

have the meaning set forth in section 1a(10) of the Act.

(f) *Confidentiality.* All information obtained by the Commission pursuant to the provisions of this section from a futures commission merchant concerning a Material Associated Person shall be deemed confidential information for the purposes of section 8 of the Act.

(g) *Implementation schedule.* Each futures commission merchant registered as of December 31, 1994 and subject to the requirements of this section shall file the information required by paragraph (a)(1) of this section no later than April 30, 1995 and the information required by paragraph (a)(2) of this section no later than May 15, 1995. Each futures commission merchant whose registration becomes effective after December 31, 1994 and is subject to the requirements of this section shall file the information required by paragraph (a)(1) of this section within 60 calendar days after registration is granted, or by April 30, 1995, whichever comes later and the information required by paragraph (a)(2) of this section within 105 calendar days after registration is granted or by May 15, 1995, whichever comes later.

[59 FR 66690, Dec. 28, 1994; 60 FR 13901, Mar. 15, 1995]

§ 1.16 Qualifications and reports of accountants.

(a) *Definitions*—(1) *Accountant's report.* The term "accountant's report," when used in regard to financial statements and schedules, means a document in which an independent licensed or certified public accountant indicates the scope of the audit (or examination) which he has made and sets forth his opinion regarding the financial statements and schedules taken as a whole or an assertion to the fact that an overall opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefore must be stated.

(2) *Audit or examination.* The terms "audit" and "examination," when used in regard to financial statements and schedules, mean an examination of the statements and schedules by an accountant in accordance with generally accepted auditing standards for the

purposes of expressing an opinion thereon.

(3) *Certified.* The term "certified," when used in regard to financial statements and schedules, means audited and reported upon with an opinion expressed by an independent certified public accountant or independent licensed public accountant.

(4) *Customer.* The term "customer" means customer (as defined in § 1.3(k)) and option customer (as defined in § 1.3(jj) of this part and in § 32.1(c) of this chapter) and includes a foreign futures and foreign options customer (as defined in § 30.1(c) of this chapter).

(b) *Qualifications of accountants.* (1) The Commission will recognize any person as a certified public accountant who is duly registered and in good standing as such under the laws of the place of his residence or principal office. The Commission will recognize any person as a licensed public accountant who was duly licensed on or before December 31, 1970, and is in good standing as such under the laws of the place of his residence or principal office.

(2) The Commission will not recognize any certified public accountant or licensed public accountant as independent who is not in fact independent. For example, an accountant will not be considered independent with respect to any applicant or registrant or any parent, subsidiary, or other affiliate of such applicant or registrant (i) in which, during the period of his professional engagement to examine the financial statements and schedules being reported on or at the date of his report, he or his firm or a member thereof had, or was committed to acquire, any direct financial interest or any material indirect financial interest, or (ii) with which, during the period of his professional engagement to examine the financial statements and schedules being reported on, at the date of his report or during the period covered by the financial statements, he or his firm or a member thereof was connected as a promoter, underwriter, voting trustee, director, officer, or employee, except that a firm will be deemed independent with respect to an applicant or registrant and its affiliates if a former employee or officer of such applicant

or registrant or any such affiliate is employed by the firm and such individual has completely disassociated himself from the applicant or registrant and its affiliates and does not participate in auditing financial statements and schedules of the applicant or registrant or its affiliates covering any period of his employment by the applicant or registrant or its affiliates. An accountant will not be considered independent if he or his firm or a member thereof performs manual or automated bookkeeping services or assumes responsibility for maintenance of the accounting records, including accounting classification decisions, of such applicant or registrant or any of its affiliates. For the purposes of this §1.16(b), the term “member” means all partners in the firm and all professional employees participating in the audit or located in the office of the firm participating in a significant portion of the audit.

(3) In determining whether an accountant may in fact not be independent with respect to a particular applicant or registrant, the Commission will give appropriate consideration to all relevant circumstances, including evidence bearing on all relationships between the accountant and that applicant or registrant or any affiliate thereof, and will not confine itself to the relationship existing in connection with the filing of reports with the Commission.

(c) *Accountant’s reports*—(1) *Technical requirements.* The accountant’s report (i) must be dated, (ii) must be signed manually, (iii) must indicate the city and State where issued and (iv) must identify without detailed enumeration the financial statements covered by the report.

(2) *Representations as to the audit.* The accountant’s report (i) must state whether the audit was made in accordance with generally accepted auditing standards, and (ii) must designate any auditing procedures deemed necessary by the accountant under the circumstances of the particular case which have been omitted and the reasons for their omission. However, nothing in this paragraph (c)(2) shall be construed to imply authority for the omission of any procedure which inde-

pendent accountants would ordinarily employ in the course of an audit made for the purposes of expressing the opinion required by paragraph (c)(3) of this section.

(3) *Opinion to be expressed.* The accountant’s report must state clearly: (i) The opinion of the accountant with respect to the financial statements and schedules covered by the report and the accounting principles and practices reflected therein and (ii) the opinion of the accountant as to the consistency of the application of the accounting principles, or as to any changes in such principles which have material effect on the financial statements and schedules.

(4) *Exceptions.* Any matters to which the accountant takes exception must be clearly identified, such exceptions specifically and clearly stated, and to the extent practicable, the effect of each exception on related financial statements and schedules given.

(5) *Accountant’s report on material inadequacies.* A registrant must file concurrently with the annual audit report a supplemental report by the accountant describing any material inadequacies found to exist or found to have existed since the date of the previous audit. An applicant must file concurrently with the audit report a supplemental report by the accountant describing any material inadequacies found to exist as of the date of the Form 1-FR being filed: *Provided, however,* That if such applicant is registered with the Securities and Exchange Commission as a securities broker or dealer, and it files (in accordance with §1.10(h)) a copy of its Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934, part II or part IIA, in lieu of Form 1-FR, the accountant’s supplemental report must be made as of the date of such report. The supplemental report must indicate any corrective action taken or proposed by the applicant or registrant in regard thereto. If the audit did not disclose any material inadequacies, the supplemental report must so state.

(d) *Audit objectives.* (1) The audit must be made in accordance with generally accepted auditing standards and must include a review and appropriate tests

of the accounting system, the internal accounting control, and the procedures for safeguarding customer and firm assets in accordance with the provisions of the Act and the regulations thereunder, since the prior examination date. The audit must include all procedures necessary under the circumstances to enable the independent licensed or certified public accountant to express an opinion on the financial statements and schedules. The scope of the audit and review of the accounting system, the internal controls, and procedures for safeguarding customer and firm assets must be sufficient to provide reasonable assurance that any material inadequacies existing at the date of the examination in (i) the accounting system, (ii) the internal accounting controls, and (iii) the procedures for safeguarding customer and firm assets (including, in the case of a futures commission merchant, the segregation requirements of section 4d(2) of the Act and these regulations and the secured amount requirements of the Act and these regulations) will be discovered. Additionally, as specified objectives the audit must include reviews of the practices and procedures followed by the registrant in making (A) periodic computations of the minimum financial requirements pursuant to §1.17 and (B) in the case of a futures commission merchant, daily computations of the segregation requirements of section 4d(2) of the Act and these regulations and the secured amount requirements of the Act and these regulations.

(2) A material inadequacy in the accounting system, the internal accounting controls, the procedures for safeguarding customer and firm assets, and the practices and procedures referred to in paragraph (d)(1) of this section which is to be reported in accordance with paragraph (e)(2) of this section includes any conditions which contributed substantially to or, if appropriate corrective action is not taken, could reasonably be expected to:

(i) Inhibit an applicant or registrant from promptly completing transactions or promptly discharging his responsibilities to customers or other creditors;

(ii) Result in material financial loss;

(iii) Result in material misstatement of the applicant's or registrant's financial statements and schedules; or

(iv) Result in violations of the Commission's segregation or secured amount (in the case of a futures commission merchant), recordkeeping or financial reporting requirements to the extent that could reasonably be expected to result in the conditions described in paragraph (d)(2) (i), (ii), or (iii) of this section.

(e) *Extent and timing of audit procedures.* (1) The extent and timing of audit procedures are matters for the independent public accountant to determine on the basis of his review and evaluation of existing internal controls and other audit procedures performed in accordance with generally accepted auditing standards and the audit objectives set forth in paragraph (d) of this section. In determining the extent of testing, consideration must be given to the materiality of an area and to the possible effect on the financial statements and schedules of a material misstatement in a related account.

(2) If during the course of an audit or interim work, the independent public accountant determines that any material inadequacies exist in the accounting system, in the internal accounting control, in the procedures for safeguarding customer or firm assets, or as otherwise defined in paragraph (d) of this section, he must call such inadequacies to the attention of the applicant or registrant, which has the responsibility to give notice to the National Futures Association and, if an applicant, or the Commission and the designated self-regulatory organization, if any, if a registrant, in accordance with paragraphs (d) and (g) of §1.12: *Provided, however,* That if the applicant or registrant is an introducing broker or applicant for registration as an introducing broker, it also has the responsibility to give notice to the National Futures Association, the designated self-regulatory organization, if any, and every futures commission merchant carrying or intending to carry customer accounts for the introducing broker or applicant for registration as an introducing broker. The applicant or registrant must also furnish

the accountant with a copy of said notice within three (3) business days. If the accountant fails to receive such notice from the applicant or registrant within three (3) business days, or if he disagrees with the statements contained in the notice of the applicant or registrant, the accountant must inform the National Futures Association, in the case of an applicant, or the Commission and the designated self-regulatory organization, if any, in the case of a registrant, by reporting the material inadequacy and, in the case of an applicant or registrant which is an introducing broker or applicant for registration as in introducing broker, the accountant must also inform the National Futures Association, the designated self-regulatory organization, if any, and every futures commission merchant carrying or intending to carry customer accounts for the introducing an introducing broker, within three (3) business days thereafter. Such report from the accountant must, if the applicant or registrant failed to file a notice, describe the material inadequacies found to exist. If the applicant or registrant filed a notice, the accountant must file a report detailing the aspects, if any, of the applicant's or registrant's notice with which the accountant does not agree.

(f) *Extension of time for filing audited reports.* (1) In the event a registrant finds that it cannot file its certified financial statements and schedules for any year within the time specified in § 1.10 without substantial undue hardship, it may file with the principal office of the Commission in Washington, DC, an application for extension of time to a specified date not more than 90 days after the date as of which the certified financial statements and schedules were to have been filed. Notice of such application must be sent to the designated self-regulatory organization, if any. The application must be made by the registrant and must:

- (i) State the reasons for the requested extension;
- (ii) Indicate that the inability to make a timely filing is due to circumstances beyond the control of the registrant, if such is the case, and describe briefly the nature of such circumstances;

- (iii) Be accompanied by the latest available formal computation of the registrant's adjusted net capital and minimum financial requirements computed in accordance with § 1.17;

- (iv) In the case of a futures commission merchant, be accompanied by the latest available computation of required segregation and by a computation of the amount of money, securities, and property segregated on behalf of customers, and by a computation of secured amounts and funds held in separate accounts for foreign futures and foreign options customers in accordance with § 30.7 of this chapter, as of the date of the latest available computation;

- (v) Contain an agreement to file the report on or before the date specified by the registrant in the application;

- (vi) Be received by the principal office of the Commission in Washington, DC and by the designated self-regulatory organization, if any, prior to the date on which the report is due; and

- (vii) Be accompanied by a letter from the independent public accountant answering the following questions:

- (A) What specifically are the reasons for the extension request?

- (B) On the basis of that part of your audit to date, do you have any indication that may cause you to consider commenting on any material inadequacies in the accounting system, internal accounting controls or procedures for safeguarding customer or firm assets?

- (C) Do you have any indication from the part of your audit completed to date that would lead you to believe that the firm was or is not meeting the minimum capital requirements specified in § 1.17 or (in the case of a futures commission merchant) either the segregation requirements of section 4d(2) of the Act and these regulations or the secured amount requirements of the Act and these regulations, or has any significant financial or recordkeeping problems?

- (2) Within ten calendar days after receipt of an application for extension of time, the Commission shall: (i) Notify the registrant of the grant or denial of the requested extension; or (ii) indicate to the registrant that additional time is required to analyze the request, in

which case the amount of time needed will be specified.

(3) On the written request of any designated self-regulatory organization or registrant, or on its own motion, the Commission may grant an extension of time or an exemption from any of the certified financial reporting requirements of this chapter either unconditionally or on specified terms and conditions.

(g) *Replacement of accountant.* (1) In the event (i) the independent public accountant who was previously engaged as the principal accountant to audit an applicant's or registrant's financial statements resigns (or indicates he declines to stand for re-election after the completion of the current audit) or is dismissed as the applicant's or registrant's principal accountant, (ii) another independent accountant is engaged as principal accountant, or (iii) an independent accountant on whom the principal accountant expresses reliance in his report regarding a subsidiary resigns (or formally indicates he declines to stand for re-election after completion of the current audit) or is dismissed or another independent public accountant is engaged to audit that subsidiary, an applicant shall file written notice of such occurrence with the National Futures Association, and a registrant shall file written notice of such occurrence with the Commission at its principal office in Washington, DC, and with the designated self-regulatory organization, if any, not more than 15 business days after such occurrence.

(2) Such notice must state (i) the date of such resignation (or declination to stand for re-election, dismissal or engagement) and (ii) whether, in connection with the audit of the two most recent fiscal years and any subsequent interim period preceding such resignation, dismissal or engagement, there were any disagreements with the former accountant on any matter of accounting principles or practices, financial statements disclosure, auditing scope or procedures, or compliance with the applicable rules of the Commission, which, if not resolved to the satisfaction of the former accountant, would have caused him to make reference in connection with his report to

the subject matter of the disagreements (if so, describe such disagreements). The disagreements required to be reported in this paragraph (g)(2) include both those resolved to the former accountant's satisfaction and those not resolved to the former accountant's satisfaction. Disagreements contemplated by this paragraph (g)(2) are those which occur at the decision-making level, *i.e.*, between personnel of the applicant or registrant responsible for presentation of its financial statements and schedules and personnel of the accounting firm responsible for rendering its report. The notice must also state whether the accountant's report on the financial statements and schedules for any of the past two years contained an adverse opinion or a disclaimer of opinion or was qualified as to uncertainties, audit scope, or accounting principles (if so, describe the nature of each such adverse opinion, disclaimer of opinion, or qualification). An applicant must also request the former accountant to furnish the applicant with a letter addressed to the National Futures Association, and a registrant must also request the former accountant to furnish the registrant with a letter addressed to the Commission, stating whether he agrees with the statements contained in the notice of the applicant or registrant and, if not, stating the respects in which he does not agree. Each copy of the notice and accountant's letter must be manually signed by the sole proprietor or a general partner or a duly authorized corporate officer of the applicant or registrant, as appropriate, and by the accountant.

(3) If (i) within the 24 months prior to the date of the most recent audited financial statement, a notice has been filed pursuant to paragraph (g)(1) of this section reporting a change of accountants, (ii) included in such filing there is a reported disagreement on any matters of accounting principles or practices, financial statements disclosure, auditing scope, or noncompliance with the applicable rules of the Commission, (iii) during the fiscal year in which the change in accountants took place or during the subsequent fiscal year, there have been any transactions

or events similar to those which involved a reported disagreement, and (iv) such transactions or events are material and were accounted for or disclosed in a manner different from that which the former accountant apparently would have concluded was required, the existence and nature of the disagreements and also the effect on the financial statements must be stated in a written notice to the National Futures Association, in the case of an applicant, or to the Commission at its principal office in Washington, DC, and the designated self-regulatory organization, if any, in the case of a registrant, if the method which the former accountant apparently would have concluded was required had been followed. These disclosures need not be made if the method asserted by the former accountant ceases to be generally accepted because of authoritative standards or interpretations subsequently issued. The notice required by this paragraph (g)(3) must be filed by the applicant or registrant concurrently with the financial statements and schedules to which it pertains.

(h) *Exemption for introducing broker or applicant therefor.* The provisions of this section do not apply to an introducing broker which is operating pursuant to a guarantee agreement, nor do such provisions apply to an applicant for registration as an introducing broker who files concurrently with such application a guarantee agreement, provided such introducing broker or applicant therefor is not also a securities broker or dealer.

(Approved by the Office of Management and Budget under control numbers 3038-0007, 3038-0024)

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§ 1.17 Minimum financial requirements for futures commission merchants and introducing brokers.

(a)(1)(i) Except as provided in paragraph (a)(2)(i) of this section, each person registered as a futures commission merchant must maintain adjusted net capital equal to or in excess of the greatest of:

(A) \$250,000;
 (B) Four percent of the following amount: The customer funds required to be segregated pursuant to the Act and these regulations and the foreign futures or foreign options secured amount, less the market value of commodity options purchased by customers on or subject to the rules of a contract market or a foreign board of trade: *Provided, however,* That the deduction for each customer shall be limited to the amount of customer funds in such customer's account(s) and foreign futures and foreign options secured amounts;

(C) The amount of adjusted net capital required by a registered futures association of which it is a member; or

(D) For securities brokers and dealers, the amount of net capital required by Rule 15c3-1(a) of the Securities and Exchange Commission (17 CFR 240.15c3-1(a)).

(ii) Except as provided in paragraph (a)(2) of this section, each person registered as an introducing broker must maintain adjusted net capital equal to or in excess of the greatest of:

(A) \$30,000;

(B) The amount of adjusted net capital required by a registered futures association of which it is a member; or

(C) For securities brokers and dealers, the amount of net capital required by Rule 15c3-1(a) of the Securities and Exchange Commission (17 CFR 240.15c3-1(a)).

(2)(i) The requirements of paragraph (a)(1) of this section shall not be applicable if the registrant is a member of a designated self-regulatory organization and conforms to minimum financial standards and related reporting requirements set by such designated self-regulatory organization in its bylaws, rules, regulations or resolutions approved by the Commission pursuant to section 4f(b) of the Act and § 1.52.

(ii) The minimum requirements of paragraph (a)(1)(i) of this section shall not be applicable to an introducing broker which elects to meet the alternative adjusted net capital requirement for introducing brokers by operating pursuant to a guarantee agreement which meets the requirements set forth in § 1.10(j). Such an introducing