U.S. COMMODITY FUTURES TRADING COMMISSION
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Division of Clearing and
Intermediary Oversight

Thomas J. Smith
Associate Deputy Director
and Chief Accountant

To: **All Commodity Pool Operators**

Attention: **Chief Financial Officer**

Subject: CFTC Observations on Annual Reports for Commodity Pools

Date: January 24, 2005

The Division of Clearing and Intermediary Oversight ("DCIO" or "Division") of the Commodity Futures Trading Commission ("CFTC" or "Commission") is issuing this letter to assist commodity pool operators ("CPOs") and public accountants with the preparation and filing of annual financial reports required under the Commodity Exchange Act ("Act") and Commission regulations.[1] This letter highlights several accounting and reporting topics, lists recent registration and other regulatory changes affecting CPOs and commodity trading advisors ("CTAs"), and notes common deficiencies observed in prior years' annual reports. CPOs, including those that operate in non-U.S. jurisdictions, are encouraged to provide this letter to their public accountants and others that assist in the preparation of commodity pool annual financial statements. Similar letters issued by the Division in prior years are available in the Compliance Information section of the CFTC Web site.

I. Accounting and Reporting Topics

A) Applicability of GAAP to Commodity Pool Annual Financial Statements

CPOs and public accountants should be familiar with the Commission's regulations in preparing and filing commodity pool annual financial statements, particularly the financial reporting requirements of Rules 4.22(c), (d) and (e). CPOs and public accountants also should be familiar with the interpretative letters issued by DCIO staff that impact commodity pool financial reporting requirements. One such letter is CFTC Interpretative Letter 94-3, *Special Allocations of Investment Partnership Equity*, which addresses how a CPO should report a special allocation of partnership equity to the general partner of an investment partnership in the financial statements of a commodity pool. Staff letters that provide written guidance concerning the Act and the Commission's regulations in the form of responses to requests for exemption, no-action and interpretation, including DCIO staff letters, from 1995 forward are available at the Commission's Web site.

[1] The Act is codified at 7 U.S.C. 1 *et seq.* (2004). The Commission's rules are found in Title 17 of the Code of Federal Regulations.

Commission rules require that commodity pool annual financial statements be prepared in accordance with U.S. generally accepted accounting principles ("GAAP"), applied on a consistent basis,[2] including disclosing risk concentrations (e.g., market and credit risk) and related party transactions, and ensuring all investments are reported at fair value. Accordingly, CPOs and public accountants should be familiar with the requirements for commodity pool financial statements that have been issued by the American Institute of Certified Public Accountants ("AICPA").

GAAP also requires that all significant accounting policies followed by an enterprise be disclosed in the notes to its financial statements (Accounting Principles Board Opinion 22). For commodity pools, one of the most significant, if not the most significant, accounting policy is how fair values of investments are determined. Accordingly, CPOs are reminded that such disclosures are required and should quantify values arrived at by the valuation methods specified in the AICPA Audit and Accounting Guide, *Audits of Investment Companies*, paragraphs 2.28 through 2.39.

The requirement that commodity pool annual financial statements be prepared in accordance with GAAP is applicable to pools that are required to distribute annual certified financial statements to pool participants, as well as to certain pools that, while required to distribute annual financial statements to pool participants, are permitted by Commission Rule 4.7 to elect to distribute unaudited financial statements. In reviewing prior years' audited and unaudited annual financial statements, instances were noted where CPOs filed pool financial statements that failed to comply with GAAP. If a commodity pool's annual financial statements do not fully comply with GAAP, the CPO may be required to revise the pool's financial statements and distribute the revised statements to the participants and refile a copy with the National Futures Association ("NFA").

B) Non-U.S. GAAP Reporting

Division staff has provided limited relief to CPOs of offshore pools to prepare and to present pool financial statements in accordance with International, United Kingdom or Irish accounting standards. In each case, the Division's relief was conditioned upon the offshore pools following certain key elements of U.S. GAAP standards, including: 1) determining fair values of investments as required using the valuation methods specified in the AICPA Audit and Accounting Guide, *Audits of Investment Companies*, 2) reporting of both realized and unrealized gains and losses through the statement of operations, 3) preparing a condensed schedule of investments,[3] and 4) reporting special allocations of partnership equity in accordance with CFTC Interpretative Letter 94-3.

CPOs that operate offshore pools and would like to request relief from the U.S. GAAP requirement may contact Ronald Carletta, Supervisory Auditor, or Al Goll, Auditor, at the phone numbers or addresses listed in Appendix A, for further information.

[2] See Commission Rules 4.22(d), 4.12(b)(2)(iii)(B), and 4.7(b)(3)(ii).
[3] As required by AICPA Statement of Position ("SOP") 95-2, subsequently amended by SOP 01-1 and SOP 03-4.

C) Reporting of Investments in Futures Contracts in the Condensed Schedule of Investments

AICPA SOP 03-04[4] specifies how commodity pools should report futures contracts in the condensed schedule of investments. SOP 03-4 requires a commodity pool to disclose the number of contracts, range of expiration dates, and cumulative unrealized gains (or losses) on open futures contracts of a particular underlying (such as wheat, cotton, specified equity index, or U.S. Treasury Bonds), regardless of exchange, delivery location, or delivery date, if the cumulative unrealized gains (or losses) on the open futures contracts exceed five percent of the pool's net assets. SOP 03-4 further provides that a CPO may not net long and short positions in futures contracts based upon the same underlying in determining whether the cumulative unrealized gains (or losses) of the open futures contracts exceed five percent of the pool's net assets. SOP 03-4 also requires a commodity pool, among other things:

- To disclose in the condensed schedule of investments the range of expiration or maturity dates and fair values of derivative instruments other than futures contracts based on whether the fair value of a specific type of derivative and underlying (for example, equity index of a particular stock exchange, U.S. Treasury Bond, natural gas, etc.) exceeds, on a gross basis, 5 percent of the pool's net assets, regardless of counterparty.

- To disclose the name, investment objective, and redemption restrictions of any investment in a nonregistered investment partnership that exceeds five percent of the pool's net asset value. (See Section D, *Fund of Funds Disclosures,* below for additional Part 4 requirements for pools that operate as funds of funds.)

- To calculate required ratios for average net assets, expenses and net investment income as detailed in the SOP.

D) Fund of Funds Disclosures

GAAP requires a commodity pool that invests over 5 percent of its net assets in nonregistered investment partnerships to disclose certain information about such investments. Specifically, SOP 03-4 requires the disclosure of the name and investment objectives of such nonregistered investment partnership, as well as any restrictions imposed upon redemptions. By requiring such disclosures, GAAP recognizes that a pool's financial statements should provide information about investments in other funds to which the pool devotes significant portions of its capital.

The Division has long believed that CPOs should report amounts of income and fees for nonregistered investment partnerships in which they invested significant portions of their capital as such information is deemed material for participants to fully comprehend the investment strategy of the CPO. Accordingly, CPOs are strongly encouraged to disclose amounts of income and fees associated with investments in nonregistered investment partnerships that exceed five

[4] AICPA Statement of Position 03-04, *Reporting Financial Highlights and Schedule of Investments by Nonregistered Investment Partnerships: An Amendment to the Audit and Accounting Guide Audits of Investment Companies and AICPA Statement of Position 95-2, Financial Reporting by Nonpublic Investment Partnerships.*

percent of the pool's net assets. The five percent threshold is consistent with the reporting thresholds set forth in SOP 95-2 and SOP 03-4 for nonregistered investment partnerships. See Attachment B for an illustration of how such information may be reported.

E) Master-Feeder Structures

Paragraph 7.06 of the AICPA Audit and Accounting Guide, *Audits of Investment Companies*, permits nonpublic feeder pools either to follow the disclosure and reporting provisions of SOP 95-2 or to present a complete set of master financial statements with each feeder financial statement. CPOs that elect to present a complete set of master financial statements with each feeder financial statement should bind the two reports together as a single document and distribute the bound reports to the participants and file a copy with NFA. If that is not possible, an acceptable alternative is to staple the back cover of the feeder annual report to the front cover of the master annual report for at least the copy filed with NFA. This would help ensure that reports are reviewed as a complete unit.

F) New Pools – Initial Annual Reports

A CPO that commences operation of a commodity pool is required to prepare an annual report for the pool within 90 days of the pool's year-end, even if the pool did not operate for a full 12-month period. A pool is deemed to commence operations upon the initiation of investment activities on behalf of participants, and not solely upon the receipt of participants' contributions.

The Commission may grant a CPO an exemption from the requirement to prepare a certified annual report as of the pool's initial year-end date in cases where a pool commences operations within three months of the end of its fiscal year. The exemption generally is conditioned upon the CPO commencing operation of the pool within three months of the end of its initial year-end date and the CPO filing with NFA and distributing to pool participants year-end unaudited pool financial statements that are prepared in accordance with U.S. GAAP and otherwise complying with Commission rules. The exemption is further conditioned upon the CPO filing a certified annual report as of the date of the pool's second year-end and must include an income statement covering the period from the commencement of operations of the pool through the date of the pool's second year-end date. For the full requirements for such an exemption, please contact Kevin Walek, Assistant Director, at kwalek@cftc.gov, or (202) 418-5463.

G) Final Annual Reports

Commission Rule 4.22(c) requires a CPO to file with NFA and to distribute to pool participants a final annual report whenever a pool ceases trading. This requirement also is applicable for pools that have claimed an exemption under Rules 4.7 or 4.12. The final report should be in the same format and include the same information as an annual financial report, even if the final report is not for a full 12-month period. If the final distribution of pool assets has not been made as of the balance sheet date, a subsequent event note to the financial statements should disclose the date on which all pool assets were subsequently, or are expected to be, distributed to the participants. A CPO should clearly state when it intends a report to be a final report. A legend on the cover of the report is an effective way to do so.

The final report is due within 90 calendar days after the end of the pool's fiscal year or the permanent cessation of trading, whichever is earlier, but in no event longer than 90 days after the assets are distributed to pool participants.

II. Pool Annual Financial Reports and Registration of CPOs and CTAs

The following contains summaries of certain rules relevant to pool annual reports. Please consult the full text of the Commission's Part 4 rules for more detailed information.

A) Pool Annual Financial Reports

- ***NFA Pilot Program permitting electronic filing of pool annual reports with NFA.*** NFA has implemented a voluntary pilot program for pool annual reports for the year ending December 31, 2004 that will permit CPOs to file electronically with NFA. NFA's electronic filing system, which uses the Internet-based EasyFile system, has three components. First, the CPO must submit a PDF version of the full annual report, including the balance sheet, income statement, schedule of investments, footnotes, and the independent auditor's opinion, if applicable. Second, the CPO must directly enter approximately 30 key financial balances into a standardized form. These balances will be obtained from the balance sheet, income statement and statement of changes in net asset value included in the pool's PDF filing, and the system will also include on-line instructions to help CPOs determine which amounts to include in the electronic schedule. Third, when the CPO submits the electronic filing, the system prompts the CPO to read and agree to an electronic oath or affirmation. This oath or affirmation covers both the information included in the PDF annual report and the financial data entered in the schedule of key financial balances.

  CPOs are required to maintain records indicating where the key financial balances reported on the EasyFile schedule appear in the complete annual report. In addition, CPOs are required to maintain a manually signed copy of the annual report in their records, as specified in Rule 4.22(j)(2), and to provide it to NFA upon request. The Commission has provided exemptive relief to CPOs that participate in the pilot program from the requirement of Rule 4.22(j) that the annual report filed with NFA contain a manual signature (CFTC Letter No. 05-01). To use EasyFile, CPOs can go to NFA's website, www.nfa.futures.org. Under the Compliance Heading on NFA's Home Page, click the Electronic Filings drop-down menu and select EasyFile (Pool filers).

- ***Permitting electronic distribution of account statements and annual reports to pool participants.*** CFTC Rule 4.22(h) permits CPOs to distribute periodic account statements and annual reports to pool participants by electronic means. Prior to transmission of any account statement or annual report to a pool participant by means of electronic media, a CPO must disclose to the participant that it intends to distribute these documents electronically, absent objection from the participant no later than 10 business days following receipt of the disclosure. CPOs must maintain a manually signed copy of each account statement or report distributed electronically; and, unless they are participating in NFA's pilot program for electronic filing, CPOs must include a manual signature on the oath or affirmation that accompanies the annual report filed with NFA.

B) Effect of Claiming Recent Part 4 Relief on Currently Registered CPOs

A CPO that withdraws from registration pursuant to relief claimed under Rules 4.13(a)(3) or (4) remains subject to the annual report requirement of Rule 4.22(c), as has been the case with CPOs that have withdrawn from registration for any other reason. The Commission believes that when a CPO leaves direct CFTC oversight, the CPO's pool participants should get all of the information they are entitled to under Commission regulations up to that time. Accordingly, CPOs generally will not be permitted to withdraw their CFTC registration until they file an annual report for the last year for each pool that was operated subject to direct CFTC oversight and the annual reports have been reviewed by NFA.

The relief under Rules 4.13(a)(3) or (4) is available to CPOs on a pool-by-pool basis. A registered CPO may claim this relief for its existing pools that meet the criteria for the relief; however, the CPO remains subject to the requirement to file final annual reports for these pools for the last year that the pools were operated prior to claiming exemption. If a person that is eligible for exemption from registration as a CPO under 4.13 does not claim such exemption and nonetheless registers as a CPO, the person must comply with all relevant Part 4 rules. This includes the filing deadlines for a pool's annual report.

III. Common Deficiencies Observed In Prior Years' Annual Reports

Each year the Division provides a listing of common deficiencies noted in prior year financial reports. Generally, the types of deficiencies have remained relatively consistent over the last several years. However, the frequency of the occurrence of the deficiencies has been greatly reduced. In order to avoid some of the most common and easily remedied deficiencies, CPOs should do the following:

- File one copy of the annual report with NFA at the address set forth in Attachment A below. CPOs are not required to file copies of any such reports with the Commission. In addition, applications for extensions of time to distribute annual reports that do not exceed 90 days from the due date need be filed only with NFA.

- Distribute the annual report to the pool participants and file one copy with NFA as soon as possible, but no later than the due date. For pools with a December 31, 2004 year-end, the due date is Thursday, March 31, 2005 (unless an extension of time has been requested and granted). CPOs operating a fund of funds pool should review the streamlined procedures described in Rule 4.22(f)(2) for claiming an extension of the due date.

- Include a signed oath or affirmation, as required by Rule 4.22(h), with each copy of the annual report filed with NFA and distributed to all pool participants. Omitting or not signing the oath or affirmation continues to be a common deficiency in annual financial report filings. Binding the oath as part of the report package or attaching it to the cover page is a best practice followed by a number of CPOs.

- If the pool is operating under the exemptions granted in Rule 4.7 or Rule 4.12, include a notation of that fact on the cover page of the report consistent with the requirements of those regulations.

- Report special allocations of partnership equity as required by CFTC Interpretative Letter 94-3, *Special Allocations of Investment Partnership Equity*.

- 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. For the report filed with NFA, provide 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. 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 the owners of a majority of the units of participation in the pool who are unaffiliated with the CPO.

  - The annual report must nonetheless be presented and computed in accordance with GAAP applied on a consistent basis. This includes the requirements of AICPA SOP 95-2, as amended by SOPs 01-1 and 03-4, and CFTC Interpretative Letter 94-3.

  - The annual report must include all other appropriate footnote disclosures.

IV. DCIO and NFA Contact Information

If a CPO or a public accountant has any questions on the foregoing, please feel free to contact the DCIO staff or NFA staff listed in Attachment A to this letter.

Very truly yours,

Thomas J. Smith
Associate Deputy Director and
Chief Accountant

ATTACHMENT A

ADDRESSES OF CFTC's DIVISION OF CLEARING

AND INTERMEDIARY OVERSIGHT OFFICES

Regional Office Locations	Contacts	Location of CPO's Principal Office
	Eastern Region	
140 Broadway, 19th Floor New York NY 10005-1146 FAX: (646)-746-9937	Ronald A. Carletta Phone: (646)-746-9726 E-Mail: rcarletta@cftc.gov Al Goll Phone: (646)-746-9723 E-Mail: agoll@cftc.gov	All states east of the Mississippi River, *except* Illinois, Indiana, Michigan, Ohio, and Wisconsin. Any location outside of the United States
	Central Region	
525 West Monroe Street Suite 1100 Chicago, IL 60661	Melissa B. Hendrickson Phone: 312-596-0661 FAX: 312-596-0712 E-Mail: mhendrickson@cftc.gov	Illinois, Indiana, Michigan, Ohio, and Wisconsin
	Southwest Region	
Two Emanuel Cleaver II Boulevard, Suite 300 Kansas City, MO 64112	Sandra McCarthy Phone: 816-960-7712 FAX: 816-960-7750 E-Mail: smccarthy@cftc.gov	All states west of the Mississippi River

NFA ADDRESS

Patricia Cushing
Associate Director
Compliance Department
National Futures Association
200 West Madison, 16th Floor
Chicago, IL 60606
Phone: 312-658-6747
E-Mail: pcushing@nfa.futures.org
FAX: 312-220-9003
Web site: http://www.nfa.futures.org

ATTACHMENT B
ILLUSTRATION – Condensed Schedule of Investments and Fund of Funds Disclosures

Condensed Schedule of Investments
December 31, 2004

Principal Amount, Shares or No. of Contracts	Description	Fair Value	Expiration dates	No. of Contracts
	DEBT SECURITIES (41.2%)			
	United States (21.4%)			
	Airlines (2.0%)			
$1,000,000	Flight Airlines Inc 12%, 7/15/07	$1,000,000		
	Government (19.4%)			
$3,000,000	US Treasury Bond, 4.50%, 11/15/07	3,031,791		
	US Treasury Bonds, 3.00%-4.75%, 1/30/05-7/15/07	6,686,175		
		9,717,966		
	Total United States (cost $15,015,200)	10,717,966		
	Mexico (19.8%)			
	Government			
	United Mexican States, 8.625%-9.125% 3/12/08-12/7/09 (cost $10,000,000)	9,922,224		
	TOTAL DEBT SECURITIES (cost $25,015,200)	20,640,190		
	INTEREST IN INVESTMENT PARTNERSHIP[5] (20.0%) (cost $8,000,000)			
	Hejmet Fund Ltd. A Cayman Islands company (20% owned)	2,500,000		
	Carron Int'l. Fund, a Bermuda company (25% owned)	2,600,000		
	Marvelous Fund NV, a Netherlands Antilles company (35% owned) (XYZ Hedge Fund LP owns 6,000 shares, valued at $9,000,000 of Leisure Cruises Inc., which is a US Company in the travel industry. The partnership's share of this investment is valued at $3,150,000 as of December 31, 200x)	2,800,000		
	Ten other funds	2,100,000		
	TOTAL INVESTMENT PARTNERSHIPS	10,000,000		
	TOTAL INVESTMENTS (61.3%) (cost $33,015,200)	$30,640,190		
	FUTURES CONTRACTS (12.5%)			
	Financial (5.2%)			
	Eurodollar (5.2%)	$2,611,825	Feb-Apr 200X	122
	Indices (5.6%)			
	S&P 500 (5.6%)	2,788,000	Mar-May 200X	89
	Metals (1.7%)	840,000		
	TOTAL FUTURES CONTRACTS	$6,239,825		
	FORWARDS (11.5%)			
	Argentinean Peso (5.8%)	$2,910,000	Oct-Nov 200X	
	Other currencies (5.7%)	2,876,315		
	TOTAL FORWARDS	$5,786,315		

[5] See Note X. Investments, for additional disclosures on Investment Partnerships

Note X. Investments

As of December 31, 2004, 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, 2004. Funds in which ABC Fund invested more than 5% 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 Mgmt	Fees Incentive	Investment Objective	Redemptions Permitted
Hejmat Fund Ltd.	5.0	$ 2,500,000	$200,000	$ 25,000	$ 30,000	Emerging market	Quarterly
Carron Int'l Fund	5.2	2,600,000	210,000	26,000	42,000	Sector investment	Monthly
Marvelous Fund NV	5.6	2,800,000	(30,000)	28,000	0	International equity	Semi-Annual
Other funds:	4.2	2,100,000	100,000	24,000	25,000	Other	Monthly-Annually
Total	20.0%	$10,000,000	$480,000	$103,000	$97,000		

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 Mgmt	Fees Incentive	Investment Objective	Redemptions Permitted
Hejmat Fund Ltd.	5.0	$ 2,500,000	$200,000	$ 25,000	$ 30,000	Emerging market	Quarterly
Carron Int'l Fund	5.2	2,600,000	210,000	26,000	42,000	Sector investment	Monthly
Other funds:	4.2	2,100,000	100,000	24,000	25,000	Other	Monthly-Annually
Subtotal	14.4	7,200,000	510,000	$75,000	$97,000		
Marvelous Fund NV	5.6	2,800,000	(30,000)	*	*	International equity	Semi-Annual
Total	20.0%	$10,000,000	$480,000				

* = 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.