

How to Master the Annual Review and Promote a Culture of Compliance

Part 3: Wrapping Up the Annual Review & Communicating with Regulators

By Elizabeth Cope

Review of Part 2: Testing & Reviews

In our previous article, we discussed:

- how to identify what to test to cover all areas pertinent to the firm.
- how to develop a testing and review schedule that is driven by the risk assessment, which you learned to develop in Part 1 of this series.
- how to conduct and document the testing to meet the expectations of the regulators and improve overall operations and the effectiveness of the firm's back office.

If you haven't read [Part 1: Create a Risk Assessment](#) and [Part 2: Testing and Reviews of How to Master the Annual Review and Promote a Culture of Compliance](#), we recommend doing so before reading Part 3 because they build on each other.

How to Wrap Up the Annual Review

In this article, we will discuss how to wrap up the annual review, including

- how to write a summary report (and why you would want to do so)
- how preparing and using a summary report can improve compliance buy-in and support from upper management
- how a summary report can demonstrate your commitment to compliance to regulators
- how to plan for the upcoming year, and
- how to communicate the results of the annual review to regulators.

Step 1: Write a Summary Report

Let me be clear. Writing a summary report is not an SEC requirement—unless you are the adviser to a mutual fund—but it is **valuable** for you to have one.

Drafting a summary of your annual review is beneficial because it is often requested by regulators as part of an SEC examination and by third parties looking to invest money with your firm. It is also an effective tool to substantiate and summarize the results for internal discussions with management staff.

The level of detail provided in a summary report may vary, based on the audience and the purpose. For example, many of our clients like to have two versions of the report, one that has extensive details and another that only references the areas covered and material issues. Our clients often provide the detailed version of the report to SEC staff and to management, whereas the brief report is more commonly provided externally, such as to third parties to satisfy due diligence requests.

If you decide a summary report is right for your firm, it would be a good place to:

- Mention new rules and regulations that came about during the year and how your firm is prepared to respond.
 - If the new rules and regulations are not applicable to your firm, document that with an explanation as to why.
- Identify significant events and material changes and how they may have impacted the firm's policies and/or risks.
- Reference the testing documentation and any exceptions.
- Finally, note any focus areas for the following year, based on the results of the annual review.

About the Author

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As with the entire annual review, the report should be tailored to fit the needs of your firm. Feel free to add more, if appropriate.

Step 2: Communicate the Results to Leadership

It is important to communicate the results of the annual review to the leadership of the firm.

You, as the CCO, need to be “empowered with full responsibility and authority to develop and enforce appropriate [compliance] policies and procedures for the firm” (Advisers Act, Rule 206(4)-7). In order for you to be empowered in your role, you need the full support of your leadership.

To obtain the support of leadership...knowledge is the key.

Leadership needs to understand what you do, why you do it, and the overall impact of compliance on the firm. Providing a summary of the annual review helps the leaders of the firm understand what is involved with compliance and what issues, if any, you need support addressing. This might involve financial resources for technology, staffing, or outside consulting. If leadership understands, it will create a stronger culture of compliance at the firm and make your job much easier and more effective.

The type of reporting you provide to leadership should be tailored to the specific needs and nature of your firm. No matter which method you choose, we highly recommend including a summary of upcoming rules and regulations to ensure management is aware of the potential impact of regulatory changes on the business.

Regulators understand the importance of leadership buy-in (often referred to as tone at the top) to support a culture of compliance. If you can substantiate to examiners your communication to leadership and their support and involvement in compliance, it will make your exam that much smoother.

Step 3: Plan for the Next Year

To plan for the next year and the next annual review, you will want to update your risk assessment, refine your testing items, adjust the testing schedule, and review and amend your policies and procedures.

Update Your Risk Assessment

To review and update your risk assessment, consider these three questions:

1. Within the last year, as you were conducting your annual review, did you discover any risks that were not previously identified or documented?
2. Are there any existing risk that have changed their level of risk, perhaps as a result of stronger policies implemented last year, or as a result of discovering violations in a particular area through your annual review?
3. Have there been any significant changes (e.g. new systems, new products, turnover) within your firm that posed new risks?

Refine Your Testing & Adjusting the Schedule

Refining your testing and adjusting the schedule is a much easier task in comparison to coming up with the testing in the first place. Once you have your testing schedule initially established, you simply modify as a result of the previous year's review and revised risk assessment.

Pro Tip #1: Keep a separate log of material violations, issues, and/or items of note for changes, **as you document the results of your testing throughout the year.** It will make planning for the next year **much** simpler. This way, you are not having to dig back months at a time to remember what the issues were.

If during the year the results of testing warranted zero violations, and the firm has a strong process in place, you could decrease the frequency of testing. The opposite could also be true. You could have an area that had some violations and therefore, to combat future violations, you could increase the frequency of review and oversight for the upcoming year.

I would also take into consideration OCIE's current focus areas and any other hot topics you gathered from conferences, roundtables, webinars, or news articles, and adjust your testing items and/or frequency accordingly.

Once you've considered how changes in your risks and changes in the industry may affect your testing, also consider

how the testing process went for you. Is there a way it could be done more efficiently? You might contemplate attempting to tackle the testing in a different way than was done previously.

Review and Amend Your Policies & Procedures

Determine if any policies need to change as a result of the testing & reviews conducted.

Pro Tip #2: At the beginning of the year, once your compliance manual is finalized, create a “work in progress” version of your current manual, and update it by redlining it (i.e., tracking changes) as the need for adjustments are identified throughout the year, or keep a separate log as described above. This is much easier than having to dig into your notes from months ago to determine what changes need to be made.

Training

It’s a good idea to conduct training with your staff on at least an annual basis. Upon completion of your annual review, you should have a good idea of the areas that your employees may need reminders about. For instance, if you had many violations on your policies for pre-clearance on personal trades, use this time to remind staff of these policies, the reason why you have the policies in place, and the importance of following them. It’s great if leadership can be present to support you. You can also discuss changes to policies, recent rules and regulations, and hot topics, such as cybersecurity.

How to Communicate the Results to Regulators

All SEC examiners and regional offices are different. Therefore, each SEC examination is unique, from the method of notification that you’ve been selected for an exam to the information and documents requested. However, examiners often request documentation to support the annual review, so it is best to be prepared for it.

To give you an idea what you might expect, below are some examples of items requested from a recent examination conducted by the Boston Office, along with our explanation of what the SEC is looking for. This is not the full request list, but rather the items that were requested, specifically related to the annual review.

Item Requested

Compliance policies and procedures, and the Adviser’s code of ethics that were in effect during the Examination Period.

Explanation

This encompasses all of your policies and procedures, including any policies and/or procedures that may be documented separately (such as your Business Continuity Plan). They will want to see all published version(s) used during the time period your examination is covering.

Item Requested

List of compliance risks that the Adviser had identified as part of its compliance process.

Explanation

Provide your risk assessment. We provided a risk assessment template, in Part 1 of this series, that you can use as a guide.

Item Requested

Risk assessment(s) conducted to assess conflict of interest risk, including steps taken to remediate and disclose such risk(s).

Explanation

Again, the SEC is asking you to provide your risk assessment. In the template we provided in Part 1 of this series, there is a section specifically to identify risks that require further disclosures.

Item Requested

Documentation maintained regarding any reviews conducted of the Adviser's policies and procedures during the Examination Period, include the most recent annual and/or interim reports.

Explanation

The documents you provide will depend on how you have your compliance program set up. We provide our clients with an Annual Review Organizer in Excel that encompasses every aspect of the annual review, from the risk assessment to the testing schedule and the support of all tests. Within the Annual Review Organizer, we document the testing that was completed, the findings, as well as a high-level summary. If your firm uses technology for this, you would need to export and provide reports from your system(s) as documentation in support of your reviews.

In addition to documentation of your testing, I would also provide the SEC staff any summary reports drafted, such as the ones discussed above.

If you are uncertain what they would like to see, I recommend setting up a call with the examiner to walk through your process and ask them what they would like to see. More than likely, they will request all documentation.

Item Requested

A record of any breach of the Adviser's compliance policies and procedures during the Examination Period and of any action taken as a result of such non-compliance.

Explanation

It's important to maintain a log of all violations and follow each up with the remedial action. It's important to demonstrate to the examiner that you have been able to identify violations through the annual review and quickly correct and make adjustments such as additional policies, training, and/or technology. This is also a good opportunity to remind your staff that it's important to follow the processes the firm has in place because all violations are reportable to the SEC.

Summary

By now you should have the resources and knowledge of how to:

1. create a risk assessment,
2. define your testing,
3. develop a testing schedule,
4. document the results of your testing,
5. write a summary report,
6. communicate the results of your annual review to management, and
7. prepare to communicate the results with regulators in the event of an SEC exam.

You should also have a better understanding of how the annual compliance review can help align and integrate compliance and operations, provide personnel an understanding of how their day-to-day tasks contribute to compliance, and give management the knowledge and awareness to make decisions that support you in your role... all contributing to creating a strong culture of compliance at your firm.

Our goal was to help you make your compliance program effective, efficient, and easy. We hope this series has provided you with the tools, guidance, templates, resources, and motivation to tackle your annual review with confidence.