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June 22, 2009

Mary Shapiro, Chairman
Elizabeth M. Murphy, Secretary
The United States Securities and Exchange Commission (SEC)
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File Number S7-09-09 and “Comments” on Custody of Funds or Securities of Clients by
Investment Advisers

Dear Ms. Shapiro and Ms. Murphy,

I trust this letter finds both of you well.

From the Bernie Madoff ponzi schemes to other notable investment fraud activities, I wanted to personally write to you regarding the proposed amendments to the custody rule under the Investment Advisers Act of 1940. As you are both well aware, your organization is currently seeking comments and recommendations for helping ensure sufficient oversight, due diligence and transparency are enacted on this now much maligned industry in our financial system. As such, my firm has provided explicit recommendations in regards to auditing these entities that perform critical, fiduciary activities and responsibilities relating to client funds and securities. Of notable concern are the technology safeguards and controls that should be incorporated as part of auditing investment advisers, advisers, or other related person(s). In short, we have provided a list of Information Technology and security (information systems) safeguards, commonly referred to as control objectives that should be required for these entities undergoing internal control audits.

Thus, enclosed are a series of responses in regards to *Custody of Funds or Securities of Clients by Investment Advisers*, [Release No. IA-2876: File Number S7-09-09]. As a PCAOB Certified Public Accounting (CPA) firm specializing in “internal control report(s)” and other related attest functions, we hereby offer responses to File Number S7-09-09 (the file). Furthermore, we are providing additional recommendations in strengthening the proposed amendments to the custody rule under the Investment Advisers Act of 1940.

Please note that our responses and recommendations are directed to the issues specifically related to the “internal control report”, commonly known as Statement on Auditing Standards No. 70 (SAS 70), under the AU Section 324 codification of auditing standards and to the recommendation of a “surprise examination”. We believe our firm’s years of expertise in

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working with the SAS 70 auditing standard allows us the opportunity to offer responses and recommendations to a critical amendment proposal relating to the Investment Advisers Act of 1940.

On behalf of NDB, Accountants and Consultants, our responses and recommendations are as follows:



Responses to Questions posed in File Number S7-09-09

“How would the timing of the internal control report relate to the timing of the surprise examination?” (page 24 of proposed rule)

Response:

We believe that the timing of the internal control report in relationship to that of a surprise examination is secondary in importance to the proper scoping and boundaries of the predefined control objectives. Thus, our response to the timing is open to other suggestions from qualified entities as we currently do not foresee a drawback or benefit to the timing at this point.

“Does it make sense to require both an internal control report and a surprise examination?”

Response: We believe that both entities: (1) “registered investment advisers that have custody of client funds or securities” and (2) “the advisor or a related person instead serves as a qualified custodian” undergo an internal control examination consistent with the AU Section 324 codification of auditing standards, thus a SAS 70 Type II audit. Both entities have fiduciary responsibilities relating to client funds and securities, and as such, there is no reasonable justification that we see as auditors for requiring one entity to undergo an audit, but not the other. The trust and the integrity of our financial system is dependant on full disclosure and transparency, thus both entities should have a SAS 70 Type II audit performed on an annual basis.

“Should we require that the independent public accountant that performs the surprise examination be a different accountant than the accountant that **prepares** the internal control report?”

Response: Greater clarification is needed in the language of this question as the word “prepares” assumes an “internal control report” is not being conducted, which we believe, based on the proposed rule, is incorrect language. The word “prepares” assumes a much lesser role and responsibility than that of one who “performs” an audit.

“Should we require that specific control objectives be addressed within the internal control report? If so, what control objectives?”

Response: We believe that a predefined set of control objectives is an absolute necessity based on the looseness of the SAS 70 auditing standard, which allows auditors to utilize control objectives at their discretion, resulting in omitting critical control objectives that should be included in the scope of this type of audit. We also recommend that the requirement for a “surprise examination” and “internal control report” be a SAS 70 Type II audit, not an Agreed Upon Procedure (AUP) engagement or any other type of internal control audit that auditors may employ. The listing of control objectives as stated in the proposed rules (page 23) are considered to be insufficient as they lack specific control objective descriptions for Information Technology



and security (information systems). We have provided a list of control objectives we feel will meet the intent and rigor for testing of information systems in the “Recommendations” section listed subsequent to this material being addressed.

Additionally, a number of questions have been posed regarding Public Company Accounting Oversight Company (PCAOB) registration for auditors that conduct surprise examinations and the internal control report.

Response: We believe that both sets of auditor, if a distinction is to be made, must be registered with the PCAOB. We have provided responses to these questions in the subsequent “Recommendations” section which discusses the advantages of PCAOB registration for independent public accountants that perform surprise examinations. We thus apply the same principles in our recommendations that independent public accountants who perform an internal control report also be registered with PCAOB.



Recommendations to File Number S7-09-09

In regards to the “surprise examination” by an independent public accountant, NDB recommends that the firm conducting the surprise examination indeed be registered with the Public Company Accounting Oversight Board (PCAOB), as the requirements for PCAOB membership help validate the independent public accountant as a credible and responsible entity capable of performing these audits. Non PCAOB independent public accountants engaging in surprise examinations may lack expertise by the simple nature of not being well-skilled or informed of PCAOB auditing standards and other related rules. These standards and rules are vital to the success of any audit, especially internal control audits, such as a SAS 70 Type II.

In regards to the selection of an independent public accountant for the surprise examinations, NDB recommends more explicit language on how this entity will be chosen. Will it be chosen by the PCAOB from an approved list of auditing firms or will the client choose the firm? More guidance on this topic would be greatly appreciated.

In regards to “Internal Control Report and PCAOB Registration and Inspection” for an “advisor” or “related person”, NDB recommends the following:

- Explicitly state that the “internal control report” be a SAS 70 Type II report. References are made to the SAS 70 Type II report, but stronger language enunciating this would provide greater clarity in using a SAS 70 Type II report versus an Agreed Upon Procedure (AUP) engagement for an “internal control report”. An AUP may very well lack the required scope and is seen as much more flexible and loose audit undertaking than that of a SAS 70 Type II, which would have predefined control objectives and tests for operating effectiveness.
- Expanding the control objectives relevant to “custodial operations” to include a list of “required” Information Technology and security (information systems) control objectives. Currently, only a brief mention of the “general control environment and information systems” is given. We believe a “required” list of information system control objectives would greatly strengthen the report. This is paramount as system access to client funds, other related assets, and any additional information can be compromised or exposed with weak I.T. and security controls. Other ancillary and supporting technology and security drivers must also be examined and included within the scope of the “internal control report”. Provided is a list of control objectives that would adequately examine and test the necessary Information Technology and security platform for an “advisor” or “related person” or other known material entity undergoing the “internal control report”. Additionally, if requested, we will provide you with the lists of tests to be conducted for each respective control objective.
 - Controls provide reasonable assurance that access to all system components (Network Devices, Operating Systems, Applications, Databases) and other components that require



authentication and authorization activities are limited to those who are authorized and access rights are commensurate with user roles and responsibilities within the organization.

- Controls provide reasonable assurance that formalized network policies and procedures are in place, secure data transmission protocols are utilized, and system components are appropriately hardened, configured, and monitored as needed for ensuring a secure environment.
- Controls provide reasonable assurance that data files are backed up in a timely and complete manner, backup logs are generated for appropriate review and critical system maintenance activities are undertaken on a regular basis.

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