February 1, 2002

To: All Commodity Pool Operators
Attention: Chief Financial Officer

Subject: 2001 Annual Reports for Commodity Pools

This is the fourth annual letter that the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission") is sending to all registered commodity pool operators ("CPOs") to share the results of the Division's experience reviewing prior years' annual pool reports. These letters are intended to assist CPOs and their public accountants in complying with Part 4 of the Commission's regulations under the Commodity Exchange Act ("CEAct") in connection with the preparation and filing of a pool's annual financial report. Previous letters (dated January 12, 2001, January 19, 2000, and February 10, 1999), are available at our website at www.cftc.gov/tm/tmcompliance.htm.

Because many of the deficiencies noted in this letter occur in reports for offshore pools, it may be helpful for you to share this letter with your offshore correspondents and their local auditors.

In order to avoid some of the most common and easily remedied deficiencies, please do the following:

- File one copy of the annual report with the National Futures Association (NFA) and two copies with the Commission at the regional office in whose jurisdiction the CPO's principal place of business is located (See Attachment A for addresses). [1]

- File the annual report as soon as possible, but no later than the due date. For pools with a December 31, 2001 year-end, the due date is Monday, April 1, 2002 (unless an extension of time has been granted). CPOs operating a fund-of-funds pool should review the streamlined procedures described in Regulation 4.22(f)(2) for claiming an extension of the due date (this topic is discussed below).

- Include a signed oath or affirmation, as required by Regulation 4.22(h), with each copy of the annual report filed with NFA, the Commission and all pool participants. Binding

[1] While Regulation 4.2 directs that materials required under Part 4 be filed at the Commission's Washington office, CPOs are strongly encouraged, and by this letter authorized (pursuant to Regulation 4.12(a) and 140.93(a)(1)), instead to file pool annual reports at the appropriate regional office of the Commission.

the oath as part of the report package or attaching it to the cover page is a helpful practice followed by a number of CPOs.

- If the pool is operating under the exemptions granted in Regulation 4.7 or Regulation 4.12, those regulations require that a notation of that fact be made on the cover page of the report.

- Report special allocations of partnership equity as required by CFTC Interpretive Letter 94-3, *Special Allocations of Investment Partnership Equity* (CCH ¶25943). This document is available on the Commission website at www.cftc.gov/tm/94-03.htm.

- Net Asset Value:

  - For unitized pools, include information concerning net asset value per outstanding participation unit in the pool as of the end of each of the pool's two preceding years.

  - For non-unitized pools, provide to each participant the total value of that participant's interest or share in the pool as of the end of each of the pool's two preceding fiscal years. Please provide *to the Commission and NFA* a schedule listing each participant's balances for those years. A code for each participant may be used in lieu of the participant's name. Of course, participants should not receive financial information concerning other participants.

- If the annual report is unaudited (pursuant to the exemption of Rule 4.7):

  - The pool operator must make a statement to that effect on the cover page of each report and state that a certified audit will be provided on request of a majority of the units of participation in the pool who are unaffiliated with the commodity pool operator.

  - The annual report must nonetheless be presented and computed in accordance with generally accepted accounting principles consistently applied.

  - The annual report must include appropriate footnote disclosures.

New Anti-Money Laundering Requirements

The International Money Laundering Act (AML) was enacted on October 26, 2001 as part of the USA Patriot Act. The focus of this new legislation is to identify and track entities and funds used for illegal purposes. It empowers the Department of the Treasury, in consultation with the Commission, to promulgate rules imposing obligations on, among others, CPOs. These regulations will likely be proposed and become effective in the coming months.

Applicability of GAAP to Commodity Pools' Annual Financial Statements

In reviewing prior years' annual reports, the Division has noted instances where CPOs filed pool financial statements that failed to comply with generally accepted accounting principles ("GAAP"). Commission rules require that financial statements of pools be presented and computed in accordance with GAAP, including disclosing risk concentrations (e.g., market and credit risk) and related party transactions, and recognizing the impairment of investment values. CPOs exempt from filing certified financial statements for certain pools they operate, such as pools qualifying under Regulation 4.7, also must compute and present their financial statements in accordance with GAAP. If a commodity pool's financial statements depart from GAAP, the CPO may be required to revise the pool's financial statements and send the revised statements to participants.

Investment Companies Guide

The recently revised AICPA Audit and Accounting Guide, *Audits of Investment Companies* (product number 012365), is effective for annual financial statements issued for fiscal years beginning after December 15, 2000. The Guide requires several new accounting and reporting standards, including: (1) a schedule of investments for commodity pools (see below), (2) disclosure of financial highlights[2], and (3) tax information regarding total distributable earnings and total distributions. A *Summary of New Accounting Standards* is included in the front section of the Guide.

On January 16, 2002, the AICPA Accounting Standards staff, assisted by industry experts, released questions and answers (Q&A's), commonly referred to as Technical Practice Aids (TPA) on the implementation by private investment companies of certain provisions of the Guide. The TPAs relate primarily to the method of disclosing financial statement highlights by private investment companies.

The TPAs will be included in the next update of the AICPA Technical Practice Aids, copies of which are available through the AICPA order department at (888) 777-7077.

Schedule of Investments Required for Calendar Year 2001 Annual Reports under GAAP

Non-public investment entities have been required to include a schedule of investments as specified by AICPA Statement of Position (SOP) 95-2, *Financial Reporting by Nonpublic Investment Partnerships (the Guide),* except for investment partnerships that were commodity pools subject to regulation under the CEAct, which were exempted. Recently, that exemption was revoked by AICPA SOP 01-1, *Amendment to Scope of Statement of Position 95-2, Financial Reporting by Nonpublic Investment Partnerships, to Include Commodity Pools*. The amended SOP 95-2 is effective for commodity pools' financial statements issued for periods ending after December 15, 2001, with earlier application encouraged. Therefore, commodity pools which are

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[2] Disclosure of total return required in the financial highlights schedule is computed based on the figures reported in that schedule. Although those presentation and computation methods differ from those required in offering documents by Regulation 4.35, the methodology set forth in the Guide should be used in financial highlights schedules included in annual financial statements.

subject to regulation by the Commission are required to include as a part of their financial statements, for the year ended December 31, 2001, a schedule of investments, as set forth in SOP 01-1. The Guide provides that investments in the securities of a single issuer should be disclosed if they exceed 5 percent of a pool's net asset value.

Fund-of-Funds Considerations

The Division continues to be concerned with the level of disclosure regarding a pool's investments in other investment companies. This topic accounted for a substantial portion of the non-compliance letters sent for prior years' annual reports.

Regulation 4.22(c)(5) requires annual reports to include appropriate disclosures and such further material information as necessary to make the statements not misleading (similar obligations are found in Regulations 4.7(b)(3)(C) and 4.12(b)(2)(iii)(A)). The Division believes that complete disclosure to the participants in a commodity pool requires that the pool's financial statements provide them information about other funds to which the pool devotes significant portions of its capital ("major investee funds"). The Division has long considered detailed income, fee and liquidity information for material investee pools and in total for all investee pools "material information," essential for full disclosure to participants. The objective is to allow the participants to see the performance of the pool's major assets and the fees associated with these investments.

Fees reported should include fees paid by the investee pool expressed in dollars. The Division recognizes that this information may not be easy to obtain, however, fund-of-funds managers are expected to make a good faith effort to obtain the required information. In those <u>unusual</u> cases where dollar amounts cannot be obtained and are unknown to the CPO, a statement to that effect should be made by the CPO and the percentages used by the investee to calculate fees should be reported as illustrated in Appendix B.

If a pool's investment in an investee fund is ten percent or more of the pool's net assets, the investee fund is considered a major investee fund. See Regulation 4.10(d)(5). Moreover, once there is at least one major investee fund, disclosure for all investee funds is appropriate (smaller funds may be aggregated and reported as a single group). The total of the net income or loss for each investee fund in the capsule information in the notes to the financial statements should agree with the single-line reported on the statement of operations for the investor fund's investment in other funds.

Even if no single investment is ten percent of the reporting pool's net assets, if the aggregate investment in other funds is at least 20 percent, the CPO should strongly consider providing the information discussed above with respect to the pool's investments in other funds, and should be prepared to justify a failure to do so. The CPO should exercise discretion in determining the best method of presenting this information. While it may not be necessary to provide information on each of the individual investee funds, the CPO should find an appropriate method of classifying the investments and reporting on each class.

Enclosed, as Attachment B, is an illustration that satisfies the objectives of fund-of-funds reporting. The disclosures in Attachment B should be made regardless of whether the investee funds are commodity pools.

There is a degree of overlap between the disclosure required for funds-of-funds and that required by SOP 95-2, discussed above. CPOs may combine these disclosures in one schedule or present them in separate schedules, depending on which method of presentation will yield greater clarity.

Master-Feeder Structures

In cases where a pool has invested all, or substantially all, of its net assets in one other pool (such as in a master-feeder structure), the investor pool may include either a schedule of investments in accordance with SOP 95-2 (see above) or complete financial statements of the investee pool with its financial statements. The financial statements of the investee pool should also include disclosures described herein for its own investee pools.

The Division considers the details of the investments carried by the investee pool as material information which is required disclosure to pool participants (see Rule 4.22(c)(5)). Accordingly, the schedule of investments at the investor pool level should contain the details of the investments carried by the investee pool. A schedule of investments at the investor pool level which simply lists the name of the investee pool is not sufficient.

Extended Due Date for Fund-of-Funds Pools

Revisions to Regulation 4.22(f) make it easier for fund-of-fund pools to obtain extensions of time for filing their annual reports. The revised rule permits CPOs to file a claim for an automatic extension of time to file the pool's annual report where the pool is invested in other collective investment vehicles, and the CPO's independent accountant cannot obtain the information necessary to comply with the rule in a timely manner.

Notices for the first year: The CPO's first notice claiming the extension must be filed within 90 days after the end of the pool's fiscal year (that is, by the normal deadline for filing the annual report). This notice must contain the following:

1) The name, main business address, main telephone number and the National Futures Association registration identification number of the commodity pool operator, and the name and NFA identification number of the commodity pool.

2) The date by which the Annual Report will be distributed and filed (the "Extended Date"). The Extended Date must be no more than 150 calendar days after the end of the pool's fiscal year, that is an extension of up to 60 calendar days.

3) Representations by the commodity pool operator that:

(A) The pool for which the Annual Report is being prepared has investments in one or more collective investment vehicles (the "Investments");

(B) The commodity pool operator has been informed by the certified public accountant selected to audit the commodity pool's financial statements that specified information establishing the value of the Investments is necessary in order for the accountant to render an opinion on the commodity pool's financial statements. The notice must include the name of the accountant; and

(C) The information specified by the accountant cannot be obtained in sufficient time for the Annual Report to be prepared, audited, and distributed before the Extended Date.

Before claiming the extension, the CPO must analyze the circumstances related to the operation of its pool and specify the period for which relief is needed. The CPO is not required to obtain a written statement from the independent accountant selected to audit the pool confirming that information in the CPO's notice. As noted above, however, the CPO will be required to name the independent accountant who has informed the CPO of the necessity of that information.

Notices for subsequent years: In subsequent years, the requisite representations may be made in a statement attached to and filed at the same time as the annual report.

The CPO responsible for the pool's operation must sign the notice or statement.

The revised regulations are available at the CFTC website (www.cftc.gov/foia/fedreg00/foi001226a.htm or .pdf.)

Applicability to Regulation 4.7 Pools. Under Regulation 4.7, CPOs may claim relief from the requirement that the exempt pool's financial statements distributed to pool participants be certified by an independent public accountant. Most CPOs operating pools for which relief under Regulation 4.7 has been claimed, nonetheless include certified financial statements in their annual reports. These CPOs may claim the relief provided in Regulation 4.22(f)(2).

This extension is applicable for fund-of-funds situations only. CPOs requesting extensions for other reasons or for whom the automatic extension period is insufficient must follow the provisions of 4.22(f)(1) and file those requests with the Commission's Washington office.

Materials Filed with the Commission's Eastern Regional Office (New York)

The Commission's Eastern Regional Office was located at One World Trade Center. When it collapsed, all pool documents at that location were lost, including comment letters and replies to them. Mail was delayed further due to the postal anthrax contamination.

The Division can generally obtain duplicate copies of annual reports and correspondence initiated by the Commission staff since duplicate copies of such material were typically filed with the Commission's Washington office and with the NFA. However, all pre-September 11 correspondence from CPOs is irretrievably lost. To assist the Division in rebuilding its files, CPOs may re-file any unique correspondence that they might have had with the Eastern Regional Office (description of organizations, transactions, etc.) along with their next annual report.

Further, in light of difficulties with mail delivery, due to changes in the location of the Office and the anthrax issue, the Division requests that any replies sent to the Eastern Regional Office between September 1 and December 31, 2001 be re-sent, preferably by E-mail or FAX, to the address set forth in Attachment A.

A few annual reports for 2000 were still pending review. Therefore, you might receive a deficiency letter concerning a 2001 annual report for items that were treated similarly in a year 2000 report.

Materials Filed with the Commission's Central Regional Office (Chicago)

The Commission's Central Regional Office will be moving as of the end of February, 2002. Please note the address in Attachment A.

New Pools – Initial Annual Reports

Regulation 4.22(g) provides that (a) a pool's initial annual report must be filed as of the first year-end after it begins operating, and that (b) the pool is considered to begin operations when the pool operator first receives funds, securities or other property for the purchase of an interest in the pool, even if the pool has not initiated trading. In cases where a pool commences operations within 3 months of the end of its fiscal year, the Commission may grant an exemption to the requirement to file a certified annual report as of its initial fiscal year-end. As a condition to the exemption, the Commission will require the CPO to file an annual report as of the end of its second fiscal year-end, which must include an income statement for the period from its commencement of operations to the second fiscal year-end. For the full requirements for such an exemption, please contact Kevin Walek, Assistant Director, at kwalek@cftc.gov or 202-418-5463.

Final Annual Reports

When a pool ceases trading, the CPO must file a final report as required by Regulation 4.22 (c). The final report should be in the same format and include the same information as the annual report, even if the final report is not for a full 12-month period. If the final distribution has not been made as of the balance sheet date, a subsequent event note to the financial statements should report the date on which all assets were subsequently, or are expected to be, distributed to the participants.

A CPO should clearly state when it intends a report to be its final report. A legend on the cover of the report is an effective way to do so.

Conclusion

In addition to noting the issues discussed in this letter, CPOs and their accountants should be familiar with the AICPA Audit and Accounting Guide, *Audits of Investment Companies* and the AICPA Practice Aid *Audits of Futures Commission Merchants, Introducing Brokers, and Commodity Pools*.

Additional information applicable to pools, such as exemptive, no-action, or interpretive letters from 1995 forward, is available at the Commission's website, www.cftc.gov/opa/opaletters.htm.

If you or your accountant have any questions on the foregoing, please feel free to contact the appropriate regional Division staff member listed in Attachment A to this letter.

Thank you for your attention to these matters.

Very truly yours,

John C. Lawton
Acting Director
Division of Trading and Markets

ATTACHMENT A

ADDRESSES OF CFTC's DIVISION OF TRADING AND MARKETS OFFICES

Regional Offices and Contacts		Location of CPO's Principal Office
Eastern Region Newport Tower, 21ST Floor 525 Washington Boulevard Jersey City, NJ 07310-1692 Ronald A. Carletta Al Goll Phone: (201) 234-6970/6976 FAX: (201) 234-6994 E-Mail: rcarletta@cftc.gov agoll@cftc.gov	*(Note: this office is scheduled to relocate in early Spring 2002, please check the CFTC web page for our new address and telephone numbers)*	All states east of the Mississippi River, *except* Illinois, Indiana, Michigan, Ohio, and Wisconsin. Any location outside of the United States
Central Region *Through February 27, 2002*: 300 South Riverside Plaza Suite 1600 North Chicago, IL 60606 John S. Dixon Phone: 312-886-3207 FAX: 312-353-3690 E-Mail: jdixon@cftc.gov	*Starting March 1, 2002*: 525 West Monroe Street Suite 1100 Chicago, IL 60661 Phone: 312-596-0573/0581 FAX: 312-596-0713	Illinois, Indiana, Michigan, Ohio, and Wisconsin
Southwest Region 4900 Main Street Suite 721 Kansas City, MO 64112 Ralph L. White Phone: 816-931-9502 FAX: 816-931-9643 E-Mail: rwhite@cftc.gov		All states west of the Mississippi River

NFA ADDRESS

National Futures Association
Compliance Department
200 West Madison 16th Floor
Chicago, IL 60606
Phone: 312-781-1300
FAX: 312-781-1467
website: nfa.futures.org

ATTACHMENT B

ILLUSTRATION – FUND – OF – FUNDS DISCLOSURES

Note X. Investments

As of December 31, 2001, ABC Fund invested in other funds, none of which were related parties.

The following table summarizes ABC Fund's investments in other funds as of December 31, 2001. Funds in which ABC Fund invested 10% or more of its net assets are individually identified, while smaller investments in three other funds are aggregated. The management agreements of the investee funds provide for compensation to the managers in the form of fees ranging from 1% to 3% annually of net assets and performance incentive fees ranging from 5% to 25% of net profits earned.

Investment	% of ABC's Net Assets	Fair Value	Income (Loss)	Fees Mgnt	Fees Incentive	Redemptions Permitted
Hejmat Fund Ltd.	11.2	$ 500,000	$145,000	$ 5,200	$ 30,000	Quarterly
Carron Int'l Fund	10.7	475,000	118,000	4,800	24,000	Monthly
Marvelous Fund NV	10.1	450,000	(24,000)	4,500	0	Semi-Annual
Other funds:	10.8	480,485	18,221	5,500	3,500	Monthly-Annually
Total	42.8%	$1,905,485	$257,221	$20,000	$57,500	

An alternative illustrative table, for *unusual cases*, where the fee information cannot be obtained is shown below:

Investment	% of ABC's Net Assets	Fair Value	Income (Loss)	Fees Mgnt	Fees Incentive	Redemptions Permitted
Hejmat Fund Ltd.	11.2	$ 500,000	$145,000	$ 5,200	$30,000	Quarterly
Marvelous Fund NV	10.1	450,000	(24,000)	4,500	0	Semi-Annual
Other funds:	10.8	480,485	18,221	5,500	3,500	Monthly-Annually
Subtotal	32.1	1,430,485	139,221	$15,200	$33,500	
Carron Int'l Fund	10.7	475,000	118,000	*	*	Monthly
Total	42.8%	$1,905,485	$257,221			

* = The fund operator is not able to obtain the specific fee amounts for this fund and does not know what those amounts are. However, management fees are computed based on 1% per year of net asset balances at the beginning of each month; incentive fees are computed based on 20% per year of net income.