

SEC Enforcement Case Summary Failure to Timely Deliver Audited Financial Statements

On December 20, 2024, the SEC charged private fund manager, Driftwood Advisers, LLC, with violations of Rule 206(4)-2 (the **Custody Rule**) under the Investment Advisers Act for failing to timely distribute audited financial statements to private fund investors. The adviser agreed to pay a civil penalty of \$115,000 to settle the case.

The Custody Rule includes specific requirements to protect client assets over which an adviser has custody, providing an alternative to private funds for complying with several of those specific requirements when those funds are subject to an annual audit by a qualified independent public accounting with qualifying audited financial statements distributed to all limited partners within 120 days of the fund's fiscal year end (FYE) (aka "**audit provision**").

Driftwood purported to rely on the audit provision under the Custody Rule. However, the SEC found that the firm failed to timely deliver audited financial statements for fiscal years 2021 and 2022 and therefore violated the Custody Rule. The SEC order does not provide details regarding whether or when the audits were ultimately provided to fund investors. Further the case does not allege any harm or damage to investors as a result of such failure.

This case follows other Custody Rule enforcement sweeps and standalone cases against fund managers for failure to comply with the audit provisions. Private fund managers should ensure that fund audits are promptly engaged to conduct audits for any private funds for which the adviser is relying on the audit provision and actively follow the status of fund audits to ensure that they will be completed and delivered timely. If an audit is expected to be late, the firm should immediately consult with legal counsel and the compliance team to determine appropriate action. This is of particular importance if the completion of audits has been delayed in prior years or for more than one fund.

See Summary - <https://www.sec.gov/files/litigation/admin/2024/ia-6804.pdf>