



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Clearing and
Intermediary Oversight

Thomas J. Smith
Deputy Director and
Chief Accountant

To: All Futures Commission Merchants
Attention: Chief Financial Officer
Subject: Audited Annual Financial Report
Date: February 8, 2007

The Division of Clearing and Intermediary Oversight (“DCIO” or “Division”) of the Commodity Futures Trading Commission (“CFTC” or “Commission”) is issuing this letter to provide guidance to futures commission merchants (“FCMs”) in meeting their obligation under the Commodity Exchange Act (“Act”) and Commission regulations to file an audited annual financial report with the Commission and with their designated self-regulatory organizations (“DSROs”).¹

FCMs are encouraged to provide this letter to their public accountants and those that assist in the preparation of FCM financial statements and other financial records. This letter is a supplemental reference only, as FCMs and public accountants are expected to be familiar with the Commission’s regulations governing the preparation and filing of their financial reports. Additional guidance on FCM minimum financial requirements is available in the Division’s “Financial and Segregation Interpretations” and its [Form 1-FR-FCM Instructions Manual](#), as well as in various no-action letters issued by the Division. Each of these references is available on the Commission’s website at www.cftc.gov.²

I. Filing Deadline: Commission Regulation 1.10(b)(1)(ii)

All FCMs are required to file an audited annual financial report with the Commission and with their DSROs within the timeframe specified in Commission Regulation 1.10(b)(1)(ii). For FCMs with a December 31, 2006 fiscal year-end, the required filing deadline is **April 2, 2007**. For FCMs that also are registered with the U.S. Securities and Exchange Commission (“SEC”) as brokers or dealers, the filing deadline for the annual financial reports is **March 1, 2007**.

¹ The Act is codified at 7 U.S.C. et seq. (2005). The Commission’s regulations are found in Title 17 of the Code of Federal Regulations.

² Audit and accounting guidance for FCM financial statements also is available in publications issued by the American Institute of Certified Public Accountants (“AICPA”). See AICPA Audit and Accounting Guide: “Brokers and Dealers in Securities” and AICPA Audit Practice Aid “Audits of Futures Commission Merchants, Introducing Brokers, and Commodity Pools.”

If an FCM finds it necessary to seek an extension of time for filing its annual audited financial report, the notification and other procedures required for requesting extensions are set forth in Commission Regulations 1.16(f)(1)(i)(A) and (B). These regulations provide that FCMs may obtain such extensions through requests made to their DSROs, or, for FCMs that are registered also as securities broker-dealers, through requests made by the FCM to its designated examining authority (“DEA”). FCMs are advised to note particularly that Regulation 1.16(f) requires FCMs to file with the Commission copies of any extension request that the FCM files with its DSRO, and also a copy of any subsequent approval or denial notice from the DSRO. If the FCM has filed an extension request with its DEA, the FCM must file a copy with its DSRO, and must file copies of the DEA’s approval or denial notice with both the Commission and its DSRO. A notice of approval from a DSRO or DEA is not deemed effective for the FCM’s annual audited report until the FCM has filed a copy of the notice with the Commission, and also a copy with the DSRO if the approval notice is from a DEA.

For purposes of these regulations, any copy that is required to be filed with the Commission shall be filed with the regional office of the Commission with jurisdiction over the state in which the FCM’s principal place of business is located. Commission Regulation 140.2 and the table at the end of this letter identify the delegated geographic areas of responsibility for each regional office.

II. Accountant’s Report on Material Inadequacies: Commission Regulation 1.16(c)(5)

Each FCM is required to supplement its audited annual financial report with a report on material inadequacies issued by the FCM’s public accountant. Depending on whether material inadequacies were found to exist, or to have existed, since the date of the previous audit, the accountant’s report will consist of either: (1) a statement that the audit did not disclose any material inadequacies; or (2) a description of any material inadequacies and the corrective action that the FCM has taken or proposes to take to address them.

In determining whether to report an item as a material inadequacy, auditors are reminded to test not only the financial statements, but also the following required regulatory supplementary schedules, which also must be audited:

- the Computation of Minimum Capital Requirements;
- the Statements of Segregation Requirements and Funds in Segregation for customers trading on U.S. commodity exchanges and for customers’ dealer option accounts (“segregated funds”); and
- the Statements of Secured Amounts and Funds held in Separate Accounts for foreign futures and foreign options customers (“secured funds”).

Furthermore, FCMs and their auditors are reminded that the term “material inadequacy” is defined in Commission Regulation 1.16(d)(2), and that the Division has provided additional

relevant guidance in Financial and Segregation Interpretation No. 4-1, issued in 1985.³ In keeping with Financial and Segregation Interpretation No. 4-1, errors in FCM financial reporting that result in changes of 10 percent or more in the FCM's excess net capital or its excess segregated or secured funds, or result in the FCM falling below required net capital "early warning" levels, require the FCM to file amended financial reports with the Commission.

III. Paper vs. Electronic Filing: Commission Regulation: 1.10(b)(2)(iii)

FCMs are required to file unaudited financial reports each month, and to file on an annual basis their audited financial reports. Commission Regulation 1.10(b)(2)(iii) requires that the Commission receive the audited annual financial reports of FCMs by mail or other physical delivery (a fax transmission is not acceptable).

The unaudited monthly financial reports of FCMs are filed with the Commission through an electronic application referred to as WinJammer. If amended, these amended monthly financial reports should be filed through WinJammer also.

Furthermore, FCMs are reminded that any amendment to audited or unaudited financial reports that are filed at the request of a DSRO or DEA must be filed with the Commission also.

IV. Reporting Material Differences between Unaudited and Audited Financial Reports: Commission Regulation 1.10(d)(2)(vi)

Commission Regulation 1.10(d)(2)(vi) requires that the audited annual financial report include a statement that no material differences exist between the audited annual financial report and the FCM's "most recent" corresponding unaudited financial report, or, if there are material differences, to include a reconciliation with appropriate explanations. If a reconciliation filed with an FCM's audited report identifies errors for which Financial and Segregation Interp. 4-1 requires amendment of the unaudited report, the FCM must amend its unaudited report accordingly.

The Division has noted that some FCMs, in order to avoid differences in the audited annual report and the monthly unaudited report filed at fiscal year-end, have amended their unaudited reports to incorporate adjustments that have been recommended by their independent auditors. Because these amendments have been made prior to filing their audited annual reports, these firms sometimes have claimed that they were not required to file reconciliations with their audited reports, as there were no differences between their audited reports and most recent amended monthly unaudited reports. FCMs should note that they cannot avoid filing reconciliations by filing amended monthly unaudited reports that eliminate any material

³ Financial and Segregation Interpretation No. 4-1, "Self-Regulatory Organization Surveillance over Members' Compliance with Minimum Financial, Segregation, Reporting, and Related Recordkeeping Requirements," can be accessed at the CFTC website at <http://www.cftc.gov/tm/tmint4.htm>.

differences with their subsequently filed audited annual financial reports.⁴ If such amended monthly audited reports have been filed, FCMs may evidence compliance with Commission Regulation 1.10(d)(2)(vi) by either of the following methods:

(1) By filing with the audited annual financial report a reconciliation that explains any material differences between the audited report and the year-end monthly unaudited report as originally filed; or

(2) By filing an amended unaudited monthly report that includes a reconciliation that explains any material differences between the amended monthly unaudited report and the original monthly unaudited report. Such reconciliations should be included in the amended electronic WinJammer filing in “general comments” under the “go to” tab. If a reconciliation is provided between the original and amended unaudited financial reports, the FCM’s audited report may be reconciled with the amended unaudited financial report, and should explain any material differences between the audited report and the amended unaudited report, or state that there are “no material differences between the audited and amended unaudited financial report dated [*month, date, year*].”

V. Exchange Memberships Excluded from Current Assets: Commission Regulation 1.17(c)(2)(x)

In connection with initial public offerings conducted by the Chicago Mercantile Exchange (“CME”), the Chicago Board of Trade (“CBOT”), and the New York Mercantile Exchange (“NYMEX”), and the recent merger of the New York Board of Trade (“NYBOT”) with the InterContinental Exchange (“ICE”), FCMs may own shares and/or trading rights in these organizations. FCMs should review the most current information in member advisories provided by these organizations concerning the required regulatory capital treatment for these shares and trading rights. In general, the following requirements apply:

- FCMs are reminded that all exchange memberships (or trading rights) owned by the FCM, whether or not held for investment, and any shares required for exchange membership (including clearing membership) must be reported on Form 1-FR Line 15 as a non-current asset, at cost. Additional guidance is provided on page 4-19 of the 1-FR-FCM Instructions Manual.
- Any other NYMEX, CME, CBT or ICE shares owned by an FCM should be reported in accordance with the instructions that page 4-3 of the 1-FR-FCM Instructions Manual provides for all other securities held by an FCM. As noted in the Manual, “marketable securities held by an FCM must be reflected at current market value,” while securities that are not readily marketable or “that are restricted as to their transferability” should be

⁴ The SEC, which has an identical regulatory requirement for securities broker-dealers, also has issued interpretive guidance to require a reconciliation statement despite the filing of such amended unaudited reports.

reported as “noncurrent assets.” Accordingly, any exchange shares owned by the FCM that are not required for membership should be:

- Included on Line 3 of the 1-FR (or lines 5 through 7 as appropriate) at market value;
- Reported as non-current assets if these shares are subject to transfer restrictions (e.g, “lock up” periods); and
- Reported as current assets if they are held free of restrictions. If reported as current assets, they are subject to the percentage haircuts set forth in SEC regulations, as noted in the 1-FR-FCM Instructions Manual.

VI. Required Oath or Affirmation: Commission Regulation 1.10(d)(4)

The audited annual financial reports of FCMs must include an oath or affirmation signed by an appropriate individual meeting the requirements of Commission Regulation 1.10(d)(4). A letter of attestation cannot be substituted for the required oath or affirmation.

VII. Replacement of Accountants: Commission Regulation 1.16(g)

FCMs are reminded to file the required notice with the Commission if they replace their accountant at any time, regardless of the reason for the replacement. The requirements for the notice are set forth in Regulation 1.16(g).

VIII. DCIO Contact Information

If an FCM or a public accountant has any questions on the foregoing, please feel free to contact the DCIO staff listed in the table attached as Appendix A.

Very truly yours,

Thomas J. Smith
Deputy Director and Chief Accountant

cc: Joint Audit Committee

APPENDIX A

Regional Office Locations	Contacts	Location of FCM's Principal Office
Eastern Region		
140 Broadway, 19 th Floor New York, NY 10005-1146	Ronald Carletta, Branch Chief Phone: 646-746-9726 FAX: 646-746-9937 E-Mail: rcarletta@cftc.gov	All states east of the Mississippi River, <i>except</i> Illinois, Indiana, Michigan, Ohio, and Wisconsin. Any location outside of the United States
Central Region		
525 West Monroe Street Suite 1100 Chicago, IL 60661	Frank Zimmerle, Branch Chief Phone: 312-596-0575 FAX: 312-596-0713 E-Mail: fzimmerle@cftc.gov	Illinois, Indiana, Michigan, Ohio, and Wisconsin
Southwestern Region		
Two Emanuel Cleaver II Boulevard, Suite 300 Kansas City, MO 64112	Thomas Bloom, Branch Chief Phone: 816-960-7710 FAX: 816-960-7750 E-Mail: tbloom@cftc.gov	All states west of the Mississippi River
Internet WebSites		
Commodity Futures Trading Commission	http://www.cftc.gov	
Code of Federal Regulations (Title 17)	http://ecfr.gpoaccess.gov	