



**PROTECTING THE INTEGRITY OF IDAHO FINANCIAL MARKETS SINCE 1905**

**Idaho Department of Finance  
Guidance Statement  
2023-01-SB**

**STATE REGISTERED INVESTMENT ADVISERS – GUIDANCE ON FINANCIAL  
STATEMENTS AND REQUIRED BOOKS AND RECORDS**

**ISSUE DATE: October 4, 2023**

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**I. Background**

In its administration of the Idaho Uniform Securities Act (Act), Idaho Code § 30-14-101, et seq., and the Rules issued pursuant to the Act, IDAPA Rule Chapter 12.10.08 (Rule), the Idaho Department of Finance (Department) regularly reviews applications and conducts compliance examinations of State Registered Investment Advisers (RIAs). The Department has observed increasing discrepancies relating to the accuracy and maintenance of RIA financial records including: 1) failures to accurately categorize or record RIA assets, liabilities, equity, and operations, and 2) commingling of outside business activities or personal expenses with RIA financial records. These discrepancies have resulted in increased concerns relating to RIA solvency compliance. As you know, RIAs are fiduciaries trusted by Idahoans to help them reach their financial goals; thus, the financial health of RIAs is essential. The following Guidance is intended to address the Department’s observations, as they relate to RIAs.

**II. Observations**

➤ **RIA Insolvency**

In examinations and in its review of RIA annual balance sheet submissions, the Department has noted increased concerns relating to RIA solvency issues due to 1) liabilities exceeding assets, resulting in a negative equity position, 2) misclassifications or omissions of liabilities, and 3) missing assets or inaccurate representations of equity investments.

➤ **Failure to Make and Keep Accurate, Current Books and Records**

As it relates to their investment advisory business, RIAs must make<sup>1</sup> and keep true, accurate, and current books and records, which include financial records relating to the RIA’s business.

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<sup>1</sup> See Rule 93 of the Act and 17 CFR 275.204-2 of the Investment Advisers Act of 1940.

### ***Noncompliance with Generally Accepted Accounting Principles***

The Department has observed that many RIA financial records do not appear to adhere to Generally Accepted Accounting Principles (GAAP), as required.<sup>2</sup> In some cases, RIAs have submitted balance sheets that do not balance.<sup>3</sup> Moreover, in violation of GAAP requirements, some RIA's accounting records have not included the appropriate classified line items within the balance sheet.

A classified balance sheet will itemize the sub asset, liability, and equity accounts within the balance sheet. For example, the current asset sub-category on a balance sheet may include bank accounts, cash, and pre-paid liabilities. Non-current assets, or assets meant for long-term use by the business, are commonly property, equipment, or long-term investments. Current liabilities can include rent, accrued expenses, accounts payable, and other short-term debt. Non-current liabilities are the debts a business owes but are not due to pay for the current year. Long-term loans and deferred tax liabilities are examples of non-current liabilities.

Recent filings of RIA balance sheets have also shown net income as a line item within equity. This does not fulfill the requirement of GAAP, as income should not be listed on the balance sheet. Rather, income would appear as a part of retained earnings on the balance sheet when properly journaled in the accounting system. The equity account would hold line items such as common stock, retained earnings, or dividends. Having the appropriate classified line items within total equity is required to maintain substantial GAAP standards.

### ***Inaccurate Reporting Due to Commingling of Outside Business Activities***

During examinations, we also observed instances of outside business activities being inappropriately commingled with RIA businesses. This practice resulted in inaccurate financial records as income, expenses, and liabilities were not recorded with the appropriate business. Additionally, misclassified transfers involving related businesses resulted in errors within the RIA's General Ledger and Income Statement.

### ***Inaccurate Reporting Due to Personal Expenses Not Related to the Business***

Our examiners also observed personal expenses not related to the RIA's business being recorded within the RIA's financial statements. In general, RIAs need to ensure that the financial information reflected in their financial records is accurate and pertains to the RIA's business.

## **III. Guidance**

To help RIAs understand their financial record responsibilities, please review the following guidance in accordance with the Department's rules, regulations, and GAAP standards:

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<sup>2</sup> See Rule 89.01(d) of the Act.

<sup>3</sup> The formula used to assess if a balance sheet will balance is the sum of liabilities and equity equaling the total of the business's assets (assets = liabilities + equity).

- RIAs must always maintain solvency. In the event a RIA is found to be insolvent, either because liabilities exceed assets or because the RIA cannot meet its obligations as they mature, the RIA’s registration application may be suspended or revoked.<sup>4</sup>
- In accordance with Rule 93 pursuant to the IUSA and 17 CFR 275.204-2 under the Investment Advisers Act of 1940, in part, the RIA is required to make and keep true, accurate and current financial books and records including:
  1. General and auxiliary ledgers (or other comparable records) reflecting asset, liability, reserve, capital, income, and expense accounts;
  2. A journal or journals, including cash receipts and disbursements, records, and any other record of original entry forming the basis of entries in any ledger;
  3. All trial balances, financial statements, and internal audit working papers relating to the business of the investment adviser as such;
  4. All checkbooks, bank statements, canceled checks, and cash reconciliations of the investment adviser;
  5. All bills or statements (or copies thereof), paid and unpaid, relating to the business of the investment adviser as such.
- According to Rule 89.01(d) of the IUSA, balance sheet submissions must be prepared “substantially in accordance with” GAAP requirements. Please review the RIA’s balance sheet to ensure the correct date and financial information is displayed before submitting it, in accordance with Rule 89.05(b) (within (90) days of fiscal year end). If you have questions relating to GAAP<sup>5</sup> requirements, setting up, or correcting a RIA’s accounting records, a financial professional, such as an accountant, should be consulted.
- A RIA’s financial books and records should reflect the RIA’s business and exclude unrelated personal or other outside business activities. If the RIA is involved in transfers between multiple business entities, appropriate records such as contracts and accounting journal entries that detail the nature of these transfers should be maintained and the income/expense associated with these entities should be correctly divided and recorded within the appropriate entity’s financial records.

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<sup>4</sup> Section 30-14-412(b) and Section 30-14-412(d)(7) of the IUSA.

<sup>5</sup> Guidance on where to list retained earnings and net income within the financials is provided within 17 CFR 210.5-03 and 17 CFR 210.5-02 under the Investment Advisers Act of 1940, respectively.

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**THE GUIDANCE IS AN AGENCY INTERPRETATION OF EXISTING LAW AND DOES NOT REPRESENT A NEW LAW OR LEGAL REQUIREMENT**

#### **IV. Summary**

Though not all inclusive, the above guidance is intended to assist registrants' compliance with the Act. In addition to the steps recommended in this Guidance, the Department encourages RIAs to consider adopting reasonable practices that will ensure the integrity of their general and auxiliary ledgers, trial balances, and financial statements. This may require professional guidance from a certified bookkeeper or licensed accountant as part of conducting ordinary business. If the RIA already has a financial professional, please ensure they are aware of the applicable requirements. In doing so, RIAs can support the Department in its mission to safeguard the financial health of Idahoans who trust and invest with RIAs.

Contact - You may direct comments or requests for additional information regarding this Guidance Statement to:

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