

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2429 / September 15, 2005

ADMINISTRATIVE PROCEEDING
File No. 3-12040

In the Matter of

JOSEPH W. LUTES,

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS
PURSUANT TO SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 (“Advisers Act”) against Joseph W. Lutes (“Respondent” or “Lutes”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over Respondent and the subject matter of these proceedings, Respondent consents to the entry of this Order Instituting Administrative Proceedings, Making Findings, and Imposing Remedial Sanctions Pursuant to Section 203(f) of the Advisers Act (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Nature of Proceedings

1. This matter involves willful aiding and abetting violations of Section 206(4) and Rule 206(4)-2 of the Advisers Act (the "custody rule") by Joseph W. Lutes, the Chief Financial Officer of CMS Fund Advisers, Inc. ("CMS"), an investment adviser registered with the Commission. The custody rule requires investment advisers that have custody of client funds and securities to retain an independent auditor to conduct surprise custody verifications of such funds and securities at least once during each calendar year. CMS had custody of client funds and securities because the firm and its principals had unrestricted access to, and control of, clients' assets for investing and payment of firm expenses, and did not qualify for an exemption. For the years 2001 through 2004, CMS had custody of client funds and securities but failed to perform the required annual custody verifications.

Respondent

2. Joseph W. Lutes, age 54, is a Pennsylvania resident, and has been a principal of CMS since 1998 and the chief financial officer from 1999 to May 2005. From January 2002 forward, Lutes was responsible for ensuring completion of CMS's custody verifications, including the engagement of an independent accounting firm to complete the verifications.

Other Relevant Party

3. CMS has been registered with the Commission as an investment adviser since 1982, and is located in Philadelphia, Pennsylvania. CMS provides advisory and administrative services to limited partnerships offered and controlled by the firm, and has over \$1 billion in assets under management.²

Facts

4. In 2000 and 2001, CMS had custody of client funds and securities but did not perform its annual surprise custody verifications as required by the custody rule.

5. The Commission staff accepted a CMS proposal in February 2002 to rectify the firm's non-compliance with the custody rule by (1) completing a custody verification for 2001 by March 31, 2002; (2) completing a surprise custody verification for 2002 during 2002 following the completion of the 2001 verification; and (3) completing annual surprise custody verifications

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

² The Commission instituted separate administrative and cease-and-desist proceedings against CMS arising out of the same events described in this Order

for each subsequent year in the corresponding calendar year in accordance with the custody rule. CMS also represented that it had engaged one accounting firm to complete all of the required verifications.

6. From January 2002 forward, Respondent was the senior CMS officer responsible for ensuring the completion of the custody verifications. He knew at the time CMS advised the Commission staff of its proposed compliance plan that the custody verifications could not be completed as represented.

7. Respondent engaged an auditor in February 2002 to perform only the 2001 verification for CMS. CMS did not complete the 2001 custody verifications until July 2003.

8. Respondent did not engage an auditor to begin the 2002 and 2003 custody verifications for CMS until April 2004. CMS completed these verifications in May 2005.

9. Respondent did not engage an independent auditor to perform the custody verification for 2004 for CMS until January 2005 and completed the verification in June 2005.³ In this verification, and in each preceding verification, CMS's auditors discovered no discrepancies in CMS's records of its investor's assets.

10. CMS failed to timely complete the custody verifications as described above, and Respondent knowingly and substantially assisted that failure. Respondent and CMS failed to timely engage an auditing firm for the 2002, 2003, and 2004 verifications, or to provide a specific deadline to the auditors.

Violation

11. As a result of the conduct described above, Respondent willfully⁴ aided and abetted CMS's violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 promulgated thereunder, as in effect at the relevant time, which prohibit an investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative, and which requires an investment adviser who has custody or possession of any funds or securities in which any client has any beneficial interest to verify such funds and securities by actual examination at

³ The Commission amended Rule 206(4)-2 effective November 5, 2003, by eliminating the surprise examination requirement if a qualified custodian sends quarterly account statements directly to the adviser's clients. CMS has had a qualified custodian providing the required quarterly statements since April 2004. CMS, therefore, was required to perform a custody verification in 2004 only for the period January through March.

⁴ "Willfully," as used in the Order, means knowingly committing the act that constitutes the violation. Cf. Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965).

least once during each calendar year by an independent public accountant at a time that shall be chosen by such accountant without prior notice to the investment adviser.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 203(f) of the Advisers Act, it is hereby ORDERED that:

Respondent is hereby censured.

By the Commission.

Jonathan G. Katz
Secretary