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General Accounting Office  
Washington, D.C. 20548

General Government Division  
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August 26, 1992



The Honorable John D. Dingell  
Chairman, Committee on Energy  
and Commerce  
House of Representatives

Dear Mr. Chairman:

In response to your March 1, 1991 written request and subsequent discussions with Consuela Washington of your staff, we reviewed Commodity Futures Trading Commission (CFTC) and self-regulatory organization (SRO) oversight of futures commission merchants' (FCM)<sup>1</sup> compliance with industry financial requirements. On December 17, 1991, February 24, 1992, and again on July 29, 1992, my staff briefed Ms. Washington on our findings. She agreed that a GAO report was not necessary. We found that CFTC and the SROs we reviewed had policies and procedures for monitoring FCM compliance with industry financial requirements. We also found that CFTC and the SROs generally followed these prescribed policies and procedures in the sample of FCM financial audits we reviewed. This letter summarizes the information we provided Ms. Washington.

The Commodity Exchange Act (CEA) requires FCMS to register with CFTC. A registered FCM must meet the minimum financial requirements of CEA, CFTC regulations, and SRO rules. Key requirements relate to minimum capital, Financial recordkeeping and reporting, and safeguards for protecting customer funds. CFTC and the SROs are responsible for monitoring compliance with these requirements.

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<sup>1</sup>FCMs solicit or accept orders from the public for buying or selling commodity futures or options contracts and accept payment from, or extend credit to, those whose orders are accepted.

GAO/GGD-92-28R, CFTC Oversight

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To assess CFTC and SRO oversight of financial compliance in the futures industry, we

- reviewed CEA provisions; CFTC and SEC financial rules, regulations, and procedures; SRO financial rules, reporting requirements, and oversight procedures; and CFTC, SEC, and SRO financial audit programs;
- interviewed CFTC and SEC headquarters and regional office officials as well as Chicago Board of Trade, Chicago Mercantile Exchange, and National Futures Association officials;
- examined CFTC files on recent cases of alleged violations of financial rules and regulations; and
- analyzed the audit reports and workpapers for a judgmental sample of 20 audits of firms, most with reported financial problems--6 audits of FCMs done by CFTC and 14 audits of FCMs done by the Chicago Board of Trade, the Chicago Mercantile Exchange, and the National Futures Association.

At your request, we included Stotler and Company, a recently failed FCM, in our audit. However, because we did not want to interfere with ongoing CFTC and SEC investigations of allegations of fraud at Stotler, we did not extend audit steps and procedures.

We found that CFTC and the SROs we reviewed have policies and procedures to monitor FCM compliance with futures industry financial requirements. These policies and procedures included periodic financial audits of FCMs to confirm compliance with requirements. Our analysis of a sample of CFTC and SRO audit reports and workpapers disclosed that in these cases prescribed procedures for doing financial audits were generally followed.

According to CFTC officials, CFTC regional offices review all FCM financial reports for compliance with regulatory requirements. FCMs are required to submit financial reports at least quarterly to both CFTC and their designated SRO. In addition, CFTC does periodic on-site reviews of each SRO as well as annual audits of selected FCMs to evaluate the effectiveness of SRO financial oversight programs.

The SROs that we reviewed maintained watch lists of firms that were suspected of having financial problems or that fell below

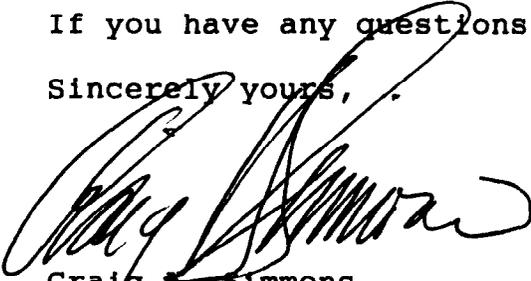
CFTC's early warning capital level.<sup>2</sup> The SROs that we reviewed also had automated financial oversight systems to assist in monitoring the financial condition and compliance of member firms. Although the systems varied, each system or group of systems tracked member firm financial reporting information, including minimum capital and other indicators of financial compliance or risk.

SROs are also required by CFTC to audit member FCMs annually to assess their compliance with industry financial requirements. SROs must use an industry standardized audit plan that is updated as needed and submitted to CFTC for review. CFTC regulations also require each FCM to annually submit to CFTC and its SRO a financial report audited by an independent public accountant, including a supplemental report disclosing any material inadequacies in the firm's internal controls.

Our review of a sample of CFTC and SRO audit reports and related workpapers disclosed that in these cases both CFTC and the SROs generally followed the policies and procedures prescribed by their audit plans. In addition, the audit reports we reviewed adequately documented the audit findings disclosed in the workpapers and the workpapers we reviewed adequately documented the completion of all required audit procedures.

If you have any questions, please contact me at 275-8678.

Sincerely yours,



Craig A. Simmons  
Director, Financial Institutions  
and Markets Issues

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<sup>2</sup>CFTC regulations require FCMs to file written notice and monthly financial reports if their capital falls below \$75,000 or 6 percent of segregated customer funds.