

## SEC's Proposed Amendments Signal a Shifting of Audit Costs to Advisors

by Eric Clarke, President of Orion Advisor Services, LLC

*NOTE: The SEC wants your opinion to help guide these regulations. Comments on the proposed amendments are due by July 28, 2009.*

On May 14, 2009, the Securities and Exchange Commission (SEC) proposed changes to the custody rule under the Investment Advisers Act of 1940, Rule 206(4)-2, which will affect investment advisors who are deemed to have custody of client assets. This definition encapsulates advisors who have custody of client accounts either directly, through affiliated custodians, or by virtue of being able to take fees from client accounts.

The proposed changes affect more than 9,600 advisors who have the authority to deduct fees from custodial client accounts. These firms would be subject to an annual surprise audit at their own expense. To accomplish this, advisors would be responsible for engaging an independent public accounting firm which could potentially cost \$8,000 or more per year (Based on the SEC's estimate). These changes hit very close to home for us as they stand to affect most of the firms we serve.

And what exactly would the accounting firm be auditing during this "surprise" audit? They are charged with the task of verifying all client funds and securities by contacting your custodians and clients to verify holdings. This process will significantly increase work at the custodial firms as they respond to auditor requests, not to mention, create a likely increase in the volume of client questions about why an auditor is asking them to verify their own account holdings (pay special attention to footnote 33 of the 2003 Custody Rule Amendment).

Meanwhile, another group of firms would be impacted by section II(B) of the proposed amendment affecting advisors who work with related custodians. These firms would be required to hire an auditing firm who is a member of the PCAOB. The \$8,000 cost I mentioned initially would likely be dwarfed by the cost of bringing in a PCAOB member (likely a "Big Four" firm). This same amendment would require the custodial firm to conduct (and pass) a SAS 70 Type 2 audit presumably by 2010. If your related custodian does not already happen to have their SAS 70 Type 2, they have some additional work to do. To be in position to pass a Type 2, a firm would most likely need to first complete a SAS 70 Type 1 in preparation for next year.

The third proposed amendment is to only allow advisors to work with independent custodians, functionally disallowing Broker/Dealers with affiliated RIAs, or Banks with internal trust departments to custody their own accounts.

In my opinion, this third amendment is less likely to pass, but it, along with the "one-two" punch of the first two, certainly warrant some comment from all advisors right now.

For that reason, I would encourage you to let your voice be heard by the SEC. They are seeking out comments from advisors like you, but the deadline is July 28, 2009. Submit your comments online at: <http://www.sec.gov/rules/proposed.shtml>. You can also read the existing comments from advisors at:

<http://www.sec.gov/comments/s7-09-09/s70909.shtml>.

I also think it would be prudent to interview a public accounting firm or two to find out what types of costs are going to be involved with a surprise audit of all of your clients' funds and securities holdings. Whether these regulations pass now, or a new Ponzi-scheme comes along next year to shake up our industry, it's likely these costs are not going down; they are going up. The trend over the past decade has been a large increase in the number of advisors, and a decrease in the number of SEC regulators. This trend appears to show a shifting of the costs of auditing and regulatory compliance away from the government, making advisors responsible for these costs. Understanding these audits and associated costs is critical, and advisors should be especially aware of additional costs to their practice as a possible factor in considering pricing structure of your client accounts.

### **How Does Orion Help?**

Orion helps advisors cope with audits by reconciling and scrubbing the firm's books to that of the custodian. We also work with CPA firms who can specialize in auditing advisors to help find a match for advisors who need (or may be in need in the near future of) this service. If any or all of these amendments pass, advisors will need to act quickly to get in compliance. While it will be a large undertaking, and an additional expense, our goal is to see it be as small of a distraction as possible so you can spend less time dealing with SEC changes and more time with clients.

Eric Clarke is President of Omaha, NE-based Orion Advisor Services, LLC, the *ULTIMATE* Portfolio Accounting Service Bureau for registered investment advisors.



### **Submit your Comments to the SEC Now.**

Comments on the proposal must be received by July 28, 2009.

Read the proposed rule at [www.sec.gov](http://www.sec.gov):

<http://www.sec.gov/rules/proposed/2009/ia-2876.pdf>

Read existing comments from Advisors:

<http://www.sec.gov/comments/s7-09->

