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## **Investment Adviser Books and Records Requirements**

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## Presenters

**Tammy Emsick**  
**Senior Compliance Consultant**  
**RIA Compliance Consultants**



**Bre Newman**  
**Compliance Specialist**  
**RIA Compliance Consultants**

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## Agenda

- Overview of Rule 204-2 of the *Investment Advisers Act of 1940*
- Electronic Record Retention Requirements
- Documents Regulators may Request During an Examination
- Common Deficiencies

## Rule 204-2 Overview

Under Rule 204-2 of the Investment Advisers Act of 1940, every investment adviser registered or required to be registered with the SEC shall make and keep true, accurate and current certain books and records relating to its investment advisor business.

## Rule 204-2 Overview

- 11 Different Primary Sections under Rule 204-2
  - (a) addresses books and records that every investment adviser must maintain;
  - (b) addresses additional books and records that must be maintained by investment advisers that have custody or possession of securities or funds of any client;
  - (c) and (d) addresses additional books and records that must be maintained regarding portfolios supervised or managed by any investment advisers who render investment supervisory or management services to any client;
  - (e) and (f) address the location and length of times records must be maintained;
  - (g) addresses the requirements for maintaining required records on micrographic or electronic mediums;

## Rule 204-2 Overview

- (h) addresses the maintenance of records that may be the same or similar to those required under other SEC regulations (e.g., broker/dealer records under the Securities and Exchange Act of 1934);
- (i) defines the term “discretionary power” for purposes of Rule 204-2;
- (j) addresses certain record keeping requirements for foreign advisors registered or applying for registration with the SEC; and
- (k) addresses provisions for investment advisers that are SEC registered and were previously maintaining books and records according to state requirements as a state registered investment adviser.



## **RULE 204-2- REQUIRED RECORDS**

- **Summary of Required Records-**
  - Records Pertaining to Business and Financial Account
  - Records Pertaining to Investment Advice and Transactions in Client Accounts
  - Records Pertaining to Client Communications and Recommendations
  - Records that Document Your Authority to Conduct Business in Client Accounts
  - Records Pertaining to Advertising and Performance Records

## **RULE 204-2- REQUIRED RECORDS**

- Records Pertaining to the Code of Ethics Rule
- Record Pertaining to Registration and Client Disclosure Documents
- Records Pertaining to Solicitor Arrangements
- Records Pertaining to Policies and Procedures Adopted and Implemented Under Compliance Program Rule
- Records Pertaining to Political Contributions
- Records Pertaining Custody of Client Assets
- Records Pertaining to Proxy Voting on Behalf of Clients

## RULE 204-2-RETENTION

- Generally- Required books and records shall be maintained and preserved in an easily accessible place for a period of not less than **five** years, the first two years in an appropriate office of the investment advisor.
  - Most record must be kept for five years from the last day of the fiscal year in which last entry was made on a document
  - Records pertaining to advertising/marketing or performance data must be kept for five years from the last day of the fiscal year during which the required record was last published or disseminated.
  - Partnership articles and any amendments to the articles, articles of incorporation, charters, minute books and stock certificate books shall be maintained in the principal office of the investment adviser and preserved for at least three years after termination of the entity.

## **RULE 204-2 RETENTION**

- Books and records may be maintained by the investment advisor in such manner that the identity of any client to whom the investment advisor renders investment supervisory services is indicated by numerical or alphabetical code or some similar designation.

## **RULE 204-2-RETENTION**

- An advisor may maintain required books and records on micrographic media (e.g., microfilm or microfiche) or electronic storage media so long as the manner in which they are maintained meets the following requirements:
  - Records must be arranged and indexed in a manner that permits easy location, access, and retrieval of any particular record;
  - A legible, true, and complete copy of the record can be provided promptly in the medium and format in which it is stored;

## **RULE 204-2-RETENTION**

- A legible, true, and complete printout of the record can be provided promptly;
- Regulators can be provided with a means, to access, view, and print the record; and
- A duplicate copy of the record is stored, on any micrographic or electronic medium allowed under Rule 204-2, separately from the original of the record for the time period required for preservation of the original record.

## **RULE 204-2-RETENTION**

- Procedures must be in place to maintain and preserve the records so as to reasonably safeguard them from loss, alteration, or destruction
- Procedures must be in place to limit access to the records to properly authorized personnel and the SEC, including its examiners and other representatives
- Procedures must be in place to reasonably ensure that any reproduction of a non-electronic original record on electronic storage media is complete, true, and legible when retrieved

# DOCUMENTATION TO PREPARE FOR AUDIT

- Financial Records
  - Cash receipt and disbursement journals
  - Financial statements- balance sheet, trial balance, income statement, and cash flow statements
  - General and auxiliary ledgers and chart of accounts
  - Any loans from clients to the Advisor or sales of the Advisor's or any affiliates stock to clients
  - Checkbooks, bank statements, cancelled checks and cash reconciliations prepared by the Advisor
  - Advisory bills or statements-paid or unpaid
  - All loan agreements and notes payable
  - All notes receivable



# DOCUMENTATION TO PREPARE FOR AUDIT

- Organization Documents
  - Company organizational chart showing ownership percentages and control persons
  - Articles of Incorporation and/or By-Laws
  - Corporate minute book
  - LLC/Partnership agreements & amendments
  - Stock certificate book
  - A schedule or chart of all affiliated or related entities
  - Names of any of the advisor's officers and/or directors who resigned and information regarding their reason for departure

# DOCUMENTATION TO PREPARE FOR AUDIT

- Form ADV
  - A copy of each brochure and brochure supplement and each amendment or revision to the brochure and brochure supplement (ADV Part 2 or ADV Part 2, Appendix 1 Wrap-Fee Brochure)
  - Any summary of material changes that satisfies the requirements in ADV Part 2 but is not contained in the brochure
  - A record of the dates that each brochure and brochure supplement, each amendment or revisions, and each summary of material changes not contained in the brochure was provided to any client or any prospective client who subsequently becomes a client

# DOCUMENTATION TO PREPARE FOR AUDIT

- Form ADV (cont.)
  - Documentation describing the method used to compute managed assets for purposes of Item 4.E of Form ADV Part 2A, if the method differs from the method used to compute regulatory assets under management reported in Form ADV Part 1A, Item 5.F
  - A memorandum describing any legal or disciplinary event listed in Item 9 of Form ADV Part 2A or Item 3 of Form ADV Part 2B and presumed to be material, if the event involved the investment adviser or any of its supervised persons and is not described in the brochure or brochure supplement—the memorandum must explain the determination that the presumption of materiality is overcome and must discuss the factors described in Form ADV

# DOCUMENTATION TO PREPARE FOR AUDIT

- Form ADV (cont.)
  - Back-up documentation for numbers reported on Form ADV (i.e. assets under management, number of clients, types of clients, number of clients provided financial planning services to)
  - A dated copy of the firm's annual offer letter
  - A list of all clients the annual offer letter was sent to
  - A log of all clients that requested a copy of the ADV Part 2 or similar disclosure document

# DOCUMENTATION TO PREPARE FOR AUDIT

- **Contracts/Agreements**
  - **All written agreements entered into by the investment adviser with any client or otherwise relating to the business of the investment adviser**
    - Solicitor agreements
    - Outside Money Manager Agreements
      - ✓ Solicitor
      - ✓ Sub-Advisor agreements
      - ✓ Consultant agreements
    - Outside service vendor contracts
  - **Sample advisory client agreements currently used and any previous versions used in past 5 years**

# DOCUMENTATION TO PREPARE FOR AUDIT

- **Contracts/Agreements (cont.)**
  - **Standard fee schedules if not otherwise stated in advisory contracts or in Form ADV Part 2**
  - **All powers of attorney and other evidences of the granting of any discretionary authority by any client to the investment adviser (Note: May be included in client contract.)**

# DOCUMENTATION TO PREPARE FOR AUDIT

- Solicitor Arrangements
  - **All written acknowledgements of client receipt of solicitor disclosure documents and a copy of the disclosure document**
  - List of all parties compensated for soliciting clients including the total cash and non-cash compensation paid and a summary of the business relationship with that entity (e.g., consulting, prime brokerage, securities lending, etc.)
  - List of all clients that the advisor is paying a solicitor fee on
  - All agreements, correspondence and the separate disclosure documents for third-party solicitors

# DOCUMENTATION TO PREPARE FOR AUDIT

- Code of Ethics
  - A copy of the investment adviser's code of ethics adopted and implemented that is in effect, or at any time within the past five years was in effect
  - A record of any violation of the code of ethics and of any action taken as a result of the violation
  - A record of all written acknowledgments for each person who is, or has been within the past five years, a supervised person
  - Affiliates current Code of Ethics and insider trading policies and procedures



# DOCUMENTATION TO PREPARE FOR AUDIT

- Code of Ethics (cont.)
  - A list of all supervised persons indicating the date they became supervised persons of the firm
  - If not included in the Code of Ethics, any policies and procedures adopted to address exemptions for employees, including those for personal hardship
  - If not incorporated in the Code of Ethics, any policies and procedures governing personal trading of contract employees and temporary employees, if applicable
  - If not stated in policies and procedures, any guides for monitoring personal trading of access persons

# DOCUMENTATION TO PREPARE FOR AUDIT

- Code of Ethics (cont.)
  - If not stated in policies and procedures, information about the process used to monitor and control the receipt, flow, and use of non-public information, including any restricted, watch or grey lists
  - Any fee splitting or revenue sharing arrangements

# DOCUMENTATION TO PREPARE FOR AUDIT

- Personal Securities Transactions
  - **A list of all access persons (current and for past 5 years indicating date individual became access person and date status as an access person terminated if applicable)**
  - **Initial and Annual Holdings Reports for all access persons**
  - **Quarterly Personal Securities Transaction Reports**
  - **A record of any decision, and the reason supporting the decision, to approve the acquisition of any security in an initial public offering or a limited offering by the access person, for at least five years after the end of the fiscal year in which the approval was granted**
  - **Brokerage Account Disclosure Forms**
  - **A list of all personal securities accounts for all access persons**

# DOCUMENTATION TO PREPARE FOR AUDIT

- Personal Securities Transactions (cont.)
  - Transaction pre-approval documentation
  - A list of all securities that were restricted from trading at anytime during indicating the time the trading restrictions were in place, what restrictions were in place, and the reason for the restrictions

# DOCUMENTATION TO PREPARE FOR AUDIT

- Advertising/Marketing
  - **Copy of each notice, circular, advertisement, newspaper article, investment letter bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons, if such document recommends the purchase or sale of a specific security and does not state the reasons for such recommendation, a memorandum or the investment adviser indicating the reasons therefor.**

# DOCUMENTATION TO PREPARE FOR AUDIT

- **Advertising (cont.)**
  - **All accounts, books, internal working papers, and any other records or documents that are necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any or all managed accounts or securities recommendations in any notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons (other than persons connected with such investment adviser); provided, however, that, with respect to the performance of managed accounts, the retention of all account statements, if they reflect all debits, credits, and other transactions in a client's account for the period of the statement, and all worksheets necessary to demonstrate the calculation of the performance or rate of return of all managed accounts shall be deemed to satisfy the requirements of this requirement**

# DOCUMENTATION TO PREPARE FOR AUDIT

- Advertising (cont.)
  - Copies of any pitch books, one-on-one presentations, brochures, pamphlets, or other promotional and/or marketing materials furnished to existing or prospective clients for each investment strategy or mandate
  - Copies of any advertisements (e.g., newspaper or magazine ads and article reprints disseminated to clients or prospective clients, radio script, newsletters, seminars, business cards, letterhead, phonebook [yellow or white page] ads) used to inform or solicit clients-if information on services and investments is available on the internet, such as websites and blogs, make all versions available either as printouts or electronic archives.
  - If websites include sections for clients or advisory representatives that are accessible only with a username and password, establish a temporary username and password for the examination staff's use during the inspection and include them in your response

# DOCUMENTATION TO PREPARE FOR AUDIT

- Advertising (cont.)
  - Performance return composites including: description and investment objectives, inception date, account minimum, and whether or not it is used in marketing
  - All accounts included in each composite- the following records for each client account in an advertised performance composite may also be requested:
    1. Internal calculations indicating beginning and ending asset values for each quarter, all capital additions and withdrawals (including the dates) and the quarterly performance return
    2. All custodial statements, including a statement that indicates the beginning asset value for the performance period. For example, the December 2009 statement for the verification of calendar year 2010 performance returns



# DOCUMENTATION TO PREPARE FOR AUDIT

- Advertising (cont.)
  - All accounts not included in a composite
  - All terminated composites
  - All parties compensated for soliciting clients including: total cash and non-cash compensation paid and a summary of the business relationship with that entity (e.g., consulting, prime brokerage, securities lending, etc.)
  - All agreements, correspondence and the separate disclosure documents for third-party solicitors
  - Documentation that the firm is complying with GIPS if applicable
  - All requests for proposals (RFPs) completed
  - Names of all third party consultants that the firm provided responses to questionnaires

## DOCUMENTATION TO PREPARE FOR AUDIT

- Client Communications
  - **Originals of all written communications received and copies of all written communications sent by such investment adviser relating to (i) any recommendation made or proposed to be made and any advice given or proposed to be given, (ii) any receipt, disbursement or delivery of funds or securities, or (iii) the placing or execution of any order to purchase or sell any security**
  - **If the investment adviser sends any notice, circular or other advertisement offering any report, analysis, publication or other investment advisory service to more than 10 persons, the investment adviser shall not be required to keep a record of the names and addresses of the persons to whom it was sent; except that if such notice, circular or advertisement is distributed to persons named on any list, the investment adviser shall retain with the copy of such notice, circular or advertisement a memorandum describing the list**

# DOCUMENTATION TO PREPARE FOR AUDIT

- Client Communications (cont.)
  - Any client complaints and documentation supporting the compliant investigation and any corrective actions taken, if applicable
  - Information about the process used for monitoring client correspondence and/or complaints, including the name of any third-party service providers used and the firm's oversight of the services provider

# DOCUMENTATION TO PREPARE FOR AUDIT

- Written Supervisory Procedures (WSPs)
  - **A copy of the investment adviser's written policies and procedures that are in effect or at any time within the past five years were in effect**
  - **Any records documenting the investment adviser's annual review of those policies and procedures**
  - A current inventory of the firm's compliance risks that forms the basis for its policies and procedures, including any changes made to the inventory and dates of change
  - Any documents maintained that map the advisor's inventory of risks to its written policies and procedures

# DOCUMENTATION TO PREPARE FOR AUDIT

- Written Supervisory Procedures (WSPs) (cont.)
  - Any written guidance that the firm has provided to its employees regarding its compliance risk assessment process and the process for creating policies and procedures to mitigate and manage its compliance risks
  - Information relating to the firm's compliance testing, including compliance reviews, quality control analysis, surveillance, and/or forensic or transactional testing performed by the firm. Information should include any significant findings, both positive and negative, of such testing and any information about corrective or remedial actions taken regarding the findings
  - Written acknowledgements of receipt of WSPs by all supervised persons (if applicable)

# DOCUMENTATION TO PREPARE FOR AUDIT

- Written Supervisory Procedures (WSPs) (cont.)
  - Log/documentation to support any training that has taken place specific to WSPs
  - Any internal audit review schedules and completed audits including the subject and date of the report
  - Documentation maintained regarding any interim reviews conducted of the firm's policies and procedures
  - Information about the oversight process the firm uses for any remote offices and/or independent advisory contractors, and any policies and procedures with respect to the oversight

# DOCUMENTATION TO PREPARE FOR AUDIT

- Proxy Voting
  - If the investment adviser exercises voting authority with respect to the client securities, copies of policies and procedures required by Rule 206(4)-6
  - A copy of each proxy statement that is received regarding client securities (An adviser may rely on a third party to make and retain, on the adviser's behalf, a copy of a proxy statement, provided that the adviser has obtained an undertaking from the third party to provide a copy promptly upon request or may rely on obtaining a copy of the proxy statement from the Commission's Electronic Data Gathering, Analysis, and Retrieval [EDGAR] system.)

## DOCUMENTATION TO PREPARE FOR AUDIT

- Proxy Voting (cont.)
  - Records of each vote cast on behalf of clients (Can rely on third party as previously noted.)
  - Any documents prepared to the advisor that were material to making a proxy voting decision or that memorialized the basis for the decision
  - Copies of written client requests for proxy voting information and copies of written responses to such requests
  - Copies of client disclosure of how they can obtain information from the advisor on how securities were voted



# DOCUMENTATION TO PREPARE FOR AUDIT

- Custody - If acting as a custodian:
  - A copy of any internal control report obtained or received pursuant to Rule 206(4)-2(a)(6)(ii) if the adviser or a related person has custody as a qualified custodian in connection with the advisory services provided
  - A journal or other record showing all purchases, sales, receipts and deliveries of securities (including certificate numbers) and all other credits and debits to these accounts
  - A separate ledger for each account showing all purchases, sales, receipts and deliveries of securities, the date and price of each purchase and sale and all other debits and credits
  - Copies of confirmations and all transactions effect by or for any account for which the firm has custody

# DOCUMENTATION TO PREPARE FOR AUDIT

- Custody (cont.)
  - **A record for each security in which any client has a position showing the name of each client having an interest, the amount, and the location of each security**
  - **A memorandum describing the basis upon which you have determined that the presumption that any related person is not operationally independent under Rule 206(4)-2(d)(5) has been overcome**
  - The SEC staff may further request that the custodian(s) for specific client accounts provide the staff directly with a confirmation of all positions, including cash, short positions and loans, held as of a particular date

# DOCUMENTATION TO PREPARE FOR AUDIT

- Political Contributions (Pay-to-Play)
  - If the adviser provides investment advisory services to a government entity or a government entity is an investor in any covered investment pool to which the investment adviser provides advisory services, books and records that pertain to Rule 206(4)-5, Political contributions by certain investment advisers, containing a list or other record of:
    - The names, titles and business and residence addresses of all covered associates of the investment adviser;

# DOCUMENTATION TO PREPARE FOR AUDIT

- Political Contributions (Pay-to-Play) (cont.)
  - All government entities to which the investment adviser provides or has provided investment advisory services, or which are or were investors in any covered investment pool to which the investment adviser provides or has provided investment advisory services, as applicable, in the past five years, but not prior to September 13, 2010;
  - All direct or indirect contributions made by the investment adviser or any of its covered associates to an official of a government entity, or direct or indirect payments to a political party of a State or political subdivision thereof, or to a political action committee; and

# DOCUMENTATION TO PREPARE FOR AUDIT

- Political Contributions (Pay-to-Play) (cont.)
  - The name and business address of each regulated person to whom the investment adviser provides or agrees to provide, directly or indirectly, payment to solicit a government entity for investment advisory services on its behalf, in accordance with § 275.206(4)-5(a)(2).

These records must be listed in chronological order and indicate:

    - ✓ The name and title of each contributor;
    - ✓ The name and title (including any city/county/State or other political subdivision) of each recipient of a contribution or payment;
    - ✓ The amount and date of each contribution or payment; and
    - ✓ Whether any such contribution was the subject of the exception for certain returned contributions pursuant to § 275.206(4)-5(b)(2).

# DOCUMENTATION TO PREPARE FOR AUDIT

- Trading
  - An order memorandum for each trade placed by the advisor for the purchase or sale of any security that includes:
    - Any special instructions received by the advisor regarding the purchase, sale, receipt or delivery of a particular security
    - Any modifications or cancellations of the order or instruction
    - The terms and conditions of the order, instruction, modification or cancellation
    - The person connected with the advisor that recommended the transaction to the client
    - The person who placed the order

# DOCUMENTATION TO PREPARE FOR AUDIT

- Trading (cont.)
  - **The account for which the order was entered**
  - **The date of entry**
  - **The bank or broker/dealer through whom the order was executed**
  - **Indicate if order was entered into pursuant to the exercise of discretionary authority**
  - **Time of placing the order**
  - **Time order was executed**

# DOCUMENTATION TO PREPARE FOR AUDIT

- Trading (cont.)
  - Trade blotter or purchase and sales journal, that lists transactions (including all trade errors, cancellations, re-bills, and reallocations) in securities and other financial instruments (including privately offered funds) for current and former clients, proprietary and/or trading accounts and access persons-Preferred format is to provide it electronically in Microsoft Excel. Separate worksheets should be provided for (1) equities (ETF trades should be included with equities); (2) fixed income; (3) cash or cash equivalents, maturities, calls, pay-downs, expirations, or reinvestments in mutual fund dividends or capital gains distributions; (4) mutual funds; and (5) options, futures, swaps, and other derivatives.



# DOCUMENTATION TO PREPARE FOR AUDIT

- Trading (cont.)
  - The report for equity securities should include the following fields of information featuring the following fields of information in chronological order:
    - ✓ Client Name/#
    - ✓ Trade Date
    - ✓ Settle Date
    - ✓ Buy or sell
    - ✓ CUSIP
    - ✓ Security Symbol
    - ✓ Security Description
    - ✓ Quantity
    - ✓ Unit Price
    - ✓ Principal/Proceeds/Notional Value
    - ✓ Total commission
    - ✓ Fees
    - ✓ Net proceeds
    - ✓ Broker

# DOCUMENTATION TO PREPARE FOR AUDIT

- Trading (cont.)
  - The report for fixed-income securities should include the following fields of information featuring the following fields of information in chronological order:
    - ✓ Client Name/#
    - ✓ Trade Date
    - ✓ Settle Date
    - ✓ Buy or sell
    - ✓ CUSIP
    - ✓ Security Description-Issuer
    - ✓ Security Description-Coupon Maturity
    - ✓ Quantity
    - ✓ Unit Price
    - ✓ Accrued Interest
    - ✓ Principal Value/Proceeds
    - ✓ Total commission
    - ✓ Net proceeds
    - ✓ Broker

# DOCUMENTATION TO PREPARE FOR AUDIT

- Trading (cont.)
  - List of approved broker/dealers
  - List of affiliated broker/dealers featuring their affiliation and a description of their clearing arrangements
  - List of all broker/dealers, affiliated or unaffiliated, that to the advisor's knowledge received order flow payments or rebates related to executing transactions for client portfolios
  - Best execution report/documentation
  - Analyst reports

# DOCUMENTATION TO PREPARE FOR AUDIT

- Trading (cont.)
  - Trade Allocations
    - All IPOs and secondary offerings in which clients, proprietary accounts, or access persons participated and, if not stated in policies and procedures or if the allocation did not follow standard policies and procedures, information regarding how allocation decisions were made. For IPOs indicate whether shares traded at a premium when secondary market trading began. Report (preferred format Excel) should include:
      - ✓ Trade date
      - ✓ Security
      - ✓ Symbol
      - ✓ Total number of shares
      - ✓ Participating accounts

# DOCUMENTATION TO PREPARE FOR AUDIT

- Portfolio Management
  - Report (preferred format Excel) of names of securities held in all client portfolios (aggregate position totals for all instruments). Report should include:
    - Name
    - Name of each client holding an interest
    - Amount owned by each client
    - Aggregate number of shares or principal and/or notional amount held
    - Total market value of the position
  - Minutes of investment and/or portfolio management committee meetings, if such committee exists, and minutes are maintained
  - Names of any publicly traded companies for which employees of the advisor or its affiliates serve as officers and/or directors, and the name(s) of such employees

## DOCUMENTATION TO PREPARE FOR AUDIT

- Portfolio Management (cont.)
  - Names of companies for which employees of the advisor or its affiliates, serve on creditors' committees, and the name(s) of such employees
  - Report of firm's 10 most profitable and ten least profitable (including unrealized gain or loss) investment decisions based on total return of positions opened and closed for each investment strategy or mandate offered to clients. Report should include:
    - Purchase date
    - Sale date
    - Percentage of gain and/or loss
    - Dollar amount of gain and/or loss

# DOCUMENTATION TO PREPARE FOR AUDIT

- Brokerage Arrangements
  - Any documents created in the evaluation of brokerage arrangements and best execution
  - Soft dollar budget or similar document that describes the products and services the firm obtains using clients' brokerage commissions
  - Commission sharing arrangements including the name of the broker-dealer and total dollars allocated to each arrangement
  - All affiliated broker-dealers including a description of the affiliation and to their clearing arrangements
  - Securities in which the firm or an affiliate was a market maker

# DOCUMENTATION TO PREPARE FOR AUDIT

- Brokerage Arrangements (cont.)
  - Securities purchased for any client in which the advisor or an affiliate underwrote or participated as an underwriting manager, purchase group and/or syndicate or selling group and the underwriting date(s)
  - Policies and procedures with respect to trade errors and information related to any errors (e.g., a trade error log or file indicating account where error took place, reason for error, and details on corrective actions taken)



# DOCUMENTATION TO PREPARE FOR AUDIT

- Valuation
  - Names of all pricing services, quotation services, and externally-acquired portfolio accounting systems used in the valuation process and information about whether they are paid in hard or soft-dollars or a combination
  - Names of all fair-valued and any illiquid securities held by clients, a description of any fair value process employed including any testing and results and all fair value reports prepared or reviewed by a valuation committee
  - Supporting documentation for advisory fee calculations, including performance fees and the manner in which the fees were calculated

# DOCUMENTATION TO PREPARE FOR AUDIT

- Client Related Files/Reports
  - **List or other record of all accounts in which the investment adviser is vested with any discretionary power with respect to the funds, securities or transactions of any client.**
  - List of clients the advisor is receiving a solicitor/referral fee on (list should indicate who is paying the fee to the advisor)
  - List of clients the advisor is a sub-advisor to
  - List of all current clients (preferred format Excel), indicating those that are wrap clients, at a minimum list should include:
    - Account name
    - Account number
    - Current balance
    - Type of account (e.g. individual, defined benefit retirement plan, registered or unregistered fund)

# DOCUMENTATION TO PREPARE FOR AUDIT

- Client Related Files/Reports (cont.)
  - Whether the client is a related person, affiliated person or a proprietary account
  - Custodian- name and location
  - Whether the custodian sends periodic account statements directly to the client, whether delivery is electronic, and, if so, a copy of the authorization and the form of electronic delivery (e.g., email or website login)
  - Whether or not advisor has discretionary authority
  - Whether the Advisor, an officer, or an affiliate of acts as the trustee, co-trustee, or successor trustee or has full power of attorney for the account

# DOCUMENTATION TO PREPARE FOR AUDIT

- Client Related Files/Reports (cont.)
  - Whether the Advisor or a related person is deemed to have custody of, possession of, or access to the client's assets, and if so, the location of the assets
  - The investment strategy (e.g., global equity, high-yield, aggressive growth, long-short, or statistical arbitrage) and the performance composite in which it is included if any
  - The account portfolio manager(s)
  - Whether the client has a directed brokerage arrangement, including commissions recapture (provide the name of broker(s), purpose for such direction, details of the arrangement and any reports used to monitor payments of commissions)

# DOCUMENTATION TO PREPARE FOR AUDIT

- Client Related Files/Reports (cont.)
  - The value of each client's account that was used for purposes of calculating the advisory fee for the most recent billing period
  - Whether the client pays a performance fee and the most recent account performance figures
  - Whether the client receives account statements directly from the custodian
  - Whether advisory fees are paid directly from the client's custodial account
  - For client obtained during the examination period, provide account inception date and name(s) of consultants related to obtaining the client, if any

# DOCUMENTATION TO PREPARE FOR AUDIT

- Client Related Files/Reports (cont.)
  - A record of all trades placed for the advisor's clients (trade blotter)
  - The total value of assets under management for all clients combined.
  - List of all clients lost, including reason, termination date and asset value at termination
  - Names of any financial planning, pension consulting or other advisory clients not included in previously referenced list

# DOCUMENTATION TO PREPARE FOR AUDIT

- Client Related Files/Reports (cont.)
  - Individual Client Files
    - Executed agreement for services and fee schedule
    - New account forms and any additional documents gathered to establish the account and determine suitability
    - Additional account paperwork (e.g., trust documents, estate paperwork)
    - Written acknowledgment of receipt of Form ADV Part 2 (or old Part II and Schedule F) or similar disclosure document
    - Written grant of trading and discretionary authority
    - Investment guidelines/restrictions
    - Reports provided to clients (position or performance)

# DOCUMENTATION TO PREPARE FOR AUDIT

- Client Relate Files/Reports (cont.)
  - Proxy voting reports
  - Written instructions for clients directed brokerage
  - Fee invoices
  - Statements\*
  - Confirmations\*

\* Can be maintained separate from the individual client file



# DOCUMENTATION TO PREPARE FOR AUDIT

- Additional Misc. Reports/Documents
  - List of all current employees, including all advisory representatives and/or independent contractors, with date of employment and current position held
  - List of employees during past 5 years showing date of termination
  - List of all access persons for past 5 years showing date they became access person and, if applicable, date status as an access person terminated
  - List of all individuals providing investment advice on behalf of the advisor- all licensed investment advisor representatives
  - List of any employees who were disciplined and/or terminated and information regarding the reason for the action

# DOCUMENTATION TO PREPARE FOR AUDIT

- Additional Misc. Reports/Documents
  - List of all service providers including name, location, the services they perform for both affiliated and unaffiliated providers, information about the due diligence process to initially evaluate and monitor thereafter the work provided, and how potential conflicts and information flow issues are addressed
  - Due diligence files for solicitors, sub-advisors, and/or service providers
  - Names of any joint ventures or any other businesses in which the firm or any officer, director, portfolio manager, or trader participates or has any interest (other than employment with the Advisor), including a description of each relationship

# DOCUMENTATION TO PREPARE FOR AUDIT

- Additional Misc. Reports/Documents (cont.)
  - Licensing/Registration
    - A separate file for each investment advisor representative (IAR)
    - A copy of current originally signed Form U4
    - Copies of initial and renewal forms filed for the firm and each IAR
    - A list of all states that the firm is licensed or notice filed in
    - A list of all IARs indicating which states they are licensed to conduct business in
  - Information Processing, Reporting and Protection
    - Any written guidance used to comply with Regulation S-P, including addressing administrative, electronic and physical safeguards for the protection of customer records and information (“information security”)

# DOCUMENTATION TO PREPARE FOR AUDIT

- Additional Misc. Reports/Documents (cont.)
  - Documentation of controls of employees access (i.e., electronic key card entry, locks, security cameras, and guards) to physical locations containing customer information (i.e., buildings, computer facilities, and records storage facilities)
  - Documentation of electronic access to controls, including user authorization and authentication, firewall configuration, security advisories on vulnerabilities in software and hardware installation configurations, and implementing workarounds, security patches and upgrades.
  - Advisor's business continuity plan/disaster recovery plan

# DOCUMENTATION TO PREPARE FOR AUDIT

- Additional Misc. Reports/Documents (cont.)
  - Privacy Policy
    - A dated copy of the firm’s privacy policy
    - A copy of any previous privacy policies during past 5 years
    - List of clients that executed the “Opt-Out” provision of the policy
  - Correspondence with Regulators
  - Any threatened, pending, and settled litigation or arbitration involving the firm or any “supervised person” (if it relates to the individual’s association with the advisor or a securities-related matter) including:
    - A description of the allegations
    - The status
    - A brief description of any “out of court” or informal settlement

# DOCUMENTATION TO PREPARE FOR AUDIT

- Additional Misc. Reports/Documents (cont.)
  - Past Regulatory Deficiency Letters
  - Section 13D, 13F, or 13G Reports

## COMMON DEFICIENCIES

- Unable to provide documents to examiner in a timely manner
- Financial records not kept current
- Not maintaining employee and access person list
- No risk inventory or documentation mapping the adviser's inventory of risks to its written policies and procedures
- Historical documents not maintained properly (i.e., Form ADV, Code of Ethics, Written Supervisory Procedures)
- Not obtaining Code of Ethics acknowledgements (especially for new employees)
- Not maintaining records of Code of Ethics violations

## COMMON DEFICIENCIES

- Order Memorandum not maintained, does not contain all required information, does not indicate discretion or non-discretion, no memorandum for cancelled orders
- Unable to produce client reports with all required information
- Not maintaining a log of clients that requested a copy of the Form ADV
- Copies of Form U4s not kept and Form U4s not kept current
- Unable to locate solicitor, sub-advisor, or service provider contracts



## COMMON DEFICIENCIES

- Not maintaining due diligence records for solicitors, sub-advisors, third-party money managers, or service providers
- Not obtaining Personal Securities Transaction Reports for all access persons or inaccurate or incomplete reports
- Not obtaining Personal Securities Holding Reports or inaccurate or incomplete reports
- Not documenting review of personal securities transaction reports for all access persons
- Not properly protecting/securing client and firm records

## COMMON DEFICIENCIES

- No business continuity or disaster recovery plan or no proof/documentation to support testing of the plan
- Not performing WSP annual assessments or no documentation to support annual assessment or on-going testing being done
- Not maintaining trade error logs or reports
- No formal best execution review process or documentation
- Not maintaining current or accurate client suitability information
- Not maintaining reports/logs of terminated clients

## COMMON DEFICIENCIES

- Not properly tracking or indexing electronically stored records to permit ease of locating
- Not maintaining proper off-site back-up for electronically maintained records
- Not properly maintaining all business-related electronic communications
- Not maintaining historical copies of website after updates are made
- No record of approval of advertising/marketing materials
- Not maintaining proper backup documentation to support/backup performance claims

## General Recommendations

- Advisors need to look beyond the Books and Records Rule requirements
- Have procedures in place and someone assigned not only for retention but also for destruction of records, know that if records are retained for longer periods than what is required, regulators are entitled to review them
- Prepare some type of spreadsheet that tracks locations, retention period, responsible parties, format in which record is stored (i.e., electronic or paper), date record was last reviewed
- Train employees
- Once you receive notice of an examination – Do not destroy anything!
- If you do not have a document requested by an examiner, do not attempt to create and back-date the document

# About Us

- ✓ Served Over 700 Investment Advisor Firms
- ✓ Principals Are Industry Experienced Working in Compliance or Law Departments & Hold Professional Credentials
- ✓ Consult with Retail & Institutional Firms
- ✓ Offer Full Array of IA Compliance Services
- ✓ Reasonably Priced at Midwest Rates

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- **Annual Compliance Calendar Checklist**
- **Books and Records Documentation Log and Suggested List of Compliance Files and Reports**
- Broker-Dealer Best Execution Evaluation Form
- Client File Review Form
- Code of Ethics Acknowledgement Form
- Compliance Violations Reporting Form
- Compliance Manual Acknowledgement Form
- Compliance Training/Meeting Attendance Sign-in Form
- Permission to Disclose Personal Information on Behalf of Client
- Fee Audit Review Form
- Personal Securities Transaction Forms
  - Brokerage Account Disclosure Form
  - Annual/Initial Personal Securities Holding Report
  - Quarterly Personal Securities Transaction Report
  - Personal Securities Trading Request Form
- Customer Privacy Policy Notice (Sample)
- Customer Privacy Policy Notice Request/Receipt Log
- Form ADV Request/Receipt Log
- Form ADV Revisions Log
- Gifts and Entertainment Reporting Form
- Gifts and Entertainment Log
- Letter to Request Duplicate Confirmations & Statements
- Lost Client Form
- Lost Client Form Log
- Outside Business Activity Reporting Form
- Political Contributions Reporting Form
- Political Contributions Log
- Professional Designation Reporting Form
- Risk Assessment Questionnaire for Clients
- Social Media Review-Approval Form
- Trade Error Documentation Form
- Whistleblower Complaint/Tracking Reporting Form

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## Thank You

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Tammy Emsick

Senior Compliance Consultant

RIA Compliance Consultants, Inc.

877-345-4034 x 102

[temsick@ria-compliance-consultants.com](mailto:temsick@ria-compliance-consultants.com)

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