REPORT OF INVESTIGATION

BERKELEY RESEARCH GROUP, LLC

ANALYSIS OF THE NATIONAL FUTURES ASSOCIATION'S AUDITS OF PEREGRINE FINANCIAL GROUP, INC.

January 29, 2013

TABLE OF CONTENTS

Page

Page

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RETENTION OF BRG AND SCOPE OF THE INVESTIGATION

On August 2, 2012, the Special Committee for the Protection of Customer Funds ("Special Committee"), a committee comprised solely of Public Directors of the National Futures Association ("NFA")[1] retained professionals at Berkeley Research Group, LLC ("BRG Investigative Team")[2] to conduct an independent review of the NFA audit practices and procedures, and the execution of those procedures in the specific instance of Peregrine Financial Group, Inc. ("PFG"), to assure that adequate procedures are in place and that they are being followed properly.

The BRG Investigative Team was specifically tasked with:

- Conducting a review of the NFA audit regulatory framework over the period during which NFA conducted audits of PFG;
- Evaluating the execution of NFA audits of PFG; and
- Determining whether the applicable policies and procedures that govern the conduct of NFA audits could be improved.

It was not the BRG Investigative Team's mandate to determine how former PFG Chief Executive Officer ("CEO") Russell Wasendorf, Sr. ("Wasendorf") conducted the fraud that caused the failure of PFG, and we have not conducted an exhaustive analysis of how he perpetrated the fraud. The BRG Investigative Team did review relevant documents during the investigation and spoke to numerous individuals, including Wasendorf himself, regarding Wasendorf's fraud for the purpose of understanding whether NFA auditors executed their audits appropriately and how those audit procedures could be improved. However, the BRG Investigative Team's conclusions are limited to the extent of its current understanding of the facts.

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[1] On March 28, 2012, following the collapse of MF Global, Daniel Roth, the President and Chief Executive Officer of NFA, testified before Congress that NFA had appointed a Special Committee for the Protection of Customer Funds comprised of the public directors on NFA's board. Testimony of Daniel J. Roth, President and Chief Executive Officer, National Futures Association, before the Oversight and Investigations Subcommittee of the Committee on Financial Services of the U.S. House of Representatives, March 28, 2012 at 1-2.
[2] The BRG Investigative Team consisted of Charles Lundelius, H. David Kotz, Jim Conversano, Jennifer Hull, Emre Carr, Karina Bjelland, Matt Torpey, Emre Aydin, Kristin Smyth and James Christenson.

EXECUTIVE SUMMARY

The BRG Investigative Team conducted a review of NFA's audits of PFG from the period of 1995 through 2012. During the course of its investigation, the BRG Investigative Team reviewed over 190,000 NFA documents containing over 3 million pages, including over 166,000 emails and related attachments sent and received by current and former NFA employees. The BRG Investigative Team also conducted interviews of 32 individuals with knowledge of the facts or circumstances surrounding NFA's audits of PFG, including 25 current or former NFA employees, 5 former PFG officials (including former PFG CEO Wasendorf), the Receiver appointed by the United States District Court for the Northern District of Illinois, and the founder of Confirmation.com, the electronic confirmation service that NFA auditors used in 2012 which resulted in the discovery of the fraud.

The investigation found that NFA conducted a total of 27 audits of PFG during the period between 1995 and 2012. These included 17 unannounced annual audits conducted every 9 to 15 months, 7 audits of PFG's branch offices, an additional audit during 2010 and two additional audits in 2011. In 7 of the 17 annual audits, NFA auditors sent a bank confirmation to U.S. Bank. The audits did not find any material issues with the confirmations until 2012, when they began using an electronic confirmation process and the fraud was uncovered.

The investigation further found that these audits were, for the most part, routine audits designed to review PFG's operations and systems in accordance with procedures established by the NFA and the Joint Audit Committee ("JAC"), and were not specifically directed to a particular tip or complaint alleging that Wasendorf was conducting a fraud. In fact, the BRG Investigative Team specifically investigated whether NFA auditors received any specific tip or complaint indicating that Wasendorf was conducting a fraud and found none. We also found that Wasendorf was able to conceal his fraud meticulously by providing numerous convincingly forged documents to his staff for use in PFG's operations and directly and indirectly to NFA auditors.

The investigation found that, overall, NFA audits were conducted in a competent and proper fashion and the auditors dutifully implemented the appropriate modules that were required in the annual audits which were based upon the JAC audit program. However, we did find that some NFA auditors did not always exhibit sufficient professional skepticism in assessing and evaluating fraud risks. We also found that some of the members of the NFA audit teams were relatively inexperienced and unfamiliar with the futures industry, and in a few instances, additional support from senior members of the auditing team was warranted. We found that, while training at NFA was readily available and effective, particularly for the inexperienced auditors, there was not always consistency in training sessions after important events in the industry, such as the Bernard Madoff Ponzi scheme, or the MF Global collapse, where there were opportunities for significant lessons to be learned for NFA auditors.

We also found that the NFA audits of PFG did not focus adequately on internal controls of PFG. For instance, some NFA auditors were not aware that Wasendorf was the only individual within PFG who had access to the original U.S. Bank statements (which provided him the ability to falsify the statements provided to PFG's staff and NFA), or that senior PFG officials, such as the Chief Financial Officer ("CFO") after 2006, had questionable qualifications. We further found that the NFA auditors had little interaction with PFG's outside auditor, did not review the outside auditor's workpapers, and some NFA auditors were not aware until the 2012 annual audit that PFG's outside auditor was, in the later years, a one-person auditing firm in suburban Chicago.

We also found that NFA auditors did not fully examine the fact that PFG was losing significant money in many years, Wasendorf's frequent and significant capital contributions, or the source of his capital contributions.

We found that NFA auditors did not express significant concerns about PFG's reverse repurchase agreements ("repos") and sweep accounts, notwithstanding their examination of such arrangements in several audits and the fact that PFG decided to forgo this arrangement altogether in 2009. In our review of PFG's repos and sweep accounts, we found that PFG historically reported the repo amounts as cash deposits in many years on the improper line of one of the largest items of PFG's financial filings. We also found that PFG's repos were subject to various NFA audit test procedures during NFA's periodic audits. However, NFA auditors did not treat the repos balance as high-risk despite: (1) the magnitude of the balance; (2) the lack of separation of duties and weak internal controls over cash and investments; and (3) repeatedly noting that the value of PFG's repos was omitted from the ending balance on the bank statement yet included in the confirmation amount.

The BRG Investigative Team found that the JAC audit program for repos noted that a Futures Commission Merchant ("FCM") should receive daily confirmations for sweep funds. However, some NFA auditors apparently were unaware that daily confirmations should have been produced and made available for review during audits. In 1999, the NFA auditors made notes about the fact that PFG could not record interest daily. The NFA auditors noted that PFG recorded a daily estimated accrual and reconciled interest income at the end of every month by using the bank statement. Further, during each of the 2003, 2008 and 2009 audits, the NFA auditors accepted one daily confirmation as sufficient audit evidence of PFG's repos. The BRG Investigative Team found no evidence that NFA auditors obtained additional daily confirmations during the 2003, 2008 and 2009 audits or that they obtained any daily confirmations for repos during other audits.

We also found that, in audits subsequent to PFG's discontinuance of repos and sweep accounts in 2009, NFA auditors did not question this decision or why approximately $200 million was being left in a customer segregated funds account and not being invested overnight.

The investigation further found that NFA's audits of PFG over the years were made more difficult in some instances because of the aggressive approach and demeanor of PFG's Director of Compliance, Susan O'Meara ("O'Meara"). However, we did not find that these concerns of possible intimidation on the part of O'Meara were elevated from the staff auditor level to senior officials at NFA.

We did not find evidence that Wasendorf's reputation or influence with the NFA or industry had any impact on NFA audits of PFG. Prior to the fraud being uncovered, Wasendorf served on the NFA's Futures Commission Merchant Advisory Committee, but the investigation found that many auditors were not aware of this fact and no one felt Wasendorf's role on an NFA advisory committee or his reputation in the industry as a whole had any effect on NFA's audits.

We also found that, while the U.S. Commodity Futures Trading Commission ("CFTC") conducted a few limited reviews of PFG over the years, there was little evidence of coordination between the CFTC and NFA with respect to their examination of PFG. In two instances, NFA auditors were not aware of the results of CFTC reviews conducted immediately prior to or simultaneous with NFA audits.

In addition, prior to the 2010, 2011 and 2012 audits, PFG was subject to several disciplinary complaints and/or warnings brought over the years by the NFA Business Conduct Committee ("BCC"), which is a group made up of industry members and public representatives who meet approximately once a month to consider potential disciplinary actions against member firms. Complaints and/or warning letters were issued against PFG on three occasions: once, in December 1996, alleging that PFG used false and deceptive promotional material, failed to maintain adequate segregated funds and failed to report to the NFA that the firm was undersegregated; again in June 2004, alleging that PFG failed to comply with an Order issued by the NFA Membership Committee in violation of NFA Compliance Rule 2-5; and in December 2008, for PFG's failure to respond properly and completely to an NFA Information Request.[3]

We also found that the BCC issued a formal complaint against PFG, and several of its senior officials, including O'Meara and Russell Wasendorf, Jr. ("Wasendorf, Jr."), in February 2012 for their failure to supervise in connection with a Ponzi scheme operated by Trevor Cook (although unrelated to PFG), in which he sold investments in a foreign currency trading program but diverted a substantial portion of the money provided to him for other purposes, including making payments to previous investors and paying personal expenses. PFG eventually resolved the BCC action by agreeing to certain undertakings and to pay a $700,000 fine. The BRG Investigative Team found that the BCC complaints and warnings against PFG prior to 2012 did not cause NFA to extend their audit procedures in connection with their audits of PFG.

Further, we found that, prior to 2012, consistent with Statement on Accounting Standard ("SAS") No. 67, the bank confirmation process used by NFA involved filling out a bank confirmation form, having a principal sign it, and then putting it in an envelope, and sending it to the bank through the mail without having any direct verbal or physical (in-person) communication with the bank. In the years when NFA auditors sent confirmations to U.S. Bank, NFA auditors reviewed the confirmations they received in the mail to attempt to verify that they showed the same balance in the bank statement.

We found that on Friday, May 13, 2011, O'Meara emailed NFA's bank confirmation to Hope Timmerman at U.S. Bank in connection with the 2011 NFA audit of PFG. That same day, Hope Timmerman sent O'Meara and the NFA field supervisor for the 2011 audit a bank confirmation that reflected a balance of $7,181,336.36 (the "$7 million Confirmation") for the PFG customer segregated account. The field supervisor stated that she did not recall looking at the U.S. Bank confirmation or comparing it to a bank statement. On Monday, May 16, 2011, the next business day, the NFA field supervisor sent an NFA staff

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[3] The BCC actions are initiated by NFA staff and are often established as a result of an NFA audit against a member firm or person.

auditor working on the PFG audit the confirmations for several bank balances and banks, including the U.S. Bank confirmation. The staff auditor stated that she uploaded and scanned the bank confirmations into NFA's audit software, noticed that the $7 million confirmation balance did not match the U.S. Bank statement which showed a balance of $218,650,550.96 and informed the field supervisor that the figures did not match. The field supervisor, on the other hand, did not recall the staff auditor having any reaction to the $7 million confirmation or any discussion at all among the auditing team about this issue. The other NFA audit team members also did not recall seeing the $7 million confirmation or being aware that a confirmation was received by NFA auditors showing an amount that was substantially different than the amount shown in the U.S. Bank statements supplied by Wasendorf.

According to Wasendorf, when he found out that NFA auditors had received the correct confirmation indicating a balance of $7 million, his reaction was, "I am in shock –I'm caught." He claimed that on May 16, 2011, he walked into U.S. Bank and convinced Hope Timmerman that the first confirmation obviously was a mistake because it did not have a correct U.S. Bank address.[4] It is undisputed that he then prepared a forged confirmation statement. Later, that same day, the NFA field supervisor received a facsimile purportedly from Hope Timmerman of U.S. Bank, with a note stating, "attached please find a corrected copy of the Bank Balance Confirmation for the Peregrine Financial Group account #621010845. Customer Segregated Account." The bank confirmation attached to the facsimile cover sheet showed a balance of $218,650,550.96. The staff auditor uploaded this "corrected" confirmation into the NFA module software and noted that the bank confirmation now matched the U.S. Bank statement created by Wasendorf. The staff auditor stated she could not recall any further conversations about the two confirmations or learning how it was resolved. We found no evidence that NFA auditors questioned the new version of the confirmation purportedly from Hope Timmerman. Instead, the NFA auditors accepted the new version, despite the vast difference between the numbers provided in the two versions of the confirmation, and did not extend their audit procedures.

In addition, an NFA manager acknowledged that, if staff determined during the confirmation process that the confirmation from the bank did not match the bank statements, there should have been further discussion, not just with him but also with his supervisor, an associate director or director, to resolve the matter.

This Report of Investigation provides a factual summary of the NFA audits of PFG from 1995 to 2012. In addition to this Report of Investigation, the BRG Investigative Team is providing a Recommendations Report that will include 21 specific recommendations to improve NFA's audit program. These recommendations are based upon the findings in this report and will be tailored to address the areas where we think that NFA audit practices and procedures can be improved.

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[4] Counsel for U.S. Bank stated that "we do not believe that any such conversation [with Hope Timmerman] took place" but did not explain what actually occurred. *See also*, Letter from Peter W. Carter, Dorsey & Whitney LLP, counsel for U.S. Bank dated January 8, 2013.

BACKGROUND

I. Actions Filed Against PFG and Wasendorf After Discovery of the Fraud

On July 9, 2012, NFA issued a Member Responsibility Action ("MRA") against PFG, a registered FCM, and Peregrine Asset Management, Inc. ("PAM"), a registered commodity pool operator ("CPO"), based upon PFG's failure to demonstrate compliance with NFA minimum net capital requirements and segregated fund requirements and because it appeared that PFG did not have sufficient assets to meet its obligations to customers.[5]

On July 10, 2012, the CFTC filed a civil complaint (the "CFTC Complaint") in the United States District Court for the Northern District for Illinois Eastern Division pursuant to Section 6c of the Commodity Exchange Act ("the Act"), as amended, 7 U.S.C. § 13a-1, et seq., against PFG, a registered FCM, and Wasendorf, PFG's CEO and sole owner, alleging a failure to maintain adequate customer funds in segregated accounts, misappropriation of such funds, and filing false reports with the CFTC regarding the amount of customer segregated funds held by PFG.[6] That day, PFG filed a voluntary petition in the United States Bankruptcy Court for the Northern District of Illinois seeking relief under Chapter 7 of the United States Bankruptcy Code.[7]

On July 12, 2012, the Federal Bureau of Investigation ("FBI") filed a criminal complaint (the "Criminal Complaint") in the United States District Court for the Northern District of Iowa against Wasendorf alleging the crime of making and using false statements in violation of Title 18, United States Code, Section 1001(a)(1) & (3).[8] According to the United States Attorney's Office, "On October 3, 2012, Chief Judge Linda R. Reade accepted Russell Wasendorf's (defendant) plea of guilty to one count of mail fraud, one count of embezzlement, one count of making false statement to the U.S. Commodity Futures Trading Commission (CFTC), and one count of making false statements to a futures association."[9] Sentencing for Wasendorf is expected at the end of January 2013.

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[5] The action prohibited PFG and PAM from: soliciting or accepting any additional customer accounts or customer funds, except as margin for existing positions; accepting or placing trades for any customer accounts except for the liquidation of existing customer positions; and distributing, disbursing or transferring any funds, including to existing customers, without the prior approval of NFA. The action also required PFG and PAM to act in the best interests of their customers in taking any action under the action. Finally, the action required PFG and PAM to provide copies of this action, by overnight courier, to all of their customers, to all banks and other financial institutions with which they have money on deposit, and to all persons and entities that solicit for PFG or PAM, introduce customers to PFG or that manage customer accounts held at PFG. Member Responsibility Action for PFG, dated July 9, 2012, at 1-2.

[6] U. S. Commodity Futures Trading Commission, Plaintiff, v. Peregrine Financial Group, Inc., and Wasendorf, Defendants, Complaint for Injunctive and Other Equitable Relief and Civil Monetary Penalties under the Commodity Exchange Act dated July 10, 2012 at 1-2.

[7] Peregrine Financial Group, Inc. voluntary petition in the United States Bankruptcy Court for the Northern District of Illinois dated July 10, 2012 at 1-3. *See also*, http://www.nfa.futures.org/NFA-investor-information/PFG.html.

[8] *United States of America v. Wasendorf*, Criminal Complaint dated July 12, 2012 at 1.

[9] http://www.justice.gov/usao/ian/VWwasendorf.html at 1. *See also*, Order Regarding Magistrate's Report and Recommendation Concerning Defendant's Guilty Pleas in the United States District Court for the Northern District of Iowa Eastern Division dated October 3, 2012 at 1.

II. Appointment of Receiver and Trustee

On July 10, 2012, Michael Eidelman ("Eidelman" or "Receiver") of Vedder Price was appointed Receiver for Wasendorf and the Wasendorf entities by the United States District Court for the Northern District of Illinois in connection with the CFTC Complaint filed against PFG.[10] "The Receiver is working closely with various law enforcement officials, regulators, the bankruptcy Trustee for PFG and others to help locate, preserve and secure assets of Russell Wasendorf and non-PFG entities owned and/or controlled by Russell Wasendorf."[11] As Receiver, Eidelman has exclusive custody, control, and possession over Wasendorf's funds, property, and other assets, customer funds and property, and all books and records of accounts, and financial records.[12] The Receiver also collects all money owed to the estate of the defendants, and is responsible for preserving and liquidating the assets of Wasendorf and the Wasendorf entities.[13] The Receiver selected Great American Group to liquidate Wasendorf's assets, and an auction was held on December 5, 2012.[14]

On July 12, 2012, Ira Bodenstein ("Bodenstein" or "Trustee") of Shaw Gussis Fishman Glantz Wolfson & Towbin, LLC, was appointed by the U.S. Trustee to act as Trustee for PFG's estate.[15] Bodenstein's role is to "maximize the net value of the estate created by the commencement of the bankruptcy case . . . [by ensuring] . . . that the cost of collecting and liquidating Peregrine's assets . . . [does] not exceed their value with respect to any particular asset," and ". . . to provide information concerning the estate and its administration to parties in interest . . . [which] would include creditors, customers and governmental units."[16] The Trustee is responsible for preserving and organizing information related to PFG's assets, and investigating the financial affairs of PFG, without duplicating the efforts of law enforcement.[17] The Trustee's role also includes "marshaling and recovering the assets of PFG's estate, including customer property, and distributing those assets pursuant to the U.S. Bankruptcy Code and CFTC Part 190 rules."[18] Bodenstein maintains a continuous dialogue with the Receiver "to ensure the orderly liquidation of

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[10] Testimony transcript of Ira Bodenstein dated August 1, 2012 at 10-11. *See also*, Vedder Price press release dated July 31, 2012 at http://www.vedderprice.com/Vedder-Price-Appointed-Receiver-in-Peregrine-Federal-District-Court-Matter-07-31-2012/.

[11] Vedder Price press release dated July 31, 2012 at http://www.vedderprice.com/Vedder-Price-Appointed-Receiver-in-Peregrine-Federal-District-Court-Matter-07-31-2012/.

[12] Order Appointing a Temporary Receiver, U.S. Commodity Futures Trading Commission v. Peregrine Financial Group, Inc., and Wasendorf, July 10, 2012, at 2-4.

[13] Temporary Receiver's Unopposed Fourth Motion for Order Authorizing Payment of Compensation to Certain Retained Individuals, U.S. Commodity Futures Trading Commission v. Peregrine Financial Group, Inc. and Wasendorf, September 18, 2012, at 3.

[14] http://www.greatamerican.com/auctions/AuctionEventDetails.aspx?EventID=680. According to published reports, the auction raised about $1 million for creditors. http://blogs.wsj.com/deals/2012/12/08/wasendorf-asset-auction-raises-1-million.

[15] Written Statement of Ira Bodenstein, Trustee for the Chapter 7 Bankruptcy Estate of Peregrine Financial Group, Inc., in conjunction with testimony before the Senate Committee on Agriculture, Nutrition and Forestry, August 1, 2012, at 11.

[16] *Id.* at 2.

[17] *Id.* at 2-3.

[18] http://www.nfa.futures.org/NFA-investor-information/PFG.html.

Peregrine's assets."[19] All creditor and customer claims will be administered by the Trustee, not the Receiver, and the Trustee will distribute PFG customer funds to customers through Vision Financial Markets.[20] Once all the assets have been collected and liquidated, and all disbursements approved, Bodenstein will file a final report with the United States Trustee and bankruptcy court.[21]

III. Background on PFG and Wasendorf

In 1972, Wasendorf began hosting educational seminars for commodity firms and introduced the "Wasendorf Trading System."[22] In 1980, Wasendorf & Son, Inc., was created, which eventually led to the formation of PFG, in 1990.[23] PFG became a registered FCM on July 15, 1992,[24] and thereafter was subject to regulation by both the CFTC and NFA.[25]

Headquartered in Cedar Falls, Iowa,[26] PFG grew from one branch in 1996[27] to 13 branches in 2012.[28] In 2012, key employees of PFG included: Wasendorf – CEO, Wasendorf, Jr. – President, Brenda Cuypers ("Cuypers") – CFO, O'Meara – Director of Compliance, Zach Schweder ("Schweder")[29] – Compliance Manager, Rebecca Wing ("Wing") – General Counsel, and Jason Cartwright – Vice President of Back Office Operations.[30] Services offered by PFG included, but were not limited to: customized trading platforms; full service and discount brokerage for futures, forex and options; managed accounts and funds; forex trading services; trading desks for futures and forex; market research; education and wealth management advisory services; precious metals; education and training through webinars, seminars, books and electronic newsletters; and account management and back office capabilities for traders, brokers and institutions.[31]

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[19] Written Statement of Ira Bodenstein, Trustee for the Chapter 7 Bankruptcy Estate of Peregrine Financial Group, Inc., in conjunction with testimony before the Senate Committee on Agriculture, Nutrition and Forestry, August 1, 2012, at 12.

[20] http://documents.visionfinancialmarkets.com/support/initial_information_on_distribution.pdf.

[21] Written Statement of Ira Bodenstein, Trustee for the Chapter 7 Bankruptcy Estate of Peregrine Financial Group, Inc., in conjunction with testimony before the Senate Committee on Agriculture, Nutrition and Forestry, August 1, 2012, at 4.

[22] PFG Best Timeline: http://www.pfgbest.com/about/docs/AnniversaryTimeline.pdf.

[23] *Id.*

[24] https://www.nfa.futures.org/basicnet/Details.aspx?entityid=%2bcKyaAnpk7s%3d&rn=N.

[25] According to NFA's Background Affiliation Status Information Center ("BASIC"), PFG's registration ID No. was 0232217. BASIC contains CFTC registration and NFA membership information and futures-related regulatory and non-regulatory actions contributed by NFA, the CFTC and the U.S. futures exchanges. http://www.nfa.futures.org/basicnet/welcome.aspx.

[26] http://www.linkedin.com/company/peregrine-financial-group.

[27] NFA00000559 (96-CEXM-431 Audit Planning and Scope Selection module).

[28] NFA00081814 (12-CEXM-299 Audit Planning and Scope Selection module).

[29] Both O'Meara and Schweder were former NFA auditors.

[30] NFA00081800-NFA00081802 (12-CEXM-299 Audit Planning and Scope Selection module).

[31] http://www.pfgbest.com/common/docs/2011/PFGBEST_CorporateBrochure.pdf,.

According to Wasendorf and Wasendorf, Jr., Wasendorf was not only the CEO of PFG but he effectively was the sole member of the Board of Directors, created the Executive Committee,[32] and had veto power over any decisions made by the PFG Executive Committee.[33]

Wasendorf also was involved in a number of outside business ventures in addition to PFG. They included: (a) a Cedar Falls, Iowa restaurant known as "My Verona"; (b) a publishing business involving SFO Magazine; (c) Romanian investments; (d) Wasendorf Air, through which Wasendorf owned an airplane; and (e) Wasendorf Construction, which owned PFG's headquarters.[34]

IV. Background on CFTC and NFA

In 1974, Congress created the CFTC as a federal regulatory agency with jurisdiction over futures trading and also authorized the creation of "registered futures associations," giving the futures industry the opportunity to create a nationwide self-regulatory organization ("SRO").[35] The NFA was formed under Title III of the Act, and began operations as the futures industry's SRO on October 1, 1982.[36] The NFA is the Designated SRO for certain FCM's, including PFG, and is responsible for monitoring and auditing those FCMs for compliance with the minimum financial and related reporting requirements. The NFA performs the following regulatory functions:[37]

- Auditing and surveillance of Members to enforce compliance with NFA financial requirements;
- Establishing and enforcing rules and standards for customer protection;
- Providing an arbitration forum for futures and forex-related disputes;
- Screening to determine fitness to become or remain an NFA member.

Accordingly, the CFTC provides government oversight for the entire futures industry, while the NFA regulates certain activities of firms or individuals who conduct futures trading business with public customers.

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[32] Interview Memorandum of Wasendorf, Jr., at 5. *See also*, Interview Memorandum of Wasendorf, at 2.
[33] Interview Memorandum of Wasendorf, Jr., at 2. *See also*, Interview Memorandum of Wasendorf, at 2.
[34] Interview Memorandum of Eidelman at 2; PFG was also required to disclose any Material Affiliated Persons in accordance with CFTC rules. NFA auditors noted in NFA00003250 (Risk Assessment Report, June 30, 2003) that PFG disclosed the Romanian entity, Peregrine Financial Group-Romania SRL (a wholly owned non-operating subsidiary of PFG) as a Material Affiliated Person. NFA auditors also noted in NFA00037071 (Risk Assessment Report, October 16, 2006) that PFG disclosed an entity called Peregrine Financial Group Canada, Inc. (a wholly owned non-operating subsidiary of PFG) as a Material Affiliated Person.
[35] https://www.nfa.futures.org/NFA-about-nfa/who-we-are/NFAs-role-US-futures-industry.HTML.
[36] https://www.nfa.futures.org/nfamanual/NFAManual.aspx?RuleID=1001&Section=1.
[37] *Id*.

V. Background on Wasendorf's Fraud

On July 9, 2012, the FBI discovered multiple copies of a lengthy, confessional statement signed by Wasendorf detailing the fraud.[38] The BRG Investigative Team obtained and reviewed a copy of Wasendorf's statement.[39] The statement, in part, indicates that Wasendorf perpetrated a nearly twenty-year fraud by forging bank account records as follows: [40]

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> Through a scheme of using false bank statements I have been able to embezzle millions of dollars from customer accounts at Peregrine Financial Group, Inc. The forgeries started nearly twenty years ago and have gone undetected until now. I was able to conceal my crime of forgery by being the sole individual with access to the US Bank account held by PFG. No one else in the company ever saw an actual US Bank statement. The Bank statements were always delivered directly to me when they arrived in the mail. I made counterfeit statements within a few hours of receiving the actual statements and gave the forgeries to the accounting department.
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> ***
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> Using a combination of Photo Shop, Excel, scanners, and both laser and Ink Jet printers I was able to make very convincing forgeries of nearing [sic] every document that came from the Bank. I could create forgeries very quickly so no one suspected that my forgeries were not the real thing that had just arrived in the mail.

Wasendorf stated that he used his position to conceal the fraud from others at PFG:

> With careful concealment and blunt authority I was able to hide my fraud from others at PFG. PFG grew out of a one man shop, a business I started in the basement of my home. As I added people to the company everyone knew I was the guy in charge. If anyone questioned my authority I would simply point out that I was the sole shareholder. I established rules and procedures as each new situation arose. I ordered that US Bank statements were to be delivered directly to me unopened, to make sure no one was able to examine an actual US Bank Statement. I was also the only person with online access to PFG's account using US Bank's online portal. On US Bank['s] side, I told representatives at the Bank that I was the only person they should interface with at PFG. [41]

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[38] *See* the Criminal Complaint at paragraphs 3 and 4. Since Wasendorf attempted suicide after drafting the confessional statement, that statement has been characterized as a "suicide note".
[39] Wasendorf's Signed Confession at 1-4.
[40] *Id.* at 1-2.
[41] *Id.* at 2.

Wasendorf's statement further explained how he was able to deceive regulators:[42]

> When it became a common practice for Certified Auditors and the Field Auditors of the Regulators to mail Balance Confirmation Forms to Banks and other entities holding customer funds I opened a post office box. The box was originally in the name of Firstar Bank but was eventually changed to US Bank. I put the address "PO Box 706, Cedar Falls, IA 50613-1030" on the counterfeit Bank Statements. When the auditors mailed Confirmation Forms to the Bank's false address, I would intercept the Form, type in the amount I needed to show, forge a Bank Officer's signature and mail it back to the Regulator or Certified Auditor.
>
> When online Banking became prevalent I learned how to falsify online Bank Statements and the Regulators accepted them without question.
>
> It was relatively simple to deceive the Regulators during their Annual Audits since their Audit Modules guided them to find a number, tick a box, tie out totals, etc. They counted on the mailed back Bank Balance Confirmations to detect any shortfall in cash balance totals. They had no way to detect a counterfeit bank statement. They were actually distracted by their own agenda - to catch Firms unknowingly violating regulations.

In Wasendorf's interview with the BRG Investigative Team on December 4, 2012, he added further detail to his statements quoted above.[43] Wasendorf stated that there was one principal bank account used to effectuate the fraud: U.S. Bank Account #0 006 2101 1845 (the "845 Account") that was opened at Firstar Bank and later changed to a U.S. Bank account when Firstar Corporation acquired U.S. Bancorp in 2001 and assumed U.S. Bank's name.[44] Wasendorf stated that the 845 Account was established to hold customer segregated funds, which was required under CFTC regulations.[45] We reviewed 86 monthly account statements for the 845 Account from May 2005 – June 2012, which were provided by U.S. Bank to NFA auditors after the fraud was discovered (the "Actual U.S. Bank Statements"). That review indicated the account owner was PFG, but did not identify, as required by CFTC regulations, that the account was for segregated funds.[46] According to U.S. Bank, its records for the 845 account "reflect the

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[42] *Id.* at 2.

[43] We would note that it was not BRG's mandate to determine how Wasendorf conducted the fraud and we have not conducted an exhaustive analysis of this matter and thus, we do not have definitive conclusions with regard to how he conducted the fraud. We did review relevant documents in the investigation regarding Wasendorf's fraud for the purpose of understanding the NFA audits and have drawn some very preliminary conclusions that are discussed in the report below.

[44] Interview Memorandum of Wasendorf at 3-4; *See also*, Federal Reserve Board Order Approving Merger at http://www.federalreserve.gov/boarddocs/press/bhc/2001/200102124/attachment.pdf.

[45] Interview Memorandum of Wasendorf at 4; *See also,* Regulation § 1.20 which provides for Customer funds to be segregated and separately accounted for.

[46] Regulation § 1.20(a), which states that "[a]ll customer funds shall be separately accounted for and segregated as belonging to commodity or option customers. Such customer funds when deposited with any bank, trust company, clearing organization or another futures commission merchant shall be deposited under an account name which

account was a business checking account and not customer segregated account."[47] However, when Wasendorf fabricated bank statements, as he described in his confessional statement quoted above, he inserted the CFTC-required identifier for customer segregated funds in the account name shown. It was these forged bank statements that were given to the NFA auditors. According to U.S. Bank, Wasendorf had provided specific instructions to U.S. Bank that no account confirmations be authorized for the 845 account.[48] It appears that NFA auditors did receive actual bank statements from JPMorgan Chase & Co. ("JPM") and other banks provided by PFG during its audits of PFG.[49] While they also reviewed bank statements purporting to be from U.S. Bank, the statements they were provided had already been altered or fabricated by Wasendorf and, in some cases, used by PFG staff in their operations. During its investigation, the BRG Investigative Team did not find any evidence that suggests that NFA auditors received Actual U.S. Bank customer segregated account statements directly from U.S. Bank, or any other source, during the audits it conducted of PFG.

At PFG, customer segregated funds consisted of cash provided by PFG customers that served as deposits used to margin their trades, and any additional funds contributed by PFG ("Excess Funds") to further protect customer accounts.[50] The 845 Account had a sweep feature that invested a set amount of funds on deposit at the bank overnight in U.S. Treasury repos, which were essentially overnight loans PFG made to U.S. Bank secured by U.S. Treasury obligations. The loan proceeds, with interest, would be returned to the 845 Account the next morning. As shown on certain Actual U.S. Bank Statements,[51] there was an actual, functioning sweep feature for the 845 Account that utilized an actual separate sweep account (#0-007-9261-1352) at U.S. Bank. Accordingly, for each night that the sweep was in operation, the actual sweep feature would invest a set amount of funds from the 845 Account in repos that were listed and carried in the actual separate sweep account. Pursuant to the governing sweep agreement, the bank would then re-deposit the proceeds from the maturing repo the next morning into the 845 Account along with interest earned. Similar to the U.S. Bank customer segregated account statements above, during its investigation, the BRG Investigative Team did not find any evidence that suggests that NFA auditors contemporaneously received actual U.S. Bank sweep account statements directly from U.S. Bank during the audits they conducted of PFG.

Wasendorf utilized the sweep feature to hide his scheme. As discussed above, he improperly withdrew funds from the 845 Account, which purportedly was a customer segregated funds account for PFG. In his interview, Wasendorf explained that he made up overnight investments under the sweep feature on

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clearly identifies them as such and shows that they are segregated as required by the [Commodity Exchange] Act and this part."

[47] Letter from Peter W. Carter, Dorsey & Whitney LLP, counsel for U.S. Bank dated January 8, 2013.

[48] *Id*.

[49] NFA00006801- NFA00006887 (08-CEXM-16 Audit Papers).

[50] In futures trading, a customer's funds may be comingled with those of other customer funds and with the firm's funds; Excess Funds, then, provide protection in the event that one customer defaults. For an expanded discussion of the issue of Fellow Customer Risk, *see* Futures Industry Association publication titled, "Protection of Customer Funds – Frequently Asked Questions" at http://www.futuresindustry.org/downloads/PCF-FAQs.PDF**.**

[51] *See*, *e.g.,* NFA02496229 (December 2008 actual U.S. Bank statement).

the fabricated bank statements that he produced using "Photoshopped"[52] bank letterhead and an Excel spreadsheet.[53] The amount allegedly invested in repos was inflated both to hide his illicit withdrawals and to tie to the incorrect values on the firm's financial statements. He stated in his interview, however, that he did not create a separate sweep account statement for the repo transactions because he was "lazy."[54]

The absence of a separate sweep account statement, however, caused NFA auditors to raise questions in later years' annual audits, especially 2003 and 2005. As will be explained later in this report, PFG's Director of Compliance, O'Meara responded to those questions from NFA auditors by asserting that U.S. Bank did not produce a separate account statement for funds invested under the sweep agreement. Instead, she provided a document purporting to be a trade confirmation for a repo purchase on the night of the last day of the period being audited by NFA auditors. This happened on at least three occasions, and, for each, Wasendorf explained that he fabricated the trade confirmation. The amount of that fake trade confirmation, when added to the amount of cash shown residing in the fabricated 845 Account statement, matched the inflated total of customer funds shown on PFG's regulatory filings, thus hiding the fraud.

According to Wasendorf, funds that he illicitly moved out of the 845 Account were wired or transferred to several businesses that he owned. [55] Many of these related entities had checking accounts at U.S. Bank. When asked why transfers of funds from PFG's 845 Account to other Wasendorf businesses did not raise questions at U.S. Bank, Wasendorf responded that his majority ownership of those businesses may have been a factor.[56] According to U.S. Bank records, the 845 Account was not designated as a customer segregated funds account and appeared to be a normal, unrestricted corporate checking account. Further, since Wasendorf owned the majority of stock in PFG, a transfer between two Wasendorf-controlled entities may have been plausible. The BRG Investigative Team notes that the 2011 confirmation of the 845 account balance that was emailed by Hope Timmerman of U.S. Bank to NFA auditors includes, in a section of the confirmation presumably not prepared by the bank, the designation as a customer funds segregated account in the account title.[57]

For many years, PFG was not profitable (PFG's profitability is discussed in greater detail later in this report). To compensate for losses, to meet increased minimum net capital requirements and to create the appearance of a better capitalized firm, Wasendorf purportedly made capital contributions of more than $60 million between 2003 and 2012. For example, in his interview, Wasendorf explained how he fabricated some contributions by falsifying deposits to PFG's operating bank account, known as the

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[52] Adobe Photoshop is a software product used to digitally edit photos and other documents. http://www.photoshop.com/products.

[53] Interview Memorandum of Wasendorf at 3. For an example of the actual U.S. Bank statement, fabricated U.S. Bank statement, repurchase agreement confirmation, and a U.S. Bank balance confirmation balance sent to NFA Auditors, see Appendix O.

[54] *Id*.

[55] *Id*.

[56] *Id.*

[57] NFA00221631-NFA000221632 (US Bank Confirmation). Note that this was a confirmation sent by U.S. Bank, not a bank statement.

"House Account" (U.S. Bank Account number #0000767467).[58] Wasendorf said that he would request a cashier's check to be drawn on the 845 Account payable to the House Account, showing Wasendorf as remitter.[59] The amount of the check would be a nominal sum of $1,000, for example, but Wasendorf said he would add three zeros to the amount on a photocopy of the check and fabricate a false deposit slip to create a larger deposit amount.[60] Wasendorf said he would deposit the real cashier's check (i.e., $1,000) into the House Account and then fabricate bank statements for the House Account for a period of time showing the higher deposit amount (i.e., $1,000,000).[61] Some House Account bank statements show funds being transferred from the House Account to the 845 Account.[62] Wasendorf then created records suggesting that he had transferred the fictitious funds from the House Account to the 845 Account, for which he was already generating fabricated bank statements, which would bring the fictitious House Account balance down to the actual House Account balance and Wasendorf would no longer need to create false House Account statements.

The end result of the process of moving cash from the 845 Account to the House Account and then back to the 845 Account was a roundtrip, but the roundtrip of inflated deposits created inflated capital and Excess Funds, along with the appearance of greater financial strength.

SCOPE OF THE BRG INVESTIGATION

I. Document Review

During the course of the investigation, the BRG Investigative Team reviewed over 190,000 NFA documents containing over 3 million pages provided by counsel for NFA via access to a searchable database. Table 1 below summarizes the documents reviewed in the database. These documents included NFA audit modules, work papers and other supporting documentation for NFA's audits conducted of PFG during the years 1995-2012. The BRG Investigative Team also reviewed NFA training materials, JAC protocols, JAC board meeting minutes, various PFG financial information, documents relating to CFTC audits/reviews of NFA and over 166,000 emails of current and former NFA employees. For a detailed summary of Database documents, see Appendix A.

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[58] Interview Memorandum of Wasendorf at 3.

[59] *Id*. An altered version of this cashier's check would later be provided to PFG's bookkeepers. The photocopies of the cashier's checks in NFA's audit files identified Wasendorf as remitter but did not reflect from which account (845 Account or otherwise) the funds were drawn.

[60] *Id.* The photocopied $1,000,000 check and the fabricated deposit slip would be provided to PFG's bookkeepers, not to U.S. Bank.

[61] Interview Memorandum of Wasendorf at 3.

[62] *See,* for example, the NFA00039308 (June 2003 House Account bank Statement) showing a deposit of $6,500,000 on June 6, 2003, and a transfer of $2,000,000 to the 845 Account on June 5, 2003. NFA00039427-NFA00039428 (2003 NFA audit files) shows the cashier's check of $6,500,000, and related deposit slip and receipt. NFA00039425-NFA00039426 also contain minutes of a Special Meeting of the Shareholders of PFG explaining that the $6,500,000 deposit was a capital contribution from Wasendorf.

Table 1: Database Documents

General Description	Number of Documents	Number of Pages
Emails and Related Attachments	166,624	3,168,891
Miscellaneous Documents	11,171	146,550
Examination and Audit Documents	9,373	41,973
Training Documents	3,743	30,060
Joint Audit Committee Documents	499	2,255
Total	**191,410**	**3,389,729**

In addition to the materials summarized above, the BRG Investigative Team also reviewed a significant amount of publicly available information including, but not limited to, regulatory rules, guidance and various interpretative notices, financial and other regulatory filings related to PFG and other FCMs, and relevant industry and company news and information. The BRG Investigative Team also reviewed approximately 1,500 pages of interview materials resulting from our interviews (discussed below).

II. Interviews

In the course of its investigation, the BRG Investigative Team interviewed 32 individuals with knowledge of the facts or circumstances surrounding NFA's audits of PFG and received written information from an additional source. The BRG Investigative Team interviewed 25 current or former NFA employees, 5 former PFG officials, including former PFG CEO Wasendorf, the Receiver appointed by the United States District Court for the Northern District of Illinois, and the founder of Confirmation.com.

23 of the 25 interviews of current and former NFA staff were conducted in person and were transcribed by a court reporter. The remaining interviews were conducted via telephone from BRG's offices. H. David Kotz, Director, BRG and Jim Conversano, Principal, BRG, led the interviews of the current and former NFA employees.

The BRG Investigative Team conducted interviews of the following 25 current or former NFA employees:[63]

1) Current Auditor no. 1, taken on September 19, 2012;
2) Former Auditor no. 1, taken on September 19, 2012;
3) Current Auditor no. 2, taken on September 19, 2012;
4) Current Auditor no. 3, taken on September 27, 2012;
5) Former Auditor no. 2, taken on September 27, 2012;
6) Current Auditor no. 4, taken on October 3, 2012;
7) Current Auditor no. 5, taken on October 3, 2012;
8) Current Auditor no. 6, taken on October 3, 2012;
9) Current Auditor no. 7, taken on October 4, 2012;

[63] The identities of the current and former NFA employees interviewed in this investigation have been redacted from this report.

10) Former Auditor no. 3, taken on October 4, 2012;
11) Former Auditor no. 4, taken on October 4, 2012;
12) Current Auditor no. 8, taken on October 22, 2012;
13) Current Auditor no. 9, taken on October 22, 2012;
14) Current Auditor no. 10, taken on October 22, 2012;
15) Current Auditor no. 11, taken on October 23, 2012;
16) Former Auditor no. 5, taken on October 23, 2012;
17) Current Auditor no. 12, taken on October 23, 2012;
18) Former Auditor no. 6, taken on October 23, 2012;
19) Current Auditor no. 13, taken on November 5, 2012;
20) Former Auditor no. 7, taken on November 5, 2012;
21) Current Auditor no. 14, taken on November 6, 2012;
22) Former Auditor no. 8, taken on November 20, 2012;
23) Current Auditor no. 15, taken on November 20, 2012;
24) Former Auditor no. 9, taken on December 10, 2012; and
25) Former Auditor no. 10, taken on January 9, 2013.

In addition, the BRG Investigative Team interviewed NFA management at NFA's Chicago office on November 28, 2012 and participated in a telephonic meeting with senior NFA management on January 11, 2013 regarding the NFA's audit programs.[64]

The BRG Investigative Team also interviewed the following former PFG officials:

1. Wasendorf, on December 6, 2012;[65]
2. Wasendorf, Jr., on December 3, 2012;[66]
3. Thomas Pearson, PFG's former CFO, on November 19, 2012;[67]
4. O'Meara, PFG's former CCO, on December 19, 2012;[68]
5. Cuypers, PFG's former CFO, on December 19, 2012.[69]

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[64] Present for NFA at the meeting in Chicago were Daniel J. Roth (President and Chief Executive Officer), Daniel A. Driscoll (Executive Vice President and Chief Operating Officer), Thomas W. Sexton, III (Senior Vice President, General Counsel and Secretary), Michael Crowley (Associate General Counsel) and Regina G. Thoele (Senior Vice President, Compliance). Present for Jenner & Block were Robert Byman (Partner) and Gregory M. Boyle (Partner). Present for BRG were Charles Lundelius (Director), H. David Kotz (Director) and Jim Conversano (Principal). Interview Memorandum of Interview with NFA Management dated November 28, 2012.

[65] BRG's interview of Wasendorf was conducted at the Linn County Correctional Facility in Cedar Falls, Iowa on December 6, 2012. Present for BRG were H. David Kotz, Charles Lundelius, and Jim Conversano. Interview Memorandum of Wasendorf dated December 6, 2012.

[66] BRG's interview of Wasendorf, Jr. was conducted via telephone from BRG's office in Washington, D.C. on December 3, 2012. H. David Kotz, Charles Lundelius, Jim Conversano, Karina Bjelland and Matthew Torpey of BRG participated telephonically. Interview Memorandum of Wasendorf, Jr. dated December 3, 2012.

[67] BRG's interview of Tom Pearson was conducted at the Union League Club of Chicago in Chicago, Illinois on November 6, 2012. Present for BRG were H. David Kotz and Jim Conversano. Charles Lundelius and Jennifer Hull of BRG also participated telephonically. Interview Memorandum of Pearson dated November 6, 2012.

[68] BRG's interview of Susan O'Meara was conducted at the law offices of Henderson & Lyman in Chicago, Illinois, on December 19, 2012. Present for BRG were Charles Lundelius, H. David Kotz and Jim Conversano. Interview Memorandum of O'Meara dated December 19, 2012.

In addition, the BRG Investigative Team interviewed the Receiver for Wasendorf and the Wasendorf entities appointed by the United States District Court for the Northern District of Illinois in connection with the CFTC Complaint filed against PFG on November 6, 2012[70] and C. Brian Fox,[71] the founder and Chief Marketing Officer of Confirmation.Com on November 16, 2012. The BRG Investigative Team also received written responses to questions from counsel to U.S. Bank.[72]

RESULTS OF THE BRG INVESTIGATION

I. Summary of the Audits and Reviews of PFG by NFA and CFTC

a. Overview of NFA Audit Process

NFA conducts four types of audits (routine, educational, investigative and focused scope) for six types of firms (FCMs, Retail Foreign Exchange Dealers ("RFED"), Independent Introducing Brokers ("IIB"), Guaranteed Introducing Brokers ("GIB"), CPOs, and Commodity Trading Advisors ("CTA")).[73] The NFA audit program conducted over 600 total audits and investigations per year during FY2008-FY2011.[74] NFA's audits differ from the required annual certified audit provided by an independent accounting firm in that NFA's audits are designed not only to test that the firm's financial statements are prepared in accordance with Generally Accepted Accounting Principles ("GAAP"), but also to test the firm's compliance with pertinent NFA regulatory requirements. While conducting its audits, NFA auditors utilize a risk-based audit approach based on various factors including the number of accounts; number of Associated Persons ("AP") and background of personnel; lack [or frequency] of an audit; the number of investigative matters (i.e., customer complaints); promotional materials used; amount of funds under management; and the types of investments.[75] Additionally, NFA annually audits all FCMs holding customer funds for which it is responsible.

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[69] BRG's interview of Brenda Cuypers was conducted via telephone at the law offices of Henderson & Lyman in Chicago, Illinois, on December 19, 2012. Present for BRG were Charles Lundelius, H. David Kotz and Jim Conversano. Interview Memorandum of Cuypers dated December 19, 2012.

[70] BRG's interview of Michael M. Eidelman was conducted at the law office of Vedder Price in Chicago, Illinois on November 6, 2012. Present for BRG were H. David Kotz and Jim Conversano. Interview Memorandum of Eidelman dated November 19, 2012.

[71] BRG's interview of Brian Fox was conducted at the office of BRG in Washington, D.C. on November 16, 2012. Present for BRG were H. David Kotz, Jim Conversano and Matthew Torpey. Interview Memorandum of Brian Fox dated November 19, 2012.

[72] The BRG Investigative Team communicated and coordinated with representatives of the CFTC during its investigation. We sought to interview CFTC personnel and in addition, prepared and submitted to CFTC a list of questions regarding CFTC reviews of PFG, NFA reviews of PFG and coordination between the CFTC and NFA. The CFTC declined to respond to the BRG Investigative Team's questions or participate in interviews, as a result of the ongoing nature of the CFTC's enforcement investigation.

[73] 2NFA00004440-2NFA00004441 (The Audit Process: A Brief Overview, undated).

[74] 2NFA00004486 (New Auditors Handbook).

[75] 2NFA00004442 (The Audit Process: A Brief Overview, undated).

The NFA audit process comprises various stages including the pre-exam/pre-audit; the planning module; module completion and review "points";[76] and exit interview and the audit report.[77]

NFA's audit program generally utilized the following personnel during its audits conducted from 1995-2012: staff auditor I and II; field supervisor I and II (formerly in-charge auditor); senior manager or manager; associate director; and director. staff auditor I personnel generally consist of new hires, staff auditor II personnel are more experienced than staff auditor I personnel and typically are able to work somewhat independently, field supervisors are responsible for scheduling and running the audit and training the staff, and managers work directly with the field supervisor, review the overall audit and "present it" to a director.[78] Managers also have "mentoring responsibilities for staff" auditors.[79]

When staffing a particular audit, the NFA audit program generally considers training needs of staff, competency requirements for the audit and staff availability.[80] Typically, newer staff personnel (staff auditor I) assigned to an audit were paired with more experienced staff (staff auditor II, field supervisor I or II).[81]

Research and other work conducted prior to an onsite visit as part of an audit is referred to as pre-audit work.[82] Pre-audit work may take a week to several weeks to complete based on the nature of the audit.[83] NFA staff auditors are responsible for the leg work to be completed prior to fieldwork (i.e., pre-audit checklists) while planning is completed by a field supervisor or experienced staff.[84] Planning is very important to the pre-audit process and one of the most important aspects to the whole audit process.[85]

Pre-audit work for FCM audits includes the creation of a firm profile that includes gathering and reviewing information pertaining to any investigation naming the firm or its principals, compliance files for the previous two exams, most recent audit report, most recent audited financial statements. In addition, auditors also "discuss with [field supervisor] any unusual information found in files that should be included."[86] The NFA staff usually has a pre-audit meeting two or three days before the audit.[87]

During the pre-audit phase, the NFA field supervisor contacts the firm and completes the Risk Assessment Guide. The Risk Assessment Guide may be used as a supplement to the planning and

[76] Field supervisors and managers review work conducted by staff and generally provide feedback and comments called "points", with the goal of enhancing and improving the work product. 2NFA00004469.
[77] 2NFA00004443 (The Audit Process: A Brief Overview, undated).
[78] Tr. of Current Auditor no. 3 at 14:12-15:6.
[79] Tr. of Current Auditor no. 7 at 9:16-21; Tr. of Current Auditor no. 8 at 23:4-6.
[80] 2NFA00004445 (The Audit Process: A Brief Overview, undated).
[81] Tr. of Current Auditor no. 2 at 45:16-46:8.
[82] *Id.* at 58:24-59:14.
[83] *Id.* at 59:15-21.
[84] 2NFA00004446 (The Audit Process: A Brief Overview, undated).
[85] 2NFA00004542 (Instructor's Guide: The Audit Process, Revised August 26, 2005).
[86] 2NFA00004449-2NFA00004451 (The Audit Process: A Brief Overview, undated).
[87] 2NFA00004455 (The Audit Process: A Brief Overview, undated).

scoping document, which is typically prepared prior to an audit.[88] NFA's 2005 New Auditor Handbook explains the risk assessment guide as follows:

> The risk assessment guide is completed by the field supervisor to obtain information regarding the firm's business operations prior to fieldwork. It includes numerous questions that the field supervisor asks the firm when the audit is announced, usually 2 weeks prior to fieldwork. The field supervisor documents the information obtained in the risk assessment guide into planning.doc to select scopes and determine what testing needs to be completed.[89]

The Risk Assessment Guide includes a series of questions related to the following topics: Futures Trading Accounts; General Firm Operations; Futures Commission Merchant & Introducing Broker Operations; Commodity Pool Operator Operations; Commodity Trading Advisor Operations; Security Futures Products Activity; Forex Activity; General Procedures; and Key Employees.[90]

The BRG Investigative Team noted that the Risk Assessment Guide does not contain substantive questions regarding the internal controls or the compliance culture (i.e., "tone at the top") of the firm being audited. For instance, the Risk Assessment Guide asks for the identification of key employees at the firm, but does not include questions regarding the segregation of duties, responsibilities and authority of such individuals at the firm.[91] The Risk Assessment Guide includes a question related to the identification of the outside auditor, but does not include questions regarding the experience or qualifications of the outside auditor.[92] The Risk Assessment Guide also includes a question regarding the amount of excess net capital at the firm, but does not include questions regarding trends pertaining to profitability and capital contributions at the firm over time.[93] The Risk Assessment Guide also does not specifically address American Institute of Certified Public Accountants ("AICPA") standards, or any other standards pertaining to fraud risk factors (see section of this report titled, "NFA's Level of Scrutiny of PFG's Internal Controls"). The Risk Assessment Guide also will be discussed in further detail in the section of this report titled, "NFA's Use of its Risk Assessment Guide."

Utilizing the information obtained from the Risk Assessment Guide, the field supervisor completes a planning document, which is used to determine the scope and length of the audit, and also can be used as a tool during the audit process to determine if any discrepancies exist between the information found during pre-audit and what is found during fieldwork.[94]

After the completion of the pre-audit work, staff auditors and field supervisors are primarily responsible for conducting the on-site fieldwork during audits and a manager typically would attend the onsite

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[88] Tr. of Former Auditor no. 2 at 28:19-24.
[89] 2NFA00004392 (The New Auditor Handbook, Audit Process, 2005).
[90] 2NFA00020324-2NFA00020328 (Risk Assessment Guide, September 2011).
[91] 2NFA00020328 (Risk Assessment Guide, September 2011).
[92] 2NFA00020326 (Risk Assessment Guide, September 2011).
[93] *Id*.
[94] 2NFA00004460 (The Audit Process: A Brief Overview, undated).

portion at the end of the audit.[95] The length of time needed to conduct the on-site portion of audits varies, but we noted that most of the audits of PFG we reviewed lasted between 1-3 months.

Each NFA audit module is usually "self-contained," and as a result, auditors should be able to complete most, if not all, of the work in the applicable module and cross-reference work completed in other modules rather than duplicating work.[96] The NFA modules also are designed to allow staff to exercise their own judgment in deciding what and how much work should be performed (which modules to complete, which audit steps are necessary, where to reduce testing and where to expand testing).[97] A detailed description of each PFG audit conducted by NFA auditors from 1995 through 2012 is contained in Appendix B. A list and description of many of the modules conducted by NFA auditors is included as Appendix C. The audit modules are based upon the recommended modules of the JAC, which are used uniformly by auditors at SROs.

NFA's goal is not to perform the "perfect" audit; however, if any mistakes are made or if subsequent events reveal something was missed, it is NFA's goal to ". . . learn from it."[98]

Audit modules list the procedures to be performed and documentation should be "clear and brief" and "answer the objective of the audit step."[99] NFA auditors utilize sampling techniques to select the scope of an audit, "rather than testing 100% of a population," and may assess the firm's internal controls to determine sample size.[100]

Staff are instructed to discuss any rule violations with their supervisor and after determining that the firm has committed a rule violation, the staff informs the firm and records the violation.[101] A single document ("Internal Control [IC] Summary") is used to summarize and record all findings, deficiencies and rule violations noted by the audit team. It is also used to record the firm's responses and any corrective action.[102] NFA auditors also typically draft an audit report and/or management representation letter.[103] NFA auditors also conduct an exit interview to inform the firm formally of the findings and recommendations noted during the course of an NFA audit and to obtain the firm's formal response with regard to the corrective actions it intends to take to resolve the problems.[104] After the exit interview, the audit team follows-up on any open items from the audit and the manager formally issues the audit report, which is the report or management letter sent to the firm that summarizes the audit team's findings during fieldwork.[105]

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[95] Tr. of Current Auditor no. 2 at 45:4-9; Tr. of Current Auditor no. 3 at 15:7-18.
[96] 2NFA00004464 (The Audit Process: A Brief Overview, undated).
[97] 2NFA00004465 (The Audit Process: A Brief Overview, undated).
[98] 2NFA00004466 (The Audit Process: A Brief Overview, undated).
[99] 2NFA00004467 (The Audit Process: A Brief Overview, undated).
[100] 2NFA00004468 (The Audit Process: A Brief Overview, undated).
[101] 2NFA00004471 (The Audit Process: A Brief Overview, undated).
[102] 2NFA00004472 (The Audit Process: A Brief Overview, undated).
[103] 2NFA00004473 (The Audit Process: A Brief Overview, undated).
[104] 2NFA00004476 (The Audit Process: A Brief Overview, undated).
[105] 2NFA00004478 (The Audit Process: A Brief Overview, undated); 2NFA00004481 (The Audit Process: A Brief Overview, undated).

Standards for NFA audits are established by JAC. The JAC is a representative committee of the Audit and Financial Surveillance departments of U.S. futures exchanges and regulatory organizations, including representatives of the NFA and other SROs as well as representatives of the CFTC.[106] Members of JAC include: [107]

Board of Trade of the City of Chicago, Inc.
Board of Trade of Kansas City
CBOE Futures Exchange, LLC
Chicago Climate Futures Exchange, LLC
Chicago Mercantile Exchange, Inc.
Commodity Exchange, Inc.
ELX Futures, LP
Eris Exchange, LLC
HedgeStreet, Inc.
ICE Futures U.S., Inc.
INET Futures Exchange, LLC
Minneapolis Grain Exchange
NASDAQ OMX Futures Exchange
National Futures Association
New York Mercantile Exchange, Inc.
NYSE Liffe, LLC
OneChicago, LLC

b. Summary of Audit Standards

Through JAC, FCMs are assigned a lead futures SRO, such as NFA, that is responsible for performing risk-based examinations designed to meet the goals of customer protection and ensuring financial integrity of commodity and futures exchanges. Such examinations are conducted in accordance with the JAC audit program,[108] which is reviewed annually by the CFTC. NFA also audits FCMs that are not members of a futures exchange.

JAC prescribes risk-based examinations only of FCMs. JAC's audit practices and procedures are prescribed in its three-part audit program: [109]

1. General
2. Compliance
3. Financial

As of March 2007, JAC noted that FCMs generally are reviewed at least every 15 months, with only extenuating circumstances and extremely low risk firms reviewed on an 18-month cycle.[110] Some sections of the JAC audit program may not be performed on every examination. However, all core program sections must be performed at least once every 3 examination cycles.

[106] 2NFA00682916 (JAC Audit Concepts, March 2007).
[107] http://www.nfa.futures.org/nfa-compliance/joint-audit-committee.HTML (as viewed on November 20, 2012).
[108] The BRG Investigative Team reviewed the 2002-2010 JAC audit programs (Examples: NFA03353289-NFA03353321 (JAC Program 2010 COMPLIANCE); NFA03353322-NFA03353368 (JAC Program 2010 FINANCIAL); NFA03353369-NFA03353391 (JAC Program 2010 GENERAL).
[109] 2NFA00682916-2NFA00682921 (JAC Audit Concepts, March 2007).
[110] 2NFA00682916 (JAC Audit Concepts, March 2007).

NFA audit programs and procedures follow JAC audit practices and procedures, and NFA audit modules are generally based on JAC audit modules. NFA audits generally met in all material respects the expectations, recommendations, and requirements of the JAC.

To the extent the JAC audit program is silent on an issue, the BRG Investigative Team looked to auditing standards developed by other relevant and recognized organizations for guidance, such as the AICPA and the Public Company Accounting Oversight Board ("PCAOB").[111]

c. Summary of CFTC Reviews of PFG

During the relevant period, the CFTC conducted audits of PFG. While the effectiveness of those audits and their findings are beyond the scope of the BRG Investigation, we include a brief description of these reviews to provide context for the regulatory environment.

The BRG Investigative Team communicated and coordinated with representatives of the CFTC during its investigation. We sought to interview CFTC personnel and in addition, prepared and submitted to CFTC a list of questions regarding CFTC reviews of PFG, NFA reviews of PFG and coordination between the CFTC and NFA. The CFTC declined to respond to the BRG Investigative Team's questions or participate in interviews, as a result of the ongoing nature of the CFTC's enforcement investigation.

i. CFTC Audits in 1994

According to Wasendorf, the CFTC "audited [PFG] five times during a six-month period" sometime around 1994.[112]

Wasendorf stated that Cliff Mortensen was the account representative at U.S. Bank for PFG in 1994. He further claimed that, as part of a CFTC audit, Bob Agnew, the Acting Regional Director of the Kansas City field office of CFTC, walked into the office of U.S. Bank and asked for all of the signed bank confirmation statements for PFG.[113] According to Wasendorf, Mortensen told the CFTC that he would not comply with their request.[114] Wasendorf claimed that he believed that Agnew's request in 1994 was the closest regulators came to uncovering the fraud.[115]

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[111] Where appropriate, we cite standards from PCAOB because the CFTC, in November 2012, proposed to require CPAs that audit FCMs to register with and be subjected to review by that body. However, it should be noted that these other standards are primarily used in connection with an audit of public company's financial statements and are not used to determine compliance with applicable regulations. Thus, the JAC and NFA modules do not always follow the PCAOB's standards.

[112] Interview Memorandum of Wasendorf at 4. These assertions by Wasendorf, like many of his assertions, could not be validated or refuted by the BRG Investigative Team. We also note that these audits took place prior to the first NFA audit of PFG that the BRG Investigative Team reviewed.

[113] *Id.* at 5.

[114] *Id*. at 5.

[115] *Id.* at 5. We note that counsel for U.S. Bank indicated that U.S. Bank had no record of a request from Agnew.

ii. CFTC 1999 Audit of PFG and Settlement of Enforcement Action in 2000

In August 1999, the CFTC's Division of Trading and Markets ("T&M") completed an audit of PFG. The CFTC audit disclosed that several adjustments would be required for PFG's financial statements to comply with Section 4f(6) of the Act. [116] The CFTC found that PFG was below its minimum financial requirements as of March 26, 1999, and that PFG failed to file a timely notice with the CFTC that its adjusted net capital was less than the minimum required.[117] The CFTC also found that PFG failed to file notice that its adjusted net capital was below the early warning threshold on several occasions, and that PFG failed to keep accurate books and records.[118]

On September 7, 2000, PFG entered into a settlement with the CFTC based upon the findings in the 1999 audit and agreed to pay a civil penalty of $90,000 (the "Settlement Order").[119] The Settlement Order included the following three violations on the part of PFG, which arose out of findings from the 1999 audit:

(1) The CFTC found PFG to be in violation of CFTC Regulation 1.17(c)2)(ii), which requires all unsecured accounts receivable to be excluded from "current assets" when calculating net capital, with a few exceptions. The CFTC found that PFG had misclassified $364,348 in receivables from Wasendorf and Associates and a $45,000 receivable from Peregrine Commodity Group, Inc.[120]

(2) The CFTC found PFG to be in violation of CFTC Regulation 1.12(a)(1)-(2), which requires that an FCM which knows (or should know) it is undercapitalized must immediately give the CFTC notice via telephone of the undercapitalization and confirm it in writing. Pursuant to this regulation, the FCM then has 24 hours to file a statement of financial condition and a computation of its minimum capital requirements with the CFTC. The CFTC found that although PFG's adjusted net capital immediately preceding certain capital infusions fell below the early warning level on several occasions in 1998 and 1999, PFG did not give the CFTC written notice of these facts until two months after the date of the undercapitalization.[121]

(3) The CFTC found that PFG's general ledger and statement of financial condition and net capital computation in its Form 1-FR-FCM as of March 26, 1999, were inaccurate because of its misclassification of receivables as described in the first violation.[122]

Under the settlement, in addition to the civil penalty, PFG agreed to the following undertakings:

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[116] CFTC Docket No. 00-32, Order Instituting Proceedings in the Matter of: Peregrine Financial Group, Inc. (September 7, 2000).
[117] *Id.*
[118] *Id.*
[119] *Id.*
[120] *Id.*
[121] *Id.*
[122] *Id.*

(1) Continue to cooperate fully with the CFTC and fully explain its financial income and earnings, budget, status of assets and financial statements.

(2) Accelerate recognition of certain capitalized expenses and classify more assets as non-current for purposes of PFG's net capital computation.

(3) Prepare more timely, accurate, and complete reconciliations of balance sheet accounts, including cash and investment accounts.

(4) Implement certain initiatives and changes to its regulatory financial reporting. The initiatives and changes concerned budgets, variance analyses, and additional regulatory reporting requirements. For instance, for a period of two years, PFG was required to notify the Division of Trading and Markets ("T&M") at the Commission's Chicago Regional Office of capital contributions exceeding $100,000.

(5) Maintain its adjusted net capital at a level that is at least $800,000 above PFG's "early warning level" (i.e., $800,000 above 150% of PFG's minimum capital requirement under the Commission's rules).

(6) Hire a certified public accountant ("CPA"), other than the CPA it was currently using, to evaluate PFG's financial statements for the quarters ending October 31, 2000, March 31, 2001 and June 30, 2001, in accordance with the "Schedule of Agreed-Upon Procedures" detailed in Attachment A to CFTC's order against PFG. The CPA was also required to submit a report of the findings to PFG and T&M for each of the three quarters.[123]

PFG retained PricewaterhouseCoopers ("PWC") to perform these functions. An example of the tasks PWC was required to complete was to, "Obtain copies of wire transfer receipts/deposit slips evidencing cash capital contributions made by the shareholder (Russell Wasendorf), or any future shareholder that may invest in PFG, during the quarters ending October 31, 2000, March 31, 2001 and June 30, 2001 and to agree such wires/deposits to the corresponding bank statements for the account to which the funds were wired/deposited."[124]

Although the settlement and agreed-upon undertakings required a second review of certain financial records, it did not specifically require the use of third party bank confirmations. Many of the tasks that PWC was asked to perform were related to the classification of assets as "current" or "non-current."[125]

[123] *Id.*
[124] *Id.*
[125] *Id.*

iii. 2009 CFTC Review of Repo Agreements

In 2009, the CFTC conducted a review of PFG. During his December 2012 interview, Wasendorf recalled receiving an inquiry from the CFTC regarding PFG's use of repos.[126] According to Wasendorf, the CFTC questioned which investments PFG was making in conjunction with the repos and whether these "investments were in compliance with the new CFTC repo regulations."[127] Wasendorf stated that he replied to the CFTC and told them that PFG would stop using the repos. Wasendorf said the CFTC "seemed glad" about this decision by PFG.[128]

On May 21, 2009, a CFTC auditor sent an email to O'Meara of PFG stating that, in connection with CFTC's review of the Master Repurchase Agreement ("Master RA") between U.S. Bank and Peregrine Financial Group, the CFTC found that U.S. Bank retained possession of the securities, which was a violation of the 1-FR-FCM instructions.[129] The CFTC auditor further stated that "if the repurchase agreement is still in effect, the investment is fine, however, we recommend the collateral should be held at another acceptable Regulation 1.25 depository."[130] O'Meara forwarded a copy of this email to the then-NFA senior manager.[131]

NFA auditors were informed of the CFTC review by O'Meara of PFG, who mentioned it to the then-NFA senior manager during NFA's 2009 audit, stating that the "CFTC was looking at the [PFG] U.S. Bank reverse repo account."[132] However, this former NFA senior manager stated that she never learned the results of the CFTC review and did not recall any communication with CFTC about the review.[133]

iv. CFTC's 2010 AML Review

In November 2010, the CFTC conducted a review of PFG's Anti-Money Laundering ("AML") Program. NFA staff found out about the CFTC's AML review from O'Meara of PFG as per a November 12, 2010 email, which reflected the following:[134]

> O'Meara mentioned that the CFTC conducted an onsite AML review of the firm. Susan was concerned as one of the CFTC staff stated during the review that PFG couldn't hold customer funds, that the firm was required to have its AML procedures signed off by senior management on an annual basis and that the firm needed to expand some of its procedures regarding SARs.

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[126] Interview Memorandum of Wasendorf, at 5.
[127] *Id.*
[128] *Id.*
[129] NFA00417806-NFA00417807 (Email exchange between NFA manager and O'Meara, May 21, 2009).
[130] *Id.*
[131] NFA00901163 (Email correspondence between O'Meara and NFA senior manager).
[132] Tr. of Former Auditor no. 7 at 20:7-8.
[133] *Id.* at 20:21-21:3.
[134] NFA00229570 (NFA internal Email dated November 12, 2010).

The NFA auditor who wrote the above-referenced email did not recall having a conversation with anyone at the CFTC regarding their onsite AML review of PFG, or ever learning the results of the CFTC's review.[135]

II. Experience Level of NFA Auditors

NFA audits are structured with two levels of staff.[136] There are staff auditors, who are often "recently new hires," and there are field supervisors and managers, who are more experienced. The staff auditors and field supervisor generally will be on-site throughout the audit while "the manager will arrive in the field towards the end of the field work."[137]

During the course of the investigation, we spoke to 25 current and former NFA employees, 23 of whom participated in the audits of PFG between 1995 and 2012. 18 out of the 23 auditors began their careers with NFA immediately after graduating from college. 11 of these auditors received degrees in Accounting, 7 others graduated with a degree in Finance, and the rest of the auditors obtained degrees in Business Administration or Business Management. Moreover, many of these auditors testified that they had little to no experience in the futures industry when they first joined NFA. For example, one auditor, who worked on the 1998 audit of PFG, and was hired by NFA in 1987, stated that, when he was hired by NFA, he did not know anything about the futures industry.[138] Another NFA auditor who worked on three PFG audits stated that the "extent" of his experience with the futures industry was "a class in derivatives" in college before joining the NFA.[139] 3 NFA auditors who worked together on the 2009 audit of PFG all acknowledged that they knew very little about the futures industry before they started with NFA.[140] By the time the 2009 audit began in January 2009, 2 of these auditors had worked for NFA for approximately 18 months and 2 years, respectively.[141]

We also found that, consistent with general industry practice, after a several-week training course, many of these auditors immediately began actively working on audits of non-FCM firms, and thereafter, FCM firms. One of the NFA auditors for the 2001 audit of PFG, who started working at NFA in June 2000, began working on an audit within the first month of her employment.[142] An auditor on the 2009 audit of PFG (who began working at NFA in January 2007) began his first audit four or five weeks after he started with NFA.[143] Several others auditors similarly reported beginning their first audits after between four and six weeks of being at NFA although the audit team also included supervisors who were reviewing

[135] Tr. of Former Auditor no. 7 at 39:16-22. The BRG Investigative Team also did not find evidence that senior officials at NFA were apprised of these CFTC findings.
[136] Tr. of Current Auditor no. 3 at 14:16-20.
[137] *Id.* at 14:20-15:18.
[138] Tr. of Former Auditor no. 3 at p. 25:3-5.
[139] Tr. of Current Auditor no. 9 at p. 8:5-7.
[140] Tr. of Current Auditor no. 10 at 15:14-17; Current Auditor no. 11 at 8:8-12 and Former Auditor no. 5 at 7:16-24.
[141] One started at NFA in June 2007 (Tr. of Current Auditor no. 8 at 6:16-20) and the other started in January 2007 (Tr. of Current Auditor no. 11 at 8:3-7).
[142] Tr. of Current Auditor no. 3 at 7:16-20.
[143] Tr. of Current Auditor no. 11 at 10:20-24.

their work product.[144] The investigation further revealed that the manner in which the audits were structured gave significant responsibility to junior auditors within the first year (or early in their career) at NFA. NFA employees who had just graduated from college were hired in the position of staff auditor I. This position was responsible for conducting modules such as net capital, cash activity, records and registration, and conducting financial testing.[145] While they worked on teams with more experienced auditors, the investigation found that some of the auditors who supervised the staff auditors were relatively inexperienced themselves. We found that some NFA auditors were promoted to the position of field supervisor[146] within two years from the time they joined NFA right out of college.[147] A few of these auditors were then promoted to senior manager only one year later.[148]

Field supervisors' roles were described as "running the audits" and reviewing the work of and training the staff auditors.[149] One auditor stated, as field supervisor, "[y]ou're the one out there responsible for the entire team."[150] While the senior managers were formally in charge of the field supervisor, we found that often, a senior manager would come out to the field "usually [only] the second week of the audit . . . [to] meet the firm to discuss any deficiencies with the audit."[151]

Two auditors who were interviewed during the investigation expressed concerns about the experience level of and support for junior auditors at NFA. The concerns expressed, which were consistent with the BRG Investigative Team's findings in this investigation, related to a lack of "support" from managers for auditors in the field.[152] Further, the BRG Investigative Team found that auditors with limited industry experience were able to execute the modules by rote; but, without significant support, they would struggle in being able to follow up on potential indicators of fraud. [153]

Several auditors indicated that the lack of experience resulted in a "check the box" mentality, particularly, when utilizing the modules. One stated explicitly that NFA needed more people "who can look beyond the audit module as just a checklist."[154] Another acknowledged that staff level auditors often "really don't know the big picture" and there were times where the supervisor or manager was "not as helpful as they could be."[155] A third auditor said, "I think when you are only hiring people

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[144] Tr. of Current Auditor no. 13 at 9:14-10:3; Tr. of Former Auditor no. 6 at 7:18-23; Tr. of Current Auditor no. 14 at 8:17-21.
[145] Tr. of Current Auditor no. 13 at 10:15-24. We note that, as discussed below, staff auditors 1s are provided additional training six months after joining NFA.
[146] Field supervisors were also known as in-charge auditors. Tr. of Current Auditor no. 1 at 24:1-11.
[147] Tr. of Current Auditor no. 2 at 8:1-13; Tr. of Former Auditor no. 2 at 8:2-5; Tr. of Former Auditor no. 3 at 8:2-9 ; Tr. of Former Auditor no. 5 at 7:10-12; Tr. of Current Auditor no. 10 at 7:13-23; Tr. of Current Auditor no. 6 at 9:1-11; Tr. of Current Auditor no. 7 at 7:3-11.
[148] Tr. of Current Auditor no. 10 at 8:1-5; Tr. of Current Auditor no. 2 at 8:15-22.
[149] Tr. of Current Auditor no. 3 at 15:1-3; Tr. of Former Auditor no. 3 at 8:12-13; Tr. of Current Auditor no. 2 at 8:12-14.
[150] Tr. of Current Auditor no. 8 at 13:8-10.
[151] Tr. of Current Auditor no. 1 at 24:20-25:9.
[152] Tr. of Current Auditor no. 7 at 39:2-4.
[153] Tr. of Former Auditor no. 2 at 13:21-14:2; 14:19-15:12; Tr. of Current Auditor no. 7 at p. 49:1-8.
[154] Tr. of Current Auditor no. 4 at 15:10-11.
[155] Tr. of Current Auditor no. 8 at 20:16-19.

directly out of college and the only thing people know is what they're trained on, you're definitely limited."[156] Another former auditor said the focus when she was at the NFA was on "minutia" and the audits were "essentially a paper exercise."[157]

The BRG Investigative Team further found that NFA field supervisors expressed concerns about managers being unresponsive on occasion, and this presented problems particularly where field supervisors had just been promoted to their positions and the staff auditors were inexperienced.[158] In the 2011 audit, for example, a staff auditor became aware of a bank confirmation that was significantly different than the corresponding bank statements supplied by PFG, but the field supervisor and manager do not have any recollection of being made aware of this fact and there was insufficient follow-up as a result.[159]

In summary, the BRG Investigative Team found anecdotal evidence of inexperienced NFA auditors lacking support and supervision. While this may have impacted several of the NFA audits of PFG, we did not find sufficient evidence to conclude that NFA audits of PFG were significantly placed at risk as a result.

NFA management commented that it has been difficult to attract auditors with industry experience to serve as staff auditors, but they recently have been more effective in hiring field supervisors and managers with significant experience. They also indicated that there were efforts underway to ensure that managers spend more time in the field to provide the necessary support for field supervisors and staff auditors.[160]

III. NFA Training Programs

In addition to formalized training for newly hired staff, the NFA audit program also provides ongoing training. For instance, the NFA audit program has developed numerous training materials, including PowerPoint presentations, web-based materials, and printed materials covering its audit modules as well as the following key topics:

1. Fraud
2. Red Flags
3. Internal Controls
4. Lessons Learned

In addition, NFA's risk-based audit approach is discussed in NFA's New Auditor Handbook and in the "Overview of NFA Audit Process" section of this report. The New Auditor Handbook lists potential risk factors that NFA auditors should be aware of when conducting audits, such as the number of new

[156] Tr. of Former Auditor no. 5 at 20:24-21:4.
[157] Interview Memorandum of Former Auditor no. 9 at 2.
[158] Tr. of Current Auditor no. 7 at 27:17-28:17; 38:14-39:7.
[159] Tr. of Current Auditor no. 13 at 39:7-40:9; Tr. of Current Auditor no. 12 at 54:16-55:6; Tr. of Current Auditor no. 15 at 68:20-69:8.
[160] Further information about NFA's internal staffing structure and recruiting efforts can be found in Appendix D.

customers, low excess net capital or operations and internal controls.[161] The New Auditor's handbook also notes, "If we make a mistake, we will learn from it."[162]

Some examples of specific training materials addressing the four key topics listed above include the following:

1. Fraud Auditing for NFA Staff, Participant Guide[163]
2. Fraud Auditing for NFA Staff, Page on Red Flags[164]
3. Fraud Auditing[165]
4. Fraud Auditing presentation[166]
5. Dig Deeper When You See Discrepancies[167]
6. The Journal of Accountancy, Top 10 Audit Deficiencies, Lessons from fraud-related SEC cases[168]
7. Financial Investigation Procedures[169]
8. New Auditor's Handbook, The Audit Process[170]
9. Leading Audits (discusses "Planning and Administering an Audit" and "Training and Developing Staff").[171]

The section on "Red Flags" in the Fraud Auditing Guide for NFA staff explains that red flags are a "warning of danger or of a potential problem" and provides examples of red flags such as: 1) a firm that uses an unusually large number of different banks; 2) a weak internal control process; 3) weak internal audit function; and 4) financial problems. The red flags section also provides a link to "Red Flags for Fraud" by Steven Hancox (2007).[172]

The Fraud Auditing presentation identifies the main elements of fraud, such as "a misrepresentation of a fact," and "intent to deceive."[173] The presentation also addresses the topic of "Professional Skepticism" which is necessary for being able to detect fraud. Using SAS No. 99: Consideration of Fraud ("SAS 99") as its source, the presentation provides the following definition:[174]

> Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence. The auditor should conduct the engagement with a mindset that recognizes

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[161] 2NFA00004390 (New Auditor's Handbook, The Audit Process).
[162] 2NFA00004387 (New Auditor's Handbook, The Audit Process).
[163] 2NFA00019899-2NFA00019928 (Fraud Auditing for NFA Staff, Participant Guide).
[164] 2NFA00689711-2NFA00689714 (Fraud Auditing for NFA Staff, Participant Guide).
[165] 2NFA00006907-2NFA00006926 (Fraud Auditing).
[166] 2NFA00019859-2NFA00019879 (Fraud Auditing presentation).
[167] 2NFA00016912-2NFA00016913 (Dig Deeper When You See Discrepancies).
[168] 2NFA00007020-2NFA00007026 (Lessons from fraud-related SEC cases).
[169] 2NFA00052059-2NFA00052060 (Financial Investigation Procedures).
[170] 2NFA00004386-2NFA00004416 (New Auditor's Handbook, The Audit Process).
[171] 2NFA00020233-2NFA00020345 (Training & Development - Leading Audits, September 2011).
[172] http://www.knowledgeleader.com/KnowledgeLeader/content.nsf/Web+Content/ChecklistsGuidesFraudRedFlags!OpenDocument , dated October 30, 2000. *See also*, 2NFA00689711 (Fraud Auditing for NFA Staff, Participant Guide).
[173] 2NFA00019864 (Fraud Auditing presentation).
[174] 2NFA00019865 (Fraud Auditing presentation).

> the possibility that a material misstatement due to fraud could be present, regardless of any past experience with the entity and regardless of the auditor's belief about management's honesty and integrity.

According to the "Fraud Triangle" page of the presentation, "insufficient internal controls" is one of the opportunity factors that could contribute to the occurrence of fraud, and one of the incentive factors listed is an "expensive lifestyle to maintain." The presentation instructs auditors to "apply certain indicators/red flags to audits and investigative work."[175] Further, auditors are instructed to put as much emphasis on intuition as they do on formal analytic procedures, to "[t]hink like a thief," and to "absorb information, no matter how small."[176]

Among the training materials used by the NFA was an article, "Lessons from fraud-related SEC cases," published by the Journal of Accountancy. This article highlighted that "CPAs can learn how to better detect financial statement fraud by understanding mistakes others made in cases . . . ," and that the most common problem was "the auditor's failure to gather sufficient audit evidence."[177] Further, audit program design was cited as an issue, because audit programs should be adjusted and tailored based on inherent risk, which is different for every audit and firm. Professional skepticism was identified as a crucial component in this summary of lessons learned. Additional common problems listed included an "overreliance on inquiry as a form of audit evidence" and "assuming internal controls exist when they may not."[178]

Additionally, there are numerous detailed training documents for the many modules that the auditors must complete. The four key topics of fraud, red flags, internal controls and lessons learned are also addressed within these training materials. For example, in the new Auditor's Handbook section on Trading, the topic of fraudulent trading of non-customer accounts and customer accounts is discussed. According to this document, "This module should detect improper internal controls or fraudulent and improper activities that can be a great liability to the firm."[179] One of the specific steps is for the auditor to "examine the monthly account statements for the Member's own trading accounts, including error accounts, and those of principals, APs, affiliates and family members for each of the past three months. Describe anything unusual noted."[180] In the training materials for AML, the topic of red flags is frequently discussed. More information and detailed descriptions on these modules can be found in Appendix C.

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[175] 2NFA00019866 (Fraud Auditing presentation). See Also, 2NFA00019862 (Fraud Auditing Presentation).
[176] 2NFA00019874 (Fraud Auditing presentation).
[177] 2NFA00007020 (Lessons from fraud-related SEC cases).
[178] *Id*.
[179] 2NFA00018515 (The New Auditor's Handbook, Trading).
[180] *See, e.g.,* NFA00007466 (08-CEXM-016 Trading module).

The BRG Investigative Team also reviewed an example of an employee proficiency test[181] dated June 2010, but could not determine if tests or certifications exist for all training topics, and it is unclear who completed this particular test.[182]

The BRG Investigative Team reviewed the training materials that NFA provided and found that the subject matter was relevant and similar to JAC materials as well as those used by other regulators. However, we did not see records of when the training materials were used or the attendance records associated with such materials. Although some of the materials are dated, there are others that are not, and for those that are dated, there is no indication of the dates they were actually used. For example, "The Audit Process" section of the New Auditor Handbook is dated 2005, however the dates of use are not apparent. For those documents dated more recently, such as 2011, it is not clear whether an earlier version of the training materials existed. As a result, it is difficult to determine how widely and consistently the training materials were used.

In addition to the training materials discussed above, new auditors are subject to an intensive training regimen. NFA auditors were trained for between 3 and 4 weeks at the outset of their employment with NFA. This initial training was described during BRG Investigative Team interviews as "the first week or two" being "used to familiarize [the auditor] with the rules and regulations and industry in general [and] type of commodities markets in general."[183] Afterward, auditors "have at least a week where [they] conduct a mock audit in a conference room setting where [they] just review all the audits or [NFA] just make[s] up audits for [them] to do."[184] In this "mock audit," NFA supervisors would "take an old audit" and have the new auditing staff "complete the testing."[185]

After an auditor has been at the NFA for approximately six months, new staff undergoes a second round of training.[186] In this second round, new staff are trained on "the more difficult modules such as seg[regation]."[187] An auditor stated that in recent years, the second round of testing has "focused on financials, whether it's pool reporting . . . [and] more advanced financials in terms of performance testing."[188] He indicated that, in recent years, the first round of training has been compliance based.[189]

In addition, numerous auditors reported that additional training over their tenure at NFA was available to them. Training was described by one auditor as "constantly available" and "in any type of specialty."[190] Another auditor described the training at NFA as "continual" and noted that there was

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[181] This training document consisted of an 11-page multiple choice examination covering numerous audit topics 2NFA000001371-2NFA00001381 (Proficiency Test June, 2010).
[182] *Id.*
[183] Tr. of Current Auditor no. 3 at 75:22-76:2.
[184] *Id.* at 76:3-7.
[185] Tr. of Current Auditor no. 6 at 8:3-6.
[186] Tr. of Current Auditor no. 11 at 11:6-10.
[187] Tr. of Current Auditor no. 12 at 14:4-7.
[188] Tr. of Current Auditor no. 8 at 15:19-22.
[189] *Id.* at 15:23-16:1.
[190] Tr. of Former Auditor no. 6 at 11:19-23.

"specialized training," as well as "periodic company-wide meetings" that contained training components.[191] A third auditor stated that NFA:[192]

> . . . offer[ed] different types of training on topics. If you needed training on debits and credits, they would . . . offer a training course where you could sign up and be trained on how to do debits and credits. So they had training throughout the year.

NFA auditors we interviewed generally reported positively on NFA's training program. One auditor stated, "I was very impressed with the very extensive training NFA provided."[193] Another auditor called the 3-4 week initial training program "definitely helpful."[194] Another auditor particularly noted the usefulness of the training for those with little experience, stating:[195]

> [S]ome people the first time you walk in the door have different expertise and knowledge base. My class itself I feel a lot of us were hired right out of college. So I felt like it was -- we learned a lot in terms of just the industry in general. And like I said, it's everyone is starting from a different perspective. So but I mean I think they do a good job in terms of training and getting overall understanding.

However, most auditors acknowledged that much of the knowledge required to be a successful auditor would come from on-the-job training. One auditor agreed that "a lot of what [she] learned was [from] on-the-job training."[196] Another stated, "the bulk of our training is done on the job."[197] Accordingly, an auditor noted that "a lot of the onus of the on-the-job training is put to our field supervisors . . . And if they're not experienced enough or haven't even seen half of the things that they're auditing, it's kind of hard for them to train the newer people."[198]

The investigation also found that many of the auditors interviewed did not attend formal training sessions or "lessons learned" presentations after either the Madoff Ponzi scheme or MF Global diversion of customer segregated funds were uncovered.[199] When asked if any such training session took place

[191] Tr. of Former Auditor no. 1 at 12:3-8.
[192] Tr. of Current Auditor no. 1 at 14:2-8.
[193] Tr. of Current Auditor no. 3 at 10:11-15.
[194] Tr. of Current Auditor no. 9 at 15:3-12.
[195] Tr. of Current Auditor no. 8 at 17:22-18:8.
[196] Tr. of Current Auditor no. 12 at 13:21-23.
[197] Tr. of Current Auditor no. 2 at 14:6-8.
[198] Tr. of Current Auditor no. 7 at 49:9-16.
[199] In addition, auditors were not familiar with the Bayou Management Ponzi scheme, a fraud that was uncovered in September 2005 that was the subject of a CFTC complaint dated September 29, 2005. The complaint alleged that Bayou Management LLC, a registered CPO with the NFA, defrauded its customers by representing that its fund was earning profits and that it was actively trading customers' funds, when, in fact, funds in customer accounts were misappropriated to principals of Bayou Management. *See* Complaint for Injunctive and Other Equitable Relief, et al. in Matter entitled *CFTC v. Bayou Management*, LLC, et al., 05 Civ. 8374. *See also,* Tr. of Current Auditor no. 9 at 28:5-12; Tr. of Current Auditor no. 8 at 37:17-38:2; Tr. of Current Auditor no. 10 at 56:12-16; Tr. of Current Auditor no. 11 at 30:20-31:1.

after Madoff or MF Global, many auditors stated that they did not recall anything occurring.[200] One auditor, because she also was a certified fraud examiner, stated that she had been to the annual fraud conference, where there were "a lot of sessions that concentrated on what we can learn from the Madoff experience."[201] One auditor recalled giving a "brown-bag" lunch presentation after Madoff and others recalled informal meetings where either Madoff or MF Global[202] were discussed, but they noted that there were no changes to any modules as a result of the lessons learned from those scandals.[203] Several auditors recalled reading about issues that arose with respect to the Madoff Ponzi scheme that were relevant in connection with the PFG fraud, particularly referencing the one-person audit shop and third-party confirmations.[204]

NFA Management commented that NFA has held event-driven training sessions but attendance has been voluntary, not mandatory. They also indicated that they believed that the training program could be more systematized and formalized to ensure full participation on all relevant subjects.

IV. NFA's Process of Obtaining Bank Confirmations in PFG Audits

a. NFA's Frequency of Bank Confirmations During Audits

Several auditors acknowledged that accounts were not routinely confirmed with banks in every audit. The BRG Investigative Team conducted an analysis of all the relevant audit documents for each audit from 1995 to 2012 and found that bank confirmations were sent out in 2003, 2005,[205] 2006, 2008, 2009, 2010, 2011, and 2012.

b. NFA's Method for Requesting Confirmations

As it was explained in the interviews, while the auditors would look to "outside sources" to compare firm documents to, such as bank statements or carrying broker statements, those bank and other statements would be provided by PFG.[206] Therefore, with the exception of the bank confirmation process, when NFA auditors compared records to third-party documents received independently, they only used the third-party documents they received from PFG.[207] In audits where no confirmations were

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[200] Tr. of Current Auditor no. 11 at 11:16-12:6; Tr. of Current Auditor no. 13 at 13:9-15; Tr. of Current Auditor no. 3 at 13:8-24.

[201] Tr. of Current Auditor no. 7 at 11:15-17.

[202] We note that the MF Global scandal was first brought to light only 8 months before the PFG fraud was uncovered.

[203] Tr. of Current Auditor no. 2 at 16:6-8; Tr. of Current Auditor no. 8 at 25:5-26:20; 68:21-69:4; Tr. of Current Auditor no. 5 at 16:8-17:21.

[204] Tr. of Current Auditor no. 2 at 19:18-22:16; Tr. of Former Auditor no. 2 at 61:10-62:11; Tr. of Current Auditor no. 6 at 18:5-19:19.

[205] In 2005, NFA auditors performed limited scope procedures on the Net Capital module and therefore chose to send out one bank confirmation to Bank One for PFG's Seg/Forex account, not to U.S. Bank. NFA00004434 (05-CEXM-716 Net Capital). Additionally, although no audit of PFG was conducted in calendar year 2007, the 2006 audit began in October 2006 and the 2008 audit began in January 2008, so that they occurred within 15 months of each other, consistent with CFTC requirements.

[206] Tr. of Current Auditor no. 7 at 21:13-22.

[207] *Id.* at 22:4-8.

used, the auditor stated that he would "trace the balances from the internal Peregrine statement to the bank statement that Peregrine supplied" and that would be as far as he would go.[208]

The process of confirming balances was described as follows. Auditors would "trace the balances to the bank statements that are provided to you by the firm, but you will always send the bank confirmations just as an extra layer of security. You will look at the bank statements to make sure they don't look fabricated, but then you will also complete the confirmations process which requires you to update a signature from the principal or whoever is responsible – bank's signatory and [the confirmation request] will go to the bank."[209] Completing the bank confirmation process included filling "out a bank confirmation form, have a principal sign it, and then put it in an envelope, put NFA's return envelope inside the envelope, and send it to the bank. Then it will come directly back to NFA, and then once you verify it, you can close the audit."[210] The BRG Investigative Team notes that it did not find that it was unusual practice for a bank to have a P.O. Box as its address for bank confirmations.

Current and former NFA auditors confirmed that, during NFA's audits, the standard process for confirming balances did not normally include any direct verbal communication with the banks.[211]

c. Confirmations Received by NFA in the 2011 Audit of PFG

In all the audits over the years where NFA auditors sent confirmations to U.S. Bank, NFA auditors received confirmations in the mail showing the same balance as in PFG's financial statements. Further, the NFA auditors were able to reconcile the third-party confirmation with the U.S. Bank statements supplied by PFG, except for in 2011. The field supervisor for the 2011 audit of PFG stated that "in years past, [she] had heard that they had a hard time getting confirmations back" and for that reason NFA auditors had O'Meara reach out to all banks from which NFA auditors requested confirmations including U.S. Bank and attach the NFA confirmation form.[212] She clarified that, in general, NFA auditors had a hard time getting confirmations from banks, not specifically related to either PFG or U.S. Bank.[213] Accordingly, on May 13, 2011, at 9:35 am, O'Meara emailed all of NFA's bank confirmations to O'Meara's contacts at the banks in connection with the 2011 NFA audit of PFG.[214]

In an email to Hope Timmerman of U.S. Bank, O'Meara stated, "Our regulator the National Futures Association is currently conducting their annual audit of PFGBEST. Attached is the confirmation that needs to be completed. If you would be so kind to get these processed and emailed back to me and [NFA field supervisor] I would appreciate it. [NFA field supervisor] will also be sending them via US Mail. NFA would appreciate an original hardcopy mailed back to them also."[215]

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[208] Tr. of Former Auditor no. 5 at 40:12-22.
[209] Tr. of Current Auditor no. 3 at 32:5-15.
[210] *Id.* at 33:10-16.
[211] Tr. of Current Auditor no. 2 at 21:23-22:4.
[212] Tr. of Current Auditor no. 12 at 48:1-23.
[213] *Id.* at 49:7-13.
[214] *Id.* at 49:19-50:2.
[215] NFA00221630 (Email exchange with Hope Timmerman, May 13, 2011).

The staff auditor for the 2011 NFA audit of PFG stated that she and the other NFA staff auditor filled out the typed portions of the bank confirmations and included the addresses for U.S. Bank as P.O. Box 706, Cedar Falls, Iowa.[216] The staff auditor clarified that there were two confirmations sent to Hope Timmerman: one for the PFG house account and one for the PFG customer segregated account.[217] She stated that she received the P.O. Box address for U.S. Bank from the U.S. Bank statement she received from PFG.[218]

That same day at 10:58 am, Hope Timmerman replied to O'Meara, asking her for the NFA field supervisor's email address.[219] After O'Meara provided Timmerman the requested email address, at 1:07 pm on the same day, Hope Timmerman sent O'Meara and the field supervisor the two completed bank confirmations for PFG.[220]

When shown the confirmation during the interview, the field supervisor confirmed that the balance reflected on the U.S. Bank confirmation for the PFG customer segregated account was $7,181,336.36.[221] The field supervisor stated she did not recall even looking at the U.S. Bank confirmation or comparing it to a bank statement.[222]

On May 16, 2011, at 2:01 pm, the field supervisor sent the staff auditor an email attaching several confirmations, including the $7 million Confirmation, a fact that both the field supervisor and staff auditor confirmed in interviews.[223] The staff auditor stated that she uploaded and scanned the bank confirmations into NFA's audit software and "looked at the balances that were included to ensure that they were consistent with what the hard copy bank statements stated."[224] She looked at the numbers for the segregated account and "noticed that they did not match" the bank statement.[225] The staff auditor stated she then "informed the [field supervisor] . . . that the numbers did not match." The staff auditor did not recall noticing that there was a substantial difference, although the bank confirmation indicated $7,181,336.36 while the U.S. Bank statements were in the neighborhood of $218 million.[226] The staff auditor clarified that she just noticed that there was a difference in the numbers.[227]

[216] Tr. of Current Auditor no. 13 at 30:5-10; *See also*, 2NFA00089871-2NFA00089872 (U.S. Bank confirmations). The BRG Investigative Team notes that it did not find that it was unusual practice for a bank to have a P.O. Box as its address for bank confirmations.
[217] Tr. of Current Auditor no. 13 at 35:12-36:4.
[218] *Id.* at 30:11-24.
[219] NFA00221629 (Email exchange with Hope Timmerman, May 13, 2011).
[220] *Id*.
[221] Tr. of Current Auditor no. 12 at 50:18-22.
[222] *Id.* at 50:23-51:3.
[223] NFA00221585 (Internal Email exchange, May 16, 2011); NFA00221632 (Attachment to NFA00221585, U.S. Bank confirmation); Tr. of Current Auditor no. 12 at 54:16-22; Tr. of Current Auditor no. 13 at 35:12-24.
[224] Tr. of Current Auditor no. 13 at 36:5-37:10.
[225] *Id*. at 37:13-15.
[226] *Id.* at 37:18-38:17.
[227] *Id.* at 38:18-23.

The staff auditor recalled telling the field supervisor about the difference when the field supervisor happened to be walking past her desk and they talked about it in front of her desk.[228] The staff auditor did not recall the field supervisor's reaction to what she told her but stated that the field supervisor said she would speak to the NFA manager about the difference.[229] The staff auditor did not follow up to find out what happened with this issue.[230]

The field supervisor, on the other hand, did not recall the staff auditor having any reaction to the $7 million Confirmation and did not recall "any discussion at all among the auditing team about this issue."[231] The manager did not recall the field supervisor ever speaking to him about the $7 million Confirmation.[232]

A second staff auditor, who completed the segregation module for the NFA 2011 audit of PFG, stated that he also never saw the $7 million Confirmation during the course of the audit.[233]

According to Wasendorf, when he found out that NFA auditors had received the correct confirmation, his reaction was, "I am in shock – I'm caught."[234] He claimed that on May 16, 2011, the next business day after NFA received the correct confirmation directly from U.S. Bank, he "walked into the bank and spoke to Hope Timmerman," and convinced her that the first confirmation obviously was a mistake since it "didn't even have a correct US bank address." Counsel for U.S. Bank stated that "we do not believe that any such conversation [with Hope Timmerman] took place" but did not explain what actually occurred.[235] It is not disputed that Wasendorf subsequently prepared a forged confirmation statement.[236]

On May 16, 2011, at 2:09 pm, the field supervisor received a facsimile, purportedly from Hope Timmerman of U.S. Bank with a note stating, "Attached please find a corrected copy of the Bank Balance Confirmation for the Peregrine Financial Group account #621010845. Customer Segregated Account."[237] The bank confirmation attached to the facsimile cover sheet showed a balance of $218,650,550.96.[238] The staff auditor stated that she uploaded this "corrected" confirmation into the NFA module software and noted that the bank confirmation now matched the U.S. Bank statement.[239] The staff auditor stated she could not recall any further conversations about the two confirmations and never learned how it

[228] *Id.* at 40:10-41:1.
[229] *Id.* at 39:13-19 & 41:2-6.
[230] *Id.* at 41:7-11.
[231] Tr. of Current Auditor no. 12 at 54:23-55:7.
[232] Tr. of Current Auditor no. 15 at 68:17-70:7.
[233] Tr. of Former Auditor no. 8 at 40:22-41:9.
[234] Interview Memorandum of Wasendorf at 4.
[235] See Letter from Peter W. Carter, Dorsey & Whitney LLP, counsel for U.S. Bank dated January 8, 2013.
[236] *Id*. O'Meara also recalled Wasendorf saying "Hope [Timmerman at U.S. Bank] made a mistake and I was pretty hard on her and I probably owe her an apology." Interview Memorandum of O'Meara at 4.
[237] NFA00729940 (Facsimile cover sheet, May 16, 2011).
[238] NFA00729941 (Facsimile document, "Corrected" U.S. Bank confirmation).
[239] Tr. of Current Auditor no. 13 at 44:1-45:20.

was resolved.[240] When asked if she thought it was odd that she initially received a confirmation with a $7 million balance and then received a second one with a $218 million balance, she replied:[241]

> I didn't think it was weird because I had alerted [the field supervisor] of the $7 million balance. And she stated that she would speak with our manager of the audit . . . And I don't know what they did or, you know, how the matter was resolved. I just -- I trusted that as the superiors that they would handle the situation. And it looked -- and it appeared to be handled . . .

When the field supervisor was asked in an interview with the BRG Investigative Team why the NFA audit team did not place more significance on the fact that they received two different confirmations, she replied that it was not "unusual" for NFA auditors to receive the incorrect balance in a confirmation.[242] Regarding the field supervisor's comment, the BRG Investigative Team noted the following procedures regarding situations where auditors may receive corrected confirmations after performing additional audit procedures to resolve inconsistencies, as described in auditing guidance:[243]

> If audit evidence obtained from one source is inconsistent with that obtained from another, or if the auditor has doubts about the reliability of information to be used as audit evidence, the auditor should perform the audit procedures necessary to resolve the matter and should determine the effect, if any, on other aspects of the audit.

The manager on the audit stated that he was not aware during the course of the audit that there had been two confirmations or a "corrected" confirmation.[244] The second staff auditor who completed the segregation module for the audit also stated that he never knew during the audit that a second or a "corrected" confirmation had ever been received by NFA auditors.[245]

The BRG Investigative Team found that the audit team for the 2011 NFA audit of PFG had less experience than that of previous NFA auditing teams.[246]

The manager acknowledged that if the NFA staff auditor had determined during the confirmation process that the confirmation from the bank did not match the bank statements, a "problem" existed and there should have been further discussion, not just with him but his supervisor, an associate director or director.[247] NFA President and CEO Dan Roth also acknowledged that NFA should have followed up on the confirmation received in 2011 and could have uncovered the fraud at that time.[248]

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[240] *Id.* at 46:11-14; 47:10-13.
[241] *Id.* at 46:20-47:5.
[242] Tr. of Current Auditor no. 12 at 56:24-57:2.
[243] AS No. 15.29, http://pcaobus.org/Standards/Auditing/Pages/Auditing_Standard_15.aspx#inconsistency.
[244] Tr. of Current Auditor no. 15 at 72:20-73:2.
[245] Tr. of Former Auditor no. 8 at 40:22-41:20.
[246] Tr. of Current Auditor no. 12 at 10:7-9; Tr. of Current Auditor no. 15 at 56:10-17.
[247] Tr. of Current Auditor no. 15 at 77:15-78:12. This refers to an employee of NFA and is not to be confused with a member of the NFA's Board of Directors.
[248] Dan Roth, Interview with Futures Magazine, November 1, 2012 at p. 2.

d. JAC and NFA Modules Regarding Confirmation Process

We scrutinized the JAC financial audit program because it described steps relating to the review of cash and securities. We found the JAC confirmation procedure to be as follows:[249]

> On a scope basis, obtain from each depository confirmation of bank balances as of the audit date. Either an original bank statement or direct confirmation with the depository may be used.

Under the JAC program, in most audit situations, an original bank statement is an appropriate substitution for direct confirmation. The JAC procedure also appeared in the NFA audit module because the NFA module only included instruction to "consider confirming balances on deposit with bank,"[250] which implied that some other audit evidence (such as a bank statement) was suitable audit evidence.[251]

Accepted auditing practices provide that extended procedures may be necessary and require direct confirmation or other procedures. For example, the AICPA, which sets U.S. Generally Accepted Auditing Standards ("GAAS"), established SAS No. 67, *The Confirmation Process*, which became effective in 1992 ("SAS No. 67"). SAS No. 67 describes situations where an original bank statement can be used in place of direct confirmation:[252]

> The lower the combined assessed level of inherent and control risk, the less assurance the auditor needs from substantive tests to form a conclusion about a financial statement assertion. Consequently, as the combined assessed level of inherent and control risk decreases for a particular assertion, the auditor may modify substantive tests by changing their nature from more effective (but costly) tests to less effective (and less costly) tests. For example, if the combined assessed level of inherent and control risk over the existence of cash is low, the auditor might limit substantive procedures to inspecting client-provided bank statements rather than confirming cash balances.

Neither JAC procedures nor the NFA modules included steps to maintain control over confirmation responses. As described in SAS No. 67:[253]

> During the performance of confirmation procedures, the auditor should maintain control over the confirmation requests and responses. Maintaining control means establishing direct communication between the intended recipient and the auditor to

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[249] NFA03353324 (JAC Financial, Revised March 2010, p. 1.) This was the same for JAC Financial 2002-2009. JAC Financial, Revised March 2010, p. 1. This procedure was the same for JAC Financial 2002-2009.

[250] Procedure #5 of the Net Capital module reads "Obtain / prepare a listing of the firm's current cash balances (operating, segregated and customer funds for Forex trading) as of the audit date. Consider confirming balances on deposit with bank." NFA00012930 (11-CEXM-239 Net Capital module).

[251] Per the NFA audit modules, bank statements are used for various audit tests. The NFA modules do not offer guidance on the form of the bank statements (i.e., original, fax, photocopy, on-line access) used for testing.

[252] AU 330.10, The Confirmation Process.

[253] AU 330.28, The Confirmation Process.

> minimize the possibility that the results will be biased because of interception and alteration of the confirmation requests or responses.

For example, an auditor can maintain control over the confirmation process by mailing the request to the bank and by instructing the bank to mail the response directly to the auditor. As an example, in 2003, NFA auditors sent the U.S. Bank confirmation to a P.O. Box, even though its own records reflected a different address for U.S. Bank.[254] However, we found that it is not uncommon for a bank to use a P.O. Box for notices or communications to be sent in connection with an audit.

JAC procedures, and likewise the NFA modules, also did not include steps to authenticate confirmation responses. SAS No. 67 includes steps to authenticate confirmation responses in certain situations:[255]

> There may be situations in which the respondent, because of timeliness or other considerations, responds to a confirmation request other than in a written communication mailed to the auditor. When such responses are received, additional evidence may be required to support their validity. For example, facsimile responses involve risks because of the difficulty of ascertaining the sources of the responses. To restrict the risks associated with facsimile responses and treat the confirmations as valid audit evidence, the auditor should consider taking certain precautions, such as verifying the source and contents of a facsimile response in a telephone call to the purported sender. In addition, the auditor should consider requesting the purported sender to mail the original confirmation directly to the auditor. Oral confirmations should be documented in the workpapers. If the information in the oral confirmations is significant, the auditor should request the parties involved to submit written confirmation of the specific information directly to the auditor.

e. Electronic Confirmations

According to an NFA director,[256] after 2008, "Bank of America, one of the larger banks, sent a letter out saying that they would no longer accept paper confirmations and all confirmations would have to be electronic except for, I think, for certain regulators."[257] As a result, NFA began "using the e[lectronic]-confirmation for some of its audits."[258] NFA then began negotiating a price with Confirmation.com, but was concerned about the cost.[259] Given the fact that more banks were requiring electronic

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[254] NFA00003272-NFA00003275 (03-CEXM-519 Cash Information worksheet) is a Microsoft Excel document of bank addresses. It listed U.S. Bank at an address in St. Paul, MN. See Appendix J for worksheet. *See also*, NFA00003495-NFA00003500 (Memorandum to files from the NFA field supervisor for the 2003 Audit of PFG). The field supervisor listed the address in St. Paul, MN. Both documents relate to 03-CEXM-519.
[255] AU 330.29, The Confirmation Process.
[256] This refers to an employee of NFA and is not to be confused with a member of the NFA's Board of Directors.
[257] Tr. of Current Auditor no. 4 at 24:20-25:9.
[258] *Id.* at 25:15-16.
[259] *Id.* at 25:20-26:5.

confirmations, NFA decided it made sense that, if some of its audits were using electronic confirmations, then all of them would.[260] Accordingly, NFA decided to use electronic confirmation for all of its audits.[261]

Brian Fox, the founder of Confirmation.com[262] confirmed that, in 2008, Bank of America decided that the electronic confirmation service worked so well that it would require all of its customers' external auditors to use electronic confirmations.[263] Fox said he had discussions with NFA, but NFA initially balked because of cost.[264] He stated that on May 2, 2011, he had a conference call with an NFA director[265] who asked him for a discount, but when he was unwilling to provide that discount, NFA decided not to use the e-confirmation service.[266] But he had a follow-up call with NFA in December 2011 in which they agreed to a discount and began using the service.[267]

The 2012 audit of PFG was the first NFA audit of PFG that utilized the e-confirmation process. In connection with the 2012 audit, NFA auditors completed a form with Confirmation.com that included all the balances that it needed to confirm.[268] NFA auditors requested the balances of PFG's segregated bank accounts as of April 30, 2012.[269] On July 2, 2012, NFA auditors requested an electronic signature through Confirmation.com from Wasendorf.[270] On July 8, 2012, Wasendorf affirmatively responded to the electronic request to confirm the balances.[271] At that moment, the system automatically sent the request to U.S. Bank and, on July 9, 2012 at 10:48 a.m., U.S. Bank recorded the April 30, 2012 balance.[272] Prior to the confirmation being received from Confirmation.com, which would have showed the discrepancy between the amount Wasendorf confirmed and the amount U.S. Bank confirmed, NFA auditors learned that Wasendorf had attempted suicide and confessed to the fraud.[273]

Although no NFA auditor we interviewed indicated that they ever suspected that the U.S. Bank statements were forged, several NFA auditors stated that they had seen forged documents in connection with audits of other firms during their tenure at NFA. An NFA manager stated she had seen forged bank statements while at NFA on several occasions, although she believed that it was clear from the face of those documents that they had been forged.[274] An NFA field supervisor stated that he once identified bank statements as forged at NFA, as he noticed that there were no cents included in the amounts listed on the statements.[275] An NFA director[276] stated that she had seen forged bank

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[260] *Id.* at 26:6-17.
[261] *Id.* at 26:15-17.
[262] https://www.confirmation.com/about.aspx.
[263] Interview Memorandum of Brian Fox at 2.
[264] *Id.*
[265] This refers to an employee of NFA and is not to be confused with a member of the NFA's Board of Directors.
[266] Interview Memorandum of Brian Fox at 3.
[267] *Id.*
[268] Tr. of Current Auditor no. 12 at 120:19-121:10.
[269] *Id.* at 121:11-13.
[270] *Id.* at 121:20-23.
[271] *Id.* at 122:11-13.
[272] *Id.* at 122:20-23.
[273] *Id.* at 124:10-13.
[274] Tr. of Current Auditor no. 7 at 47:13-24.
[275] Tr. of Current Auditor no. 8 at 57:1-11.

statements, as well, but explained that in that situation, unlike with respect to PFG, the documents were "pretty obvious that they [we]re forged."[277]

NFA management pointed out the fact that the e-confirmation process reduces the possibility that this type of forgery could happen again. They also indicated that NFA planned to obtain daily segregation balances from banks by the end of 2012 in addition to the electronic confirmations already in place for audits.

V. Coordination Between CFTC and NFA

As discussed in greater length in section I(c)(ii) of this report, the CFTC conducted an audit of PFG in 1999, which culminated in a settlement agreement between the CFTC and PFG in 2000. NFA, in fact, followed up with PFG in its 2000 audit to ensure that PFG was fulfilling the conditions of the CFTC settlement.[278] While there was a reference in NFA's 1999 audit that NFA staff "teleconferenced with CFTC staff on 9/1/99 to discuss the items contained in the [CFTC] Report,"[279] NFA auditors who worked on the 1999, 2000, and 2001 audits of PFG did not recall significant coordination with the CFTC regarding the CFTC audit work. A staff auditor on the 2001 NFA audit of PFG did not recall being aware of the CFTC audit in the previous years and did not recognize documents regarding the CFTC settlement with PFG.[280] Another staff auditor on both the 1999 and 2000 NFA audits of PFG, did not recall "dealing with the CFTC or factoring in the CFTC action against Peregrine in the NFA audit."[281] A third staff auditor who worked on the 1999, 2000, and 2001 audits of PFG did not recall the CFTC audit of PFG, the settlement it entered into with PFG or interacting with any CFTC officials at that time.[282]

In addition, we found that NFA auditors learned about CFTC reviews or audits of PFG that occurred in 2009 and 2010 from PFG officials rather than from the CFTC itself. As discussed in greater detail in section I(c)(iii) of this report, in 2009, while NFA auditors were conducting their 2009 audit of PFG, a former NFA senior manager was informed by O'Meara that the "CFTC was looking at the [PFG] U.S. Bank reverse repo account" and forwarded to NFA a copy of an email from the CFTC to PFG relating to CFTC's review of the repo account.[283] However, this former NFA senior manager stated that she never learned the results of the CFTC review and did not recall any communication with the CFTC about the review.[284] In 2010, the same former NFA senior manager also was informed by O'Meara that the CFTC was conducting an onsite AML review of PFG.[285] As with the CFTC review of PFG's repo accounts, the former

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[276] This refers to an employee of NFA and is not to be confused with a member of the NFA's Board of Directors.
[277] Tr. of Current Auditor no. 4 at 53:5-12.
[278] NFA00001216-NFA00001220 (Memorandum to Files from NFA auditors dated December 2, 1999).
[279] NFA00001175 (99-CEXM-370 Audit Planning and Scope Selection module).
[280] Tr. of Current Auditor no. 3 at 23:3-24:1.
[281] Tr. of Former Auditor no. 6 at 26:17-22.
[282] Tr. of Former Auditor no. 5 at 42:2-43:10.
[283] Tr. of Former Auditor no. 7 at 20:7-8; NFA00901163 (Email correspondence between O'Meara and NFA senior manager).
[284] Tr. of Former Auditor no. 7 at 20:21-21:3.
[285] *Id.* at 38:17-39:4.

NFA senior manager stated that she did not recall having any conversations with the CFTC about this matter and did not learn about the results of the CFTC's review.[286]

A current director[287] at NFA reported the following:

> We are not always privy to a CFTC [exam or audit] . . . Most of the time we find out [about a CFTC audit] from a conversation with the firm or my FCMs. . . If I'm aware of the CFTC audit, I do my best to find out what their findings -- what their concerns are. They are not always willing to share.[288]

O'Meara, PFG's Director of Compliance commented in her interview that there was no sharing of information whatsoever between the CFTC and NFA and that she would say to both of them "why don't you guys just get in a room and share the information" but never got a satisfactory response back from either side.[289]

We also found that the CFTC conducted several reviews of NFA's programs during the period between 1997 and 2012 which related in part to NFA's audits. In 1997, the CFTC's Division of Trading and Markets conducted a review of NFA's compliance program pertaining to members who were registered as CPOs and CTAs. In 1999, the CFTC examined the NFA's CPO and CTA Disclosure Document Review Program. In 2002, the CFTC's Division of Clearing and Intermediary Oversight examined the NFA's disciplinary program. In 2006, the CFTC Division of Clearing and Intermediary Oversight conducted a review of NFA's compliance program pertaining to CPOs and CTAs and in 2007, conducted a follow-up review of the same program. The BRG Investigative Team did not find evidence that these reviews related to PFG.

NFA management indicated that they believed that, overall, there was significant coordination and communication between NFA and the CFTC, although primarily at higher levels. NFA shares its logs of audits with the CFTC and works closely with CFTC Enforcement personnel on a routine basis.[290]

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[286] *Id.* at 39:5-22.

[287] This refers to an employee of NFA and is not to be confused with a member of the NFA's Board of Directors.

[288] Tr. of Current Auditor no. 4 at 32:10-33:10. Other auditors also stated that they would reach out to the CFTC if they became aware that the CFTC was conducting an audit of the same firm, but, at least one of these auditors noted that the CFTC would not always tell NFA that the CFTC was conducting an audit. Tr. of Current Auditor no. 4 at 32:4-34:23; Tr. of Current Auditor no. 1 at 67:5-21; Tr. of Current Auditor no. 7 at 36:1-19.

[289] Interview Memorandum of O'Meara at 3.

[290] The BRG Investigative Team communicated and coordinated with representatives of the CFTC during its investigation. We sought to interview CFTC personnel and in addition, prepared and submitted to CFTC a list of questions regarding CFTC reviews of PFG, NFA reviews of PFG and coordination between the CFTC and NFA. The CFTC declined to respond to the BRG Investigative Team's questions or participate in interviews, citing the ongoing nature of the CFTC's Enforcement investigation.

VI. Conduct of NFA Audits of PFG

a. NFA's Use of its Risk Assessment Guide

NFA has been using a risk assessment guide to primarily assist with the planning and scoping of audits of FCMs since 2000. The risk assessment guide can be used as a supplement to the planning module, which is typically prepared prior to an audit and includes steps to obtain information regarding the firm's business operations.[291] NFA's 2005 New Auditor Handbook explains the risk assessment guide as follows:[292]

> The risk assessment guide is completed by the field supervisor to obtain information regarding the firm's business operations prior to fieldwork. It includes numerous questions that the field supervisor asks the firm when the audit is announced, usually 2 weeks prior to fieldwork. The field supervisor documents the information obtained in the risk assessment guide into planning.doc to select scopes and determine what testing needs to be completed.

Likewise, JAC's general and risk-based scope rationale audit programs include, in part, steps for establishing the scope of the exam, completing the preliminary risk analysis review, and documenting the firm profile. In addition, JAC provides a general questionnaire which, once completed by the auditor, documents the firm's financial, operational and risk management procedures and practices. Topics covered include, among other things, the controls, policies, personnel, and systems of the firm's financial records, changes in relationships with third parties, account monitoring procedures (margining and risk management analysis), customer proprietary, noncustomer, and affiliate trading and segregation of cash and settlement responsibilities.[293]

In the past, NFA personnel have used the risk assessment guide during verbal interviews with the firm or as a written questionnaire to be completed and returned by the firm through email.[294] At one point, NFA managers considered only requiring auditors to verbally discuss the risk assessment guide with the firm. In particular, the minutes from the May 3, 2011 NFA manager Meeting stated, in part:

> It was also discussed that the Risk Assessment Guide (RAG) should NOT be emailed to a firm; you are required to schedule a time to discuss the guide with your firm.[295]

Subsequent to that May 3, 2011, manager meeting, however, NFA's Training & Development - Leading Audits, September 2011 training guidance for audit supervisors recommended either discussing the risk assessment guide directly with firm personnel or sending a copy of it to the firm with a deadline to

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[291] Tr. of Former Auditor no. 2 at 28:19-24.
[292] 2NFA00004392 (The New Auditor Handbook, Audit Process, 2005).
[293] 2NFA00682916 (JAC Audit Concepts, March 2007) and NFA03353369-NFA03353391 (General Audit Program, March 2010). This general summary also applies to the General Audit Program for 2002-2009.
[294] Tr. of Current Auditor no. 2 at 64:24-65:7; 2NFA00360739 (NFA Email dated August 10, 2009); 2NFA00361183 (NFA Email dated August 19, 2008).
[295] NFA00842912 (Minutes from the May 3, 2011 Manager Meeting).

respond.[296] NFA's Training & Development - Leading Audits, October 2012 guidance also indicated that personnel may "[e]ither discuss the Risk Assessment Guide/Planning directly with the firm personnel (most efficient and effective) or send the Risk Assessment Guide (that is tailored to the firm's known operations) with a deadline."[297]

If the audit was announced, the risk assessment guide was used prior to arriving onsite to conduct the audit fieldwork, otherwise, it was used on the first day of the fieldwork.[298] The risk assessment guides reviewed by the BRG Investigative Team generally included a number of operational questions for a firm, such as the number and types of futures trading accounts, the number of offices, identification of key employees, use of promotional materials, and processes for filling orders at the firm. The investigation identified several iterations of the risk assessment guides that appeared to have been used during audits conducted for the years 2008 through 2012.[299] We noted that several of these guides included "Revised 9/2/03" in the document footer. Based on this review, it appears that the risk assessment guide was not available or not used for many of the earlier exams. During interviews conducted by BRG, several auditors did not recall using a risk assessment guide during any audits.[300]

The investigation also found that the risk assessment guides and Planning modules used by NFA auditors did not appear to reflect significant developments that could affect the audits of their member firms. For instance, the risk assessment guides did not incorporate "lessons learned" from the Madoff Ponzi scheme or the collapse of MF Global that could be used to identify similar risks or issues at firms that were being audited. We did note that a discussion of current events and recent MRAs were included in training classes and might involve interaction with supervisors and members of NFA's "risk team."[301] Within the "past year and a half or so," NFA formed a Risk Management Group that reviews periodic financial statements, quarterly holdings statements and annual questionnaires filed by FCMs internally at NFA in order to compile a list of firms that should be audited.[302]

NFA management stated that the risk assessment guides have been in use since 2000. They also acknowledged there were ways in which they could improve the process so that all applicable information could be incorporated into the risk assessment steps contained in the Planning module.

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[296] 2NFA00020340 (Training & Development - Leading Audits, September 2011).
[297] 2NFA00020619 (Training & Development - Leading Audits, October 2012).
[298] Tr. of Current Auditor no. 3 at 21:1-9.
[299] 2NFA00020324-2NFA00020328 (Risk Assessment Guide, September, 2011); 2NFA00020603-2NFA00020607 (Risk Assessment Guide, October, 2012) ; 2NFA00360741-2NFA00360744 (Completed Risk Assessment Guide, 2009); 2NFA00361185-2NFA00361191 (Completed Risk Assessment Guide, 2008); NFA00031821-NFA00031825 (Completed PFG Risk Assessment Guide, 2009); NFA00237214-NFA00237218 (Completed Risk Assessment Guide 2010); NFA02832547-NFA02832550 (Completed Risk Assessment Guide, 2011).
[300] Tr. of Current Auditor no. 1 at 33:19-23; Tr. of Former Auditor no. 1 at 17:17-20. NFA management notes that the use of the Risk Assessment Guide was voluntary.
[301] Tr. of Current Auditor no. 4 at 99:6-23.
[302] Tr. of Current Auditor no. 14 at 74:6-75:9. For a further discussion of the Risk Management Group, see Appendix D.

b. CFTC Regulations 1.14 and 1.15 Risk Assessment Reports

From the FCM's perspective, risk assessments and risk reports are an integral part of the FCM's obligations as a registered firm. CFTC Regulations 1.14 and 1.15, which generally have been in effect since 1994, pertain to the recordkeeping of risk assessment reports and reporting of risk assessment reports, respectively. FCMs are required to file risk reports with the CFTC pursuant to CFTC Regulation 1.15. The risk assessment reports include key information pertaining to the FCM, including periodic financial statements and capital adequacy, organizational charts and copies of the financial, operational and risk management policies, procedures and systems maintained by the FCM. We did not see evidence that the disclosures in these risk assessment reports were scrutinized closely by NFA auditors, nor did we see any concerns or significant changes in audit procedures as a result of new information provided in subsequent risk assessment reports. For instance, PFG disclosed different Material Affiliated Persons in the 2003 and 2006 reports (Peregrine Financial Group Romania, SRL vs. Peregrine Financial Group Canada, Inc.), but we were unable to locate documentation noting whether or not NFA auditors verified the nature and any significance of such change. Moreover, there was no discussion of financial and capital adequacy in either report that, in accordance with CFTC Regulation 1.14(a)(ii)(B), should have contained a description of "sources of funding, together with a narrative discussion by management of the liquidity of the material assets of the futures commission merchant, the structure of debt capital, and sources of alternative funding." Given PFG's lack of profitability and questions concerning the source of Wasendorf's capital contributions (discussed in detail in Section X of this report), the absence of discussion of financial and capital adequacy in the risk assessment reports should have been a topic of review by NFA auditors.

NFA management stated that while NFA has not routinely reviewed or obtained copies of the reports filed with the CFTC pursuant to CFTC Regulations 1.14 and 1.15, NFA obtained most of the information that would be contained in those reports from other sources. However, NFA will update its audit modules to include a step requiring auditors to obtain copies of the reports from the firm and, depending on their availability, from the CFTC, and review these reports in connection with the audit planning.

VII. NFA's Level of Scrutiny of PFG's Internal Controls

The Committee of Sponsoring Organizations of the Treadway Commission, an organization dedicated to the development of comprehensive frameworks and guidance on enterprise risk management, internal control, and fraud deterrence, describes the importance of internal controls:[303]

> Implementing a system of internal control allows management to stay focused on the organization's pursuit of its operations and financial performance goals, while operating within the confines of relevant laws and minimizing surprises along the way. Internal control enables an organization to deal more effectively with changing economic and competitive environments, leadership, priorities, and evolving business models. It

[303] COSO's Draft Update to *Internal Control – Integrated Framework* http://www.coso.org/documents/coso_framework_body_v6.pdf.

promotes efficiency and effectiveness of operations, and supports reliable reporting and compliance with laws and regulations.

In addition, a second GAAS standard pertaining to fieldwork states: "A sufficient understanding of internal control is to be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed."[304] The AICPA issues Statements on Auditing Standards that provide guidance about implementing the second standard of fieldwork.[305]

For instance, SAS No. 78, effective in 1997, advises that "[internal control] knowledge is ordinarily obtained through previous experience with the entity and procedures such as inquiries of appropriate management, supervisory, and staff personnel; inspection of entity documents and records; and observations of entity activities and operations."[306]

To obtain knowledge about a company's internal controls over the reporting of cash balances, for example, an auditor can make inquiries of the bookkeeper responsible for performing bank reconciliations. The auditor can also examine bank records, including lists of authorized signatories, withdrawal requests and bank statements.

Instruction to consider internal controls is reflected in the 2010 JAC audit program:

> Certain programs and/or audit steps may or may not be selected for testing based on an assessment of the firm's internal controls, customer complaints, results of past audits, restrictions imposed on the firm, a profile of accounts carried, its order and solicitation process, and the general nature of its business operations.[307]

However, JAC protocols offered no instruction about how to perform an assessment of a firm's internal controls.

Internal controls over financial reporting ("ICFR") are designed to reduce the chance of fraud in financial statements, and a fundamental premise of ICFR is segregation of duties. Segregation of duties forces a fraud perpetrator to collude with at least one other individual in order to commit fraud, and collusion is difficult to initiate prior to the fraud, execute during the fraud and maintain after the fraud. Under a typical segregation of duties regime, the individual opening the bank statement is separate from individuals who have the authority to sign checks. A fraudster performing both functions, as in PFG's

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[304] AU 150.02. In 2006, SAS No. 105 expanded the scope of the understanding that the auditor must obtain in the second standard of fieldwork from 'internal control' to 'the entity and its environment, including its internal control.

[305] SAS No. 78, *Consideration of Internal Control in a Financial Statement Audit: An Amendment to Statement on Auditing Standard No. 55* and SAS No. 109, *Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement*. In addition, SAS No. 78 and SAS No. 109 refers to *Internal Control—Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission.

[306] AU 319.58. SAS No. 109, effective in 2006, contains similar instruction and is codified at AU 314.06.

[307] NFA03353322 (JAC Financial, Revised March, 2010, cover page). This note is also on the JAC Financial cover pages from 2002-2009.

case, can sign a check drawn on the company's bank account to pay for personal expenses and then intercept the bank statement and alter it to hide the improper withdrawal.

The AICPA Standards codified at AU 316.85[308] list "inadequate segregation of duties" as the first opportunity risk factor relating to misstatements arising from misappropriation of assets. With inadequate segregation of duties and absent any compensating controls, a CPA auditor must conclude that there is a significant deficiency in internal controls and most likely will conclude that there is a material weakness, defined at AU 325.06 as "a deficiency, or combination of deficiencies, in internal controls, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis."[309]

AU 316.85 also discusses fraud risk factors relating to the presence of a domineering CEO. Specifically, the auditing guidance states:[310]

> There is ineffective monitoring of management as a result of the following:
>
> - Domination of management by a single person or small group (in a nonowner-managed business) without compensating controls.
> - Ineffective board of directors or audit committee oversight over the financial reporting process and internal control.

Wasendorf described in his attempted suicide note how he was able to conceal the fraud at PFG as follows:

> With careful concealment and blunt authority I was able to hide my fraud from others at PFG. PFG grew out of a one man shop, a business I started in the basement of my home. As I added people to the company everyone knew I was the guy in charge. If anyone questioned my authority I would simply point out that I was the sole shareholder. I established rules and procedures as each new situation arose. I ordered that US Bank statements were to be delivered directly to me unopened, to make sure no one was able to examine an actual US Bank Statement. I was also the only person with online access to PFG's account using US Bank's online portal. On [the] US Bank side, I told representatives at the Bank that I was the only person they should interface with at PFG.[311]

[308] "Lack of appropriate segregation of duties" was listed as one of several "risk factors relating to controls" in Statement on Auditing Standards No. 82 ("SAS 82"), effective for fiscal years ending on or after December 15, 1997. The current standard, cited here, is from SAS 99, which superseded SAS 82 for fiscal years beginning on or after December 15, 2002.
[309] Statement on Auditing Standards No. 115 ("SAS 115"), effective for fiscal years ending on or after December 15, 2009.
[310] SAS 99, Appendix A-2. Based on review of the 2002-2010 JAC audit programs and NFA audit modules, consideration of various fraud risk factors were not audit steps performed by NFA auditors.
[311] Wasendorf's Signed Confession at p.2.

In his December 2012 interview with the BRG Investigative Team, Wasendorf explained that he only requested that U.S. Bank statements be sent directly to him, not bank statements from other banks.[312] Wasendorf also said he was the only signatory for the U.S. Bank segregated funds account, a fact confirmed by U.S. Bank.[313] Former PFG CFO Tom Pearson ("Pearson") stated that when he was at PFG between 1995 and 2005, "he never looked at the bank statements."[314] He further recalled that "Russ Wasendorf, kept all the banking files himself, saying, if you needed anything related to the accounts, you just asked him and he provided it to you."[315]

Thus, both conditions appearing in the fraud risk factors relating to the presence of a domineering CEO discussed above were present at PFG. As to domination of management by a single person, Wasendorf declared in his confessional statement that he used "blunt authority" to manage and hide his fraud, and the use of intimidating authority was corroborated by former PFG CFO Pearson. As to the second condition, Pearson also stated that "there was no Board of Directors," speaking figuratively.[316]

However, none of the 23 auditors that we interviewed stated that they performed an assessment of PFG's internal controls or that they were aware that Wasendorf was the only individual at PFG who received the original U.S. Bank statements.[317] Several auditors stated that this type of information would not normally be requested in an NFA audit, with one noting that NFA did not conduct a review of "a broader level of how [a firm's] operations work in regard to finance," and that this was "not really part of the questioning on an NFA audit."[318]

When asked if she was "surprised that given all the audits that NFA did that they didn't uncover the fraud," the NFA' s field supervisor for the 1998 and 1999 audits of PFG, stated, "Yes and no." She clarified, "Yes because we did so much testing, and no, because we didn't have some of the safeguards in place for internal controls that we probably should have." One example of these safeguards would have been to determine whether Wasendorf was "the only person getting the bank statements."[319]

An NFA senior manager who oversaw the 1996 and 1997 NFA audits of PFG stated that when she first started with the NFA in 1985, NFA auditors "asked a lot of questions" regarding "internal controls," but over time, NFA auditors "moved away from that."[320] She further acknowledged that "internal controls

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[312] Interview Memorandum of Wasendorf at 3.
[313] *Id.;* Letter from Peter W. Carter, Dorsey & Whitney LLP, counsel for U.S. Bank dated January 8, 2013.
[314] Interview Memorandum of Pearson at 2.
[315] *Id.* at 2. Wasendorf, Jr. stated that he was not aware while he was President of PFG that Wasendorf was the only one at PFG with access to U.S. Bank statements. Interview Memorandum of Wasendorf, Jr. at 3.
[316] In actuality, there was little evidence that came to the attention of the BRG Investigative Team of a functioning Board of Directors at PFG.
[317] Wasendorf received the U.S. Bank statements and provided fabricated statements to PFG bookkeepers for review and reconciliation.
[318] Tr. of Current Auditor no. 9 at 69:3-22; *See also*, Tr. of Current Auditor no. 11 at 33:2-18; Tr. of Current Auditor no. 6 at 32:12-33:21. We note that we did not find evidence that NFA auditors were trained on the guidance of the Treadway Commission or the AICPA standards regarding internal controls nor were they incorporated into the NFA modules.
[319] Tr. of Current Auditor no. 7 at 44:24-45:15.
[320] Tr. of Current Auditor no. 2 at 98:11-16.

was not a major focus of the audits that were done historically at the NFA."[321] Another former NFA employee who was a staff auditor for the 1999, 2000 and 2001 PFG audits, agreed, stating, "internal controls wasn't something that I recall NFA really being focused on as far as what the procedures were, what those steps were, who had control of information, or how those processes worked."[322]

Wasendorf stated that "nobody at PFG, NFA or the independent CPA raised any questions or concerns regarding internal controls."[323] Both PFG's Director of Compliance, O'Meara and CFO Cuypers indicated that NFA was not focused on internal controls or segregation of duties in their audits.[324]

Based on a review of available NFA audit work papers between 1995 and 2012, the BRG Investigative Team found the following references to PFG's internal controls:

- Beginning in 2004, NFA auditors verified that the external auditors issued an annual Report on Internal Accounting Control Required by CFTC Regulation 1.16 and confirmed that the auditor's report described no material weaknesses.[325]

- The NFA auditors briefly discussed internal controls over cash during 11-CEXM-939, the post-MF Global exam. An NFA auditor emailed O'Meara on December 19, 2011 and stated "in conjunction with our review of PFG's November 18 customer segregated funds, we would also like to gain a better understanding of the firm's internal controls in place related to customer segregated accounts." However, we found no evidence that NDA auditors followed-up and gained an understanding of the internal controls over cash and repos at U.S. Bank.[326]

NFA management stated that NFA tests internal controls indirectly through its testing of compliance with NFA requirements. However, NFA management also acknowledged that there should be more emphasis placed on internal controls in NFA audits. NFA management also noted that FCMs should be required to comply with more stringent standards for internal controls. NFA anticipates issuing guidance to that effect in the near future.

VIII. NFA's Level of Scrutiny on Qualifications and Promotions of Senior PFG Personnel

The former CFO at PFG, Pearson, stated in an interview that when he left PFG in 2005, he was replaced as CFO by Cuypers. Cuypers was initially hired by PFG as an assistant bookkeeper and then worked as the controller before being promoted to the position of CFO.[327] Pearson further stated that many people in the industry were surprised that someone with such little experience got the CFO position at

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[321] *Id.* at 98:3-7.
[322] Tr. of Former Auditor no. 5 at 54:14-19.
[323] Interview Memorandum of Wasendorf at 2.
[324] Interview Memorandum of O'Meara at 5; Interview Memorandum of Cuypers at 2.
[325] NFA00111474-NFA00111515 (PFG Certified Stmts Checklist Comments).
[326] NFA00185985-NFA00185988 (Email exchange between O'Meara and NFA manager). *See also*, NFA00014103 (O'Meara's answers are documented, SD-Internal Controls).
[327] Interview Memorandum of Pearson at 1.

PFG.[328] Cuypers' formal education consisted of an associate's degree from Hawkeye Community College in Iowa.[329] She never attended or participated in any auditing classes and acknowledged that her education and training were more focused on bookkeeping and accounting mechanics.[330] She was not a CPA and had never taken any continuing education courses to supplement her associate's degree.[331] When she obtained the CFO position after Pearson left, Cuypers said there were no other candidates considered for the CFO job, other than herself.[332]

Eidelman, who was appointed as the Receiver for the Wasendorf estate, stated in an interview that "Wasendorf's M.O. was to surround himself with people he thought would not be able to detect his fraud."[333] As examples, the Receiver stated that Heather McCallum had only a 2-years associate's degree but was installed as the CFO of one of his restaurants.[334] In addition, Eidelman said another senior manager at PFG was relatively inexperienced.[335]

The JAC audit program directs auditors, during the planning phase, to identify specific firm personnel responsible for (a) financial statement preparation, (b) daily position and money balancing, and (c) general compliance/sales practice areas. Auditors are instructed to detail the backgrounds of relevant individuals new to their positions.[336]

However, the investigation found that NFA auditors did not scrutinize the qualifications of senior PFG officials. A former staff auditor on the 2001 audit of PFG stated that, as "a standard procedure," NFA auditors would not look at the qualifications of PFG officials, like the CFO and compliance officer.[337] Further, he noted that NFA auditors would not normally be aware of officials being promoted quickly to high levels at firms.[338] Another former NFA staff auditor, who worked on the 2005 audit of PFG, stated that analyzing the qualifications of officials at an FCM was not a "priority" for the NFA, nor was analyzing whether employees were being promoted quickly to higher levels.[339] A current NFA supervisor, who worked as a staff auditor on the 2008 audit of PFG, said NFA auditors would not review the qualifications of senior-level FCM officials or look at promotions unless there already were "concerns brought up in the audit."[340]

[328] *Id*.
[329] Interview Memorandum of Cuypers at 1.
[330] *Id.*
[331] *Id.*
[332] *Id.* at 2.
[333] Interview Memorandum of Michael M. Eidelman at 1.
[334] *Id.*
[335] *Id.*
[336] NFA03353369-NFA03353391 (JAC Program 2010 GENERAL). This applies to the 2002-2009 JAC Programs as well.
[337] Tr. of Former Auditor no. 2 at 33:10-17.
[338] *Id.* at 33:18-22.
[339] Tr. of Current Auditor no. 5 at 25:5-24.
[340] Tr. of Current Auditor no. 6 at 27:20-28:5.

A current director[341] at NFA similarly replied to a question about NFA's review of qualifications of key firm officials, as follows:[342]

> As far as looking at the qualifications of the individuals, what we would do -- we would do a check on BASIC to see if there have been any investigations or any complaints, have we taken any disciplinary action against this individual. But as far as looking into their educational background or their prior work experience, no, we don't do that unless they're required to be a principal and go through our registration system.

NFA management stated that NFA has made inquiries into the qualifications of senior-level officials at FCMs when its testing has indicated a problem with their work or in connection with their responsibilities. NFA management also indicated that for at least two years, new FCMs have been subjected to an interview process that includes these types of questions.

IX. NFA's Level of Scrutiny of PFG's Outside Auditing Firm

The NFA auditors interviewed during the investigation generally were aware that PFG used an outside accounting firm, but were not aware that the accounting firm, Veraja-Snelling & Company, was, particularly in the later audits, a small, obscure firm with an office in the suburbs of Chicago.[343] A current director[344] at NFA, who oversaw the 2006 NFA audit of PFG stated, "I was not aware – at the time I was not aware [that] their CPA was this one-person shop in the suburbs of Chicago."[345] She further described her reaction to learning this information in 2012 after the fraud was uncovered:

> And when I found out the background of the CPA, I was alarmed. Because I met Russ [Wasendorf], Jr. and Sr. on several occasions, and that's not the type of -- their appearance and the way they ran PFG and the other subsidiaries, they gave the appearance that they would tout the fact that I'm with a Big 4 or a big law firm. So that was a big shock to me.[346]

The field supervisor for NFA's 1998 and 1999 audits of PFG further stated that NFA auditors traditionally did not look at the experience, background, or expertise of an FCM's outside auditing firm.[347] (*See also,* interview of auditor on 2005 PFG audit, where he stated that, at that time, NFA auditors would not seek

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[341] This refers to an employee of NFA and is not to be confused with a member of the NFA's Board of Directors.
[342] Tr. of Current Auditor no. 4 at 36:10-21.
[343] According to Wasendorf, Jr., the PFG Executive Committee was considering using another, larger firm, but Wasendorf "had absolute final decision on which auditor to use and believed Veraja-Snelling was the best choice." Interview Memorandum of Wasendorf, Jr. at 4.
[344] This refers to an employee of NFA and is not to be confused with a member of the NFA's Board of Directors.
[345] Tr. of Current Auditor no. 4 at 56:9-12.
[346] *Id.* at 56:16-24.
[347] Tr. of Current Auditor no. 7 at 16:20-17:4.

to determine the firm's auditor's background, experience, or expertise).[348] Likewise, we found no evidence of a JAC audit program requiring auditors to review or consult with external auditors.[349]

A staff auditor on the 2009 NFA audit of PFG similarly stated that if he had known that PFG was utilizing an obscure, one-person auditing firm, it would be a "red flag . . . especially with the amount of business they were doing." [350] (*See also,* interview of staff auditor in 2001 PFG audit who stated that if an auditor became aware that a firm like PFG used a one-person, obscure auditing firm, that could be a red flag.[351])

Several of the auditors we interviewed were aware that the issue of a large sophisticated firm using a small, obscure outside accounting firm was also a "red flag" in connection with the Madoff Ponzi scheme, with one auditor acknowledging that after the discovery of Madoff's fraud scheme, NFA auditors could have conducted "due diligence" to learn more about the Veraja-Snelling firm, although he still maintained that since Veraja-Snelling had "held a relationship [with PFG] over the years," there was "never any reason to believe anything was wrong."[352]

A review of PFG's certified financial statements from 2000 until 2012 revealed that Veraja-Snelling was at least one of PFG's auditors for that entire time period. Veraja-Snelling initially served in 2000 as PFG's outside auditor as part of the firm of DiMaggio and Robinson, then as DiMaggio and Veraja and finally, in late 2006, as the sole accountant in Veraja-Snelling, Inc.[353]

The BRG Investigative Team did not find evidence that NFA auditors performed analytical procedures or reasonableness tests on PFG's expenses for various professional fees, including the expense for external audit fees. Further, NFA auditors did not ascertain whether PFG's external audit fees were comparatively low, comparatively high, or increasing rapidly.[354]

In our review of NFA audit files for audits between 1995 and 2012, we found only two instances where there was any specific reference questioning any aspect of PFG's accounting firm. In NFA's PFG Certified Statements Checklist Comments for December 2006, it stated: [355]

> NFA noted the CPA per the statement Veraja-Snelling & Company which does not exactly agree with the CPA on file. However, per discussion with [PFG CFO] Cuypers,

[348] Tr. of Current Auditor no. 5 at 34:12-19.
[349] The BRG Investigative Team reviewed the 2002-2010 JAC audit programs.
[350] Tr. of Current Auditor no. 8 at 58:2-10.
[351] Tr. of Current Auditor no. 3 at 48:16-22.
[352] Tr. of Former Auditor no. 2 at 61:20-62:17.
[353] NFA00029548 (PFG Accrued Legal/Accounting Fees, January 2004-November 2008); NFA00155049 (Charts of PFG Accrued Legal/Accounting Fees, December 2008-April 2012).
[354] Per NFA00029548 and NFA00155049, beginning in November of 2009, the records show that PFG's monthly accrual for accounting fees increased from $2,500 a month to $6,000. The annual fees also increased significantly. From 2004 to 2008, the annual audit cost PFG between $18,000 and $22,000. But, beginning in 2009, the annual fees increased substantially, to $46,575 in 2009 and $67,835 in 2010. The substantial and unexpected increase of auditing fees may reflect significant additional work on the part of the CPA and accordingly, it would have behooved NFA auditors to inquire about the reason behind the possible additional workload.
[355] NFA00111496 (PFG Certified Statements Checklist Comments).

NFA noted that the CPA went through a name change; as such, a change in CPA letter is not necessary. However, NFA Updated Firm Notes to reflect the proper information.

In the Net Capital module review in March of 2012, in connection with the 2012 audit, NFA auditors noted under "General Information" that "the firm engaged a 1-person CPA firm to conduct an annual audit of the firm that increases the possibility of human error or fraud."[356] We saw no evidence of any follow-up on this issue in the 2012 audit, although the fraud was uncovered when Wasendorf attempted suicide in July 2012, prior to the audit's conclusion.

NFA management indicated that both NFA and CFTC are contemplating whether they should enforce higher standards for CPAs who act as outside auditors for FCMs.

X. NFA's Level of Scrutiny of PFG's Lack of Profitability and Wasendorf's Capital Contributions

The investigation found that PFG incurred losses in 6 out of the 10 years for which financial statements were available for review.[357] During the 6 years that it lost money, PFG losses totaled $16,602,143. Profits totaled $4,101,086 in the 4 years PFG made a profit. In the aggregate, PFG lost $12,501,057 between 2000 and 2011, excluding 2002 and 2003, for which financial statements were not available.

Moreover, PFG's accumulated deficit suggests that in 2002 and 2003 PFG incurred further losses of $2,166,000.[358] Similarly, based on the accumulated deficit, PFG incurred total pre-tax losses in excess of $6,822,000 in its first 8 years of operation.[359] Therefore, PFG's accumulated deficit was approximately $21 million by December 31, 2011.

Further, the investigation found that PFG's repos with U.S. Bank constituted a significant portion of the interest revenues of the firm between 2005 and 2009. Based on PFG's available accounting records for the U.S. Bank segregated customer fund account, between 2005 and 2009, PFG recorded $16,605,496 of interest from the repos out of total reported interest income of $25,593,359 (i.e., approximately 65%).[360] As discussed in more detail in Section X below, most of the repo interest revenue was fictitious.

JAC's general and risk-based scope rationale audit program instructs the auditor, during the planning stage, to "identify areas noted during recent reviews as having significant trends or material fluctuations. Consider the following balances: …Retained earnings/P&L, Ownership Equity".[361]

The investigation found that Wasendorf had always been the sole or majority shareholder of PFG.[362] Wasendorf purportedly contributed $69,125,000 to PFG between 2000 and 2011, according to forms 1-

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[356] NFA00081704 (12-CEXM-299 Net Capital module).
[357] PFG Forms 1-FR-FCM were not available for 2002 and 2003 as well as for years before 2000.
[358] PFG Forms 1-FR-FCM for: NFA00038553-NFA00038586(2001) and NFA00043323-NFA00043352(2004).
[359] PFG Form 1-FR-FCM for: NFA00042217-NFA00042243(2000).
[360] PFG Forms 1-FR-FCM, including audited financial statements therein, for: NFA00042217-NFA00042243(2000), NFA00038553-NFA00038586(2001), NFA00043323-NFA00043352(2004), NFA00043421-NFA00043449(2005), NFA00043471-NFA00043499(2006) , NFA00043510-NFA00043538(2007), NFA00043542-NFA00043572(2008), NFA00043625-NFA00043659(2009), NFA00043660-NFA00043696(2010), and NFA00149404-NFA00149439(2011).
[361] NFA03353369-NFA03353391 (JAC Program 2010 GENERAL). This was the same for the 2002-2009 JAC Programs except that "ownership equity" was added in 2003.

FR-FCM. During that same time period, PFG's minimum net capital requirement increased from $3,774,467 to $21,136,983.[363] Separately, the minutes of shareholders' meeting included in the AML module provide documentation for many of Wasendorf's individual capital contributions. Table 2 below lists Wasendorf's capital contributions based on those records.

Table 2: Wasendorf Capital Contributions

Date		Contribution [1]
January 10, 2003	$	1,000,000
February 11, 2003	$	1,000,000
May 23, 2003	$	7,000,000
June 6, 2003	$	6,500,000
September 30, 2005	$	4,000,000
December 9, 2005	$	5,000,000
May 8, 2006	$	2,000,000
August 14, 2007	$	5,000,000
December 26, 2007	$	7,350,000
November 26, 2008	$	5,000,000
March 4, 2009	$	4,300,000
April 29, 2009	$	7,000,000
August 27, 2009	$	2,000,000
October 20, 2009	$	1,000,000
January 26, 2010	$	2,000,000
January 26, 2012	$	50,000
March 20, 2012	$	85,000
April 27, 2012	$	1,000,000
May 31, 2012	$	1,000,000
June 22, 2012	$	1,000,000
TOTAL	**$**	**63,285,000**

[1] Contribution obtained from Shareholders' Meetings Minutes[364]

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[362] NFA audit workpapers from 2003-2005 indicate two other shareholders, but each shareholder is noted as holding less than 1% of PFG shares.

[363] PFG Forms 1-FR-FCM, including audited financial statements therein, for: NFA00042217-NFA00042243(2000), NFA00038553-NFA00038586(2001), NFA00043323-NFA00043352(2004), NFA00043421-NFA00043449(2005), NFA00043471-NFA00043499(2006) , NFA00043510-NFA00043538(2007), NFA00043542-NFA00043572(2008), NFA00043625-NFA00043659(2009), NFA00043660-NFA00043696(2010), and NFA00149404-NFA00149439(2011).

[364] NFA00039414 (January 2003), NFA00039417 (February 2003), NFA00039421 (May 2003), NFA00039425 (June 2003), NFA00036683 (September 2005), NFA00037063 (December 2005), NFA00037067 (May 2006), NFA00036090 (August 2007), NFA00036085 (December 2007), NFA00031900 (November 2008), NFA00024946 (March 2009), NFA00024950 (April 2009), NFA00024953 (August 2009), NFA00024956 (October 2009), NFA00024941 (January 2010), NFA00178401 (January 2012), NFA00178403 (March 2012), NFA00178405 (April 2012), NFA00178409 (May 2012), NFA00178411 (June 2012). However, at least some of these capital contributions appear to be fictitious, because the authentic bank statements that we obtained did not show these deposits.

In his interview, Wasendorf stated that "No one ever looked at [his] capital contributions" or the source of such contributions."[365]

Although the JAC program includes general guidance during the planning stage of an audit, we found no evidence of specific prescribed JAC audit steps to be performed on owner's equity or capital contributions.[366] In our review of the NFA audit files, we found that NFA auditors took note of the large, recurrent capital contributions in response to losses as early as 1999 in the owner's equity section of the net capital module, stating as follows:[367]

> Per review of the capital account, NFA noted that the firm has a pattern of recurring losses. Therefore, NFA had a concern regarding the issue, and spoke to [then-CFO Tom] Pearson regarding the issue during fieldwork. Pearson represented that the firm will propose a detailed budget for 2000. Pearson stated that Russ [Wasendorf] Sr. has infused two million in capital, to increase the firm's [Excess Net Capital]. Pearson stated that it is the firm's intention that the budget eliminate the issue of losses in the future. It is not the firm's intention to repeatedly infuse capital to cover recurring losses. NFA will monitor the firm's progress in the future through analysis of their financial statements.

In 2003, NFA auditors also noted the contribution without reference to losses:[368]

> Per review of the 12/31/02 AFS, NFA noted that PFG's preferred stock has increased from $9.3 million on 12/31/02 to $24.8 million on 6/30/03. Per discussion with Susan [O'Meara] on 08/04/03, the increase in capital is due to an investment by Wasendorf. Wasendorf wanted to maintain a large excess in net cap, and made the capital contribution to increase the excess in net capital. Appears reasonable, pass further review.

NFA auditors did not make a reference to capital contributions in conjunction with losses after 2003.[369] PFG showed small profits in 2006, 2007, 2008, and 2010.

The investigation found that, until 2012, NFA auditors did not scrutinize either the fact that PFG was losing significant money in many years or Wasendorf's frequent capital contributions. Regarding owner's equity, NFA's net capital module require the auditor to "compare current capital account balances with balances on last certified statement and note any unusual or large variations below. (Review appropriate documentation and authorization if needed). Any unusual or large items should be discussed with firm personnel."[370] The Owner's Equity section of the net capital module was completed in all of the audits over the relevant period, see Appendix E.

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365 Interview Memorandum of Wasendorf at 2.
366 Based on a review of the 2002-2010 Audit Programs.
367 NFA00001092 (99-CEXM-370 Net Capital module).
368 NFA00003369 (03-CEXM-519 Net Capital module).
369 NFA00004022 (04-CEXM-544 Net Capital module); NFA00010649 (10-CEXM-206 Net Capital module).
370 NFA00005902 (06-CEXM-521 Net Capital module).

Notwithstanding the notation in the net capital module in 1999, an auditor on the 1999 and 2000 PFG audits did not recall any discussion about PFG losing money.[371] An auditor who worked on the 2006 and 2010 PFG audits stated that he did not take note of PFG's losses or the capital contributions, as "almost every FCM [was] losing money . . . and [was] being propped up by one person or another."[372] He also noted that NFA auditors would not have analyzed the possibility of money laundering by Wasendorf, since NFA's "anti-money laundering [module] is more about looking at customers laundering money through the firm rather than employees themselves laundering money through the firm."[373] Both O'Meara and Cuypers stated that NFA auditors never asked about the source of Wasendorf's capital contributions.[374]

In 2012, shortly before the fraud was uncovered, NFA auditors became concerned with the rate at which PFG was losing money and arranged a conference call to discuss the matter.[375] NFA indicated that the firm losing money could adversely impact PFG's excess balances.[376] During the conference call, PFG officials described their plan to "limit […] monthly losses" by "cutting expenses in some areas" and the fact that Wasendorf was going to infuse more capital into the firm.[377] The NFA field supervisor stated that, at that time, there was no concern on the part of NFA auditors about the source of the money that Wasendorf was using to make capital contributions into the firm.[378] The former NFA director[379] who oversaw the 2012 audit stated that she did not recall any concern being raised prior to 2012 about either PFG losing money or Wasendorf's capital contributions although she did acknowledge that it was a "concern from an auditing perspective that a firm is losing a lot of money and that the owner is continuously putting in capital infusions."[380] She further stated that in 2012, the NFA audit team had continued concerns about customer accounts given the amount of money PFG was losing and had planned to have further conversations with the firm about this matter when the fraud was uncovered.[381]

NFA management stated that there have been other instances where NFA was able to identify possible money laundering by a principal from examining the principal's cash deposits and withdrawals from his trading account and the firm's capital account. NFA management also stated that large infusions of capital by a principal into a firm for no apparent business purpose could indicate the possibility of money laundering.

[371] Tr. of Former Auditor no. 6 at 41:17-20.
[372] Tr. of Current Auditor no. 9 at 41:2-4.
[373] *Id.* at 41:18-22.
[374] Interview Memorandum of O'Meara at 5; Interview Memorandum of Cuypers at 4.
[375] Tr. of Current Auditor no. 12 at 113:10-24.
[376] *Id.* at 114:8-10.
[377] *Id.* at 115:5-15.
[378] *Id.* at 115:20-116:5.
[379] This refers to an employee of NFA and is not to be confused with a member of the NFA's Board of Directors.
[380] Tr. of Former Auditor no. 7 at 24:3-25:2; *Id.* 26:16-24.
[381] Tr. of Current Auditor no. 13 at 30:11-23.

XI. NFA's Level of Scrutiny of PFG's Repo Agreement and Sweep Accounts

a. PFG's Repo Transactions and U.S. Bank Sweep Account

i. U.S. Bank Accounts

PFG had multiple accounts at JPM, U.S. Bank, and other banks.[382] The PFGBEST website instructed customers to wire funds to JPM Account Number 5330355265.[383] From there, customer funds were transferred to the 845 Account from time to time. The forged account statements (the "Fabricated U.S. Bank Statements") for the 845 Account were labeled as "Peregrine Financial Group Inc. Segregated Funds Acct," and, until the fraud was revealed, NFA auditors only saw the Fabricated U.S. Bank Statements for the 845 Account.[384] This account commonly was referred to in audit papers as a "customer segregated funds account" (or "segregated account" for short).[385] However, according to U.S. Bank, its records for the 845 Account "reflect the account was a business checking account and not customer segregated account."[386] Our review of limited quantities of monthly account statements provided by U.S. Bank[387] for the 845 Account from May 2005 – June 2012 after the fraud was discovered (the Actual U.S. Bank Statements) indicated the account owner was PFG, but did not indicate that the account was for segregated funds as required by CFTC regulations.[388] During its audit of PFG, the NFA auditors reviewed bank statements from JPM and other banks.[389] The BRG Investigative Team did not find evidence that NFA auditors contemporaneously reviewed specific transfers of funds between JPM and U.S. Bank segregated accounts during its audits of PFG.

Before there were any references to the 845 Account in the audit papers, there was another account at Firstar Bank that audit work papers referred to as a segregated account.[390] (As discussed above, Firstar Corporation merged with U.S. Bancorp on February 27, 2001, and the new company retained the U.S. Bancorp name). Firstar account number 15-943-4 was referred to as a segregated account in the 1995 audit and carried a balance of approximately $5 million. Auditors referred to the 845 Account as the Firstar segregated account for the first time during the 1997 audit, without any mention of account number 15-943-4.[391] The change in account number for the Firstar/U.S. Bank segregated account was not reflected in the audit modules despite the fact that the segregation module asked auditors in

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[382] NFA00012930-NFA00012944 (11-CEXM-239 Net Capital module).
[383] http://www.pfgbest.com/fund/wire.asp.
[384] *See, e.g.,* NFA00040501-NFA00040502 (Firstar Bank Statement for the 845 Account for the period 7/01/2001 through 7/31/2001) or NFA00024631-NFA00024632 (US Bank Statement for the 845 Account for the period 11/01/08 through 11/30/2008).
[385] NFA00003498-NFA00003499 (NFA 2003 field supervisor memorandum about Sweep Account (August 14, 2003).
[386] Letter from Peter W. Carter, Dorsey & Whitney LLP, counsel for U.S. Bank dated January 8, 2013.
[387] *See, e.g.,* NFA02496229 (Actual U.S. Bank statement, December 2008).
[388] CFTC Regulation §1.20 "Customer funds to be segregated and separately accounted for." The BRG Investigative Team notes that CFTC Regulation 1.20 does not include affirmative reporting or filing requirements related to the identification of segregated accounts.
[389] *See, e.g.,* NFA00006801-NFA00006887 (08-CEXM-16 audit papers, SD-Seg6 Seg Bank Accounts for 11/30/07).
[390] NFA00000037 (95-CEXM-454 Unusual Cash Transactions worksheet, Notes tab); NFA00000373 (95-CEXM-454 Statement of Segregation Requirements and Funds in Segregation worksheet).
[391] NFA00000740 (97-CEXM-628 Segregation worksheet, Note 1).

Question 3 to list any new depositories since the last audit where customer funds/securities are held. In Question 4 the module asked auditors to ascertain that the firm maintains copies of the required acknowledgements from each of the depositories in Question 3. The 1996 or 1997 responses for Questions 3 and 4 did not include any reference to Firstar or the 845 Account. For comparison, in the audit, NFA auditors noted the bank name change from Firstar to U.S. Bank.

In the audit files, a designation letter from U.S. Bank to PFG stating that the 845 Account was a segregated account[392] was provided, at the earliest, in 2001.[393] While the document was not explicitly referenced in the 2001 audit modules, there is a note in the 2002 Segregation module that PFG had U.S. Bank prepare a new acknowledgement in order to show the name change from Firstar.[394]

ii. Reverse Repurchase Transactions

To invest segregated account cash, PFG entered into repo transactions[395] with U.S. Bank and its predecessor, Firstar through the actual 845 account. The Master RA between PFG and Firstar was dated December 12, 1994.[396] An addendum to the Master RA designated Firstar demand deposit account 15-943-4 as the settlement account, which, presumably, was later replaced by the 845 Account.

The 845 Account had a sweep feature that invested a set amount of funds on deposit at the bank overnight in U.S. Treasury repos, which were essentially overnight loans PFG made to U.S. Bank secured by U.S. Treasury obligations. The loan proceeds, with interest, would be returned to the 845 Account the next morning for use in the commercial checking account. As shown on certain Actual U.S. Bank Statements,[397] there was an actual, functioning sweep feature for the 845 Account that utilized an actual separate sweep account (#0-007-9261-1352) at U.S. Bank. Accordingly, for each night that the sweep was in operation, the actual sweep feature would invest a set amount of funds from the 845 Account in repos that were listed and carried in the actual separate sweep account. Pursuant to the governing sweep agreement, the bank would then re-deposit the proceeds from the maturing repo the next morning into the 845 Account along with interest earned. During its investigation, the BRG Investigative Team did not find any evidence that suggests that NFA auditors contemporaneously received Actual U.S. Bank Statements for sweep accounts from U.S. Bank, or any other source, during the audits it conducted of PFG.

The Actual U.S. Bank Statements, which NFA auditors did not receive during the audit of PFG, indicate that PFG entered into repo transactions with U.S. Bank until July 2009.[398] However, the BRG

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[392] CFTC Regulation § 1.20(a) states that an FCM must, with some exceptions, obtain a "written acknowledgement" from the bank that the bank "was informed that the customer funds deposited therein are those of commodity or option customers and are being held in accordance with the provisions of the [Commodity Exchange] Act."
[393] NFA00010196 (Hope Timmerman memorandum re: CEA Customer Accounts, July 5, 2001).
[394] NFA00002944 (02-CEXM-306 Exam Segregation module).
[395] A repo is a transaction under which the seller of a security agrees to repurchase the security later at a set, higher, price. The difference between the original price paid by the buyer and the price the buyer later receives under the repurchase agreement is the return on the investment.
[396] NFA00010038-NFA00010047 (Firstar Master Repurchase Agreement).
[397] *See*, for example, NFA02496229 (December 2008 actual U.S. Bank statement).
[398] NFA02546221 (U.S. Bank Beg & End Balances, May 2005 - June 2012).

Investigative Team also found that repo interest, presumably fictitious, was accrued in the PFG general ledger until about June 9, 2009, and was later reversed for the month of June 2009. The PFG accounting department presumably used the Fabricated U.S. Bank Statements for interest accrual, and the Fabricated U.S. Bank Statements showed repo sweep balances greatly in excess of the balances in the Actual U.S. Bank Statements.

To illustrate the differences between the documentation of the actual and fictitious sweep balances, in December of 2008, the Actual U.S. Bank Statement showed two accounts on the same statement: a deposit account (#0-006-2101-1845, *i.e.,* the 845 Account) and a separate sweep account (#0-007-9261-1352). The Actual U.S. Bank Statement deposit account showed a commercial checking balance of $100,010.31 and the sweep account showed the "Repurchase Agreement Sweep" in the amount of $13.5 million as of December 31, 2008.[399] In comparison, the Fabricated U.S. Bank Statement for November of 2008 did not show a separate sweep account and showed "Sweep Repurchase Agreement Principal" in the amount of $177 million as of the end of the month.[400, 401]

iii. Related Regulations for Reverse Repurchase Sweep Accounts

CFTC Regulation 1.25 governs an FCM's investment of customer funds, including investments made pursuant to repos.[402] Under Rule 1.25, investment of customer funds in U.S. government securities is permitted without any limit on concentration. Term of the agreements may not be more than one business day or otherwise the reversal of the transaction must be possible. The agreements to resell must specifically identify the securities by coupon rate, par amount, market value, maturity date, and CUSIP or ISIN number and confirmations specifying the terms must be provided immediately.[403] The immediate confirmations of specific securities in every repo transaction make it possible for auditors to determine an FCM's compliance with requirements on permissible investments and concentration limitations throughout a reporting period, not just at the end.

In addition to CFTC rules governing how FCM's may enter repos, banking regulations govern what documentation bank counterparties in repos must provide their customers, including FCMs. These documentation requirements are helpful to understand what is readily available during the audit of an FCM.

According to Federal Deposit Insurance Corporation ("FDIC") regulations, a "sweep account" is "an account held pursuant to a contract between an insured depository institution and its customer involving the pre-arranged, automated transfer of funds from a deposit account to either another

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[399] NFA02496229 (Actual December 2008 U.S. Bank Statement).
[400] NFA00024631-NFA00024632 (Fabricated November 2008 U.S. Bank Statement).
[401] NFA00010389 (Amount in 09-CEXM-003 Segregation Worksheet).
[402] http://www.ecfr.gov/cgi-bin/retrieveECFR?gp=&SID=e63bfbb246d030cfacb4bd20797bfda7&r=SECTION&n=17y1.0.1.1.1.0.4.24.
[403] *Id.*

account or investment vehicle."[404] CFTC regulations, though, appear to further limit the method by which a sweep account may function. Regulation 1.20 states, in part:

> (a) All customer funds shall be separately accounted for and segregated as belonging to commodity or option customers. Such customer funds when deposited with any bank, trust company, clearing organization or another futures commission merchant shall be deposited under an account name which clearly identifies them as such and shows that they are segregated as required by the Act and this part.
>
> (c) Each futures commission merchant shall treat and deal with the customer funds of a commodity customer or of an option customer as belonging to such commodity or option customer. All customer funds shall be separately accounted for, and shall not be commingled with the money, securities or property of a futures commission merchant or of any other person, or be used to secure or guarantee the trades, contracts or commodity options, or to secure or extend the credit, of any person other than the one for whom the same are held: *Provided, however*, That customer funds treated as belonging to the commodity or option customers of a futures commission merchant may for convenience be commingled and deposited in the same account or accounts with any bank or trust company, . . .

CFTC Financial and Segregation Interpretation 2-1 elaborated on requirements for investments in repos. Interpretation 2-1 states, in relevant part:

> 5. The securities transferred under the repos are held in or irrevocably credited to a safekeeping account with a bank . . . in an account which is titled to identify it as containing securities segregated for the benefit of the FCM's commodity customers . . .

While FDIC regulations may allow movement of funds in a sweep account from a deposit account to either "another account" or an "investment vehicle," CFTC Regulation 1.20 states that customer funds, at all times, are to "be deposited under an account name" and "in the same account or accounts with any bank." As for repos, the securities transferred under the Master RA must be credited to a properly titled "safekeeping account," in accordance with CFTC Regulations 1.25(d)(7) and 1.26.

Therefore, the intersection of CFTC and FDIC regulations imply that sweep funds may only be deposited in "another account," separate from the deposit account and that such separate account must be designated a "customer segregated funds account" and that a bank acknowledgement letter reflecting that status must be obtained and retained in accordance with CFTC Regulation 1.26.

Thus, CFTC-compliant sweep repo accounts are actually two accounts: a business checking account, which is a non-interest bearing account that allows the business to transact, and an investment account

[404] 12 CFR 360.8. http://www.fdic.gov/regulations/laws/rules/2000-7800.html. The definition of a sweep account was added to 12 CFR 360.8 on February 2, 2009 (74 FR 5806). Prior to 2009, Federal Reserve Board and other bank regulators referred to a "sweep" as the movement of funds from one account to another account. *See,* for example, Federal Reserve Bank of New York, Open Market Operations During 1995, p. 25.

that enters into the repo. The funds and the interest earned are deposited back into the business checking account on a daily basis. Once the funds leave the checking account and enter the investment account, they are secured by the repo securities, and are not FDIC-insured deposits.

When deposit sweep funds are invested in U.S. government securities, appropriate agreements must be in place, required disclosures must be made, and daily confirmations must be provided to the customer in accordance with the requirements of the Government Securities Act of 1986 and CFTC Regulations 1.25(d)(10) and 1.27.[405]

FDIC regulations also require that a bank effecting a securities transaction for a cash management sweep account give or send its customer a written statement for each month in which a purchase or sale of a security takes place in the account and not less than once every three months if there are no securities transactions in the account.[406]

Banks that retain custody of government securities that are subject to a hold-in-custody repurchase agreement, such as the Firstar Master RA in this case, are subject to additional requirements. Depository banks, when serving as government securities brokers or dealers that hold government securities for customer accounts subject to hold-in-custody repo agreements, are subject to custodial, documentation, and disclosure requirements.[407] These requirements include a written repo agreement as well as written confirmations specifying the securities that are the subject of the transaction. The confirmation must be issued and delivered no later than the opening of the next business day in which the transaction was initiated. It should be noted that for sweep hold-in-custody repo transactions, a confirmation must be issued each day since sweep repos give rise to a new repo transaction daily. Confirmations must contain specified information about the repo securities including: the issuer, maturity date, coupon rate, par amount, and market value. Financial institutions may use an electronic medium, such as email, to satisfy the requirement of issuing confirmations to their customers for hold-in-custody repo transactions. In addition to prompt confirmations, a bank effecting a securities transaction for a cash management sweep account is required to provide its customer a monthly written statement.[408]

With respect to holdings of government securities for customer accounts, banks must maintain possession or control of all government securities held for the account of customers by segregating such securities from the assets of the depository institution and keeping them free of any lien, charge or claim of any third party granted or created by such depository institution.[409]

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[405] FED, 2011 Commercial Bank Examination Manual, 3000.1 available at www.federalreserve.gov/boarddocs/supmanual/cbem/3000.pdf.
[406] 12 CFR 344.6., effective April 1, 1997. http://www.fdic.gov/regulations/laws/rules/2000-6400.html#fdic2000part3446.
[407] 17 CFR 403.5., effective April 1, 1997. http://www.fdic.gov/regulations/laws/rules/8000-900.html.
[408] 12 C.F.R. § 344.6. http://www.fdic.gov/regulations/laws/rules/2000-6400.html#fdic2000part3446.
[409] CFTC Regulation 1.26; 17 C.F.R. 450. http://www.fdic.gov/regulations/laws/rules/8000-1000.html#fdic8000dotpart450.

Other regulations specify that bank must disclose to customers that the repo investments are not FDIC insured.

iv. JAC Audits of Repos

In accordance with JAC audit procedures, if the auditor chooses to perform the "Securities" portion of the module of the JAC audit program completely, the auditor should prepare a list of all reverse repo and repo agreements. The list should identify the counterparty, settlement dates, contract price, accrued interest, collateral, market value of collateral, depository and haircuts on all agreements. However, the JAC audit program further provides that certain programs and/or audit steps may or may not be selected for testing based on an assessment of the firm's internal controls, customer complaints, results of past audits, restrictions imposed on the firm, a profile of accounts carried, its order and solicitation process, and the general nature of its business operations.[410]

The auditor must also "[r]eview investments of customer segregated funds for propriety," then "[r]efer to the attached summary of CFTC Reg 1.25 for allowable investments," and finally "[e]nsure that these securities are readily marketable and highly liquid."[411] JAC's summary of CFTC Reg 1.25 notes that investments in reverse repo and repo agreements are allowed and directs the auditor to "see guide to Reverse Repurchase and Repurchase Agreements for details."[412] The four-page Guide covers issues such as financial statement presentation, haircuts, securities allowed for collateral, term of transaction, and written agreement requirements.[413]

v. NFA Audits of PFG Repos

PFG's repos were subject to various test procedures during NFA's periodic exams. The following pages contain a summary of the NFA audit work on PFG's repos. Based on documents reviewed by the BRG Investigative Team, NFA auditors generally documented their work on PFG's repos in one or more of the following workpapers:

- *Cash Section of the Net Capital module:* The Cash Section is the first section of the Net Capital module and is designed to identify the firm's bank accounts (operating and segregated). Cash accounts were first identified and then sometimes confirmed with third parties. Sometimes the repos were mentioned in the Cash Section, but that section was actually not designed to examine the repos.

- *Securities section of the Net Capital module:* Repo agreements mainly are covered in the Securities section of the Net Capital module because capital charges for repos depend on the

[410] NFA03353322.
[411] NFA03353322-NFA03353368 (JAC audit program, Financial, March 2010) at NFA03353332. This was the same for the 2002-2009 JAC audit programs, except the sentence "Ensure that these securities are readily marketable and highly liquid" was not added to this step until 2010.
[412] *Id.* at NFA03353334. This was the same for the 2002-2009 JAC audit programs.
[413] *Id.* at NFA03353335-NFA03353338.

difference between the market value of the securities under the repurchase agreement and their contracted repurchase price.[414] Audit steps in this section of the module instructed the auditors first to obtain the repos and then consider confirming these agreements with the opposite party.

- *Segregation module:* To address repo agreements with segregated customer funds, repo-related audit steps from the Net Capital module were repeated in the Segregation module beginning in 2009. The purpose was to identify investments with segregated funds and ensure they were qualified investments under CFTC Regulation 1.25. Audit steps included testing the market value, indicating source and basis, obtaining a listing of repos, and considering confirmation with the opposite party.

- *Segregation worksheet:* The Segregation worksheet is the excel workbook where NFA auditors noted their work for the Segregation module. Within the workbook are worksheets for the segregation statement, statement of secured amounts, general notes, and tables. The tables reflect the tracing of applicable firm balances. There are no sections in the workbook that examine repos, but PFG’s repos generally were noted by NFA auditors in the workbook as “reconciling” items.

[414] Instructions for Line 4 (p. 4-4 & 4-5) on Form 1-FR-FCM state that the charges applicable to reverse-repurchase agreements are specified in SEC's Rule 240.15c3-1(c)(2)(iv)(F).

Table 3: Summary of Actions Documented in Net Capital Module – Securities Section[415]

Exam #	Securities Section Completed?	NFA Auditor Notes About Repo Investment	Obtained Repo Agreement?	Confirmed Repo with Bank?	Tested Market Value
95-CEXM-455	N/A[416]	N/A	N/A	N/A	N/A
96-CEXM-431	Yes	T-Bills	Yes	No	Yes
97-CEXM-628	Yes	T-Bills	Yes	No	Yes
98-CEXM-393	Yes	T-Bills	No	No	Yes
99-CEXM-370	Yes	T-Bills	No	No	No
00-CEXM-341	Yes	No Reference	No	No	No
01-CEXM-420	Yes	No Reference	Yes	No	No
02-CEXM-306	No	No Reference	No	No	No
03-CEXM-519	No	T-Notes[417]	No	No	No
04-CEXM-544	No	No Reference	No	No	No
05-CEXM-716	No	No Reference	No	No	No
06-CEXM-521	No	No Reference	No	No	No
08-CEXM-016	No	T-Notes	No	No	No
09-CEXM-003	Yes	T-Notes	Yes	No	No

Table 4: Summary of Actions Documented in Segregation Module[418]

Exam #	Completed Module?	Completed Worksheet?
95-CEXM-455	Yes	Yes
96-CEXM-431	Yes	Yes
97-CEXM-628	Yes	Yes (Appendix G)
98-CEXM-393	Yes	No
99-CEXM-370	Yes	No
00-CEXM-341	Yes	No
01-CEXM-420	Yes	No
02-CEXM-306	Yes	Yes (Appendix H)
03-CEXM-519	Yes	Yes (Appendix I)
04-CEXM-544	Yes	Yes (Appendix K)
05-CEXM-716	Yes	Yes (Appendix L)
06-CEXM-521	Yes	No
08-CEXM-016	Yes	Yes (Appendix M)
09-CEXM-003	Yes	Yes (Appendix N)

415 For a more detailed table showing the actions taken in the Net Capital modules see Appendix E.

416 No corresponding section in 95-CEXM-455.

417 NFA00003499-NFA00003500 (NFA 2003 field supervisor Memorandum to Files, August 14, 2003).

418 For a more detailed table showing the actions taken in the Segregation modules and worksheets see Appendix F.

vi. 1996-1998 Audits

a. Net Capital Module

The first mention in NFA workpapers of the repo was in the Cash section of the Net Capital module in the amount of $554,000 in the 96-CEXM-431 audit.[419] As instructed by the module, NFA auditors obtained and prepared a list of the firm's current cash balances as of the audit date and reviewed the list for clerical accuracy. NFA auditors noted that PFG incorrectly classified the segregated repo as segregated cash.[420]

In the Securities section, the auditors obtained the repo agreement and had a discussion with PFG management about the agreement. Management explained that PFG entered into overnight repos with Firstar. The notes in the audit file described that PFG invested segregated funds in T-Bills.[421] Auditors tested the market value of the Treasuries. They noted that market value was greater than the contract price; as such, no haircut was necessary. In addition, PFG did not need to increase its capital requirements and NFA auditors passed on confirming the repo directly with Firstar.[422]

b. Segregation Worksheet

NFA auditors noted the sweep repo in the accompanying segregation worksheet for the 97-CEXM-628 audit. See Appendix G for the 97-CEXM-628 Segregation worksheet. Auditors talked to PFG management and noted the transaction was for $7,790,000.[423] This amount was also identified in the Net Capital module.[424] There was no mention of the agreement in the Segregation module.

vii. 1999 Audit

a. Net Capital Module

The audit file stated that, in 1999, the CFTC noted that PFG was not accruing interest on a daily basis for segregation purposes.[425] However, auditors noted that, "the bank only reflects interest on the reverse repo on a monthly basis. The interest received by the firm is not for the benefit of the customers and is accrued by the firm for monthly net capital purposes." NFA auditors noted that this was not specified in the repo agreement, but the firm had always treated the interest as benefiting the house (i.e., PFG).[426]

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[419] NFA00000546 (96-CEXM-431 Net Capital module).
[420] NFA00000544 (96-CEXM-431 Net Capital module).
[421] NFA00000546 (96-CEXM-431 Net Capital module).
[422] *Id.*
[423] NFA00000740 (97-CEXM-628 Segregation worksheet).
[424] NFA00000698 (97-CEXM-628 Net Capital module).
[425] It was not stated how NFA was told of this by CFTC and there was no documentation showing the CFTC's work.
[426] NFA00001080 (99-CEXM-370 Net Capital module).

b. Segregation Module

It appears that the 1999 audit (in worksheet 99-CEXM-370) was the first time the repos were documented in the Segregation module work papers. NFA auditors noted that the balances of the Firstar Customer Segregated account did not match with the Daily Segregation Report. Management (O'Meara) explained that the interest earned in the repo did not show up on the bank statement until the beginning of the following month. When the Daily Segregation Reports were compiled, PFG used an estimate for interest earned. When the interest earned was learned from the bank statements at the end of the month, PFG made an adjustment to the statement. NFA auditors noted that the adjustment was immaterial when compared to excess segregation and passed on further review.[427] The auditor referenced the Net Capital module for information regarding the repos. Had they reviewed the relevant regulations, or examined the documents enumerated in the regulations, they might have pressed O'Meara more strenuously, and the PFG assertions may not have held up.

viii. 2000-2001 Audits

a. Net Capital Module

The notes in the 2000 audit file (00-CEXM-341) did not reference any concern about the reporting of accrued interest from Firstar repos noted in the 1999 file (99-CEXM-370). In addition, a repo agreement with Sentinel Management Group, Inc. ("Sentinel") was referenced and auditors discussed the testing in previous audits.[428] Auditors chose to pass on confirming the repo balance with Firstar.[429]

In 2001, auditors again noted (in worksheet 01-CEXM-420) the repos with Firstar/U.S. Bank and Sentinel, respectively.[430] Auditors performed the same type of work conducted in the 2000 audit (at 00-CEXM-341) on Sentinel[431] and discussed the calculation of the coupon interest for the Firstar/U.S. Bank agreement. An auditor noted that the recalculation of the coupon interest had been tested in previous audits and it was immaterial.[432] NFA auditors reviewed the Master RA to ensure it was consistent with its file and traced the balance to the Firstar Bank Reconciliation and noted agreement of the balances.[433]

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[427] NFA00001201 (99-CEXM-003 Segregation module).

[428] The agreement was in the amount of $108,961.14, as of June 30, 2000. The auditor noted that NFA auditors performed testing on these agreements in a prior audit of Sentinel in 95-CEXM-270. This statement implies that PFG and Sentinel have had a Repo since 1995, yet this was the first time it was documented in a PFG audit. (NFA00001394, 00-CEXM-341 Net Capital module). The BRG Investigative Team did not review work papers and records related to audits conducted by NFA auditors of Sentinel. NFA instituted an MRA against Sentinel on August 17, 2007 alleging that it failed to maintain adequate books and records, including records to demonstrate the location of certain segregated account assets and whether or not the account's assets were unencumbered. See Notice of Member Responsibility Action Under NFA Compliance Rule 3-15 dated August 17, 2007.

[429] NFA00001394, 00-CEXM-341 (Net Capital module).

[430] NFA00002258 (Firstar/U.S. Bank valued at $37,109,395.54 and Sentinel valued at $1,011,345.85).

[431] Passing on further review because of previous review during a previous Sentinel examination 95-CEXM-270 (NFA00002259).

[432] *Id.* (Reference to 99-CEXM-370 and 00-CEXM-341).

[433] Firstar Reconciliation showed Deposits in Transit to be $37,109,395.54 and 7/31/01 Bank Statement for Segregated Account, shows "Sweep Repurchase Agreement Principal" in the amount of $34,450,000 for every business day (SD-SEG3 1/3)(NFA00001692 – NFA00001695).

This was the last time NFA auditors documented the repos in the Net Capital module until 2009. However, at that time, repos were documented in the Segregation module (see Appendix F).

ix. 2002-2004 Audits

a. Net Capital Module

In summary, the 2002-2004 audits accepted the findings in previous audits as given and did not raise additional questions regarding PFG's repos. The notes in the 01-CEXM-420 audit file described that recalculation of the coupon interest had been performed in the two previous audits (99-CEXM-370 and 00-CEXM-341) and found it to be immaterial. Since there were no deficiencies, NFA auditors reviewed the Master RA to ensure it was consistent with NFA records and traced the firm balance with the Firstar Bank Reconciliation. As these balances were in agreement, NFA auditors passed on further review.[434] From this point on, and even through the credit market crisis of 2008, auditors passed on reviewing the repos, confirming the agreements, and calculating the market values for net capital purposes. NFA auditors did conduct a review of the repos in 2009, when the "Investments of Segregated Funds and Customer Owned Securities" section was added to the Segregation module (discussed later in the section of this report related to the 2009 Audit, Segregation module). *See* Table 3 above for the steps taken and passed in the Net Capital modules over the relevant period.

b. Segregation Module

Although NFA auditors passed examining repos in the Net Capital module during 2002-2004, the repos were identified in other areas as a significant reconciling item for the bank balances during audits in 2002 and 2003. In the 2002 audit, the 02-CEXM-306 Segregation module[435] did not reference the repo, but NFA auditors noted repos in the amount of $53 million as a reconciling adjustment in the Segregation worksheet. See Appendix H for the 02-CEXM-306 Segregation worksheet. In the 2003 audit, NFA auditors did not note the repo in either the Segregation module[436] or worksheet; however, a "sweep account" was noted in the 03-CEXM-519 Cash Information worksheet[437] and the field supervisor's memo to files.[438] See Appendix I for the 03-CEXM-306 Segregation worksheet and Appendix J for the 03-CEXM-519 Cash Information worksheet. In 2004, the repo again was not identified in either the Segregation module[439] or worksheet[440] and the BRG Investigative Team was unable to locate the corresponding bank statement to identify the amount of the repo for that year. See Appendix K for the 04-CEXM-544 Segregation worksheet. The Segregation worksheets for 2002,[441] 2003[442] and 2004[443] indicated that bank balances were reconciled to the PFG statements.

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434 NFA00002259 (01-CEXM-420 Net Capital module).
435 NFA00085073-NFA00085081 (02-CEXM-306 Segregation module).
436 NFA00003446-NFA00003450 (03-CEXM-519 Segregation module).
437 NFA00003272-NFA00003275 (03-CEXM-519 Cash Information worksheet).
438 NFA00003499-NFA00003500 (field supervisor Memorandum to Files, August 14, 2003).
439 NFA00004088-NFA00004092 (04-CEXM-544 Segregation module).
440 NFA00004093-NFA00004107 (04-CEXM-544 Segregation worksheet).
441 NFA00002948-NFA00002957 (02-CEXM-306 Segregation worksheet).

c. 2003 NFA Field Supervisor Memorandum and Related Confirmation

During the 2003 audit, the NFA field supervisor summarized in a memorandum what NFA auditors knew about PFG's sweep account and repos.[444] Specifically, the field supervisor wrote that O'Meara represented that (i) funds were invested in repos overnight; (ii) there was no separate sweep account for this activity, (iii) the 1994 Firstar Master RA was still in effect; and (iv) the account number referenced in the Master RA was the old account number and no longer in use. The NFA field supervisor did not mention whether NFA auditors asked for an amendment of the Master RA for the account number or any documentation as to the account number change. In addition, there was no indication as to why "there was no separate sweep account for this activity," given that FDIC regulations described the sweep function as the "automated transfer of funds from a deposit account to . . . another account. . ." and that CFTC Regulation 1.26 requires separate accounts to be maintained for investments of customer funds made pursuant to CFTC Regulation 1.25.

The 2003 audit file did contain what purported to be a "Repurchase Agreement Confirmation," dated June 30, 2003, indicating U.S. Treasury Notes as security, for the U.S. Bank 845 Account, with principal amount of $60,284,000 and carrying a repo rate of 3.000%.[445] However, that rate appears to be excessive when compared to market rates at that time – *see* Table 5 (several pages) below. Furthermore, the confirmation should not have referenced the 845 Account, which was the deposit account, but "another account" as described in CFTC Regulation 1.26 and the FDIC regulations.

x. 2005-2008 Audits

Documentation in the 2005-2008 audit workpapers pointed to a discrepancy between the bank statement balance (obtained from a Fabricated U.S. Bank Statement that NFA auditors thought was authentic) and segregated cash reported by PFG. The discrepancy was that the bank statement balance per the Fabricated U.S. Bank Statement did not include the amounts invested in repos, yet PFG reported those amounts as cash (segregated). PFG's explanation was, again, that the repos were under a sweep agreement for which there was no separate sweep account, other than the account that auditors were looking at (the 845 Account). To support this explanation, the audit files contain confirmations purportedly received from U.S. Bank that included the repo amounts in the cash balance. This was in essence already summarized in the 2003 NFA field supervisor's memorandum discussed above.

a. 2005 Audit

The first reference to a discrepancy in the segregation worksheets appeared in 05-CEXM-716 for the 2005 audit.[446] See Appendix L for the 05-CEXM-716 Segregation worksheet. Auditors noted the following in the segregation worksheet:[447]

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[442] NFA00003451-NFA00003464 (03-CEXM-519 Segregation worksheet).
[443] NFA00004093-NFA00004107 (04-CEXM-544 Segregation worksheet).
[444] NFA00003495-NFA00003500 (NFA 2003 field supervisor Memorandum dated August 14, 2003).
[445] NFA00039380 (U.S. Bank Repurchase Agreement Confirmation, settlement date June 30, 2003).
[446] NFA00004681 ($90,000,000 difference calculated in Table 2 – Seg 8/31/05 OTE and Cash Balances).

> NFA obtained the Firm's 8/31/05 Bank Reconciliation and noted that the $90M difference is the amount swept into a separate, interest bearing bank account (Sweep Account) every night and deposited back into the account every morning. Further, NFA noted the bank statement shows the appropriate deposit and withdrawal for each day.
>
> Per discussion with O'Meara on 1/10/06, NFA noted the firm has no separate bank account statement or account number for the sweep account to verify the amount coming in the account at night and out of the account in the morning. Further, O'Meara represented that this issue comes up year after year in NFA's Audits. Per review of the 2003 & 2004 PFG audit, NFA noted the Segregated Cash Balance per Firm and the balance per the Bank Statement have agreed. As such, the situation regarding a separate sweep account has been discussed but never recorded.[448]
>
> As such, O'Meara provided NFA with a copy of the Purchase/Repurchase agreement (and all addendum's) the firm made with Firstar Bank (which US Bank purchased and is now US Bank) on 12/12/94. Per review of the agreement, NFA noted this appears reasonable. As such, NFA will pass on further review.

NFA auditors then found a reference in PFG's bank reconciliation to "a separate, interest bearing bank account ('Sweep Account')," but, upon questioning O'Meara, NFA auditors were told that the absence of a separate Sweep Account "comes up year after year in NFA's Audits." NFA auditors noted that the 845 Account cash balance, per PFG, agreed with the bank statements in 2003 and 2004, and when O'Meara provided a copy of the Firstar Master RA, the auditors determined that "this appears reasonable." Therefore, even though NFA auditors found a $90,000,000 difference between bank statement and book amounts, they appeared to be satisfied with a copy of the Master RA from 1994 and notations in prior years' work papers that there were no differences. The BRG Investigative Team did not locate documentation indicating that NFA auditors sent a confirmation request for the 845 Account to U.S. Bank or inquired further as to the existence of a $90,000,000 repo on August 31, 2005. Nor is there any assessment in the work papers noting how the absence of a Sweep Account comports with CFTC and FDIC regulations.[449]

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[447] *Id.* (Note 2 of 05-CEXM-716 Segregation worksheet).

[448] Apparently, the NFA auditor writing this note was not aware of the 2003 field supervisor memorandum, discussed above, that recorded the position of the PFG Compliance Director that "there was no separate sweep account for this activity."

[449] NFA auditors performed bank statement reviews beginning in late October 2005. One month earlier, on September 29, 2005, CFTC filed suit against Bayou Management LLC and related individuals alleging "that the defendants misappropriated customer funds, acquired funds through false pretenses, engaged in unauthorized trading, and misrepresented material facts to actual and prospective investors, including the rates of return the hedge funds earned, the value of assets under management, and the existence and identity of the accounting firms that had purportedly audited the hedge funds." The defendants pleaded guilty the same day. (CFTC Release 5121-05). Even though the scandal involved hundreds of millions of dollars and received widespread media attention, this news did not appear to influence NFA auditors assigned to PFG.

The NFA workpapers for 2005, in the "Audit Planning and Scope Selection" (NFA00004432-47), stated:[450]

Net Capital	Due to capital testing in previous audits, NFA elected to complete limited testing. Specifically, NFA will complete Steps - #1-6, 10, 28-29, 34-35, 42, 44-45 & 47-48. NFA will re-calculate the firm's risk-based & forex requirements, to ensure the firm is using the correct net capital requirements.
Segregation	Yes – NFA will complete detail seg testing as of 8/31/05.

The limited scope testing noted above was approved by a team manager and a field supervisor.[451]

Step #5 on Net Cap module was to "Obtain / prepare a listing of the firm's current cash balances (operating and segregated) as of the audit date. Review for clerical accuracy and agree total to the firm's listing of current assets" (NFA00004432-NFA00004447). The NFA auditor's response to that step was the following:[452]

NFA noted the following current cash balances:

Account Name	Balance as of 8/31/05
Bank One Customer Seg. – Forex	$1,239,821.62
Firstar/US Bank House	$1,202,749.76
Bank One House Account Mexican Peso	$6,860.43
Bank One House Account Euro	$2,876.73
Bank One House Account Canadian Dollar	$22,671.65
Bank One House Account British Pound	$30,202.89
Lakeside Bank House	$10,705.40
Bank One/JP Morgan Flexible Spending Account	$6,525.90
Petty Cash	$269.73
Total	$2,522,684.11 &&

450 NFA00004620 (05-CEXM-716 Audit Planning and Scope module).
451 NFA00004432 (05-CEXM-716 Net Capital module). In addition, NFA auditors added a note stating that PFG recently became a "Forex Dealer Member" and will complete all forex related steps.
452 NFA00004433 (05-CEXM-716 Net Capital module).

> NFA traced and agreed the 8/31/05 Balance Sheet (SD-NCAP1 1/5). Pass further review.

Due to the particular focus on forex, the U.S. Bank segregation account with its $90,000,000 difference, was omitted from the list above. The U.S. Bank segregated account balance would be reviewed in the Segregation module per the bank statements, but would not be considered for a written cash balance confirmation. Step #6.E referred the auditor to the list created for step #5 and instructed the auditor to "consider confirming balances on deposit with bank." The module reflects the following:

> NFA elected to confirm the firm's largest bank balance "Forex Bank Account #5330355796". NFA noted the confirm was mailed on 10/27/05. See SD-NCAP10. NFA noted that the confirm agreed to the firm's 8/31/05 documented balance. Pass further review.

Therefore, upon reaching the point in the audit program at which the auditor was to "consider confirming balances on deposit with bank," the NFA auditor chose from an abbreviated list of bank accounts based upon the limited scope.[453]

b. 2006 Audit

NFA auditors elected to pass on reviewing segregated and customer funds for forex trading in the Cash section of the Net Capital module, as it would be reviewed in Step 1 of the Segregation module.[454] In the Cash section, NFA auditors noted that bank confirmations would be sent, but referred to Step 5 of the Audit Planning and Scope module for information about the selection of the confirmations.[455] Step 5 identified that several confirmations were sent out and referred to the Source worksheet to see when the confirmations were sent and received.[456] NFA auditors sent a bank confirmation to U.S. Bank on November 10, 2006, and received a response on November 27, 2006 for the Segregated, House and Forex accounts.[457] The bank confirmation purportedly sent to, received and completed by U.S. Bank stated that the 845 Account had a balance of $144,206,357.09 as of August 31, 2006.[458] In the Segregation module, NFA auditors elected to pass on creating the Segregation worksheet and conducted the segregation testing in the module itself. In the Segregation module, NFA auditors noted:[459]

> NFA traced and agreed selected material customer seg bank balances (Note 4) to bank statements [. . .]
>
> Note 4: NFA traced and agreed select 8/31/06 bank balances from the firm's seg statement to banks statement & reconciliations (SD-Seg6). From SD-Seg1, NFA

[453] NFA00004666-NFA00004695 (05-CEXM-716 Segregation worksheet, Table 2).
[454] NFA00005892 (06-CEXM-519 Net Capital module).
[455] NFA00005893 (06-CEXM-519 Net Capital module).
[456] Confirmations were sent to banks, carrying brokers, counterparties of PFG, selected customers of PFG and PECTA. NFA00005936 (06-CEXM-519 Audit Planning Scope module). *See* NFA00006051-NFA00006054 for 06-CEXM-519 Source worksheet.
[457] NFA00006054 (06-CEXM-519 Source Worksheet).
[458] NFA00004895 (06-CEXM-519 SD-Planning5, U.S. Bank Confirmation).
[459] NFA00006040 (06-CEXM-519 Segregation module).

> judgmentally selected 2 of 4 bank balances representing $154,669,976 (or more than 99%) of total customer seg bank balances (See SD-Seg1).

As noted above, the bank confirmation from U.S. Bank stated that the 845 Account had a balance of $144,206,357.09 as of August 31, 2006; however, the monthly account statement for the 845 Account showed a balance of only $56,357.09 as of August 31, 2006.[460] The NFA auditors made a handwritten annotation to that monthly account statement in the audit files in order to reconcile it with the bank confirmation as follows: Underneath the summary ending balance of $56,357.09 on page 1 of the bank statement, an auditor wrote "$144,150,000.00 + page 2," which reflected the purported amount of the "Sweep Repurchase Agreement Principal" as of August 31, 2006 and also referenced the month-end account balance of $56,357.09 on page 2 of the account statement. The auditor then apparently combined the month-end account balance of $56,357.09 with the month-end principal amount of $144,150,000 to obtain the amount of $144,206,357.09, which was also handwritten on page 1 of the account statement and matched the amount shown on the bank confirmation.

PCAOB Auditing Standard No. 15.29 states the following:[461]

> If audit evidence obtained from one source is inconsistent with that obtained from another, or if the auditor has doubts about the reliability of information to be used as audit evidence, the auditor should perform the audit procedures necessary to resolve the matter and should determine the effect, if any, on other aspects of the audit.

There were no notes in the supporting document or Segregation module explaining the significant adjustment needed to reconcile the difference between the monthly account statement and the bank confirmation. The Segregation module documentation indicates that the work was reviewed by a field supervisor and team manager.[462]

c. 2008 Audit

In 2008, auditors noticed the same difference between ending bank statement balance and the balance per PFG books for the 845 Account with the much larger magnitude of $136 million.[463] See Appendix M for the 08-CEXM-016 Segregation worksheet. Auditors noted in the Segregation worksheet of the 08-CEXM-016 audit:[464]

> NFA obtained the Firm's 11/30/07 Bank Reconciliation and noted that the $136M difference is the amount swept into a reverse repo agreement that invests in US Treasury Notes (Sweep Account) every night and deposited back into the account every morning. Further, NFA noted the bank statement shows the appropriate deposit and withdrawal for each day. NFA reviewed the repo agreement confirmation with a

[460] NFA00005389 (U.S. Bank Statement for 845 Account).
[461] AS No. 15.29, http://pcaobus.org/Standards/Auditing/Pages/Auditing_Standard_15.aspx#inconsistency.
[462] NFA00006038 (06-CEXM-519 Segregation module).
[463] NFA00007426 ($135,950,000 difference calculated in Table 2 – Seg 11/30/07 OTE and Cash Balances).
[464] NFA00007424 (Note 1 of 08-CEXM-016 Segregation worksheet).

settlement date of 11/30/07 and the repurchase date of 12/3/07and noted that the cash was invested in US Treasury Notes. In addition, NFA noted no capital charge as the contract price of the repos is the same as the market value of the securities. Further, NFA sent a bank confirmation to US Bank regarding this account and confirmed the balance as of 11/30/07. See SD-SOURCE1 2/29.

NFA also obtained the reverse repo agreement between PFG and US Bank, noting no unusual items (SD-SEG14).

When auditors sent a confirmation request form to U.S. Bank to confirm the 845 Account balance, the purported U.S. Bank confirmation response verified the balance, including the repo amount, but again, as in the past, without any explanation as to why the repo amount was omitted from the bank statement ending balance yet included in the confirmation amount. Professional skepticism would suggest that if a bank's confirmation includes the repo amount in the ending balance, but the bank's statement does not, an auditor should inquire further.[465] NFA auditors did not ask U.S. Bank why the printed bank statement balance did not match the balance on the confirmation. NFA auditors did not attempt to talk to a bank representative.

In addition, NFA auditors received a repo confirmation as of November 30, 2007 showing an interest rate of 3.5%, which was higher than market.[466]

xi. 2009 Audit

The following year, auditors noticed the same difference between ending bank statement balance and the balance per PFG books for the 845 Account with an even larger magnitude of $177 million.[467] They also examined a repo executed from the U.S. Bank forex account showing a smaller $1 million discrepancy sharing the same fact pattern.

a. Net Capital Module

In the Cash section of the Net Capital module, NFA auditors noted that there was a material amount of reconciling for the U.S. Bank Segregated account and discussed the account balances with the firm's management (Schweder).[468] NFA auditors noted a "balance per bank" of $123,800.00, and a "balance per book" of $177,074,888.80.[469] PFG management indicated that the balance in the account was swept to an internal U.S. Bank account to purchase U.S. Treasury Notes. The next morning, the balance would be swept back with the earned interest.[470] NFA auditors obtained a single sweep confirmation

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[465] Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence. Gathering and objectively evaluating audit evidence requires the auditor to consider the competency and sufficiency of the evidence (Statement on Auditing Standards No. 82).
[466] *See* Table 5 for sweep investments.
[467] NFA00010393 ($176,951,088 difference calculated in Table 2 – Deposits in Segregated Funds Bank Accounts).
[468] NFA00007767 (09-CEXM-003 Net Capital module).
[469] NFA00010389 (09-CEXM-003 Segregation worksheet).
[470] NFA00007767 (09-CEXM-003 Net Capital module).

statement.[471] The principal amount of $176,951,088.80 from the repo confirmation exactly matched the difference between book and bank balances.[472] NFA auditors noted "[a]s this appears reasonable, NFA will pass on further review" associated with the significant reconciling adjustment related to the repo.[473] NFA auditors indicated that they would confirm the balance of the account with the bank and appear to have done so.[474] The NFA audit work papers included a purported U.S. Bank confirmation statement for the 845 Account with a balance of $177,074,888.80 as of November 30, 2008.[475]

b. Repo Scrutiny – U.S. Bank Forex Account

Later in the Cash section of the Net capital module, NFA auditors also scrutinized another repo executed from the U.S. Bank forex account. The firm listed the account balance to be $1,118,996.07, but NFA auditors noted an ending balance of $0.00 in the November 2008 bank statement.[476] The balance traced directly to the reconciliation, which had an adjustment of $1,117,895.51 titled "Repurchase." Management (Schweder) indicated that the account was swept on a daily basis to an internal U.S. Bank account (bearing the same account number) and the balance was swept back along with earned interest the following morning. NFA auditors noted that they obtained the confirmation the firm received on a daily basis and noted that the balance agreed with the firm's reported figure, and that NFA auditors later would obtain the repo agreement.[477] The auditors noted that the U.S. Bank forex account sweeps daily balances[478] into U.S. Bank National Association Commercial Paper.[479] NFA auditors requested the daily confirmations from U.S. Bank and the firm provided NFA auditors with a daily activity print out of the sweep in and out of the account (SD-NCAP4 15-18/35).[480] This was not a proper repo confirmation because it did not carry specific information about the repo securities, as required by CFTC Regulation 1.25 and FDIC regulations. The Forex sweep account statement[481] was titled "sweep" and noted that it was not FDIC insured. NFA auditors did not compare the interest rate of the Forex account repo to that of the segregated account.

As to the repo investments, PFG management (O'Meara) represented that the Commercial Paper was a short term promissory note with a term of one day. Since a short-term promissory note, such as

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471 NFA00024634 (Repurchase Agreement Confirmation in the amount of $176,951,088.80 with the settlement date of November 28, 2008).

472 The BRG Investigative Team notes that NFA auditors previously stated (1999 workpapers) that PFG did not have confirmations that included daily interest yet, this repo confirmation included daily interest.

473 NFA00010389 (09-CEXM-003 Segregation worksheet).

474 NFA00007767 (09-CEXM-003 Net Capital module).

475 NFA00008684 (U.S. Bank confirmation statement dated November 30, 2008).

476 NFA00027314 (U.S. Bank statement, PFG Forex Account, November 2008).

477 NFA00007781 (09-CEXM-003 Net Capital module).

478 NFA00027314-NFA00027315 (U.S. Bank Statement, PFG Forex Account, November 2008).

479 NFA00035666-NFA00035670 (U.S. Bank $10 Million Placement of Commercial Paper Offering Memorandum).

480 NFA00008570-NFA00008573 (09-CEXM-003 Net Capital supporting document).

481 The BRG Investigative Team notes that unlike with the 845 account, the NFA auditors received a sweep account statement for the forex account.

commercial paper, with a maturity date of less than 30 days did not require a haircut charge, the auditors passed on further review and did not confirm the agreement with the bank.[482]

c. Segregation Module

In the same audit, NFA auditors added a review for investments of segregated funds and customer owned securities in the Segregation module.[483] This was the first time NFA auditors explicitly reviewed investments, such as repos, with regard to the Segregation module. Previously, such review was documented elsewhere. After reviewing the agreement, NFA auditors noted that the agreement had the Firstar footer and was dated 1994. After review of correspondence between PFG and U.S. Bank,[484] NFA auditors stated that this appeared reasonable.

xii. Audits After 2009

The 2009 audit (09-CEXM-003 Segregation worksheet, see Appendix N) was the last time NFA auditors noted PFG's use of repos. As mentioned above, PFG stopped investing segregated funds in repos (or any other allowable investments) around June 2009. There is no documentation in the 2010 audit worksheet (10-CEXM-206) for the Net Capital module[485] that the repos had ceased despite the fact that repos had been used since at least 1994 and despite the significance of the U.S. Bank repos for PFG. Also, there is no written record within the module of any question as to why the agreement ceased. There were also no records of the repos suddenly ceasing in the Segregation modules[486] or worksheets.[487] Auditors did not question why approximately $200 million was being left in a non-interest bearing demand deposit account and not being invested overnight. Moreover, in 2009, the Financial Institutions Regulatory Authority ("FINRA"), the SRO of securities brokers and dealers, had determined that the use of sweep accounts was increasing[488] and implemented additional procedures for FINRA examiners: [489]

> As a result of 2008 credit market events, we have seen increased use of bank deposit programs for the sweeping of customer free credit balances. [Brokers and dealers] considering establishing new programs or making changes to existing programs are urged to contact their FINRA Coordinator ahead of time. Our examiners will continue to review the disclosures made to customers with respect to FDIC and SIPC protection, methodology for determining interest rates on the balances swept and disclosure of any

[482] NFA00007818 (09-CEXM-003 Net Capital module).
[483] NFA00007946-NFA00007955 (09-CEXM-003 Segregation module).
[484] NFA00010048 (Douglas Boe, Senior VP at U.S. Bank, memorandum to Wasendorf dated August 16, 2007).
[485] NFA00010577-NFA00010658 (10-CEXM-206 Net Capital module).
[486] NFA00010951-NFA00010966 (10-CEXM-206 Segregation module).
[487] NFA00012540-NFA00012578 (10-CEXM-206 Segregation worksheet).
[488] In 2008, as well, FINRA stated that "FINRA will continue to examine the programs of broker-dealers sweeping customer credit balances into deposits at banks." March 24, 2008 FINRA Letter to Members and May 2008 FINRA Improving Examination Results.
[489] FINRA letter to Executive Representatives, March 9, 2009, p. 10. The BRG Investigative Team did not find evidence that the NFA auditors were aware of the FINRA determination or the increased focus of regulators with regard to the use of repos.

> compensation the broker-dealer and/or registered representative receives arising from the arrangement. The examiners also will review the documentation between the bank where the funds are maintained as well as an intermediary bank that may be used to facilitate the arrangement. Further, examiners will review the reconciliations performed with the deposit bank to determine whether any differences are promptly resolved.

On the closing date of NFA's 2010 audit period, there were no outstanding repos (or other permissible investments) for segregated funds with U.S. Bank.[490]

xiii. Repo Confirmation Interest Rates

In each of the 2008 and 2009 audits, as in the 2003 audit, NFA auditors received a purported "Repurchase Agreement Confirmation," dated as of the balance sheet date being audited, and showing U.S. Treasury Notes as security, for the U.S. Bank segregated account.[491] Based on the widely used ICAP market index, however, the repo rates shown in repo confirmations for all years were consistently above market by a significant difference.[492]

Table 5: Repo Rates vs. ICAP Market Rates for Three Confirmations Inspected by NFA Auditors

Date of Transaction	Stated Interest Rate	ICAP Market Rate	Difference
06/30/2003	3.000%	1.14%	1.86%
11/30/2007	3.500%	3.00%	0.50%
11/28/2008	0.975%	0.25%	0.73%

In contrast, the actual repo rates PFG earned were much lower than market in the actual statements that the BRG Investigative Team examined.[493] While the JAC audit program does not explicitly require a review and analysis of repo interest rates, professional skepticism should urge auditors to scrutinize transactions whose terms differ significantly from current market conditions.

xiv. CFTC Examination of the Repos in 2009

In May 2009, the CFTC conducted a limited scope review of PFG's repo with U.S. Bank.[494] A CFTC auditor noted in reviewing the 1994 Master RA between U.S. Bank (Firstar) and PFG that U.S. Bank retained

[490] In addition, a review of FCMs and brokers comparable in size to PFG that provided data to NFA for 2009 indicated that *all* invested segregated customer funds in investments other than cash. However, the number of comparable firms was small, and one broker showed no investments other than cash for 2008.
[491] NFA00003223 (Repo Confirmation, June 30, 2003); NFA00007042 (Repo Confirmation, November 30, 2007); NFA00010055 (Repo Confirmation, November 28, 2008).
[492] ICAP Plc is the largest inter-dealer broker of U.S. government debt and compiles a market rate for repurchase transactions available through Bloomberg.
[493] NFA02496225 (Actual U.S. Bank Statement, April 2006).
[494] NFA00417798 (Email from Leslie Garcia to Compliance).

possession of the securities, which was a violation of the instructions for Form 1-FR-FCM.[495] The auditor noted that if the repo was still in effect, the investment would be fine; however, they recommended that the collateral should be held at another acceptable Regulation 1.25 depository, because "[s]ecurities purchased under a reverse repurchase agreement may be considered current assets, provided the securities are in the possession and control of the FCM, and are outside the control of and are not held by the counterparty to the agreement."[496]

PFG discontinued repos within days after this audit, according to the PFG ledger.[497] The BRG Investigative Team could not find evidence that the CFTC or the NFA followed up on the audit's finding in later months to see whether PFG had changed the location of the repo collateral. The interest rates on repos appeared to be low relative to available indices on comparable rates, averaging 15 basis points in May and June 2008, so PFG did not forego a large amount of income.[498] Yet, the company's reported net loss was over $6 million in 2009,[499] and investments of segregated funds would have reduced that loss.

xv. NFA Auditor Testimony on Repos and Sweep Account

NFA auditors generally were not concerned about PFG's repos and sweep accounts. In the 2005 audit, NFA auditors found a significant ($90 million[500]) discrepancy in reconciling bank statements to PFG's books and noted in their files that "NFA obtained the firm's 8/31/05 bank reconciliation and that the $90 million difference is the amount swept into a separate interest-bearing bank account, sweep account, every night, and deposited back into the account every morning. Further, NFA auditors noted the bank statement shows the appropriate deposit withdrawal for each day."[501] The notes for the 2005 audit further provided that, "per discussion with O'Meara on 1/10/06, NFA auditors noted the firm has no separate bank account statement or account number for the Sweep account to verify the amount coming in, the amount at night, and out of the account in the morning."[502] When the senior manager for the 2005 audit was questioned as to whether the fact that the U.S. Bank sweep account had no bank account number was considered a "red flag" for NFA auditors, he replied, "[p]er review of the previous audits, it looked like there was no problems with that."[503]

In the 2008 audit, NFA auditors found a similar but larger ($136 million)[504] discrepancy in reconciling bank statements, and stated in its files that "NFA obtained the firm's 11/30/07 bank reconciliations and noted that the $136 million difference is the amount swept into a reverse repo agreement that invests

[495] NFA00039370-NFA00039380 (Firstar/U.S. Bank Master Repurchase Agreement & Confirmation June 30, 2003) at NFA00039372.
[496] CFTC Form 1-FR-FCM Instructions, at p. 4-4, March 31, 2007.
[497] 2NFA00297452-2NFA00297455 (U.S. Bank Ledger 2009); NFA02546221-NFA02546224 (U.S. Bank Beg & End Balances, May 2005 - Jun 2012).
[498] The repo rate average is based on the ICAP market index available through Bloomberg.
[499] NFA00043632 (PFG 2009 Consolidated Statement of Operations).
[500] See Appendix L.
[501] NFA00004681 (05-CEXM-716 Segregation worksheet).
[502] *Id.*
[503] Former Auditor no. 4 at 70:23-71:4.
[504] See Appendix M.

in U.S. Treasury Note, Sweep account, every night and deposited back into the account every morning."[505] The auditor on the 2008 audit stated he did not consider this discrepancy to be a "red flag" and said he satisfied himself by reviewing the Master RA.[506]

An auditor on the 2009 NFA audit of PFG stated that he was aware that PFG was "investing segregated funds with overnight sweeps."[507] He further stated he did not view that as a "concern."[508] Audit documents for the 2009 audit demonstrated that PFG had represented to NFA auditors that they did not receive the requisite confirmation from U.S. Bank as required under CFTC Regulation 1.25(d)(10) and bank regulations.[509] The auditor explained that PFG informed NFA auditors that PFG received confirmation from U.S. Bank for the "seg repo account" but not for the sweep account.[510] The auditor did not believe the lack of a confirmation was a "red flag" because "the actual statement showed the sweeps going back and forth."[511] Thus, the auditor stated that he was "satisfied" as to the "issues regarding the repurchase agreement and sweep account."[512]

A former NFA director[513] who oversaw the 2009 and 2010 audits of PFG stated that "while NFA was conducting its 2009 audit of PFG, it was brought to [her] attention that the CFTC was looking at the U.S. Bank reverse repo account. And PFG was basically saying that if the - essentially if the CFTC doesn't like it for whatever reasons, that they were going to get out of it."[514] NFA auditors did not recall learning what the nature of the CFTC's concerns were with the repo account or communicating with CFTC officials after its review although O'Meara did forward to NFA auditors a copy of an email from the CFTC to PFG relating to CFTC's review of the repo account.[515] NFA auditors noted in 2010, if not earlier, that PFG was no longer using the repo accounts and no longer investing approximately $200 million in customer funds. The fact that PFG stopped using these accounts did not, however, "raise any concerns" with the auditors.[516]

Two auditors on the 2009 PFG audit stated that if they had become aware that the repos ceased soon after the as-of date of their audit, they would have liked to have been able to follow-up on PFG's decision not to use the repos anymore and indicated that they would have asked why PFG suddenly stopped sweeping the money.[517] The field supervisor for the 2011 audit concurred, stating that "[i]f I was a staff, and, you know, in prepping for this 2009 audit had looked back and seen they were doing

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505 NFA00007424 (08-CEXM-016 Segregation worksheet).
506 Tr. of Current Auditor no. 6 at 47:5-19.
507 Tr. of Current Auditor no. 11 at 22:12-18.
508 *Id.* at 22:19-22.
509 2NFA00376593 (09-CEXM-003 NFA Net Capital module notes).
510 Tr. of Current Auditor no. 11 at 24:2-9.
511 *Id.* at 24:10-16.
512 *Id.* at 25:17-20.
513 This refers to an employee of NFA and is not to be confused with a member of the NFA's Board of Directors.
514 Tr. of Former Auditor no. 7 at 20:5-12.
515 *Id.* at 20:21-21:3; NFA00901163 Email correspondence between O'Meara and NFA senior manager.
516 Tr. of Former Auditor no. 7 at 21:18-22:19.
517 Tr. at Current Auditor no. 11 at 26:23-27:13; Tr. of Current Auditor no. 8 at 35:13-23.

repurchase agreements the prior year and they weren't doing them, it might be something you ask about."[518]

xvi. CFTC/NFA Reporting and Classification of Repos

The Statement of Segregation Requirements and Funds in Segregation of Form 1-FR-FCM requires FCMs to report separately in lines 7a and 7b, their cash holdings and securities holdings in segregated accounts representing customer funds. Repos explicitly are included in the latter line item, 7b, at the lower of market value of the securities that are the subject of the agreement, or the cost of the securities involved plus interest accrued under the repos.

Contrary to the requirements, PFG historically reported the repo amounts as cash deposits under 7a of the statement of segregation, except in 2008.[519] The 2008 statement is the only instance after 2004 when PFG reported the repos under 7b. This line was one of the largest items on PFG's financial filings in all years. The BRG Investigative Team did not identify any instances where NFA auditors asked why PFG reported the purported repos under 7a instead of 7b between 2004 and 2008, and why PFG switched the reporting of repos in 2008 from 7a to 7b.[520]

NFA management stated that it believes its reviews of the repo in audits were conducted in accordance with applicable professional standards. For example, in 2009, the most recent year in which the repo was reviewed, an auditor completed the "ReverseRepo.xls" worksheet testing the repo agreement for compliance with Rule 1.25, and received a written confirmation that purported to be from U.S. Bank confirming the balance of the 845 account and referencing the reverse repo. NFA recognizes that it is possible a direct communication with U.S. Bank personnel about the repo and/or sweep account could have led to information uncovering the Wasendorf fraud.

XII. NFA Auditors' Interactions with PFG Officials During Audits

a. O'Meara

The investigation found that NFA's audits of PFG over the years were made more difficult in some instances because of the aggressive approach and demeanor of PFG's Director of Compliance, O'Meara, who worked for the NFA prior to joining PFG. A staff auditor involved in the 2001 PFG audit recalled a specific incident in dealing with O'Meara as follows: [521]

> O'Meara had just a well-known reputation as somebody who is very stern and difficult to work with. And I don't remember ever having issue with her prior to this incident. But with regards to her, she just is somebody that you - I felt that you always had to

[518] Tr. of Current Auditor no. 12 at 61:22-62:3.
[519] PFG Forms 1-FR-FCM for 2004, 2005, 2006 , 2007, and 2008.
[520] Before 2004, only 2000 (NFA00039931-NFA00039957, PFG 2000 financial statements) and 2001 (NFA00038553-NFA00038586, PFG 2001 financial statements) filings were available for the BRG Investigative Team review. In these filings, PFG reported the repos under 7b in the segregation statement, yet as cash in its audited balance sheet.
[521] Tr. of Current Auditor no. 3 at 63:4-64:9.

> provide all the facts with otherwise she will question, she will -- she was very difficult to work with. . . She was difficult to work with in the sense that she would question everything. She used her stern personality and her well-known, rounded knowledge as a basis to question everything.

The auditor further acknowledged that, while NFA as the regulator had issues with how certain matters relating to PFG were being addressed, O'Meara should have been answering to NFA, rather than NFA answering to her.[522]

The field supervisor for NFA's 1998 and 1999 audits of PFG further stated that "when [O'Meara] was at Peregrine I know that she would fight for her stance and a lot of people would back down or they didn't like dealing with her because she was feisty."[523] The field supervisor for the 2009 PFG audit stated that if an NFA auditor would approach O'Meara "and maybe [you] aren't 100 percent confident on what you're asking her . . . If you kind of don't know what you're talking about if you went in there to ask about something and didn't have the right follow-up questions," she would make the NFA auditor "look foolish."[524]

Several auditors stated they believed NFA auditors may have felt "intimidated" by O'Meara, with one auditor, stating, "I would say that she would intimidate the staff,"[525] another auditor stating that some junior-level auditors "would have felt" intimidated by O'Meara[526] and a third auditor stating that she could see how O'Meara "could be intimidating especially to somebody who just started working at NFA."[527]

In fact, former CFO of PFG, Pearson, noted in his interview that, at times, "Susan [O'Meara] would bulldoze some NFA examiners" so the firm wouldn't have a problem or issue. Her frame of mind was to "keep NFA off of the firm's back."[528]

O'Meara stated that while she believed she treated NFA auditors "professionally," she acknowledged that she "probably had been less than nice to a few people at NFA" during audits.[529] She admitted that she "butted heads with NFA sometimes" and acknowledged that she was a "little rude" at times.[530] She said that there were people at NFA who didn't like her and people at NFA who "had a dart board with her picture on it."[531]

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522 *Id.* at 63:19-21.
523 Tr. of Current Auditor no. 7 at 54:5-9.
524 Tr. of Current Auditor no. 12 at 73:14-74:3.
525 Tr. of Current Auditor no. 4 at 45:4-9.
526 Tr. of Current Auditor no. 9 at 51:22-52:9.
527 Tr. of Current Auditor no. 10 at 68:18-20.
528 Interview Memorandum of Pearson at 2.
529 Interview Memorandum of O'Meara at 2.
530 *Id.*
531 *Id.*

The investigation did not find evidence that specific allegations of possible intimidation on the part of O'Meara were elevated from the staff auditor level to senior officials at NFA.[532]

While it is unclear whether O'Meara's approach specifically impacted NFA auditors' ability to uncover Wasendorf's fraud, there were at least two instances where NFA auditors did not pursue matters after one instance, involving interactions with O'Meara; and in another instance, PFG took strong positions. In connection with the 2000 Supervision module, the staff auditor stated that NFA auditors sought copies of PFG audit reports generated regarding their GIBs and branches, but O'Meara insisted they were PFG internal documents and, therefore, "there was not much [NFA] could do."[533] In addition, in 2011, NFA auditors had concerns about PFG's limited excess segregation as, although not a regulatory requirement, NFA preferred for firms to have at least 10% excess segregation and PFG had closer to 5%.[534] In an October 20, 2011, internal NFA email, the question was raised about speaking to PFG about this matter and the response given was, "I wouldn't press PFG as they will never put money in unless they actually have to."[535]

External auditors are required to consider the risk of fraud in a financial statement audit during the planning phase of an audit. AICPA guidance describes "domineering management behavior" as a fraud risk: [536]

> The following are examples of risk factors relating to misstatements arising from fraudulent financial reporting . . . domineering management behavior in dealing with the auditor, especially involving attempts to influence the scope of the auditor's work.

In accordance with external audit guidance, the nature, timing, and extent of planned audit procedures are reconsidered upon the identification of fraud risks. In this matter, NFA auditors did not identify O'Meara's behavior or that of PFG's management as a fraud risk and, therefore, missed an opportunity to expand its planned audit procedures and potentially uncover the fraud.

An external auditor must also be attentive to fraud indicators beyond the planning stage and throughout the entire audit: [537]

> The auditor's assessment of the risks of material misstatement due to fraud should be ongoing throughout the audit. Conditions may be identified during fieldwork that

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[532] Tr. of Former Auditor no. 7 at 45:8-46:4.
[533] Tr. of Former Auditor no. 6 at 33:5-12; *See also,* NFA00001464-NFA00001467 (2000 NFA Supervision module document). In 2010 and 2011, as part of a BCC investigation brought against PFG by the NFA relating to its audits of GIBs, NFA received copies of the audit reports and found them to be inadequate. Tr. of Current Auditor no. 14 at 51:23-52:10.
[534] Tr. of Current Auditor no. 12 at 82:13-16.
[535] NFA00838464-NFA00838465 (NFA internal Email exchange dated October 20-21, 2011).
[536] AU 316.17 for audits of financial statement for periods ending on or after December 15, 1997. AU 316 was amended in 2002 and 2010, but the fraud risk factor relating to "domineering management behavior" remains to this date. For instance, *see* AU 316.85 for audits of fiscal years beginning on or after December 15, 2010.
[537] AU 316.68 for audits of fiscal years beginning on or after December 15, 2002 but before December 15, 2010 and Appendix C of Auditing Standard 14 for audits of fiscal years beginning on or after December 15, 2010.

change or support a judgment regarding the assessment of the risks, such as . . . problematic or unusual relationships between the auditor and management, including . . . management intimidation of audit team members, particularly in connection with the auditor's critical assessment of audit evidence or in the resolution of potential disagreements with management.

As previously described, O'Meara refused to provide copies of certain PFG reports in 2000. Although the reports were not related to the actual fraud occurring at PFG, this was an opportunity for NFA auditors to identify the fraud risk and expand its audit procedures.

b. Schweder

The BRG Investigative Team also analyzed the role of the individual who worked for O'Meara in PFG's compliance department, Schweder. Schweder was identified as the field supervisor for NFA's 2006 audit of PFG in the Audit Planning and Scope Selection module.[538] Shortly after the 2006 audit, Schweder left NFA to join PFG and in August of 2007, he emailed an NFA manager with information about PFG's daily segregation reports with the title "Compliance Manager, Peregrine Financial Group."[539] In the 2008 NFA Audit Planning and Scope Selection module for PFG, Schweder is listed as one of two PFG contacts for the audit.[540]

An NFA manager who worked on the 1997, 2002, 2003, 2004, 2005, 2006 and 2008 PFG audits acknowledged that, "Schweder actually worked on an NFA audit of Peregrine and then was one of the contact people the next year or the year after for Peregrine with respect to the NFA audit."[541] When the BRG Investigative Team asked about this arrangement, another NFA manager noted that "it happens all the time" and there is no "cooling-off period" before an auditor can work for a member of which he conducted audits while at NFA.[542]

c. Wasendorf

BRG's investigation did not find any evidence that Wasendorf's reputation or influence with NFA or industry had any impact on NFA audits of PFG. Prior to the discovery of the fraud, Wasendorf served on the NFA's Futures Commission Merchant Advisory Committee.[543] The investigation found that many auditors were not aware of this fact and no one felt Wasendorf's role on an NFA advisory committee or his reputation in the industry as a whole had any effect on NFA's audits.

One current NFA auditor, who served as field supervisor for the 1998 and 1999 audits, stated that, before she started the audits, she did not know who Wasendorf was or that he had served on an NFA

[538] NFA00005924 (06-CEXM-521 Audit Planning and Scope Selection module).
[539] 2NFA00037948 (Email dated August 23, 2007).
[540] NFA00007484-NFA00007485 (08-CEXM-271 Audit Planning and Scope Selection module).
[541] Tr. of Former Auditor no. 4 at 19:20-20:1.
[542] Tr. of Current Auditor no. 4 at 107:17-108:14.
[543] For a snapshot of cashed version, go to http://eliteeservices.blogspot.com/2012/07/russell-wasendorf-sr-on-nfa-advisory.html.

committee.[544] The field supervisor for the 2001 PFG audit, stated that, prior to the audit, he did not know who Wasendorf was other than that he was the CEO of PFG. The field supervisor also stated that he was not aware of any involvement by Wasendorf on any NFA committee.[545] Another current auditor, who served as field supervisor for the 2009 and 2010 audits and manager for the 2011 audit, stated he did not know who Wasendorf was until the week before the audit when he learned Wasendorf was the owner of PFG, and, while he was aware at some point during the audit process that Wasendorf was on an NFA committee, he did not know how long he served or in what capacity.[546]

In addition, the evidence shows that the NFA auditors did not have that much contact with Wasendorf and, thus, there would not have been opportunities for Wasendorf improperly to influence the audits personally. Wasendorf stated in his interview that, after the first few years, he did not personally meet or directly deal with the NFA auditors.[547] Former PFG CFO Pearson stated that, once O'Meara was hired, she largely interacted with NFA auditors, as it was her job "to deal with NFA and get NFA off of Wasendorf's back."[548] O'Meara confirmed that Wasendorf did not interact much with NFA after meeting the auditors during the first week of an NFA audit.[549]

In addition, the auditors who were interviewed generally reported relatively little contact with Wasendorf. For example, an auditor on the 2001 audit said she never even met Wasendorf during the audit.[550] Similarly, an auditor on the 2009 PFG audit said he only met Wasendorf briefly when he came into a conference room and said hi for a few minutes,[551] while an auditor on the 1997 PFG audit stated that she did not recall meeting Wasendorf at all during the audit.[552] Finally, an auditor on the 2005 NFA audit of PFG said he met Wasendorf only briefly in the hallway.[553]

NFA management stated that they would be surprised if an auditor's performance would have been affected by intimidation by O'Meara or others, and that, often when an FCM contact is difficult, it is counter-productive, as the NFA personnel may be even more suspicious and require more audit review. NFA management did indicate that it would be appropriate for there to be more specific guidance for junior auditors as exactly how to deal with intransigent or unprofessional firm personnel. They also stated they were not aware of any "cooling-off" period that would have impacted Schweder, but would consider whether any such rules would make sense in the future.

[544] Tr. of Current Auditor no. 7 at 47:7-12.
[545] Tr. of Former Auditor no. 2 at 70:5-14.
[546] Tr. of Current Auditor no. 15 at 127:2-16.
[547] Interview Memorandum of Wasendorf at 1.
[548] Interview Memorandum of Pearson at 1.
[549] Interview Memorandum of O'Meara at 2.
[550] Tr. of Current Auditor no. 3 at 49:16-18.
[551] Tr. of Current Auditor no. 6 at 38:16-20.
[552] Tr. of Current Auditor no. 1 at 62:6-7.
[553] Tr. of Current Auditor no. 5 at 37:3-9.

XIII. Warnings and Actions Brought by NFA Against PFG

The investigation found that PFG had been subject to several disciplinary complaints and/or warnings brought by NFA's BCC over the years. The BCC is a group made up of industry members and public representatives who meet approximately once a month to consider potential disciplinary actions against member firms.[554] If NFA becomes aware of information that may lead to a disciplinary matter, it conducts an investigation and drafts a report to be provided to the BCC for approval.[555]

The first complaint involving PFG was issued on December 2, 1996, and alleged that PFG used fraudulent and deceptive communications with the public, used false and deceptive promotional material, failed to calculate segregated funds computations correctly, failed to maintain adequate segregated funds, failed to report to the NFA that the firm was undersegregated, and failed to supervise.[556] As a result of this 1996 complaint, PFG agreed to pay a fine of $75,000, and to comply with several undertakings, including the creation of the Director of Compliance position.[557]

The BCC issued a second complaint against PFG in June 2004, alleging that PFG failed to comply with an Order issued by the NFA Membership Committee in violation of NFA Compliance Rule 2-5, which requires, in pertinent part, that "Each Member and Associate shall comply with any order issued by the Executive Committee, the Membership Committee, the Business Conduct Committee, the Appeals Committee or any NFA hearing or arbitration panel."[558] The BCC ordered PFG to pay a $5,000 fine and to adopt procedures to ensure future compliance with NFA compliance rules.

On December 24, 2008, the BCC issued PFG a warning letter because of its finding that PFG failed to respond properly and completely to an NFA Information Request.[559] The Information Request related to an action NFA brought against Capital Blu Management LLC ("Capital Blu"), a CTA located in Melbourne, Florida.[560] The BCC found that, when NFA contacted O'Meara of PFG seeking information regarding any accounts that PFG had with Capital Blu and related persons, O'Meara replied that she was "busy" and did not provide all of the information the NFA requested.[561] The BCC warning further found that even after NFA issued a formal Information Request and NFA personnel followed up with O'Meara on several occasions, at various times, PFG failed to disclose fully all accounts and business activities that PFG had with Capital Blu.[562]

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[554] Tr. of Current Auditor no. 14 at 42:5-44:14.
[555] *Id*. at 42:21-44:1.
[556] NFA00821695-NFA00821697 (Memorandum from Compliance Department, NFA to Business Conduct Committee dated June 24, 2011, BCC Memo).
[557] *Id.* at NFA000821696-NFA00821697.
[558] NFA Compliance Rule 2-5; *See also,* Memorandum from Compliance Department, NFA to Business Conduct Committee dated June 24, 2011, BCC Memo, NFA00821695-NFA00821697.
[559] NFA00265062-NFA00265064 (Letter from Business Conduct Committee to Wasendorf, President/CEO, PFG dated December 24, 2008).
[560] *Id.* at NFA00265062.
[561] *Id.*
[562] *Id.* at NFA00265063.

The JAC audit program directs an auditor, during the audit planning stage, to "[c]onsult other Compliance Departments, Clearing Houses (Trade Practice, Market Surveillance, and Risk Management), NFA and SROs where the firm has membership privileges. Identify and document any material problems they have had with the subject firm which would affect the scope of our review."[563] No further instruction is provided in the JAC audit program on this issue.

The BRG Investigative Team did find that, at least for the 1996 BCC complaint, all subsequent audits included examinations of segregation, supervision and promotional material which were the subjects of the 1996 complaint.

An NFA former director[564] who oversaw the 2009 and 2011 NFA audits of PFG confirmed that she was aware of the December 2008 BCC finding that "PFG failed to respond promptly and completely to NFA's information request which is a violation of NFA Compliance Rule 2-5."[565]

However, while the former director stated that NFA auditors paid attention during the 2009, 2010 and 2011 audits of PFG to the fact that PFG had been determined to be unresponsive to NFA requests for information, as they would on any other audits, she acknowledged that there were no concrete steps taken in any module in the audits as a result of the 2008 findings of the BCC.[566]

An auditor who worked on both the 2010 and 2011 NFA audits of PFG stated that, in March 2010, he and other NFA personnel began investigating PFG for another matter that led to a significant BCC action.[567] This investigation began when NFA auditors became concerned with the adequacy of PFG's efforts to supervise the activities of its GIBs based, in part, on complaints that the BCC had issued against five of those GIBs.[568] NFA's investigation found that its concerns about the effectiveness of PFG's supervisory efforts were warranted.[569] After an extensive investigation, in which they deposed O'Meara and several other PFG senior officials, the BCC concluded that "[t]here is little doubt that PFG's supervisory effort was a contributing factor to five of its GIBs being named in fraud based on BCC complaints since the beginning of 2010."[570] The BCC further found that "PFG, O'Meara and Schweder all maintain some level of responsibility for the actions of the firm's GIBs in relation to complying with NFA Rules."[571]

The BCC action also raised significant concerns about PFG's failure to take appropriate action with regard to "several suspicious" transactions relating to a Ponzi scheme that Trevor Cook operated. In August 2010, Trevor Cook was sentenced in federal court in Minneapolis for orchestrating a Ponzi

[563] NFA03353369-NFA03353391 (JAC Program 2010 GENERAL). The was the same for the 2002-2009 JAC Programs except that "Clearing houses," "risk management," and "NFA and SRO's" as examples were added over time.
[564] This refers to an employee of NFA and is not to be confused with a member of the NFA's Board of Directors.
[565] Tr. of Former Auditor no. 7 at 11:14-17.
[566] *Id.* at 15:16-23.
[567] Tr. of Current Auditor no. 14 at 19:18-20:18.
[568] NFA00821695-NFA00821717 (Memorandum from Compliance Department, NFA to Business Conduct Committee dated June 24, 2011) at NFA00821697.
[569] *Id.* at NFA00821698.
[570] I*d.* at NFA00821699.
[571] I*d.* at NFA00821707.

scheme that collectively cost more than 900 investors $158 million.[572] Cook was charged on March 30, 2010, and pleaded guilty on April 13, 2010 to one count of mail fraud and one count of tax evasion.[573] He was sentenced to 300 months in prison in connection with the crime.[574] In his plea agreement, Cook admitted that, from January 2007 through July 2009, he schemed to defraud people purportedly by selling investments in a foreign currency trading program.[575] In reality, however, he diverted a substantial portion of the money for other purposes, including making payments to previous investors and paying personal expenses.[576]

A memorandum from NFA to the BCC stated that PFG should have been aware of "red flags" in connection with Cook's PFG accounts and should have followed up on suspicious activity.[577] For example, the memorandum to the BCC stated that NFA auditors noted a large amount of transfer activity within Cook's accounts at PFG, including several large transfers from Cook's account to customers.[578] The memorandum to the BCC stated that "[i]n talking to PFG, it was clear the firm did not question any of these cash movements."[579] The memorandum to the BCC also specifically cited O'Meara as the firm's AML Officer for her failure to implement an adequate AML program.[580]

The BCC action, which began with a staff investigation in March 2010, culminated in February 2012 with a formal complaint issued by the BCC charging PFG, and several of its senior officials, including, O'Meara and Wasendorf, Jr., with violations of NFA Compliance Rule 2-9(a) and a failure to supervise.[581] The Complaint provided that, as sanctions for the conduct described, NFA could impose expulsion or suspension from NFA membership, formal censure or reprimand, and a monetary fine of $250,000 for each of the numerous violations found.[582]

PFG eventually resolved the BCC action matter by agreeing to pay a $700,000 fine, to retain an independent consultant to review PFG's existing procedures for supervising its GIBs, to designate a full-time AML officer, and not to enter into any new guarantee agreements with any IBs for two years.[583] The former NFA director[584] who oversaw the 2009 and 2010 NFA audits of PFG stated that the $700,000

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[572] Press Release of Federal Bureau of Investigation, Minneapolis Division, dated August 24, 2010.
[573] *Id.*
[574] *Id.*
[575] *Id.*
[576] *Id.*
[577] NFA00821695-NFA00821717 (Memorandum from Compliance Department, NFA to Business Conduct Committee dated June 24, 2011) at NFA00821711.
[578] *Id.* at NFA00821712.
[579] *Id.* at NFA00821716.
[580] *Id.* at NFA00821711.
[581] Complaint dated February 8, 2012 from the National Futures Association Business Conduct Committee, In the Matter of Peregrine Financial Group, Inc. et al., at 5-6.
[582] *Id.* at 13-14.
[583] NFA00277176-NFA00277179 (NFA Memorandum dated January 20, 2012 from Compliance Department to Business Conduct Committee). In addition, in June 2012, NFA again faulted PFG for failing to fully and promptly respond to a request for information. *See also*, NFA00265065-NFA00265068 (Letter from Senior Vice President, Regina G. Thoele, NFA to O'Meara dated June 28, 2012); *See also,* Tr. of Former Auditor no. 7 at 16:3-15.
[584] This refers to an employee of NFA and is not to be confused with a member of the NFA's Board of Directors.

fine against PFG was a "substantial fine" and "one of the highest fines the NFA had ever issued."[585] She also noted that the failure to supervise charge was levied specifically against O'Meara and Schweder.[586]

In June 2012, NFA again faulted PFG for failing to respond fully and promptly to a request for information.[587]

The BRG Investigative Team found that these BCC complaints and warnings against PFG prior to 2012 did not cause NFA to extend their audit procedures in connection with their audits of PFG. An auditor who was involved with both the 2010 and 2011 audits stated that the auditors working on the 2010 annual audit of PFG did not "do anything different" in their audit as they related to the issues concerning Cook, and that the Cook issues were looked at separately and not part of the audits of PFG.[588] He further stated that "the way [NFA] did the modules [also] didn't differ" in the 2011 audit in light of NFA's knowledge of the Trevor Cook issues."[589]

An NFA auditor who worked on the Cook matter stated that, during the 2010-2011 time frame, as they were investigating PFG's actions related to Cook, they never took O'Meara and PFG's "first answer" to a question if it sounded suspicious and "went back for meetings and meetings and we had their general counsel involved and our directors and our legal department involved just because we didn't feel that they were fully answered."[590]

A staff auditor on the 2011 PFG audit stated categorically that there is "no impact" on an annual audit of the NFA separately and contemporaneously investigating the same firm as in the Cook investigation.[591] She further stated that, in connection with her role on the 2011 audit, she was not informed at any point in time of the issue related to the BCC action and not told to look out for anything suspicious in the 2011 audit. [592]

NFA management stated there was and is an intention to ensure that NFA auditors are aware of the issues related to the BCC actions against firms like PFG, but felt it was possible that this intention was not entirely conveyed to the staff auditor in the 2011 audit.

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[585] Tr. of Former Auditor no. 7 at 55:5-8.
[586] *Id.* at 18:2-4.
[587] NFA00265065-NFA00265068 (Letter from Senior Vice President, Regina G. Thoele, NFA to O'Meara dated June 28, 2012); *See also,* Tr. of Former Auditor no. 7 at 16:3-15.
[588] Tr. of Current Auditor no. 14 at 21:6-11.
[589] *Id.* at 23:8-24.
[590] *Id*. at 64:14-24.
[591] Tr. of Current Auditor no. 13 at 87:24-88:13.
[592] *Id.* at 88:14-89:2 *;* It was also during the 2011 NFA audit of PFG that NFA had O'Meara obtain a U.S. Bank confirmation via email and during which NFA received two bank confirmations from U.S. Bank, one of which was inconsistent with the U.S. Bank statements yet NFA auditors did not follow-up on this information.

XIV. Lack of Complaints Regarding Fraud or Direct Evidence of Fraud

In the audits conducted by NFA, NFA auditors inquired as to whether there were any outstanding complaints issued against PFG that needed to be investigated. As part of NFA's pre-audit work, NFA auditors reviewed any customer complaints that were made to NFA about PFG by reviewing NFA internal databases.[593] The auditors also reviewed the firm's log of complaints and compared the firm's log with the complaints received internally by NFA.[594]

None of the 23 auditors we interviewed recalled there ever being a complaint that alleged that Wasendorf or PFG was operating a fraud or Ponzi scheme. In 2010, there was one complaint that used the word "fraud" in its allegation related to an unregistered pool.[595] However, this complaint related to activities occurring after the customer who was complaining had left PFG and it did not allege that PFG was conducting a fraud.[596] Wasendorf, O'Meara and Cuypers all stated they did not recall any complaints or arbitration matters alleging that Wasendorf was perpetrating a fraud.[597]

Several auditors stated that, if they had received a complaint specifically alleging that PFG or Wasendorf was perpetrating a fraud, it would have triggered further actions to follow up on the allegations. The field supervisor for the 1996 and 1997 audits stated that, if there had been a specific complaint alleging fraud, NFA auditors would have conducted further financial testing and more scrutiny into internal controls at the firm.[598] The staff auditor for the 2008 NFA audit of PFG stated that NFA auditors would have conducted specific testing with respect to any complaint that had been made about the firm.[599] Another staff auditor stated that a specific complaint would have been investigated thoroughly and the audit would be modified to include a review of the complaint.[600]

The auditors also reviewed arbitration matters as part of their pre-audit work.[601] NFA auditors reviewed the firm's records of arbitration matters and attempted to review internal NFA records as well.[602] Several auditors we interviewed spoke about a "Chinese wall" between the arbitration and compliance departments at NFA, but noted that if they needed to review a particular arbitration, they would be given access to the relevant documents.[603] There was no indication that any arbitration involved allegations of the specific fraud that eventually was uncovered.

A *New York Times* article dated July 12, 2012, referred to an alleged letter sent to NFA and the CFTC in 2004 asking them to intervene to prevent PFG from misusing its customers' money and another tip

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[593] Tr. of Current Auditor no. 3 at 20:5-14; Tr. of Former Auditor no. 2 at 29:16-22.
[594] Tr. of Current Auditor no. 9 at 23:22-24:3.
[595] *Id.* at 36:17-38:10.
[596] *Id.* at 38:1-39:16.
[597] Interview Memorandum of Wasendorf at 2; Interview Memorandum of O'Meara at 5; Interview Memorandum of Cuypers at 4.
[598] Tr. of Current Auditor no. 2 at 112:17-113:20.
[599] Tr. of Current Auditor no. 6 at 53:9-54:5.
[600] Tr. of Current Auditor no. 1 at 60:12-19.
[601] Tr. of Current Auditor no. 9 at 25:16-26:2.
[602] *Id.* at 27:6-10.
[603] Tr. of Current Auditor no. 10 at 82:11-83:7 ; Tr. of Current Auditor no. 14 at 84:7-19.

allegedly sent to NFA in 2009 asking NFA to review PFG's bank account information for accuracy.[604] The BRG Investigative Team did not find any record of either tip or complaint. We understand that Dan Roth of NFA was informed by the *New York Times* reporter that the 2004 letter was sent via facsimile to the attention of a particular former NFA employee. We reviewed all relevant emails for that employee and found no evidence of or reference to any PFG-related letter, tip or complaint in her emails. We also conducted an interview of this former employee and she stated she has no recollection of any such letter being sent (faxed or mailed) to NFA. She also stated that she does not recall any specific complaints regarding PFG and indicated that she especially would have remembered any complaint regarding customer funds at an FCM or issues involving the accuracy of bank statements associated with an FCM.[605]

We also understand that NFA employees reviewed internal records relating to PFG for the years 2004 through 2009 and found no record of any allegations of the type described in the *New York Times* article. NFA employees and its counsel also asked CFTC representatives if the CFTC had a copy of any such letters or complaints and were informed that CFTC had not located any copies of the same either. Counsel for NFA also represented that in the more than 3 million pages of documents reviewed in connection with this matter, they did not identify any documents that appear to be, or reference the purported 2004 or 2009 letters.

Given the absence of any specific allegation of fraud and the fact that NFA was conducting annual routine audits, rather than a targeted review based upon an allegation of fraud, several auditors stated they were not surprised that the NFA auditors were unable to uncover the fraud. One auditor noted the complexity of the fraud and the lengths to which Wasendorf went to hide the fraud.[606] Another auditor pointed out that NFA auditors were sending confirmations to the bank and receiving in return documents that they assumed came from the bank.[607]

NFA management concurred and indicated that this was not a situation like Madoff, where a regulator had direct evidence of possible fraud or was conducting targeted examinations of a specific complaint about fraud. NFA management further noted that neither NFA nor the CFTC were ever provided any direct evidence or significant "red flags" that Wasendorf was committing a fraud and the documents were forged in such a manner as to make it very difficult to determine that they were fake.

[604] Azam Ahmed and Peter Lattman, "At Peregrine Financial, Signs of Trouble Seemingly Missed for Years". New York Times, July 12 2012.
[605] Interview Memorandum of Former Auditor no. 10 at 2.
[606] Tr. of Current Auditor no. 11 at 36:21-37:8.
[607] Tr. of Current Auditor no. 6 at 40:7-10.

CONCLUSION

The investigation found that NFA auditors conducted a total of 27 audits of PFG from the period 1995 to 2012. The investigation further found that these audits were, for the most part, routine audits designed to review PFG's operations and systems and not specifically directed to a particular tip or complaint alleging that Wasendorf was conducting a fraud. In fact, the BRG Investigative Team specifically investigated whether NFA auditors had received any specific tip or complaint indicating that Wasendorf was conducting a fraud and found none. We also found that Wasendorf was able to conceal the fraud meticulously by providing numerous convincingly forged documents to NFA auditors.

We found that, overall, the NFA audits were conducted in a competent and proper fashion and the auditors dutifully implemented the appropriate modules that were required in the annual audits, including for example, the Segregation and Promotional modules. However, we found that certain areas, such as internal controls, Wasendorf's capital contributions and PFG's repos and sweep accounts, were not examined closely in the audits. We also found that, in 2011, NFA auditors received a confirmation from U.S. Bank showing an amount in PFG's customer segregated account that was substantially different than the amount shown in the U.S. Bank statements but there was little discussion among the audit team about this finding, and no follow-up with U.S. Bank after a "corrected" confirmation was provided, which subsequently has since been determined to have been forged by Wasendorf.

This Report of Investigation provides a factual summary of the NFA audits of PFG from 1995 to 2012. In addition to this Report of Investigation, the BRG Investigative Team subsequently will be providing a Recommendations Report that will include specific recommendations to improve NFA's audit program. These recommendations will be based upon the findings in this report and will be tailored to address the areas where we feel that NFA operations may be improved.

APPENDIX A
Summary of Database Documents Reviewed

Bates Range [1]	General Category	Number of Pages	General Description
NFA00000001-NFA00000456	Audit	456	1995 Audit
NFA00000457-NFA00000633	Audit	177	1996 Audit
NFA00000634-NFA00000757	Audit	124	1997 Audit
NFA00000758-NFA00000993	Audit	236	1998 Audit
NFA00000994-NFA00001243	Audit	250	1999 Audit
NFA00001244-NFA00001483	Audit	240	2000 Audit
NFA00001484-NFA00002541	Audit	1,058	2001 Audit
NFA00002542-NFA00002992	Audit	451	2002 Audit
NFA00002993-NFA00003504	Audit	512	2003 Audit
NFA00003505-NFA00004151	Audit	647	2004 Audit
NFA00004152-NFA00004723	Audit	572	2005 Audit
NFA00004724-NFA00006182	Audit	1,459	2006 Audit
NFA00006183-NFA00007679	Audit	1,497	2008 Audit
NFA00007680-NFA00010475	Audit	2,796	2009 Audit
NFA00010476-NFA00012867	Audit	2,392	2010 Audit
NFA00012868-NFA00014370	Audit	1,503	2011 Audit
NFA00014371-NFA00015750	Audit	1,380	Work papers from the NFA's 2010 audit of PFG
NFA00015751-NFA00016418	Audit	668	Work papers from the NFA's 2011 audit of PFG
NFA00016419-NFA00026964	Audit	10,546	More work papers from the NFA's 2010 audit of PFG
NFA00026965-NFA00041917	Audit	14,953	NFA's 2009 audit of PFG, PFG registration files for the years 1990 through 2011, and general compliance files relating to PFG for the years 1990 through 2012
NFA00041918-NFA00041922	Misc.	5	Misc.
NFA00041923-NFA00041935	Misc.	13	Current Auditor no. 12 Notes
NFA00041936-NFA00044223	Misc.	2,288	Misc.
NFA00044224-NFA00078403	Misc.	34,180	Electronic media located in work papers
NFA00078404-NFA00083778	Misc.	5,375	Misc.
NFA00083779-NFA00095997	Misc.	12,219	Electronic media located in work papers
NFA00095998-NFA00096000	Misc.	3	Additional images we were able to successfully process to TIFFs post production
NFA00096001	Misc.	1	Electronic media located in work papers
NFA00096002	Misc.	1	Additional image we were able to successfully process to TIFFs post production
NFA00096003-NFA00111473	Misc.	15,471	Electronic media located in work papers
NFA00111474-NFA00111521	Misc.	48	Financial surveillance
NFA00111522-NFA00111861	Misc.	340	Resource Modules
NFA00111862-NFA00147998	Misc.	36,137	2011 Sharefile documents The Sharefile docs are from the site set up by PFG where it uploaded documents for the 2011 and 2012 audits
NFA00147999-NFA00182594	Misc.	34,596	2012 Sharefile documents The Sharefile docs are from the site set up by PFG where it uploaded documents for the 2011 and 2012 audits
NFA00182595-NFA00182665	Misc.	71	2012 Sharefile documents The Sharefile docs are from the site set up by PFG where it uploaded documents for the 2011 and 2012 audits
NFA00182666-NFA00264312	Emails	81,647	Non-privileged emails to and from Current Auditor no. 12
NFA00264313-NFA00429158	Emails	164,846	emails to and from Former Auditor no. 7
NFA00429159-NFA00624114	Emails	194,956	emails to and from Former Auditor no. 7, Current Auditor no. 15, and NFA Staff; and activity reports and hard-copy 2012 work papers

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Bates Range [1]	General Category	Number of Pages	General Description
NFA00624115-NFA00643186	Emails	19,072	Current Auditor no. 9 emails
NFA00643187-NFA00652731	Emails	9,545	NFA Staff emails
NFA00652732-NFA00659309	Emails	6,578	Current Auditor no. 13 emails
NFA00659310-NFA00674575	Emails	15,266	NFA Staff emails
NFA00674576-NFA00674608	Emails	33	Current Auditor no. 12 emails
NFA00674609-NFA00674612	Emails	4	Current Auditor no. 15 emails
NFA00674613-NFA00700430	Training	25,818	Electronic Training Materials
NFA00700431-NFA00742729	Emails	42,299	Current Auditor no. 12 emails
NFA00742730-NFA00752506	Emails	9,777	Current Auditor no. 12 documents
NFA00752507-NFA00753569	Emails	1,063	NFA Staff emails
NFA00753570-NFA00754339	Emails	770	Current Auditor no. 12 emails
NFA00754340-NFA00764078	Emails	9,739	Current Auditor no. 12 documents
NFA00764079-NFA00766008	Emails	1,930	Current Auditor no. 12 emails
NFA00766009-NFA00767751	Emails	1,743	Current Auditor no. 12 documents
NFA00767752-NFA00798410	Emails	30,659	Former Auditor no. 8 emails
NFA00798411-NFA00804061	Emails	5,651	NFA Staff emails
NFA00804062-NFA00804352	Emails	291	Current Auditor no. 12 emails and documents
NFA00804353-NFA00821227	Emails	16,875	Former Auditor no. 8 documents
NFA00821228-NFA00836288	Emails	15,061	Current Auditor no. 14 emails and documents
NFA00836289-NFA00840202	Emails	3,914	Current Auditor no. 12 emails and documents
NFA00840203-NFA00998612	Emails	158,410	Former Auditor no. 7 emails and documents
NFA00998613-NFA00998764	Training	152	Organizational Charts
NFA00998765-NFA00998992	Training	228	2008 Training Materials: Segregation
NFA00998993-NFA00999083	Training	91	2008 Training Materials: Forex Promotional Materials
NFA00999084-NFA00999133	Training	50	2008 Training Materials: CTA Performance
NFA00999134-NFA00999357	Training	224	2008 Training Materials: AFS/PFS
NFA00999358-NFA01000303	Emails	946	Current Auditor no. 12 emails and documents
NFA01000304-NFA01245358	Emails	245,055	Former Auditor no. 7 emails and documents
NFA01245359-NFA01380689	Emails	135,331	Current Auditor no. 15 emails and documents
NFA01380690-NFA01388860	Emails	8,171	Former Auditor no. 7 emails and documents
NFA01388861-NFA01388989	Interview Transcript	129	Former Auditor no. 1 Interview transcript and exhibits
NFA01388990-NFA01389233	Interview Transcript	244	Current Auditor no. 2 Interview transcript and exhibits
NFA01389234-NFA01389332	Interview Transcript	99	Current Auditor no. 1 Interview transcript and exhibits
NFA01389333-NFA01453242	Emails	63,910	NFA Staff emails and documents
NFA01453243-NFA01502246	Emails	49,004	Current Auditor no. 13 emails and documents
NFA01502247-NFA01502401	Emails	155	Current Auditor no. 15 emails and documents
NFA01502402-NFA01502477	Interview Transcript	76	Current Auditor no. 6 Interview transcript
NFA01502478-NFA01502606	Interview Transcript	129	Current Auditor no. 4 Interview transcript
NFA01502607-NFA01502848	Interview Transcript	242	Former Auditor no. 4 Interview transcript and exhibits
NFA01502849-NFA01502892	Interview Transcript	44	Former Auditor no. 3 Interview transcript and exhibits
NFA01502893-NFA01505874	Emails	2,982	Current Auditor no. 15 emails and documents
NFA01505875-NFA01506139	Emails	265	Current Auditor no. 2 emails
NFA01506140-NFA01507527	Emails	1,388	Current Auditor no. 3 emails

APPENDIX A
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Bates Range [1]	General Category	Number of Pages	General Description
NFA01507528-NFA01511125	Emails	3,598	Current Auditor no. 6 emails
NFA01511126-NFA01522135	Emails	11,010	Current Auditor no. 5 emails
NFA01522136-NFA01524192	Emails	2,057	Former Auditor no. 4 emails
NFA01524193-NFA01526285	Emails	2,093	Current Auditor no. 7 emails
NFA01526286-NFA01530677	Emails	4,392	Current Auditor no. 4 emails
NFA01530678-NFA01607155	Emails	76,478	Current Auditor no. 9 emails
NFA01607156-NFA01620565	Emails	13,410	Current Auditor no. 13 emails
NFA01620566-NFA01853835	Emails	233,270	Current Auditor no. 12 emails (post - 7/9/2012)
NFA01853836-NFA01869358	Emails	15,523	Current Auditor no. 8 emails
NFA01869359-NFA01890101	Emails	20,743	Current Auditor no. 11 emails
NFA01890102-NFA02081968	Emails	191,867	Current Auditor no. 15 emails and documents
NFA02081969-NFA02089524	Emails	7,556	Current Auditor no. 10 emails
NFA02089525-NFA02150859	Emails	61,335	Current Auditor no. 14 emails
NFA02150860-NFA02151170	Misc.	311	NFA Hard Copy Files
NFA02151171-NFA02155001	Emails	3,831	NFA Staff emails and documents
NFA02155002-NFA02155845	Emails	207	Current Auditor no. 13 emails and documents
NFA02155846-NFA02155931	Interview Transcript	86	Current Auditor no. 5 Interview transcript
NFA02155932-NFA02155998	Interview Transcript	67	Current Auditor no. 7 Interview transcript
NFA02155999-NFA02156000	Interview Transcript	2	Current Auditor no. 1 Interview exhibit
NFA02156001-NFA02156030	Interview Transcript	30	Current Auditor no. 6 Interview exhibits
NFA02156031-NFA02156091	Interview Transcript	61	Current Auditor no. 5 Interview exhibits
NFA02156092-NFA02156135	Interview Transcript	44	Current Auditor no. 4 Interview exhibits
NFA02156136-NFA02547162	Emails	391,027	Former Auditor no. 7 emails (post - 7/9/2012)
NFA02547163-NFA02566936	Emails	19,774	NFA Staff emails and documents
NFA02566937-NFA02597298	Emails	30,362	Former Auditor no. 8 emails and documents
NFA02597299-NFA02623694	Emails	26,396	NFA Staff emails and documents
NFA02623695-NFA02685274	Emails	61,580	Current Auditor no. 14 emails and documents
NFA02685275-NFA02729050	Emails	43,776	Former Auditor no. 7 emails (post - 7/9/2012)
NFA02729051-NFA02730986	Emails	1,936	Current Auditor no. 15 emails
NFA02730987-NFA02736445	Emails	5,459	NFA Staff emails (post - 7/9/2012)
NFA02736446-NFA02740671	Emails	4,226	Current Auditor no. 15 emails (post - 7/9/2012)
NFA02740672-NFA02742507	Emails	1,836	Former Auditor no. 8 emails (post - 7/9/2012)
NFA02742508-NFA02743116	Emails	609	Current Auditor no. 15 Hard Copy documents
NFA02743117-NFA02743172	Audit	56	08-CEXM-148 Audit documents
NFA02743173-NFA02743175	Emails	3	Current Auditor no. 12 emails
NFA02743176-NFA02743178	Emails	3	Current Auditor no. 13 emails
NFA02743179-NFA02789176	Emails	45,998	NFA Staff emails and documents
NFA02789177-NFA02943927	Emails	154,751	NFA Staff emails and documents
NFA02943928-NFA03044684	Emails	100,757	Current Auditor no. 9 emails and documents
NFA03044685-NFA03052991	Emails	8,307	NFA Staff emails and documents
NFA03052992-NFA03053000	Misc.	9	Confirm Contacts
NFA03053001-NFA03053610	JAC documents	610	JAC Minutes
NFA03053611-NFA03053616	Emails	6	NFA Staff emails and documents

APPENDIX A
Summary of Database Documents Reviewed

Bates Range [1]	General Category	Number of Pages	General Description
NFA03053617-NFA03054281	Emails	665	NFA Staff emails and documents
NFA03054282-NFA03134958	Emails	80,677	NFA Staff emails and documents
NFA03134959-NFA03244752	Emails	109,794	NFA Staff emails and documents
NFA03244753-NFA03244766	Emails	14	NFA Staff emails and documents
NFA03244767-NFA03338780	Emails	94,014	NFA Staff emails and documents
NFA03338781-NFA03353288	Emails	14,508	NFA Staff emails and documents
NFA03353289-NFA03353391	JAC documents	103	JAC Protocols
NFA03353392-NFA03354492	Emails	1,101	NFA Staff emails and documents
NFA03354493-NFA03355468	Emails	976	NFA Staff emails and documents
NFA03355469-NFA03356087	Emails	619	Current Auditor no. 9 emails and documents
NFA03356088-NFA03356248	Emails	161	NFA Staff emails and documents
NFA03356249-NFA03356539	Emails	291	NFA Staff emails and documents
NFA03356540-NFA03357051	Emails	512	NFA Staff emails and documents
NFA03357052-NFA03358175	Emails	1,124	NFA Staff emails and documents
NFA03358176-NFA03358487	Emails	312	NFA Staff emails and documents
NFA03358488-NFA03358493	Training	6	Training Materials: Booklet - Fraud Squad
NFA03358494-NFA03358527	Training	34	Training Materials: FCM Issues- Margins and Segregation (3/20/96)
NFA03358528-NFA03358575	Training	48	Training Materials: Segregated Funds
NFA03358576-NFA03358684	Training	109	Training Materials: Advanced Net Capital (1/7/00)
NFA03358685-NFA03358702	Training	18	Training Materials: Intro to Net Capital and Seg Funds (9/7/00)
NFA03358703-NFA03358713	Training	11	Training Materials: Risk-Based Auditing (Oct 26, 2000)
NFA03358714-NFA03358946	Training	233	Training Materials: Financial - Net Capital
NFA03358947-NFA03359104	Training	158	Training Materials: Risk-Based Minimum Net Cap Trading
NFA03359105-NFA03359372	Training	268	Training Materials: Intermediate Seg - Seg Training
NFA03359373-NFA03359419	Training	47	Training Materials: Scoping Training (May/June 2011)
NFA03359420-NFA03359529	Training	110	Training Materials: Leading Audits (9/2011)
NFA03359530-NFA03359560	Training	31	Training Materials: Compliance Staff Training Manual (June 2012)
NFA03359561-NFA03359575	Training	15	Training Materials: Compliance Staff Training Manual (January 2011)
NFA03359576-NFA03359611	Training	36	Training Materials: Compliance Staff Training Manual (June 2011)
NFA03359612-NFA03359641	Training	30	Training Materials: Fraud Auditing for NFA Staff
NFA03359642-NFA03359693	Training	52	Training Materials: Investigative Interviewing 10/22/04
NFA03359694-NFA03359736	Training	43	Training Materials: Fraud Detection and Prevention 2/8/2005
NFA03359737-NFA03359859	Training	123	Training Materials: Investigations/Audits Training - FACTS 2000
NFA03359860-NFA03360024	Training	165	Training Materials: Leading Audits (June 2010)
NFA03360025-NFA03360213	Training	189	Training Materials: Fraud Auditing for NFA Staff (2/2012)
NFA03360214-NFA03360285	Emails	72	Current Auditor no. 12 emails and facsimiles
NFA03360286-NFA03360518	Emails	233	NFA Staff facsimiles
NFA03360519-NFA03360674	Emails	156	Former Auditor no. 8 emails and facsimiles
NFA03360675-NFA03360730	Emails	56	NFA Staff facsimiles
NFA03360731-NFA03360755	Emails	25	Current Auditor no. 15 emails and facsimiles
NFA03360756-NFA03360839	Emails	84	Current Auditor no. 13 emails and facsimiles
NFA03360840-NFA03361926	Training	1,087	Training Materials: Compliant Staff Manual- June 2011 (CD-ROM)
NFA03361927-NFA03362088	Interview Transcript	162	Former Auditor no. 2 Interview transcript and exhibits

APPENDIX A
Summary of Database Documents Reviewed

Bates Range [1]	General Category	Number of Pages	General Description
NFA03362089-NFA03362218	Interview Transcript	130	Current Auditor no. 3 Interview transcript and exhibits
NFA03362219-NFA03362384	Interview Transcript	166	Current Auditor no. 9 Interview transcript and exhibits
NFA03362385-NFA03362483	Interview Transcript	99	Current Auditor no. 8 Interview transcript and exhibits
NFA03362484-NFA03362777	Interview Transcript	294	Current Auditor no. 10 Interview transcript and exhibits
NFA03362778-NFA03363189	Interview Transcript	412	Current Auditor no. 12 Interview transcript and exhibits
NFA03363190-NFA03363413	Interview Transcript	224	Former Auditor no. 7 Interview transcript and exhibits
NFA03363414-NFA03363478	Interview Transcript	65	Current Auditor no. 11 Interview transcript and exhibits
NFA03363479-NFA03363612	Interview Transcript	134	Former Auditor no. 6 Interview transcript and exhibits
NFA03363613-NFA03363755	Interview Transcript	143	Current Auditor no. 14 Interview transcript and exhibits
NFA03363756-NFA03363931	Interview Transcript	176	Current Auditor no. 13 Interview transcript and exhibits
NFA03363932-NFA03363945	Misc.	14	SD-Confirms1 (June 20, 2011 Backup)
NFA03363946-NFA03390383	Emails	26,438	NFA Staff emails and documents
NFA03390384-NFA03390385	Emails	2	NFA Staff emails
NFA03390386-NFA03390387	Emails	2	NFA Staff emails
NFA03390388-NFA03390531	Interview Transcript	144	Former Auditor no. 5 Interview transcript and exhibits
NFA03390532-NFA03390582	Interview Transcript	51	Former Auditor no. 8 Interview transcript and exhibits
NFA03390583-NFA03390750	Interview Transcript	168	Current Auditor no. 15 Interview transcript and exhibits
NFA03390751-NFA03391431	Training	681	Compliance Staff Training Manual - January 2011
NFA03391432-NFA03391433	Misc.	2	Financial Internal Control Questions
NFA03391434-NFA03391436	Misc.	3	New Audit Documentation Standard
NFA03391437-NFA03391445	Misc.	9	Summary of 2008 Technical Roundtable
NFA03391446-NFA03391448	Training	3	NFA Handbook
NFA03391449-NFA03392104	Misc.	656	2011 Focused Scope Seg Review emails
NFA03392105-NFA03393985	Emails	1,881	Electronic documents from and emails to and from Former Auditor no. 9
2NFA00000001-2NFA00003687	Training	3,687	Training materials
2NFA00003688-2NFA00025818	Training	22,131	Training materials
2NFA00025819-2NFA00028749	Emails	2,931	Current Auditor no. 2 emails
2NFA00028750-2NFA00030137	Emails	1,388	Current Auditor no. 3 emails
2NFA00030138-2NFA00033575	Emails	3,438	Current Auditor no. 6 documents
2NFA00033576-2NFA00037521	Emails	3,946	Current Auditor no. 5 documents
2NFA00037522-2NFA00039574	Emails	2,053	Former Auditor no. 4 documents
2NFA00039575-2NFA00039627	Emails	53	Current Auditor no. 6 documents
2NFA00039628-2NFA00041560	Emails	1,933	Current Auditor no. 7 documents
2NFA00041561-2NFA00047153	Emails	5,593	Current Auditor no. 5 documents
2NFA00047154-2NFA00050709	Emails	3,556	Current Auditor no. 4 documents
2NFA00050710-2NFA00050713	Emails	4	Former Auditor no. 4 documents
2NFA00050714-2NFA00050874	Emails	161	Current Auditor no. 5 documents
2NFA00050875-2NFA00051556	Emails	682	Current Auditor no. 4 documents
2NFA00051557-2NFA00052149	Training	593	NFA 2008 Training Materials
2NFA00052150-2NFA00084799	Emails	32,650	Current Auditor no. 9 emails and documents
2NFA00084800-2NFA00117627	Emails	32,828	Current Auditor no. 13 emails and documents
2NFA00117628-2NFA00354258	Emails	236,631	Current Auditor no. 12 emails
2NFA00354259-2NFA00367177	Emails	12,919	Current Auditor no. 8 emails

APPENDIX A
Summary of Database Documents Reviewed

Bates Range [1]	General Category	Number of Pages	General Description
2NFA00367178-2NFA00391278	Emails	24,101	Current Auditor no. 11 emails
2NFA00391279-2NFA00587372	Emails	196,094	Current Auditor no. 15 emails
2NFA00587373-2NFA00594899	Emails	7,527	Current Auditor no. 10 emails
2NFA00594900-2NFA00663095	Emails	68,196	Current Auditor no. 14 emails
2NFA00663096-2NFA00664041	Emails	946	Current Auditor no. 12 emails and documents
2NFA00664042-2NFA00672212	Emails	8,171	Former Auditor no. 7 emails and documents
2NFA00672213-2NFA00675194	Emails	2,982	Current Auditor no. 15 emails and documents
2NFA00675195-2NFA00679025	Emails	3,831	NFA Staff emails and documents
2NFA00679026-2NFA00679336	Emails	311	NFA Hard Copy Files emails and documents
2NFA00679337-2NFA00679725	Emails	389	Current Auditor no. 13 emails and documents
2NFA00679726-2NFA00680116	Emails	391	NFA Staff emails and documents
2NFA00680117-2NFA00680502	Emails	386	Former Auditor no. 8 emails and documents
2NFA00680503-2NFA00680835	Emails	333	NFA Staff emails and documents
2NFA00680836-2NFA00682869	Emails	2,034	Current Auditor no. 14 emails and documents
2NFA00682870-2NFA00683479	JAC Documents	610	JAC minutes
2NFA00683480-2NFA00684580	Emails	1,101	NFA Staff emails and documents
2NFA00684581-2NFA00685556	Emails	976	NFA Staff emails and documents
2NFA00685557-2NFA00686175	Emails	619	Current Auditor no. 9 emails and documents
2NFA00686176-2NFA00686336	Emails	161	NFA Staff emails and documents
2NFA00686337-2NFA00686627	Emails	291	NFA Staff emails and documents
2NFA00686628-2NFA00687139	Emails	512	NFA Staff emails and documents
2NFA00687140-2NFA00688263	Emails	1,124	NFA Staff emails and documents
2NFA00688264-2NFA00688575	Emails	312	NFA Staff emails and documents
2NFA00688576-2NFA00690301	Training	1,726	Training Materials
2NFA00690302-2NFA00693529	Misc.	3,228	Financial Information re FCMs
2NFA00693530-2NFA00694616	Training	1,087	Training Materials
2NFA00694617-2NFA00695297	Training	681	Compliance Staff Training Manual - January 2011
2NFA00695298-2NFA00697178	Misc.	1,881	Documents Requested and ESI from Former Auditor no. 9
2NFA00697179-2NFA00698110	JAC Documents	932	JAC Audit Programs

[1]Bates ranges are provided by counsel for NFA

General Description	Number of documents	Number of Pages
Emails and Related Attachments	166,624	3,168,891
Miscellaneous documents	11,171	146,550
Audit documents	9,373	41,973
Training documents	3,743	30,060
Joint Audit Committee documents	499	2,255
Total	**191,410**	**3,389,729**

APPENDIX B
Description of NFA Audits of PFG, 1995-2012

NFA performs periodic audits of its members to ensure compliance with applicable rules and standards. The audits incorporate numerous individual modules designed to review a specific company practice or process. Depending on the nature of the audit planned and the particular circumstances at a given firm, NFA staff may elect to proceed or pass on a specific module.[1] In addition, in certain cases, some modules are completed on a "limited scope" basis.[2]

NFA auditors conducted 17 annual audits of PFG over the past 18 years, every year from 1995[3] to 2012, except for 2007, and NFA auditors were in the process of conducting its audit in 2012 when the fraud came to light. NFA auditors performed 7 additional audits of the following PFG branch offices: (1) Winter Park, FL, in May 2001; (2) Newport Beach, CA, in July 2001; (3) Austin, TX, in August 2001; (4) Westlake Village, CA, in October 2001; (5) Nashville, TN, in December 2002; (6) Scottsdale, AZ in September 2008; and (7) Mission Viejo, CA, in September 2008. In 2010, NFA conducted a second audit of PFG to track the firm's progress in implementing changes required to be compliant with CFTC's new Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries.[4] In 2011, after the MF Global bankruptcy, NFA conducted 2 additional reviews of PFG. Thus, there were a total of 27 audits or reviews of PFG during the period 1995 through 2012.

During 7 of the 17 annual audits, including the last 6 audits, NFA auditors sent a bank confirmation to U.S. Bank.[5] NFA auditors did not find any material issues with the confirmations in any year other than 2012, when NFA began using an electronic confirmation process and the fraud was uncovered.

In 4 of the 17 annual audits, NFA auditors included no deficiencies with PFG's operations in its report to PFG. In the rest of the annual audits (other than 2012), NFA's audit reports contained 3 or fewer deficiencies on 7 occasions, and 4 or more deficiencies on 5 occasions.

Outlined below is a brief summary of each annual audit from 1995 until 2012. The scope of the branch office audits was limited to tests of the books and records of the branch office and did not deal with segregation or bank confirmation matters. NFA completed the planning module in addition to the modules listed as completed in each audit.

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[1] Tr. of Current Auditor no. 3 at 19:19-20.

[2] Tr. of Former Auditor no. 4 at 46:21-47:14 and Tr. of Current Auditor no. 2 at 52:15-18.

[3] While there were NFA audits of PFG prior to 1995, NFA did not retain records related to PFG audits prior to 1995, and consequently, the audit files the BRG Investigative Team were able to review only went back to 1995.

[4] Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries, 75 FR 55410 (Sept. 10, 2010) (Final CFTC Retail Forex Rule).

[5] This practice adhered to the 2002-2010 JAC procedures (Example 2010 JAC procedures at NFA03353324), which guided the NFA auditor to "on a scope basis, obtain from each depository confirmation of bank balances as of the audit date. Either an original bank statement or direct confirmation with the depository may be used."

APPENDIX B
Description of NFA Audits of PFG, 1995-2012

i. 1995 NFA Audit (95-CEXM-455)

NFA's 1995 audit of PFG began in late November and fieldwork was completed in a month.[6] The NFA audit team comprised of six NFA auditors, but the audit documentation did not designate their respective titles or professional ranks.[7] According to NFA documentation, NFA auditors conducted a full audit, and there was no indication that NFA auditors passed or limited its scope on any particular area or module.[8] During the 1995 audit, NFA auditors completed a segregation review[9] and during that review matched customer segregated cash balances from PFG's segregated statement records to PFG's trial balances.[10] NFA auditors discovered during its review of the Segregation module that the CFTC, in its own examination, had adjusted historical segregation calculations that caused PFG to be under segregated on certain dates, but PFG did not report these adjustments to NFA. With regard to that particular finding, NFA's audit team's Summary of Internal Control Recommendations and Rule Violations included the following comments:[11]

> Description of Internal Control Violation
>
> NFA noted that the CFTC reviewed PFG's daily segregation computations for 3/3/95 and 3/6/95 and made adjustments which resulted in the firm being under segregated on such dates. However, PFG did not report the corrected amounts to NFA.
>
> Firm Comments
>
> The firm stated that in the future they will report all material changes of the daily segregation information to NFA.

At the conclusion of the audit, the following deficiencies were identified:[12]

1) PFG failed to submit to NFA a foreign futures and options quarterly report;
2) PFG lacked proper supervision and disclosures with regard to segregated accounts (discussed above);
3) PFG used promotional material that contained misrepresentations;
4) PFG made commission payments and advances to a non-registered NFA member;
5) PFG did not clearly identify bank accounts;
6) PRG's financial statements required adjustments that would accurately reflect all transactions affecting the firm's asset, liability, income, expense and capital accounts;

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[6] NFA00000254 (95-CEXM-455 General Program module).
[7] *Id.*
[8] NFA00000254-NFA00000261 (95-CEXM-455 General Program module).
[9] NFA00000230-NFA00000232 (95-CEXM-455 Segregation module).
[10] NFA00000368-NFA00000377 (95-CEXM-455 Segregation worksheet).
[11] NFA00000308 (95-CEXM-455 Summary of Internal Controls Recommendations and Rule Violations module).
[12] NFA00000307-NFA00000313 (95-CEXM-455 Summary of Internal Controls Recommendations and Rule Violations module).

7) PFG fell below its equity withdrawal restriction. In addition under the restriction, the firm made unsecured advances to employees;
8) PFG fell below its early warning requirement as of August 31, 1995;
9) PFG included a debit liability on its August 31, 1995 trial balance for Customer Ledger Balance Difference;
10) PFG failed to take the required charge of under margined customer accounts;
11) PFG did not reduce its adjusted net capital by taking a haircut charge on T-bills that mature more than three months from the statement date; and
12) PFG entered into a new guarantee agreement while its adjusted net capital was below its early warning requirement.

NFA auditors noted that all deficiencies were resolved or in the process of being resolved by PFG.

ii. 1996 NFA Audit (96-CEXM-431)

NFA's 1996 audit of PFG began in mid-October and fieldwork was completed in over a month. The audit team was comprised of a manager, supervisor, senior auditor, in-charge auditor, and three staff auditors.[13] NFA auditors chose to perform 12 modules (Net Capital, Segregation, Registration, Solicitation, Bunched Orders, Records, Trading, Promotional Material, Cash, Supervision, Margins and Subsequent Review), and passed on 6 modules.[14] NFA management stated that NFA auditors did not perform 3 of the modules (Pool Reporting, Commodity Pool Operator Disclosure Document and Commodity Trading Advisor Disclosure Document) because they pertained to Commodity Pool Operator/Commodity Trading Advisor operations, which were not applicable to PFG at the time; did not perform another module (Seldom Seen Issues) because it was not applicable to PFG's operations; and passed on 2 modules (Order Processing and Affiliates) because they had been tested in prior audits with no material deficiencies.[15]

NFA auditors completed the Segregation module[16] and as such, traced balances from the firm's segregated statements to applicable records (PFG trial balances, balances on carrying broker statements, etc.) provided by PFG.[17] With regard to third-party confirmations, "NFA passed on confirming the balances on deposit with the bank."[18]

At the conclusion of the audit, the following deficiencies were identified:[19]

1) PFG's promotional material contained misstatements of fact;
2) PFG failed to maintain accurate books regarding foreign balances;

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[13] NFA00000562 (96-CEXM-431 Audit Planning and Scope Selection module).
[14] NFA00000560-NFA00000561 (96-CEXM-431 Audit Planning and Scope Selection module).
[15] See NFA management statements at Appendix D.
[16] NFA00000589-NFA00000591 (96-CEXM-431 Segregation module).
[17] NFA00000590 (96-CEXM-431 Segregation module).
[18] NFA00000544 (96-CEXM-431 Net Capital module).
[19] NFA00000484-NFA00000486 (96-CEXM-431 IC Summary module).

3) PFG had problems associated with its split fill order process; and
4) PFG did not mark its securities to market or use the cost method for valuing its customer seg securities.

With regard to the improperly marked securities, NFA auditors stated that the firm would like to value the securities at 95% of face value instead of 90%.[20] With regard to the bookkeeping of foreign balances, NFA auditors noted that PFG represented that it was in the process of revising the firm's account procedures and, in the future, all accounting would be reviewed by the CFO.[21] All other deficiencies were considered resolved by NFA auditors.

iii. 1997 NFA Audit (97-CEXM-628)

NFA's 1997 audit of PFG began in mid-October and fieldwork was completed in under a month. The audit team comprised of a manager, supervisor, senior auditor, in-charge auditor and three staff auditors.[22] NFA auditors chose to perform 10 modules (Net capital, Segregation, Registration, Solicitation, Bunched Orders, Promotional Material, Cash, Supervision, Subsequent Review and NFA Fees) and passed on 9 other modules.[23] NFA management stated that NFA auditors did not perform 3 of the modules (Pool Reporting, Commodity Pool Operator Disclosure Document and Commodity Trading Advisor Disclosure Document) because they pertained to Commodity Pool Operator/Commodity Trading Advisor operations, which were not applicable to PFG at the time; did not perform another module (Seldom Seen Issues) because it was not applicable to PFG's operations; and passed on 5 modules (Records, Order Processing, Trading, Margins and Affiliates) because they had been tested in prior audits with no material deficiencies.[24]

NFA auditors completed the Segregation module[25] and as such, traced balances from the firm's segregated statements to applicable records (PFG trial balances, balances on carrying broker statements, etc.) provided by PFG.[26] NFA auditors passed on completing the Cash section of the Net Capital module,[27] which included a step to consider confirming cash balances on deposit with the bank.[28]

At the conclusion of the audit, the following deficiencies were identified in an undated letter from NFA to PFG:[29]

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[20] NFA00000486 (96-CEXM-431 IC Summary module).
[21] NFA00000485 (96-CEXM-431 IC Summary module).
[22] NFA00000713 (97-CEXM-628 Audit Planning and Scope Selection module).
[23] NFA00000711-NFA00000712 (97-CEXM-628 Audit Planning and Scope Selection module).
[24] See NFA management statements at Appendix D.
[25] NFA00000728-NFA00000732 (97-CEXM-628 Segregation module).
[26] *Id.*
[27] NFA00000695-NFA00000696 (97-CEXM-628 Net Capital module).
[28] *Id.*
[29] NFA00000634 (97-CEXM-628 NFA Audit Findings Letter).

1) Improper calculation of net capital due to overstated assets;
2) Missing accruals for legal fees; and
3) Lack of oversight in registering individuals affiliated with the company with the NFA.

With regard to the improper calculation of net capital, the undated letter from NFA to PFG specifically stated:[30]

> The firm did not calculate adjusted net capital properly because it overstated current assets due to the classification of property, plant and equipment. NFA noted the firm is currently seeking a No-Action position from the CFTC regarding this issue (NFA Compliance Rule 2-10 and CFTC Regulation 1.18(a)).

The BRG Investigative Team did not find any documentation indicating that PFG received a No-Action Letter from NFA regarding the issue noted above. The undated letter from NFA to PFG also stated, "During the exit interview, you represented that corrective action has been or will be taken, therefore, no response to this report is necessary."[31]

iv. 1998 NFA Audit (98-CEXM-393)

NFA's 1998 audit of PFG began in mid-September and fieldwork was completed in under a month. The audit team comprised of a team manager, field supervisor, and three staff auditors.[32] NFA auditors chose to perform 14 modules (Net Capital, Segregation, Registration, Solicitation, Records, Order Processing, Trading, Promotional Material, Cash, Supervision, Margins, Commodity Pool Operator Disclosure Document, Subsequent Review, and Affiliates) and passed on 5 other modules.[33] NFA management stated that NFA auditors did not perform 2 of the modules (Pool Reporting and Commodity Trading Advisor Disclosure Document) because they pertained to Commodity Pool Operator/Commodity Trading Advisor operations, which were not applicable to PFG at the time; did not perform another module (Seldom Seen Issues) because it was not applicable to PFG's operations; and passed on 2 modules (Bunches Orders and NFA Fees) because they had been tested in prior audits with no material deficiencies.[34]

NFA auditors completed the Segregation module[35] and, as such, traced balances from the firm's segregated statements to applicable records (PFG trial balances, balances on carrying broker

[30] *Id.*
[31] *Id.*
[32] NFA00000933-NFA00000942 (98-CEXM-393 Audit Planning and Scope Selection module).
[33] NFA00000939-NFA00000940 (98-CEXM-393 Audit Planning and Scope Selection module).
[34] See NFA management statements at Appendix D.
[35] NFA00000963-NFA00000967 (98-CEXM-393 Segregation module).

statements, etc.) provided by PFG.[36] NFA auditors passed on confirming the balances on deposit with the bank.[37]

At the conclusion of the audit, the following deficiencies were identified in a letter from NFA to PFG dated February 11, 1999:[38]

1) Promotional materials containing a misstatement of facts;
2) A failure to disclose positions to the NFA; and
3) Adjustments were required to PFG's net capital calculation.

With regard to the adjustments required to PFG's net capital calculation, the February 11, 1999 letter stated:[39]

> The following adjustments were proposed as of July 31, 1998 which reduced the firm's excess net capital from \$255,958 to \$223,723. (NFA Compliance Rule 2-10 and CFTC Regulation 1.18):
>
> | | | |
> |---|---|---|
> | Receivables from Customers for Debit/Deficit Accounts- Non-Current | \$12,000 | |
> | Receivables from Customers for Debit/Deficit Accounts-Current | | \$12,000 |
>
> This adjustment was necessary to properly reflect customer debit/deficits which were unsecured.
>
> | | | |
> |---|---|---|
> | Receivables from Employees-Non-Current | \$20,235 | |
> | Commissions Payable | | \$20,235 |
>
> This adjustment was necessary to properly classify receivables from employees.
>
> As a result of the second adjustment – the reclassification of commissions payable, the firm's adjusted net capital fell below the early warning level of \$753,626 on July 31, 1998. (NFA Financial Requirements Section 6 and CFTC Regulation 1.12(b)).

As a result, NFA auditors determined that PFG's adjusted capital fell below its early warning level and that PFG was not in compliance with NFA Financial Requirements Section 6 and CFTC Regulation 1.12(b).[40]

According to an internal memorandum by an NFA auditor, PFG responded in writing on February 24, 1999.[41] With regard to the adjustment, PFG disagreed with NFA's findings and provided evidence to

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[36] NFA00000963 (98-CEXM-393 Segregation module).
[37] NFA00000837 (98-CEXM-393 Net Capital module).
[38] NFA00000758-NFA00000760 (98-CEXM-628 NFA Audit Findings Letter).
[39] *Id.*
[40] *Id.*
[41] NFA00000931-NFA00000932 (98-CEXM-393 NFA Memorandum regarding PFG response to audit findings).

support their claims. On March 18, 1999, NFA received the firm's evidence for the remaining items and noted that the firm provided sufficient support. Based on the above information, NFA auditors recalculated the firm's adjusted net capital ("ANC") as the following:[42]

Unadjusted ANC as of 7/31/98		$758,375
Plus	Increase in fmv of life ins	$24, 197
Plus	Cancelled checks	$4,181
Less	Silver Statue	$12,000
Less	Reclass of comm pybl ($20,235 - $1,940)	$18,295
Adjusted ANC		$756,458

Based on the adjusted ANC, NFA auditors noted that PFG was above the Early Warning Requirement.[43] However, as indicated in the NFA February 11, 1999 letter, PFG had already corrected these deficiencies and thus, no additional response was necessary.[44]

v. 1999 NFA Audit (99-CEXM-370)

NFA's 1999 audit of PFG began in September and fieldwork was completed was completed in over a month. The audit team comprised of a team manager, a field supervisor and three staff auditors.[45] In September of 1999, the CFTC issued a report noting incorrect material items on PFG's "financial balances."[46] NFA auditors noted the following in its Audit Planning and Scope Selection module: "As many material items were noted regarding the financial balances, NFA will ensure that the firm is correctly classifying these specific items noted by the CFTC."[47]

The NFA auditors chose to perform 11 modules (Net Capital, Segregation, Registration, Solicitation, Bunches Orders, Trading, Promotional Material, Cash, Supervision, Subsequent Review, and Affiliates) and passed on 8 modules.[48] NFA management stated that NFA auditors did not perform 3 of the modules (Pool Reporting, Commodity Pool Operator Disclosure Document and Commodity Trading Advisor Disclosure Document) because they pertained to Commodity Pool Operator/Commodity Trading Advisor operations, which were not applicable to PFG at the time; did not perform another module (Seldom Seen Issues) because it was not applicable to PFG's operations; and passed on 4 modules (Records, Order Processing, Margins and NFA Fees) because they had been tested in prior audits with no material deficiencies.[49]

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[42] *Id.*
[43] *Id.*
[44] NFA00000758-NFA00000760 (98-CEXM-628 NFA Audit Findings Letter).
[45] NFA00001167 (99-CEXM-370 Audit Planning and Scope Selection module).
[46] NFA00001175-NFA00001176 (99-CEXM-370 Audit Planning and Scope Selection module). See also, CFTC Settlement, dated September 7, 2000, at 1-2.
[47] NFA00001175 (99-CEXM-370 Audit Planning and Scope Selection module).
[48] NFA00001174-NFA00001175 (99-CEXM-370 Audit Planning and Scope Selection module).
[49] See Appendix D.

APPENDIX B
Description of NFA Audits of PFG, 1995-2012

NFA auditors completed the Segregation module[50] and as such, traced balances from the firm's segregated statements to applicable records (PFG trial balances, balances on carrying broker statements, etc.) provided by PFG.[51] During the review of the Segregation module, NFA auditors found inaccurate calculations in daily reports filed with NFA and that PFG further failed to report changes made to daily segregation reports when errors were corrected.[52] NFA auditors relied on the bank records provided by PFG and passed on confirming the balances on deposit with the bank.[53]

At the conclusion of the audit, the following deficiencies were identified in a letter from NFA to PFG dated December 3, 1999:[54]

1) PFG's promotional materials contained misstatement of facts;
2) The firm's error account was used for trading purposes;
3) There were inaccurate calculations in net capital and segregated funds; and
4) PFG employees lacked proper registration.

With regard to the inaccurate calculations in net capital and segregated funds, NFA proposed a number of adjustments that reduced the firm's excess net capital from $1,451,415 to $1,022,489 and increased excess segregated funds from $220,279 to $220,442.[55]

In a December 3, 1999 letter to PFG, NFA noted, "that during the exit interview, PFG represented that corrective action has been or will be taken with respect to these deficiencies, no further response is necessary."[56] In the same letter, NFA warned PFG, noting, "Please be advised that the violations noted in this report are serious violations of NFA Rules. Any future violations of NFA Requirements may subject your firm to further disciplinary action pursuant to NFA Rules."[57]

vi. 2000 NFA Audit (00-CEXM-341)

NFA's 2000 audit of PFG began in early August and fieldwork was completed in over a month. The audit team comprised of a manager, a field supervisor, and three staff auditors.[58] NFA auditors chose to perform 13 modules (Net Capital, Segregation, Registration, Bunches Orders, Order Processing, Trading, Promotional Material, Cash, Supervision, Margins, Subsequent Review, Affiliates and Automated Order Routing) and passed on 7 other modules.[59] NFA management stated that NFA auditors did not perform 3 of the modules (Pool Reporting, Commodity Pool Operator Disclosure Document and Commodity

[50] NFA00001189-NFA00001201 (99-CEXM-370 Segregation module).
[51] *Id.*
[52] NFA00001023-NFA00001027 (99-CEXM-370 IC Summary module).
[53] NFA00001077 (99-CEXM-370 Net Capital module).
[54] NFA00000994-NFA00000998 (99-CEXM-370 NFA Audit Findings Letter).
[55] *Id.*
[56] *Id.*
[57] *Id.*
[58] NFA00001413 (00-CEXM-341 Audit Planning and Scope Selection module).
[59] NFA00001420 (00-CEXM-341 Audit Planning and Scope Selection module).

Trading Advisor Disclosure Document) because they pertained to Commodity Pool Operator/Commodity Trading Advisor operations, which were not applicable to PFG at the time; did not perform another module (Seldom Seen Issues) because it was not applicable to PFG's operations; and passed on 3 modules (Solicitation, Records and NFA Fees) because they had been tested in prior audits with no material deficiencies.[60]

NFA auditors completed the Segregation module[61] and as such, traced balances from the firm's segregated statements to applicable records (PFG trial balances, balances on carrying broker statements, etc.) provided by PFG.[62] NFA auditors noted no material problems with the bank reconciliations, and passed on confirming balances on deposit with the bank.[63]

NFA auditors also conducted a follow-up review related to the findings associated with the 1999 report issued by the CFTC to ensure PFG had successfully addressed any deficiencies noted by the CFTC.[64] No deficiencies related to the CFTC report were noted.

At the conclusion of the audit, the following deficiencies were identified in a letter from NFA to PFG dated October 17, 2000:[65]

1) Improper promotional materials;
2) Non-compliance with block order procedures; and
3) Adjustments to the Initial Margin Requirement and Maintenance Margin Requirement were required for one account.

With regard to the adjustments to the Initial Margin Requirement and Maintenance Margin Requirement, NFA auditors noted that PFG ensured the account in question would be properly calculated in the future.[66] NFA auditors further stated that PFG had already corrected the deficiencies and no additional response was necessary.[67]

vii. 2001 NFA Audit (01-CEXM-420)

NFA's 2001 audit of PFG began in early September and fieldwork was completed in over 2 months. The audit team comprised of a team manager, a field supervisor, and three staff auditors.[68] NFA auditors chose to perform 14 modules (Net Capital, Segregation, Registration, Bunches Orders, Records, Trading, Promotional Material, Cash, Supervision, Margins, Subsequent Review, Affiliates, NFA Fees, and

[60] See NFA management statements at Appendix D.
[61] NFA00001441-NFA00001453 (00-CEXM-341 Segregation module).
[62] *Id.*
[63] NFA00001390 (00-CEXM-341 Net Capital module).
[64] NFA00001421 (00-CEXM-341 Audit Planning and Scope Selection module). NFA00001270-NFA00001278 (00-CEXM-341, PFG's Financial Procedures).
[65] NFA00001244-NFA00001245 (00-CEXM-341 NFA Audit Findings Letter).
[66] NFA00001301 (00-CEXM-341 IC Summary module).
[67] NFA00001244-NFA00001245 (00-CEXM-341 NFA Audit Findings Letter).
[68] NFA00002274 (01-CEXM-420 Audit Planning and Scope Selection module).

Automated Order Routing) and passed on 6 other modules.[69] NFA management stated that NFA auditors did not perform 3 of the modules (Pool Reporting, Commodity Pool Operator Disclosure Document, and Commodity Trading Advisor Disclosure Document) because they pertained to Commodity Pool Operator/Commodity Trading Advisor operations, which were not applicable to PFG at the time; did not perform another module (Seldom Seen Issues) because it was not applicable to PFG's operations; and passed on 2 modules (Solicitation and Order Processing) because they had been tested in prior audits with no material deficiencies.[70]

NFA auditors completed the Segregation module[71] and as such, traced balances from the firm's segregated statements to applicable records (PFG trial balances, balances on carrying broker statements, etc.) provided by PFG.[72] NFA auditors noted no material problems with bank reconciliations and passed on confirming balances on deposit with the banks.[73] NFA auditors again followed up on the implementation of CFTC recommendations in 1999 and found PFG to be compliant.[74] The 2001 audit concluded with no material deficiencies, as indicated in a letter from NFA to PFG dated November 29, 2001.[75]

viii. 2002 NFA Audit (02-CEXM-306)

NFA's 2002 audit of PFG began in mid-July and fieldwork was completed in less than 1 month. The audit team comprised of a team manager, a field supervisor, and two staff auditors.[76] 2002 was the first year that NFA added the Anti-Money Laundering module[77] to its audit program, based upon a review of the audit documentation.[78] NFA auditors chose to perform 10 modules (Net Capital, Segregation, Registration, Solicitation, Promotional Material, Cash, Supervision, Margins, Subsequent Review and Anti-Money Laundering) and passed on 11 other modules.[79] NFA management stated that NFA auditors did not perform 3 of the modules (Pool Reporting, Commodity Pool Operator Disclosure Document and Commodity Trading Advisor Disclosure Document) because they pertained to Commodity Pool Operator/Commodity Trading Advisor operations, which were not applicable to PFG at the time; did not perform another module (Seldom Seen Issues) because it was not applicable to PFG's operations; and passed on 7 modules (Bunches Orders, Records, Order Processing, Trading, Affiliates, NFA Fees and Automated Order Routing) because they had been tested in prior audits with no material deficiencies.[80]

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[69] NFA00002281-NFA00002282 (01-CEXM-420 Audit Planning and Scope Selection module).
[70] See NFA management statements at Appendix D.
[71] NFA00002342-NFA00002349 (01-CEXM-420 Segregation module).
[72] *Id.*
[73] NFA00002255 (01-CEXM-420 Net Capital module).
[74] NFA00002284 (01-CEXM-420 Audit Planning and Scope Selection module).
[75] NFA00001669 (01-CEXM-420 NFA Audit Findings Letter).
[76] NFA00002903 (02-CEXM-306 Audit Planning and Scope Selection module).
[77] NFA00002543-NFA00002547 (02-CEXM-306 Anti-Money Laundering module).
[78] NFA00002911 (02-CEXM-306 Audit Planning and Scope Selection module).
[79] NFA00002911-NFA00002912 (02-CEXM-306 Audit Planning and Scope Selection module).
[80] See NFA management statements at Appendix D.

NFA auditors completed the Segregation module[81] and as such, traced balances from the firm's segregated statements to applicable records (PFG trial balances, balances on carrying broker statements, etc.) provided by PFG.[82] NFA auditors performed limited testing on the Net Capital module, "as no cites were noted in the previous audit."[83] By performing a limited test, the NFA auditors passed on confirming balances on deposit with the banks.

The 2002 audit concluded with no material deficiencies, as indicated in an undated letter from NFA to PFG.[84]

ix. 2003 NFA Audit (03-CEXM-519)

NFA's 2003 audit of PFG began in late July and fieldwork was completed in less than a month. The audit team comprised of a team manager, a field supervisor, and three staff auditors.[85] NFA auditors chose to perform 15 modules (Net Capital, Segregation, Registration, Order Processing, Promotional Material, Cash, Supervision, Affiliates, Anti-Money Laundering, Security Futures Products notification, Security Futures Product Records, Security Futures Product Trading, Security Futures Product Promotional Material, Security Futures Product Supervision and Security Futures Product Margins) and passed on 12 modules.[86] NFA management stated that NFA auditors did not perform 3 of the modules (Pool Reporting, Commodity Pool Operator Disclosure Document and Commodity Trading Advisor Disclosure Document) because they pertained to Commodity Pool Operator/Commodity Trading Advisor operations, which were not applicable to PFG at the time; did not perform another module (Seldom Seen Issues) because it was not applicable to PFG's operations; and passed on 8 modules (Solicitation, Bunches Orders, Records, Trading, Margins, Subsequent Review, NFA Fees and Automated Order Routing) because they had been tested in prior audits with no material deficiencies.[87]

NFA auditors completed the Segregation module[88] and, as such, traced balances from the firm's segregated statements to applicable records (PFG trial balances, balances on carrying broker statements, etc.) provided by PFG.[89] The 2003 audit documentation also indicated that NFA auditors completed third party confirmations on bank account balances.[90]

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[81] NFA00002939-NFA00002947 (02-CEXM-306 Segregation module).
[82] *Id.*
[83] NFA00002912 (02-CEXM-306 Audit Planning and Scope Selection module), Steps #1-4 and #43-47 were completed; however, the step to confirm cash balances was not included in this limited scope review.
[84] NFA00002542 (02-CEXM-306 NFA Audit Findings Letter).
[85] NFA00003389 (03-CEXM-519, Audit Planning and Scope Selection module).
[86] NFA00003389-NFA00003406 (03-CEXM-519 Audit Planning and Scope Selection module).
[87] See NFA management statements at Appendix D.
[88] NFA00003446-NFA00003450 (03-CEXM-519 Segregation module).
[89] *Id*.
[90] NFA00003361-NFA00003364 (03-CEXM-519 Net Capital module); NFA00039391-NFA00039399 (03-CEXM-519 3rd Party Bank Confirmations).

The 2003 audit concluded with no material deficiencies, as indicated in an undated letter from NFA to PFG.[91] This was the third consecutive year in which the NFA auditors found no material deficiencies as a result of its audit of PFG.

x. 2004 NFA Audit (04-CEXM-544)

NFA's 2004 audit of PFG began in late September and fieldwork was completed in less than a month. The audit team comprised of a team manager, a field supervisor, and three staff auditors.[92] The NFA auditors chose to perform 21 modules (Net Capital, Segregation, Registration, Bunches Orders, Records, Trading, Promotional Material, Cash, Supervision, Commodity Pool Operator Disclosure Document, Pool Reporting, Subsequent Review, NFA Fees, Automated Order Routing, Anti-Money Laundering, Security Futures Product Notification, Security Futures Product Records, Security Futures Product Trading, Security Futures Product Promotional Material, Security Futures Product Supervision and Security Futures Product Margins) and passed on 6 modules.[93] NFA management stated that NFA auditors did not perform 1 module (Commodity Trading Advisor Disclosure Document) because it pertained to Commodity Trading Advisor operations, which was not applicable to PFG at the time; did not perform another module (Seldom Seen Issues) because it was not applicable to PFG's operations; and passed on 4 modules (Solicitation, Order Processing, Margins and Affiliates) because they had been tested in prior audits with no material deficiencies.[94]

NFA auditors completed the Segregation module[95] and, as such, traced balances from the firm's segregated statements to applicable records (PFG trial balances, balances on carrying broker statements, etc.) provided by PFG.[96] NFA auditors chose to perform a limited testing[97] of the Net Capital module and passed on confirming cash balances on deposit with the banks.[98]

At the conclusion of the audit, the following deficiencies were identified in a letter from NFA to PFG dated January 24, 2005:[99]

1) Did not meet standards in registering employees in branch offices; and
2) Lacked supervision of its Guaranteed Introducing Brokers.

In a letter from PFG to NFA dated February 7, 2005, PFG informed NFA that PFG had terminated its guarantee agreements with all three Guaranteed Introducing Brokers mentioned in the Audit Findings letter. Further, PFG implemented a quarterly verbal interview with each Introducing Broker. During the

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[91] NFA00002993-NFA00002994 (03-CEXM-519 NFA Audit Findings Letter).
[92] NFA00004026 (04-CEXM-544 Audit Planning and Scope Selection module).
[93] NFA00004034-NFA00004036 (04-CEXM-544 Audit Planning and Scope Selection module).
[94] See NFA management statements at Appendix D.
[95] NFA00004088-NFA00004092 (04-CEXM-544 Segregation module).
[96] *Id.*
[97] NFA00004035 (04-CEXM-544 Audit Planning and Scope Selection module).
[98] NFA00004013 (04-CEXM-544 Net Capital module).
[99] NFA00003505-NFA00003506 (04-CEXM-544 NFA Audit Findings Letter).

interview, PFG said that it would document general information regarding the Introducing Broker, the business it is conducting, review its website for compliance, and review the registration on the Online Registration System in order to resolve the outstanding issues.[100]

xi. 2005 NFA Audit (05-CEXM-716)

NFA's 2005 audit of PFG began in mid-October and fieldwork was completed in about 2 months. The audit team comprised of a team manager, a field supervisor, and 3 staff members.[101] NFA auditors chose to perform 10 modules (Net Capital, Segregation, Registration, Records, Order Processing, Promotional Material, Cash, Supervision, Margins and Subsequent Review) and passed on 17 modules.[102] NFA management stated that NFA auditors did not perform 1 module (Commodity Trading Advisor Disclosure Document) because it pertained to Commodity Trading Advisor operations, which was not applicable to PFG at the time; did not perform another module (Seldom Seen Issues) because it was not applicable to PFG's operations; and passed on 9 modules (Solicitation, Bunches Orders, Trading, Commodity Pool Operator Disclosure Document, Pool Reporting, Affiliates, NFA Fees, Automated Order Routing and Anti-Money Laundering) because they had been tested in prior audits with no material deficiencies; and passed on 6 other modules (Security Futures Product Notification, Security Futures Product Records, Security Futures Product Trading, Security Futures Product Promotional Material, Security Futures Product Supervision and Security Futures Product Margins) because PFG had very few Security Futures Product accounts.[103]

NFA auditors completed the Segregation module[104] and, as such, traced balances from the firm's segregated statements to applicable records (PFG trial balances, balances on carrying broker statements, etc.) provided by PFG.[105] NFA auditors also chose to confirm the cash balance of the Bank One "Customer Seg – Forex" account, which it mailed to Bank One on October 27, 2005.[106] NFA auditors noted that the confirmation statement from the bank agreed with the firm's August 31, 2005 documented balance and passed on further review.[107]

The 2005 audit concluded with no material deficiencies, as indicated in a letter from NFA to PFG dated February 8, 2006.[108]

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[100] NFA00003880 (Memorandum from PFG in response to NFA's Audit Findings Letter).
[101] NFA00004610 (05-CEXM-716 Audit Planning and Scope Selection module).
[102] NFA00004618-NFA00004620 (05-CEXM-716 Audit Planning and Scope Selection module).
[103] See NFA management statements at Appendix D.
[104] NFA00004661-NFA00004665 (05-CEXM-716 Segregation module).
[105] *Id.*
[106] NFA00004434 (05-CEXM-716 Net Capital module).
[107] NFA00004435 (05-CEXM-716 Net Capital module).
[108] NFA00004152- NFA00004153 (05-CEXM-716 NFA Audit Findings Letter).

xii. 2006 NFA Audit (06-CEXM-521)

NFA's 2006 audit of PFG began in mid-October and fieldwork was completed in a month. The audit team comprised of a team manager, a field supervisor and three staff auditors.[109] NFA auditors chose to perform 13 modules (Net Capital, Segregation, Registration, Solicitation, Records, Order Processing, Promotional Material, Cash, Supervision, Commodity Pool Operator Disclosure Document, Pool Reporting, Subsequent Review and Anti-Money Laundering) and passed on 14 modules.[110] NFA management stated that NFA auditors did not perform 1 module (Commodity Trading Advisor Disclosure Document) because it pertained to Commodity Trading Advisor operations, which was not applicable to PFG at the time; did not perform another module (Seldom Seen Issues) because it was not applicable to PFG's operations; and passed on 6 modules (Bunches Orders, Trading, Margins, Affiliates, NFA Fees and Automated Order Routing) because they had been tested in prior audits with no material deficiencies; and passed on 6 other modules (Security Futures Product Notification, Security Futures Product Records, Security Futures Product Trading, Security Futures Product Promotional Material, Security Futures Product Supervision and Security Futures Product Margins) because PFG had very few Security Futures Product accounts.[111]

NFA auditors completed the Segregation module[112] and, as such, traced balances from the firm's segregated statements to applicable records (PFG trial balances, balances on carrying broker statements, etc.) provided by PFG.[113] NFA auditors sent cash balance confirmation statements to a number of banks, including U.S. Bank on November 10, 2006 and no material differences were found.[114]

At the conclusion of the audit, the following deficiencies were identified in a letter from NFA to PFG dated March 15, 2007:[115]

1) Failure to calculate concentration charge against its net capital;[116]
2) Misleading promotional material;
3) Mislabeled accounts at JPMorgan and Dresdner; and
4) An inaccurate disclosure document for PECTA LLC.

With regard to the mislabeling of accounts, the March 15, 2007 letter noted the following: [117]

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[109] NFA00005924 (06-CEXM-521 Audit Planning and Scope Selection module).
[110] NFA00005936-NFA00005938 (06-CEXM-521 Audit Planning and Scope Selection module).
[111] See NFA management statements at Appendix D.
[112] NFA00006038-NFA00006046 (06-CEXM-521 Segregation module).
[113] *Id.*
[114] NFA00006051-NFA00006054 (06-CEXM-521 Sources worksheet). NFA auditors received the U.S. Bank confirmation on November 27, 2006; NFA00037005 (U.S. Bank 3rd Party Bank Confirmation).
[115] NFA00004823-NFA00004826 (06-CEXM-521 NFA Audit Findings Letter).
[116] *Id.*, NFA noted that the adjustment resulted in an immaterial decrease in its Adjusted Net Capital.
[117] *Id.*

> The JPMorgan Chase Bank account is titled "Customer Segregated Fund Account/Forex." This implies that customer funds are segregated and given special protections under the bankruptcy laws. (NFA Compliance Rule 2-36)
>
> *Subsequent to fieldwork, the firm had the account title changed to 'Forex Customer Account' and provided documentation to NFA.*
>
> The accounts at Dresdner and JPMorgan Chase Banks for the firm's secured accounts do not properly identify that the funds were segregated for foreign futures and options customers. (NFA Compliance Rule 2-31 and CFTC Regulation 30.7(c))
>
> *Subsequent to fieldwork, the firm had the account titles changed to reflect that the accounts represent 30.7 secured funds and provided documentation to NFA.*

With regard to the JPM account, on January 5, 2007, PFG provided NFA with the new signature card that the firm was required to fill out from JPM with the new account title; and on February 22, 2007, PFG provided NFA auditors with a screen shot from the bank showing the new title of the account.[118] With regard to the Dresdner account, an undated PFG letter to Dresdner informed the bank to designate the PFG account as "Peregrine Financial Group, Inc. – Customer 30.7."[119] With regard to the failure to calculate concentration charge against its net capital, PFG stated it would prepare the calculation and provide it to NFA. In addition, PFG stated that it would ensure that concentration charge calculations were prepared in the future.[120] As indicated in the letter, PFG had already corrected all deficiencies and no additional response was considered necessary.[121]

xiii. 2008 NFA Audit (08-CEXM-016)

NFA's 2008 audit of PFG began in early January and fieldwork was completed in less than 1 month. The audit team comprised of a team manager, a field supervisor, and three staff auditors.[122] NFA auditors chose to perform 12 modules (Net Capital, Segregation, Bunches Orders, Trading, Promotional Material, Cash, Supervision, Pool Reporting, Subsequent Review, NFA Fees, Automated Order Routing and Anti-Money Laundering) and passed on 16 modules.[123] NFA management stated that NFA auditors did not perform 1 module (Commodity Trading Advisor Disclosure Document) because it pertained to Commodity Trading Advisor operations, which was not applicable to PFG at the time; did not perform 2 modules (Seldom Seen Issues and Not-Doing-Business) because they were not applicable to PFG's operations; and passed on 7 modules (Registration, Solicitation, Records, Order Processing, Margins, Commodity Pool Operator Disclosure Document and Affiliates) because they had been tested in prior

[118] NFA00005873-NFA00005874 (06-CEXM-521 Summary of Audit Findings). For JPMorgan Chase signature card, email and printout of account details, *see* NFA00005712-NFA00005715 (06-CEXM-521 supporting documents).
[119] NFA00005709 (PFG letter to Dresdner re: customer segregated account).
[120] NFA00005871-NFA00005872 (06-CEXM-521 Summary of Audit Findings).
[121] NFA00004823 (06-CEXM-521 NFA Audit Findings Letter).
[122] NFA00007360- NFA00007361 (08-CEXM-016 Audit Planning and Scope Selection module).
[123] NFA00007375-NFA00007377 (08-CEXM-016 Audit Planning and Scope Selection module).

audits with no material deficiencies; and passed on 6 other modules (Security Futures Product Notification, Security Futures Product Records, Security Futures Product Trading, Security Futures Product Promotional Material, Security Futures Product Supervision and Security Futures Product Margins) because PFG had very few Security Futures Product accounts.[124]

NFA auditors completed the Segregation module and as such, traced balances from the firm's segregated statements to applicable records (PFG trial balances, balances on carrying broker statements, etc.) provided by PFG.[125] NFA auditors noted that PFG was compliant with the December 21, 2007, FDM requirement change of increased levels of Net Capital.[126] NFA auditors also confirmed cash balances of certain PFG accounts with their respective banks.[127] No material deficiencies with regard to bank confirmations were noted.[128]

At the conclusion of the audit, the following deficiency was identified in a letter from NFA to PFG dated April 24, 2008:[129]

1) PFG futures and Forex websites contained misstatements of fact or unbalanced discussion of risk.

With regard to the deficiency, PFG revised the statements on both websites to ensure compliance with NFA rules.[130] Accordingly, NFA determined that PFG had already corrected these deficiencies and no additional response was necessary.[131]

xiv. 2009 NFA Audit (09-CEXM-003)

NFA's 2009 audit began in early January 2009 and fieldwork was completed in a month. The audit team comprised of a team manager, a field manager, and four staff auditors.[132] NFA auditors chose to perform 11 modules (Net Capital, Segregation, Solicitation, Trading, Promotional Material, Cash, Supervision, Margins, Pool Reporting, Automated Order Routing and Anti-Money Laundering) and passed on 17 modules.[133] NFA management stated that NFA auditors did not perform 1 module (Commodity Trading Advisor Disclosure Document) because it pertained to Commodity Trading Advisor operations, which was not applicable to PFG at the time; did not perform 3 modules (Bunches Orders, Seldom Seen Issues and Not-Doing-Business) because they were not applicable to PFG's operations; and passed on 7 modules (Registration, Records, Order Processing, Commodity Pool Operator Disclosure

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[124] See NFA management statements at Appendix D.
[125] NFA00007412-NFA00007415 (08-CEXM-016 Segregation module).
[126] NFA00007372 (08-CEXM-016 Audit Planning and Scope Selection module).
[127] NFA00007339-NFA00007342 (08-CEXM-016 Net Capital module); NFA00035856 (08-CEXM-016 3rd Party Bank Confirmation**)**.
[128] NFA00007416-NFA00007439 (08-CEXM-016 Segregation worksheet, *See* note 1 of Table 2 notes).
[129] NFA00006190-NFA00006192 (08-CEXM-016 NFA Audit Findings Letter).
[130] NFA00007325-NFA00007326 (08-CEXM-016 Summary of Audit Findings).
[131] NFA00006190 (08-CEXM-016 NFA Audit Findings Letter).
[132] NFA00007856-NFA00007857 (09-CEXM-003 Audit Planning and Scope Selection module).
[133] NFA00007881-NFA00007886 (09-CEXM-003 Audit Planning and Scope Selection module).

Document, Subsequent Review, Affiliates and NFA Fees) because they had been tested in prior audits with no material deficiencies; and passed on 6 other modules (Security Futures Product Notification, Security Futures Product Records, Security Futures Product Trading, Security Futures Product Promotional Material, Security Futures Product Supervision and Security Futures Product Margins) because PFG had very few Security Futures Product accounts.[134]

NFA auditors completed the Segregation module and as such, traced balances from the firm's segregated statements to applicable records (PFG trial balances, balances on carrying broker statements, etc.) provided by PFG.[135] NFA auditors also confirmed cash balances of certain PFG accounts with their respective banks.[136] No material deficiencies with regard to bank confirmations were noted.[137]

At the conclusion of the audit, the following deficiencies were identified in a letter from NFA to PFG dated May 29, 2009:[138]

1) PFG promotional materials possess misstatements of fact;
2) PFG lacks supervision of unregulated solicitors;
3) PFG submitted inaccurate Forex weekly reports; and
4) PFG's anti-money laundering program is inadequate.

With regard to PFG's Anti-Money Laundering program, the May 29, 2009 letter specifically stated:[139]

> The anti-money laundering program developed and implemented by the firm was not adequate. Specifically, the annual independent anti-money laundering audit was conducted by Schweder, the firm's Compliance Manager, who works in an area that is potentially susceptible to money laundering and as such, is not an independent party. (NFA Compliance Rule 2-9(c))
>
> On January 29, 2009, the firm stated that this audit has been conducted by Schweder and the former PFG Compliance Manager for the past several years and PFG believed these individuals were independent as they do not perform any anti-money laundering functions for the firm. However, as of February 2, 2009, PFG entered into an agreement with EA Compliance, Inc., an independent third party, to conduct its annual anti-money laundering audits going forward.

[134] See NFA management statements at Appendix D.
[135] NFA00007927-NFA00007929 (09-CEXM-003 Segregation module).
[136] NFA00007764-NFA00007780 (09-CEXM-003 Net Capital module); NFA00008684 (09-CEXM-003 3rd Party Bank Confirmation).
[137] NFA00007927-NFA00007929 (09-CEXM-003 Segregation module).
[138] NFA03136468-NFA03136475 (09-CEXM-003 NFA Audit Findings).
[139] NFA03136475 (09-CEXM-003 NFA Audit Findings).

The May 29, 2009 letter also indicated that, "[s]ome findings from this examination are serious violations of NFA Rules . . ." but added that "PFG has already corrected all items; therefore, no additional response is necessary . . ."[140]

xv. 2010 NFA Audit (10-CEXM-206)

NFA's 2010 audit began in late March and fieldwork was completed in 2 months. The audit team comprised of a team manager, two field supervisors, and four staff auditors.[141] During the audit, NFA auditors noted that the 2009 issues related to anti-money laundering, solicitation, and promotional materials would be reinvestigated to ensure compliance.[142] The audit team chose to perform 10 modules (Net Capital, Segregation, Registration, Order Processing, Promotional Material, Cash, Supervision, NFA Fees, Automated Order Routing and Anti-Money Laundering) and passed on 19 modules.[143] NFA management stated that NFA auditors did not perform 4 modules (Commodity Pool Operator Disclosure Document, Commodity Trading Advisor Disclosure Document, Pool Reporting and Fund of Funds) because they pertained to Commodity Pool Operator/Commodity Trading Advisor operations, which were not applicable to PFG at the time; did not perform 3 modules (Bunches Orders, Seldom Seen Issues and Not-Doing-Business) because they were not applicable to PFG's operations; passed on 6 modules (Solicitation, Records, Trading, Margins, Subsequent Review and Affiliates) because they had been tested in prior audits with no material deficiencies; and passed on 6 other modules (Security Futures Product Notification, Security Futures Product Records, Security Futures Product Trading, Security Futures Product Promotional Material, Security Futures Product Supervision and Security Futures Product Margins) because PFG had very few Security Futures Product accounts.[144]

NFA auditors completed the Segregation module and, as such, traced balances from the firm's segregated statements to applicable records (PFG trial balances, balances on carrying broker statements, etc.) provided by PFG.[145] NFA auditors also confirmed cash balances of certain PFG accounts with their respective banks.[146]

At the conclusion of the audit, the following deficiencies were identified in a letter from NFA to PFG dated August 6, 2010:[147]

1) Incorrect material statements in promotional material; and
2) Lack of supervision of Guaranteed Introducing Broker activities, specifically the websites and promotional materials of PFG's Guaranteed Introducing Brokers.

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[140] NFA03136468 (09-CEXM-003 NFA Audit Findings).
[141] NFA00010674-NFA00010675 (10-CEXM-206 Audit Planning and Scope Selection module).
[142] *Id*.
[143] NFA00010700-NFA00010705 (10-CEXM-206 Audit Planning and Scope Selection module).
[144] See NFA management statements at Appendix D.
[145] NFA00010951-NFA00010953 (10-CEXM-206 Segregation module).
[146] NFA00010579-NFA00010596 (10-CEXM-206 Net Capital); NFA00594038 (10-CEXM-206 3rd Party Bank Confirmation).
[147] NFA03244805-NFA03244808 (10-CEXM-206 NFA Audit Findings Letter).

NFA determined that PFG already had corrected these deficiencies and no additional response was necessary.[148]

xvi. 2010 NFA Second Audit (10-CEXM-613)

NFA's second 2010 audit of PFG began in July and fieldwork was completed in over 2 months. NFA conducted a second audit of PFG to track the firm's progress in implementing changes required to be compliant with CFTC's new Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries.[149] The new regulations and amendments established requirements for, among other things, registration, disclosure, recordkeeping, financial reporting, minimum capital, and other operational standards.[150] Specifically, the regulations required:[151]

1) The registration of counterparties offering retail foreign currency contracts as either a FCM or RFED;
2) That persons who solicit orders, exercise discretionary trading authority or operate pools with respect to retail forex will be required to register as commodity trading advisers, commodity pool operators or associated persons;
3) That leverage in retail forex customer accounts will be subject to a security deposit requirement; and
4) Retail forex counter parties and intermediaries distribute forex-specific risk disclosure statement to customers.

The audit team comprised of one manager and one field supervisor. The audit began in early October and focused on registration, CFTC Regulation 5.5 Disclosure, margin requirements, capital compliance and solicitors.[152] As a result of this focused review, the NFA audit team concluded that there were no material deficiencies.[153]

xvii. 2011 NFA Audit (11-CEXM-239)

NFA's 2011 audit began in early May and fieldwork was completed in months. The audit team comprised of a team manager, two field supervisors, and three staff auditors.[154] NFA auditors chose to perform 10 modules (Net Capital, Segregation, Registration, Bunches Orders, Records, Promotional Material, Cash, Supervision, NFA Fees and Anti-Money Laundering) and passed on 19 modules.[155] NFA

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[148] *Id.*
[149] Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries, 75 FR 55410 (September 10, 2010) (Final CFTC Retail Forex Rule).
[150] *Id.*
[151] CFTC Press Release dated August 30, 2010, "CFTC Releases Final Rules Regarding Forex Transactions." Available at http://www.cftc.gov/PressRoom/PressReleases/pr5883-10.
[152] NFA00012643-NFA00012665 (10-CEXM-613 Audit Planning and Scope Selection module).
[153] *Id.*
[154] NFA00012983-NFA00013017 (11-CEXM-239 Audit Planning and Scope Selection module).
[155] *Id.*

management stated that NFA auditors did not perform 4 modules (Commodity Pool Operator Disclosure Document, Commodity Trading Advisor Disclosure Document, Pool Reporting and Fund of Funds) because they pertained to Commodity Pool Operator/Commodity Trading Advisor operations, which were not applicable to PFG at the time; did not perform 2 modules (Seldom Seen Issues and Not-Doing-Business) because they were not applicable to PFG's operations; passed on 7 modules (Solicitation, Order Processing, Trading, Margins, Subsequent Review, Affiliates and Automated Order Routing) because they had been tested in prior audits with no material deficiencies; and passed on 6 other modules (Security Futures Product Notification, Security Futures Product Records, Security Futures Product Trading, Security Futures Product Promotional Material, Security Futures Product Supervision and Security Futures Product Margins) because PFG had very few Security Futures Product accounts.[156]

NFA auditors completed the Segregation module and, as such, traced balances from the firm's segregated statements to applicable records (PFG trial balances, balances on carrying broker statements, etc.) provided by PFG.[157] NFA auditors noted in the IC Summary module that PFG, "did not prepare or maintain daily segregation statements on a currency by currency basis."[158] NFA auditors also confirmed cash balances of certain PFG accounts with their respective banks.[159]

As explained in more detail in Section IV of this report, NFA auditors received conflicting confirmations from U.S. Bank during this audit. On Friday, May 13, 2011, NFA auditors received the confirmation form from U.S. Bank stating that PFG's customer segregated account held $7,181,336.36.[160] On Monday, May 16, 2011, NFA auditors received a "corrected" U.S. Bank confirmation form with the customer segregated account balance adjusted to $218,650,550.96.[161] After the "corrected" balance was received, the NFA auditors did not take any further steps to determine the reason for such a large correction, and as a result, no material deficiencies were noted with regard to the confirmation of the balance in the U.S. Bank customer segregated account.

At the conclusion of the audit, the following deficiencies were identified in a letter from NFA to PFG dated September 26, 2011:[162]

1) NFA fees were improperly applied to customers;
2) PFG submitted inaccurate Forex Weekly reports to NFA;
3) Procedures were not followed to ensure that the individuals or entities that the firm conducts business with are properly registered;
4) PFG failed to prepare its daily segregation statements on a currency-by-currency basis; and

[156] See NFA management statements at Appendix D.
[157] NFA00013080-NFA00013082 (11-CEXM-239 Segregation module).
[158] NFA00012926 (11-CEXM-239 IC Summary module).
[159] NFA00012930-NFA00012936 (11-CEXM-239 Net Capital module).
[160] 2NFA00122082-2NFA00122083 (11-CEXM-239 3rd Party Bank Confirmation).
[161] 2NFA00122084-2NFA00122086 (11-CEXM-239 3rd Party Bank Confirmation).
[162] NFA03136527-NFA03136529 (11-CEXM-239 NFA Audit Findings Letter).

5) PFG promotional material included hypothetical performance results without disclosing the material assumptions made in arriving at the hypothetical performance.

As indicated in NFA's September 26, 2011 letter, PFG corrected items 3) through 5), and NFA asked PFG to provide a written response for items 1) and 2).[163] On October 13, 2011, PFG responded to NFA stating that corrective actions had been taken to resolve items 1) and 2).[164]

xviii. 2011 NFA Post-MF Global Audit (11-CEXM-853)

In response to the MF Global bankruptcy on October 31, 2011, NFA conducted a limited audit of PFG on November 1, 2011, and fieldwork was completed in 1 day.[165] The audit team was comprised of a manager and a field supervisor. NFA auditors identified PFG accounts with MF Global and the impact the bankruptcy would have on PFG's excess segregated funds and excess net capital.[166] PFG had one account at MF Global, which was an omnibus account in the amount of $5,373.79.[167] NFA auditors noted, "As the firm is well capitalized and the balance at MFG [MF Global] will not affect either the segregated funds or net capital requirements, NFA will pass on further review."[168]

xix. 2011 NFA Second Post-MF Global Audit (11-CEXM-939)

Later in November, NFA conducted an additional focused, but limited, review of PFG during 2011 at the request of the CFTC. The CFTC described the review as "a coordinated review with the CME and NFA of all FCMs that carried customer funds to assess compliance with the protection of customer funds and Commission regulations."[169] The CFTC further stated that "[t]he limited reviews relied to a great extent on the records and third-party source documents maintained at the FCMs. Staff did not confirm balances directly with depositories or other entities holding customer funds."[170]

The audit team was comprised of two managers, two field supervisors and four staff auditors and began in late November 2011.[171] According to the Audit Planning and Scope Selection document for the audit, the audit was limited in scope as follows: [172]

> . . . . Unless testing warrants, NFA will solely be completing Step 1 of the Segregation module for the purposes of its review. Due to the nature of the review NFA will not be issuing a formal audit report. If any deficiencies were discovered during the review, they have been discussed with the firm and appropriate corrective action has been obtained . . . .

[163] *Id.*
[164] NFA00018622 (11-CEXM-239 PFG Response to NFA Findings).
[165] NFA00013883-NFA00013884 (11-CEXM-853 Audit Planning and Scope Selection module).
[166] NFA00013883 (11-CEXM-853 Audit Planning and Scope Selection module).
[167] *Id.*
[168] *Id.*
[169] http://www.cftc.gov/PressRoom/PressReleases/pr6171-12.
[170] *Id.*
[171] NFA00013984-NFA00013985 (11-CEXM-939 Audit Planning and Scope Selection module).
[172] NFA00013984 (11-CEXM-939 Audit Planning and Scope module).

NFA auditors interviewed PFG regarding its internal controls related to segregated accounts and concluded the following: [173]

> . . . NFA noted that PFG solely withdraws segregated funds through its JP Morgan Chase segregated accounts . . . .
>
> . . . . PFG has multiple internal controls that check and record the movement of segregated funds. All money movement must go through multiple levels of review and approval . . . Further, all customer withdrawals are verified with the customer over the phone prior to the initiation of the withdrawal. PFG also maintains copies of all emails, check requests, wire requests, transfer requests, margin wires and copies of check deposits which are compiled by Josh Gates, Shannon Marsh, Jenni Hashman, or Cody Banks. Further, PFG stated that the daily computation of excess segregation also provides an overall review of the movement of segregated funds for any errors or imbalances. Lastly, NFA noted that any withdrawal of $100,000 or must be approved by Russell Wasendorf Jr.

The audit documentation did not indicate that NFA auditors conducted further testing to verify the efficacy of such internal controls.

As a result of the audit, NFA auditors noted an understatement in PFG's excess segregated funds in the amount of $183,342.89. The understatement was a result of data entry errors, an omission of a T-bill, and warehouse receipt rate adjustments; but noted that these adjustments were immaterial based on the amount of segregated funds in the account.[174] NFA's 2011 Post-MF Global review into PFG's segregated accounts concluded that there were no material issues.[175]

xx. 2012 NFA Audit (12-CEXM-299)

NFA's 2012 audit of PFG began in June. The audit team comprised of a team manager, three field supervisors, and three staff auditors.[176] NFA auditors chose to perform 16 modules (Net Capital, Segregation, Registration, Solicitation, Bunches Orders, Records, Order Processing, Trading, Promotional Material, Cash, Supervision, Margins, Subsequent Review, Automated Order Routing, Anti-Money Laundering, and Business Continuity/Disaster Recovery) and pass on 16 modules.[177] NFA management stated that NFA auditors did not perform 6 modules (Commodity Pool Operator Disclosure Document, Commodity Trading Advisor Disclosure Document, Pool Reporting, Fund of Funds, 4.7 Disclosure Commodity Trading Advisor and 4.7 Disclosure Commodity Pool Operator) because they pertained to Commodity Pool Operator/Commodity Trading Advisor operations, which were not applicable to PFG at

[173] NFA00014103 (11-CEXM-939 Supporting Documentation–Internal Controls).
[174] NFA00014006-NFA00014018 (11-CEXM-939 Segregation module).
[175] *Id.*
[176] NFA00081797-NFA00081798 (12-CEXM-299 Audit Planning and Scope Selection module).
[177] NFA00081797-NFA00081830 (12-CEXM-299 Audit Planning and Scope Selection module).

the time; did not perform 2 modules (Seldom Seen Issues and Not-Doing-Business) because they were not applicable to PFG's operations; passed on 1 module (NFA Fees) because it had been tested in prior audits with no material deficiencies; passed on 1 module (Affiliates) because PFG had no current receivables from affiliates; and passed on 6 other modules (Security Futures Product Notification, Security Futures Product Records, Security Futures Product Trading, Security Futures Product Promotional Material, Security Futures Product Supervision and Security Futures Product Margins) because PFG had very few Security Futures Product accounts.[178]

NFA auditors completed the Segregation module and as such, traced balances from the firm's segregated statements to applicable records (PFG trial balances, balances on carrying broker statements, etc.) provided by PFG.[179] NFA's documentation in the Segregation module shows PFG "passed" or "appeared reasonable" in all completed steps of the review.[180]

In the Net Capital module, NFA auditors assessed PFG as a high control risk because, "the firm manually inputs balances from accounting software into excel" and its use of "a 1-person CPA firm to conduct an annual audit."[181] In addition, NFA auditors documented that PFG had recurring problems with improper reporting/classification of receivables and debits/deficits.[182]

For the first time, NFA auditors used an online electronic confirmation process via confirmation.com to conduct third-party confirmations with banks holding PFG cash balances, including U.S. Bank. NFA auditors requested the balances of PFG's segregated bank accounts as of April 30, 2012.[183] On July 2, 2012, NFA auditors requested an electronic signature from Wasendorf through confirmation.com.[184] On July 8, 2012, Wasendorf affirmatively responded to the electronic request to confirm the balances.[185] When Wasendorf clicked on the button authorizing the balance, the system automatically sent the balance request to U.S. Bank. U.S. Bank then filled out the amount of the balance on July 9, 2012 at 10:48 a.m.[186]

Wasendorf attempted suicide before the confirmations were returned from the banks.[187] The third party bank confirmation showed that the 845 Account held approximately $5 million. PFG bank statements filed with the NFA showed a balance of $223,811,055.39.[188] These facts suggested that

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[178] See NFA management statements at Appendix D.
[179] NFA00082876-NFA00082893 (12-CEXM-299 Segregation module).
[180] *Id*.
[181] NFA00081704 (12-CEXM-299 Net Capital module).
[182] NFA00081704-NFA00081705 (12-CEXM-299 Net Capital module).
[183] Tr. of Current Auditor no. 12 at 121:15-122:13.
[184] *Id.* at 122:2-6.
[185] *Id.* at 122:11-13.
[186] *Id.* at 122:20-23.
[187] *Id.* at 123:3-6.
[188] NFA00082835-NFA00082836 (12-CEXM-299 Segregated Bank Statements); Holden, Denise (July 10, 2012). "Narrative for 0232217 – Peregrine Financial Group Inc." The National Futures Association.

Wasendorf had potentially misappropriated money from the customer segregated accounts and covered his actions by falsifying bank statements.[189]

On July 9, 2012, PFG's Board of Directors drafted a resolution seeking protection under Chapter 7 of U.S. bankruptcy laws.[190] The same day, NFA issued a notice of MRA against PFG which temporarily ceased its operations and froze its assets.[191] On July 10, 2012, the CFTC issued a formal complaint that alleged fraud, misappropriation of customer funds, violation of customer segregated fund laws, and making false statements against both Wasendorf and PFG.[192]

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[189] Holden, Denise. (July 10, 2012). "Narrative for 0232217 – Peregrine Financial Group Inc." The National Futures Association.

[190] United States Bankruptcy Court Filing, Northern District of Illinois (July 10, 2012). Peregrine Financial Group, Inc. Bankruptcy Filing; Resolution of the Board of Directors (July 9, 2012). Peregrine Financial Group Resolution to file for Bankruptcy.

[191] Member Responsibility Action (July 9, 2012). National Futures Association.

[192] CFTC v. PFG Complaint for Injunctive and Other Equitable Relief and Civil Monetary Penalties Under the Commodity Exchange Act. (July 10, 2012).

APPENDIX C
Overview of NFA Audit Modules

Introduction

NFA management stated that NFA's examinations are conducted pursuant to a number of audit modules that are developed in conjunction with JAC and submitted annually to the CFTC for its review. Each module addresses a specific area of regulatory compliance. Over the years, the number of modules in the Futures Commission Merchant audit program has ranged from 18 to the current 25. NFA management identified the current modules by the following topics:

Net Capital	Segregation
Registration issues	Solicitation of customers
Block Orders	Record keeping regarding customer accounts
Customer orders	Noncustomer trading/discretionary accounts
Promotional material	Cash transactions
Supervision	Margins
Subsequent events	Transactions with affiliates
NFA fees	Anti-Money laundering
Automated Order Routing	Security Futures Products (6 modules)
Seldom Seen Issues (e.g., deliveries, inventory)	Disaster Recovery

The remainder of this appendix contains a brief description of the modules reviewed by the BRG Investigative Team.

Net Capital

The purpose of the Net Capital module is to test the firm's books and records to ensure that it is properly classifying and calculating its capital.[1] This module is one of the most comprehensive modules in the audit process, containing twelve sections: cash, securities, debits/deficits, other receivables and advances, additional assets, bank loans, accounts payable, subordinated liabilities, owner's equity, monthly net capital computations, charges/haircuts and forex dealer member.[2] The most notable sections of the module include the Cash, Securities, and Owner's Equity sections. The main objectives are to ensure the firm is properly computing its net capital requirements in accordance with the CFTC and NFA regulations, that all current assets are properly stated and classified in accordance with the CFTC regulations, and that the firm is preparing and maintaining all required financial records.[3]

The Cash section is particularly important because it includes steps to identify all of the firm's bank accounts.[4] This section also includes consideration for confirmation of cash balances directly from the bank, ". . . to ensure that the firm did not falsify a bank statement."[5] In this step, NFA auditors will send the Standard Form to Confirm Accounts Balances to the banks with the appropriate account numbers

[1] 2NFA00004493 (The New Auditor Handbook, The Audit Process, 2012).
[2] 2NFA00005782-2NFA00005805 (The New Auditor Handbook, Net Capital Module, 2004).
[3] 2NFA00005791 (The New Auditor Handbook, Net Capital, 2004).
[4] 2NFA00005784 (The New Auditor Handbook, Net Capital, 2004).
[5] 2NFA00005785 (The New Auditor Handbook, Net Capital, 2004).

already provided on the form.[6] It is the bank's responsibility to fill in the accurate balances for the accounts listed and return the completed document to NFA.[7]

The Securities section identifies investments held by customers of the firm and the firms, including reverse repurchase ("repo") agreements.[8] In this section of the module, auditors confirm that the repo agreement is accurately reflected by the firm[9] and that the proper accounting procedures are utilized.[10] NFA auditors can also elect to have the repo agreement confirmed with the bank, or other party, to ensure that the terms of the repo agreement provided by the firm are accurate and complete.[11]

The Owner's Equity section contains a step to ensure that there have been no material changes in the firm's capital balances. The auditor reviews the last certified financial statement and compares it to the balance as of the audit date. If there are material changes, the auditor will discuss these changes with firm personnel.[12]

Segregation

Consistent with CFTC Rule 1.20, the Segregation module is used to ensure that Futures Commission Merchants have sufficient funds in a segregated account to meet all obligations to customers and that those Futures Commission Merchants prepare a segregation statement for all segregated accounts.[13] Consistent with CFTC Regulation 30.7, the Segregation module also is used to ensure that Futures Commission Merchants who accept money, securities, or property from U.S. customers maintain in a separate account or accounts such money, securities, and property in an amount at least sufficient to cover or satisfy all of its current obligations to those customers.[14]

While conducting its review for compliance with CFTC Rules 1.20 and 30.7, NFA auditors examine the firm's segregated statements, as of the exam date, and identify the balances in the firm's segregated and secured bank accounts.[15] NFA auditors conduct a review to ensure that customer, non-customer, domestic and foreign omnibus accounts are properly identified; and also review segregation acknowledgements and disclosures from the firm identifying any new depositories that hold customer funds/securities.[16] NFA auditors typically select a sample of the firm's daily segregation statements and

[6] NFA00008677 (Standard form to Confirm Account).
[7] NFA00008683 (Standard form to Confirm Account).
[8] 2NFA00005786-2NFA00005790 (The New Auditors Handbook, Net Capital, 2004).
[9] 2NFA00005789 (The New Auditors Handbook, Net Capital, 2004).
[10] 2NFA00005787-2NFA00005789 (The New Auditors Handbook, Net Capital, 2004).
[11] 2NFA00005789-2NFA00005790 (The New Auditors Handbook, Net Capital, 2004).
[12] 2NFA00005800 (The New Auditor Handbook, Net Capital, 2004).
[13] CFTC Rule 1.20 (Customer Funds to be Segregated and Separately Accounted).
[14] CFTC Rule 30.7 (Treatment of foreign futures or foreign options).
[15] 2NFA00006482-2NFA00006483 (Resource Module, Segregation Instructions, 2007).
[16] 2NFA00006486-2NFA00006487 (Resource Module, Segregation Instructions, 2007).

trace selected balances from those statements to appropriate firm records, which may include copies of bank statements provided to NFA auditors by the firm.[17]

Registration/Bylaw 1101

NFA Bylaw 1101 requires that "NFA members can only conduct business with other NFA members" and therefore, NFA auditors use the Registration module to determine whether the member's principals, APs, and Branch Office Managers are properly registered.[18] NFA auditors also verify that APs with discretionary authority meet the minimum experience requirement.[19] Records needed from the member to conduct the Registration module include articles of incorporation, stock ledgers, accounting records for capital accounts, subordinated loan agreements, minutes of board of directors meetings, cash receipts/disbursement journals, commission records, current equity run and customer account documents.[20]

Solicitation of Customers

The purpose of this module is to monitor member firm solicitations to ensure they are not misleading and are in compliance with NFA Rule 2-29.[21] NFA Rule 2-29 covers communications by members who solicit customers to trade on-exchange futures and options, and prohibits deceptive or misleading communications with the public.[22]

Record Keeping Regarding Customer Accounts ("Records")

The Records module is used to confirm that members obtain all required signed documents from customers before opening accounts, and that the member has established procedures to provide customers with additional risk disclosures, if necessary.[23]

Customer Orders

The CFTC and NFA require that each Futures Commission Merchant and Introducing Broker receiving customer orders immediately prepare a written record of the order which includes account identification, order number and appropriate timestamps. The purpose of this module is to prevent various forms of customer abuse, such as fraudulent allocation of trades, by providing an adequate audit trail that allows customer orders to be tracked at every step of the order processing system. NFA

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[17] 2NFA00006488 (Resource Module, Segregation Instructions, 2007).
[18] 2NFA00017774 (The New Auditor Handbook, Registration/Bylaw 1101, 2005); 2NFA00004552 (Instructors Guide, The Audit Process, 2005).
[19] 2NFA00004552 (Instructors Guide, The Audit Process, 2005).
[20] 2NFA00017775 (The New Auditor Handbook, Registration/Bylaw 1101, 2005).
[21] 2NFA00004552 (Instructors Guide, The Audit Process, 2005).
[22] National Futures Association. (September 2010). A Guide to NFA Compliance Rules 2-29 and 2-36. at 3 and at 8 http://www.nfa.futures.org/nfa-compliance/publication-library/compliance-rule-2-29.pdf.
[23] 2NFA00004552 (Instructors Guide, The Audit Process, 2005).

auditors review the firm's order tickets and discuss order procedures with the firm.[24] The auditor must also determine if the firm is giving account numbers at the time the order is placed for execution, test systems of Omnibus Futures Commission Merchants, and ensure large trader reports are accurate and being filed with NFA.[25]

Noncustomer Trading/Discretionary Account ("Trading")

The module makes sure members have controls in place to monitor non-customer and discretionary trading to ensure brokers are not committing unauthorized trading, or taking advantage of customers through misuse of non-customer and proprietary accounts.[26] The Trading module also includes a review of the calculation of the commission/equity ratio to ensure that discretionary accounts are not being over traded (i.e., "churned") for the sake of generating commissions.[27] The Trading module also examines the internal controls of the firm to prevent fraudulent or improper trading, determines if the firm is taking advantage of its customers, and reviews customer complaints regarding improper trading.[28]

Promotional Material

This module is used to ensure that industry members are compliant with NFA Compliance Rule 2-29 pertaining to promotional materials.[29] The firm's promotional materials are reviewed to determine that discussions of profits and risks are balanced, asserted statements are factually true, and any calculations are done in a method approved by the CFTC.[30] Promotional materials containing hypothetical performance calculations are also checked for appropriate disclaimers and disclosures.[31]

Cash Transactions

The Cash Transactions module, different from the Cash section of the Net Capital module, is used to investigate any unusual cash activity and confirm that cash transactions are properly recorded.[32] The module directs auditors to review trading and cash receipts for unusual activity as well as identify unusual transactions between the pool operator, its principals, employees and others pools.[33] Additionally, for Omnibus Futures Commission Merchants, auditors are instructed to determine that

[24] 2NFA00016425 (Instructors Guide, The Audit Process, 2005).
[25] *Id.*
[26] 2NFA00004403 (New Auditor Handbook, The Audit Process, 2005).
[27] 2NFA00018515 (The New Auditor's Handbook, Trading, 2008).
[28] *Id.*
[29] 2NFA00017071 (Resource Module Promotional Material).
[30] 2NFA00017074–2NFA00017075 (New Auditor Handbook, Sales Practice & Promotional Material-Checklist, 2005).
[31] 2NFA00017076 –2NFA00017077 (New Auditor Handbook, Sales Practice & Promotional Material-Checklist, 2005).
[32] 2NFA00004688 (Instructor's Guide – CASH).
[33] 2NFA00004689-2NFA00004690 (Instructor's Guide – CASH).

customer segregated funds are properly recorded.[34] For Introducing Brokers and fully disclosed Futures Commission Merchants, auditors take steps to ensure that the firm is not accepting money in its name and properly depositing it or forwarding it to its carrying broker.[35] NFA auditors review and document all bank statements, cash receipts and disbursement records, and monthly statements of the firm, principals, APs and affiliates.[36]

Supervision

The Supervision module is used to ensure NFA members are properly supervising their employees, Guaranteed Introducing Brokers, and commodity business operations. The Supervision module allows NFA auditors to determine if customer complaints are being investigated and resolved in a timely manner.[37] Further, NFA auditors investigate whether potentially misleading solicitations are being made by APs and how actively they are monitored.[38] NFA members are expected to have ethics training in place for new registrants as mandated by the NFA Compliance Rule 2-9.[39] Records obtained from members and reviewed by NFA auditors include audit programs and post-audit reports for on-site visits of branches and guaranteed Introducing Brokers, records/copies of all customer complaints received, and reports issued by other regulatory agencies.[40]

Margins

The CFTC and SEC have set minimum initial and maintenance margin levels for securities futures at 20% of the current market value of the positions. "Current market value" means the daily settlement price of the security future.[41] The Margins module tests firm's margin systems to ensure proper capital charges are taken and procedures to ensure margin calls are made in a timely fashion.[42] Auditors ensure that the firm's margin requirements are at least as high as Standard Portfolio Analysis of Risk Performance ("SPAN") requirements, margin calls are being made daily, proper firm procedures for under margined accounts exist, and that the firm is collecting the appropriate deposits for foreign currency and options.[43]

Transactions with Affiliates ("Affiliates")

The Affiliates module addresses risks associated with the financial position of Introducing Brokers and Futures Commission Merchants by conducting a review of the firm's transactions with its affiliates. The module is often completed by NFA auditors when the firm has a current receivable from an affiliated

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[34] 2NFA00004691 (Instructor's Guide – CASH).
[35] *Id.*
[36] 2NFA00004688 (Instructor's Guide – CASH).
[37] 2NFA00004552 (Instructors Guide, The Audit Process, 2005).
[38] 2NFA00018418 (Resource Module, Supervision, 2007).
[39] 2NFA00018419 (Resource Module, Supervision, 2007).
[40] 2NFA00018415 (Resource Module, Supervision, 2007).
[41] http://www.nfa.futures.org/nfa-compliance/publication-library/security-futures-products.pdf at 17.
[42] 2NFA00004493 (The New Auditor Handbook, The Audit Process, 2012).
[43] For example, see NFA00007752-NFA00007761 (09-CEXM-003 Margins module).

entity.[44] The module also analyzes whether firm expenses have been paid by an affiliate and evaluates the risks associated with proprietary trading by the firm and its affiliates.[45]

NFA Fees

The purpose of the NFA Fees module is to ensure that the firm is properly calculating the fees it owes to NFA.[46]

Automated Order Routing ("AOR")

The Automated Order Routing module is completed to ensure that a Member's Automated Order Routing system has risk parameters in place and to establish whether the member is knowledgeable of such system.[47] In addition, the NFA auditor determines if the AORS protects the reliability and confidentiality of customer orders throughout the order process.[48] Members are required to assign a capable employee to oversee the Automated Order Routing system process, maintain personnel and facilities for timely delivery of customer orders, handle customer complaints in a timely manner, and prevent customers from entering into trades that create undue financial risks for the member's other customers.[49]

Anti-Money Laundering ("AML")

The Anti-Money Laundering module seeks to test whether the Futures Commission Merchant's anti-money laundering procedures are in compliance with NFA rule 2-9(c) and applicable interpretive notices.[50] NFA members' Anti-Money Laundering programs "must include internal policies, procedures and controls; a designated compliance officer to oversee day-to-day operations of the program, an ongoing training program for employees, and an independent audit function to test the program."[51] NFA auditors will often look for members' internal Anti-Money Laundering programs to possess: customer identification program to screen customers, up-to-date Anti-Money Laundering procedures designed to detect suspicious activity, procedures for continual risk assessment of its customers with respect to Anti-Money Laundering and sound recordkeeping.[52] The primary focus of the Anti-Money Laundering module is on the review of customer funds and activity, rather than the activity of Futures Commission Merchant principals.[53]

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[44] 2NFA00002967 (Technical Roundtable Minutes, August 31, 2009).
[45] *Id.*
[46] 2NFA00004493 (The New Auditor Handbook, The Audit Process, 2012).
[47] 2NFA00004552 (Instructors Guide, The Audit Process, 2005).
[48] NFA00111553 (Automated Order Routing System instructions, 2011).
[49] NFA00111554-NFA00111555 (Automated Order Routing System instructions, 2011).
[50] 2NFA00004552 (Instructors Guide, The Audit Process, 2005).
[51] Interpretive Notice NFA Compliance Rule 2-9 at http://www.nfa.futures.org/nfamanual/NFAManual.aspx#45.
[52] *Id.*
[53] For example, see NFA00006200-NFA00006218 (Objectives and Procedures – Anti-Money Laundering).

APPENDIX C
Overview of NFA Audit Modules

Business Continuity and Disaster Recovery

The Business Continuity and Disaster Recovery module evaluates whether Futures Commission Merchants have established and maintained written procedures for business continuity and disaster recovery responses.[54] In addition, NFA auditors review its records to ensure that it is in possession of the proper emergency contact information for each firm.[55]

[54] NFA Compliance Rule 2-38 at http://www.nfa.futures.org/nfamanual/NFAManual.aspx?RuleID=RULE%202-38&Section=4.
[55] *Id.*

APPENDIX D
Supplemental Information on NFA's Compliance Department and Audit Function Provided by NFA Management

The following was provided to the BRG Investigative Team by NFA Management on January 9, 2013.

Organizational Chart and Staffing of Audit Function

(Attachment – Organizational Chart)

NFA's Compliance Department staff currently consists of 115 individuals in Chicago and 32 in New York. At the end of the month, we are adding 24 additional auditors who will attend a several week training class. We are also currently recruiting for 2 additional Audit Directors. All Compliance staff have a background in finance or accounting and 7% of the staff are CPAs. Additionally, 29% of the staff have been with NFA for at least 5 years while 18% have been here 10 years or longer. The vast majority of compliance staff who have been at NFA longer than one year have passed the Series 3 exam and approximately 4% have passed the Series 7 exam. In addition, 32 staff members have passed the Certified Fraud Examiner test.

Description of Audit Team Structure

Audits are staffed with an Audit Manager, Field Supervisor and staff level auditors (with the number of staff auditors varying based on the type of audit). Under the supervision of the Field Supervisor, audit staff performs the modules assigned to them and their work is reviewed on site by the Field Supervisor. For FCM audits, field work lasts an average of about 4 weeks. Typically, the Audit Manager spends the last week of field work on site to review the modules that have been completed and to conduct the exit interview with the firm. After field work, staff follows up on open items such as confirmations and remedial measures the firm has agreed to adopt.

The Compliance Department staff is not divided into groups that focus on audits of a particular membership category. All staff members work on a variety of audits because we have always believed it is important that all of our auditors have knowledge of each membership category. Although staff members work on audits of each membership category, we strive to have consistency at the Field Supervisor and/or Audit Manager level on a particular FCM's annual audit from year to year.

Scope of Yearly Audit Activity

NFA staff conducts approximately 600 audits each year. Audits of FCMs that hold customer funds, Forex Dealer Members (FDMs) and newly registered Independent IBs are required to be done within certain time periods based on CFTC and/or NFA internal requirements. Below is a summary of yearly audit priorities:

- FCM (that hold customer funds) Audits – NFA is the DSRO for 25 FCMs that hold customer funds. NFA audits these FCMs once a year.

- FDM Audits – NFA is the DSRO for 11 FDMs. FDMs act as the counterparty to retail forex transactions and hold customer funds. NFA audits these firms once a year.

- Newly Registered Independent IBs – NFA conducts an audit of newly registered independent IBs within the first six months of the IB's registration.

APPENDIX D
Supplemental Information on NFA's Compliance Department and Audit Function Provided by NFA Management

- The audits of all other Membership Categories are guided by our risk profile system (described below), which takes into consideration the length of time since a Member's last audit. We generally conduct about 350 of these audits yearly and these Members are generally audited every 3.5 years.

- Applicant Audits – Given the risks associated with FCMs, RFEDs, and IBs, particularly in the areas of segregation, net capital compliance, financial recordkeeping, and compliance with anti-money laundering and disaster recovery regulations, we conduct audits of these firms before their registration and membership is approved. We review the firm's financial records, obtain support to ensure that their balances are accurate, and review certain procedures, including the firm's AML and disaster recovery programs. We also conduct interviews of firm personnel to ensure that they have the expertise to operate a regulated entity. We generally conduct about 100 of these audits each year.

Description of Risk System: In 2009, NFA completed a three-year project to revamp our risk management program to identify high-risk Member firms. This risk system draws upon all information NFA currently has concerning Member firms to create individual risk profiles of Member firms. These profiles are based on different data points that are extracted from annual questionnaires, financial statements, quarterly pool filings, disclosure documents, investigations, audits, registration records, arbitration filings and disciplinary history. The risk management system not only tracks changes in any of the data, but also, based on relationships between the various data fields, ranks the Members based on their risk profiles. Additionally, the system uses a subset of the data and relationships to alert staff of issues requiring more immediate attention. For example, if one data point indicates a firm is not doing business but another shows that members of the public are seeking information on the firm from our BASIC system, the risk profile system will generate an alert for immediate follow up.

This enhanced risk management system is a useful tool, but it is not a substitute for human judgment in identifying suspicious patterns of activity that warrant closer examination. We have staff dedicated to monitoring the system on a daily basis and investigating any potentially unusual issues as soon as the system identifies them.

Below is a chart summarizing audit activity for the last three years:

	Seg. FCM	FDM	Other FCM	IB	CPO	CTA	Applicant	AML	Total
2010	19	31	7	161	88	162	113	2	583
2011	42	21	3	236	126	235	95	2	760
2012	37	12	6	130	121	168	126	4	604
Totals	98	64	16	527	335	565	334	8	1947

APPENDIX D
Supplemental Information on NFA's Compliance Department and Audit Function Provided by NFA Management

Management Review and Audit Sign-off

FCMs that hold customer funds and FDM audits are subject to the highest level of review. The entire audit is reviewed by a Field Supervisor and an Audit Manager. In addition, one of the Audit Directors reviews the Planning, Net Capital and Segregation modules and the final audit report before it is issued. In addition, the CFTC receives copies of all audit reports issued to these Members.

The Audit Director is also involved in the planning of the audits of FCMs and FDMs. Prior to these examinations, the Audit Director, Audit Manager and Field Supervisor assigned to the examination meet to discuss a range of topics, including the firm, its operations, prior examination results, the firm's financial statements, prior investigations, customer complaints and arbitration cases. That group then decides which audit modules to perform and the extent of testing in each. Once in the field, those decisions are subject to change based on the results of the current exam. The planning meeting also considers whether any staffing changes should be made based on specific areas of concern about the firm or the anticipated complexity of the exam.

For all other Membership categories, the entire audit is reviewed by a Field Supervisor and an Audit Manager. The audit may also be reviewed by a Senior Audit Manager, an Associate Audit Director or an Audit Director depending on the complexity of the audit or the problems uncovered. The final audit report is reviewed by a Senior Audit Manager, an Associate Audit Director or an Audit Director before it is issued. The Audit Director is often involved in the planning of these audits as well.

Audit Evaluation Process

NFA's audit modules are regularly reviewed both externally and internally. NFA participates in Joint Audit Committee meetings with the other SROs and the CFTC. Discussions at these meetings include new rules/interpretations, concerns and updates in audit processes. Once a year, these JAC meetings include a comprehensive review of the JAC audit modules and any changes to those modules. On annual basis, the CFTC receives copies of all modules, which incorporate any updates or changes to the modules during the previous year.

Additionally, all members of NFA's audit staff continuously review NFA's audit processes and modules for improvements and communicate their ideas to Compliance management at the weekly management meetings or to a member of NFA staff's audit module committee. The audit module committee is made up of an Audit Director and at least two Audit Managers including at least one of NFA's JAC representatives. At the end of each quarter, NFA's audit module committee formally updates NFA's modules and communicates these module changes and any audit policy changes through an "Audit Issues Memo" to the department. These memos are also maintained on our internal portal site along with a log of each issue for use by existing and newly hired staff. Changes are incorporated into the department's training materials. If a rule change or material policy change takes effect at an interim period, the audit module committee will effect an immediate change and communicate through a special issue of the Audit Issues Memo and training session, as appropriate. On an annual basis, NFA sends the CFTC copies of all modules, which incorporate any updates or changes to the modules during the previous year.

Audit Module Selection for PFG Audits

NFA completed the planning module in addition to the specific modules listed as completed in each audit.

1996 Audit – NFA completed 12 modules (net capital, segregation, registration, solicitation, bunched orders, records, trading, promotional material, cash, supervision, margins and subsequent review) in the 1996 audit, and passed on 6 other modules. NFA did not perform 3 of the modules (pool reporting, CPO disclosure document and CTA disclosure document) because they pertained to CPO/CTA operations, which were not applicable to PFG at the time; did not perform seldom seen issues module (which covers topics such as deliveries, warehouse receipts and inventory) because it was not applicable to PFG's operations; and passed on 2 modules (orders and affiliates) because they had been tested in prior audits with no material deficiencies.

1997 Audit – NFA completed 10 modules (net capital, segregation, registration, solicitation, bunched orders, promotional material, cash, supervision, subsequent review and NFA fees) and passed on 9 other modules. NFA did not perform 3 of the modules (pool reporting, CPO disclosure document and CTA disclosure document) because they pertained to CPO/CTA operations, which were not applicable to PFG at the time; did not perform another module (seldom seen issues) because it was not applicable to PFG's operations; and passed on 5 modules (records, orders, trading, margins and affiliates) because they had been tested in recent prior audits with no material deficiencies.

1998 Audit – NFA completed 14 modules (net capital, segregation, registration, solicitation, records, orders, trading, promotional material, cash, supervision, margins, CPO DD, subsequent review and affiliates) and passed on 5 other modules. NFA did not perform 2 of the modules (pool reporting and CTA disclosure document) because they pertained to CPO/CTA operations, which were not applicable to PFG at the time; did not perform another module (seldom seen issues) because it was not applicable to PFG's operations; and passed on 2 modules (bunched orders and NFA fees) because they had been tested in recent prior audits with no material deficiencies.

1999 Audit – NFA completed 11 modules (net capital, segregation, registration, solicitation, bunched orders, trading, promotional material, cash, supervision, subsequent review and affiliates) and passed on other 8 modules that year. NFA did not perform 3 of the modules (pool reporting, CPO disclosure document and CTA disclosure document) because they pertained to CPO/CTA operations, which were not applicable to PFG at the time; did not perform another module (seldom seen issues) because it was not applicable to PFG's operations; and passed on 4 modules (records, orders, margins and NFA fees) because they had been tested in recent prior audits with no material deficiencies.

2000 Audit – NFA completed 13 modules (net capital, segregation, registration, bunched orders, orders, trading, promotional material, cash, supervision, margins, subsequent review, affiliates and AORS) and passed on 7 other modules. NFA did not perform 3 of the modules (pool reporting, CPO disclosure document and CTA disclosure document) because they pertained to CPO/CTA operations, which were not applicable to PFG at the time; did not perform another module (seldom seen issues) because it was not applicable to PFG's operations; and passed on 3 modules (solicitation, records and NFA fees) because they had been tested in recent prior audits with no material deficiencies.

2001 Audit – NFA completed 14 modules (net capital, segregation, registration, bunched orders, orders, trading, promotional material, cash, supervision, margins, subsequent review, affiliates and AORS) and passed on 6 other modules. NFA did not perform 3 of the modules (pool reporting, CPO disclosure document and CTA disclosure document) because they pertained to CPO/CTA operations, which were not applicable to PFG at the time; did not perform another module (seldom seen issues) because it was not applicable to PFG's operations; and passed on 2 modules (solicitation and orders because they had been tested in recent prior audits with no material deficiencies.

2002 Audit – NFA completed 10 modules (net capital, segregation, registration, solicitation, promotional material, cash, supervision, margins, subsequent review and AML) and passed on 11 other modules. NFA did not perform 3 of the modules (pool reporting, CPO disclosure document and CTA disclosure document) because they pertained to CPO/CTA operations, which were not applicable to PFG at the time; did not perform another module (seldom seen issues) because it was not applicable to PFG's operations; and passed on 7 modules (bunched orders, records, orders, trading, affiliates, NFA fees and Automated Order Routing Systems(AORS)) because they had been tested in recent prior audits with no material deficiencies.

2003 Audit – NFA completed 15 modules (net capital, segregation, registration, orders, promotional material, cash, supervision, affiliates, AML, Security Futures Products ("SFP") notification, SFP records, SFP trading, SFP promotional material, SFP supervision and SFP margins) and passed on 12 other modules in 2003. NFA did not perform 3 of the modules (pool reporting, CPO disclosure document and CTA disclosure document) because they pertained to CPO/CTA operations, which were not applicable to PFG at the time; did not perform another module (seldom seen issues) because it was not applicable to PFG's operations; and passed on 8 modules (solicitation, bunched orders, records, trading, margins, subsequent review, NFA fees and AORS) because they had been tested in recent prior audits with no material deficiencies.

2004 Audit – NFA completed 21 modules (net capital, segregation, registration, bunched orders, records, trading, promotional material, cash, supervision, CPO DD, pool reporting, subsequent review, NFA fees, AORS, AML, SFP notification, SFP records, SFP trading, SFP promotional material, SFP supervision and SFP margins)during its audit and passed on 6 other modules. NFA did not perform 1 module (CTA disclosure document) because it pertained to CTA operations, which was not applicable to PFG at the time; did not perform another module (seldom seen issues) because it was not applicable to PFG's operations; and passed on 4 modules (solicitation, orders, margins and affiliates) because they had been tested in recent prior audits with no material deficiencies.

2005 Audit – NFA completed 10 modules (net capital, segregation, registration, records, orders, promotional material, cash, supervision, margins and subsequent review) and passed on 17 other modules.

NFA did not perform 1 module (CTA disclosure document) because it pertained to CTA operations, which was not applicable to PFG at the time; did not perform another module (seldom seen issues) because it was not applicable to PFG's operations; and passed on 9 modules (solicitation, bunched orders, trading, CPO disclosure document, pool reporting, affiliates, NFA fees, AORS and AML) because they had been tested in recent prior audits with no material deficiencies; and passed on 6 other modules (Security Futures Products ("SFP") notification, SFP records, SFP trading, SFP promotional material, SFP supervision and SFP margins) because PFG had very few SFP accounts.

2006 Audit – NFA completed 13 modules (net capital, segregation, registration, solicitation, records, orders, promotional material, cash, supervision, CPO DD, pool reporting, subsequent review and AML) and passed on 14 other modules. NFA did not perform 1 module (CTA disclosure document) because it pertained to CTA operations, which was not applicable to PFG at the time; did not perform another module (seldom seen issues) because it was not applicable to PFG's operations; and passed on 6 modules (bunched orders, trading, margins, affiliates, NFA fees and AORS) because they had been tested in recent prior audits with no material deficiencies; and passed on 6 other modules (SFP notification, SFP records, SFP trading, SFP promotional material, SFP supervision and SFP margins) because PFG had very few SFP accounts.

2008 Audit – NFA completed 12 modules (net capital, segregation, bunched orders, trading, promotional material, cash, supervision, pool reporting, subsequent review, NFA fees, AORS and AML) and passed on 16 other modules. NFA did not perform 1 module (CTA disclosure document) because it pertained to CTA operations, which was not applicable to PFG at the time; did not perform2 modules (seldom seen issues and not-doing-business) because they were not applicable to PFG's operations; and passed on 7 modules (registration, solicitation, records, orders, margins, CPO disclosure document and affiliates) because they had been tested in recent prior audits with no material deficiencies; and passed on 6 other modules (SFP notification, SFP records, SFP trading, SFP promotional material, SFP supervision and SFP margins) because PFG had very few SFP accounts.

2009 Audit – NFA completed 11 modules (net capital, segregation, solicitation, trading, promotional material, cash, supervision, margins, pool reporting, AORS and AML) and passed on 17 other modules. NFA did not perform 1 module (CTA disclosure document) because it pertained to CTA operations, which was not applicable to PFG at the time; did not perform 3 modules (bunched orders, seldom seen issues and not-doing-business) because they were not applicable to PFG's operations; and passed on 7 modules (registration, records, orders, CPO disclosure document, subsequent review, affiliates and NFA fees) because they had been tested in recent prior audits with no material deficiencies; and passed on 6 other modules (SFP notification, SFP records, SFP trading, SFP promotional material, SFP supervision and SFP margins) because PFG had very few SFP accounts.

2010 Audit – NFA completed 10 modules (net capital, segregation, registration, orders, promotional material, cash, supervision, NFA fees, AORS and AML) and passed on 19 other modules. NFA did not perform 4 modules (CPO disclosure document, CTA disclosure document, pool reporting and fund of funds) because they pertained to CPO/CTA operations, which were not applicable to PFG at the time; did not perform 3 modules (bunched orders, seldom seen issues and not-doing-business) because they were not applicable to PFG's operations; passed on 6 modules (solicitation, records, trading, margins, subsequent review and affiliates) because they had been tested in recent prior audits with no material deficiencies; and passed on 6 other modules (SFP notification, SFP records, SFP trading, SFP promotional material, SFP supervision and SFP margins) because PFG had very few SFP accounts.

2011 Audit – NFA completed 10 modules (net capital, segregation, registration, bunched orders, records, promotional material, cash, supervision, NFA fees and AML) and passed on 19 other modules. NFA did not perform 4 modules (CPO disclosure document, CTA disclosure document, pool reporting and fund of funds) because they pertained to CPO/CTA operations, which were not applicable to PFG at the time; did not perform 2 modules (seldom seen issues and not-doing-business) because they were not applicable to PFG's operations; passed on 7 modules (solicitation, orders, trading, margins, subsequent review, affiliates and AORS) because they had been tested in recent prior audits with no material deficiencies; and passed on 6 other modules (SFP notification, SFP records, SFP trading, SFP promotional material, SFP supervision and SFP margins) because PFG had very few SFP accounts.

2012 Audit – NFA completed 16 modules (net capital, segregation, registration, solicitation, bunched orders, records, orders, trading, promotional material, cash, supervision, margins, subsequent review, AORS, AML and business continuity/disaster recovery) and passed on 16 other modules. NFA did not perform 6 modules (CPO disclosure document, CTA disclosure document, pool reporting, fund of funds, 4.7 disclosure CTA and 4.7 disclosure CPO) because they pertained to CPO/CTA operations, which were not applicable to PFG at the time; did not perform 2 modules (seldom seen issues and not-doing-business) because they were not applicable to PFG's operations; passed on 1 module (NFA fees) because it had been tested in recent prior audits with no material deficiencies; passed on 1 module (affiliates) because PFG had no current receivables from affiliates; and passed on 6 other modules (SFP notification, SFP records, SFP trading, SFP promotional material, SFP supervision and SFP margins) because PFG had very few SFP accounts.

(caw: Special Committee_Audit Summary Information)

APPENDIX E
Summary of Selected NFA Auditor Notes and Actions Taken in Net Capital Modules

Exam #	Owner's Equity Section Completed?	Securities Section Completed?	NFA Notes About Repo Investment	Obtained Repo?	Confirmed Repo?	Tested Market Value for Repo?	3rd Party Cash Balance Confirmations Sent?	3rd Party Cash Balance Confirmation Sent to U.S. Bank?
95-CEXM-455	N/A[1]	N/A[1]	N/A	N/A	N/A	N/A	N/A	N/A
96-CEXM-431	Yes	Yes	T-Bills	Yes	No	Yes	No	No
97-CEXM-628	Yes	Yes	T-Bills	Yes	No	Yes	No	No
98-CEXM-393	Yes	Yes	T-Bills	No	No	Yes	No	No
99-CEXM-370	Yes	Yes	T-Bills	No	No	Yes	No	No
00-CEXM-341	Yes	Yes	No Reference	Yes	No	Yes	No	No
01-CEXM-420	Yes	Yes	No Reference	Yes	No	No	No	No
02-CEXM-306	Yes	No	No Reference	No	No	No	No	No
03-CEXM-519	Yes	No	T-Notes[2]	No	No	No	Yes	Yes
04-CEXM-544	Yes	No	No Reference	No	No	No	No	No
05-CEXM-716	Yes	No	No Reference	No	No	No	Yes	No
06-CEXM-521	Yes	No	No Reference	No	No	No	Yes	Yes
08-CEXM-016	Yes	No	T-Notes[3]	No	No	No	Yes	Yes
09-CEXM-003	Yes	Yes	T-Notes	Yes	No	No	Yes	Yes
10-CEXM-206	Yes	Yes	N/A[4]	N/A	N/A	N/A	Yes	Yes
11-CEXM-239	Yes	No	N/A[4]	N/A	N/A	N/A	Yes	Yes
12-CEXM-299	Yes	Yes	N/A[4]	N/A	N/A	N/A	Yes	Yes

BRG Investigative Team Notes:
[1] No corresponding section in 95-CEXM-455.
[2] See NFA00003500 (Field Supervisor Memorandum to Files, August 14th, 2003).
[3] See NFA00007421 (08-CEXM-016 Segregation worksheet).
[4] PFG discontinued the repo in June, 2009.
[5] NFA auditors obtained repo transaction confirmation.

APPENDIX E
Summary of Selected NFA Auditor Notes and Actions Taken in Net Capital Modules
Source Documents

Exam #	Module Source
95-CEXM-455	N/A
96-CEXM-431	NFA00000542-NFA00000552
97-CEXM-628	NFA00000693-NFA00000706
98-CEXM-393	NFA00000832-NFA00000849
99-CEXM-370	NFA00001071-NFA00001094
00-CEXM-341	NFA00001385-NFA00001405
01-CEXM-420	NFA00002251-NFA00002272
02-CEXM-306	NFA00002893-NFA00002902
03-CEXM-519	NFA00003360-NFA00003371
04-CEXM-544	NFA00004012-NFA00004025
05-CEXM-716	NFA00004432-NFA00004447
06-CEXM-521	NFA00005890-NFA00005906
08-CEXM-016	NFA00007338-NFA00007357
09-CEXM-003	NFA00007762-NFA00007855
10-CEXM-206	NFA00010577-NFA00010658
11-CEXM-239	NFA00012928-NFA00012977
12-CEXM-299	NFA00081704-NFA00081761

APPENDIX F

Summary of Selected NFA Auditor Notes and Actions Taken in Segregation Modules and Worksheets

Examination	Segregation Module Completed?	Segregation Worksheet Completed?	U.S. Bank Segregated Account Balance per PFG Segregation Statement	U.S. Bank Segregated Account Balance as Recorded by NFA Auditor	Repo Noted in Worksheet by NFA Auditor?	Amount of Repo
95-CEXM-455	Yes	Yes	$4,827,586	$4,827,586	- - Not Documented - -	
96-CEXM-431	Yes	Yes	$5,706,680	$5,706,680	No	$554,000 [1]
97-CEXM-628	Yes	Yes (Appendix G)	$8,487,831	$697,831	Yes	$7,790,000
98-CEXM-393	Yes	No	N/A	N/A	No	$9,190,000 [2]
99-CEXM-370	Yes	No	N/A	N/A	- - Not Documented - -	
00-CEXM-341	Yes	No	N/A	N/A	No	$30,750,806 [3]
01-CEXM-420	Yes	No	N/A	N/A	No	$37,109,395 [4]
02-CEXM-306	Yes	Yes (Appendix H)	$58,083,194	$5,133,194 [5]	Yes	$52,950,000
03-CEXM-519	Yes	Yes (Appendix I)	$63,924,578	$3,640,578 [6]	No	$60,284,000 [6]
04-CEXM-544	Yes	Yes (Appendix K)	$86,338,031	$86,338,031 [7]	- - Not Documented - -	[7]
05-CEXM-716	Yes	Yes (Appendix L)	$92,360,120	$2,360,120	Yes	$90,000,000
06-CEXM-521	Yes	No	$144,206,357 [8]	$56,357 [9]	No	$144,150,000 [8]
08-CEXM-016	Yes	Yes (Appendix M)	$136,067,600	$117,600	Yes	$135,950,000
09-CEXM-003	Yes	Yes (Appendix N)	$177,074,888	$123,800	Yes	$176,951,089
10-CEXM-206	Yes	Yes	$207,260,962	$207,266,962	No Repo	No Repo
11-CEXM-239	Yes	Yes	$218,650,551	$218,650,551	No Repo	No Repo
12-CEXM-299	Yes	Yes	$223,811,055	$223,811,055	No Repo	No Repo

BRG Investigative Team Notes:

[1] NFA auditors documented the repo amount in 96-CEXM-431 Net Capital Module (NFA00000546).

[2] NFA auditors documented the repo amount in 98-CEXM-393 Net Capital Module (NFA00000839).

[3] NFA auditors documented the repo amount in 00-CEXM-341 Net Capital Module (NFA00001394).

[4] NFA auditors documented the repo amount in 01-CEXM-420 Net Capital Module (NFA00002258).

[5] BRG modified this balance so that it excludes the amount of the repo.

[6] BRG modified this balance so that it excludes the amount of the "sweep account". NFA auditors noted this balance and reference a sweep account in the 03-CEXM-519 Cash Information worksheet, but did not note this balance or the sweep account in the segregation worksheet. NFA auditors also noted the U.S. Bank address to be located in Minnesota.

[7] BRG was unable to modify this balance to reflect the amount of the repo because the amount was not documented.

[8] Per NFA auditor handwritten notes in audit work files (NFA00005389, NFA00005391). For further discussion on this amount, see the Report of Investigation.

[9] See ending balance on the August 2006 Fabricated U.S. Bank Statement for the 845 account (NFA00005389).

APPENDIX F

Summary of Selected NFA Auditor Notes and Actions Taken in Segregation Modules and Worksheets

Source Documents

Examination	Module Source	Worksheet Source
95-CEXM-455	NFA00000228-NFA00000240	NFA00000368-NFA00000377 NFA00000049-NFA00000054
96-CEXM-431	NFA00000589-NFA00000591	NFA00000592-NFA00000596
97-CEXM-628	NFA00000728-NFA00000732	NFA00000737-NFA00000742
98-CEXM-393	NFA00000963-NFA00000967	N/A
99-CEXM-370	NFA00001189-NFA00001201	N/A
00-CEXM-341	NFA00001441-NFA00001453	N/A
01-CEXM-420	NFA00002342-NFA00002349	N/A
02-CEXM-306	NFA00002939-NFA00002947	NFA00002948-NFA00002957
03-CEXM-519	NFA00003446-NFA00003460	NFA00003451-NFA00003464
04-CEXM-544	NFA00004088-NFA00004092	NFA00004093-NFA00004107
05-CEXM-716	NFA00004661-NFA00004665	NFA00004666-NFA00004695
06-CEXM-521	NFA00006038-NFA00006046	N/A
08-CEXM-016	NFA00007412-NFA00007415	NFA00007416-NFA00007439
09-CEXM-003	NFA00007927-NFA00007955	NFA00010384-NFA00010402
10-CEXM-206	NFA00010951-NFA00010966	NFA00012540-NFA00012578
11-CEXM-239	NFA00013080-NFA00013095	NFA00013808-NFA00013852
12-CEXM-299	NFA00082876-NFA00082893	NFA00082894-NFA00082924

APPENDIX G
97-CEXM-628 Segregation Worksheet and NFA Auditor's Notes
Excerpt from: NFA00000740

General Note:
NFA mounted the firm's Daily Segregation Report worksheet on **S_seg**; however, NFA noted the worksheet is not identical to the Seg Stmt (1-FR) format. As a result, NFA noted the following amounts were grouped or itemized on the Seg Stmt:

Note 1:
Per **S_seg** and the firm prepared 8/31/97 bank reconciliations for the Harris Bank ("Harris") Customer Segregated account (Acct# 375-795-2) and the Firstar Bank ("Firstar") Segregated Funds account (Acct# 621011845), NFA noted Cash on the Seg Stmt is comprised of the following:

Per Firstar Bank acct:		wp reference
Balance per bank	$698,178.91	**S_REP A 1/3**
Outstanding checks	($176.39)	
adjust interest	($171.05)	
Subtotal	**$697,831.47**	
Per Harris Bank acct:		
Balance per bank	$289,040.29	*
Outstanding checks	($112,075.36)	
deposit in transit	$117,063.10	
Subtotal	**$294,028.03**	**S_seg 1/2**
Total	**$991,859.50**	

BRG Investigative Team Note:
To reconcile the difference between PFG and the bank statement balance for the Firstar segregated account, NFA auditors added the repo amount to the bank balance as follows:

Balance per PFG: $8,487,831
Balance per Bank: $697,831
Repo Amount: $7,790,000

$697,831 + $7,790,000 = $8,487,831

Note 2:
Per review of the 8/31/97 bank reconciliation for the Firstar Segregated Funds account, sweep repurchase agreement (**S_REP B**) and discussion with Rooks [PFG Compliance Personnel]on 10/21/97,
NFA noted the $7,790,000 represents a Sweep Repurchase Agreement.

APPENDIX H

02-CEXM-306 Segregation Worksheet and NFA Auditor's Note

Excerpt from: NFA00002953-NFA00002955

NOTE 3: FIRM'S 5/31/02 OTE AND CASH BALANCES Segregated Cash Balance (Bank Accounts)	Per Firm	W/P Reference	Per Bank Stmts	W/P Reference	Difference	Explanation/ Tickmark
Firstar Customer Seg Balance	$58,083,194	**SD-SEG-12, 1/3**	$58,075,194	**SD-SEG-12, 1/3**	($8,000)	**ggg**
Magic Valley Customer Seg Balance	$83,115	**SD-SEG-14, 1/2**	$83,115	**SD-SEG-14, 1/2**	$0	
American National Bank Customer Seg Balance	$3,259,023	**SD-SEG-13, 4/5**	$3,938,701	**SD-SED-13, 5/5**	$679,678	**ttt**
Subtotal	**$61,425,332**	**SD-SEG-1, 1/3 Line 7A**	**$62,097,010**		**$671,678**	
					1.08%	Immaterial difference

Note ggg:
Per review of the reconciliation for the Firstar Customer Seg Account (SD-SEG-12, 1/3), NFA noted a cash balance of $5,125,194. However, per review of the stmt, NFA noted that the firm entered into a repurchase agreement on 5/31/02, with a principal balance of $52,950,000. As such, NFA included this repurchase balance in the Firstar Customer Seg Balance.

BRG Investigative Team Notes:
The Firstar Customer Seg balance "per bank statement" reflects the added total of the cash balance of the seg account and the amount of the repo. This was noted by NFA auditors in note ggg in the segregation worksheet.

02-CEXM-306 is the first of three exams (also '03 & '04) where NFA auditors added the cash balance and repo amounts together to reflect the bank balance.

APPENDIX I
03-CEXM-519 Segregation Worksheet
Excerpt from: NFA00003456-NFA00003460

Table 3 - Seg - 6/30/03 OTE AND CASH BALANCES						
Segregated Cash Balances (Bank)	**Per Firm**	**W/P Reference**	**Per Bank Stmts**	**Difference**	**% Difference**	**W/P Reference**
US Bank Customer Seg (previously Firstar)	$63,924,578		$63,924,578	$ -		
Magic Valley Bank Customer Seg	$50,500		$50,500	$ -		
Bank of America Customer Seg	$717		$717	$ -		
Bank One Customer Seg	$2,372,997		$2,372,997	$ -		
First Premier Bank Customer Seg	$44,546		$44,546	$ -		
Subtotal	**$66,393,338**	**G.**	**$66,393,338**	$ -		

BRG Investigative Team Notes:
The U.S. Bank Customer Seg balance "per bank statement" reflects the added total of the cash balance of the seg account and the amount of the repo ($60,283,999). This was not noted by NFA auditors in the segregation worksheet. The repo amount was documented in the 03-CEXM-519 Cash Information worksheet.

03-CEXM-519 is the second of three exams (also '02 & '04) where NFA auditors added the cash balance and repo amounts together to reflect the balance.

APPENDIX J
03-CEXM-519 Cash Information Worksheet and NFA Auditor's Notes
Exerpt from: NFA00003272-NFA00003275

Segregated Accounts: Name	Account #	Reconcilied Balance as of 6/30/03	Bank Balance as of 6/30/03
Peregrine Financial Group, Inc. - **Bank One - Indianapolis, IN** (Formerly American National Bank House)	533 0355 265	2,372,997	2,909,180
Peregrine Financial Group, Inc. - **Magic Valley Bank - Twin Falls, ID**	1011669	50,500	50,500
Peregrine Financial Group, Inc. - **US Bank - St. Paul, MN**	621011845	63,924,578	3,640,578
Peregrine Financial Group, Inc. – **Bank of America - Chicago, IL**	8666109322	717	717
Peregrine Financial Group, Inc. - **First Premier - Sioux Falls, SD**	1701345338	44,546	44,546

Cash Balance reconciliations	66,393,338.14	
Cash Balance per Seg Statement	66,393,338.00	
Difference	0.14	
Cash Balance per bank statements		6,644,805

Non-Segregated Accounts Name	Account #	Reconcilied Balance as of 6/30/03	Bank Balance as of 6/30/03
Peregrine Financial Group, Inc. - **US Bank**	767467	17,207,643	17,208,976
Peregrine Financial Group, Inc. – **Bank One - Indianapolis, IN** (Formerly American National Bank) (House Payroll)	533 0355 257	27,150	74,749
Peregrine Financial Group Inc. **Lakeside Bank - Chicago, IL** (Operating Expenses)	01669059-00	-230,389	104,447
Jackson Financial Group Inc. – **Bank One - Indianapolis, IN**	533 0356 903	-59,209	5,003
Jackson Financial Group Inc. – **Bank One - Indianapolis, IN** Market Index Account	533 0356 911	1,178,407	1,178,407
Jackson Financial Group Inc. - **Fifth Third Bank - Elmhurst, IL**	7231260899	1,001,555	1,001,555

NFA Auditor Note:
This includes sweep account balance, see page 2 on the bank statement.

NFA Auditor Note:
This does not include the 6/30/03 Sweep.

BRG Investigative Team Note:
To Reconcile the difference between the firm and bank balances for the U.S. bank segregated account, NFA auditors added the repo amount to the bank balance as follows:

Balance per Firm: $63,924,578
Balance per Bank: $3,640,578
Repo Amount: $60,284,000

$3,640,587 + $60,284,000 = $63,924,587

BRG Investigative Team Note:
NFA auditors recorded a U.S. Bank address different from the U.S. Bank address to which they sent confirms. Also see Field Supervisor's memo dated August 14, 2003 (NFA00003498-NFA00003499).

BRG Investigative Team Note:
The following is stated in the Field Supervisor's memo dated August 14, 2003:

"O'Meara represented that the cash swept out each night is not maintained in a separate bank account but is part of the original account number."

APPENDIX K
04-CEXM-544 Segregation Worksheet
Excerpt from: NFA00004098-NFA00004102

Table 2 - Seg - Note B - 7/30/04 OTE AND CASH BALANCES						
Segregated Cash Balances (Bank)	**Per Firm**		**Per Bank Stmts**	**Difference**	**% Difference**	
US Bank/Firstar Bank #621011845	$86,338,031		$86,338,031	$ (0)	0%	
Bank One Customer Seg #5330355265	$4,895,263		$5,504,180	$ 608,917	11%	**Note A**
Bank of America Customer Seg #8666109322	$466		$466	$ -	0%	
First Premier Bank Customer Seg	$51,293		$51,293	$ -	0%	
Subtotal	**$91,285,054**	**G.**	**$91,893,970**	$ 608,917	1%	**Immaterial Difference**

BRG Investigative Team Notes:
BRG was unable to identify the amount of the repo because the amount was not documented.

The U.S. Bank/Firstar Bank balance "per bank statement" reflects the added total of the cash balance of the segregated account and the amount of the repo. This was not noted by NFA auditors in the segregation worksheet.

04-CEXM-544 is the third of three exams (also '02 & '03) where NFA auditors added the cash balance and repo amounts together to reflect the bank balance.

APPENDIX L
05-CEXM-716 Segregation Worksheet and NFA Auditor's Note
Excerpt from: NFA00004681

Table 2 - Seg, 8/31/05 OTE and Cash Balances						
Segregated Cash Balances (Bank)	**Per Firm**	**Reference**	**Per Bank Stmts**	**Difference**	**% Difference**	**Notes**
US Bank/(Previously First Star Bank #621011845)	$92,360,119.97		$2,360,120	-$90,000,000.00	-3813%	**Note 2**
Bank Of America #8666109322	$1,000.00		$1,000.00	$0.00	0%	-
First Premier #1701345338	$117,215.20		$177,991	$60,775.91	34%	**Note 3**
Bank One/JP Morgan #5330355365	$941,866.34		$1,385,754	$443,887.73	32%	**Note 4**
Subtotal:	**$93,420,202**	E	**$3,924,865**	**-$89,495,336.36**	**-2280%**	**Note 2,3,4**

Table 2 Notes:

Note 2: NFA obtained the Firm's 8/31/05 Bank Reconciliation and noted that the $90M difference is the amount swept into a separate, interest bearing bank account ("Sweep Account") every night and deposited back into the account every morning. Further, NFA noted the bank statement shows the appropriate deposit and withdrawal for each day.

Per discussion with Susan O'Meara on 1/10/06, NFA noted the firm has no separate bank account statement or account number for the sweep account to verify the amount coming in the account at night and out of the account in the morning. Further, O'Meara represented that this issue comes up year after year in NFA's Audits. Per review of the 2003 & 2004 PFG audit, NFA noted the Segregated Cash Balance per Firm and the balance per the Bank Statement have agreed. As such, the situation regarding a separate sweep account has been discussed but never recorded.

As such, O'Meara provided NFA with a copy of the Purchase/Repurchase agreement (and all addendum's) the firm made with Firstar Bank (which US Bank purchased and is now US Bank) on 12/12/94. Per review of the agreement, NFA noted this appears reasonable. As such, NFA will pass on further review.

BRG Investigative Team Note:
The $90 million difference between PFG's balance and the bank statement balance for the U.S. Bank segregated account is reconciled by the amount of the repo.

APPENDIX M
08-CEXM-016 Segregation Worksheet and NFA Auditor's Note
Excerpt from: NFA00007424-NFA00007426

Table 2 - Seg, 11/30/07 OTE and Cash Balances							
Segregated Cash Balances (Bank)	Per Firm	Reference	Per Bank Stmts	W/P Ref	Difference	% Difference	Table 2 Notes
US Bank #621011845	$136,067,600.11	^^	$117,600.11	*	-$135,950,000.00	-115604%	**Note 1**
Bank Of America #8666109322	$1,000.00	^^	$1,000.00	*	$0.00	0%	-
First Premier #1701345338	$137,225.39	^^	$137,225.39	*	$0.00	0%	-
Bank One/JP Morgan #5330355365	$3,781,598.37	^^	$5,065,981.74	*	$1,284,383.37	25%	**Note 2**
Wells Fargo/ANTC #415-9437490	$3,416.55	^^	$38,054.03	*	$34,637.48	91%	**Note 3**
Total Cash held at Bank:	**$139,990,840**	**E Seg Stmt Tab**	**$5,359,861**		-$134,630,979.15	-2512%	**Note 1,2,3**

Table 2 Notes:

Note 1: NFA obtained the Firm's 11/30/07 Bank Reconciliation and noted that the $136M difference is the amount swept into a reverse repo agreement that invests in US Treasury Notes ("Sweep Account") every night and deposited back into the account every morning. Further, NFA noted the bank statement shows the appropriate deposit and withdrawal for each day. NFA reviewed the repo agreement confirmation with a settlement date of 11/30/07 and the repurchase date of 12/3/07and noted that the cash was invested in US Treasury Notes. In addition, NFA noted no capital charge as the contract price of the reverse repurchase agreement is the same as the market value of the securities. Further, NFA sent a bank confirmation to US Bank regarding this account and confirmed the balance as of 11/30/07. See SD-SOURCE1 2/29.

NFA also obtained the reverse repo agreement between PFG and US Bank, noting no unusual items (SD-SEG14).

BRG Investigative Team Note:
The $136 million difference between PFG's balance and the bank statement balance for the U.S. Bank segregated account is reconciled by the amount of the repo.

APPENDIX N

09-CEXM-003 Segregation Worksheet and NFA Auditor's Note

Excerpt from: NFA00010389, NFA00010393-NFA00010395

Table 2 - Deposits in Segregated Funds Bank Accounts - SD-SEG2, General Note 4

Bank Account	S/D Reference	Balance Per Bank	S/D Reference	Balance Per Book	S/D Reference	Reconciliation	Notes
BOA PFG Customer Seg (#8666109322)	SD-SEG2 p. 1-2/18	$952.96	SD-SEG2 p. 1/18	$952.96	SD-SEG2 p. 2/18	$0.00	
First Premier Bank PFG Customer Seg (#1701345338)	SD-SEG2 p. 3-4/18	$85,376.43	SD-SEG2 p. 3/18	$85,376.43	SD-SEG2 p. 4/18	$0.00	
US Bank PFG Customer Seg (#62101845)	SD-SEG2 p. 5-8/18	$123,800.00	SD-SEG2 p. 5/18	$177,074,888.00	SD-SEG2 p. 8/18	-$176,951,088.00	Reverse Repo, Listed in 11-30-08 Seg Stmt Cell E27
JPMorgan Chase PFG Boss Customer Seg (#789868502)	SD-SEG2 p. 9-10/18	$254,829.16	SD-SEG2 p. 9/18	$254,829.16	SD-SEG2 p. 10/18	$0.00	
JPMorgan Chase PFG Customer Seg 2 (#78964816)	SD-SEG2 p. 11-12/18	$488.00	SD-SEG2 p. 11/18	$488.00	SD-SEG2 p. 12/18	$0.00	
JPMorgan Chase PFG Customer Seg (#5330355265)	SD-SEG2 p. 13-17/18	$10,753,075.51	SD-SEG2 p. 13/18	$9,477,998.77	SD-SEG2 p. 14/18	$1,275,076.74	Uncleared Checks and Wires Sent
Totals		**$11,218,522.06**		**$186,894,533.32**		**-$175,676,011.26**	
			Less Repo	-$176,951,088.00			
		Cash from Banks on 11/30/08 Seg		**$9,943,445.32**	**11/30/08 Seg Stmt Cell E26**		

Table 2 Notes:

Note 4 - Funds in Segregated Bank Accounts

Per fieldwork on 1/9/09, NFA obtained the firm's Customer Segregated Bank Accounts (SD-SEG2). NFA noted the firm maintains an account at Bank of America, First Premier, and US Bank, and 3 accounts at JPMorgan Chase. NFA also obtained any bank reconciliations that PFG had regarding the total balances listed on the bank accounts and the 11-30-08 Seg Stmt. Further, NFA imported the account balances per bank and book into Table 2. NFA noted that two of the accounts, the US Bank Account and the Main Customer Seg Account held at Chase had different balances listed per bank and book. In the US Bank Account (Account #621011845), NFA noted a balance per bank of $123,800.00 (p. 6) and a balance per book of $177,074,888.80 (p. 7). Per discussion with O'Meara and per review of SD-SEG2 p. 6-7/18, NFA noted PFG has a reverse repo agreement with US Bank for $176,951,088.80. Further, NFA noted this is listed in Cell E27 of the 11-30-08 Seg Stmt. As this appears reasonable, NFA will pass on further review.

BRG Investigative Team Note:
The $177 million difference between PFG's balance and the bank statement balance for the U.S. Bank segregated account is reconciled by the amount of the repo.

APPENDIX N
Account 845 Documentation for November 2008

1. **Fabricated U.S. Bank Statement (NFA00024631-NFA00024632)**
2. **Actual U.S. Bank Statement (0060849)**
3. **Fabricated Standard Form to Confirm Account Balance (NFA00008684)**
4. **Fabricated Repurchase Agreement Confirmation (NFA00024634)**

*The BRG Investigative Team was unable to locate the actual Repurchase Agreement Confirmation for November 2008.

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U.S. Bank National Association
PO Box 706
Cedar Falls, Iowa 50613-0030

4217 TRC Y ST01

Bank Statement

Some banks promise great service. U.S. Bank guarantees it!

Statement Period
11/01/08 through 11/30/08

Primary Account Number
621011845

To Contact U.S. Bank
By Phone: 1-800-347-7827
Internet: usbank.com

000042564 1 AV 0.324 106481010908171 P
PEREGRINE FINANCIAL GROUP INC
CUSTOMER SEGREGATED FUNDS ACCT
3812 CEDAR HEIGHTS DRIVE
CEDAR FALLS IA 50613-6260

Bank Information
BK: 2081
BR: 4217 CYC: 097
PR: 66 ENC: 000

COMMERCIAL CHECKING Account Number 0621011845 Member FDIC

Account Summary

Beginning Balance on 11/01/08	$115,000.00
Deposits and Other Additions	2,978,759,154.72
Check Activity	$0.00
Other Deductions and Withdrawals	2,978,750,354.72
Ending Balance on 11/30/08	$123,800.00
Average Daily Balance	$115,896.09
Number of Days in Statement Period	30

Names on the account:
PEREGRINE FINANCIAL GROUP INC
CUSTOMER SEGREGATED FUNDS ACCT

Deposits and Other Additions

Date	Description of Transaction	Ref Nbr	Amount
11/04/08	DEPOSIT	43807152	$19,500.00
11/12/08	DEPOSIT	45515878	$750.00
11/13/08	DEPOSIT	46059421	$20,000.00
11/14/08	DEPOSIT	46155910	$10,100.00
11/18/08	DEPOSIT	45244158	$293.18
11/19/08	DEPOSIT	46769778	$6,100.00
11/21/08	DEPOSIT	47238135	$5,000.00
11/25/08	DEPOSIT	44413982	$23,800.00
11/26/08	DEPOSIT	48170299	$5,000.00
11/26/08	DEPOSIT	48897712	$5,000,000.00
11/06/08	WT INC 0811060005209JPMCHASE*PFG CUST SEG ACCT	06002011	$10,000,000.00
11/06/08	WT INC 0811060020003BK AMER NYC TOM HERRMANN K	06007358	$500,000.00
11/21/08	WT INC 0811210008847USBANK*RWASENDORF*6210162	06017743	$1,000,000.00
11/26/08	WT INC 0811260013101JPMCHASE*PFG CUST SEG ACCT	06004717	$5,000,000.00
11/03/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL PREV DAY	00097804	$155,237,903.62
11/04/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL PREV DAY	00072030	$155,243,031.99
11/05/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL PREV DAY	00077180	$155,253,161.66
11/06/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL PREV DAY	00081934	$155,268,292.53
11/07/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL PREV DAY	00070228	$165,777,751.19
11/10/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL PREV DAY	00073525	$165,809,630.16
11/12/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL PREV DAY	00075373	$165,820,557.06
11/13/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL PREV DAY	00077525	$165,826,020.25
11/14/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL PREV DAY	00082282	$165,832,234.72
11/17/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL PREV DAY	00083397	$165,848,630.71
11/18/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL PREV DAY	00085667	$165,854,095.29
11/19/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL PREV DAY	00089761	$165,879,561.78
11/20/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL PREV DAY	00090958	$165,895,128.59
11/21/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL PREV DAY	00075998	$165,900,622.15
11/24/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL PREV DAY	00077511	$166,917,402.15
11/25/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL PREV DAY	00081462	$166,928,999.90

Continued on next page

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Deposits and Other Additions

Date	Description of Transaction	Ref Nbr	Amount
11/26/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL PREV DAY	00086402	$166,934,498.99
11/28/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL PREV DAY	00092239	$176,941,088.80
	Total Deposits and Other Additions.........		**2,978,759,154.72**

Other Deductions and Withdrawals

Date	Description of Transaction	Ref Nbr	Amount
11/26/08	RETURNED CHECK: NSF:DEPOSIT DATE 11/21/08.............	01009187	...........$5,000.00
11/03/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL...............	00098058	$155,237,903.62
11/04/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL...............	00072217	$155,248,031.99
11/05/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL...............	00077380	$155,263,161.66
11/06/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL...............	00082146	$165,772,292.53
11/07/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL...............	00070422	$165,793,251.19
11/10/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL...............	00073733	$165,809,630.16
11/12/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL...............	00075573	$165,820,557.06
11/13/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL...............	00077739	$165,826,770.25
11/14/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL...............	00082509	$165,832,234.72
11/17/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL...............	00083619	$165,848,630.71
11/18/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL...............	00085895	$165,874,095.29
11/19/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL...............	00090009	$165,889,661.78
11/20/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL...............	00091209	$165,895,128.59
11/21/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL...............	00076209	$166,900,915.33
11/24/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL...............	00077754	$166,923,502.15
11/25/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL...............	00081716	$166,928,999.90
11/26/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL...............	00086670	$176,929,498.99
11/28/08	SWEEP REPURCHASE AGREEMENT PRINCIPAL...............	00092450	$176,951,088.80
	Other Deductions and Withdrawals.........		**2,978,750,354.72**

Balance Summary

Date	Ending Balance	Date	Ending Balance	Date	Ending Balance
11/03/08	.......$115,000.00	11/12/08	.......$100,750.00	11/20/08	.......$106,393.18
11/04/08	.......$129,500.00	11/13/08	.......$120,000.00	11/21/08	.......$111,100.00
11/05/08	.......$119,500.00	11/14/08	.......$130,100.00	11/24/08	.......$105,000.00
11/06/08	.......$115,500.00	11/17/08	.......$130,100.00	11/25/08	.......$128,800.00
11/07/08	.......$100,000.00	11/18/08	.......$110,393.18	11/26/08	.......$133,800.00
11/10/08	.......$100,000.00	11/19/08	.......$106,393.18	11/28/08	.......$123,800.00

usbank *Five Star Service Guaranteed*

P.O. Box 1800
Saint Paul, Minnesota 55101-0800

4217 TRC Y ST01

Business Statement

Account Number:
0 006 2101 1845
Statement Period:
Nov. 3 , 2008
through
Nov. 30, 2008

000042564 1 AV 0.324 106481010908171 P
PEREGRINE FINANCIAL GROUP INC
3812 CEDAR HEIGHTS DR
CEDAR FALLS IA 50613-6260

To Contact U.S. Bank

24-Hour Business Solutions:	*1-800-673-3555*
Telecommunications Device for the Deaf:	*1-800-685-5065*
Internet:	*usbank.com*

INFORMATION YOU SHOULD KNOW

Price changes for U.S. Bank's Business Checking, Savings and Treasury Management Services are effective January 1, 2009. You can view revised pricing (only those prices that changed) at https://www2.usbank.com/tmpricing beginning December 1, 2008. Log onto this secure Web site using the account number (omit leading zeroes and dashes) and five-digit zip code from your statement. If you are unable to access the Internet or this information, please contact your Banker, Relationship Manager, Treasury Management Sales Consultant or Commercial Customer Service Team for assistance. If you prefer, you can send an email to commercialsupport@usbank.com.

SUMMARY OF YOUR U.S. BANK RELATIONSHIP

This section reflects the total balances for all accounts on this statement.

Deposit Accounts	*Account Number*		*Balance*	*Page*
Commercial Checking	0-006-2101-1845	$	123,800.00	1
	Total Deposit Balances	**$**	**123,800.00**	

Sweep Account	*Account Number*		*Balance*	*Page*
Repurchase Agreement Sweep	0-007-9261-1352	$	15,773,465.33	4
	Total Sweep Balances	**$**	**15,773,465.33**	

COMMERCIAL CHECKING

Member FDIC

Account Number 0-006-2101-1845
U.S. Bank National Association

Account Summary

	# Items		
Beginning Balance on Nov. 3		$	115,000.00
Customer Deposits	9		90,543.18
Other Deposits	3		15,500,000.00
Sweeps From Investment	41		170,953,227.78
Other Withdrawals	15		1,952,877.29-
Sweeps To Investment	18		184,582,093.67-
Ending Balance on Nov. 30, 2008		**$**	**123,800.00**

Customer Deposits

Number	Date	Ref Number	Amount
	Nov. 4	6043807152	19,500.00
	Nov. 12	6045515878	750.00
	Nov. 13	5946059421	20,000.00
	Nov. 14	5946155910	10,100.00
	Nov. 18	6145244158	293.18
	Nov. 19	6046769778	6,100.00
	Nov. 21	6047238135	5,000.00
	Nov. 25	6944413982	23,800.00
	Nov. 26	6048170299	5,000.00

Total Customer Deposits $ 90,543.18

us bank Five Star Service Guaranteed

PEREGRINE FINANCIAL GROUP INC
3812 CEDAR HEIGHTS DR
CEDAR FALLS IA 50613-6260

Business Statement
Account Number:
0 006 2101 1845
Statement Period:
Nov. 3, 2008
through
Nov. 30, 2008

COMMERCIAL CHECKING (CONTINUED)

Account Number 0-006-2101-1845

Other Deposits

Date	Description of Transaction			Ref Number		Amount
Nov. 6	Wire Credit REF007358 ORG=TOM HERRMANN KAY A	BK AMER NYC HERRMANN	081106020003		$	500,000.00
Nov. 6	Wire Credit REF002011 ORG=PEREGRINE FINANCIAL	JPMCHASE NYC GROUP INC CUSTOMER SEGR	081106005209			10,000,000.00
Nov. 26	Wire Credit REF004717 ORG=PEREGRINE FINANCIAL	JPMCHASE NYC GROUP INC CUSTOMER SEGR	081126013101			5,000,000.00
				Total Other Deposits	**$**	**15,500,000.00**

Sweeps From Investment

Date	Description of Transaction		Ref Number		Amount
Nov. 3	REPO Sweep Interest			$	2.97
Nov. 4	REPO Sweep Interest				2.97
Nov. 4	REPO Sweep Interest				5.95
Nov. 5	REPO Sweep Interest				2.98
Nov. 6	REPO Sweep Interest				2.96
Nov. 7	REPO Sweep Interest				17.55
Nov. 10	REPO Sweep Interest				17.57
Nov. 12	REPO Sweep Interest				17.57
Nov. 12	REPO Sweep Interest				35.14
Nov. 13	REPO Sweep Interest				15.07
Nov. 13	REPO Sweep Interest				17.57
Nov. 14	REPO Sweep Interest				15.07
Nov. 17	REPO Sweep Interest				15.07
Nov. 18	REPO Sweep Interest				15.06
Nov. 18	REPO Sweep Interest				30.14
Nov. 19	REPO Sweep Interest				15.09
Nov. 20	REPO Sweep Interest				15.10
Nov. 21	REPO Sweep Interest				15.10
Nov. 24	REPO Sweep Interest				15.10
Nov. 25	REPO Sweep Interest				15.11
Nov. 25	REPO Sweep Interest				30.21
Nov. 26	REPO Sweep Interest				15.11
Nov. 28	REPO Sweep Interest				21.89
Nov. 3	REPO Sweep Principal	From 00792611352			2,144,199.30
Nov. 4	REPO Sweep Principal	From 00792611352			2,144,202.27
Nov. 5	REPO Sweep Principal	From 00792611352			2,149,211.19
Nov. 6	REPO Sweep Principal	From 00792611352			2,134,214.17
Nov. 7	REPO Sweep Principal	From 00792611352			12,638,217.13
Nov. 10	REPO Sweep Principal	From 00792611352			12,653,734.68
Nov. 12	REPO Sweep Principal	From 00792611352			12,653,752.25
Nov. 13	REPO Sweep Principal	From 00792611352			10,850,689.96
Nov. 14	REPO Sweep Principal	From 00792611352			10,851,472.60
Nov. 17	REPO Sweep Principal	From 00792611352			10,851,487.67
Nov. 18	REPO Sweep Principal	From 00792611352			10,847,740.45
Nov. 19	REPO Sweep Principal	From 00792611352			10,867,785.65
Nov. 20	REPO Sweep Principal	From 00792611352			10,877,900.74
Nov. 21	REPO Sweep Principal	From 00792611352			10,877,915.84
Nov. 24	REPO Sweep Principal	From 00792611352			10,878,224.12
Nov. 25	REPO Sweep Principal	From 00792611352			10,884,339.22
Nov. 26	REPO Sweep Principal	From 00792611352			10,884,384.54
Nov. 28	REPO Sweep Principal	From 00792611352			15,763,399.65
			Total Sweeps From Investment	**$**	**170,953,227.78**

us bank Five Star Service Guaranteed

PEREGRINE FINANCIAL GROUP INC
3812 CEDAR HEIGHTS DR
CEDAR FALLS IA 50613-6260

Business Statement
Account Number:
0 006 2101 1845
Statement Period:
Nov. 3 , 2008
through
Nov. 30, 2008

COMMERCIAL CHECKING (CONTINUED)

Account Number 0-006-2101-1845

Other Withdrawals

Date	Description of Transaction		Ref Number		Amount
Nov. 17	Iowa Tax		1700000000	$	245.44-
Nov. 26	Wire Debit REF000540 BNF=ANAC NO ADDRESS	BK ONE CHGO 081126005306 GIVEN			8,500.00-
Nov. 12	Wire Debit REF002404 BNF=ANAC NO ADDRESS	JPMCHASE NYC 081112023916 GIVEN			6,000.00-
Nov. 12	Wire Debit REF002391 BNF=AEGIS RS NO ADDRESS	WACHOVIA ROANOKE 081112023882 GIVEN			18,000.00-
Nov. 26	Wire Debit REF000507 BNF=AEGIS RS NO ADDRESS	WACHOVIA ROANOKE 081126005099 GIVEN			24,500.00-
Nov. 26	Electronic Funds Transfer	To Account 196473400329			5,000.00-
Nov. 26	Electronic Funds Transfer	To Account 196473400303			20,000.00-
Nov. 26	Electronic Funds Transfer	To Account 196473400311			58,000.00-
Nov. 26	Deposited Item Returned		1000529409		5,000.00-
Nov. 17	Analysis Service Charge		1700000000		3,516.85-
Nov. 12	Telephone Transfer	To Account 00173431140			500,000.00-
Nov. 12	Telephone Transfer	To Account 00173431140			1,114,115.00-
Nov. 12	Telephone Transfer	To Account 196473400311			5,000.00-
Nov. 5	Telephone Transfer	To Account 196473400329			25,000.00-
Nov. 12	Telephone Transfer	To Account 196473400329			160,000.00-
			Total Other Withdrawals	**$**	**1,952,877.29-**

Sweeps To Investment

Date	Description of Transaction		Ref Number		Amount
Nov. 3	REPO Sweep Transfer	To 00792611352	0300000260	$	2,144,202.27-
Nov. 4	REPO Sweep Transfer	To 00792611352	0400000256		2,149,211.19-
Nov. 5	REPO Sweep Transfer	To 00792611352	0500000236		2,134,214.17-
Nov. 6	REPO Sweep Transfer	To 00792611352	0600000240		12,638,217.13-
Nov. 7	REPO Sweep Transfer	To 00792611352	0700000251		12,653,734.68-
Nov. 10	REPO Sweep Transfer	To 00792611352	1000000252		12,653,752.25-
Nov. 12	REPO Sweep Transfer	To 00792611352	1200000325		10,850,689.96-
Nov. 13	REPO Sweep Transfer	To 00792611352	1300000274		10,851,472.60-
Nov. 14	REPO Sweep Transfer	To 00792611352	1400000209		10,851,487.67-
Nov. 17	REPO Sweep Transfer	To 00792611352	1700000257		10,847,740.45-
Nov. 18	REPO Sweep Transfer	To 00792611352	1800000274		10,867,785.65-
Nov. 19	REPO Sweep Transfer	To 00792611352	1900000242		10,877,900.74-
Nov. 20	REPO Sweep Transfer	To 00792611352	2000000265		10,877,915.84-
Nov. 21	REPO Sweep Transfer	To 00792611352	2100000224		10,878,224.12-
Nov. 24	REPO Sweep Transfer	To 00792611352	2400000282		10,884,339.22-
Nov. 25	REPO Sweep Transfer	To 00792611352	2500000244		10,884,384.54-
Nov. 26	REPO Sweep Transfer	To 00792611352	2600000248		15,763,399.65-
Nov. 28	REPO Sweep Transfer	To 00792611352	2800000251		15,773,421.54-
			Total Sweeps To Investment	**$**	**184,582,093.67-**

Balance Summary

Date	Ending Balance	Date	Ending Balance	Date	Ending Balance
Nov. 3	115,000.00	Nov. 12	100,750.00	Nov. 20	106,393.18
Nov. 4	129,500.00	Nov. 13	120,000.00	Nov. 21	111,100.00
Nov. 5	119,500.00	Nov. 14	130,100.00	Nov. 24	105,000.00
Nov. 6	115,500.00	Nov. 17	130,100.00	Nov. 25	128,800.00
Nov. 7	100,000.00	Nov. 18	110,393.18	Nov. 26	133,800.00
Nov. 10	100,000.00	Nov. 19	106,393.18	Nov. 28	123,800.00

Balances only appear for days reflecting change.

REPURCHASE AGREEMENT SWEEP *This Account is NOT FDIC Insured*

Account Number 0-007-9261-1352

Account Summary

	# Items		
Beginning Balance on Nov. 1		$	2,144,202.27
Investment Purchases	42		184,582,490.84
Investment Redemptions	41		170,953,227.78-
Ending Balance on Nov. 30, 2008		$	**15,773,465.33**

Interest Earned this Period	$	440.98
Interest Paid this Period	$	397.17
Interest Paid this Year	$	361,079.00
Average Amount Invested	$	10,586,721.46
Average Rate		0.05%
Number of Days in Statement Period		30

Investment Purchases

Date		Description of Transaction		Ref Number		Amount
Nov.	3	Interest Paid		0300000353	$	2.97
Nov.	3	Interest Paid		0300000352		5.95
Nov.	3	REPO Sweep Purchase	From 00621011845 @ 0.05%	0300000259		2,144,202.27
Nov.	4	Interest Paid		0400000336		2.98
Nov.	4	REPO Sweep Purchase	From 00621011845 @ 0.05%	0400000255		2,149,211.19
Nov.	5	Interest Paid		0500000324		2.96
Nov.	5	REPO Sweep Purchase	From 00621011845 @ 0.05%	0500000235		2,134,214.17
Nov.	6	Interest Paid		0600000309		17.55
Nov.	6	REPO Sweep Purchase	From 00621011845 @ 0.05%	0600000239		12,638,217.13
Nov.	7	Interest Paid		0700000321		17.57
Nov.	7	REPO Sweep Purchase	From 00621011845 @ 0.05%	0700000250		12,653,734.68
Nov.	10	Interest Paid		1000000337		17.57
Nov.	10	Interest Paid		1000000336		35.14
Nov.	10	REPO Sweep Purchase	From 00621011845 @ 0.05%	1000000251		12,653,752.25
Nov.	12	Interest Paid		1200000421		15.07
Nov.	12	Interest Paid		1200000420		17.57
Nov.	12	REPO Sweep Purchase	From 00621011845 @ 0.05%	1200000324		10,850,689.96
Nov.	13	Interest Paid		1300000367		15.07
Nov.	13	REPO Sweep Purchase	From 00621011845 @ 0.05%	1300000273		10,851,472.60
Nov.	14	Interest Paid		1400000279		15.07
Nov.	14	REPO Sweep Purchase	From 00621011845 @ 0.05%	1400000208		10,851,487.67
Nov.	17	Interest Paid		1700000335		15.06
Nov.	17	Interest Paid		1700000334		30.14
Nov.	17	REPO Sweep Purchase	From 00621011845 @ 0.05%	1700000256		10,847,740.45
Nov.	18	Interest Paid		1800000343		15.09
Nov.	18	REPO Sweep Purchase	From 00621011845 @ 0.05%	1800000273		10,867,785.65
Nov.	19	Interest Paid		1900000310		15.10
Nov.	19	REPO Sweep Purchase	From 00621011845 @ 0.05%	1900000241		10,877,900.74
Nov.	20	Interest Paid		2000000336		15.10
Nov.	20	REPO Sweep Purchase	From 00621011845 @ 0.05%	2000000264		10,877,915.84
Nov.	21	Interest Paid		2100000298		15.10
Nov.	21	REPO Sweep Purchase	From 00621011845 @ 0.05%	2100000223		10,878,224.12
Nov.	24	Interest Paid		2400000372		15.11
Nov.	24	Interest Paid		2400000371		30.21
Nov.	24	REPO Sweep Purchase	From 00621011845 @ 0.05%	2400000281		10,884,339.22
Nov.	25	Interest Paid		2500000315		15.11
Nov.	25	REPO Sweep Purchase	From 00621011845 @ 0.05%	2500000243		10,884,384.54
Nov.	26	Interest Paid		2600000322		21.89
Nov.	26	REPO Sweep Purchase	From 00621011845 @ 0.05%	2600000247		15,763,399.65
Nov.	28	Interest Paid		2800000338		21.89
Nov.	28	Interest Paid		2800000339		21.90
Nov.	28	REPO Sweep Purchase	From 00621011845 @ 0.05%	2800000250		15,773,421.54
			Total Investment Purchases		$	**184,582,490.84**

us bank. Five Star Service Guaranteed

PEREGRINE FINANCIAL GROUP INC
3812 CEDAR HEIGHTS DR
CEDAR FALLS IA 50613-6260

Business Statement
Account Number:
0 006 2101 1845
Statement Period:
Nov. 3 , 2008
through
Nov. 30, 2008

REPURCHASE AGREEMENT SWEEP (CONTINUED)

Account Number 0-007-9261-1352

Investment Redemptions

Date	Description of Transaction		Ref Number	Amount
Nov. 3	Interest Redemption			$ 2.97-
Nov. 3	REPO Sweep Redemption	To 00621011845		2,144,199.30-
Nov. 4	Interest Redemption			2.97-
Nov. 4	Interest Redemption			5.95-
Nov. 4	REPO Sweep Redemption	To 00621011845		2,144,202.27-
Nov. 5	Interest Redemption			2.98-
Nov. 5	REPO Sweep Redemption	To 00621011845		2,149,211.19-
Nov. 6	Interest Redemption			2.96-
Nov. 6	REPO Sweep Redemption	To 00621011845		2,134,214.17-
Nov. 7	Interest Redemption			17.55-
Nov. 7	REPO Sweep Redemption	To 00621011845		12,638,217.13-
Nov. 10	Interest Redemption			17.57-
Nov. 10	REPO Sweep Redemption	To 00621011845		12,653,734.68-
Nov. 12	Interest Redemption			17.57-
Nov. 12	Interest Redemption			35.14-
Nov. 12	REPO Sweep Redemption	To 00621011845		12,653,752.25-
Nov. 13	Interest Redemption			15.07-
Nov. 13	Interest Redemption			17.57-
Nov. 13	REPO Sweep Redemption	To 00621011845		10,850,689.96-
Nov. 14	Interest Redemption			15.07-
Nov. 14	REPO Sweep Redemption	To 00621011845		10,851,472.60-
Nov. 17	Interest Redemption			15.07-
Nov. 17	REPO Sweep Redemption	To 00621011845		10,851,487.67-
Nov. 18	Interest Redemption			15.06-
Nov. 18	Interest Redemption			30.14-
Nov. 18	REPO Sweep Redemption	To 00621011845		10,847,740.45-
Nov. 19	Interest Redemption			15.09-
Nov. 19	REPO Sweep Redemption	To 00621011845		10,867,785.65-
Nov. 20	Interest Redemption			15.10-
Nov. 20	REPO Sweep Redemption	To 00621011845		10,877,900.74-
Nov. 21	Interest Redemption			15.10-
Nov. 21	REPO Sweep Redemption	To 00621011845		10,877,915.84-
Nov. 24	Interest Redemption			15.10-
Nov. 24	REPO Sweep Redemption	To 00621011845		10,878,224.12-
Nov. 25	Interest Redemption			15.11-
Nov. 25	Interest Redemption			30.21-
Nov. 25	REPO Sweep Redemption	To 00621011845		10,884,339.22-
Nov. 26	Interest Redemption			15.11-
Nov. 26	REPO Sweep Redemption	To 00621011845		10,884,384.54-
Nov. 28	Interest Redemption			21.89-
Nov. 28	REPO Sweep Redemption	To 00621011845		15,763,399.65-
			Total Investment Redemptions	**$ 170,953,227.78-**

Balance Summary

Date	Ending Balance	Date	Ending Balance	Date	Ending Balance
Nov. 3	2,144,211.19	Nov. 12	10,850,722.60	Nov. 20	10,877,930.94
Nov. 4	2,149,214.17	Nov. 13	10,851,487.67	Nov. 21	10,878,239.22
Nov. 5	2,134,217.13	Nov. 14	10,851,502.74	Nov. 24	10,884,384.54
Nov. 6	12,638,234.68	Nov. 17	10,847,785.65	Nov. 25	10,884,399.65
Nov. 7	12,653,752.25	Nov. 18	10,867,800.74	Nov. 26	15,763,421.54
Nov. 10	12,653,804.96	Nov. 19	10,877,915.84	Nov. 28	15,773,465.33

Balances only appear for days reflecting change.

Investments in Repurchase Agreements are not insured by the Federal Deposit Insurance Corporation, are not guaranteed by the bank and may lose value.

STANDARD FORM TO CONFIRM ACCOUNT BALANCE INFORMATION WITH FINANCIAL INSTITUTIONS

ORIGINAL
To be mailed to accountant

Peregrine Financial Group, Inc.
CUSTOMER NAME

Financial Institution's Name and Address
[
U.S. Bank
P.O. Box 706
Cedar Falls, IA 50613-0706
]

[Att: Hope Timmerman]

We have provided to our accountants the following information as of the close of business on November 30, 2008 regarding our deposit and loan balances. Please confirm the accuracy of the information, noting any exceptions to the information provided. If the balances have been left blank, please complete this form by furnishing the balance in the appropriate space below.* Although we do not request nor expect you to conduct a comprehensive, detailed search of your records, if during the process of completing this confirmation additional information about other deposit and loan accounts we may have with you comes to your attention, please include such information below. Please use the enclosed envelope to return the form directly to our accountants.

1. At the close of business on the date listed above, our records indicated the following deposit balance(s):

ACCOUNT NAME	ACCOUNT NO.	INTEREST RATE	BALANCE*
Peregrine Financial Group, Inc.	#767467		$236,342.03
Peregrine Financial Group, Inc.	#621011845**		$177,074,888.80
Peregrine Financial Group, Inc.	#196455993366**		$1,117,895.51

**Please include balances of Securities for Reverse Repos

1,118,996

2. We were directly liable to the financial institution for loans at the close of business on the date listed abov

ACCOUNT NO./ DESCRIPTION	BALANCE*	DATE DUE	INTEREST RATE	DATE THROUGH W INTEREST IS P	AL
NA					

(Customer's Authorized Signature) 16 Jan 2009 (Date)

The information presented above by the customer is in agreement with our records. Although we have not conducted a comprehensive, detailed search of our records, no other deposit or loan accounts have come to our attention except as noted below.

Doug Boe
(Financial Institution Authorized Signature)
Douglas Boe

January 22, 2009
(Date)

Senior Vice President, Commercial Banking Division
(Title)

EXCEPTIONS AND/OR COMMENTS
NA

Please return this form directly to our accountants:

[Attn: Pete Krol]
NATIONAL FUTURES ASSOCIATION
300 S. Riverside Suite 1800
Chicago, IL 60606

* Ordinarily, balances are intentionally left blank if they are not

us bank.

REPURCHASE AGREEMENT CONFIRMATION

U.S. BANK IOWA N.A. (SWEEP REPO) Phone #800-236-5800

We confirm our sale to you of securities described below. We hold the described securities in safekeeping for you and agree to repurchase these securities on the maturity date. This transaction is subject to the terms and condition of the Master Repurchase Agreement and, if a sweep account, The Sweep Service Agreement between you and us.

PEREGRINE FINANCIAL GROUP INC
CEA CUSTOMER SEGREGATED ACCT
3812 CEDAR HEIGHTS DRIVE
PO BOX 849
CEDAR FALLS IA 50613-0849

#000-621011845

Any funds held by us in connection with this transaction are not a deposit and therefore are not FDIC Insured.

us bank.

PEREGRINE FINANCIAL GROUP INC

Customer Account Number	Trade Number	Settlement Date	Principal	Repurchase Date	Current Rate	Interest
000-621011845	092450	11/28/08	176,951,088.80	12/01/08	0.975%	14,202.01

The following securities are sold under agreement to repurchase:

Security type	CUSIP Number	Coupon Rate	Maturity Date	Par Value	Market Value
U S TREASURY NOTES	912828EX4	4.500%	02/28/11	195,450,000.00	176,965,290.81

7/1