Securities Industry Association

AUDIT GUIDELINES
INVESTMENT MANAGEMENT
(Compliance and Administration)

August 2005

The Audit Guidelines (the "guidelines") are intended to provide members of the Securities Industry Association ("SIA"), Internal Auditors Division with information for the purpose of developing or improving their approach towards auditing certain functions or products typically conducted by a registered broker-dealer. These guidelines do not represent a comprehensive list of all work steps or procedures that can be followed during the course of an audit and do not purport to be the official position or approach of any one group or organization, including SIA or any of its divisions or affiliates. Neither SIA, nor any of its divisions or affiliates, assumes any liability for errors or omissions resulting from the execution of any work steps within these guidelines or any other procedures derived from the reader's interpretation of such guidelines. In using these guidelines, member firms should consider the nature and context of their business and related risks to their organization and tailor the work steps accordingly. Internal auditors should always utilize professional judgment in determining appropriate work steps when executing an audit.

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I. INTRODUCTION

General Background

The investment management business has grown dramatically since the 1980's in terms of assets managed and the types of investment advisory services provided to the public. Investment advisory services include such activities as traditional mutual fund management company activities, fee-based money management services provided by independent advisers, and advisory services provided to private banking clients of financial institutions. This circumstance, along with the phenomenal success of mutual funds, the rapid development of the financial planning industry and the enormous growth in pension plan assets ensures an increasingly influential role for investment advisory services in the financial markets.

Investment management may be grouped into two broad types of businesses, mutual funds and investment advisory services. While there are similarities between the two, in large part the activities and requirements of each of these businesses differ significantly.

A mutual fund serves as a financial intermediary for investing funds of individuals or institutions. The fund receives monies in exchange for shares in the fund and invests these pooled funds primarily in publicly traded securities. A fund is "mutual" in the sense that all of its returns, less expenses are shared by the fund's shareholders. A mutual fund hires an investment advisor (i.e., management company) to manage the investments of the fund, and pays an advisory fee to the advisor under a management contract approved by the fund's independent directors. Each mutual fund has a principal underwriter, usually affiliated with its investment advisor, which organizes the sales of fund shares. Fund shares may be sold directly by the underwriter or through a broker/dealer network.

In an investment advisor relationship, an individual or institution hires an advisor to directly advise the individual or institution on investments. The basis for the relationship is a legal contract between the client and the advisor. An account is established for the client in which all activity arising from the advisory services is recorded. The advisor may or may not have discretionary authority over the account. Investment advisors may be independent firms that are in the sole business of providing investment advice to clients or may be part of a larger financial institution such as a broker/dealer or bank. Starting in early 2006, most, if not all hedge funds will have to be registered as investment advisors.

Both the mutual fund business and the investment advisory business frequently utilize third party service providers to perform required functions in lieu of building the necessary infrastructure themselves. Sometimes the service provider is an affiliated entity. Frequently, however, the service provider is an independent organization. Functions for which a service provider may be utilized include, among other things: portfolio management, trading, clearance and settlement, asset servicing, custody and shareholder services. Whether the service provider is an independent or affiliated entity a service level agreement should be executed, establishing a contractual arrangement for the services to be provided.

In auditing investment management activities it is important to distinguish the type of business under review since that will have a major implication on the risks and controls that should be present as well as the audit steps to be performed.

General Background

The investment management business encompasses a wide variety of activities, each with their attendant risks. These activities have been categorized into the following components:

- Portfolio management
- Operations
- Accounting
- Compliance
- Administration
- Sales and marketing
- Distribution

The above components will be covered in three separate guidelines. The activities encompassed in this guideline include compliance with legal and regulatory requirements and administration (including technology) of an investment management business. A separate guideline will cover portfolio management, trading, operations and accounting while a third guide line will cover sales, marketing and distribution activities.

This Audit Guideline for the compliance and administrative functions of an investment management business is intended as a tool to facilitate the internal auditor's determination and assessment of the potential risks inherent in those activities and the related controls that an organization may use to manage, monitor, and evaluate those risks. Also included are possible work steps that the internal auditor may perform to assess the adequacy and effectiveness of controls and processes used in the monitoring of compliance with regulatory requirements and administration over investment management activities.

Investment Company Act of 1940

The principal law regulating mutual funds is the Investment Company Act of 1940 (the 1940 Act). It imposes regulations not only on the funds themselves but also on their investment advisers, principal underwriters, directors, officers and employees.
The 1940 Act requires, among other things: registration with the Securities and Exchange Commission; daily pricing of its assets; restrictions on transactions between a fund and its manager; limits on leverage; governance practices, and; filing of periodic reports, including adherence to proxy rules.

Some of the key provisions of the 1940 Act include:

- Section 80a-8: Registration of investment companies
- Section 80a-10: Affiliations or interest of directors, officers and employees
- Section 80a-12: Functions and activities of investment companies
- Section 80a-15: Contracts of advisers and underwriters
- Section 80a-16: Board of Directors
- Section 80a-29: Reports and financial statements
- Section 80a-30: Accounts and records
- Section 80a-35: Breach of fiduciary duty

Investment Advisers Act of 1940

The investment adviser business is primarily governed by the Investment Advisers Act of 1940 (the Advisers Act).The Advisers Act was enacted, in part, to strengthen the fiduciary relationships between advisers and their customers. Allowing for certain exemptions, an adviser is defined as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the advisability of investing in, purchasing, or selling securities, or who for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities." The SEC has stated that investment advisers owe their clients several specific duties as fiduciaries, including: providing suitable advice, full disclosure of all material facts and potential conflicts of interest, utmost and exclusive loyalty and good faith, best execution of client transactions, and the exercise of reasonable care to avoid misleading clients.

In 1997 regulation of investment advisers was split between the SEC and the states. Advisers that manage more than $25 million of assets or advise a registered investment company must register only with the SEC. Although these firms do not have to register with the states, their representatives are required to be registered in states where they conduct business. Firms who manage under $25 million in assets must register in states where their principal place of business is domiciled. They do not have to register with the SEC.

Some of the key sections of the Advisers Act include:

- Section 80b-3: Registration of investment advisers
- Section 80b-4: Reports of investment advisers, misuse of nonpublic information
- Section 80b-5: Investment advisory contracts
- Section 80b-6: Prohibited transactions (anti-fraud provision)
- Section 80b-7: Material misstatements

Compliance

The highly regulated environment of the investment management business necessitates that an important priority be placed on the development of a strong monitoring system for compliance with regulatory requirements. Rule 38a-1 of the 1940 Act mandates that a registered investment company must:

- Adopt and implement written compliance policies and procedures
- Obtain approval for those policies and procedures from the fund's board of directors
- Perform an annual review of the effectiveness of the policy and procedures
- Designate a chief compliance officer charged with the responsibility of administering the policy and procedures

Rule 38a-1 applies equally to activities performed either internally or through external service providers. Consequently, there must be sufficient procedures in place to assess the effectiveness of controls over those activities performed by external parties.

The Advisers Act authorizes the SEC to take action against an investment adviser or any person associated with the adviser if they have "failed reasonably to supervise, with a view to preventing violations of" the securities laws, including the 1940 Act and the Advisers Act.

Particular controls over regulatory compliance will vary from organization to organization depending on factors such as size, method and scope of operation, internal structure and types of clients. However, certain principles should remain constant. First, there should be controls built into the systems and procedures at the operating level designed to prevent inadvertent or intentional violations. Secondly, a comprehensive compliance program should exist to monitor adherence to regulatory requirements. Such a system should include the generation of exception reports that identify potential violations and the procedures to be followed to determine whether or not those exceptions are in deed actual violations. Finally, those responsible for administering the compliance program must have a sufficient level of independence from the business unit and an adequate degree of authority so that they cannot be unduly influenced by business management.

The scope of an audit examination might be influenced if the auditor can conclude that there is a strong compliance program in existence and that it is administered by a group with the necessary independence from the business unit. In that case the auditor may reasonably decide that the emphasis of the examination may be directed towards the effectiveness of the independent compliance program, with less emphasis on the compliance related procedures employed at the business level.

In any audit of investment management compliance activities the focus of the review will be significantly impacted by the type of business conducted (i.e., investment company or investment adviser). The included guidelines indicate those risks associated with investment an investment company business (1940 Act) and those related to an investment adviser business (Advisers Act).

Risks/Audit Objectives

There are a great number of risks associated with an investment management business. This audit guideline specifically covers those risks arising from the compliance, administration and technology aspects of an investment management business. Those risks associated with portfolio management, trading, operations and accounting and the risks associated with sales and marketing matters are the subjects of audit guidelines dealing with those specific topics. For purposes this Audit Guideline the risks have been separated into two general categories. Those risks and the related audit objectives are described below.

Regulatory risk is the potential that violations of securities regulations might occur and go undetected.

> ***Audit objective:*** Ascertain that effective procedures are in place to (1) prevent and detect potential violations of securities laws; (2) follow-up and resolve potential violations, and; (3) ensure that a strong and independent compliance program is in place to monitor regulatory compliance.

Contractual risk includes the potential failure to comply with agreed upon investment guidelines or the failure of service providers to adhere to service level agreements.

> ***Audit objective:*** Verify that systems and procedures are in place to ensure that (1) agreed upon investment guidelines are adhered to, and; (2) service providers perform in accordance with service level agreements.

Technology risk is present in any environment where substantial reliance is placed on systems for conducting business activities. Ensuring that only authorized individuals can affect transactions, that adequate segregation of duties exists to prevent one individual from having end-to-end control of the process and that system integrity and availability is ensured is critical.

> ***Audit objective:*** Determine that systems are (1) properly safeguarded from unauthorized access, and; (2) protected from unintended disruption.

Audit Guidelines

The following guidelines are presented to assist the internal auditor in conducting a review of compliance, administration and technology activities for an organization's asset management business. It is important to note that these guidelines are general in nature and do not necessarily represent an exhaustive set of procedures for auditing these functions. Judgment should be exercised when determining the specific procedures to be performed and those procedures should be tailored to the environment being reviewed.

II A. AUDIT GUIDELINES

This guideline is intended to provide members of the Securities Industry Association, Internal Auditors Division, with information for the purpose of developing or improving internal audit programs. The information is designed to provide guidance to member firms in the preparation of procedures tailored to the specific needs of their individual environment. Internal auditors should always use professional judgment in determining the specific procedures to complete audit steps.

The numbered references in the "Risks to be Managed" section of the following tables are a cross-reference to the "Process Flowchart" included on pages 21 and 22 . These references are included for informational purposes and can be used to determine the potential areas of investment management that may be affected.

Regulatory Risk

Risks to be Managed	***Types of Controls to Manage or Eliminate Risks***	***Potential Audit Work Step***
Non-compliance with the requirements of the Investment Advisers Act of 1940 may expose the organization to regulatory sanctions, legal action and reputation damage. • Investment advisory activities are not properly registered, as required, under federal and/or state regulations (Section 203). • Investment advisory contracts are not obtained or contain provisions prohibited by regulation (Section 205). • Providing false or misleading disclosure statements to clients. • Personal trading of investment advisory personnel may breach the fiduciary responsibility of always acting in the best interest of clients.	• Registrations or notification filings for the organization and registrations for investment adviser representatives have been filed with the appropriate Federal or state governing authorities. ♦ A process exists for making required filings, specifying individuals responsible for preparation, review and filing. ♦ Filings are made prior to the start of business activities commencing. • An approved standardized form is used for investment advisory contracts. ♦ Changes to the standard contract require approval of legal and compliance. ♦ Signed contracts are obtained prior to commencing business.	• Review the process for registering the organization and its investment adviser representatives under Federal and applicable state registrations. ♦ Determine that the organization is properly registered. ♦ Verify, for a sample of investment adviser representatives, that they are properly registered as required under Federal and state regulations. ♦ Note that registrations are in effect prior to the commencement of advisory activities. ♦ Ascertain that the responsible individuals have prepared, reviewed and filed the registrations. • Review the standard investment advisory contract and determine that it provides an accurate representation of the services provided. Select a sample of advisory clients and: ♦ Verify that a signed contract is on file. ♦ Determine that any variations from the standard agreement have been approved by legal.

Regulatory Risk

Risks to be Managed	*Types of Controls to Manage or Eliminate Risks*	*Potential Audit Work Step*
• Inadequate procedures and controls could lead to the misuse of nonpublic information (Section 204A). • Client assets are not custodied in conformity with the exemptive provisions of the regulations (Section 206). (1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16)	• Disclosure statements are provided to clients prior to commencing business. ♦ Disclosures are accurate and properly reflect the operations of the advisory business. ♦ Disclosure documents require approval of legal and compliance. • Formal policies exist governing the personal trading of investment advisory employees designed to prevent employees from trading in their own accounts to the detriment of clients (e.g., front running). ♦ Employees are required to sign an annual statement that they have read and understand the employee trading policy. ♦ Employees are required to obtain compliance department pre approval for their trades. ♦ Compliance department monitors employee trading activity to ensure that employees have not traded improperly in relation to client trading activity.	• Obtain a copy of the disclosure statement (Form ADV or other disclosure brochure) given to existing or prospective clients. ♦ Review the disclosure document and ascertain that it does not contain any false or misleading information and that it includes the following: ▪ Advisory services and fees, including the basis for compensation. ▪ The types of clients for which advisory services are generally provided. ▪ The types of securities generally covered. ▪ Methods of analysis, sources of information, allocation procedures and investment strategies. ▪ General standards of education and business background required of advisory personnel. ▪ Other securities industry activities of the adviser (e.g., if a registered broker-dealer). ♦ Verify that the document has been approved by legal and compliance. ♦ If a document other than Form ADV Part II is used determine that the disclosures are consistent with those contained in Form ADV. ♦ For a sample of clients examine evidence indicating the date that it was delivered either physically or electronically. Verify that it was delivered timely.

Regulatory Risk

Risks to be Managed	*Types of Controls to Manage or Eliminate Risks*	*Potential Audit Work Step*
	♦ Employees are prohibited from investing in covered securities for a period of 30 calendar days prior to taking investment action through the date that investment action is complete. ♦ Employees are required to hold investments for a period of 60 calendar days. • Corporate policy specifically prohibits the exchange of non-public information between different areas of the organization. ♦ Areas of the organization with knowledge of non-public information (e.g., corporate finance, firm trading) are physically separated from areas that are restricted from having such knowledge. ♦ All employees have received training in procedures regarding information sharing. • Client assets are held at a "qualified custodian" as defined in the rules. ♦ Client assets may not be withdrawn or otherwise accessed from the custodian. ♦ Custodial agreement requires custodian to send quarterly statements directly to the customer.	• Review the policies and procedures for monitoring the personal trading activity of investment management personnel. Select a sample of employees and: ♦ Verify that the employees have signed an acknowledgment stating that they have read and understand the policy. ♦ Ascertain that reports of employee trading activity are produced and are reviewed by their supervisors and by compliance. ♦ Determine whether quarterly reports of trading activity are produced, distributed and signed by the employees attesting to the completeness and accuracy of the report. ♦ Verify that compliance department pre-approval is obtained for employee trades. ♦ Determine what steps have been taken in instances where pre-approval was not obtained. • Verify that employees are restricted from investing in covered securities for a period of at least 30 calendar days prior to investment action. • Review and test procedures for ascertaining that employees hold personal investments for a period of at least 60 calendar days. • See review of Compliance Department procedures (page 12) for additional steps.

Regulatory Risk

Risks to be Managed	*Types of Controls to Manage or Eliminate Risks*	*Potential Audit Work Step*
		• Ascertain that physical barriers exist between investment management personnel and other areas of the organization which may have knowledge of material non-public information. • Verify that investment management personnel have received training in the policies and procedures regarding restrictions on the sharing of information. • Ascertain that client assets are held at a "qualified custodian" as defined in the rules (e.g., bank, registered broker-dealer). • Review the custodial agreement and verify that: ♦ Client assets can not be accessed by the investment adviser (including automatic deduction of fees). ♦ The custodian is required and, in fact does, mail quarterly statements directly to the customer.

Regulatory Risk

Risks to be Managed	*Types of Controls to Manage or Eliminate Risks*	*Potential Audit Work Step*
Non-compliance with the requirements of the Investment Company Act of 1940 may expose the organization to regulatory sanctions, legal action and reputation damage. • Failure to register as an investment company with either the SEC or the appropriate states as required. • Making false or misleading statements in regulatory filings (e.g., Form ADV, prospectus). • Failure to comply with prospectus or Form ADV disclosures (e.g., investment objectives). • Insufficient representation on the board of directors by non-interested persons. • Fund performance is not calculated properly (e.g., in accordance with AIMR standards). • Personal trading of investment personnel may result in violations of SEC Rule 17j-1. (1, 2, 3, 4, 10, 11, 12, 13, 14)	• Registrations or notification filings for the organization as required under the Investment Company Act of 1940 have been filed with the appropriate Federal or state governing authorities. ♦ A process exists for making required filings, specifying individuals responsible for preparation, review and filing. ♦ Filings are made prior to the start of business activities commencing ♦ Filings contain complete and accurate information regarding, among other things: ▪ Policy with respect to the scope of business activities. ▪ Investment policies requiring shareholder approval to change. ▪ Name and address of each affiliated person and the name and address of every other company of which each such person is an officer, director, or partner. . • A group independent from investment management monitors compliance with prospectus or Form ADV disclosures, such as investment objectives.	• Review the process for filing for registration or notification under the Investment Company Act of 1940. ♦ Ensure that the individuals responsible for the preparation, review and filing are in fact performing those functions. ♦ Determine that the filings have been made prior to the commencement of business. ♦ Review a sample of filings and verify that they contain the information described under "Types of Controls." • Review the process followed to monitor compliance with prospectus or Form ADV disclosures and: ♦ Determine that it is performed by a group independent from investment management. ♦ Review exception reports indicating departures from stated disclosures and verify that appropriate corrective action was taken.

Regulatory Risk

Risks to be Managed	*Types of Controls to Manage or Eliminate Risks*	*Potential Audit Work Step*
	• Independent directors of the Boards of the funds comprise at least 75% (or 2 of 3 members) of the membership, including the Chairman of the board. • A group independent from investment management is responsible for calculating fund performance. ♦ Fund performance is automatically calculated in accordance with prescribed methodology (e.g., AIMR standards). ♦ Calculations are reviewed and approved by the area responsible before being published.\ • See "Risk of non-compliance with the requirements of the Investment Advisers Act of 1940" for controls and audit steps related to personal trading by investment management personnel.	• Verify that the Boards of Directors of the funds have sufficient representation by non-interested persons. • Review the process for calculating fund performance. ♦ Determine that the group responsible for performance calculations is independent from investment management. ♦ Examine a sample of calculations and verify their accuracy in accordance with the prescribed methodology. ♦ Verify that review of performance calculations is adequate and timely.

Regulatory Risk

Risks to be Managed	*Types of Controls to Manage or Eliminate Risks*	*Potential Audit Work Step*
The absence of an effective compliance program to prevent and detect potential violations of legal and regulatory requirements, increasing the risk that a violation will go undetected. (20, 21, 22, 23)	• Written policies and procedures designed to prevent and detect violations of Federal Securities laws have been implemented (Rule 38a-1 of the Investment Company Act of 1940). ♦ Such policies and procedures are reviewed and approved annually by the Board of Directors. ♦ An individual has been designated as Chief Compliance Officer. ♦ The Chief Compliance Officer provides a written report to the Board addressing the operation of the policies and procedures and any material compliance matters that have occurred. ♦ The Compliance Department receives periodic exception reports designed to detect potential violations of regulations. Exception items are investigated in order to determine whether a violation has occurred.	• Review the written compliance procedures for completeness and appropriateness. ♦ Determine whether the procedures have been reviewed and approved by the Board of Directors. ♦ Note whether an individual has been designated as the Chief Compliance Officer and whether such individual has sufficient access to the Board. ♦ Review the Compliance Officer's written report to the Board and ascertain that any material compliance matters noted therein have been adequately addressed. • Review the monitoring procedures followed by the Compliance for detecting possible regulatory violations. Examine exception reports utilized in the Compliance program and: ♦ Verify the completeness and accuracy of the reports. ♦ Ascertain that the reports are reviewed on a daily basis. ♦ Ensure that exceptions are appropriately followed up and resolved. ♦ Determine that there is adequate supervisory review of the work performed.

Regulatory Risk

Risks to be Managed	*Types of Controls to Manage or Eliminate Risks*	*Potential Audit Work Step*
	• Exception reports include, but are not limited to: ♦ Possible violations of personal trading policies. ♦ Indications of potential violations of misuse of insider information. ♦ Instances of non-compliance with stated investment objectives. ♦ Potential violations of investment restrictions.	
A code of ethics has not been established as required by: ♦ Rule 17j-1 of the 1940 Act ♦ Rule 204A-1 of the Advisers Act (24, 25, 26, 27)	• A code of ethics has been adopted and: ♦ Covers all required elements under the rules (e.g., personal trading by "Access Persons"). ♦ Has been approved by the Board of Directors. ♦ Is enforced by the Chief Compliance Officer (COO). ♦ Has been issued to all relevant employees who have been required to sign an acknowledgement of receipt. ♦ Exceptions to the code of ethics are reported to the COO and are researched and appropriate action taken. ♦ Holding reports and transaction reports are received from employees within required timeframes.	• Review the code of ethics and verify that it: ♦ Contains all required elements. ♦ Has been approved by the Board of Directors. ♦ Is enforced by the COO. ♦ Has been issued to all relevant employees who have acknowledged receipt. • Review the process for reporting code exceptions to the COO: ♦ Ascertain that exceptions are researched and appropriate action. ♦ Verify that appropriate reporting is made to the Board of Directors. ♦ Assess whether there is an inordinate number of exceptions and the reasons why. • For a sample of employees verify that holding and transaction reports have been received on a timely basis.

Regulatory Risk

Risks to be Managed	*Types of Controls to Manage or Eliminate Risks*	*Potential Audit Work Step*
Inaccurate regulatory filings or other required reports might result in regulatory exposure. • Form ADV or other disclosure document. • Semi-annual and annual reports. (33, 34)	• A calendar of regulatory filings is maintained by the group responsible for preparation and filing of required reports. • Reports are prepared and distributed for internal review prior to filing. • Portfolio management, senior management, compliance and legal review the reports.	• Review the calendar of regulatory filings and confirm that it is complete and accurate. • Verify the accuracy of a sample of reports. • Ascertain that the reports are reviewed and approved on a timely basis by, among others: ♦ Portfolio management ♦ Compliance ♦ Legal
Books and records are not maintained as required (Rule 204-2). (35)	• Books and records are maintained and preserved as required. • There is an appropriate segregation of duties concerning the preparation and maintenance of records. ♦ Access to the general ledger is restricted to those individuals as required by the job responsibilities (e.g., excluding portfolio management personnel). ♦ A record management system is in place that provides for a complete inventory of the books and records maintained and their location.	• Review the procedures followed for maintaining and preserving books and records: ♦ Confirm that the procedures comply with regulatory requirements. ♦ Select a sample of records stored both on-site and off-site and request that they be produced. ♦ Evaluate whether the records are produced on a timely basis. • Assess the adequacy of restrictions on access to key books and records (e.g., general ledger)
Annual fund proxy statements are not complete, accurate or mailed to shareowners on a timely basis, subjecting the organization to regulatory sanctions. (36, 37)	• A formalized procedure exists for preparation of annual fund proxy statements. ♦ A non-investment management group performs preparation.	• Review the proxy process for: ♦ Timeliness ♦ Accuracy ♦ Segregation of duties

Contractual Risk

Risks to be Managed	*Types of Controls to Manage or Eliminate Risks*	*Potential Audit Work Step*
Non-compliance with client or prospectus imposed investment restrictions could expose the organization to litigation risk. • Client/prospectus restrictions are not documented. • Client restrictions are impractical either to adhere to or to monitor. • No process exists for monitoring compliance with investment restrictions. (28, 29, 30, 31, 32)	• Client imposed restrictions are reviewed during the account acceptance process to determine whether they are reasonable and whether it is feasible and practicable to comply and monitor compliance. • Client/fund imposed investment restrictions are programmed to prevent or identify potential violations. ♦ Exceptions are monitored independent from fund/client management. ♦ Items identified are referred to portfolio management for prompt resolution. ♦ Reports are prepared daily and distributed to portfolio and senior management. .	• Verify that client imposed restrictions are reviewed for feasibility during the account acceptance process by someone independent from account/fund management. • Review the procedures for monitoring compliance with investment restrictions. ♦ Obtain a report or listing of all restrictions, either client imposed or per the prospectus and verify that, where appropriate, restrictions have been programmed to prevent non-compliance. ♦ Select a sample of restricted securities (per the prospectus for funds and from client instructions for managed accounts) and verify that their has been no activity in those securities. ♦ Examine exception reports identifying possible violations and determine that they have been referred to investment management for prompt resolution. ♦ Verify accuracy and completeness of daily reports of exceptions and ascertain appropriate distribution.

Contractual Risk

Risks to be Managed	*Types of Controls to Manage or Eliminate Risks*	*Potential Audit Work Step*
	• A committee comprised of members who are independent from investment decision making regularly review managed account or fund activity. ♦ In addition to reviewing investment performance, violations of compliance with investment restrictions are also reviewed.	• Review the minutes of the committee responsible for overseeing managed account or fund investment activities: ♦ Ascertain that the minutes contain a sufficient record of matters reviewed and actions taken by the committee. ♦ Determine that the actions taken with respect to violations of investment restrictions were appropriate and timely.
Service providers are not performing in accordance with regulatory requirements and service level agreements (SLA), exposing the organization to possible regulatory sanctions. (17, 18, 19)	Appropriate committee minutes of matters reviewed and actions taken are maintained • SLA's specify the roles and responsibilities of each party with respect to regulatory requirements: ♦ The legal and compliance departments have approved the agreements. ♦ Agreements are reviewed annually and modified as conditions change. ♦ Agreements require that service providers submit an annual SAS 70 report from its independent accountants. ♦ In the absence of a SAS 70 requirement the agreement includes a right to audit clause. • SAS 70 reports are reviewed and potential issues are followed up with the service provider.	• Review SLA's with internal and external service providers: ♦ Determine that the SLA's adequately define the roles and responsibilities of the parties concerning regulatory requirements. ♦ Verify that SLA's have been approved by legal and compliance. ♦ Confirm that SLA's are reviewed at least annually and revised as needed. ♦ Determine that SLA's include either a SAS 70 requirement or a right to audit clause. • Ascertain that SAS 70 reports are reviewed, potential issues identified and addressed with the service provider.

Technology Risk

Risks to be Managed	*Types of Controls to Manage or Eliminate Risks*	*Potential Audit Work Step*
Technology risk can lead to unauthorized system access and inappropriate authority levels as well as to loss of system availability: • System access is not appropriately restricted to authorized personnel. • Authorized users have the authority to perform functions that are not in line with their duties and responsibilities. • System program changes are not sufficiently controlled. • Disaster recovery is not adequate to ensure continued system availability and capability. (38, 39, 40, 41, 42, 43, 44, 45, 46)	• A responsible individual (e.g., system administrator) with no investment management responsibility controls all system access. ♦ Access forms are utilized to add, delete or change an individual's access. ♦ Forms must be approved by business managers. • Authority levels for users are established by the system administrator commensurate with their duties and responsibilities (i.e., no incompatible duties). • System access and authority level reports are periodically produced and reviewed by appropriate business managers to ensure access remains appropriate. • Individual user ID's and passwords are required. • ID's and passwords must be changed frequently. • Daily reports of all unsuccessful log on attempts are produced and reviewed by the system administrator. • Programmed controls automatically log system changes. • System changes are only made through an established change control process. Business continuity and disaster recovery plans exist and have been approved and tested	• Determine that the system administrator has no other investment management responsibilities. • For a sample of system users verify that approved access forms are on file. • Obtain system reports of user access and authority and: ♦ Determine that only appropriate personnel have system access. ♦ Ensure that user authority levels are commensurate with their roles and responsibilities. ♦ Reconcile access reports to payroll records. • Verify that system access reports are periodically produced and reviewed by appropriate business managers. • Select a sample of former employees who had system access and ascertain that their access was removed on a timely basis. • Ensure that user ID's and passwords are required and must be changed frequently. • Verify that the system limits log-on and input attempts. • Verify that system exception reports of failed log on's are reviewed daily. • Review logs of system changes and verify that changes are made through an established change control process. • Verify the existence and regular testing of a Business Contingency Plan. • Evaluate the adequacy of the back up plan in case of system unavailability.

II B. SEGREGATION OF DUTIES CHECKLIST

Introduction

Adequate segregation of duties reduces the likelihood that errors (intentional or unintentional) will not be prevented and remain undetected. The basic idea underlying segregation of duties is that no one employee or group of employees should be in a position both to perpetrate and to conceal errors or irregularities in the normal course of their duties. Additionally, errors may occur due to inadequate supervision of employee activity. In general, the principal incompatible duties to be segregated are: authorization, custody of assets, and recording or reporting of transactions. In addition, the risk management function as well as other oversight functions (Controllers, Compliance, Legal, Credit) should be separated from the functions that are originating risk itself and the processing of a transaction.

A practical method for using this checklist is to list the names of individuals responsible for particular functions. Review the checklist for individuals whose names are listed more than once and then make a determination whether that represents a potential lack of segregation of duties. Also consider whether individuals are performing incompatible duties. Once an individual is identified as performing incompatible duties, all duties performed by that individual should be challenged as to whether the effectiveness of those duties is reduced or eliminated by the lack of segregation of duties identified. Larger organizations may find it sufficient to list only the department performing each of these duties or functional job titles, rather than the names of individuals. Those companies could then evaluate whether any departments were performing incompatible duties.

Keep in mind that not all instances where an individual performs more than one function represent a lack of segregation of duties. In addition, it is important to remember that there is a possibility of a lack of segregation of duties within the same category. Consequently, completion of this checklist is intended to highlight potentially conflicting duties, not to be the only method of identifying all such conflicting duties. The segregation of duties checklist is located on the following page.

SEGREGATION OF DUTIES CHECKLIST

Registration

Who prepares requests for registration? _____
Who approves requests for registration? _____
Who files requests for registration? _____
Who prepares notification filings? _____
Who approves notification filings? _____
Who files notification filings? _____

Advisory Contracts and Disclosure Documents

Who establishes advisory contracts? _____
Who approves advisory contracts? _____
Who prepares disclosure documents? _____
Who approves disclosure documents? _____
Who distributes disclosure documents? _____

Client Assets

Who manages client assets? _____
Who custodies client assets? _____
Who has access to client assets? _____

Employee Trading

Who approves employee trades? _____
Who reviews employee trades and positions? _____

Code of ethics

Who establishes the code of ethics? _____
Who approves the code of ethics? _____
Who is responsible for compliance with the code of ethics? _____

Service Level Agreements

Who establishes service level agreements? _____
Who approves service level agreements? _____
Who monitors adherence with service level agreements? _____

System Access and Authority

Who is responsible for granting system access? _____
Who establishes user authority levels? _____
Who approves system access and authority levels? _____
Who reviews system access reports? _____

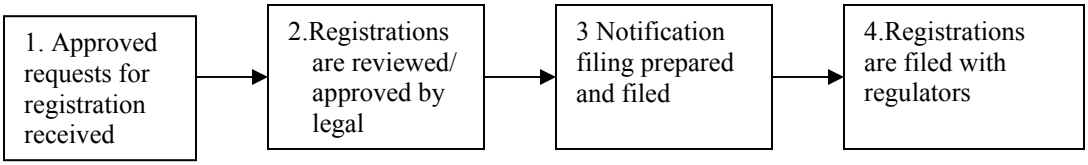
III. PROCESS FLOWCHART

The following flowchart illustrates some of the typical activities that take place in an investment management process. Definitions for the individual process steps are included below. Such definitions are numbered in order to cross-reference with the appropriate process steps.

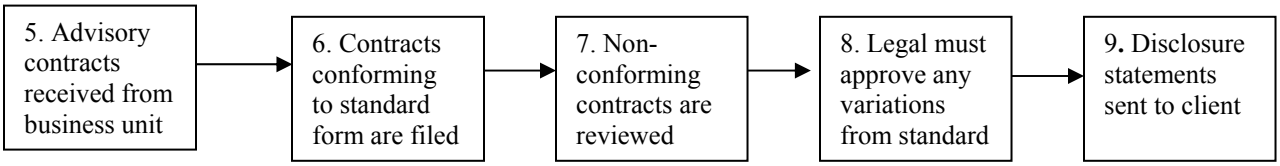
Investment Management Process Diagram Flowchart

Investment Advisor Activities

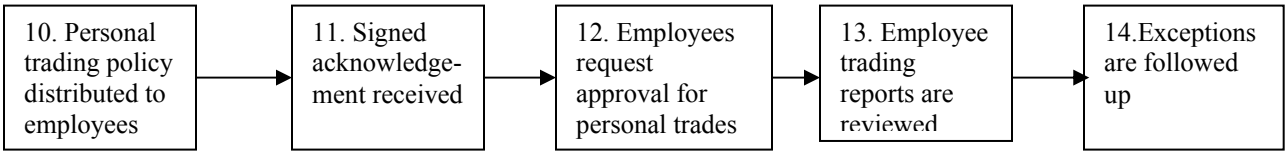
Registration



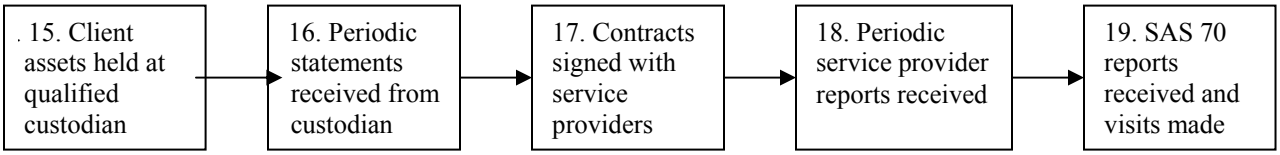
Advisory Contracts



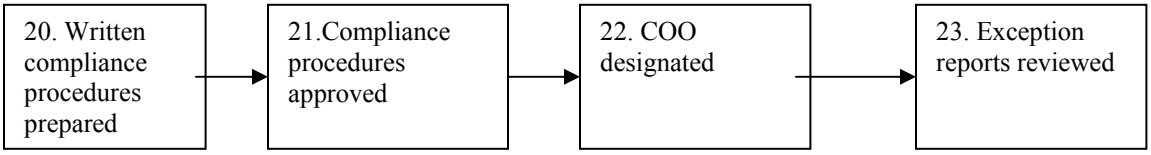
Employee Trading



Custody/Service Providers

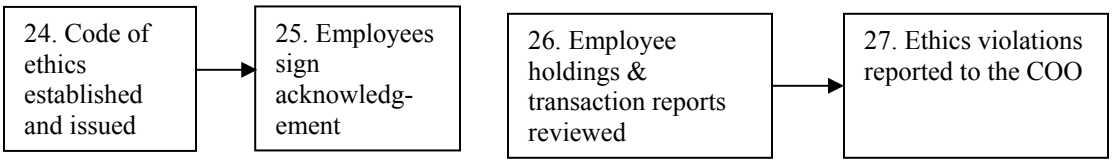


Compliance

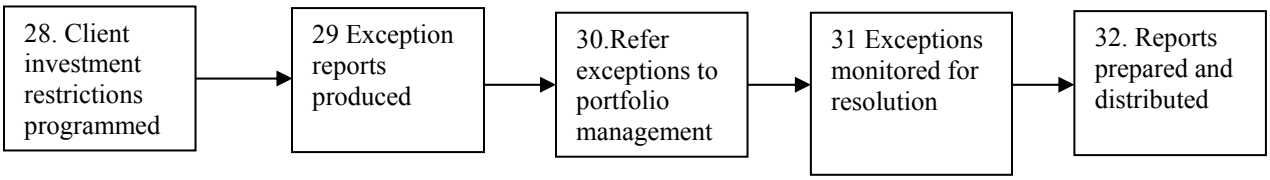


Investment Management Process Diagram Flowchart

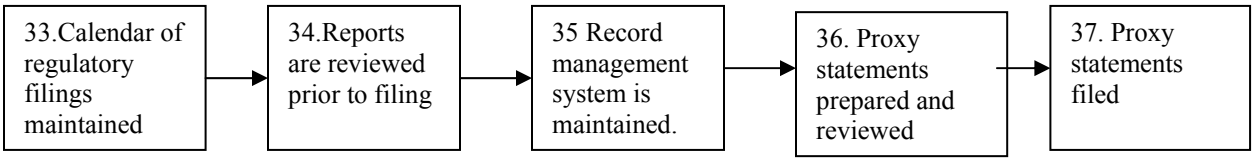
Compliance



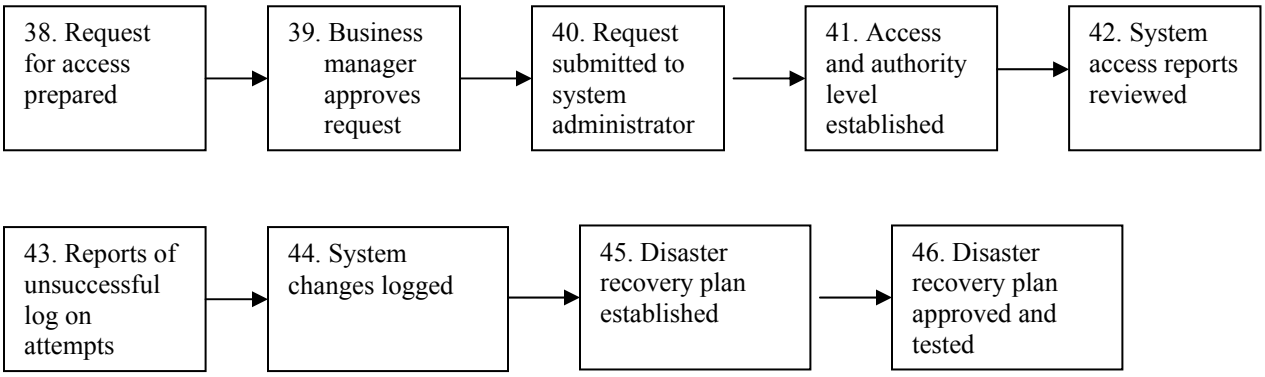
Investment Restrictions



Reports / Books and Records/Proxy



System Access



Definition of Process Steps

1. Requests for registration as an investment advisor are received from the business unit after being approved by the appropriate business manager. Notification filings for the organization as required by the Investment Company Act are prepared.
2. Registration forms are reviewed and approved by the legal department.
3. Notifications are filed prior to the commencement of business.
4. Registration applications are filed.
5. Investment advisory contracts are received from the business unit.
6. Contracts conforming to the standardized language are reviewed and filed.
7. Contracts that do not conform to the standardized language are forwarded to the legal department for review.
8. Legal must review and approve any variation to the standard contract.
9. Disclosure statements are mailed to investment advisory clients.
10. Personal trading policy is established and distributed to all employees.
11. Employees must sign an acknowledgement that they have read, understand and agree to comply with the policy.
12. Employees request pre-approval for personal trades.
13. Daily reports of employee trades are reviewed.
14. Any possible exceptions to firm policy are followed up with the employee.
15. All investment advisory client assets are kept at a "qualified custodian."
16. The custodian provides quarterly statements of holdings and activity directly to the client with a copy to the advisor.
17. Contracts are signed with service providers. Legal must approve all contracts.
18. The service provider sends periodic reports (e.g., daily, weekly, monthly). Reports are reviewed in order to monitor compliance with the service level agreement.
19. Annual SAS 70 reports are received for each service provider and reviewed. Periodic visits are made to each service provider.
20. Written compliance procedures designed to prevent and detect potential violations of legal and regulatory requirements are developed.
21. Compliance procedures are reviewed and approved by senior management, or in the case of investment companies, by the Board of Directors.
22. A Chief Compliance Officer is designated. For investment companies the Chief Compliance Officer is approved by the Board of Directors.
23. Daily exception reports of questionable activity are reviewed by compliance. Exception items are investigated.
24. An approved code of ethics is established and distributed to all employees.
25. Employees must sign an acknowledgement that they have received, understand and agree to comply with the code of ethics.
26. Employee holdings and transaction reports are reviewed for potential violations of the code of ethics.
27. Ethics violations are reported to the Chief Compliance Officer.
28. Client or fund investment restrictions are programmed into the order processing system to prevent, where possible, inappropriate investments.
29. Exception reports of questionable investments are produced.
30. Exceptions are referred to portfolio management or investment advisers for resolution.
31. Resolution of exceptions are monitored.
32. Periodic reports are distributed that show the incidence and cause of violations of investment restrictions.

Definition of Process Steps

33. A calendar of due dates for regulatory filings is maintained by the area responsible for making the filings.
34. Reports are prepared and reviewed prior to filing.
35. The record management system maintains a complete inventory of the books and records maintained, including their location.
36. Proxy statements for funds are prepared and reviewed.
37. Proxy statements are filed in accordance with regulations.
38. Request for system access form is prepared for individuals requiring access.
39. Appropriate business manager approves access request form.
40. Access request form is submitted to the system administrator.
41. System access and authority level is established after determining that authority level is consistent with the individual's responsibilities.
42. Periodically reports detailing who has system access and the level of their access are sent to business managers for verification.
43. System generated reports showing who successfully accessed system and who unsuccessfully attempted to access the system are reviewed by the system administrator.
44. System changes are automatically logged via programmed controls.
45. Business continuity and disaster recovery plans have been established.
46. Business continuity and disaster recovery plans have been approved and tested.