

*NRS Advanced Compliance Training &
Risk Management Techniques Conference
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Undertaking Risk Audits



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Undertaking Risk Audits

- Introduction
- Risk Audit - What is it?
 - Differences between Mock SEC audit and Internal / Risk Audit
- Regulatory Requirements - Is it required?

Best Practices / Required Practices?

- Investment Advisers Act Section 203(e)(6)
 - Failure to supervise - a Safe Harbor
 - Elements of Defense
 - Establish procedures reasonably expected to prevent and detect violations
 - Reasonably discharge duties and obligations
- Proposed Rule 206(4)-7
 - Adopt and implement reasonable policies and procedures to prevent violations
 - **Periodic reviews**
 - Chief Compliance Officer designation

Advantages & Disadvantages of Risk Audits

- Advantages

- Find violations
- Detect weakness
- Test policies & procedures
- Confirm records
- Educate
- Fix problems
- Instill atmosphere that is pro-compliance
- SEC comfort level & focus on internal controls

- Disadvantages

- Time
- Expense
- Staffing

Conducting a Risk Audit

- When
 - Periodically
 - Time from last SEC/state examination
 - Surprise or scheduled?
- Who
 - Internal Staff
 - Legal
 - Compliance
 - Internal Audit Department
 - Outside counsel
 - Outside accountants
 - Independent consultants
- What
 - Scope of Review
 - Identifying systemic problems

Conducting a Risk Audit

- How
 - Review SEC examination request lists
 - SEC's new risk module
 - Review policies / procedures for subject area
 - Analyze processes
 - Separation of functions
 - Approach to exceptions
 - Identify priorities
 - Review and test prior SEC deficiencies
 - Conduct interviews
 - Management
 - Department managers
 - Staff
 - Sample and test firm policies & procedures
 - Verify required records
 - Review disclosures
 - Discuss success/practicability of policies & procedures
 - Are they working?
 - Honest and open
 - Educate
 - Remote offices

Enterprise Audits for Large Firms

- SEC focus on complex compliance
 - Identified as problems with firm consolidations
 - Inconsistent compliance policies
 - Conflicting policies governing affiliated transactions
 - Uneven enforcement of policies
 - Insufficient communication among compliance personnel
 - Varying levels of awareness
 - Emphasized need for achieving “synergized compliance systems”

Enterprise Audits for Large Firms

- Range of Complex Wide Issues
 - Beneficial ownership reporting (13D/F/G)
 - Chinese wall/disaggregation policies
 - Big stakes in companies
 - Proxy voting
 - Possible 9(a) disqualification
 - Affiliated transactions
 - Transactions in affiliated issuers
 - ADV references to affiliates
 - Contract issues (e.g., affiliate indemnification & hold harmless clauses)
 - Internal Controls
 - Exception Reports
 - Compliance Checklists
 - Trade Allocation
 - Trade Errors
 - Pricing Issues
 - Overrides
 - Fair value pricing
 - Soft dollars
 - Different mixed use allocations
 - Insider trading procedures

Hiring Consultants

- Use of non-legal consultants
 - Hire through counsel (in- or out-house)
 - Their mandate should be to assist counsel in providing legal advice in connection with possible claims or litigation
 - Consultant's work product should be deemed
 - "work product" of hiring counsel
 - privileged & confidential

Results

- Written report
 - Advantages
 - Disadvantages
- No written report
 - Advantages
 - Disadvantages

Confidentiality / Privilege Issues

- What information is privileged?
- Protecting the privilege

Take Action

- Illegal Activities
 - Outside counsel
 - Regulators
- Prompt corrective action
 - Review with management
 - Review with department managers
 - Set timeline to correct deficiencies
 - Revise policies & procedures, if necessary
 - Prompt action (30 - 60 days)
 - Follow-up report to management
- Periodic follow-up reviews

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