Turloff Financial Consulting, Inc.
PO Box 11526, Bainbridge Island, WA 98110-5526 (206) 842-1422 E-mail: eric@turloff.com

July 22, 2009

Elizabeth M. Murphy, Secretary
U. S. Securities & Exchange Commission
100 F Street NE
Washington DC 20549-1090

Subject: File Number S7-09-09
Custody of Funds or Securities of Clients by Investment Advisers
Surprise Audit Requirement

Dear Ms. Murphy:

The Commission has proposed several revisions to rule 206(4)-2 under the Advisers Act. I oppose the provision in File Number S7-09-09 that requires Registered Investment Advisors that have custody of client funds or securities to undergo an annual surprise examination by a CPA. While I have no doubt that the intention of these revisions is to improve the safekeeping of investors' assets, I strongly believe this requirement would actually harm investors and do very little to detect fraud. Below is an outline of the basis of my opinion, along with a recommendation of steps that can be taken by the SEC to detect billing fraud.

Custody Rule

The SEC stipulates that any RIA that debits its fees from a client's account is considered to have custody of that account, despite the fact that an independent third-party broker, such as Schwab or TD Ameritrade, is the true custodian of the funds.

Harmful to investors

In order to nullify the surprise audit requirement, an advisor could choose to have clients send a monthly check for advisor fees rather than debiting the client's account. This seemingly simple step would prevent the advisor from being classified as a custodian of funds. Although this sounds like a simple change on the surface, in reality this change in billing procedures would drive up client fees unnecessarily.

For example, many investors using my services have their money in tax deferred accounts, such as IRAs. Since the accounts are tax-deferred, advisor fee debits are not subject to taxation. Some clients may find it necessary to take a withdrawal from their IRAs, resulting in early withdrawal penalties as well as state and federal taxes. In addition, this change in billing procedures would result in reduced efficiency due to the increased costs associated with the time to send out invoices, maintain accounts receivable, deposit checks, etc. Clients will see their taxes increase; consequently, their investment management costs could double.

Unduly burdensome to low-fee firms

Like John Bogle, founder of Vanguard, I believe that keeping fees low is very important. At Turloff Financial Consulting, Inc., we have built a business model based on low fees to our clients. It's a known fact that if you keep the client's fees low, their portfolios will grow faster and more income will be provided during their retirement years. As a result, our fees

are one-third of those big Wall Street firms receiving taxpayer bailout money. This regulation will drive up costs and force us to increase fees, directly impacting our clients' funds and affecting our ability to compete in the marketplace.

Fraud prevention measures are already in place

There are a number of requirements already in place to guard against the fraudulent conversion of assets by participants in the securities industry. For investment advisors, these include:

- Periodic audits and/or surprise inspections by federal and/or state securities regulators.
- The use of independent third-party custodians to hold clients' assets.
- Custodian review of fees. According to my custodian, Charles Schwab, the custodian reviews fees for reasonableness by comparing the fee to the account balance.
- Investors can review the fees on the invoice. At the end of every quarter, I generate an invoice that is mailed to the client along with my quarterly report. The client also receives statements from the custodian. The client can clearly see the amount deducted and compare it to their invoice. In addition, they can easily double-check my fee calculations if they choose. Any errors can easily be detected.

No evidence of harm as a result of fee deduction

NAPFA (The National Association of Personal Financial Advisors) has stated that they are unaware of any instance in which fee deduction has led to substantial misappropriation of funds from client accounts. While there have been some high-profile instances of financial advisors appropriating client funds, these have been limited to those who have had personal control of client accounts and who have not used independent third-party custodians. Because of this, advisors who have custody of client funds solely as a result of their authority to withdraw advisory fees from client accounts should be exempt from the surprise audit requirement, as it would be unfairly burdensome and provide no known benefit.

CPAs are not trained to detect fraud

As a CPA myself, I am qualified to discuss how effectively CPAs can detect fraud. CPAs are not effective in detecting fraud because:

1) CPAs are not trained to detect fraud. During my fourth year of college, I, like all CPA students, took my first and only auditing class. The first thing the professors tell you is that audits are not intended to detect fraud; rather, they evaluate the adequacy of internal controls and substantiate select balance sheet accounts.

   During my three decade career in the financial industry, I have had the opportunity to participate in many audits. In several situations I observed the auditor giving a clean opinion, only to have it discovered later that the auditee was perpetrating a fraud. In these cases the auditor did a proper job; however, the auditee was skilled in hiding certain items from the auditors.

Twice during my career I have had the opportunity to participate in fraud audits. The accountants conducting these examinations were not ordinary CPAs. First, they had significantly more education and training in the area of fraud auditing. In addition, when they looked at documents they did not just look for compliance with procedures, they examined how the documents were actually prepared.

2) Traditionally, CPA firms use young college graduates to perform audits. Frequently, their training is minimal. Junior auditors are usually told to do what the auditor did last year and often wind up copying last year's work papers. As a result, it is often easy for the auditee to outsmart the auditor.

3) CPAs have a longstanding history of failing to detecting fraud. We do not have to look very far back in history to find examples. To name only a couple -- Bernie Madoff's CPA did notice his Ponzi scheme, and CPAs at Arthur Andersen did not notice that Enron management was cooking the books. The list goes on and on.

What should the SEC do?

Thirty years ago, we would take our paychecks down to the bank, stand in a very long line, then deposit our checks. We would then go home, sit down with a pile of bills, write checks, put the checks into envelopes, lick stamps, drop the envelopes in the mailbox and pray that the payment was received and posted to our accounts in a timely manner. Sometimes the process would be delayed and we would get charged late fees.

Today, checks are electronically deposited into our accounts and almost all of our bills are paid electronically. Consumers have moved toward to a system of electronic movement of cash because it saves time, is more accurate and reduces costs. These types of productivity improvements have helped reduce costs to consumers and have promoted economic growth.

It is true that it is easier for dishonest people to cheat consumers; however, any consumer who reviews their statements can see potential irregularities. In addition, consumers are backed up by laws that have been enacted to recover any losses. RIAs are a small minority among businesses that automatically deducting fees from their clients' accounts. Rather than imposing additional costs that have questionable benefits upon RIAs, the government should consider how all electronic payments could be made safer while keeping costs low for the investing public.

However, if the SEC wishes to do more with respect to RIA payments, I believe you should concentrate your efforts in two areas:

1) **Investor education**

   Send a letter to investors outlining the process of fee deductions and what they should do to make sure the RIA deducted the correct amount from their account.

2) **Monitor fees deducted and make inquiries on an exception basis**

   If I was in your position and I wanted to find RIAs who are overcharging investors, I would go to the custodian of any account that is subject to fee debit and request them to electronically provide me with a month-end account balance for the past 12 months, along with a statement of fees deducted for those 12 months. I would then use that information to compute the annual fees as a percentage of the average account balance. If the fees exceed a predetermined amount, such as 1.5%, then I would give the advisor a phone call and ask them why. I would suggest that the advisor furnish the SEC a written explanation and copies of supporting documentation. If the supporting documentation includes the consumer authorization, fee schedules and work paper documenting the fee calculation, the SEC would be in a position to re-compute the fee and conclude whether or not the amount deducted from the investor's account was correct. As a CPA, I would be able to execute this procedure for minimal cost and I would get 100% coverage of all fees deducted.

The vast majority of RIAs are honest people who are trying to help their clients manage their financial affairs. The people like Bernie Madoff are few and far between. Implementing a mandatory audit for all RIAs would only increase costs for the investing public while not guaranteeing any benefit. I would hope the SEC will choose a less expensive path to weed out the Bernie Madoffs of the world.

The United States is one of the most productive countries in the world. As a result, our citizens enjoy more services at reduced costs … not because our businesses don't work hard or because they spend more money, but because we work smarter and spend less money to provide services. At Turloff Financial Consulting, we charge one-third of what most Wall Street investment firms charge. We can do this because we are making every effort to work smart, and I encourage the SEC to do the same.

Regards,

Eric E Turloff, CPA CFA
www.turloff.com