

July 13, 2009

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
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File Number S7-0909

Ladies and Gentlemen:

Thank you for the opportunity to offer comments on the proposed amendments to the custody rule under the Investment Advisers Act of 1940 and related forms.

DALBAR has been conducting third-party audits of advisers since receiving a No Action letter (enclosed) from the SEC in 1998 that exempted DALBAR Ratings from the testimonial rule. These activities were expanded with the passage of the Pension Protection Act of 2006, which required annual audits of Fiduciary Advisers.

The need for additional controls of investment advisers who have custody of client funds and securities is indisputable and an independent audit is a practical approach to meeting this need. For these audits to be successful they must not only detect but also deter attempts at fraud and abuse. With the billions of dollars at stake it should be expected that wrongdoers will construct elaborate and costly schemes to avoid detection.

The following are our concerns regarding the proposed amendments.

Surprise Audit

Considering the potential scale of fraudulent activities, it is unlikely that a surprise audit will be any more effective in detecting fraud than a scheduled event might be. The complexity of the business and today's technology make it virtually impossible to avoid leaving clues of fraudulent activity. Even if clues are missed in the first audit, concealing them in subsequent years would be extremely unlikely. We believe that effectiveness is achieved by a careful examination and following clues and aberrations that are observed.

The element of surprise would be effective if the fraudulent activity is expected to be of a casual nature. If this were the case the surprise would detect fraudsters while they were not paying attention. We do not expect there to be casual fraud but instead well planned and sophisticated schemes. Such schemes are seldom vulnerable to surprises. Specifically, in the Madoff case a surprise would yield no more insight than a planned review.

Comments on Proposed Amendments

The element of surprise adds a level of inefficiency to the audit since the required people may not be available, records may not be ready for examination and the coordination between adviser and custodian may take a longer time to complete.

The effect of the surprise audit is a more cumbersome and costly examination with little if any discernable benefits.

Duplicated Audits

We believe that it is also important to minimize the administrative and cost burden on the thousands of highly ethical advisers. It is for this reason that we suggest that those investment advisers who must undergo annual audits required for IRAs (IRC 4975) and ERISA plans (Section 408(g)) be permitted to combine these audits.

Since most investment advisers have clients with IRAs and/or 401(k), the majority of advisers would require duplicated audits.

The suggestion of combining these audits would require accepting the standards used in these other regulatory audits as well as meeting the requirements of the audits being proposed here.

Prerequisites for Auditors

We are concerned that the proposal does not include standards of independence of the auditors. Of great concern are firms that offer both audits and securities services. Without standards of independence, one firm's audit practice could audit another's investment practice and vice versa. Firms that provide any securities services should be prohibited from performing these audits.

Additionally, existing contractual arrangements between an investment adviser and an auditor could influence an examination or give the appearance of impropriety. We suggest a requirement that the contractual arrangement for the proposed audit should be the largest if not the only contract between the auditor and that investment adviser.

Thank you for your consideration;


Louis S. Harvey
President