



CORE COMPLIANCE & LEGAL SERVICES, INC.
SOLUTIONS FOR TODAY'S BUSINESS

619-278-0020

SEC Provides Relief from PCAOB Inspection Requirements for Auditors to Private Funds

Under Rule 206(4)-2 of the Advisers Act (the "Custody Rule"), investment advisers to one or more private funds are deemed to have custody of the assets in the fund, and accordingly must implement certain procedures designed to protect those assets from loss, misuse or misappropriation. Under the Custody Rule, advisers with custody must generally undergo an annual surprise examination by an independent public accountant. However, the Custody Rule provides an exception from the surprise examination requirement for private funds subject to annual audit by an independent public accountant that is registered with, and subject to regular inspection by the Public Company Accounting Oversight Board ("PCAOB") in accordance with its rules (the "Annual Audit Provision"). Currently, however, PCAOB rules only subject auditors to public companies to regular inspection. Auditors to broker-dealers, for example, are required to be registered with the PCAOB, but may not be currently subject to inspection by the PCAOB.

Because many private funds are audited by independent public accountants that also act as auditors to broker-dealers, such auditors may be required to register with the PCAOB, but may not be subject to inspection. Therefore, such audits do not satisfy the requirements of the Annual Audit Provision, and may not be relied upon by advisers seeking to avoid the surprise audit requirement of the Custody Rule. Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act provides the PCAOB with the authority to develop rules regarding the regular inspection of auditors to broker-dealers.^[1] However, until these rules are adopted and take effect, many advisers would be unable to rely on the Annual Audit Provision of the Custody Rule, and such advisers would be subject to the surprise examination requirement under the Custody Rule or would be required to replace their current auditors until the new PCAOB inspection rules take effect.

To avoid this harsh result and the significant additional costs to advisers and investors in such private funds, the SEC recently granted no-action relief under the Custody Rule to permit advisers to continue to use their current auditors, so long as the following conditions are met:

- the auditor was engaged to audit the financial statements of one or more of the private funds for the most recently completed fiscal year;
- the auditor was registered with the PCAOB and engaged to audit the financial statements of a broker or dealer on July 21, 2010 and is registered with the PCAOB and engaged to audit the financial statements of a broker or dealer as of the issuance of audited financial statements used to satisfy the Annual Audit Provision; and
- the adviser provides written notification to each investor in each private fund prior to the distribution of the financial statements that the private fund's auditor is not subject to regular inspection by the PCAOB.^[2]

This relief applies only to financial statements issued prior to the adoption of rules governing the inspection of auditors to broker-dealers by the PCAOB or July 21, 2011, whichever is earlier. For any questions on this recent no-action relief, please contact us at (619) 278-0020.

[1] See Dodd-Frank Wall Street Reform and Consumer Protection Act § 982.

[2] Seward & Kissell LLP, SEC No-Action Letter (pub. avail. Oct. 12, 2010)

©2010 Core Compliance & Legal Services, Inc. | 5920 Friars Road, Suite 208 | San Diego, CA 92108 | Phone: (619) 278-0020 | Fax: (619) 278-0050 [Privacy Notice](#)