied to any particular account over the reviewed period.

Anti-Money Laundering

--Review client files for all necessary account-opening documentation as may be called for by adviser's anti-money laundering procedures.

--Check names of new and existing clients against the OFAC (Office of Foreign Assets Control) SDN (Specially Designated Nationals and Blocked Persons) List and any other pertinent lists made available by OFAC.

--Contact any custodians or other service providers on which adviser is relying to implement its own AML program, to make sure procedures are being undertaken faithfully by the custodian or provider.

--Commission independent audit of client accounts to test compliance with AML procedures.