

REPORT OF THE INDEPENDENT CONSULTANT
APRIL 15, 1986

Re: Securities and Exchange Commission
In the Matter of E.F. Hutton & Company Inc.
Administrative Proceeding File No. 3-6582

FREDERICK M. WERBLOW
Independent Consultant

Assisted by:
PRICE WATERHOUSE

Legal Counsel:
STANLEY J. FRIEDMAN, ESQ.
Shereff, Friedman, Hoffman & Goodman

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RE: SECURITIES AND EXCHANGE COMMISSION
IN THE MATTER OF E.F. HUTTON & COMPANY INC.
ADMINISTRATIVE PROCEEDING FILE NO. 3-6582

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E.F. HUTTON & COMPANY INC.

REPORT OF THE INDEPENDENT CONSULTANT

APRIL 15, 1986

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LETTER

FREDERICK M. WERBLOW
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April 15, 1986

Securities and Exchange Commission

The Boards of Directors of:
E.F. Hutton & Company Inc.
The Investment Companies for which
E.F. Hutton & Company Inc.
acts as Investment Adviser or Sponsor.

IN THE MATTER OF E.F. HUTTON & COMPANY INC.
ADMINISTRATIVE PROCEEDING FILE NO. 3-6582

I was engaged as the independent Consultant pursuant to the Securities and Exchange Commission "Order Instituting Proceedings, Findings and Order Imposing Remedial Sanctions" (the Order). According to Section IV.G. of the Order, the overall objectives were to review the manner in which E.F. Hutton & Company Inc. (E.F. Hutton) administers its investment company operations and to report upon and make recommendations relating to the administration and operations of investment companies to which E.F. Hutton acts as investment adviser or sponsor (Hutton funds), to determine whether:

- (a) Hutton's transmission of monies arising from the settlement of the Hutton funds' transactions in their capital stock is consistent with prospectus disclosure;
- (b) the funds' capital stock transactions are in compliance with the requirements of Rule 22c-1 as well as prospectus disclosure;
- (c) the monies received under the funds' 12b-1 plans are computed in accordance with the methods described in the plans;

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- (d) the procedures for the transmittal of monies by Hutton for the purchase of variable annuities are consistent with federal securities laws and to make recommendations for whatever remedial actions are deemed appropriate;
- (e) the policies and procedures utilized by Hutton to prevent violations of federal securities laws in connection with its investment company business are adequate and to recommend, where appropriate, changes in policies and procedures and staffing necessary to assure ongoing compliance.

I have considered the directives described above in determining the scope of the review. (As used throughout this letter and report, the term "review" constitutes the procedures listed in Section I - Project Scope of the attached report.)

The review has included procedures to identify the administrative requirements applicable to the operations of the Hutton funds contained in their prospectuses and statements of additional information and the applicable federal securities laws to which such investment companies are subject. I relied upon Stanley J. Friedman, Esq. and the firm of Shereff, Friedman, Hoffman & Goodman, of which he is a partner, to advise me as to the applicable federal securities laws.

From the requirements so identified, specific control objectives were developed for the administration and operations of the Hutton funds. The review then concentrated upon

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identifying and obtaining descriptions of the control procedures designed to provide reasonable assurance that such objectives were met. A review was then made of the identified control procedures to determine whether such procedures were suitably designed to meet the control objectives. Where the procedures did not appear to be sufficient, recommendations were made for improvement. The review was performed during the period December 2, 1985 to April 11, 1986 and the findings and recommendations are applicable as of the date the review procedures were performed.

The management of E.F. Hutton and the Hutton funds are responsible for establishing and maintaining systems of control for administering their investment company operations in accordance with the federal securities laws and the related rules and regulations thereunder. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. One of the primary objectives of a system of control is to provide management with reasonable, but not absolute, assurance that investment company operations are administered in accordance with the federal securities laws and other applicable regulations.

Because of inherent limitations in any system of controls, errors, irregularities or instances of noncompliance may occur and not be detected. Also, projection of any evaluation of a system to future periods is subject to the risk

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that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

This review is unique in several respects. First, there is no authoritative guidance in professional literature for a review of this particular type. Second, as there is no objective definition of the federal securities laws that apply to such a review, some interpretation is required. Furthermore, there is no commonly accepted set of control objectives derived from the federal securities laws for which procedures should be designed, and, it is recognized that the body of federal securities law is extensive, detailed and complex. Few, if any, similar organizations have been subject to such a review to determine how their procedures comply with the federal securities laws; so there is little or no precedent available to judge the results of such a review. It is important to consider the nature of this study in order to evaluate the findings and recommendations resulting therefrom.

As a result of the review, recommendations have been developed to improve the design of the control procedures to administer the operations of the Hutton funds. The more significant recommendations, including the findings and recommendations directly related to items listed in Section IV.G.(1)(a)-(e) of the Order, are included in this letter. Other recommendations to improve the design of control procedures are included in Section II of the report.

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During the course of the review, as preliminary findings became known, they were discussed with E.F. Hutton and/or Hutton Life personnel and in some cases with Hutton's counsel and counsel for the funds. As a result, in response to certain recommendations, E.F. Hutton represented that certain procedures were modified or new procedures were instituted. The findings and recommendations in Section II of the report are based upon conditions noted at the time of the review and do not reflect subsequent changes in control procedures.

FINDINGS AND RECOMMENDATIONS FOR STRENGTHENING ADMINISTRATIVE CONTROL PROCEDURES:

While E.F. Hutton has many established policies and procedures, execution of such procedures depends upon trained personnel and adequate supervision and is affected by many factors, including transaction volumes and market changes. Adherence to the philosophy of maintaining a strong control and monitoring function requires continued dedication of sufficient resources to perform that function.

As noted in Section II of the report, a measure of control of the operations of the Hutton funds is provided by a combination of separation of duties among various E.F. Hutton entities and outside agents, the use of data processing and the confirmation process. The system is further strengthened when entities and/or individuals who are completely independent of the processing make periodic reviews, as is the case in the independent third party review of the shareholder accounting system at the transfer agent for some of the funds.

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Notwithstanding these general controls, the administrative procedures performed by Hutton Asset Management Division (HAM) and by Hutton Life are the primary control mechanisms. The following recommendations are designed to strengthen the policies, procedures and staffing of Hutton Asset Management and Hutton Life to enable them to better perform their functions in administering those Hutton funds pursuant to the federal securities laws:

RECOMMENDATION 1:

E.F. Hutton should provide additional management resources to its Hutton Asset Management Division Administration section and should fully adopt or, where applicable, retain the procedures described in Section II of the report to monitor its investment company operations and supervise the activities of its agents.

While at the time of this review, work was being performed on a daily basis to monitor compliance, the effectiveness of the Hutton Asset Management Administration group could be improved by providing additional management resources to more fully support the Chief Administrator. While management must evaluate the cost of the enhanced staffing in relation to the potential benefits to be derived, the following additional resources should be considered:

1. An assistant to the Chief Administrator to whom the Chief Administrator can delegate ongoing responsibility for supervising and monitoring the outside agents serving the funds. Also, the assistant should have the responsibility of establishing continuing education programs covering, among other subjects, compliance issues for HAM officers and employees.
2. A full time in-house legal counsel resident in, or in close proximity to, the offices of HAM with broad experience in dealing with issues surrounding the Investment Company Act of 1940 and other federal securities laws and with appropriate access to senior management of E.F. Hutton and Hutton Asset Management.

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3. Resources to support the manager in charge of the Finance Department in the preparation of financial statements, monitoring the agents' calculations of the funds' daily net asset values per share, including the calculations of the fees pertaining to 12b-1 plans, reviewing tax returns, the development and/or review of tax basis financial information and anticipating tax issues for the funds based upon emerging tax regulations.
4. An internal audit function dedicated solely to the Hutton funds. The responsibilities of such an individual or group should be to develop a formal program to monitor the activities of agents serving the funds and to provide additional assurance to the management of Hutton Asset Management and the directors of the funds that the detailed policies and procedures which are listed throughout Section II of the accompanying report have been implemented, continue to be in place and are working as intended. The activities of that auditor or group should combine periodic on-site reviews of each outside agent and the E.F. Hutton entities serving the funds, as well as procedures performed on an unannounced (surprise) basis to ascertain whether controls are in place and functioning as intended. The audit function should incorporate reviews of automated functions as well as manual procedures.

RECOMMENDATION 2:

Hutton Life should organize a department with management resources to administer existing and any new investment companies.

Even though the Hutton VIP Separate Account and VIP Fund are of modest size, the same complement of administrative resources should be applied to those operations as are applied to the other Hutton funds. Such resources should include a general counsel and an accountant, each thoroughly familiar with the Investment Company Act of 1940; and an administrator/compliance officer to, among other activities, monitor the outside agents serving these funds.

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While full-time resources may not be cost justified, the cost/benefit deliberations should take into consideration the need of the funds to comply with the federal securities laws even when they are of modest size.

Initially the activities of the staff assigned to Hutton Asset Management and Hutton Life should focus on the recommendations included in this report and the development of policies and procedures to carryout those recommendations. In addition, if new investment company products are developed, a program should be organized to identify the control objectives relevant to such products pursuant to the federal securities laws and to establish policies and procedures designed to provide reasonable assurance that such objectives are met.

FINDINGS REGARDING ITEMS SPECIFICALLY ADDRESSED IN THE ORDER:

Sections IV.G.(1)(a)-(e) of the Order defined the nature of the review. Items (a)-(d) identified specific issues to be addressed. The scope of the work performed to address these issues is described in Section I of the report. The findings and recommendations resulting therefrom are described below and follow the statement of each issue:

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IV.G.(1)(a): Hutton's transmission of monies arising from the settlement of the funds' transactions in their capital stock is consistent with prospectus disclosure.

Throughout the development of the control objectives and the documentation of procedures presented in Section II of the report, the flow of monies associated with each of the funds was identified and documented. Also, selected transactions were followed through the applicable processing cycles. The timing of those transactions was evaluated and compared to prospectus disclosures.

The following recommendations relate to two inconsistencies with prospectus disclosures that were found.

RECOMMENDATION 3:

Legal counsel of the Cash Funds should be consulted regarding the procedures under which the daily settlement with the Bank of New England includes a payment to E.F. Hutton for estimated redemptions paid to Provident Bank for shareholder checks written and credit card purchases, in order to resolve any possible inconsistencies with the federal securities laws.

Shareholders with AMA and ARA accounts have checkwriting privileges with Provident National Bank of Philadelphia (Provident) and, in the case of the AMA account, may have American Express credit card purchases debited to their Hutton brokerage account. These debits may require a redemption from the shareholder's Cash Fund if the debits exceed a customer's free credit balances. E.F. Hutton settles these charges with Provident in federal funds on the day they are presented, but does not receive the proceeds of

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Cash Fund redemptions in federal funds until the next business day. Each day E.F. Hutton is paid an amount based on an estimate of the redemptions arising from these charges presented that day. On the next business day, the difference between the actual charges and the estimate is settled and, contemporaneously, the procedure is repeated. This practice should be considered as explained in the recommendation above.

RECOMMENDATION 4:

All monies received by Hutton Life for the purchase of variable annuities should be deposited directly with Hutton Life.

For initial and subsequent payments, Hutton Life deposits checks received into a California bank account of E.F. Hutton for wire transfer to E.F. Hutton in New York. It was noted during the review that the procedure was for monies to be wired back to Hutton Life within two days for transfer to First Interstate Bank in Los Angeles, custodian for the VIP Fund. This transfer procedure allows E.F. Hutton, rather than Hutton Life, to use the funds for the two-day period. Accordingly, procedures should be changed to eliminate transfers of cash to and from E.F. Hutton in New York.

IV.G.(1)(b): The funds' capital stock transactions are in compliance with the requirements of Rule 22c-1 as well as prospectus disclosure.

Procedures for compliance with Rule 22c-1 were identified and documented. The following recommendation relates to an exception that was noted during the review.

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RECOMMENDATION 5:

Share redemptions and purchases of the VIP Separate Account and VIP Fund as a result of contractowner transfer requests should be processed on the same day in accordance with prospectus disclosures.

For transfers within the VIP Separate Account and VIP Fund series a one-day delay existed between the day redemptions were executed and the day purchases were executed. The one-day lag in the transfer procedure existed only for the period January 6, 1986 through January 13, 1986.

Subsequently, Hutton Life reimbursed the fund and its contractowners for the change in value for that one-day lag and began processing both components of the transfer on the same day.

In addition, based upon the review, the following recommendation should be considered:

RECOMMENDATION 6:

E.F. Hutton should develop a plan to have a review of its data processing functions made by personnel independent of the Hutton data processing department to provide additional assurance that critical functions affecting the administration of investment company operations are performed as outlined in the funds' prospectuses.

During the review it was determined that certain essential functions that affect compliance with the funds' prospectus guidelines relating to Rule 22c-1 are performed by E.F. Hutton internal data processing systems. Such functions include the transaction processing cutoffs at both 2:00 P.M. and 4:00 P.M. for the Cash Funds and the HIS and MUNI Funds, respectively, the sweep of "good funds" from the

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AMA/ARA accounts into the Cash Funds at the Bank of New England, edits of shareholder account information and transactions and the preparation of confirmations and statements. It would seem consistent with the interests of the funds to have an independent review of these systems performed.

IV.G.(1)(c): The monies received under the funds' 12b-1 plans are computed in accordance with the methods described in the plans.

The distribution plans for the HIS and Cash Funds were reviewed and some fee calculations were tested. As a result of inquiries made during the review, HAM has recently learned that there is a need for the HIS recordkeeping agent to recompute the distribution fees for HIS beginning in September 1985. Accordingly, the following recommendation should be adopted:

RECOMMENDATION 7:

E.F. Hutton should have the distribution fee for HIS recomputed beginning September 1985 and implement procedures to ascertain that the daily calculation of the distribution fee, including underlying support, is accurate.

During the review the observation was made that the calculation procedures for HIS would be easier to understand and monitor if the distribution plan were more specific as to the method of calculation.

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Also, in light of current regulatory interest in Rule 12b-1 plans, HAM should consider, with outside counsel for HIS and the Cash Funds, the nature of the expenses that may be incurred and the fees that may be received by the distributor under the distribution plans, and, in the case of HIS, the process by which those expenses should be allocated among its series. Consideration of these matters by such outside counsel should be helpful to the directors of HIS and the Cash Funds in their evaluation of information and deliberations regarding the distribution plans and their annual renewal.

IV.G.(1)(d): The procedures for the transmittal of monies by Hutton for the purchase of variable annuities are consistent with federal securities laws.

The control objectives and E.F. Hutton and Hutton Life's procedures for administering the Hutton VIP Separate Account and VIP Fund are described in Section II-D of the Report. The procedures for the transmittal of applications and payments for purchases of variable annuities were analyzed and tested. Based upon the advice of my legal counsel, I believe these procedures were in conformity with the federal securities laws.

RECOMMENDATION 8:

E.F. Hutton should adopt a uniform method of transmitting monies and applications to Hutton Life for the initial purchases of variable annuity contracts.

During the review it was noted that at least two methods were used for transmitting initial applications and payments for variable annuity contracts to Hutton Life for processing. Some transmittals were made by wire and others were made by mail. Those sent by mail served to extend the time

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between execution of the application by the prospective contractowner and the receipt of the application and payment at Hutton Life, which issues the contracts. Since the process was discretionary, it resulted in a need to monitor and control two sets of procedures.

There is no specific mandate in the federal securities laws for a preferred processing mode. Nevertheless, it seemed to be in the best interests of both the prospective contractowners and E.F. Hutton if an expedited (wire) transmittal were adopted as the standard. Also, this seems to be in keeping with the spirit of Rule 22c-1.

I have been advised that instructions were sent by E.F. Hutton to its sales offices to adopt the wire order transmittal method as the standard.

IV.G.(1)(e): The policies and procedures utilized by Hutton which are designed to prevent violations of federal securities laws in connection with its investment company business are adequate.

As a result of the review, recommendations were developed to institute or to strengthen policies and procedures to prevent violations of the federal securities laws. Certain of these recommendations are contained below in this letter and the rest are described and summarized in Section II of the accompanying report.

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RECOMMENDATIONS RESULTING FROM INCONSISTENCIES WITH OR
POSSIBLE VARIANCES FROM THE DISCLOSURES IN THE FUNDS'
PROSPECTUSES AND/OR STATEMENTS OF ADDITIONAL INFORMATION
AND/OR FROM POSSIBLE INCONSISTENCIES WITH THE FEDERAL
SECURITIES LAWS.

During the course of the review, in consultation with my legal counsel, the following recommendations explained in the caption above were developed:

RECOMMENDATIONS:

9. A determination should be made whether transactions with affiliates of American Express Company are consistent with prospectus and statement of additional information restrictions of the Municipal Cash Reserve Fund, AMA Cash Fund and the Hutton Government Fund.
10. The calculation of the market value of collateral received on repurchase agreements as a percentage of the amount due on the agreement should be documented. This percentage should be verified and documented on subsequent days until maturity of the agreement to monitor the adequacy of the collateral.
11. Hutton Asset Management should compute the net asset values for the Short Term Investment Series of HIS and the Money Market Series of the VIP Fund each week on a market value basis and compare that computation to the amortized cost valuations as required by the procedures adopted by the Boards of Directors.
12. The financial statements of the VIP Fund and the VIP Separate Account should be prepared to more fully comply with the requirements of Regulation S-X and Section 30(d) of the 1940 Act and the rules thereunder and Hutton Life procedures should be enhanced to monitor compliance.
13. Hutton Life should review with outside counsel for the VIP Fund and its directors the arrangements under which VIP Fund assets are maintained at First Interstate Bank to determine compliance with applicable federal securities regulatory requirements.

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Boards of Directors of:

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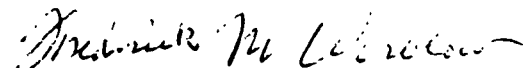
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This report is intended solely for use by the Securities and Exchange Commission and the Boards of Directors of E.F. Hutton & Company Inc. and the Hutton funds. Under their agreement pursuant to the Order, it should not be used or relied on for any other purpose.

* * * * *

During the course of this review, Price Waterhouse, Stanley J. Friedman, Esq. and Shereff, Friedman, Hoffman & Goodman, and I have received all documents requested of E.F. Hutton, met with all persons associated with E.F. Hutton with whom we desired to meet and have received the cooperation of E.F. Hutton and its officers, agents and employees. The cooperation received from E.F. Hutton was consistent with the Order, Sections IV.G. (2) and (3).

Yours very truly,



Frederick M. Werblow

REPORT

I. APPROACH TO THE REVIEW

I. APPROACH TO THE REVIEW

E.F. HUTTON & COMPANY INC.

APPROACH TO THE REVIEW

INTRODUCTION:

Mandate for the review:

This report describes the approach, the findings and recommendations resulting from a review of the administration of the Hutton funds. The review was undertaken pursuant to a Securities and Exchange Commission "Order Instituting Proceedings, Findings and Order Imposing Remedial Sanctions" (the Order) dated October 29, 1985.

The Order contains the mandate for the review in Section IV.G.(1). That section describes four specific areas to be covered (Section IV.G.(1)(a)-(d)) and a general mandate to study the policies and procedures used by E.F. Hutton to prevent violations of the federal securities laws in connection with administering its investment company business. (Section IV.G.(1)(e)). The applicable sections state:

"Within 15 days after the date of the Order, [E.F. Hutton shall] employ an independent Consultant knowledgeable in investment adviser and investment company operations and acceptable to the Commission, who shall review and examine the manner in which Hutton administers its investment company operations. The Consultant's duties and responsibilities shall include, without limitation or restriction of any kind:

- (1) Full and complete authority to review, report upon and make recommendations relating to administration and operations of investment companies ("funds"), to which Hutton acts as investment adviser or sponsor to determine whether:

- (a) Hutton's transmission of monies arising from the settlement of the funds' transactions in their capital stock is consistent with prospectus disclosure;
- (b) the funds' capital stock transactions are in compliance with requirements of Rule 22c-1 as well as prospectus disclosure;
- (c) the monies received under the funds' 12b-1 plans are computed in accordance with methods described in the plans;
- (d) the procedures for the transmittal of monies by Hutton for the purchase of variable annuities are consistent with federal securities laws and to make recommendations for whatever remedial actions he deems appropriate;
- (e) the policies and procedures utilized by Hutton to prevent violations of federal securities laws in connection with its investment company business are adequate and to recommend, where appropriate, changes in policies and procedures and staffing necessary to assure ongoing compliance."

Appointment of the Independent Consultant:

With the concurrence of the Securities and Exchange Commission, E.F. Hutton selected Frederick M. Werblow, a partner of Price Waterhouse, as the independent Consultant to conduct the review.

The Order states in Sections IV.G.(2) through (7), that the independent Consultant:

- (2) "...shall have access to any and all documents in the possession of Hutton and may meet with any person, including, but not limited to, any officer, director, agent and employee of Hutton;"
- (3) "...shall receive the full cooperation of Hutton...;"
- (4) "...may communicate with the staff of the Commission...;"

- (5) "...shall report to the Commission...as the Commission shall request...;"
- (6) "...may engage such assistance, clerical, legal or expert, as necessary and at reasonable cost to carry out his duties...;"
- (7) "...shall prepare and submit to the Commission and Hutton a public report of his findings and recommendations for any changes in Hutton's operations. The report shall also contain recommendations relating to new procedures and the continuation of existing procedures concerning items (a) to (e) above, to ensure that all such operations and procedures are in accordance with applicable law. The Report shall be provided to Hutton's Board of Directors and to the Boards of Directors of the funds."

This report is intended to satisfy the objective stated in Section IV.G.(7).

Assistance Engaged:

Section IV.G.(6) of the Order permits the independent Consultant to engage assistance as necessary to carry out his duties. Accordingly, Mr. Werblow engaged the firm of Price Waterhouse, of which he is a partner, to conduct the review with him, and Stanley J. Friedman, Esq., a partner of Shereff, Friedman, Hoffman & Goodman, and that firm to act as his legal counsel. The Commission and E.F. Hutton approved these appointments.

Interpretation of the Order:

While paragraphs IV.G.(1)(a)-(d) are specific, paragraph IV.G.(1)(e) contains two terms that require interpretation: "federal securities laws" and "investment company business."

Federal securities laws - Upon advice of Stanley J.

Friedman, Esq. and Shereff, Friedman, Hoffman & Goodman, it was decided that the federal securities laws relevant to the subject under review include:

- o Investment Company Act of 1940, as amended.
- o Securities Act of 1933, as amended.
- o Securities Exchange Act of 1934, as amended.
- o Investment Adviser's Act of 1940, as amended.

These four statutes and the rules and regulations thereunder were considered in light of the mandate in Section IV. G. (1)(e) of the Order "to determine whether...the policies and procedures utilized by Hutton to prevent violations of federal securities laws in connection with its investment company business are adequate and to recommend, where appropriate, changes in policies and procedures and staffing necessary to assure ongoing compliance". Since most of the requirements and restrictions governing Hutton's investment company business are imposed by the Investment Company Act of 1940, the other three statutes were considered primarily in terms of their applicability to policies and procedures required for compliance with the Investment Company Act of 1940. For example, the prospectuses and statements of additional information of the Hutton funds were read not for general compliance with the Securities Act of 1933 and the applicable forms thereunder, but rather as a guide in identifying the control objectives and describing the policies and procedures set forth in Section II of this report. In addition, specific disclosures in these documents were considered and evaluated where required as part of the review mandated by items (a) and (b) of Section IV. G. (1) of the Order or where the review mandated by those items and items (c), (d) and (e) of that section indicated that particular policies and procedures might be inconsistent with the Investment Company Act of 1940.

The review also considered the procedures relating to compliance with subchapter M of the Internal Revenue Code and with certain state securities laws since these are important aspects of the administration of investment company operations.

Investment company business - E.F. Hutton's investment company business can be viewed from several perspectives: the investment companies that are sponsored by E.F. Hutton; the Hutton internal organization and outside agents that serve those investment companies and form the environment for the administration of investment company operations; and the functions that the Hutton entities and its outside agents perform on behalf of the Hutton sponsored investment companies.

Hutton Sponsored Investment Companies:

The Order makes specific reference to both the Hutton Investment Series Inc. (HIS) and Hutton's variable annuity contracts and identifies specific objectives related to them. The text of Section IV.G.(1) is expanded to include "administration and operations of investment companies ("funds") to which Hutton acts as investment adviser or sponsor..."

After discussions with the staff of the Securities and Exchange Commission and E.F. Hutton and its legal counsel, the independent Consultant and the advisers he engaged determined that the scope of the Order should include the following:

Hutton Investment Series Inc. (HIS)

- o Short Term Investment Series
- o Growth Series
- o Bond and Income Series

- o Emerging Growth Series
- o Option Income Series
- o Government Securities Series
- o Basic Value Series
- o Precious Metals Series

Hutton Municipal Bond Funds (MUNI)

- o Hutton National Municipal Fund Inc.
- o Hutton California Municipal Fund Inc.
- o Hutton New York Municipal Fund Inc.

Hutton Cash Funds (CASH)

- o Cash Reserve Management, Inc.
- o Municipal Cash Reserve Management, Inc.
- o Hutton AMA Cash Fund, Inc.
- o Hutton Government Fund, Inc.

Hutton Variable Investment Program (VIP)

- o The VIP Separate Account of E.F. Hutton Life Insurance Company
- o Hutton VIP Fund
 - Money Market Series - Variable Account I
 - Equity Series - Variable Account II
 - Bond and Income Series - Variable Account III

Hutton Sponsored Unit Investment Trusts (UITs)

- o The Consultant was advised that as of December 1985 there were approximately \$4.4 billion of assets in over 300 separate series of unit investment trusts that had been sponsored by E.F. Hutton.

Hutton Telephone & Telecommunications Tax-Advantaged Trust

- o This fund had approximately \$200,000 in assets at October 31, 1985.

The work program that was developed to study these investment companies grouped the funds into four categories:

- o HIS and MUNI Funds
- o CASH Funds
- o VIP Separate Account and VIP Fund
- o UITs

The administration and operations surrounding each of these groups are fairly consistent for all funds within each group. The only exceptions are the series of the Hutton VIP Fund. These represent the investment vehicles for the Hutton VIP Separate Account and are administered by many of the same agents as the Hutton HIS and MUNI funds. Yet, for clarity, the description of administrative activities pursuant to the federal securities laws for the VIP Fund is included in Section II D. which describes the administration of the VIP Separate Account of E.F. Hutton Life Insurance Company.

The size of the Hutton Telephone & Telecommunications Tax-Advantaged Trust at the time of this study was relatively insignificant. What is more important, Hutton has advised that this trust is being discontinued. Accordingly, it was given little consideration during the review.

Hutton Internal Organization and Outside Agents:

The organization that provides for the administration of the operations of the Hutton funds is large and diverse. Directly or indirectly, it involves a portion of the internal E.F. Hutton organization and a variety of outside agents. Exhibit 1 at the end of this section contains a chart which depicts each of the Hutton investment company groups and the entities that are involved in providing ad-

ministration and support services to them. This review has identified the functions provided by these internal and outside agents.

The process is controlled largely by the Administration section within the Hutton Asset Management Division of E.F. Hutton. The organization of this section is shown in Exhibits 2 and 3. This group reports to the Senior Officer in charge of Hutton Asset Management and, ultimately, is responsible to the funds' directors. It has the responsibility to interact with, supervise and monitor the outside agents, including outside legal counsel, who serve the funds and to coordinate with the various E.F. Hutton entities which serve or interact with the funds.

E.F. Hutton Life Insurance Company staff provides administration for the Hutton VIP Separate Account and VIP Fund.

The organization and functions performed by these administrative groups are described more fully in the Overview sections included in Section II of the report.

Functions Performed:

In order to provide a focus for the review and a structure for the resulting report, the essential functions or activities of the funds are grouped into several categories:

- o Shareholder (capital stock) and variable annuity contractholder (unit) activities (sales, redemptions, exchanges, etc.), dividend and distribution declarations, disbursements to or reinvestments for shareholders or contractholders and the transmission of monies
- o Portfolio (investment) activities (buys, sells, income and capital changes) and transmission of monies

- o Fund and Separate Account expenses, including accrual and disbursements of expenses, including distribution fees
- o Fund accounting, including calculations of net asset values of the funds and unit values of the Separate Account
- o Financial reporting
- o Regulatory compliance

These functions apply to the HIS, MUNI and CASH funds. The VIP Fund has many of the same characteristics except that each series has only one shareholder, the Separate Account. The Hutton VIP Separate Account has characteristics in addition to those mentioned above and differs in certain respects from the HIS, MUNI and CASH funds. The UITs are not actively managed after the day of deposit and, by definition, they do not continuously offer their shares in the ordinary course of business. Hence, the grouping of functions described above are not applicable to UITs.

Notwithstanding the differences noted, this grouping of functions identified provided a framework for conducting the review. The findings and recommendations contained in Section II of this report generally follow that structure.

PROJECT APPROACH AND SCOPE

Approach to the review:

This review was divided into five phases -

1. Compilation of a comprehensive list of control questions and control objectives.
2. Documentation of work flow and cash flow.

3. Limited verification of procedures.
4. Development of recommendations to strengthen the administration of investment company operations.
5. Preparation of a final report.

The following is a general description of each phase; however, the Project Scope Section contains the procedures performed for each group of funds.

Phase 1: Compilation of a Comprehensive List of Control Questions and Control Objectives.

The Order states that the review should cover the way in which Hutton administers its investment company operations and should consider the policies and procedures to prevent violations of the federal securities laws. This has been interpreted to mean the identification of the policies and procedures that create a control environment for the Hutton investment company operations and development of recommendations designed to improve such control procedures. Therefore, a primary requirement was to compile a list of control questions which were used to formulate control objectives for each of the major groupings of Hutton sponsored investment companies. The control objectives so developed were used to identify the control procedures employed by E.F. Hutton and its outside agents which were designed to provide E.F. Hutton with reasonable assurance of compliance with policies and restrictions outlined in the prospectuses and statements of additional information of each of the Hutton funds as well as with the applicable federal securities laws.

The control objectives developed for each area of the review are outlined in Section II of the report. That section contains a series of charts grouped by type of investment company and by function within company. Each chart contains

a list of control objectives, a description of the E.F. Hutton control procedures designed to provide reasonable assurance that each control objective is met and, wherever appropriate, recommendations to enhance the control procedures or to institute new procedures.

The control objectives were prepared with the assistance of the independent Consultant's legal counsel. Such counsel reviewed the funds' prospectuses and statements of additional information, as well as the procedures dealt with in this report, in light of the federal securities laws and the rules and regulations thereunder.

Although the review pursuant to the order covered each detailed control objective identified in the federal securities laws and in the funds' prospectuses and statements of additional information, the objectives contained in Section II of this report are presented sometimes at a summary level to highlight the essential administrative functions.

Phase 2: Documentation of Work Flow and Cash Flow:

This phase involved identifying and documenting Hutton's policies and procedures for the administration of investment company operations. This objective was pursued by:

- o interviewing those involved in or responsible for the process involving each investment company or fund group
- o gathering written documentation of the procedures, wherever it was available, or preparing such documentation, if it was not; and
- o gathering, on a selective basis, relevant evidentiary matter to support the representations made by those who were interviewed.

The documentation prepared covered not only the control procedures and flow of transactions, but also the timing and nature of the cash flows associated with the transactions affecting the Hutton funds. The process of preparing documentation was useful in gaining an understanding of the control procedures contained in Section II of the report.

Phase 3: Limited Verification of Procedures:

During the course of Phase 2, particular attention was paid to the items outlined in the Order, specifically procedures described in Section IV.G.(1)(a)-(d). These procedures were tested by tracing selected transactions through the processing steps outlined in the documentation.

The testing performed in conjunction with this review was intended to provide those conducting the review with a better understanding of the design of the process. The testing was not intended to assure that any specific set of transactions was processed accurately nor was it intended to provide assurance with regard to financial statement balances contained in any reports covering the Hutton funds identified in this review.

Once the documentation was fully prepared, copies were reviewed with the E.F. Hutton management and supervisory personnel, outside counsel for the funds and representatives of the outside agents serving the funds to confirm that the procedures documented were representative of the control procedures in effect at the time of the review.

Phase 4: Development of Recommendations:

During the course of this review, and in the preparation of supporting documentation and this report, opportunities were identified where the organization, staffing and procedures

surrounding Hutton's administration of investment company operations should or could be strengthened. The recommendations so developed were divided into two categories.

The first set of recommendations concern issues in which it was perceived there was an inconsistency or possible variance from the disclosures in the prospectuses and/or statements of additional information and/or possible inconsistencies with the federal securities laws. They are presented in the letter which is an integral part of the final report of the independent Consultant.

The second set represent conditions where, in the view of the independent Consultant, controls would be strengthened if the recommendations were adopted. These recommendations are presented in Section II and arose, either as a result of the documentation of the control procedures or were developed based upon the Consultant's experience with similar practices in the industry.

During the course of the review, as preliminary findings became known they were discussed with E.F. Hutton and/or Hutton Life personnel responsible for the areas involved and, in some cases, with Hutton's counsel and counsel for the funds. As a result, in response to certain recommendations, E.F. Hutton represented that certain procedures were modified or new procedures were instituted. The findings and recommendations in Section II of the report are based upon conditions noted at the time of the review and do not reflect subsequent changes in control procedures.

Phase 5: Preparation of a Final Report:

The final report of the independent Consultant consists of the letter and the accompanying report.

The letter describes the findings and sets forth the more important recommendations of the independent Consultant. The report describes the approach to the project and the scope of the work performed. It also presents in detail the control objectives reviewed and the procedures employed by E.F. Hutton and its agents to meet those objectives and describes the findings of the review.

Consistent with an understanding of the requirements in the Order, the review was not of sufficient scope to enable the independent Consultant or those he engaged to express, and he and they do not express, an opinion as to whether the degree of compliance with the control procedures referred to above was sufficient to provide the Board of Directors of E.F. Hutton & Company Inc. and the Boards of Directors of the Hutton funds with reasonable assurance that the control objectives were met at any time or for any period of time. Also, he, and those he engaged, are unable to express, and do not express an opinion on the system of controls for the administration of investment company operations taken as a whole.

The review was not an examination conducted in accordance with generally accepted auditing standards and, accordingly, neither the independent Consultant nor those he engaged express an opinion on any financial statements of E.F. Hutton or any of the Hutton funds.

Project Scope:

General:

The project scope for the HIS, MUNI, Cash and VIP Funds consisted of the following general steps:

1. Reading each prospectus and statement of additional information for each of the funds and identifying

investment policies and restrictions, operating guidelines and compliance issues. In addition, the transfer agent and custodian agreements as well as the 1984 annual financial statements for each of the funds was read.

2. Compilation of the requirements of the applicable federal securities laws and the rules and regulations thereunder for the administration of investment company operations. Such requirements were reviewed by the legal counsel for the independent Consultant as described under Interpretation of the Order.
3. Preparation of checklists to be used during the interviews which considered the requirements identified in steps 1 and 2.
4. Formulation of control objectives. The control objectives were further refined as the Project Team visited units within E.F. Hutton as well as the various departments within each of the outside agents providing administrative services to the Hutton funds.
5. Interviews with managers in each of the Hutton departments and at various departments of the outside agents listed on Exhibit 1 (excluding subcustodians, legal counsel and independent accountants). These interviews included obtaining selected documents to confirm the interviewers' understanding of the representations made during the interview process. A limited number of transactions were traced through certain transaction processing systems in order to further confirm the Project Team's understanding of the system design. The documentation prepared as a result of the interviews was reviewed with those who were interviewed as an additional check that it accurately described the procedures represented to be in effect.

6. Copies of the reports of the independent accountants of the funds regarding internal accounting controls resulting from their December 31, 1985 examinations were obtained and read. No material weaknesses were disclosed in any of those reports.

7. The Project Team requested E.F. Hutton to obtain a written report from the independent accountants of each fund describing the scope of the procedures performed on the items set forth in the Order, including the four items in Section IV.G.(1)(a)-(d). Also requested was a description of the procedures performed by such independent accountants relating to EDP systems and the data processing environment of E.F. Hutton. Copies of these reports were read. Matters included therein were clarified by discussions with the respective independent accountants.

Regulatory Compliance:

Regulatory compliance was one of the major functional areas reviewed and the scope of this review covered the following departments of E.F. Hutton and Hutton Asset Management Division, which is primarily responsible for establishing policies and procedures designed to provide reasonable assurance that the funds comply with the applicable regulatory requirements:

- o Investment management
- o Compliance Department
- o Finance Department
- o Fund administration
- o Shareholder operations
- o E.F. Hutton Legal Department

Investment management:

The Project Team interviewed each of the senior or lead portfolio managers. This group included lead managers of portfolios for virtually all of the investment companies subject to the review. Other selected portfolio managers, traders and operations personnel were interviewed as well. During the interviews, emphasis was placed on identifying the procedures used to comply with the applicable investment objectives and restrictions contained in the funds' prospectuses and statements of additional information and with other regulatory requirements. In addition, the following procedures were discussed:

- o the investment decision making process
- o trade authorization and execution
- o interaction with the custodians and recordkeeping agents for the funds
- o monitoring interest and dividends receivable and corporate actions.

The Project Team observed certain procedures performed by these various individuals and obtained copies of selected documentation and reports.

The Project Team documented the procedures and reviewed the documentation with those interviewed, who confirmed that it was representative of the procedures in effect.

Compliance department:

The Project Team interviewed the Compliance Officer and obtained copies of the compliance manuals for all funds. Such manuals contained checklists used on a daily basis to monitor compliance with certain investment restrictions, the Investment Company Act of 1940 and rules thereunder. The

compliance checklists for all funds were reviewed for completeness by comparison to the investment restrictions contained in the prospectuses and statements of additional information as well as to the applicable rules of the Investment Company Act of 1940. The Project Team selected one day's portfolio transaction authorization tickets for two portfolios of HIS and one Cash Fund and traced selected tickets to the applicable fund portfolio records. The Project Team obtained completed daily compliance checklists prepared by the HAM Compliance Department personnel which documented the compliance of such transactions with the investment restrictions.

The Project Team also obtained and read the "access persons" lists maintained by the Compliance Officer.

The procedures performed to monitor compliance with the requirements of Subchapter M of the Internal Revenue Code, and in particular, the 30% gross income limitation, were discussed with the Compliance Officer.

The Project Team read a selection of the Compliance Officer's reports to the Boards of Directors for HIS and for a selected Cash Fund as well as selected portfolio managers' signed statements indicating compliance with the requirements of Rules 10f-3, 17a-7 and 17e-1.

Finance department

The Project Team compared the 1984 annual financial reports for the funds to Article 6 of Regulation S-X and with Section 30 of the Investment Company Act of 1940 to identify the presence or absence of required disclosures.

The manager of the Finance department was interviewed to identify the functions performed by the department including

the functions related to both internal and external financial reporting and the degree of his monitoring of the recordkeeping agents.

The control procedures surrounding, budgeting, approving fund disbursements, review and revision of expense accruals, allocation of expenses to each series of the series funds, preparation of management information and the extent of the department's involvement in the preparation of annual and semiannual reports to shareholders, Form N-SAR, Form N-1A, proxy information and the 24(f)-2 filings were identified, among others.

Copies of selected financial and operating reports prepared by the Finance department and submitted to management and directors of the HIS series were obtained and read.

Fund administration:

The Project Team interviewed the Fund Administrator to determine the duties and responsibilities of that position and the procedures followed to meet the control objectives identified. Copies of the distribution lists for director's information and registration statements were obtained to corroborate the representations made regarding preparation and distribution of such information. Copies of the regular newsletters and information sheets sent to Account Executives were also obtained and the procedures for communicating with the Account Executives and others were identified.

The Project Team also interviewed the Chief Administrator and obtained a description of the control procedures used by him and the other departments of Hutton Asset Management Division to provide reasonable assurance that the funds

comply with the applicable federal securities laws. The Project Team gained an understanding of the manner in which the Chief Administrator supervises the departments that report to him and the procedures for interacting with other E.F. Hutton departments.

The Project Team obtained and read the 1985 compliance calendars for the funds for which HAM has administrative responsibilities. Such calendars were also reviewed by legal counsel to the independent Consultant.

The compliance calendars for HIS and Cash Reserve Management Inc. were selected and compared to the summary of applicable requirements of the Investment Company Act of 1940 and the rules and regulations thereunder.

The Project Team selected items listed on the calendars and compared the items selected to the corresponding minutes of the meetings of the Boards of Directors in order to determine whether the actions were taken as required.

The minutes of the meetings of the Boards of Directors for HIS and Cash Reserve Management, Inc. were reviewed for the adequacy of the presentation and the content of the information contained therein by legal counsel to the independent Consultant.

Finally, the Project Team made inquiries about cash flows with regard to portfolio transactions and procedures used to follow up failed portfolio trades and past due income, including the extent to which credit is received by the funds from the custodians on cash balances. The Project Team compared their understanding of these procedures with the other members of the Project Team performing work at the funds' custodians.

Shareholder operations:

The Project Team interviewed the manager in charge of Shareholder Operations to gain an understanding of the procedures used to monitor compliance with state securities laws. It was found that Hutton Asset Management engages the outside legal counsel to the funds to monitor the state securities law requirements and register additional shares. The Project Team interviewed outside legal counsel to the Cash Funds to identify the procedures used to monitor share sales and registrations.

E.F. Hutton Legal Department:

The Project Team interviewed the in-house legal counsel of E.F. Hutton who has been assigned the responsibility for assisting the Hutton Asset Management Division. The interview concentrated on procedures performed by such counsel and the extent of his involvement in investment company matters for the funds.

HIS AND MUNI FUNDS:

Procedures Performed by Area of the Review:

The HIS and MUNI Funds were considered together because they are served by the same set of agents and their transactions follow the same general transaction paths.

The first step was to understand the flow of transactions for these investment companies. In addition to the general procedures mentioned above, this was done by discussions with the Chief Administrator at Hutton Asset Management, as well as with the supervisors of each of the departments involved in the administration process. These discussions

were supplemented by reading the descriptions of procedures contained in E.F. Hutton's Mutual Fund Directory. Also, a review was made of the current prospectus and statement of additional information for each of the investment companies. From this information a set of control objectives was prepared which was used as the basis for the review. This set of control objectives was combined with control objectives developed from the detailed review of the federal securities laws.

The control objectives were further refined as the project team visited units within E.F. Hutton as well as the various departments within each of the outside agents providing administrative services to these investment companies.

To enhance the Project Team's understanding of the flow of transactions and to review the specific areas of inquiry noted in Section IV.G.(c) of the Order, the Project Team performed the following procedures in addition to the general procedures mentioned above.

Shareholder transactions:

Section IV.G.(1) of the Order identified the two following specific areas of inquiry regarding shareholder transactions:

- (a) Hutton's transmission of monies arising from the settlement of the funds' transactions in their capital stock is consistent with prospectus disclosure.
- (b) The funds' capital stock transactions are in compliance with the requirements of Rule 22c-1 as well as prospectus disclosure.

These matters were specifically considered during the review and the procedures set forth below were performed.

The Project Team read the prospectus disclosures regarding the pricing of capital shares for the Bond and Income Series and the Government Securities Series of HIS. The time of valuation of such shares was changed from 2:00 p.m. to 4:00 p.m. (New York City time) as disclosed in the HIS prospectus dated November 18, 1985. This amendment was considered in the Project Team's review of the pricing of capital share purchases for the HIS series.

A visit was made to a branch office of E.F. Hutton to discuss and observe matters regarding shareholder order processing. The Project Team interviewed the branch office manager and an Account Executive to discuss and observe procedures for (i) opening an E.F. Hutton investment account, (ii) order ticket processing and entry, including time and date stamping, and (iii) preparation of transaction confirmations and customer statements. Supervisory review and approval procedures were also discussed and observed. Order ticket documents supporting a limited number of sample shareholder transactions, as reflected on E.F. Hutton transaction reports, were read.

Several visits were made to the transfer agents for the funds to discuss and obtain an understanding of the processing of shareholder transactions, including share purchases, redemptions, exchanges, transfers, dividends and distributions and shareholder account maintenance. General and application controls surrounding the processing and recording of shareholder transactions were also discussed and observed.

The Project Team obtained and read the most recent third party report on the internal accounting control review of the DST Systems, Inc. Mutual Fund System.

Sample documents evidencing the flow of transactions were inspected during the detailed interviews. Such documents served to confirm the Project Team's understanding of procedures for processing shareholder transactions, including those transmitted by E.F. Hutton.

The Project Team visited the E.F. Hutton Cashiering Control department to discuss the procedures for the transmission of monies from E.F. Hutton to the custodian for capital share transactions. The Project Team interviewed the department manager and inspected sample reports and documents evidencing capital share transactions and the transmission of related monies. The Project Team traced a sample transmission of share purchase transactions and monies from E.F. Hutton to IFTC where the transactions were recorded on the shareholder accounting system and the monies were deposited in the fund custody account.

Department managers and supervisors at both the E.F. Hutton HFD department and Retirement Account Operations department were interviewed to improve the Project Team's understanding of procedures and work flow regarding E.F. Hutton's handling of shareholder redemption orders. Procedures were discussed and observed regarding handling of different types of shareholder accounts (e.g., retirement accounts, regular accounts); reviews of shareholder orders; cutoff procedures; transmission of orders to the transfer agent; and other functions performed by these departments. Sample documents were obtained as evidence of the work and information flow and were discussed during the interviews.

To further confirm the understanding of procedures and work flow, the Project Team traced a sample of share purchase and redemption transactions (20 items) from E.F. Hutton transaction activity reports and summaries to the recording

of those items in the individual shareholder accounts on the DST Mutual Fund System. Sales charges on MUNI funds and contingent deferred sales charges on the HIS redemptions were recalculated for these transactions where applicable.

Portfolio transactions:

Interviews were conducted at IFTC with personnel having responsibility for custody and portfolio accounting functions. Procedures for recording portfolio transactions, interacting with HAM and the sub-custodian and the reconciliation of portfolio holdings were discussed in detail. Sample documents evidencing the authorization of trade executions and settlements were inspected as were reconciliations of statements of portfolio holdings prepared by the sub-custodian to the accounting records of the funds.

The IFTC Portfolio Accounting and Custody department manual was obtained and read and the procedures included therein were discussed with IFTC managers and supervisors. In addition, the third party report on the internal accounting control review of the DST Systems, Inc. Portfolio Accounting System utilized by IFTC was reviewed by the Project Team in detail. This report provided documentation of the system's general and specific application controls. The "client responsibilities" identified in the report as well as IFTC's procedures to fulfill them were discussed in detail with IFTC.

Cash, accounts payable and expenses:

Section IV.G.(1) of the Order identified as a specific area of inquiry:

"(c) the monies received under the funds' 12b-1 plans are computed in accordance with the methods described in the plans."

The Project Team performed the following procedures related to this issue:

- . The Distribution Plan of Hutton Investment Series Inc., as amended, and the related Distribution Agreement were obtained and read.
- . Plan disclosure in the HIS prospectus and statement of additional information dated November 18, 1985 was read.
- . The methodology applied by IFTC in the calculation of the HIS distribution fee was discussed with representatives of IFTC and E.F. Hutton.
- . The calculation of the HIS distribution fee for the month of December 1985 performed by IFTC was tested. The fee accrual for each day during the month was calculated and the calculation data was traced to its underlying support for a period of five days. Documentation evidencing payment of the December 1985 fee to E.F. Hutton was also examined.

The Project Team discussed the cash disbursement and expense authorization and recording procedures with HAM and IFTC personnel. The daily cash reconciliation procedures were discussed with IFTC and a few reconciliations were read.

Fund accounting and calculation of net asset value per share:

General accounting and review procedures were discussed with IFTC personnel on various occasions. Procedures were also discussed relating to the IFTC accounting manual and the DST Portfolio Accounting System third party review report, as noted above. Securities valuation and net asset value per share computation procedures were discussed with HAM and IFTC personnel. A few documents evidencing review procedures and supervisory approval (e.g., Pricing Stratification reports and Net Asset Value Rollforward schedules) were obtained and read.

CASH FUNDS

Procedures Performed by Area of the Review

To enhance the Project Team's understanding of the flow of transactions and to review the specific areas of inquiry in Section IV.G.(1) of the Order, the Project Team performed the following procedures for the Cash Funds in addition to the general procedures mentioned above.

Shareholder Transactions:

Section IV.G.(1) of the Order identified the two following specific areas of inquiry regarding shareholder transactions:

- (a) Hutton's transmission of monies arising from the settlement of the funds' transactions in their capital stock is consistent with prospectus disclosure.
- (b) The funds' capital stock transactions are in compliance with the requirements of Rule 22c-1 as well as prospectus disclosure.

These matters were specifically addressed during the review as part of the following procedures.

A visit was made to a branch office of E.F. Hutton to discuss and observe shareholder order processing. The Project Team interviewed the branch office manager and an Account Executive. During these interviews procedures were discussed and observed for (i) opening an E.F. Hutton investment account, (ii) accepting and entering orders for Cash Fund capital share transactions and (iii) tracing transactions through customer statements. At the same time, supervisory and approval procedures were also discussed and observed.

Several visits were made to BNE to discuss, observe and document processing of shareholder transactions, including direct transactions with shareholders, transactions submitted by E.F. Hutton, processing of dividends to shareholders and changes in shareholder account information. General and application controls surrounding BNE's computerized shareholder accounting system were also discussed and observed during separate visits. During the course of these detailed interviews, selected documents evidencing the flow of transactions were read to reconfirm the Project Team's understanding of the procedures for processing transactions.

The Money Market Instruments Section of E.F. Hutton was also visited in order to discuss and observe procedures relating to the transmission of shareholder transactions to and from BNE, including procedures surrounding the follow up of items on the "break list" of differences between E.F. Hutton and BNE records. A selection was made of differences reflected on one list and documentation evidencing the disposition of the items was obtained and read.

Portfolio Transactions

Interviews were conducted at BNE with personnel having responsibility for custody and portfolio accounting. For one fund, documentation relating to a single day's portfolio transactions was obtained, including trade authorizations, interest cards, delivery/receipt instructions and settlement advices. Information regarding each transaction was traced through each relevant document evidencing various stages of the transaction cycle at BNE. As previously described, procedures relating to investment management were also discussed and observed at Hutton Asset Management.

Cash/Accounts Payable/Expenses

Section IV.G.(1) of the Order identified as a specific area of inquiry:

- (c) "the monies received under the Cash Fund's 12b-1 plan are computed in accordance with the methods described in the plan."

This matter was considered during the review and the procedures described below were performed.

Interviews were conducted at BNE with personnel responsible for fund accounting. Cash activity for the fund and day referred to as "Portfolio Transactions" was traced from the cash disbursement and receipts journals to documentation evidencing the transaction, and to the general ledger posting.

The computation of each fund's distribution fee was obtained for a selected day and the amount charged to the expense was recalculated, noting that the net asset value used in the calculation agreed to that day's net asset value computation. In addition, information contained in the 1985 annual financial statements was used to recompute the approximate ratio of distribution fees to average net assets for the year. The method of computation of 12b-1 fees was compared to the 12b-1 plan. Such plan was read by legal counsel to the independent Consultant.

Fund Accounting and Calculation of Net Asset Value:

Interviews were conducted at BNE with personnel responsible for fund accounting and the computation of net asset value. Procedures and controls surrounding fund accounting were discussed, including the performance of key reconciliations and the comparison of the portfolio's market value to the amortized cost valuation.

The net asset value computation and general ledger were obtained for the fund and day referred at "Portfolio Transactions" above. Portfolio purchases and sales and other selected activity were traced to the funds accounting records. General ledger balances were traced to the day's net asset value computation.

Data Processing Systems

The primary data processing systems affecting the Cash Funds are the E.F. Hutton order ticket processing system and the various systems at the Bank of New England. Unlike the HIS and MUNI Funds, neither of these systems is subject to a third party review. As a consequence, the Project Team made brief inquiries of the data processing group within E.F. Hutton as to the nature of the controls surrounding its application systems, its general data processing controls and its data security controls. In addition, the Team received representations from the external auditors for E.F. Hutton & Company Inc. regarding the nature of their review of data processing within E.F. Hutton. With regard to the Bank of New England, the Project Team made inquiries of the internal auditors of the Bank of New England to determine the nature and extent of the review performed by them of the data processing systems at the Bank. In addition, certain inquiries were made regarding general EDP controls at E.F. Hutton by the Project Team.

HUTTON VIP SEPARATE ACCOUNT AND HUTTON VIP FUND

The review covered the operations and control procedures of E.F. Hutton Life Insurance Company ("Hutton Life") with respect to the offer, sale and maintenance of individual flexible premium deferred annuity and variable accumulation contracts issued by the VIP Separate Account and funded through investments in the Hutton VIP Fund.

In its Order the SEC stated in paragraph No. 21:

"Hutton receives payment for the purchase of variable annuity contracts. In some instances, monies remitted are not transmitted by Hutton in a timely manner resulting in, among other things, some annuity contracts being purchased at other than current net asset value."

The SEC then ordered in paragraph "F" that:

"Hutton shall immediately take steps to insure that all monies received by it as payment for variable annuities shall be promptly transmitted to the issuers of the variable annuities."

Furthermore, Section IV.G.(1) of the Order identified a specific area of inquiry:

"(d) the procedures for the transmittal of monies by Hutton for the purchase of variable annuities are consistent with federal securities laws and to make recommendations for whatever remedial actions he deems appropriate.

The principal objective of the Project Team was to determine whether the procedures for transmitting and processing purchase payments for Hutton Life variable annuity contracts are consistent with the federal securities laws. The most pertinent provision of the federal securities laws in this regard is Section 22 of the 1940 Act and Rule 22c-1 thereunder according to legal counsel to the independent Consultant. For variable annuity contracts, Rule 22c-1 allows a variable annuity issuer (Hutton Life) to process initial purchase payments within a two-day/five-day time span. For subsequent payments, pricing must occur utilizing the current net asset value next computed after receipt of a purchase order in good form with payment.

Accordingly, a part of this review was to evaluate the existing systems and procedures utilized by Hutton Life to administer variable annuity contracts with particular emphasis on initial and subsequent purchase payments and the timing of the recording of the purchase in the VIP Separate Account and VIP Fund.

The Project Team followed a set of general procedures similar to those employed for the other funds including:

- (1) Obtaining and reading samples of the variable annuity contracts, prospectuses and statements of additional information of the Hutton VIP Separate Account and VIP Fund.
- (2) Defining specific contract objectives.
- (3) Identifying control procedures in existence to meet the defined control objectives.
- (4) Conducting interviews with Hutton Life personnel involved with variable annuity processing.
- (5) Documenting the procedures.
- (6) Performing tests of the procedures for selected variable annuity contracts.

Hutton Life uses the services, systems and procedures of certain outside agents to process transactions and to maintain records and documents for its variable annuity contracts and for the operations of the Hutton VIP Fund. These service/system providers include Investors Fiduciary Trust Company ("IFTC"), DST Systems, Inc. ("DST") and First Interstate Bank ("FIB"). Additionally, Hutton Asset Management serves as Investment Adviser for the Hutton VIP Fund.

The Project Team did not review the systems of DST or IFTC. These systems were looked at in conjunction with the procedures performed for the HIS and MUNI funds. The DST Annuity System is used by Hutton Life on a remote basis. Rather, the Team read the third party internal control reports of the operations and control procedures of DST Systems, Inc. related to its Annuity System Participant Accounting Application, dated September 16, 1985, Portfolio Accounting System, dated October 2, 1985 and the Mutual Fund Transfer Agency and Shareowner Servicing Functions, dated October 15, 1985. To supplement the review of these reports, the Team inquired into user controls at Hutton Life to the extent that such reports identified procedures or responsibilities of users of these systems.

Through discussions with certain of the personnel at FIB, custodian for Hutton VIP Fund, the Project Team gained an understanding of the control procedures used by FIB's Institutional Custody Services and Trust Securities Operation Department as related to the VIP Fund.

Finally, since these variable annuity contracts are distributed solely by E.F. Hutton & Company Inc. Account Executives, the Project Team visited a Hutton branch office and interviewed the Insurance Coordinator for the region. At that time, the specific procedures and systems utilized at the branch office level to process the sale of variable annuity contracts were identified.

On two separate visits in January and February 1986, the Project Team identified and documented the major activities of the departments of Hutton Life which are involved in the processing, issuance and maintenance of variable annuity contracts, the VIP Separate Account and the Hutton VIP Fund, including their interaction with DST, IFTC, FIB and Hutton

Asset Management. Hutton Life officials, supervisors and clerical/administrative staff were interviewed to obtain an understanding of the relevant systems, procedures and records. Access was provided to the personnel and records requested; however, information pertaining to an internal audit of Hutton Life's Accounting and Annuity Service operations, was not provided until April 9, 1986.

To focus on the specific directives of the SEC Order, the Project Team reviewed the processing of contractowner payments and related transactions. This review included the Annuity Owner Service (AOS), Annuity Receipt Processing (ARP) and Accounting departments which are primarily responsible for these functions. The period from November 1 to December 31, 1985 was chosen to select new contacts issued and certain other operations were inquired into concurrently with visits made in January and February 1986.

As part of the inquiry, a selection was made of variable annuity transactions consisting of initial and subsequent premium payments received by wire and mail, redemptions/withdrawals, both full and partial, transfers between variable subaccounts, cancelations, death benefit claims and the issuance and maintenance of contracts and the maintenance of contractowner's records. A separate selection was made on a judgmental basis from contracts issued during the period November 1 through December 31, 1985 for each type of variable annuity contract issued and each type of payment processing mode, wire or mail, as well as of the other contractowner transactions noted above. Actual contractowner files were read which show the history of the contractowner's account. The transaction values including net asset values/pricing for the various transactions were selectively recomputed. On selected dates during the test

period payments/ receipts and disbursements were reconciled to and from Hutton Life for the Separate Account.

The Project Team also inquired into the processing of payments received by Hutton Life from E.F. Hutton, and the processing of transactions between Hutton Life and FIB and Hutton Life and IFTC.

UNIT INVESTMENT TRUSTS (UITs):

In its Order of Temporary Exemption (Investment Company Act Release No. 14774, October 29, 1985) the SEC did not discuss, in the context of its review of the deficiencies in E.F. Hutton's investment company operations, any deficiencies specifically with respect to E.F. Hutton's unit investment trust operations. Accordingly, the scope of the review by the independent Consultant was not directed at any specific problem areas.

The following SEC releases were read:

- a. Order Instituting Proceedings, Findings, and Order Imposing Remedial Sanctions (Investment Company Act Release NO. 14773, October 29, 1985); and
- b. Order of Temporary Exemption and Notice of and Order for Hearing on Application (Investment Company Act Release No. 14774, October 29, 1985); and
- c. Litigation Release No. 10915, October 29, 1985.

In none of the foregoing releases was there any mention or discussion of any violations by the unit investment trusts of any of the federal securities laws including, in particular, the Investment Advisers and Investment Company Acts of 1940. In its Order granting a Temporary Exemption from Section 9(a) of the Investment Company Act, the Commission

imposed certain restrictions upon E.F. Hutton. However, the Commission specifically stated that E.F. Hutton could sponsor new unit investment trusts or new series of existing UITs.

Accordingly, a review of the administrative matters in the formation and monitoring of UITs which E.F. Hutton sponsors was conducted to determine whether the policies and procedures of E.F. Hutton were adequate to provide reasonable assurance of compliance with control objectives relating to the federal securities laws, specifically Section 26 of the Investment Company Act of 1940 applicable to UITs. The review did not extend to the operations of the independent trustees for UITs, the United States Trust Company of New York or the Bank of New England as the order was directed only to E.F. Hutton's policies and procedures. Also, review did not extend to the sales and secondary market activity of UITs since those functions are broker-dealer activities and are not considered part of investment company operations or administration.

The review of administration of UITs sponsored by E.F. Hutton consisted of the following steps:

1. Reading of orders and release referred to above to ascertain which findings, if any, pertain to the unit investment trust operations of E.F. Hutton.
2. Consultation with legal counsel to the independent Consultant to determine the applicable federal securities laws pertaining to the administration of UITs by E.F. Hutton.
3. Inquiry as to the number of unit investment trust offered and personnel responsible for creating and supervising these trusts.
4. Reading prospectus and trust indenture documents for a sample of series to determine any significantly different features among the varieties of trusts.

5. Interviews with selected personnel, depicted in the organization chart in Section II.E. of this report, who are responsible for creating and supervising these trusts to gain an understanding of their procedures and responsibilities covering the creation and monitoring of the trusts.
6. Identification of procedures associated with:
 - Compliance with federal securities laws, specifically Section 26 of the Investment Company Act of 1940 as it applies to unit investment trusts.
 - Compliance with responsibilities as set forth in the prospectuses and trust indentures for E.F. Hutton.
 - Appropriate authorization and approvals
 - Custody and safekeeping of trust assets
 - Trust accounting and recordkeeping
 - Financial reporting to unitholders
 - Compliance with SEC annual report and registration statement filing requirements.
7. Development of recommendations, where applicable, to institute or strengthen policies and procedures to maintain or improve compliance with the Investment Company Act of 1940 and prospectus and trust indenture guidelines for the Trusts.

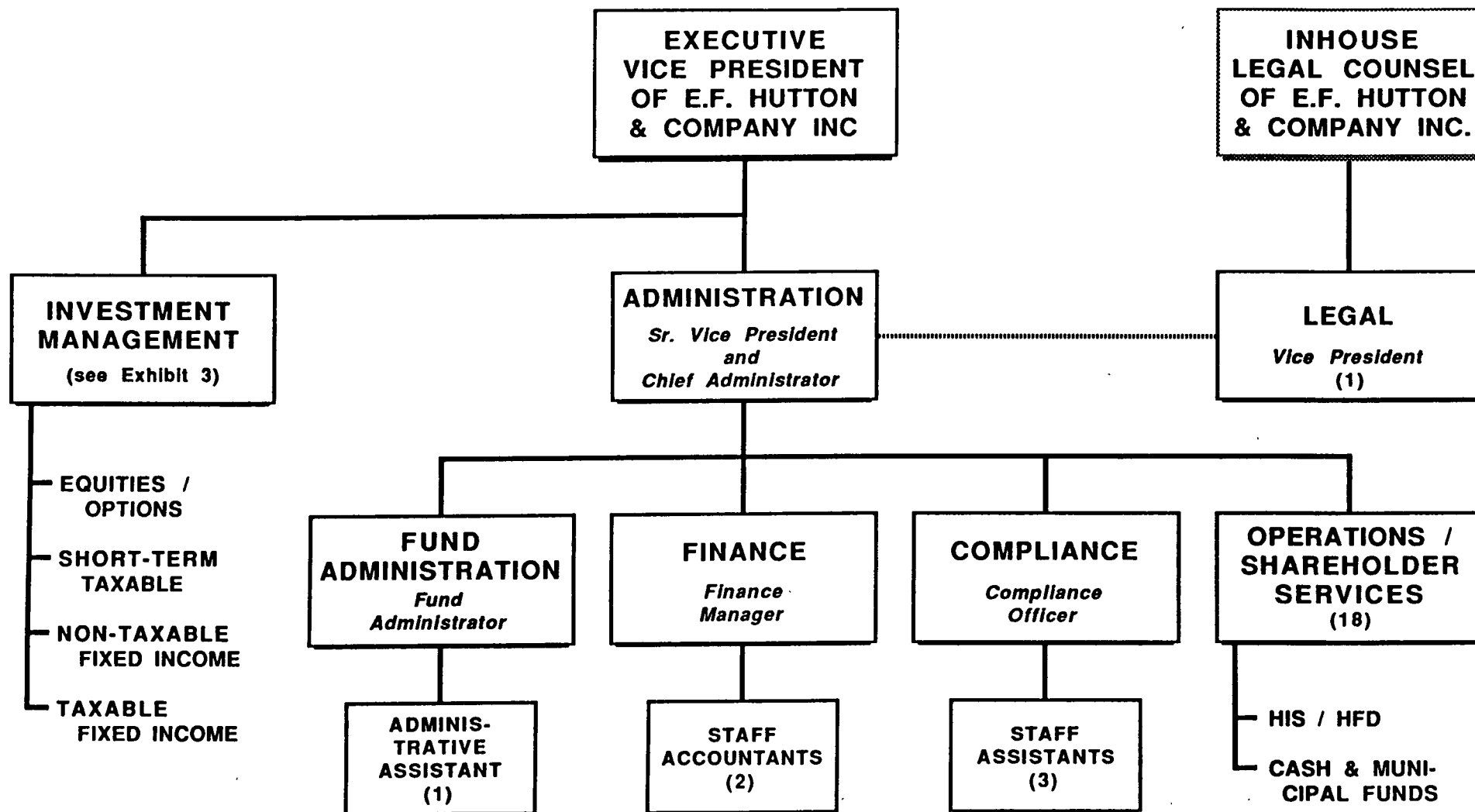
E.F. HUTTON & COMPANY INC.ENTITIES SERVING THE E.F. HUTTON INVESTMENT COMPANIES

<u>Entities</u>	<u>Hutton Investment Series</u>	<u>Municipal Bond Funds</u>	<u>Cash Funds</u>	<u>Hutton VIP Separate Account</u>	<u>Hutton VIP Fund</u>	<u>UITs</u>
o E.F. Hutton - Broker/Dealer -						
. Branches and Account Executives	X	X	X	X		X
o Hutton Asset Management						
. Portfolio Managers/Assistants	X	X	X		X	
. Administration						
- Administrator	X	X	X			
- Finance	X	X	X			
- Compliance	X	X	X		X	
- Line Operations	X	X	X			
. Hutton Fund Distributors (HFD)	X	X				
o Legal	X	X	X			
o Public Finance (N.Y., Phila.)						X
o Cashiering Control	X	X				
o Money Market Instruments			X			
o AMA/ARA Account Operations			X			
o E.F. Hutton Data Processing						
. Systems Development	X	X	X			
. Operations	X	X	X			
. Telecommunications	X	X	X			
o E.F. Hutton Life Insurance Company				X	X	
o Transfer Agent and Dividend Disbursing Agent						
. Investors Fiduciary Trust Company	X	X			X	
- DST Systems, Inc.	X	X				
. Bank of New England			X			

<u>Entities</u>	<u>Hutton Investment Series</u>	<u>Municipal Bond Funds</u>	<u>Cash Funds</u>	<u>Hutton VIP Separate Account</u>	<u>VIP Funds</u>	<u>UITs</u>
o Custodian and Recordkeeping Agents						
. Investors Fiduciary Trust Company	X	X			X (1)	
- Chase Manhattan Bank - subcustodian	X	X				
. Bank of New England			X			
- Bankers Trust Company - subcustodian			X			
. First Interstate Bank					X	
- Chase Manhattan Bank - subcustodian					X	
o Trustees						
. U.S. Trust Company of New York						X
. Bank of New England						X
o Legal Counsel to the Funds						
. Cahill Gordon & Reindel			X			
. Dechert Price & Rhoads	X	X		X	X	
o Legal Counsel to the Independent Directors						
. Goodwin, Proctor and Hoar	X	X	X			
. Hufstedler, Miller, Carlson and Beardsley					X	
o Independent Accountants						
. Arthur Andersen	X	X	X			X
. Touche Ross & Co.				X	X	
o Evaluators						X

(1) Recordkeeping agent only.

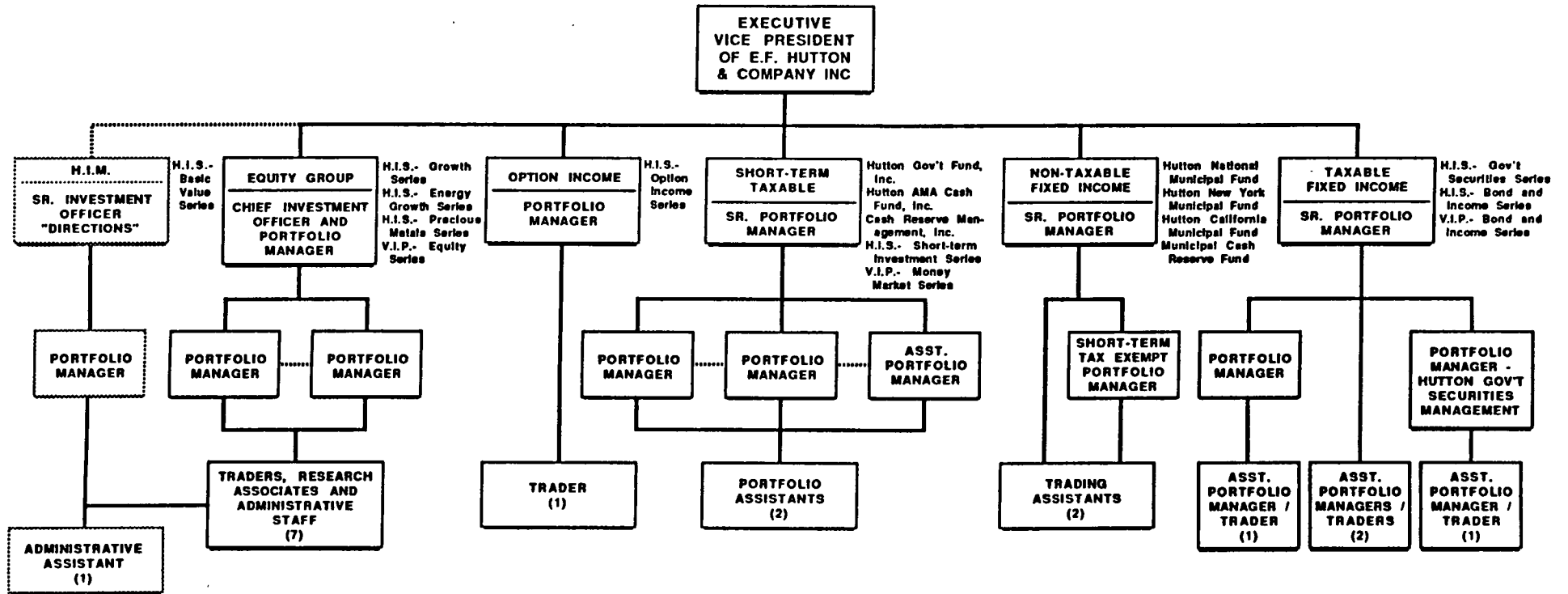
HUTTON ASSET MANAGEMENT DIVISION



HUTTON ASSET MANAGEMENT DIVISION

INVESTMENT MANAGEMENT GROUPS

RELATING TO INVESTMENT COMPANY OPERATIONS



II. FINDINGS AND RECOMMENDATIONS

II. HUTTON FUNDS
FINDINGS AND RECOMMENDATIONS

E.F. HUTTON & COMPANY INC.

FINDINGS AND RECOMMENDATIONS

This section summarizes the findings of the review of investment company operations at E.F. Hutton, Hutton Life Insurance Company and their agents. It is comprised of five major sections.

The first section presents findings relating to regulatory compliance issues for the HIS, MUNI, and Cash Funds. These issues were summarized in this section to avoid duplication in the remaining sections since these funds are subject to similar control procedures. Occasionally a regulatory issue will be included in another section for these funds where it was considered necessary to clearly present a set of procedures. Regulatory compliance issues for the VIP Separate Account, VIP Fund and UITs are included in the sections applicable to those fund groups.

The remaining four sections summarize the findings for the four fund groups which were the subject of the review, namely:

- o HIS and MUNI Funds
- o Cash Funds
- o VIP Separate Account and the VIP Fund
- o Hutton sponsored UITs

Each of the five sections is comprised of two subsections, an Overview and a summary of Control Objectives and Procedures. In each case, the Overview describes the investment products or funds to which it applies, the E.F. Hutton, Hutton Life entities or outside agents who

participate in processing transactions for the funds or perform administrative duties for the funds, the key transaction cycles for the funds and the general control environment.

The summary of Control Objectives and Procedures consists of a series of charts which are divided into three columns. The first column contains a description of the control objectives which were the subject of the review. The second column contains a list of procedures or functions performed by the E.F. Hutton entities, Hutton Life or the funds' outside agents which are designed to provide reasonable assurance that the control objectives are satisfied. The third column is used to express a view as to the adequacy of the procedures and describe comments or findings or to present recommended procedures to strengthen the administrative controls over the administration of E.F. Hutton's or Hutton Life's investment company operations.

Generally the charts are organized by the types of transactions or activities that effect the E.F. Hutton investment companies. The major groupings are:

- o Shareholder transactions
- o Portfolio transactions
- o Cash, accounts payable and expenses
- o Fund accounting and net asset value computations
- o Financial reporting

In many cases, these categories are further subdivided. The categories are different for UITs and the Hutton VIP Separate Account. The Regulatory Compliance section is subdivided by the various federal securities laws. In reading the charts, it will be noticed that the nature and extent of the control objectives and the procedures employed

to satisfy the objectives may differ among the fund groups. These differences are due to differences in the nature of the funds and variety of entities and agents involved in serving them. It was found that more than one set of procedures could be deemed to be appropriate to satisfy the control objectives.

In attempting to review the effectiveness of the administration of investment company operations, one of the first considerations was to develop an understanding of the general control environment. It was noted that there are several factors common to the fund administrative network of Hutton entities and outside agents which provide an important measure of control. These include:

- o Separation of duties
- o Use of data processing
- o "Third party" or "single auditor" reviews
- o Dual processing systems
- o The confirmation process
- o Administrative controls

Separation of Duties - The number of entities involved in the process of administering the Hutton funds' operations serves as a measure of control since duties that might be deemed incompatible from a control standpoint if performed by one entity are divided among several entities, both internal and external to Hutton. While this adds to the complexity of the organizational structure, it also serves to provide a variety of cross checks of one entity or agent's work against another's, and this provides a broad measure of control.

During this study the separation of duties and the nature and extent of the cross checks performed was reviewed. These primary control procedures were documented and are summarized in the charts contained herein.

Use of Data Processing - The transaction processing environment both within E.F. Hutton and at its outside agents places a high degree of reliance upon automated systems. Such systems include:

- o The E.F. Hutton Order Ticket Processing, Bookkeeping (Cashiering), Security Margin and Statements systems.
- o Automated interfaces with the Bank of New England and DST Systems, Inc. (DST);
- o Automation at Investors Fiduciary Trust Company and at DST of the Portfolio Accounting System (PAS), Mutual Fund System and the Annuity System Participant Accounting Application (Annuity System) processing system;
- o Automation of the shareholder accounting system at the Bank of New England.

All are a part of the general control environment.

Data processing systems can provide an added measure of control versus manual processing. In such an environment reliance can be placed upon properly designed and controlled systems to handle the same transactions uniformly over a period of time. The emphasis, of course, is upon properly designed and controlled systems. Systems that are poorly designed and controlled can significantly increase the risk of both intentional and unintentional errors. The extent to which the systems involved in the Hutton funds operations environment are controlled is addressed in general in the remainder of this section and in specific references in the charts summarizing control operations and procedures.

Third Party Reviews - With the emphasis placed upon the proper design and control of data processing systems, a useful secondary control can be obtained if third parties have made recent, substantive reviews of the controls and the processing environment. In the case of the Hutton funds the following third party reports were issued covering DST Systems, Inc.:

- o General EDP Controls dated September 2, 1985
- o Portfolio Accounting System (PAS) dated October 2, 1985
- o Mutual Fund Transfer Agency and Shareowner Servicing Functions dated October 15, 1985
- o Annuity System Participant Accounting Application dated September 16, 1985

The added control of these reviews is implied when these systems are referenced throughout this report.

The data processing systems at E.F. Hutton are extensive, highly integrated and complex. They are subject to annual review by the independent accountants of E.F. Hutton as part of their examination of the financial statements.

The processing systems at the Bank of New England are not subject to a third party or single auditor review, but they are reviewed by the internal auditors within the bank and they come under scrutiny during the independent audit of the Bank and the Cash Funds of Hutton as part of their annual examination of the financial statements of such entities.

Dual Processing - In limited instances, notably in the processing of shareholder transactions for the Cash Funds by the Bank of New England (BNE), there is an added measure of control since BNE and E.F. Hutton run systems in parallel.

Most shareholder transactions are processed through the E.F. Hutton network and forwarded to BNE as shareholder servicing agent and as the accounting agent for the Cash Funds.

Transactions processed by BNE directly with Cash Fund shareholders are sent to E.F. Hutton as well. Hutton has control procedures designed to balance the records of Hutton and BNE daily and investigate and correct any differences.

The rationale for dual processing is that the Cash Funds are used as the investment vehicle for free credit balances for certain Hutton investment accounts and those balances are "swept" automatically into the Cash Funds generally on a daily basis. Also, the Cash Funds may be used as a temporary investment vehicle by other Hutton clients. Therefore, it is important for E.F. Hutton to have data regarding transactions in the Cash Funds to include in its client statements. Likewise, it is critical for BNE to control all transactions effecting the Cash Funds in its role as shareholder servicing agent.

This dual processing of the Cash Funds represents a broad based general control.

Confirmation Process - Generally, financial or maintenance transactions, whether submitted by the shareholder directly to the agent or through their Account Executive or performed by automated processes, e.g., dividend reinvestments, systematic payment plans, systematic withdrawal plans, sweep of free credit balances, are confirmed. The confirmation may be a separate form or may be the monthly shareholder statement. While this control depends upon the effective review of the confirmation or statement by the shareholder, it does represent a significant control mechanism.

Cash Fund transactions whether effected through the E.F. Hutton Order Ticket System and its related integrated processing systems or directly with BNE are confirmed to Hutton clients in Hutton's monthly statements. For the HIS and MUNI Funds, the Transfer Agent sends a confirmation directly to the shareholder. This confirmation process represents a significant primary control which is enhanced since both the shareholder and the shareholder's Account Executive are sent copies of the confirmations and/or statements.

Administrative Controls - Another important general control feature in the administration of E.F. Hutton investment company operations is the Hutton Asset Management Division Administration section depicted in Exhibit 2 to Section I of this report. It is the function of this group to supervise and monitor most of the investment company operations, to interact with E.F. Hutton departments and outside agents and, as is described more fully in the Regulatory Compliance Overview as well as the charts which follow, to perform certain financial reporting and compliance functions on behalf of the E.F. Hutton investment companies. This monitoring of the control network is itself a significant secondary control feature. Consequently, the analysis of the organization, staffing, functions and qualifications of this group within E.F. Hutton formed a significant part of this review.

Hutton Life Insurance Company and is charged with administration of operations surrounding the Hutton VIP Separate Account and the VIP Fund series.

Administration of the UITs is divided among several Hutton entities depending upon the types of investments being made by the trusts. As described in Section II.E. of this report, there are three Divisions within E.F. Hutton which share this responsibility: Hutton Asset Management and the Public Finance divisions in New York and Philadelphia.

A. REGULATORY COMPLIANCE

A.1. REGULATORY COMPLIANCE

OVERVIEW

E.F. HUTTON & COMPANY INC.

REGULATORY COMPLIANCE
OVERVIEW

INVESTMENT PRODUCTS:

This section applies to the following investment companies advised or sponsored by E.F. Hutton:

HUTTON INVESTMENT SERIES INC.
HUTTON NATIONAL MUNICIPAL FUND INC.
HUTTON CALIFORNIA MUNICIPAL FUND INC.
HUTTON NEW YORK MUNICIPAL FUND INC.
HUTTON AMA CASH FUND, INC.
CASH RESERVE MANAGEMENT INC.
MUNICIPAL CASH RESERVE MANAGEMENT, INC.
HUTTON GOVERNMENT FUND INC.

CONTROL SYSTEMS - KEY PARTICIPANTS:

Hutton Asset Management (HAM) is the division of E.F. Hutton which is responsible for administering the above fund operations. It interfaces with various other departments and divisions of E.F. Hutton, including the marketing, distribution and legal departments. In its capacity as investment adviser to the Hutton funds, HAM administers the affairs of the funds and provides the funds with investment management and is responsible for making investment decisions on behalf of the Hutton funds in accordance with the investment objectives, policies and restrictions set forth in the funds' registration statements. HAM also provides the funds with the necessary office space, telephone and other communications facilities and personnel to perform administrative and clerical functions, including monitoring the performance of the funds' agents and overseeing the financial reporting to shareholders and the funds' compliance with the federal securities laws and the other laws and regulations to which the funds are subject.

HAM also provides investment management to the VIP Fund. The administrative and other functions for the VIP Fund are performed by E.F. Hutton Life in La Jolla, California or agents and are discussed in Section II.D. of this report.

This section provides a brief description of HAM's organizational structure, staffing levels, functional responsibilities and relationships with outside agents as well as the general policies and procedures used by HAM to oversee that the funds for which it has administration responsibility comply with the applicable regulatory requirements.

HAM is organized along functional lines as follows:

- Investment Management
- Administration
- Finance
- Compliance
- Shareholder Support Operations

Investment Management

Investment management - is provided by several groups, each of which specializes in certain types of securities and is directed by a senior portfolio manager.

The portfolio managers and assistant portfolio managers in each group are responsible for making investment decisions for each of the portfolios which they manage and they report directly to a senior official of E.F. Hutton & Company Inc. who is the chief executive in charge of E.F. Hutton's HAM division and is President of the funds.

Each group has several traders and trading assistants who are responsible for assisting the portfolio managers by executing transactions, preparing and maintaining the portfolio records, interfacing with the custodians of the respective funds and performing other functions necessary to provide investment management services.

HAM utilizes essentially manual portfolio records. Each portfolio group follows many similar procedures; however, there are distinct differences in the degree of utilization of the records provided by the custodians of the funds and the review procedures performed with respect to such records. A description of each group and the related portfolios for which the group is responsible follows:

1. Equity Group: This group manages the HIS Growth, Emerging Growth, and Precious Metals Series and the VIP Fund Equity Series. Including the senior portfolio manager, the group consists of three full-time portfolio managers, two traders and five research associates and administrative support staff.

2. "Directions" Group: This group is part of the Hutton Investment Management Division of E.F. Hutton & Company Inc. and prepares an advisory letter and manages several non-investment company portfolios. Its only investment company responsibility is to provide portfolio management to the HIS Basic Value Series. One portfolio manager in the group has been assigned this responsibility in addition to his other duties. This portfolio manager utilizes the operations support staff of the Equity Group for executing trades and maintaining the required records for the Basic Value Series.

3. Option Group: The option group consists of a portfolio manager and a trading assistant and is responsible for the management of the HIS Option Income Series.

4. Taxable Money Market Group: The taxable money market group is responsible for managing the Cash Reserve Management Fund Inc., the Hutton Government Fund, Inc., the Hutton AMA Cash Fund, Inc. and the Short Term Investment Series of HIS as well as the Money Market Series of the VIP Fund. In addition, this group interfaces with the other portfolio groups and invests the temporary cash portion of the equity and long-term taxable debt portfolios. The group consists of a senior portfolio manager and three other portfolio managers/assistant portfolio managers and two portfolio assistants.

5. Taxable Long Term Debt Group: This group is responsible for managing the HIS Government Series and the HIS Bond and Income Series as well as the Bond and Income Series of the VIP Fund. In addition, the group is responsible for managing institutional accounts under the direction of a separate portfolio manager who

reports to the senior portfolio manager. The group consists of three portfolio managers and four assistant portfolio managers/traders. In addition to its portfolio management responsibilities, this group is unique with respect to the funds because it furnishes prices to the recordkeeping agent for use in the computation of the daily net asset values of the above mentioned long term debt portfolios.

6. Tax Exempt Group: This group is responsible for managing the Hutton National Municipal Fund, the Hutton New York Municipal Fund and the Hutton California Municipal Fund as well as the Municipal Cash Reserve Fund. The senior portfolio manager is assisted by another portfolio manager whose responsibility is managing the Municipal Cash Reserve Fund and the temporary cash portion of the other MUNI funds. The group also has two trading assistants.

Administration -

The Chief Administrator of HAM is responsible for all the administrative and operational functions of all of the Hutton funds managed by HAM with the exception of the administrative functions of the VIP Funds which are the responsibility of Hutton Life. The Chief Administrator is assisted by a Fund Administrator and an administrative assistant. The Fund Administrator's responsibilities include coordination of the preparation of registration statements with outside legal counsel, independent accountants and the applicable departments within HAM; coordination with the marketing and sales departments; and various communications regarding fund distribution, including presentation of training seminars. The other departments which are described below report directly to the Chief Administrator.

Finance Department -

This department consists of a manager and two assistants. This department is responsible for internal reporting of HAM's financial results, internal reporting for the funds and coordinating with the funds' recordkeeping agents, independent accountants and outside legal counsel regarding the preparation of external reports for

shareholders and financial information to be included in regulatory reports and filings. The Finance Department also coordinates with the recordkeeping agents and independent accountants on financial and tax reporting issues applicable to the funds.

Compliance Department -

The Compliance Department consists of a Compliance Officer and three assistants who have responsibility for determining transactions reported by the portfolio managers have been appropriately processed by the recordkeeping agents of the funds. This department also determines that such transactions are in compliance with certain prospectus restrictions and certain other investment restrictions and limitations to which the funds, including the VIP Fund, are subject. These include Rules 10f-3 and 17a-7 under the Investment Company Act of 1940. The Compliance Officer is responsible for reviewing the reports received from certain "access persons" pursuant to the codes of ethics adopted by the funds.

The group prepares an analysis of the realized gains on the sale of securities held less than three months and is responsible for alerting management concerning compliance with the 30% gross income limitation on such gains for federal income tax purposes. The Compliance Officer reports directly to the Board of Directors on the various funds' compliance with the investment restrictions and the above mentioned rules.

Shareholder Support Operations -

This group has responsibility for checking certain redemption requests made on the HIS Series and interfacing with the transfer agent and the distributor. Its prime functions are described in the HIS and MUNI funds section of this report.

Outside Professional Firms:

HAM relies extensively on outside legal counsel to the Hutton funds and on the funds' independent accountants in administering the funds' operations and effecting compliance with federal securities laws, state securities laws and federal and state tax rules and

regulations. Certain of the functions provided by such professionals are described in detail in the procedures sections which follow. Dechert Price & Rhoads are the outside legal counsel to the HIS and MUNI funds and the VIP Fund and VIP Separate Account. Cahill Gordon & Reindel are the outside legal counsel to the Cash funds. Arthur Andersen & Co. are the independent accountants for the HIS, Muni and Cash funds. Touche Ross & Co. are the independent accountants for the VIP Fund and the VIP Separate Account. Legal counsel to the independent directors of all the Hutton funds except the VIP Fund are Goodwin, Proctor & Hoar. Hufstedler, Miller, Carlson & Beardsley are legal counsel to the independent directors of the VIP Fund.

CONTROL SYSTEM - PRINCIPAL CONTROLS:

The objectives and procedures section which follows identifies individual control objectives and the procedures used by HAM and its agents to accomplish the objectives. Some of the more important elements of the control environment are summarized below.

- Management reporting and review:

The procedures adopted by HAM provide for review of investment and operating data by executive management. The portfolio managers meet regularly with the senior Hutton official in charge of HAM to discuss investment strategies and performance. Operational information is prepared on a monthly basis and reviewed by both the senior Hutton official in charge of HAM and the Chief Administrator. HAM provides performance and other data, including portfolio brokerage commission summaries and expense data to the boards of directors of the Hutton funds on a quarterly basis.

- Awareness of Prospectus limitations:

HAM portfolio managers have the responsibility to determine that trades comply with the restrictions and limitations in the prospectus and statement of additional information for each of the Hutton funds. The portfolio managers in the different groups have adopted procedures regarding their responsibility for compliance to different degrees.

- Independent review of each transaction for compliance:

Checklists which contain the more significant restrictions and limitations are used by the Compliance Department to check whether each transaction made by any of the funds violates any restrictions. Such compliance checklists also include certain restrictions imposed by the Investment Company Act of 1940 and rules and regulations thereunder, including Rule 2a-7, Rule 10f-3 and Rule 17a-7.

- Periodic monitoring of compliance with certain federal income tax requirements:

Qualification checklists are prepared monthly by the Compliance Department to determine compliance with certain Subchapter M requirements.

- Reliance on independent accountants for federal and state tax reporting compliance:

Hutton requests its independent accountants to supervise its recordkeeping agent in the preparation of tax basis information and relies on such accountants to prepare the federal and state tax returns. This effort is coordinated by the manager of the HAM Finance Department.

- Receipt of written summaries of actions necessary to comply with federal and state securities laws:

HAM requests each outside legal counsel to the funds to furnish compliance calendars which are listings of all filings and other actions required under the federal and state securities laws.

The Chief Administrator delegates to others at HAM and to outside entities the actions listed on such calendars and informally monitors the status of such actions.

A.2. REGULATORY COMPLIANCE
CONTROL OBJECTIVES AND PROCEDURES

A.2.a. REGULATORY COMPLIANCE
COMPLIANCE WITH THE INVESTMENT
COMPANY ACT OF 1940

E.F. HUTTON & COMPANY INC.
HIS, HUTTON MUNICIPAL AND CASH FUNDS
COMPLIANCE WITH THE INVESTMENT COMPANY ACT OF 1940

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>Calculation of net asset value and recording of transactions complies with the requirements of Rule 2a-4 and 2a-7 with respect to the Cash Funds.</u>	1.(a) See Calculation of Net Asset Value section for a description of the procedures established to comply with Rule 2a-4. (b) The funds' directors have adopted procedures designed to comply with Rule 2a-7. Such procedures have been reviewed by the funds' outside legal counsel. (c) HAM's Compliance Department is responsible for monitoring compliance with 2a-7.	Control design is considered adequate except as otherwise disclosed in the "Calculation of Net Asset Value" sections of this report.
2. <u>The fund complies with the diversification requirements of the 1940 Act.</u>	2. Compliance with the prospectus restrictions is monitored on a daily basis by the HAM Compliance Department. Such prospectus requirements are more restrictive than the diversification requirements; so compliance with prospectus requirements should ensure compliance with the diversification requirements in the 1940 Act.	Control design is considered adequate.
3. <u>The composition of the board of directors of each fund complies with the requirements of Sections 10 and 16 of the 1940 Act.</u>	3. HAM relies on outside legal counsel to the funds to monitor compliance with this requirement.	Control design is considered adequate.
4. <u>Each member of the board of directors of each fund holds such office in accordance with the requirements of Section 16 of the 1940 Act.</u>	4. HAM relies on the funds' outside legal counsel to advise when such actions must be taken and to include this item for appropriate action at directors' and shareholders' meetings.	Control design is considered adequate.
5. <u>The principal accounting officer is designated annually by the directors.</u>	5.(a) HAM relies on outside legal counsel to the funds to include such action in the respective board meeting agendas on a timely basis. Actions are taken at the directors meetings. (b) HAM provides the name of the person to be designated the principal accounting officer.	5-1 The person designated as the principal accounting officer does not function in that capacity. Accordingly, consideration should be given to designating the individual who performs such functions as the principal accounting officer.

Control Objectives

6. Purchases of securities of an issuer during the existence of an underwriting or selling syndicate in which E.F. Hutton is a member are made in accordance with the requirements of Rule 10f-3.

7. The investment restrictions imposed by Section 12 of the Act and the various rules adopted thereunder are followed.

8. A plan pursuant to Rule 12b-1 has been adopted if distribution expenses are to be reimbursed to the distributor from the assets of the fund.

Control Procedures

- 6.(a) The boards of directors have adopted and annually approve procedures and review on a quarterly basis transactions effected in accordance with Rule 10f-3.
- (b) The portfolio managers and traders inquire for all "new issues" as to whether E.F. Hutton is a member of the underwriting syndicate.
- (c) Certain portfolio managers, including those who manage the cash funds, have established an informal procedure of not purchasing securities in which E.F. Hutton is a member of the underwriting syndicate. Portfolio managers who purchase such securities represented that they do so with full knowledge of the limitations and requirements of Rule 10f-3.
- (d) The established procedures of HAM require that transactions made by the portfolio managers pursuant to Rule 10f-3 be reported to the Compliance Officer quarterly. The Compliance Officer reviews such transactions for compliance with Rule 10f-3 and includes the listings signed by the portfolio managers in a report to the funds' boards of directors.

7. Most of the investments prohibited by Section 12 are included in the funds' investment restrictions disclosed in their Registration Statements.

- 8.(a) The Chief Administrator of HAM is aware of the requirements of Rule 12b-1 and the funds have adopted 12b-1 plans wherever the distributor is reimbursed for distribution expenses from the assets of the fund.
- (b) The funds' outside legal counsel is also familiar with the distribution arrangements of each fund. HAM relies on such counsel to advise management and the directors of the funds of the need for adoption of such a plan wherever necessary.

Comments/Recommendations

6-1 Procedures should be revised to require portfolio managers or traders to indicate on the trade ticket whether transactions effected are subject to Rule 10f-3 so that the Compliance Department can be alerted to such transactions.

6-2 Forms which list the requirements of Rule 10f-3 should be revised to include all the requirements of Rule 10f-3. Such forms should be completed for each trade subject to Rule 10f-3 either by the portfolio manager or by the Compliance Department of HAM on a timely basis, not quarterly, as required by current procedures.

7-1 HAM should include all restrictions imposed by Section 12 and the applicable rules thereunder on the checklists used by the Compliance Department.

7-2 See recommendations made in the Investment Portfolio section for the respective funds.

Control design is considered adequate.

Control Objectives

9. The Plan is administered in accordance with the requirements of Rule 12b-1.

Control Procedures

- 9.(a) All 12b-1 plans have been reviewed by both the outside legal counsel to the funds and the outside legal counsel to the independent directors of the funds.
- (b) The outside legal counsel to each fund prepares listings of actions required to be taken by the funds, called "compliance calendars", as well as agendas listing actions required for each meeting of the Boards of Directors.
- (c) Outside legal counsel to the independent directors requests in writing that HAM prepare specific information which is required to be presented to the directors in order for the directors to review and properly evaluate the continuance of the 12b-1 plan annually.
- (d) Information to be presented to the directors is prepared as a coordinated effort of the outside counsel for each fund and the Fund Administrator of HAM. Both the Chief Administrator of HAM and the President of the funds review all materials submitted to the boards of directors.
- (e) The boards of directors, including the disinterested directors, take actions required by Rule 12b-1.
- (f) The information submitted to the directors regarding expenses incurred by the distributor under Rule 12b-1 is prepared from the internal records of HAM which are part of the accounting and recordkeeping system of E.F. Hutton and are subject to audit by the independent accountants of E.F. Hutton.
- (g) The information used in the calculation of the 12b-1 fees is generated by third party agents which maintain the books and records of the funds. These calculations are subject to independent audit on an annual basis.

Comments/Recommendations

- 9-1 See Recommendation No. 7 in the Letter in this report.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
10. <u>The funds' investments in broker/dealers comply with the requirements of Rule 12d3-1 which permits purchases of such broker/dealers if the applicable requirements are met.</u>	10.(a) The portfolio managers are aware of the limitations and restrictions which apply to investments in broker/dealers under Rule 12d-1 prior to its amendment on July 20, 1984 through Release No. IC-14036 and redesignation as Rule 12d3-1. The combination of the previous requirements and the investment restrictions of the funds is more restrictive than the current requirements of Rule 12d3-1. (b) The compliance checklists which are used to review each securities transaction entered into by any of the funds contains guidance regarding the requirements of old Rule 12d-1 and serves as a check for compliance with certain requirements of this rule.	10-1 Checklists used by the Compliance Department should be updated to include the requirements of Rule 12d3-1. 10-2 The Compliance Department should maintain a listing of all such broker/dealers and any applicable parent companies as a reference to assure all applicable transactions in broker/dealer securities are identified and the requirements of Rule 12d3-1 are reviewed for compliance. 10-3 When applicable, portfolio managers and traders should clearly indicate on the trade ticket that a transaction is subject to the requirements of Rule 12d3-1.
11. <u>The advisory and underwriting contract, including the adoption and renewal of such contracts, comply with the requirements of Section 15 and the applicable rules thereunder.</u>	11.(a) Outside legal counsel to the funds reviews the investment advisory and underwriting contracts to determine that such contracts are in compliance with the applicable requirements of the 1940 Act and the rules and regulations thereunder. (b) Outside legal counsel is responsible for preparing the compliance calendars and agendas for the meetings of the boards of directors and helping to ensure that the actions required to be taken by the directors are taken in a timely manner in accordance with the applicable rules. (c) Procedures similar to those described above for Rule 12b-1 (Control Objective No. 9.) with respect to information provided by HAM apply to the advisory contracts. (d) The independent directors of the fund review and approve continuance of the investment advisory and principal underwriting contracts on an annual basis.	Control design is considered adequate.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
12. <u>Affiliated and interested parties are identified by fund management and reviewed with directors.</u>	<p>12.(a) The funds' outside and in-house legal counsel coordinate with HAM to define affiliated and interested parties and, periodically, discuss the requirements and prohibitions of dealing with affiliated parties with the portfolio management groups of HAM.</p> <p>(b) The Compliance Officer of HAM prepares a listing of "access persons" and submits it to outside legal counsel for inclusion in the material sent to the board of directors.</p> <p>(c) The funds have adopted a code of ethics which requires all "access persons" to report affiliated transactions to the Compliance Officers or the funds' outside counsel monthly.</p> <p>(d) The Compliance manuals include definitions of affiliated persons and types of prohibited transactions.</p>	See recommendations 14-1; 14-2 and 14-3.
13. <u>The reports required by the code of ethics are filed and monitored for potential conflicts/affiliated transactions or other transactions requiring consideration by management and the directors.</u>	<p>13.(a) A code of ethics is reviewed annually for applicability and access persons are required to submit written reports to the Compliance Officer of HAM, or in the case of the senior officers and directors to outside legal counsel, regarding any transactions that should be reported under such code of ethics.</p> <p>(b) The Compliance Officer and outside legal counsel receive listings of securities transactions of the funds as well as securities listed on the recommended list of E.F. Hutton. They compare them to the transactions listed on the monthly reports from "access persons". Established procedures require that exceptions to the code of ethics be brought to the attention of the Chief Administrator of HAM.</p> <p>(c) The Compliance Officer and the funds' outside legal counsel have established procedures to follow-up and obtain required reports from all "access persons".</p>	Control design is considered adequate.

Control Objectives	Control Procedures	Comments/Recommendations
<p>14. <u>Transactions with affiliates prohibited by Section 17(a) are not entered into and those permitted by Rules 17a-6 are only undertaken in accordance with the provisions of such rules.</u></p>	<p>14.(a) See the procedures described above under Control Objective No. 12 regarding identification of affiliates.</p> <p>(b) Transactions permitted by Rule 17a-6 are not entered into as a matter of internal policy.</p>	<p>14-1 A comprehensive list of affiliates, interested parties, and access persons should be developed. Types of prohibited transactions with such persons should be indicated and the list should be distributed to all portfolio managers and other members of HAM's Administration, Finance and Compliance Departments.</p>
<p>15. <u>Securities transactions with related investment companies are effected in accordance with the requirements of Rule 17a-7.</u></p>	<p>15.(a) The board of directors of any fund intending to engage in transactions with an affiliated fund has adopted procedures under Rule 17a-7. Such procedures are reviewed by the funds' outside legal counsel.</p> <p>(b) The directors review such procedures for continued applicability annually.</p> <p>(c) HAM portfolio managers of the Fixed Income and Money Market funds generally do not deal with affiliated funds and the Cash Funds have not adopted Rule 17a-7 procedures. Established procedures of HAM require that the equity portfolio managers execute any securities transactions between related investment companies in accordance with the procedures adopted by the Directors under Rule 17a-7.</p> <p>(d) The portfolio managers report quarterly any such transactions to the Compliance Officer who includes them in the reports submitted for review by the boards of directors.</p>	<p>14-2 HAM should require written confirmation on a quarterly basis by all portfolio managers that transactions entered into comply with all the applicable 1940 Act rules and regulations with respect to affiliated transactions.</p>
<p>16. <u>Securities transactions executed through E.F. Hutton are made in compliance with the requirements of Rule 17e-1.</u></p>	<p>16.(a) The boards of directors of the HIS and Hutton Municipal Funds have adopted procedures pursuant to Rule 17e-1. Such procedures have been reviewed by the outside legal counsel to the funds. The Cash Funds do not deal with E.F. Hutton to effect securities transactions and therefore have not adopted procedures pursuant to Rule 17e-1.</p>	<p>14-3 See Recommendation No. 9 in the Letter in this report.</p> <p>15-1 Forms should be developed which list all the requirements of Rule 17a-7. Such forms should be completed for each of the transactions subject to Rule 17a-7 either by the portfolio manager or by the Compliance Department of HAM on a timely basis.</p> <p>Control design is considered adequate</p>

Control Objectives

Control Procedures

Comments/Recommendations

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| 17. <u>The custodian selected complies with the requirements of Sections 17(f) and 26 of the Act.</u> | (b) Outside legal counsel to the funds prepare the annual compliance calendars and board meeting agendas previously described, on which they include the annual approval of the procedures adopted under Rule 17e-1.

(c) HAM procedures require the portfolio managers to list all transactions executed during the prior quarter at other than the established rates and the commission amounts per share for such transactions. Such reports are submitted to the boards of directors for review and approval. | Control design is considered adequate. |
| 18. <u>The use of securities depositories, such as the Federal Book Entry System or Depository Trust Company is reviewed and approved in accordance with the requirements of Rule 17f-4.</u> | 17.(a) HAM analyzes the custodians it has selected by making a review of their financial statements and third party auditor reports where available.

(b) Outside legal counsel to the funds prepares custodian agreements entered into by the funds to ensure such agreements comply with the requirements of the 1940 Act and rules and regulations thereunder.

(c) Provisions in the custodian agreements require that the funds approve any subcustodian arrangements prior to such arrangements being entered into by the custodians. | Control design is considered adequate. |
| 19. <u>Custody of foreign assets is in accordance with an arrangement which complies with the requirements of Rule 17f-5.</u> | 18.(a) HAM relies on outside legal counsel to the funds to include the annual review and approval of the depositories (Federal Book Entry and Depository Trust Co.) on the agendas for the board meetings.

(b) The boards of directors review and approve such arrangements.

19.(a) HAM has represented that the funds own no foreign securities or other foreign assets requiring a foreign custodian. Securities of foreign issuers purchased by the funds are limited to American Depository Receipt shares and are held by the regular custodians/subcustodians.

(b) HAM has advised that, should investments in foreign issuers requiring foreign custodians be contemplated, procedures pursuant to 17f-5 must be adopted. | Control design is considered adequate. |

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
20. <u>The boards of directors, including the required number of disinterested directors, determine the adequacy of the fidelity bond each fiscal year and that such bond complies with the requirements of Rule 17g-1.</u>	<p>(c) Outside legal counsel to the funds has discussed the issue with the directors and made them aware of such requirements.</p> <p>20.(a) HAM relies on outside legal counsel to the funds to determine actions needed to be taken by the boards of directors and to include such actions on the compliance calendars and/or the board meeting agendas referred to above.</p> <p>(b) HAM's Fund Administrator coordinates the information required for each directors' meeting and, with respect to Rule 17g-1, provides the information required by outside counsel to present to the directors.</p>	Control design is considered adequate.
21. <u>The adequacy of the fidelity bond is reviewed periodically by management to determine coverage is in accordance with Rule 17g-1(d).</u>	<p>21.(a) The adequacy of the fidelity bond is reviewed annually as described under Control Objective No. 20 above.</p> <p>(b) HAM's policy is to maintain the fidelity bond at a level that would comply with the requirements of Rule 17g-1(d) if all funds insured under the bond reach the maximum level of growth projected in the HAM Division annual business plan.</p>	21-1 A HAM officer or employee should review the adequacy of the fidelity bond for compliance with Rule 17g-1 at least quarterly.
22. <u>A code of ethics meeting the requirements of Rule 17j-1 has been adopted by management and directors.</u>	<p>22.(a) HAM has adopted for all funds a code of ethics pursuant to Rule 17j-1.</p> <p>(b) Outside legal counsel to the funds has reviewed the code of ethics for technical compliance with Rule 17j-1.</p>	Control design is considered adequate.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
23. <u>Capital transactions and borrowings comply with the requirements of Section 18(f).</u>	23.(a) The investment restrictions included in each of the funds' prospectuses have been drafted to be as restrictive or more restrictive than the requirements of Section 18. Compliance therewith should achieve compliance with Section 18. (b) The various checklists used by the Compliance Department of HAM contain questions which would indicate noncompliance with some requirements of Section 18.	23-1 HAM should incorporate all of the applicable requirements of Section 18 in the checklists used by the Compliance Department.
24. <u>The voting requirements imposed by Rule 18(f) are complied with for matters voted on by directors and shareholders.</u>	24. HAM relies on the fund's outside legal counsel to monitor that voting on the items noted in Rule 18(f) is in accordance with the rule.	Control design is considered adequate.
25. <u>Distributions made comply with the notification requirements of Rule 19a-1.</u>	25.(a) The manager of the Finance Department of HAM has advised that he is aware of the sources of dividends and distributions and coordinates the calculation of such distributions with the independent accountants. (b) HAM relies on the funds' independent accountants to advise HAM if distributions are made from a source requiring notification under Rule 19a-1. (c) The manager of the Finance Department drafts the language in the notification to shareholders in conjunction with the independent accountants and the recordkeeping agent.	Control design is considered adequate.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
26. <u>Distributions of long-term capital gains are made no more than once during any twelve month period as required by Rule 19b-1</u>	<p>26.(a) The independent accountants for the funds calculate the distributable income of the funds in conjunction with the recordkeeping agents on an annual basis.</p> <p>(b) The Manager of the Finance Department reviews with the funds' independent accountants the amounts to be distributed and the sources from which such distributions are to be made.</p> <p>(c) HAM's Finance Manager has advised that he is aware of the prohibitions of this rule and has, for one of the cash funds, obtained exemptive orders permitting more frequent distributions.</p> <p>(d) Portfolio managers have been instructed to monitor the portfolio for investments held longer than six months and advise the Chief Administrator prior to realizing gains on the sale of such investments.</p>	<p>26-1 HAM should establish more formal procedures to monitor long-term capital gains from securities transactions for the money market funds which do not have exemptive orders permitting more frequent distributions than once during a twelve-month period. Also, consideration should be given to seeking exemptive orders for such funds.</p> <p>26-2 See recommendations included in the section of this report entitled "Compliance with Federal and State Tax Regulations."</p>
27. <u>The appropriate material to be required in proxy statements by the 1940 Act and rules thereunder is included therein and there are no material omissions or misstatements.</u>	<p>27.(a) HAM has delegated the preparation of proxy materials to the funds' outside legal counsel and coordinates the preparation of such statements with each outside legal counsel.</p> <p>(b) The funds' outside legal counsel prepares a list of information required of fund directors and officers.</p> <p>(c) HAM's Chief Administrator receives such questionnaires, distributes them to the appropriate parties and coordinates the submission of such information with the funds' outside legal counsel.</p> <p>(d) Financial information included in the proxy statement is prepared by HAM.</p> <p>(e) Proxy statements are reviewed by the Chief Administrator and the President of the funds.</p>	Control design is considered adequate.

Control Objectives	Control Procedures	Comments/Recommendations
<p>28. <u>The directors take the necessary action of approving the time of determination of net asset value in accordance with the requirements of Rule 22c-1.</u></p>	<p>28.(a) HAM relies on each fund's outside legal counsel to advise it and the directors that the time of day of determination of the net asset value should be approved each year. Such legal counsel also reviews each prospectus and is responsible for helping ensure that the disclosure made therein with respect to the timing of the calculation of net assets is in compliance with the rule.</p> <p>(b) HAM is responsible for assuring that the operations of each fund with respect to pricing are in compliance with the prospectus disclosures. HAM undertakes to accomplish this objective by the procedures described under Control Objective No. 2 of the Compliance with the Securities Act of 1933 section.</p>	<p>Control design is considered adequate.</p>
<p>29. <u>The sales and redemptions of fund shares comply with the requirements of Section 22 and in particular Rules 22c-1, 22d-1 and 22e-1.</u></p>	<p>29.(a) Outside legal counsel participates in drafting the funds' registration statements which disclose the policies required by such rules.</p> <p>(b) HAM distributes such registration statements to the portfolio managers, the custodian and transfer agents as well as its Chief Administrator and in house legal counsel for review of the applicable sections.</p> <p>(c) HAM also obtains written assurance on an annual basis from the agents of the funds that they are complying with the requirements of the prospectuses and statements of additional information. HAM's Chief Administrator visits each agent at least quarterly, and has advised that he intends to obtain such assurance on a quarterly basis.</p> <p>(d) As an additional control, HAM requests the independent accountants of the funds to review such prospectuses and statements of additional information and advise HAM as to whether the information contained therein is consistent with their knowledge of the funds' operations gained during their annual examination of the funds' financial statements.</p> <p>(e) See procedures described in the Shareholder Transactions and Fund Accounting and Calculation of the Net Asset Value sections of this report.</p>	<p>Control design is considered adequate.</p>

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
30. <u>All sales literature of the Hutton funds is filed with the Securities and Exchange Commission as required by Rule 24b-2 and is reviewed for compliance with NASD guidelines.</u>	30.(a) Sales and advertising literature is required to be sent to in-house counsel of E.F. Hutton who reviews and forwards it to the outside counsel to the funds. Outside counsel files such information with the NASD, the SEC and the various states, as applicable, after becoming satisfied with the adequacy of the disclosures and the compliance with NASD requirements. (b) The funds' outside legal counsel sends copies of the filings to or otherwise notifies in-house legal counsel. (c) The Chief Administrator reviews sales literature prior to its use.	Control design is considered adequate.
31. <u>The notifications and filing fees required by Rule 24f-2 are prepared accurately, and are filed within 60 days subsequent to each funds' fiscal year-end.</u>	31.(a) The requirements and due dates for filing the notices are brought to the attention of HAM by the funds' outside legal counsel. (b) Such filing is listed on the compliance calendar prepared by the funds' outside legal counsel and furnished to HAM. (c) The information required for the filings is furnished by HAM. (d) The Fund Administrator is responsible for coordinating with the funds' outside legal counsel and providing such counsel with the information necessary to prepare the 24f-2 notice and to file it on a timely basis. (e) Draft 24f-2 notices are sent back to HAM by such counsel and the information thereon is checked by the manager of the Finance department prior to filing. (f) The funds' outside legal counsel sends a copy of the filing or verbally confirms to HAM the 24f-2 filings were made.	Control design is considered adequate.
32. <u>Sales of shares do not exceed authorized or registered shares.</u>	32. HAM relies upon the funds' outside counsel and its transfer agents to advise it when to authorize or register additional shares.	32-1 HAM should establish procedures whereby a designated officer checks, at least monthly, that shares sold do not exceed shares authorized or registered.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
33. <u>Shareholder reports required under Section 30 and Rule 30d are filed and conform with those requirements as well as with Regulation S-X.</u>	<p>33.(a) The time of reporting requirements to shareholders are communicated to HAM by its outside counsel on the compliance calendar.</p> <p>(b) The Manager of the Finance Department coordinates with the funds' outside legal counsel and the funds' independent accountants in order to effect timely and accurate filing of the information required.</p> <p>(c) HAM relies on its independent accountants to ensure that the reports filed comply with Regulation S-X, Section 30(d) of the 1940 Act and Rule 30(d) thereunder and generally accepted accounting principles.</p>	33-1 See the recommendations listed under the Financial Reporting section of this report for the respective funds.
34. <u>The funds' books and records, including those maintained by their agents, meet the requirements of Rule 31a-1 and 31a-3 and are maintained for the required periods of time pursuant to Rule 31a-2.</u>	<p>34.(a) The funds' contracts with their agents require such agents to maintain the records for which they are responsible in accordance with Rule 31a-1 and for the periods of time required by Rule 31a-2.</p> <p>(b) Outside legal counsel was engaged to perform and did perform a review for compliance with Rules 31a-1 and 31a-2 for the records maintained by HAM. HAM's Chief Administrator has represented that this procedure will become an annual procedure.</p>	<p>34-1 The Chief Administrator of HAM should obtain a written report from the funds' outside legal counsel stating the findings of their review to verify compliance with Rules 31a-1 and 31a-2.</p> <p>34-2 HAM should consider establishing procedures to determine that the agents of the funds and other departments of E.F. Hutton maintain the records required by Rules 31a-1 and 31a-3 in proper form and for the period required by Rule 31a-2.</p>
35. <u>The funds' independent public accountants are selected annually as required under Section 32 of the Act.</u>	35. HAM relies on the funds' outside legal counsel to advise when such actions must be taken and to include this item for appropriate action at the directors' and shareholders' meetings.	Control design is considered adequate.

Control Objectives

36. The funds comply with all other relevant requirements of the Investment Company Act of 1940 and have a procedure to identify and comply with changes in such requirements.

Control Procedures

- 36.(a) HAM relies on the funds' outside counsel to advise it of all the relevant requirements of the Investment Company Act of 1940 and the rules and regulations thereunder. HAM also relies on outside counsel to identify changes in regulatory requirements and to advise HAM of the actions required to ensure compliance.
- (b) HAM personnel receive and are responsible for reviewing letters from the Investment Company Institute which indicate changes in applicable regulatory requirements.
- (c) HAM sends officials to industry conferences that discuss recent developments.

Comments/Recommendations

- 36-1 See Recommendation No. 1 in the Letter in this report.
- 36-2 Responsibility for reviewing for changes in regulations or coordinating such review with outside legal counsel should be fixed in one individual at HAM. That individual should be responsible for advising portfolio managers and other appropriate individuals of the applicable changes.
- 36-3 HAM should require their portfolio managers, Compliance Officer and other applicable employees to attend, at least annually, continuing education seminars emphasizing compliance with regulatory requirements and investment restrictions as well as current changes in such requirements.
- 36-4 HAM should adopt a plan to prepare written procedural manuals for each department.

A.2.b. REGULATORY COMPLIANCE
COMPLIANCE WITH THE SECURITIES
ACT OF 1933

E. F. HUTTON & COMPANY INC.
HIS, HUTTON MUNICIPAL AND CASH FUNDS
COMPLIANCE WITH THE SECURITIES ACT OF 1933

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>Registration statements and amendments include all disclosures required to be made by the applicable Form (Form N-1A) or other applicable federal securities laws regulations and interpretations.</u>	<p>1.(a) HAM relies on outside legal counsel for the funds to prepare the registration statements in accordance with the applicable rules and regulations of the 1933 and 1940 Acts. Counsel coordinates information needed from HAM with the Fund Administrator.</p> <p>(b) The Fund Administrator is responsible for requesting such information from the applicable agents and the applicable departments at HAM.</p> <p>(c) Drafts prepared by outside counsel are sent to the Fund Administrator who distributes them to the applicable agents and departments which supplied the information and to the Chief Administrator of HAM and the President of the funds. Outside legal counsel is responsible for incorporating the appropriate comments received into the final draft.</p> <p>(d) The final draft is then reviewed by the independent accountants for the funds to determine that the financial and other information is in agreement with the records of the funds and with the independent accountants understanding of the funds' operations.</p> <p>(e) The Fund Administrator maintains a final approval listing and obtains written approval from each department as well as the independent accountants for the material included in the registration statements prior to printing and filing.</p> <p>(f) The registration statements and prospectuses are reviewed and approved by the boards of directors.</p>	<p>1-1 Control design is considered adequate; however, see Recommendation No. 1 in the letter in this report.</p>

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
2. <u>The funds operate as described in their prospectuses and registration statements.</u>	2.(a) See the procedures described throughout this report. (b) HAM requests the agents for the funds to review and to submit written statements on an annual basis that the services performed by them are in accordance with the prospectus. (c) The HAM Chief Administrator meets with the outside agents on a quarterly basis to review their operations. He also meets with the portfolio managers and other managers of HAM departments on a weekly basis, among other matters, and could become aware of any actual or proposed changes in operations.	Control design is considered adequate.
3. <u>Information (including financial information) set forth or incorporated by reference in the registration statements is included on the basis of appropriate supporting data and such filings are reviewed and approved by management prior to filing.</u>	3. See the procedures described in 1.(a) and 2(b) above. Also the manager of the Finance Department is responsible for the accuracy of all financial information and checks such information prior to giving final clearance to the Fund Administrator.	Control design is considered adequate.
4. <u>Registration statements are amended as required to keep them materially correct and such amendments are prepared and filed on a timely basis, in accordance with Rule 485(a) or 485(b) of the 1933 Act.</u>	4.(a) HAM relies on the funds' outside legal counsel to determine the filing requirements of registration statements and amendments thereto, and to include such requirements on the compliance calendars which are furnished to HAM. (b) These calendars are up-dated one month in advance of the month actions are required to be taken thereon, and responsibilities for the actions to be taken as listed on such calendars are delegated to managers within HAM. (c) The Fund Administrator has responsibility to coordinate the timing and information furnished to the funds' outside legal counsel, as noted above; so the draft of the registration statement can be prepared on a timely basis. (d) HAM relies on the funds' outside legal counsel to review the final filing copy and to file the registration statements with the SEC. Such counsel are delegated responsibility for checking that all written consents, signatures, reports and exhibits are included.	Control design is considered adequate.

Control Objectives

Control Procedures

Comments/Recommendations

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| 5. <u>Prospectuses are sent to existing shareholders and prospective shareholders as required.</u> | 5. The Fund Administrator and/or the operations department staff coordinate the printing of the final prospectus and shipping to the shareholder servicing agent or the E.F. Hutton departments responsible for mailing. HAM corresponds with such agents or departments to confirm such mailings have taken place as required. | Control design is considered adequate. |
| 6. <u>The funds comply with all other relevant requirements of the Securities Act of 1933 as well as any changes in applicable rules and interpretations.</u> | 6.(a) HAM relies on the funds' outside legal counsel to advise HAM of all the requirements of the 1933 Act so HAM may furnish whatever information is required and authorize outside legal counsel to prepare and file whatever reports or notices are required under the 1933 Act. In this connection such counsel prepare compliance calendars and furnish them to HAM.

(b) HAM relies on outside legal counsel for the funds to identify changes in the applicable securities laws, to advise HAM of the change and to assist in reviewing the effect on HAM's operations and on the various E.F. Hutton funds.

(c) HAM personnel receive and are responsible for reviewing letters from the Investment Company Institute which indicate changes in applicable regulatory requirements. | 6-1 See the comment under Control Objective No. 36. in the Compliance with the Investment Company Act of 1940 section.

6-2 HAM should document on the compliance calendars, the HAM manager responsible for ensuring that each item listed is appropriately performed.

6-3 HAM should request the outside legal counsel to the Cash Funds to expand the listing and descriptions of items requiring action on the compliance calendars. |

A.2.c. REGULATORY COMPLIANCE
COMPLIANCE WITH THE SECURITIES
AND EXCHANGE ACT OF 1934

E.F. HUTTON & COMPANY INC.

HIS, HUTTON MUNICIPAL AND CASH FUNDS

COMPLIANCE WITH THE SECURITIES AND EXCHANGE ACT OF 1934

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>Proxy statements are prepared in accordance with the applicable regulations and include all disclosures required to be included therein by the federal securities laws.</u>	1. HAM relies on the funds' outside legal counsel to draft proxy statements and to include all required information.	Control design is considered adequate.
2. <u>The information included in proxy materials is correct in all material respects.</u>	2.(a) The funds' outside legal counsel requests information necessary to be included in the proxy statement from HAM. The Fund Administrator or another officer of HAM, as designated by the Chief Administrator, has the responsibility for coordinating with outside legal counsel in gathering and providing such information to counsel. (b) The designated HAM official distributes the proxy statement to the Chief Administrator and the independent accountants for their review. All comments received are communicated to the funds' outside legal counsel. (c) The funds' outside legal counsel is responsible for revising the draft and preparing the final proxy statement. (d) Financial information included in the proxy statement is sent by HAM to the funds' independent accountants for review.	2-1 HAM should consider fixing responsibility in the Fund Administrator for coordinating proxy preparation with outside counsel for all funds administered by HAM. 2-2 Distribution sheets and sign-off procedures for the preparation of proxy statements similar to those used for the preparation of registration statements should be adopted. 2-3 See recommendation 36-1 in the Compliance with the Investment Company Act of 1940 section.
3. <u>Proxy statements are prepared and mailed in accordance with the timing requirements of the applicable regulations.</u>	3. HAM uses the shareholder servicing agent, an independent proxy solicitor and distribution agent, or the applicable department of E. F. Hutton to mail proxy statements and receive responses. The Fund Administrator is responsible for coordinating the printing and distribution of proxy statements to the agent or Hutton department responsible for mailing the proxy statements.	Control design is considered adequate.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
4. <u>Actions are approved or disapproved by vote of the required percentage of shareholders in accordance with the federal securities laws.</u>	4. Ham requests outside legal counsel for the funds to determine whether the vote on each proposal is legally sufficient in order to pass or reject such proposals.	Control design is considered adequate.
5. <u>The funds comply with all other relevant requirements of the Securities and Exchange Act of 1934.</u>	5.(a) HAM relies on the funds' outside legal counsel to advise HAM and the directors of the funds of relevant requirements of the Securities and Exchange Act of 1934 in order that they may take any actions necessary to meet such requirements. (b) The manager of the Finance Department of HAM receives and is responsible for reviewing letters from the Investment Company Institute which indicate changes in applicable regulatory requirements.	See comment under Control Objective No. 1 under the section of this report entitled "Compliance with the Securities Act of 1933."

A.2.d. REGULATORY COMPLIANCE
COMPLIANCE WITH THE INVESTMENT
ADVISERS ACT OF 1940

E.F. HUTTON & COMPANY INC.

HIS, HUTTON MUNICIPAL AND CASH FUNDS

COMPLIANCE WITH THE INVESTMENT ADVISERS ACT OF 1940
(LIMITED TO PROVISIONS AFFECTING REGULATED INVESTMENT COMPANIES)

Control Objectives

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that:

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| <p>1. <u>Records required by Rule 204-2(a)(12) regarding transactions made by the adviser or advisory representatives are maintained.</u></p> | <p>1.(a) The E.F. Hutton Legal Department has advised each E.F. Hutton division performing advisory functions of the applicable recordkeeping requirements of the Investment Advisers Act of 1940, including the records required by Rule 204-2(a)(12) at least annually.</p> <p>(b) Outside legal counsel of the funds request HAM to prepare a list of "access persons" each quarter and this is submitted to the boards of directors quarterly. Such counsel review HAM's procedures to monitor transactions made by such persons.</p> <p>(c) Written reports from all "access persons" are required to be submitted monthly to the Compliance Officer at HAM or outside legal counsel who review such reports to identify any transactions made which are not in accordance with the Code of Ethics or federal securities laws. They also follow-up on reports not received.</p> | | | <p>1-1 E.F. Hutton should establish procedures to review annually the records maintained by HAM for compliance with the recordkeeping requirements of the Investment Advisers Act of 1940 and particularly, Rule 204-2(a)(12), at least annually.</p> |
| <p>2. <u>"Access persons" are identified and procedures exist to monitor transactions by access persons.</u></p> | <p>2. See the procedures described above.</p> | | | <p>See recommendation 1-1 above.</p> |
| <p>3. <u>The portfolio managers comply with the provisions of Rule 206(3)-2 with respect to agency cross transactions and allocations of cost/proceeds on transactions made for several funds are fair and equitable.</u></p> | <p>3.(a) In-house legal counsel of E.F. Hutton, in coordination with outside legal counsel to the funds, periodically discuss certain of the regulatory requirements of the 1940 Advisers Act with the portfolio managers, including affiliated party transaction prohibitions.</p> | | | <p>3-1 Written documentation of the procedures used by the portfolio managers in effecting block transactions for more than one fund should be prepared by HAM and distributed to the applicable equity portfolio managers. Compliance with such procedures should be monitored by the Compliance Department or an internal auditor.</p> |

Control Objectives

Control Procedures

Comments/Recommendations

- (b) HAM advised that the portfolio managers, other than the equity portfolio managers, do not engage in agency cross transactions as a matter of internal policy. The equity portfolio managers effect such transactions in accordance with procedures adopted by the boards of directors which are designed to comply with the requirements of Rule 17a-7 under the Investment Company Act of 1940.
- (c) HAM advised that the equity portfolio managers are informed that block trades for more than one fund should be allocated on a fair and equitable basis.

A.2.e. REGULATORY COMPLIANCE
COMPLIANCE WITH FEDERAL AND
STATE TAX REGULATIONS

E.F. HUTTON & COMPANY INC.

HIS, HUTTON MUNICIPAL AND CASH FUNDS

COMPLIANCE WITH FEDERAL AND STATE TAX REGULATIONS

Control Objectives

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that:

1. The funds meet the various requirements of subchapter M of the Internal Revenue Code, and qualify as regulated investment companies for federal income tax purposes.

- 1.(a) HAM's manager of the Finance Department prepares budget estimates of the "short-short" gains allowable for each series of HIS and each other fund at the beginning of each year.
- (b) The estimates are furnished to each portfolio manager after review and approval by the Chief Administrator of HAM and the President of the funds.
- (c) The Compliance Officer prepares the 30% short-short gains report daily based upon reports received from the recordkeeping agent and distributes such reports to the Chief Administrator of HAM and the President of the funds. It is his responsibility to alert the President of the funds whenever there is a concern as to compliance with this tax requirement.
- (d) The Compliance Officer prepares a checklist on a monthly basis which includes the asset diversification and income requirements of Subchapter-M.

- 1-1 HAM should establish procedures to develop information on a tax basis monthly and utilize such tax basis information in the preparation of the monthly compliance checklists.
- 1-2 Responsibility for preparation of the monthly tax compliance checklist should be fixed in an individual who is familiar with the federal income tax requirements applicable to regulated investment companies. Otherwise, a qualified tax consultant should be engaged to periodically prepare such checklists.
- 1-3 Summary checklists of the more important tax regulations which affect portfolio management and book/tax differences should be developed and sent to the portfolio managers. Also, consideration should be given to having portfolio managers identify transactions with book/tax differences (i.e. original issue discounts, wash sale losses, gains on option transactions, etc.).
- 1-4 HAM should expedite efforts to develop a system to monitor the book and tax requirements of options and futures transactions.

Control Objectives

Control Procedures

Comments/Recommendations

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| <p>2. <u>The taxable income and capital gains for the reporting period are determined and procedures exist to ensure distribution of such amounts in order to have no federal tax liability for the investment company.</u></p> | <p>(e) HAM advised that it requests its independent accountants to perform a detailed compliance review during the annual audit and to instruct and supervise the recordkeeping agents to prepare annual tax basis information for each fund. Also HAM requests the independent accountants to determine that book/tax adjustments are made and that the information complies with the federal income tax rules and regulations.</p> <p>2.(a) Ham advised that it requests its independent accountants to determine that the income and capital gains amounts prepared by the recordkeeping agents are in accordance with the federal income tax regulations to which the fund is subject.</p> <p>(b) The manager of the Finance Department receives a copy of certain of the recordkeeping agents working papers and discusses the dividend and distribution amounts with the independent accountants.</p> <p>(c) The funds' dividend and distribution amounts are discussed by the Finance Manager with the respective portfolio managers for reasonableness.</p> <p>(d) The Fund Administrator and/or manager of the Finance Department coordinate with the funds' outside legal counsel to present to the directors the appropriate resolutions and information so they may declare the appropriate dividends and distributions for tax purposes.</p> <p>(e) The manager of the Finance Department is responsible for coordinating with the shareholder servicing agent to determine that the dividends and distributions distributed by the shareholder servicing agent are in agreement with the amounts declared by the directors.</p> | <p>1-5 The recordkeeping agents' responsibility for maintaining tax basis records should be expressly stated in the custodian contract.</p> <p>2-1 The reconciliation of financial accounting to tax basis information should be obtained and reviewed by the manager of the Finance Department.</p> |
| <p>3. <u>Federal and state tax returns are reviewed and approved by a knowledgeable individual prior to filing.</u></p> | <p>3.(a) The manager of the Finance Department reviews the tax returns prior to signing by the Chief Administrator.</p> | <p>3-1 The tax policies followed by each fund should be documented in writing and reviewed and approved by the manager of the Finance Department.</p> |

Control Objectives

Control Procedures

Comments/Recommendations

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| <p>4. <u>Tax returns are prepared appropriately and are filed on a timely basis and other federal and state tax reporting requirements are met.</u></p> <p>5. <u>Changes in federal and state tax legislation and regulations are monitored on a timely basis and the funds' policies and procedures are changed as required.</u></p> | <p>(b) HAM advised that it requests its independent accountants to determine that the tax policies used by the funds are consistent with those used in prior years and to bring any differences to HAM's attention for review and approval.</p> <p>4.(a) HAM engages its independent accountants to prepare the federal, state and local tax returns of each fund and to advise HAM to file such returns on a timely basis.</p> <p>5.(a) HAM relies on its outside legal counsel and its independent accountants to bring to HAM's attention any legislation or changes which may affect any of the funds.</p> <p>(b) HAM Finance Department coordinates with the independent accountants and outside legal counsel to review the impact of any new tax legislation.</p> | <p>Control design is considered adequate.</p> <p>5-1 HAM should fix responsibility for reviewing changes in tax rules and regulations and determining their impact on the funds' accounting and operating policies in an appropriate HAM official knowledgeable about tax matters.</p> |
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B. HIS AND HUTTON MUNICIPAL FUNDS

B.1. HIS AND HUTTON MUNICIPAL FUNDS

OVERVIEW

E. F. HUTTON & COMPANY INC.
HIS AND HUTTON MUNICIPAL FUNDS

OVERVIEW

INVESTMENT PRODUCTS:

The Hutton Investment Series Inc. ("HIS") consists of the following eight series:

Short Term Investment Series - invests in a variety of money market instruments.

Bond and Income Series - invests in bonds and other income-producing securities.

Government Securities Series - invests primarily in U.S. Government securities. The series also may write listed covered call options and secured put options and purchase protective put options on U.S. Government securities. For hedging purposes, the series may purchase and sell interest rate futures contracts and listed put and call options thereon.

Growth Series - invests in common stocks or securities convertible into or exchangeable for common stocks.

Emerging Growth Series - invests in common stocks, or securities convertible into or exchangeable for common stocks, primarily of emerging growth companies.

Option Income Series - invests primarily in dividend-paying common stocks and writing listed covered call options thereon. The series also may write secured and purchase protective put options.

Basic Value Series - invests in common stocks or securities convertible into or exchangeable for common stocks which are believed by the investment adviser to be undervalued.

Precious Metals Series - invests primarily in equity securities of companies principally engaged in mining, processing, fabricating or distributing gold or other metals or minerals. The series also may invest in gold or silver bullion or other metals, write covered call options and write secured and purchase protective put options.

The Hutton National Municipal Fund Inc., Hutton California Municipal Fund Inc., and Hutton New York Municipal Fund Inc. ("Hutton Municipal Funds") invest primarily in debt securities exempt from federal income taxes and state and city income taxes, as applicable.

CONTROL SYSTEM - KEY PARTICIPANTS:

E. F. Hutton & Company Inc. ("E.F. Hutton"), through its Hutton Asset Management ("HAM") division, serves as the investment adviser to the HIS and Hutton Municipal Funds. E.F. Hutton also is the distributor of the shares of these funds. HAM portfolio managers are responsible for all investment decisions for the funds. The HAM Compliance Department is responsible for monitoring the funds' investment compliance with the applicable prospectus and regulated investment company requirements. The HAM Finance Department is responsible for matters relating to external and internal financial reporting.

Investors Fiduciary Trust Company ("IFTC") is the transfer agent and custodian for the HIS and Hutton Municipal Funds. IFTC has a service agreement with DST Systems, Inc. ("DST") providing for DST to perform all transfer agent functions for the funds. All fund shareholder records are maintained on DST's Mutual Fund System (the "DST System").

IFTC also performs the daily accounting and calculation of net asset value per share for the funds. HAM portfolio management informs IFTC of executed securities transactions and the HAM Finance Department provides IFTC with relevant information regarding fund expenses, dividends and distributions.

The Chase Manhattan Bank, N.A. ("Chase Manhattan") serves as sub-custodian to the funds pursuant to sub-custodian agreements with IFTC. Chase Manhattan maintains all securities positions, including those through book entry in central depositories (Depository Trust Company and the Federal Reserve Book Entry System) and performs other custodial functions for the funds, such as the collection of investment income.

CONTROL SYSTEM - KEY TRANSACTION CYCLES:

Shareholder transactions:

Shares of the funds may be purchased only through Account Executives of E.F. Hutton, except for subsequent purchases of Hutton Municipal Fund shares and HIS shares for non-retirement accounts which may be made directly through DST. Purchases of fund shares through Account Executives flow through the regular E.F. Hutton Order Entry System. The transaction information flow for purchases and other significant shareholder transactions is shown in the Exhibit at the end of this section. The E.F. Hutton Order Entry System performs various edit and validation checks on purchase transactions entered at the E.F. Hutton branch offices. E.F. Hutton systematically transmits purchase transaction data to DST on the settlement date of the trades (five business days after trade date).

Shareholders may redeem shares by contacting their Account Executive (provided shares are held in non-certificate form) or by telephoning or writing to DST. E.F. Hutton communicates instructions to DST for redemptions and other shareholder transactions, (e.g., transfers of account registrations), through a teletype wire system (the "Wire System"). The E.F. Hutton HFD Department reviews all redemption requests prior to their transmission to DST. Such reviews include a "lookup" of the shareholder's account on the DST System on a remote inquiry terminal to check essential account information and balances. The HFD Department also handles Account Executives' inquiries and requests for certain changes to shareholder account registrations.

The E.F. Hutton Retirement Account Operations ("RAO") reviews redemption requests, prior to HFD Department review, for shareholder retirement accounts (e.g., IRA, Keogh accounts) where E.F. Hutton is the trustee ("EFH Self-Directed Accounts"). This review is performed to ascertain that requests include all required information, however, no lookup of the shareholder's account is performed. RAO is also responsible for handling Account Executives' inquiries and assisting in setting up Systematic Withdrawal Plans for EFH Self-Directed Accounts.

DST is responsible for recording all shareholder transactions transmitted to it by E.F. Hutton or received from shareholders in the funds' shareholder records if received in "good order". The overall control environment of the DST System consists of the following four components:

1. Organizational and management controls,
2. Control procedures performed by DST operating personnel (manual procedures),
3. Control features programmed into the DST System software (system controls), and
4. Controls over the electronic data processing (EDP) function.

Within DST there is one division dedicated to the E.F. Hutton funds with well defined reporting lines. DST management reports that DST processing personnel receive appropriate training upon hire and all employees are bonded.

DST quality control personnel and internal audit groups regularly perform reviews of the DST System's internal controls and transaction processing. In addition, an independent "third party" internal accounting control review of the DST System is performed annually. No material internal control weaknesses were disclosed as a result of the 1985 "third party" review.

Portfolio transactions:

IFTC advises HAM portfolio management of cash available for investment; portfolio managers also maintain their own records of cash availability. HAM portfolio management advises IFTC of portfolio transactions for recording in the funds' records and as an authorization to receive or deliver securities. IFTC provides instructions to Chase Manhattan for transaction settlements. IFTC communicates with HAM portfolio management and Chase Manhattan to resolve any failed transaction settlements.

Fund accounting and calculation of net asset value per share:

IFTC maintains the funds' portfolio and accounting records on a computerized DST Portfolio Accounting System. IFTC fund accounting personnel record investment, shareholder and other transactions in the funds' subsidiary and general ledgers. Securities pricing is performed by the system based on market prices obtained by system interfaces with outside service bureaus and manually entered prices. The system automatically calculates net asset value per share for review by IFTC personnel.

An independent "third party" review of the DST general EDP controls and the Portfolio Accounting System application controls is performed annually. No material weaknesses regarding such controls were disclosed as a result of the 1985 "third party" review.

Financial reporting:

Financial reporting to shareholders is the responsibility of the HAM Finance Department. Financial statements and note disclosures are prepared by the Finance Department based on the records maintained for the funds by IFTC. The financial statements and note disclosures are audited by the independent accountants. The filing requirements for the reports on Form N-SAR and the registration statements and amendments thereto are determined by the outside legal counsel to the funds. The outside legal counsel prepares and files the Forms N-SAR and registration statements in coordination with the HAM Finance Department and Chief Administrator.

CONTROL SYSTEM - PRINCIPAL CONTROLS:

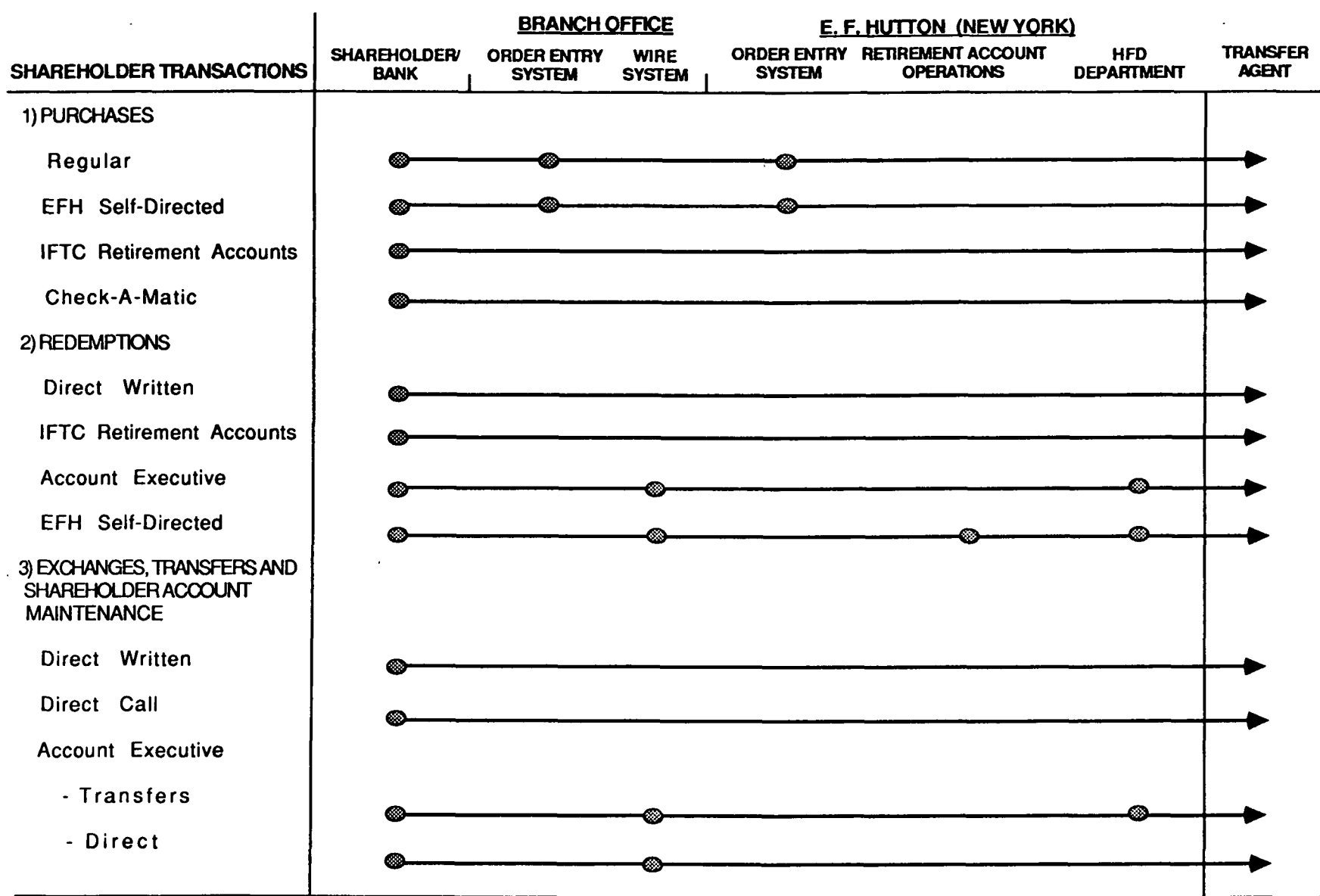
The principal controls for the HIS and Hutton Municipal Funds include (i) the separation of duties among the various E.F. Hutton departments and agents for the funds (ii) the confirmation procedures and (iii) the third party reviews of certain data processing systems utilized. Such controls are an integral part of the overall control environment as discussed in the forepart of this section II.

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The above E.F. Hutton departments and entities serve to form a broad control environment for the HIS and Hutton Municipal Funds. The involvement of these various groups provides for a complex control environment but also adds a measure of control where such groups interact and check each others' work.

E.F. HUTTON
HIS AND HUTTON MUNICIPAL FUNDS
SHAREHOLDER TRANSACTIONS
INFORMATION FLOW

EXHIBIT



B.2. HIS AND HUTTON MUNICIPAL FUNDS
CONTROL OBJECTIVES AND PROCEDURES

B.2.a. HIS AND HUTTON MUNICIPAL FUNDS
SHAREHOLDER TRANSACTIONS

E.F. HUTTON & COMPANY INC.
HIS AND HUTTON MUNICIPAL FUNDS
SHAREHOLDER TRANSACTIONS
PURCHASES

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>All capital stock purchase transactions are properly authorized.</u>		
(a) Purchases through E.F. Hutton	1.(a)(1) In order to process a trade, a prospective shareholder must have an account with EFH. Standard forms and procedures exist to establish an account. (2) An application must be completed to establish a tax-deferred retirement account. Standard procedures exist to complete the application. (3) Purchase transactions through EFH are confirmed by EFH to the client and Account Executive. (4) Trades settle on settlement date automatically (see description at the control objectives 4., 7. and 14. below). (5) Purchase transactions are confirmed by DST to the shareholder and Account Executive.	Control design is considered adequate.
(b) Purchases through transfer agent	(b)(1) All purchase orders sent to the transfer agent directly must be for an established shareholder account and include payment. Shareholders may make subsequent purchases of Hutton Municipal Fund shares and HIS retirement account purchases through the transfer agent. (2) All purchase transactions are confirmed by DST to the shareholder and Account Executive. (3) The processing at DST is subject to periodic internal quality control reviews and a third party review.	Control design is considered adequate.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
2. <u>Purchase orders comply with minimum purchase dollar amounts as set forth in each prospectus.</u>	2.(a) Transactions processed through the EFH Order Entry System are edited to determine that minimum purchase requirements are met. (b) DST has established procedures for processing personnel to review orders to check required minimum purchase amounts are met. The DST System does not edit transactions for this requirement.	Control design is considered adequate. Control design is considered adequate.
3. <u>Purchase orders are not accepted for same day pricing after 4:00 p.m. "New York City" (Eastern Standard) time.</u>	3.(a) The EFH Order Entry System has a programmed cut-off at 4:00 p.m. New York City time. Mutual fund transactions will not be accepted by the system after this time. (b) DST has established procedures for processing personnel to cut-off the acceptance of purchase orders for processing in accordance with the requirements outlined in each prospectus.	Control design is considered adequate. Control design is considered adequate.
4. <u>Purchases through E.F. Hutton settle five business days after the order is accepted.</u>	4. Established EDP operations routines at EFH provide for the direct transmission of the "Pending File" of detailed transaction data to the DST System (computer-to-computer) on settlement date. This takes place on the morning of the fifth business day after the trade date ("T+5").	Control design is considered adequate.
5. <u>Adjustments and corrections to purchase orders placed with E.F. Hutton prior to settlement date are properly authorized.</u>	5.(a) Adjustments (nonmonetary) to purchase transactions flow through the EFH Order Entry System in the same way that the original purchase transactions do as described above. Adjustments are cut-off on the fourth business day after the trade date ("T+4").	Control design is considered adequate.

Control Objectives

Control Procedures

Comments/Recommendations

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| | (b) | Corrections (monetary) are transmitted to New York for correction where they are reviewed, approved and entered. Account Executives may not process such corrections directly. | |
| | (c) | Corrections are confirmed to the shareholder and Account Executive through the EFH system. | |
| | (d) | The transmission to DST on T+5 incorporates the adjustments and corrections. The updated trades are confirmed to the shareholders and Account Executives by DST after processing. | |
| 6. <u>Purchases made by check or by wiring federal funds to the transfer agent by 4:00 p.m. "New York City" (Eastern Standard) time are settled on the same business day.</u> | 6.(a) | DST dates and time stamps all purchase orders upon receipt. DST has established procedures to cut off all purchase orders at 4:00 P.M. "New York City" time. | Control design is considered adequate. |
| | (b) | DST has established procedures to review such purchase orders and check that payments, instructions and other shareholder information are in good order. Purchases in good order are entered into the DST System for nightly processing. | |
| | (c) | DST confirms all purchases to the shareholder and Account Executive. | |
| | (d) | Each day a report of transaction statistics is prepared by DST which highlights any processing backlogs by type of transaction. DST supervisors monitor these reports daily. HAM also reviews such reports periodically. | |
| 7. <u>All purchase orders placed with E.F. Hutton are accurately transmitted to the transfer agent on settlement date and processed.</u> | 7.(a) | EFH has established EDP controls to assure the transactions entered into the EFH Order Entry System flow into the "Pending File." | Control design is considered adequate. |
| | (b) | EFH has established EDP controls to assure the transmission of the "Pending File" to DST on T+5. | |

Control Objectives

Control Procedures

Comments/Recommendations

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| | (c) | EFH provides DST with updated batch control totals of pending purchases for each fund everyday. Both DST and EFH Cashiering Control personnel reconcile the batch control totals to the actual purchase transactions transmitted each day. EFH Cashiering Control investigates and resolves any differences noted. | |
| | (d) | The morning after settlement date, DST sends a computer record to EFH of all purchase transactions accepted by the DST System. The EFH computer compares this record to its own records and a "break list" of any exceptions is created. The exceptions are investigated and resolved by EFH Cashiering Control personnel. | |
| | (e) | DST confirms all purchase transactions processed to the shareholder and Account Executive. | |
| | (f) | The purchase transaction charge to the client's EFH investment account appears on the client's monthly EFH brokerage statement. | |
| 8. <u>Periodic purchases under Check-A-Matic programs are properly authorized and comply with prospectus requirements.</u> | 8.(a) | Shareholders complete a standard authorization form for DST to establish a Check-A-Matic program and for the shareholder's bank to accept preauthorized check (PAC) requests for transmission of monies to DST. | Control design is considered adequate. |
| | (b) | The standard form includes all items required by the prospectuses. | |
| | (c) | The form is reviewed and approved by DST personnel prior to entry into the DST System. | |
| | (d) | Paid PAC checks, originally generated by the DST System, are returned to shareholders with their bank statements. | |
| | (e) | Check-A-Matic purchases are confirmed by DST to the shareholder and Account Executive. | |

Control Objectives

Control Procedures

Comments/Recommendations

9. Purchases are effected using the net asset value per share next determined after receipt of the order.
- 9.(a) IFTC fund accounting (record keeping agent for the funds) provides the DST corporate actions department with the closing net asset value (NAV) per share for each fund at the end of each day along with the change in NAV per share from the previous day. The corporate actions department enters the daily prices into the DST System.
- (b) To help check that a correct NAV price is entered into the system, DST procedures require that the current NAV per share and the change from the previous day be entered into the system. The system calculates the change in NAV per share and compares it to the change entered. The changes must agree or the new NAV price is not accepted.
- (c) The application of the current NAV per share to the transactions is part of the regular nightly processing routines which operate under system controls. These controls are subject to a third party review and the DST processing of transactions is subject to periodic internal quality control reviews.
- (d) Confirms to shareholders and Account Executives include transaction prices.
10. The appropriate sales charge is applied to purchases of Hutton Municipal Fund capital shares, including those pursuant to rights of accumulation and Letters of Intent.
- (a) Purchases through E. F. Hutton
- 10.(a)(1) The EFH Order Entry System calculates the appropriate sales charge based on the rate indicated on the sales order by the Account Executive. This is done so that only net sales proceeds are sent to the fund for transactions processed through E.F. Hutton.
- (2) The DST System also calculates the sales charges for purchases through EFH. The net dollar amounts calculated by DST should agree to the amounts calculated and transmitted by EFH. Differences are identified and resolved in the daily cash reconciliation process at DST.
- Control design is considered adequate.

Control Objectives

Control Procedures

Comments/Recommendations

	(3) Purchases of shares through EFH are confirmed to the shareholder and Account Executive by both EFH and DST.	
(b) Purchases through transfer agent.	(b)(1) The sales charge on purchases of Hutton Municipal Fund shares is calculated by the DST System based on rights of accumulation information or Letters of Intent supplied directly by the shareholder or through EFH.	Control design is considered adequate.
	(2) DST quality control and internal audit personnel perform reviews of DST order processing periodically.	
	(3) DST confirms all purchases to the shareholders and Account Executives.	
11. <u>Purchase transactions are accurately recorded in the shareholder accounts on a timely basis.</u>	11.(a) Transactions are edited and balanced through the DST System daily.	Control design is considered adequate.
	(b) Daily cash reconciliations are prepared at DST.	
	(c) Exceptions are resolved by DST personnel.	
	(d) Transactions processed are confirmed to the shareholders and Account Executives.	
12. <u>Purchase transactions are accurately confirmed to shareholders and Account Executives.</u>	12.(a) Confirmations to shareholders and Account Executives are automatically produced by the EFH Order Entry System if the trade was transmitted through such system.	Control design is considered adequate.
	(b) Confirmations to shareholders and Account Executives are generated by the DST System as part of the normal processing routines.	
13. <u>Capital shares issued reconcile to monies received for such purchases.</u>	13.(a) DST and IFTC reconcile capital share activity to cash receipts reflected on fund custody bank statements (see further description at 14(c) below).	Control design is considered adequate.
	(b) The reconciliation is performed by DST personnel independent of the transaction processing areas.	

Control Objectives

Control Procedures

Comments/Recommendations

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| 14. <u>Monies for purchase orders placed with E.F. Hutton are transmitted to the custodian on settlement date.</u> | 14.(a) Each day the EFH Order Entry System produces a Daily Mutual Fund Trading Activity Report which indicates the net cash due to the funds for all pending settlement dates. This information is reported to DST each day by telex wire.

(b) On the morning of settlement date EFH Cashiering Control authorizes a wire transfer of monies from EFH to each fund's bank account at the custodian. Collection of amounts due from shareholders is the responsibility of individual Account Executives at the branch offices. Personnel at the transfer agent reconcile cash transfers to information previously received by telex wire.

(c) Monies received by IFTC are transferred into fund custody accounts at IFTC and are available on morning of T+6. DST personnel reconcile monies received from EFH to information previously provided by telex wire and to the processed shareholder transactions. | Control design is considered adequate. |
| 15. <u>Capital shares certificates are properly controlled.</u> | 15.(a) Certificates are issued by DST only upon written request from the shareholder or EFH (based on shareholder request).

(b) There is a certificate log on the DST System indicating the sequence of certificates issued and their current status.

(c) There are manual controls over used, not used and voided certificates.

(d) Blank certificates are under physical control and subject to periodic physical counts by personnel independent of the EDP and certificate processing areas.

(e) These procedures are subject to internal as well as third party reviews. | Control design is considered adequate. |
| 16. <u>The fund shares are legally registered for sale in the states in which sales are made, and the registration fees are properly computed and paid.</u> | 16. HAM relies on the funds' outside legal counsel to register shares of the funds in states in which shares are sold and that registration fees are properly computed and filing requirements are met. | Control design is considered adequate. |

Control Objectives

Control Procedures

Comments/Recommendations

17. Additional shares are registered in each state and become effective with sufficient time to preclude sales in excess of shares registered.

17.(a) HAM has its outside legal counsel prepare compliance calendars or otherwise advise it of dates by which additional shares should be registered in each state. HAM receives totals of shares sold in each state on a monthly basis and submits such information to the fund's outside legal counsel.

(b) Outside legal counsel has been engaged to compare shares sold to shares registered and coordinate with the operations department personnel at HAM to register shares with sufficient time to preclude excess sales.

17-1 HAM should assign an officer or employee the responsibility to monitor reports prepared by outside counsel for consistency with fund sales data.

E.F. HUTTON & COMPANY INC.
HIS AND HUTTON MUNICIPAL FUNDS
SHAREHOLDER TRANSACTIONS
REDEMPTIONS

Control Objectives

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that:

1. All capital share redemption transactions are properly authorized and in good order.

(a) Redemptions through E.F. Hutton

- 1.(a)(1) Redemptions through E.F. Hutton are initiated by the shareholder contacting his or her Account Executive. Account Executives transmit all redemption requests, including the required shareholder account and transaction information, by wire to the E.F. Hutton HFD Department (regular accounts) or to the E.F. Hutton Retirement Account Operations department (EFH Self-Directed Accounts).
- (2) Personnel at the HFD Department review each redemption request to determine if it is in good order. Redemption orders for shares held in EFH Self-Directed Accounts are initially reviewed by the Retirement Account Operations department and then transmitted to the HFD Department by wire. HFD confirms the essential information by viewing the shareholder's account on the DST System via a remote terminal. If everything is in good order, HFD wires the request to DST.
- (3) DST personnel perform a similar review and, if everything is in order, the request is entered into the DST System for nightly processing.
- (4) The DST System performs edit and validation checks on all requests during processing.
- (5) DST confirms all transactions to shareholders and Account Executives.

Control design is considered adequate.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
(b) Redemptions through transfer agent	<p>1.(b)(1) The DST review and entry process is essentially the same as described at 1.(a) (3) - (5) above, plus DST personnel ascertain whether the requests include proper endorsements and signature guarantees.</p> <p>(2) Redemption checks and shareholder orders are reviewed by the DST processing department prior to distribution of the checks.</p> <p>(3) The processing at DST is subject to a third party review.</p>	<p>1-1 Daily quality control reviews of redemption orders sent directly to DST should be performed by DST personnel independent of the processing function who should ascertain that any processing errors and transactions listed on exception reports are followed up and corrected.</p>
<p>2. <u>Redemption requests accepted by E.F. Hutton are promptly and accurately transmitted to the transfer agent.</u></p>	<p>2. The HFD Department will not accept orders after 1:00 p.m. New York time in accordance with prospectus guidelines. HFD personnel review and assemble orders in batches which are wired to the transfer agent by 2:00 p.m. New York City time for same day processing.</p>	<p>Control design is considered adequate.</p>
<p>3. <u>Redemption requests in excess of account balances are not processed.</u></p>	<p>3.(a)(1) The HFD Department reviews the shareholder's account balance on a remote DST inquiry terminal to ensure the request does not exceed the balance in the account. If it is in excess, the request is rejected and referred back to the respective Account Executive. If it is not in excess, the request is wired to DST for processing.</p> <p>(2) DST personnel receiving redemption request wires from EFH also review the shareholder's account balance prior to processing the transaction. If it exceeds the account balance it is rejected and referred back to HFD. If not, it is processed.</p>	<p>Control design is considered adequate.</p>
(a) Redemptions through E.F. Hutton		

Control Objectives

Control Procedures

Comments/Recommendations

	(3) During the nightly batch cycle, the DST System edits the transaction to confirm the request does not exceed the account balance. If it does, the transaction is rejected and printed on an edit error listing for resolution with EFH.	
(b) Redemptions through transfer agent	3.(b) The process is the same as 3.(a)(2) and (3) above except that DST resolves rejected items by communication with the shareholder directly.	Control design is considered adequate.
4. <u>For shares held in certificate form, the certificates are returned to the transfer agent prior to effecting the redemption request.</u>	4.(a) Such redemptions must be processed directly through DST. (b) DST personnel review the shareholder's account on the system to determine if shares are held in certificate form. If so, personnel check to ascertain the appropriate certificates accompany the request with proper endorsements and signature guarantees. These personnel cancel the certificates and process the transaction. (c) The HFD Department checks redemption requests submitted through EFH by viewing the shareholder account on a DST inquiry terminal to be certain shares are not held in certificate form. If they are, the request is rejected and the Account Executive is notified to instruct the shareholder to forward the request to DST directly.	Control design is considered adequate.
5. <u>Redemption requests are not accepted for same day pricing after the times specified in the prospectuses.</u>		
(a) Processed through E.F. Hutton	5.(a)(1) Account Executives are made aware of cut-offs through internal EFH written instructions and the prospectuses. (2) The EFH wire system time and date stamps all wires transmitted. (3) EFH personnel responsible for forwarding wire redemption requests to the transfer agent monitor the cut-offs.	Control design is considered adequate.

Control Objectives

Control Procedures

Comments/Recommendations

	(4) DST personnel are instructed not to process redemption requests for same day pricing if received after the cut-off time.	
(b) Processed through transfer agent	5.(b)(1) DST personnel time and date stamp all direct redemption requests upon receipt. (2) DST personnel are instructed not to process redemption requests for same day pricing if received after the cut-off time specified in the prospectus.	Control design is considered adequate.
 <u>6. Redemptions under Systematic Withdrawal Plans are made in accordance with prospectus guidelines.</u>		
(a) Regular accounts	6.(a)(1) Normal processing procedures require the shareholder to complete a standard request form for a Systematic Withdrawal Plan (SWP) which incorporates the prospectus requirements. (2) The form is submitted to the Account Executive who forwards it to DST. (3) DST personnel review the request and enter the essential information into the DST system. (4) The system generates the periodic redemption checks during the normal processing routines. (5) Checks are mailed to the shareholders by DST personnel independent of the processing areas, or the checks are deposited in a EFH Kansas City branch account and recorded as credits to the shareholders' EFH investment accounts. The funds are available to the shareholder on the morning following the day of deposit. (6) All redemption transactions are confirmed to the shareholders and Account Executives.	Control design is considered adequate.

Control Objectives

Control Procedures

Comments/Recommendations

(b) EFH Self-Directed Accounts	6.(b)(1) The process is essentially the same as described in 6.(a) above except the request form is submitted through the EFH Retirement Account Operations department. (2) Redemption checks are returned to Retirement Account Operations to be processed and credited to the shareholders' EFH investment accounts.	6-1 Systematic withdrawal plan redemption checks should not be returned to personnel responsible for forwarding instructions to the transfer agent. This condition is mitigated somewhat by the confirmation of redemptions to shareholders by DST, however, internal controls would be strengthened if such checks were credited directly to the client's investment account other than through Retirement Account Operations.
(c) IFTC retirement accounts	6.(c) The process is the same as described in 6.(a) above except the checks are mailed directly to the shareholders.	Control design is considered adequate.
7. <u>Redemptions are effected at the net asset value per share next determined after receipt of the request in "good order".</u>	7.(a) See procedures described for control objective 9. under Purchases. (b) The procedures and controls described for the control objectives (1)-(6) above serve to check that the transactions are entered at the proper time and in accordance with prospectus guidelines. (c) Transactions are confirmed to the shareholders and Account Executives and such confirms include the NAV prices used.	Control design is considered adequate.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
8. <u>Redemptions are accurately recorded in the shareholder accounts on a timely basis.</u>	<p>8.(a) The DST System performs edit and validation routines covering shareholder fund code, name, account balance, etc. and produces edit listings of rejected items.</p> <p>(b) Edit listings of rejected items are reviewed and resolved by DST personnel daily.</p> <p>(c) Shareholders are provided with a DST statement of their account as a part of the confirmation process after every transaction and periodically as specified in the prospectus.</p>	Control design is considered adequate.
9. <u>The correct contingent deferred sales charge is imposed on HIS redemptions.</u>	<p>9.(a) The charge may be waived in certain cases. This is noted on redemption orders and entered into the system so that no deferred sales charge is applied.</p> <p>(b) If applicable, the DST System calculates the deferred sales charge in accordance with prospectus guidelines wherever possible. Due to certain limitations of the current system, this is not always possible and the system rejects such transactions. The charge is then calculated manually by DST personnel.</p> <p>(c) All redemption checks and related documentation are reviewed after processing by the processing department.</p> <p>(d) Redemptions, including the deferred sales charges, are confirmed by DST to the shareholders and Account Executives.</p>	<p>9-1 DST, under the supervision of HAM, is in the process of enhancing its system to calculate the contingent deferred sales charge for all HIS redemption orders processed. HAM should continue to check the calculation of the deferred sales charge, at least monthly, through the implementation of the DST System enhancements, and thereafter, quarterly.</p> <p>9-2 See recommendation at 1-1 above in this Redemptions section.</p>

Control Objectives

Control Procedures

Comments/Recommendations

10. Redemption proceeds are promptly paid to redeeming shareholders.

- 10.(a) Redemption checks are produced by DST as a normal part of the nightly processing routines.
- (b) Checks are distributed and/or mailed subject to established procedures on the day after the nightly processing.
- (c) For shareholders who wish the redemption proceeds to be credited to their EFH investment account, the checks are batched and delivered to the EFH Kansas City branch and deposited. The redemption proceeds are keyed into the E.F. Hutton system at the Kansas City office and are reflected in the shareholders' accounts the following morning. These funds are available to shareholders when reflected in their accounts.
- (d) Cash payments for redemption are reflected on the DST "supersheets" which are reconciled to each fund's custodian bank account activity.
- (e) Redemptions are confirmed by DST to the shareholders and Account Executives.
- (f) If redemption proceeds are credited to the shareholder's EFH investment account, this will appear on the monthly brokerage statement.

Control design is considered adequate.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
11. <u>Redemptions processed reconcile to monies disbursed for such transactions.</u>	11.(a) Capital stock activity as reflected in the "supersheets" is reconciled daily to the cash activity reflected in the fund's custody bank account. (b) Reconciliations are performed by a separate department at DST charged with this responsibility and by IFTC fund accounting personnel.	Control design is considered adequate.
12. <u>Redemptions are accurately confirmed to shareholders and Account Executives.</u>	12.(a) Confirmations to the shareholders and Account Executives are produced as a normal part of the DST System processing routines. (b) The DST system is subject to a third party review.	Control design is considered adequate.

E.F. HUTTON & COMPANY INC.
HIS AND HUTTON MUNICIPAL FUNDS
SHAREHOLDER TRANSACTIONS
EXCHANGES, TRANSFERS AND SHAREHOLDER ACCOUNT MAINTENANCE

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>Exchanges and transfers of fund shares are properly authorized in accordance with prospectus guidelines.</u>		
(a) Processed through E.F. Hutton	1.(a)(1) The shareholder instructs his or her Account Executive to place an order for the exchange or transfer. (2) Account Executives wire instructions directly to DST for exchanges and to the E.F. Hutton HFD Department for transfers (registration changes). The HFD Department reviews transfer requests and then wires instructions to DST. All wires are time and date stamped. (3) DST personnel review exchange and transfer requests and compare the shareholder information to the shareholder's account on the DST System. (4) Transactions are then processed in the normal processing cycle and confirmed to the shareholder and Account Executive.	Control design is considered adequate.
(b) Processed through transfer agent	1.(b)(1) For exchanges, the shareholder may call or send written instructions to DST directly. Phone call requests are tape recorded. (2) For transfers, a shareholder must provide written instructions and a signature guarantee to DST. (3) See control procedures 1.(a)(3) and (4) above.	Control design is considered adequate.
2. <u>No sales charge or other fees are charged for exchanges of Hutton Municipal Fund shares.</u>	2.(a) The DST System is programmed to exclude the sales charge calculation on exchanges of Hutton Municipal Fund shares.	Control design is considered adequate.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
3. <u>No contingent deferred sales charge is imposed on exchanges of HIS shares.</u>	(b) DST confirms exchanges of fund shares, including share prices and amounts and dollar amounts, to the shareholders and Account Executives. (c) DST transaction processing is subject to periodic internal quality control reviews and a third party review.	Control design is considered adequate.
4. <u>Exchanges and transfers in excess of account balances are not processed.</u>	3.(a) The DST System is programmed to exclude the contingent deferred sales charge calculation on exchanges of HIS shares. (b) DST confirms exchanges of fund shares to the shareholders and Account Executives. (c) DST transaction processing is subject to periodic internal quality control reviews and a third party review. 4.(a) DST personnel review each exchange and transfer request and compare transaction amounts to the shareholder's account balance to ensure it is not in excess. (b) The DST System edits each request against the shareholder's account balance and rejects transfers in excess of the account balance. Exchange requests in excess of the account balance are processed but only to the extent of the account balance. (c) The transactions are confirmed to the shareholders and Account Executive. (d) DST transaction processing is subject to periodic internal quality control reviews and a third party review.	Control design is considered adequate.
5. <u>Exchanges are valued at the proper dollar/share amounts.</u>	5.(a) The DST System edits and processes both sides of the transaction at the same time and applies the NAV price entered into the system for the day to determine the number of shares sold and new shares received. See description of procedures for entering NAV prices at 9. under Purchases.	Control design is considered adequate.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
6. <u>All exchanges and transfers are accurately recorded in the shareholder accounts on a timely basis.</u>	<p>(b) Both sides of the transaction are confirmed to the shareholder and Account Executive including the dollar amounts and share prices and amounts.</p> <p>6.(a) DST personnel are instructed that exchanges are to be processed, if the request is received in "good order" by 4:00 p.m. New York City time.</p> <p>(b) The DST System provides appropriate edit and validation routines as described above.</p> <p>(c) The DST System has internal balancing routines and prints out of balance conditions on an exception report for investigation.</p> <p>(d) DST confirms all transactions to the shareholders and Account Executive.</p> <p>(e) DST transaction processing is subject to internal quality control reviews and a third party review.</p>	Control design is considered adequate.
7. <u>Maintenance changes to shareholder accounts are properly authorized.</u>	<p>7.(a)(1) Instructions are communicated by the shareholder to the Account Executive who wires them to DST.</p> <p>(2) DST personnel review the request and the shareholder's account and process the change.</p> <p>(3) Confirms are generated by the system for any change in an account and sent to the shareholder and Account Executive.</p> <p>(4) Shareholder account maintenance is subject to periodic internal quality control reviews and a third party review.</p>	Control design is considered adequate.
(b) Processed through transfer agent	7.(b)(1) The process is as described at 7(a) (2) - (4).	Control design is considered adequate.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
8. <u>Maintenance changes to shareholder accounts are processed on a timely basis.</u>	8.(a) These transactions are monitored by DST supervisors using reports detailing transaction statistics and status. (b) Statements to shareholders indicate whether or not such changes were made as would the lack of a confirmation of a change to the shareholder and Account Executive.	Control design is considered adequate.
9. <u>Exchanges, transfers and other account changes are confirmed to shareholders and Account Executives.</u>	9.(a) Confirms are produced as a result of regular system processing routines. Confirms are mailed by persons independent of transaction processing. (b) In the case of a change of address, DST sends a confirmation to the shareholder at the new address and to the Account Executive. (c) The DST System is subject to a third party review.	9-1 Control design is considered adequate, except for changes of shareholders' addresses. For changes of shareholders' addresses, DST should be instructed to send confirmations to the old addresses as well as the new addresses, which would provide additional assurance that shareholders receive notification of all changes.
10. <u>Shareholder correspondence and communications are adequately monitored.</u>	10. The nature and volume of shareholder correspondence and telephone inquiries is monitored by DST management through use of statistical reports, which also indicate response times, and by direct contact with employees responsible for such matters.	Control design is considered adequate.

E.F. HUTTON & COMPANY INC.

HIS AND HUTTON MUNICIPAL FUNDS

SHAREHOLDER TRANSACTIONS

INVESTMENT INCOME DIVIDENDS AND CAPITAL GAIN DISTRIBUTIONS

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>Dividend and distribution rates are properly authorized.</u>	1.(a) Dividend and capital gain distribution rates are approved by the Board of Directors of each fund. Such resolutions are reflected in the minutes of the Directors meetings. (b) The amount of the distribution is communicated to the transfer agent by a designated fund officer. (c) For other than daily dividends which are determined by IFTC as approved by the funds, periodic dividends and distributions are determined and approved by fund officers.	Control design is considered adequate.
2. <u>Shareholders begin to receive dividends as specified in the prospectuses.</u>	2.(a) The DST System is programmed to begin processing dividends and distributions to shareholder accounts as of the dates specified in the fund prospectuses.	Control design is considered adequate.
3. <u>Dividends and distributions are properly processed and recorded in the shareholder accounts.</u>	3.(a) The DST System calculates the dividends and distributions applicable to each shareholder's account. (b) Amounts credited to shareholder accounts are aggregated and reconciled to the total amount declared. Differences are investigated and resolved. (c) Dividends and distributions are confirmed to the shareholders and Account Executives.	Control design is considered adequate.
4. <u>Dividend and distribution payments and reinvestments are processed in accordance with shareholder elections.</u>	4.(a) The shareholder makes a formal election on initial purchase and can modify the election by communicating with the Account Executive or DST.	Control design is considered adequate.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
5. <u>Dividend and distribution checks are processed on a timely basis and adequately controlled.</u>	<p>(b) DST personnel enter dividend and distribution elections and any subsequent changes into the system. The system automatically produces a check or reinvests the dividends and distributions as specified on payment dates.</p> <p>(c) Dividends and distributions reinvested are confirmed to the shareholders and Account Executives.</p> <p>5.(a) The DST System produces checks during nightly processing for designated payment date.</p> <p>(b) DST produces daily reports showing all processing and cash activity which are reviewed by DST and IFTC personnel who are familiar with regular processing routines.</p> <p>(c) Dividend and distribution payments are confirmed to shareholders and Account Executives and reflected on monthly statements.</p> <p>(d) Used, unused and voided check stock are maintained under numerical control and are reconciled periodically.</p>	Control design is considered adequate.
6. <u>Dividends and distributions are confirmed to shareholders and Account Executives.</u>	6. DST confirmations are prepared as a normal part of the DST processing routines.	Control design is considered adequate.
7. <u>Dividend and distribution information is accurately reported to shareholders and the Internal Revenue Service (IRS).</u>	7. Dividend and distribution information reported to shareholders and to the IRS is extracted from the same shareholder data files updated during daily processing. DST and fund management assure this information is reported on a timely basis.	Control design is considered adequate.

B.2.b. HIS AND HUTTON MUNICIPAL FUNDS
PORTFOLIO TRANSACTIONS

E.F. HUTTON & COMPANY INC.
HIS AND HUTTON MUNICIPAL FUNDS
PORTFOLIO TRANSACTIONS
TRADE INITIATION AND RECORDING

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>Portfolio transactions are authorized by appropriate personnel.</u>	1. Hutton Asset Management (HAM) makes all investment decisions for HIS and the Hutton Municipal Funds. HAM portfolio managers and traders in New York execute trades and document details of transactions on trade tickets which are approved in writing by the responsible portfolio manager. In the absence of the portfolio manager, a designated officer of the fund will approve the transaction. Employees of IFTC have been instructed not to accept trade tickets which are not properly authorized.	Control design is considered adequate.
2. <u>Details of executed and cancelled transactions are accurately recorded by traders.</u>	2.(a) Portfolio managers and traders confirm details of transactions with contra parties by phone or through the Depository Trust Company ID System prior to execution. (b) Portfolio managers and traders maintain their own records of securities positions and periodically agree amounts to reports received from IFTC.	2-1 Control design is considered adequate; however, interest purchased on variable rate securities should be recomputed by HAM to check that amounts paid are accurately determined.
3. <u>All transactions executed are accurately and completely communicated to the recordkeeping agent by the investment adviser.</u>	3.(a) HAM telecopies the trade tickets to IFTC for recording of securities transactions. Trade tickets for money market instruments are telecopied on trade date; all others on day following trade date. (b) For all securities except U.S. Government securities, control totals of the number or amount of trades for the day are used by HAM and IFTC. U.S. Government securities transactions are confirmed individually. (c) HAM personnel compare trade tickets to transactions recorded by IFTC on the day following trade date for money market instruments and on the second day following trade date for all other securities.	3-1 Control procedures are considered adequate for all transactions except securities dispositions pursuant to tender offers. HAM should develop and implement procedures to identify and report to IFTC securities tendered for recording on appropriate dates.

Control Objectives

Control Procedures

Comments/Recommendations

4. The recordkeeping agent accurately records all portfolio transactions no later than the business day following trade date.

- 4.(a) IFTC accountants enter portfolio transactions into the portfolio accounting system based on trade tickets received from HAM. The system requires the entry of a security CUSIP number and all key fields for each transaction and performs extensions and other calculations. Transactions are recorded in investment related files in an "on-line, real-time" mode.
- (b) Debt maturities and expirations of options and futures contracts are identified by the system on pending files which are reviewed by IFTC accountants and manually accepted for recording on effective dates.
- (c) Price quotes obtained from Quotron do not contain prices for options after their expiration dates. This would be shown on the pricing reports. Accountants review pricing reports and investigate omitted prices which should identify any unrecorded option expirations.
- (d) IFTC accountants batch purchase and sale trade tickets received from HAM each day and agree the control totals (including maturities noted at 4(b)) to net postings in general ledger investment accounts.
- (e) See HAM procedures at 2.(b) above.

4-1 See recommendation to strengthen controls at 3. above.

5. Investment restrictions set forth in prospectuses are complied with including those with respect to:

- . Types of investments
- . Industry limitations
- . Individual issuers

- 5.(a) Portfolio managers have stated that they are knowledgeable of prospectus policies and restrictions as well as current portfolio positions. Portfolio managers approve all portfolio trades.
- (b) For certain funds, portfolio summary sheets are prepared which indicate prospectus investment restrictions by the HAM Compliance Department.
- (c) Every portfolio transaction is checked to a tailored compliance checklist of prospectus investment restrictions by the HAM Compliance Department.
- (d) The Compliance Officer is required to periodically report to the Boards of Directors the status of compliance with prospectus policies and restrictions.

- 5-1 Summary listings of prospectus investment requirements should be updated or developed, where applicable, for use by portfolio managers.
- 5-2 Compliance department checklists should include all applicable prospectus, 1940 Act, SEC, and significant IRS requirements.
- 5-3 All portfolio management questions regarding compliance should initially be directed to and coordinated by the HAM Compliance Officer.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
<p>6. <u>Portfolio transactions are in compliance with rules and regulations under the 1940 Act and with restrictions and limitations included in state Blue-Sky laws, including:</u></p> <ul style="list-style-type: none"> . Portfolio diversification . Transactions with affiliated persons 	<p>6.(a) See procedures described at 5. above.</p> <p>(b) Information regarding compliance is prepared by the Compliance Officer.</p> <p>(c) HAM relies on the funds' outside legal counsel to ascertain that all restrictions and limitations included in the various states securities laws are included as restrictions and limitations in the funds' objectives and policies which are monitored as noted at 5. above.</p>	<p>6-1 See recommendations under 5. above.</p>
<p>7. <u>Prospectus restrictions relating to repurchase agreements are adhered to, including:</u></p>	<p>7.(a) 1. The Boards of Directors have adopted written procedures regarding repurchase agreements.</p> <p>2. HAM monitors the credit-worthiness of contra parties and presently conducts transactions only with primary dealers. The listing of approved dealers is reviewed by the Board of Directors annually.</p> <p>(b) 1. The funds have written agreements with all of their contra parties.</p> <p>2. Sub-custodian procedures provide for amounts to be paid only against receipt of collateral.</p> <p>3. Portfolio managers and traders ascertain the adequacy of collateral upon entering into the transaction.</p>	<p>7-1 HAM should continue efforts to have all dealers sign a recently revised repurchase agreement and ensure all agreements properly perfect a security interest in collateral received.</p> <p>7-2 HAM should consider establishing limits for outstanding repurchase agreements with individual contra parties.</p> <p>7-3 See Recommendation No. 10 in the Letter in this report.</p>
<p>(a) Credit-worthiness of contra parties</p> <p>(b) Possession of collateral and adequacy of market value</p>		
<p>8. <u>With respect to reverse repurchase agreements:</u></p>	<p>8.(a) See procedures described at 7.(a) above.</p> <p>(b) The sub-custodian delivers securities only against payment in accordance with its contract.</p>	<p>8-1 See recommendation 7-1 above.</p> <p>8-2 HAM should improve procedures to check that the market value of collateral delivered for reverse repurchase agreements is not excessive.</p>
<p>(a) Agreements are entered into only with credit-worthy parties.</p> <p>(b) Collateral delivered by the funds is not excessive.</p>		

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
(c) Agreements are entered into only when investments with a more favorable interest rate are available.	(c) Portfolio managers are charged with responsibility to enter into reverse repos only when proceeds may be invested at a higher rate.	Control design is considered adequate.
(d) Sufficient cash or liquid assets are maintained in a segregated account to cover the amount of obligations.	(d) Portfolio managers and traders identify collateral to be held in a segregated account by the sub-custodian and ascertain that initial market value segregated is in excess of the related liability.	Control design is considered adequate.
9. <u>With respect to when-issued and delayed delivery securities:</u>		
(a) Transactions are appropriately identified and reported to IFTC.	9.(a) Portfolio managers and traders identify such transactions on trade tickets telecopied to IFTC.	9-1 HAM should improve procedures to determine the adequacy of the value of segregated assets underlying liabilities for when-issued and delayed delivery securities throughout the period such commitments are outstanding.
(b) Sufficient cash and liquid assets are maintained in a segregated account to cover the related liability.	(b) Portfolio managers and traders identify cash and or liquid assets to be held in a segregated account by the sub-custodian and are responsible to check the value of such assets is sufficient.	Control design is considered adequate.
10. <u>Sufficient collateral is held by the funds for loans of portfolio securities.</u>		
10. Portfolio managers have stated that as a matter of internal policy, portfolio securities lending is not performed. Responsibility for adherence to internal policy is vested in portfolio managers under general supervision of fund management.	Control design is considered adequate.	
11. <u>Futures transactions are conducted with approved and creditworthy parties and margin calls are properly calculated and approved.</u>		
11.(a) Futures contracts are limited to the HIS Government Securities Series.	11-1 Portfolio managers and traders should verify margin requirements for futures contracts determined by the subcustodian periodically (at least weekly) and authorize all related cash movements in writing.	
(b) The Government Securities Series clears futures contracts and margin calls through the IFTC/sub-custodian. The sub-custodian agreement and credit-worthiness have been approved by HAM.		

E.F. HUTTON & COMPANY INC.

HIS AND HUTTON MUNICIPAL FUNDS

PORTFOLIO TRANSACTIONS

TRADE SETTLEMENT

Control Objectives

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that:

- | | | |
|--|---|---|
| <p>1. <u>Deliveries and receipts of securities, including those effected through book entry procedures, and related cash movements are based upon appropriate authorization.</u></p> | <p>1.(a) IFTC instructs the sub-custodian to receive and deliver securities and cash for trade settlements by way of an authorization form signed by two IFTC authorized signers. Forms are completed based on trade tickets received from HAM and are telecopied by IFTC to designated personnel at the sub-custodian.</p> <p>(b) Sub-custodian personnel are instructed to agree securities settling to appropriate authorizations and to report any discrepancies to IFTC for follow-up with the HAM portfolio managers.</p> <p>(c) IFTC accountants agree actual movements of cash and securities reflected on daily bank statements to pending securities settlements and money market transactions recorded on the portfolio accounting system.</p> | <p>Control design is considered adequate.</p> |
| <p>2. <u>Securities are delivered only upon receipt of payment, and payment is made only upon receipt of securities by the sub-custodian.</u></p> | <p>2.(a) The sub-custodian has established procedures to receive and deliver cash and securities only in exchange for amounts indicated on IFTC authorization forms.</p> <p>(b) See description of procedures at 1(b) above.</p> | <p>Control design is considered adequate.</p> |
| <p>3. <u>Differences on transaction settlements are promptly identified and resolved.</u></p> | <p>3.(a) The system automatically creates a pending settlement record for each securities transaction recorded, except for transactions with same day settlement, such as money market transactions.</p> <p>(b) IFTC accountants agree actual settlements reflected on daily bank statements to pending settlement records and follow-up on differences noted. Settlement records for Hutton funds must be cleared manually on the system.</p> | <p>Control design is considered adequate.</p> |

Control Objectives

Control Procedures

Comments/Recommendations

(c) In recording cash transactions and reversing receivables and payables for securities transactions, IFTC accountants are instructed to identify settlement differences. IFTC accountants and supervisors are responsible to resolve differences with the sub-custodian and HAM.

4. Fails are promptly investigated and resolved.

4.(a) Fails are identified by IFTC and sub-custodian procedures described at 1. and 3. above. IFTC accountants and supervisors are responsible to contact HAM portfolio managers or traders and the sub-custodian to resolve fails.

Control design is considered adequate.

(b) Upon notification of fails from IFTC or brokers, HAM portfolio traders investigate fails and follow up until resolved.

E.F. HUTTON & COMPANY INC.
HIS AND HUTTON MUNICIPAL FUNDS
PORTFOLIO TRANSACTIONS
SAFEKEEPING

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>Securities are held by an independent custodian; personnel responsible for custody of securities are independent of accounting functions or other incompatible duties.</u>	1. All securities are held under fund custody agreements with IFTC, an independent bank. Physical securities and book entry positions in central depositories (Depository Trust Company and Federal Reserve) are actually maintained by Chase Manhattan (under sub-custodian agreements with IFTC which the funds have approved). Chase Manhattan personnel responsible for custody of securities have no fund accounting responsibilities.	Control design is considered adequate.
2. <u>Assets held by sub-custodian are properly segregated. Securities are periodically counted or compared to amounts held in a central depository account.</u>	2. Securities positions are maintained by the subcustodian in separate accounts for each fund. Physical securities are segregated by fund. The sub-custodian has established procedures to periodically count securities held physically and to reconcile positions maintained by book entry.	Control design is considered adequate.
3. <u>Securities are appropriately registered in the name of the fund or appropriate nominee.</u>	3. Securities are usually maintained by book entry in central depositories (DTC and Federal Reserve) if eligible. Other securities are registered in a subcustodian nominee name except for certain municipal obligations which are maintained in the existing registration upon acquisition to facilitate the collection of interest earned and subsequent transactions.	3-1 Control design is considered adequate; however, HAM should consider requiring all municipal obligations to be registered in an appropriate nominee name.
4. <u>Statements of holdings are periodically reconciled to the accounting records.</u>	4. IFTC has established procedures to reconcile statements of holdings prepared by the sub-custodian to the fund accounting records each month. Reconciliations are performed for each fund and all positions recorded on the fund's records are reconciled. Reconciliations are reviewed and approved by IFTC supervisors.	4-1 Control design is considered adequate; however, HAM personnel should review IFTC reconciliations of investment balances to sub-custodian holdings on a monthly basis.

E.F. HUTTON & COMPANY INC.
HIS AND HUTTON MUNICIPAL FUNDS
PORTFOLIO TRANSACTIONS
INCOME RECORDING AND COLLECTION

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
<p>What procedures are designed to provide reasonable assurance that:</p> <p>1. <u>Dividend declarations and other corporate actions are properly monitored and recorded.</u></p>	<p>1.(a) The DST portfolio accounting system automatically identifies (through an interface with outside services) cash dividends and corporate actions (e.g., stock splits and stock dividends) and sets up entries to record such items. IFTC accountants review dividends and corporate actions identified by the system and "accept" entries for recording. IFTC accountants review The Wall Street Journal and Standard & Poor's dividend reports to identify any dividends or corporate actions not reported by the outside service.</p> <p>(b) IFTC accountants are instructed to consult supervisors for recording of securities cost adjustments for corporate actions.</p> <p>(c) IFTC accountants review significant securities market price fluctuations to identify dividends and corporate actions as part of their daily review of securities valuations.</p> <p>(d) Designated HAM trader assistants review dividends recorded by IFTC for the funds.</p>	<p>Control design is considered adequate.</p>
<p>2. <u>Interest income is properly accrued on a daily basis.</u></p>	<p>2.(a) The accounting system automatically accrues interest income on debt instruments based on data entered when recording securities purchases.</p> <p>(b) Interest accruals in the aggregate are reviewed as part of daily analysis of the change in net asset value per share or yield.</p>	<p>Control design is considered adequate.</p>
<p>3. <u>Interest rate changes on variable rate instruments are promptly identified and reflected in the computation of interest income.</u></p>	<p>3.(a) HAM portfolio managers are responsible for obtaining interest rate changes and reporting such changes to IFTC for recording.</p> <p>(b) IFTC accountants anticipate regular interest rate changes and contact HAM portfolio managers in the absence of notification.</p>	<p>3-1 Control design is considered adequate; however, control would be enhanced if IFTC personnel checked rate changes supplied by HAM, at least on a sample basis, and checked interest rates for instruments where regular changes are not made, on a monthly basis.</p>

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
4. <u>Non-tax-exempt interest is appropriately identified for the Hutton Municipal Funds.</u>	4. IFTC has established manual procedures to identify and accumulate non-tax-exempt interest for these funds. IFTC personnel review year-to-date income journals to accumulate this information.	4-1 Control design is considered adequate; however, efficiency could be improved by identifying non-tax-exempt issuers upon acquisition and programming the system to accrue non-qualifying interest in a separate general ledger account.
5. <u>Appropriate follow-up procedures exist with respect to past-due receivables and with respect to discrepancies between amounts accrued and amounts received.</u>	<p>5.(a) IFTC accountants record the receipt of interest and dividends as shown on daily bank statements. Differences between amounts accrued and received are identified by IFTC accountants in reversing receivables.</p> <p>(b) Amounts not received on payment dates are automatically moved by the system to past due receivable general ledger accounts and are recorded on past due income reports.</p> <p>(c) IFTC has established procedures for accountants to investigate and resolve discrepancies and amounts not received with the sub-custodian.</p> <p>(d) The HAM equity group receives IFTC reports on dividends receivable and follows up with IFTC on past due amounts.</p>	5-1 Control design is considered adequate, however, designated HAM personnel should review IFTC reports of past due interest income on a monthly basis.
6. <u>Bond discounts and premiums are properly amortized.</u>	<p>6.(a) The accounting system automatically calculates and records the amortization of discounts and premiums on bonds to maturity/call based on data entered for securities acquisition.</p> <p>(b) Information regarding original issue discount, market discount and other items requiring special tax treatment is manually accumulated by IFTC personnel under the supervision of the funds' independent accountants.</p>	6-1 Control design is considered adequate for financial reporting purposes; however, see recommendations 1-1 and 1-3 under Compliance with Federal and State Tax Regulations.
7. <u>Premiums received on options are accounted for properly.</u>	7.(a) IFTC accountants record premiums received on options upon instructions from the funds' portfolio managers (see procedures at 3. and 4. under Trade Initiation and Recording).	Control design is considered adequate.

Control Objectives

Control Procedures

Comments/Recommendations

8. <u>Realized gains and losses are properly computed and classified.</u>	(b) IFTC has established procedures to mark-to-market such amounts and record a realized gain or loss upon the expiration or disposition of an option. 8.(a) When securities dispositions are recorded by IFTC accountants, the portfolio accounting system automatically selects the securities lots sold based on a programmed method, unless specifically identified by the portfolio manager. The system also calculates the realized gain or loss and classification as less than 3 months, 3-6 months or over 6 months. (b) IFTC accountants review the reasonableness of recorded realized gains and losses determined by the system daily as part of the review of net asset value per share.	Control design is considered adequate.
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E.F. HUTTON & COMPANY INC.
HIS AND HUTTON MUNICIPAL FUNDS
PORTFOLIO TRANSACTIONS
CREDIT ON FAILED SECURITIES TRANSACTIONS
AND UNCOLLECTED INCOME

Control Objectives

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that the funds do not suffer economic loss or loss of cash availability for investment from:

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|--|---|---|
| <p>1. <u>Failed securities transactions.</u></p> | <p>1.(a) The daily cash availability amounts reported by the custodian include all trades that should settle for the day.</p> <p>(b) The HAM short-term portfolio manager attempts to invest all available cash reported at least on an overnight basis (and not more than the reported amount.) The custodian identifies additional cash credit balances resulting from failed securities purchase transactions and gives the funds credit on their custodian fees as a percentage of the 90 day Treasury Bill rate. Credits are not given in excess of the custodian fees for the year.</p> | <p>1-1 Control design is considered adequate; however, HAM should review with IFTC ways to utilize fail credits not utilized during the year.</p> |
| <p>2. <u>Uncollected or partially collected income as of day following payable date.</u></p> | <p>2.(a) For interest and dividends on securities held in a central depository (DTC), as well as coupon debentures, the custodian gives cash availability to the funds on day following receipt, except for U.S. Government securities and other federal funds instruments where cash availability is given on payable date.</p> <p>(b) See IFTC and HAM procedures for the follow-up of past due income for the control objective 5. under the Income Recording and Collection section.</p> | <p>2-1 Control design is considered adequate; however, see recommendation 5-1 under the Income Recording and Collection section.</p> |

B.2.c. HIS AND HUTTON MUNICIPAL FUNDS

CASH/ACCOUNTS PAYABLE/EXPENSES

E.F. HUTTON & COMPANY INC.

HIS AND HUTTON MUNICIPAL FUNDS

CASH/ACCOUNTS PAYABLE/EXPENSES

CASH

Control Objectives

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that:

1. Cash disbursements and receipts are subject to appropriate authorization and review.

- 1.(a) The custodian agreements with IFTC specify the levels of authorization required for various cash activities. IFTC maintains listings of authorized signatories.
- (b) Cash disbursements and receipts in connection with securities transactions are authorized as described at 1. under the Trade Initiation and Recording section.
- (c) Cash disbursements for expenses are made by IFTC after receiving written authorization from HAM.
- (d) IFTC has established procedures to control transfers of monies into or out of fund custody bank accounts. Such control procedures include the requirement that all transfers be approved by two IFTC authorized signers.

Control design is considered adequate.

2. Recorded cash disbursements/receipts represent aggregate payments and collections during the period and are properly applied in reduction of payable/receivable balances or other appropriate accounts.

- 2.(a) IFTC bank account reconciliation procedures (see description at 3. below) require that all cash receipts and disbursements are accounted for and recorded.
- (b) IFTC procedures for reviewing and recording trade settlements (see description at 3. under Trade Settlement section above) require that associated cash is recorded and applied to trade payable/receivable balances.
- (c) IFTC procedures for recording receipt of interest and dividends (see description at 5. under Income Recording and Collection section above) require that such amounts are recorded and applied to the appropriate receivable balances.

Control design is considered adequate.

Control Objectives

Control Procedures

Comments/Recommendations

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| 3. <u>Bank reconciliations and related procedures are adequate to assure that activity and balances reflected in bank statements have been properly recorded.</u> | (d) Procedures for the authorization of disbursements for expenses (see description at 1. under Accounts Payable and Expenses section) provide for the proper recording of such amounts. Authorizations prepared by HAM and IFTC personnel indicate the applicable fund. Such disbursements are actually made from an IFTC general disbursement account which is funded by transfers of monies from fund bank accounts, authorized as described at 1.(d) above. | 3-1 Control design is considered adequate; however, HAM personnel should review IFTC bank reconciliations on a monthly basis. |
| 4. <u>Cash transactions and requirements are properly monitored to provide assurance that cash obligations can be met and portfolio managers are aware of cash available for investment.</u> | 3. IFTC has established procedures for accountants to reconcile bank statements for each fund daily. Accountants are required to account for all cash activity, as described at 2. above, and reconcile ending bank balances to general ledgers. Bank reconciliations are approved by supervisory personnel.

4.(a) IFTC prepares a daily cash availability worksheet for each fund. All activity affecting cash balances is considered, including shareholder transactions and securities trade settlements and maturities. Every morning IFTC reports each fund's cash available for investment to HAM portfolio management.

(b) Cash flow projections are furnished to HAM short-term portfolio managers continuously throughout the day until the final cash worksheet is prepared no later than 12:30 p.m. New York City time.

(c) HAM portfolio managers and traders maintain their own records of cash available for investment and compare their balances to those reported by IFTC for reasonableness.

(d) Actual cash transactions are authorized and reviewed by procedures described at 1. and 2. above. | Control design is considered adequate. |

E.F. HUTTON & COMPANY INC.
HIS AND HUTTON MUNICIPAL FUNDS
CASH/ACCOUNTS PAYABLE/EXPENSES
ACCOUNTS PAYABLE AND EXPENSES

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>Expenses are properly authorized and borne by each fund in accordance with current agreements and the prospectus.</u>	1. HAM personnel review and approve expense invoices and other charges for the funds. Approved expenses are transmitted to IFTC for payment.	Control design is considered adequate.
2. <u>With respect to HIS, general expenses are properly allocated among the series.</u>	2.(a) HAM identifies expenses relating to individual series and general expenses to be allocated among the series, such as directors' fees, accounting and legal expenses. HAM determines the allocation of general expenses in accordance with prospectus guidelines. (b) IFTC records the allocation of general expenses to the series as authorized by HAM.	Control design is considered adequate.
3. <u>Expenses are properly accrued for in the daily calculation of net asset value per share.</u>	3.(a) HAM develops an expense budget and accrual rates for each fund which are provided to IFTC. For expenses other than investment advisory and distribution fees which are calculated and accrued separately, IFTC accrues an amount each day based on the information supplied by HAM. (b) IFTC reviews the reasonableness of daily expense accruals as part of the daily analysis of the change in net asset value per share or yield (see description at 5. below). (c) HAM and IFTC analyze expense accruals and rates in detail semi-annually to determine their reasonableness and any required adjustments.	3-1 HAM Finance Department personnel should monitor the accuracy of expense accruals at least on a monthly basis. 3-2 Consideration of the requirements of Rule 2a-4, including an analysis of the impact on capital share activity, should be documented by the HAM Finance Department personnel for the adjustment of expense accruals and rates. Formal, written documentation for expense adjustments should be provided to IFTC.

Control Objectives	Control Procedures	Comments/Recommendations
4. <u>Expense limitations pursuant to state securities regulations are monitored and complied with appropriately.</u>	4.(a) IFTC personnel monitor compliance with applicable expense limitations, as required, to properly reflect net asset value per share. (b) IFTC reviews expense limitations in conjunction with its monthly financial reporting to HAM. (c) HAM reviews compliance with expense limitations as part of their semiannual review of expenses.	4-1 See recommendations at 3. above.
5. <u>Investment advisory fees are properly calculated and recorded in accordance with current advisory agreements and prospectus disclosure.</u>	5.(a) HAM is responsible for providing IFTC with current advisory fee rates as specified in current advisory agreements and prospectuses. (b) IFTC fund accounting personnel enter current advisory fee rates into the accounting system, except for the HIS Short Term Investment Series for which the fee calculation is performed manually. The system automatically calculates the advisory fees based on daily net assets and accrues such amounts. (c) HAM personnel review fund advisory fees for reasonableness on a monthly basis. (d) See description of IFTC NAV calculation review procedures at 5.(b) under Fund Accounting and Calculation of Net Asset Value Per Share section below.	5-1 Control design is considered adequate; however, HAM Finance Department personnel should check IFTC's calculations of advisory fees on a quarterly basis and as of the effective dates of any rate changes.
6. <u>Distribution fees are properly calculated and recorded in accordance with the Distribution Plan and prospectus disclosure.</u>	6.(a) HAM is responsible for advising IFTC of any changes in the distribution plan status or fee structure. (b) IFTC calculates the distribution fee for HIS on a manual basis. IFTC obtains information regarding capital share activity from reports produced by the DST System and other data prepared by DST. Daily net asset information is obtained from fund accounting records. (c) See description of IFTC NAV review procedures at 5.(b) under Fund Accounting and Calculation of Net Asset Value Per Share section below.	6-1 See Recommendation No. 7 in the Letter in this report.

B.2.d. HIS AND HUTTON MUNICIPAL FUNDS
FUND ACCOUNTING AND CALCULATION OF NET
ASSET VALUE PER SHARE

E.F. HUTTON & COMPANY INC.
HIS AND HUTTON MUNICIPAL FUNDS
FUND ACCOUNTING AND CALCULATION OF
NET ASSET VALUE PER SHARE

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>Journal entries and other accounting input are appropriately reviewed and approved.</u>	1.(a) Investment transactions are authorized and recorded transactions are reviewed by IFTC and HAM personnel as described under Trade Initiation and Recording. (b) The accounting system automatically sets up journal entries to record trade settlements, maturities, dividends, etc.; however, IFTC accountants must enter an "acceptance" into the system prior to actual recording. Accrual of interest is automatically recorded by the system. (c) IFTC has established procedures for fund administrators to file manually prepared support for all miscellaneous journal entries in posting books which are reviewed by supervisors.	Control design is considered adequate.
2. <u>All assets and liabilities of the fund are reflected in the computation of net asset value on a timely basis.</u>	2.(a) The computation of net asset value is performed automatically by the system for each fund at the end of the day. IFTC fund administrators are instructed to check portfolio trades, journal entries and other system updates entered prior to the pricing of the portfolio (see 3. below) and calculation of NAV. (b) Since the DST portfolio accounting system calculates net asset value per share, the current general ledger balances are used in the computations. (c) Transactions recorded by IFTC are recorded in an "on-line, real-time" mode by the system and investment related files are updated at the same time. This helps to check that subsidiary ledgers and journals are in agreement with general ledger accounts.	2-1 Control design is considered adequate; however, consideration of the requirements of Rule 2a-4, including an analysis of the impact on capital share activity, should be documented by the HAM Finance Department personnel. Formal written documentation for adjustments should be provided to IFTC.
o Assets and liabilities used in net asset value computations agree with underlying ledger balances.		
o Subsidiary ledgers and journals are in agreement with related general ledger accounts.		
o Inclusion of all securities positions in the net asset value computation.		

Control Objectives

Control Procedures

Comments/Recommendations

- (d) The system highlights out-of-balance conditions (including differences between subsidiary and general ledgers) on various reports. IFTC accountants are instructed to investigate such conditions immediately.
- (e) Procedures described under the Trade Initiation and Recording section and those above provide for all securities to be recorded and investment subsidiary ledgers to be in agreement with the general ledger.

3. Securities are properly valued.

- o Valuations are in accordance with policies set forth in prospectuses.
- o Significant or unusual changes in market prices are investigated.

- 3.(a) Fund management at HAM are responsible for advising IFTC of fund securities pricing policies as set forth in prospectuses and any changes thereto.
- (b) IFTC obtains market prices for securities, as specified in prospectuses, through system interface with outside pricing services (Quotron and J.J. Kenney), except for corporate bond U.S. Government and certain other securities where prices are supplied by HAM.
- (c) Market prices for corporate bonds, U.S. Government and certain other securities are based on quotations obtained by HAM portfolio management from brokers and market makers for IFTC.
- (d) IFTC accountants review market prices for reasonableness by reviewing a pricing stratification report which indicates significant changes in prices and omitted prices. Accountants are instructed to investigate significant changes and omitted prices immediately which are also reviewed by supervisors. The change in each fund's total portfolio market value is also reviewed for reasonableness as part of the daily analysis of the change in net asset value per share.

- 3-1 Adjustments to securities valuations and pricing errors should be evaluated by HAM Finance Department personnel giving consideration to the requirements of Rule 2a-4. The disposition should be documented in writing by Compliance Department personnel and approved by management.
- 3-2 HAM should establish procedures for a second individual to check prices obtained and telecopied to IFTC for GNMA securities.
- 3-3 HAM should establish procedures to check securities prices obtained by IFTC to an independent source on a test basis, especially for thinly traded securities such as municipal bonds.
- 3-4 For equity portfolios, the portfolio managers or traders should adhere to established procedures and review securities valuations performed by IFTC.

Control Objectives

Control Procedures

Comments/Recommendations

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| 4. <u>The correct number of outstanding capital shares is used in the calculation of net asset value per share.</u> | (e) The HAM long-term taxable and tax-exempt bond portfolio management groups review IFTC securities valuations for reasonableness. | Control design is considered adequate. |
| 5. <u>The net asset value per share computation is properly reviewed and approved.</u> | 4.(a) IFTC accountants record shareholder activity based on information supplied by EFH, for share purchases through EFH, and reports produced on the DST System. Since purchases through EFH have a normal 5 business day settlement period, EFH provides DST and IFTC with their total purchase amounts for each fund on day following trade date. IFTC converts dollar amounts to shares based on trade date NAV per share when recording EFH purchases.

(b) IFTC accountants reconcile capital shares recorded on each fund's accounting records to DST's daily report of outstanding shares.

(c) DST has established extensive system and processing controls to provide assurance that shareholder activity is properly processed and reported to system users. See Shareholder Transactions section for further description of procedures. | 5-1 Control design is considered adequate with respect to procedures performed by IFTC; however, HAM should review the Net Asset Rollforward schedules and calculations of net asset value per share for each fund on a monthly basis. |
| 6. <u>For money market funds using the amortized cost method to value securities and compute net asset value, procedures are adequate to determine the extent of deviation from market value and that such valuations are appropriate.</u> | 5.(a) IFTC accountants investigate significant changes in securities prices as described at 3.(d) above. Supervisors review dispositions.

(b) IFTC requires that an analysis of the change in net asset value per share, or yield for money market funds, be prepared each day and approved by supervisors prior to the issuance of fund prices. These analyses are performed by completion of standard Net Asset Rollforward schedules for equity or bond funds and money market funds. The Rollforward schedules isolate the components of the change in net assets from the beginning to the end of the day.

6. The HAM Compliance Department checks investments made by money market funds for compliance with Rule 2a-7 of the 1940 Act and certain related procedures adopted by the Board of Directors. | 6-1 See Recommendation No. 11 in the Letter in this report. |

Control Objectives

Control Procedures

Comments/Recommendations

7. State expense limitations are properly monitored and reimbursements are made, if applicable.

7.(a) State expense limitations are reviewed by the manager of the HAM Finance Department and the funds' independent accountants on a semi-annual basis.

(b) IFTC reviews expense limitations on a monthly basis.

7-1 State expense limitations should be reviewed on a monthly basis by the HAM Finance Department, particularly in start-up situations.

8. Books and records are maintained in accordance with Rules 31a-1, 31a-2 and 31a-3 under the 1940 Act.

8.(a) The funds' custodian agreements affix responsibility with IFTC for the proper maintenance of accounting and related records. The custodian agreements also provide for the funds' ownership of and accessibility to such records.

(b) The IFTC accounting manual includes these rules and the records appear suitably designed to facilitate compliance.

Control design is considered adequate.

B.2.e. HIS AND HUTTON MUNICIPAL FUNDS
FINANCIAL REPORTING

E.F. HUTTON & COMPANY INC.

HIS AND HUTTON MUNICIPAL FUNDS

FINANCIAL REPORTING

Control Objectives

Control Procedures

Comments/Recommendations

A. Annual and semi-annual reports to shareholders

What procedures are designed to provide reasonable assurance that:

1. The financial statements included in the annual and semi-annual reports to shareholders are prepared on the basis of appropriate supporting data and final trial balances.

1.(a) The funds have a third-party recordkeeping agent whose procedures include controls designed to check that general ledger transactions are properly accumulated, classified and summarized in the accounts and that closing entries are reviewed and approved by authorized personnel.

(b) Monthly statements of assets and liabilities and operations are prepared by the recordkeeping agent and furnished to the HAM Finance Department. The financial statements to be included in the semi-annual and annual reports are prepared from these financial statements by the manager of the HAM Finance Department.

(c) The draft financial statements are then reviewed by the fund's independent accountants for the funds and agreed to or reconciled to the balances on the funds' general ledgers.

(d) The annual financial statements are subject to an examination in accordance with generally accepted auditing standards. The semi-annual financial statements are subject to a more limited review by the independent accountants.

1-1 Control design is considered adequate.

2. Proposed adjustments by the independent accountants are reviewed and approved or waived by an appropriate official of Hutton Asset Management.

2.(a) Established procedures require that the independent accountants review the proposed adjustments developed during the annual examination with the manager of the HAM Finance Department.

2-1 Control design is considered adequate.

Control Objectives

Control Procedures

Comments/Recommendations

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| 3. <u>The annual and semi-annual financial statements included in the respective reports to shareholders are fairly presented in accordance with generally accepted accounting principles.</u> | (b) The manager of Finance is responsible for authorizing the recording or waiving of such adjustments.

(c) The recording of any adjustments in the accounting records of the fund is the responsibility of IFTC and this is verified by the independent accountants.

(d) Both the manager of the Finance Department and the independent accountants determine that any agreed upon adjustments have been reflected in the financial statements of the fund prior to approving the final draft for printing. | |
| 4. <u>The financial statements included in the annual and semi-annual reports include all the disclosures required by Regulation S-X for regulated investment companies.</u> | 3.(a) HAM Finance Department drafts the financial statements of the funds and informally compares the disclosures therein to the financial statements of the prior year. Matters arising during the year which would impact financial accounting policies or disclosure are addressed as they arise and are considered in the preparation of the annual and semi-annual financial statements.

(b) HAM relies on its independent accountants to determine that the financial statements are fairly presented in accordance with generally accepted accounting principles, disclosures made therein comply with such principles and the accounting policies disclosed therein are the policies followed by each fund during the period reported on. | 3-1 HAM should establish formal procedures to review the financial statements for fair presentation in accordance with generally accepted accounting principles and should consider the development and use of an appropriate checklist. |
| | 4. HAM relies on its independent accountants to determine that all disclosure required by Regulation S-X is included in the financial statements of the funds. | 4-1 HAM Finance Department should perform a review for compliance with the applicable requirements of Regulation S-X and with Section 30(d) and Rule 30d of the 1940 Act to check that all disclosures required by federal securities laws are included. A comprehensive checklist should be developed for this purpose and completed and initialed by the HAM Finance Department manager for each fund. |

Control Objectives

Control Procedures

Comments/Recommendations

5. The financial information in management's discussion and the other financial information included in the annual report is consistent with the financial statements and is materially correct.

5.(a) The other financial information included in the annual report is prepared from data supplied by the recordkeeping agent or from information disclosed in the financial statements.

(b) HAM Finance Department is responsible for supplying and/or checking all of the other financial information included in the annual and semi-annual reports.

(c) The independent accountants review the other data included in the annual report and verify to the extent possible that it is consistent with the audited financial statements.

6. The annual and semi-annual reports, including the financial statements, are reviewed and approved by the appropriate levels of management before issuance.

6.(a) The manager of the HAM Finance Department is responsible for the final review and approval of the annual and semi-annual financial statements and other financial information included in the annual and semi-annual reports.

(b) The Chief Administrator of the funds also reviews all the information included in the annual report other than the financial statements.

7. The annual and semi-annual reports are mailed to shareholders and are sent to the Securities and Exchange Commission on a timely basis.

7.(a) Outside legal counsel advises HAM through the use of compliance calendars of the filing and mailing due dates for annual and semi-annual reports.

(b) The manager of the Finance Department at HAM is responsible for coordinating the preparation of the financial statements and the reports in order to effect timely printing, mailing and filing.

(c) The Chief Administrator monitors the status of the preparation of such reports with the Finance Department manager.

4-2 Procedures to update the checklist referred to in 4-1 for changes in regulations should be established.

5-1 Control design is considered adequate.

6-1 Control design is considered adequate.

7-1 Control design is considered adequate.

Control Objectives

Control Procedures

Comments/Recommendations

- (d) The HAM Finance Department manager is responsible for checking that reports are printed and sent to IFTC for timely mailing to shareholders. HAM also follows up and receives verbal representation from IFTC that such reports have been mailed on time.
- (e) Outside legal counsel is requested to file reports to the SEC on a timely basis.

B. Annual and semi-annual reports on Form N-SAR

What procedures are designed to provide reasonable assurance that:

- 1. The information included in Form N-SAR is accurate and complete and includes all required information.

- 1.(a) HAM is notified of the N-SAR filing requirements by outside legal counsel to the funds.
- (b) HAM relies on outside legal counsel to request the information required by them to properly prepare Form N-SAR. Outside legal counsel makes a written request of the Chief Administrator and others within HAM for the information needed.
- (c) The Chief Administrator delegates the gathering of the information and coordination with outside legal counsel to the HAM Finance Department manager or the Compliance Officer. The designated manager separates the requirements and obtains the information required from the recordkeeping agent and the applicable departments within HAM and furnishes such information to outside legal counsel.
- (d) The funds' N-SARs are reviewed by the Finance Department manager who is responsible for checking the financial information included therein and copies of the N-SARs are sent to the independent accountants who check the accuracy of the other financial information included therein.

1-1 Control design is considered adequate.

Control Objectives

2. The N-SAR is reviewed and approved by the appropriate levels of management prior to filing.

C. Registration statement - Form N-1A

What procedures are designed to provide reasonable assurance that:

1. The financial information included in Form N-1A is consistent with the annual financial statements and/or the books and records of the fund.

Control Procedures

2. Once the HAM Finance Department manager approves the N-SAR it is reviewed by the Chief Administrator and sent to outside legal counsel for filing with the SEC on a timely basis.

1. See procedures described for preparation of financial information in Form N-1A under the section Compliance with the Securities Act of 1933.

Comments/Recommendations

2-1 Control design is considered adequate.

1-1 Control design is considered adequate.

C. CASH FUNDS

C. CASH FUNDS

C.1. CASH FUNDS

OVERVIEW

E.F. HUTTON & COMPANY INC.

CASH FUNDS

OVERVIEW

INVESTMENT PRODUCTS:

Hutton AMA Cash Fund, Inc. ("Cash Fund")
Cash Reserve Management, Inc. ("CRM")
Municipal Cash Reserve Management, Inc. ("MCRM")
Hutton Government Fund, Inc. ("Government Fund")

The Cash Fund and CRM invest in a variety of debt instruments maturing in less than one year. The Cash Fund is available exclusively to participants in E.F. Hutton's Asset Management Account ("AMA") program or its Asset Reserve Account ("ARA") program. These accounts combine an E.F. Hutton securities margin account, "a checking privilege on an account maintained" at Provident National Bank of Philadelphia ("Provident Bank"), and an investment in a money market fund; the AMA Account also features an American Express Gold Card. CRM is available to E.F. Hutton customers who are not AMA/ARA participants.

MCRM invests in short term obligations the interest of which is exempt from Federal income taxes. The Government Fund invests in obligations issued or guaranteed by the United States or its agencies or instrumentalities. Each fund is available both to AMA/ARA participants and to other E.F. Hutton customers.

All four funds are "money market funds" that seek to provide current income while maintaining liquidity and a constant net asset value of \$1.00 per share.

CONTROL SYSTEM - KEY PARTICIPANTS:

E.F. Hutton & Company Inc. ("EFH") acts as distributor for the cash funds. Contact with the transfer agent is the principal responsibility of the Money Market Instruments Department ("MMI"). Individual Account Executives have principal responsibility for contact with customers.

Hutton Asset Management ("HAM") provides investment advisory services to the funds. Portfolio managers are responsible for decisions regarding the purchase and sale of portfolio securities. Compliance Department personnel are responsible for monitoring various matters relating to each fund's compliance with applicable regulatory requirements. The Finance Department is responsible for matters relating to external and internal financial reporting.

Bank of New England, National Association ("BNE") is the Funds' custodian and transfer agent. BNE's Operations group carries out the transfer agency function. The Custody Department performs the daily accounting for the funds. The Accounting Control group performs a variety of checking procedures with respect to work performed by other BNE departments.

Bankers Trust Company ("Bankers Trust") is the sub-custodian for the funds, holding and processing these securities which must be held in physical form as compared to book entry. BNE performs custodial functions for securities held in Fed book entry.

CONTROL SYSTEM - KEY TRANSACTION CYCLES:

There are several key transaction cycles affecting capital shares:

- Shareholders may purchase or redeem shares by direct wire transactions with BNE.
- Redemptions may be effected through the use of a checkwriting privilege.
- Purchase and redemption orders also may be placed with the customer's account executive, who transmits entries through the EFH order entry system.
- Customers may request that the proceeds of a securities sale be used to purchase shares on the transaction's settlement date. Securities purchases will be paid for through redemption of shares, unless the customer requests otherwise.
- AMA/ARA shareholder transactions are automatically generated as Free Credit Balances achieve levels necessary to trigger automatic purchases, and as charges to the participant accounts (including both the brokerage account and checks written against the participant's account with Provident Bank) trigger redemptions.

BNE Custody advises HAM portfolio managers of cash availability, based upon information received from BNE Operations regarding shareholder transactions. HAM portfolio managers advise BNE Custody of portfolio transactions; BNE Custody updates cash availability for such transactions as well as any additional information received from BNE Operations. BNE Custody authorizes settlement by its Fed book entry area or by Bankers Trust's cage.

BNE Custody records the investment, shareholder and other transactions in the general ledger and performs the daily calculation of net asset value and determines the dividend rate. BNE Operations computes, on a daily basis, dividends payable to shareholders, posts these to shareholders' individuals dividends payable accounts and monthly pays (through EFH) or reinvests the dividends.

CONTROL SYSTEM - PRINCIPAL CONTROLS:

A principal control surrounding the shareholder transactions of the cash funds is the dual processing and recordkeeping by the transfer agent (BNE) and the distributor (EFH). BNE periodically furnishes to EFH a computer tape containing shareholders' positions in each fund. MMI runs this tape against EFH records and creates a "break list" of discrepancies between the two sets of records. MMI is responsible for investigating and resolving these discrepancies and documenting the disposition of each item.

Another principal control surrounding the Funds is the existence of a separate Accounting Control department at BNE. This department performs (or reviews) a variety of key reconciliations and procedures, independent of the departments originating the processing. Apart from the actual performance of the procedures, the existence of a separate group dedicated to control functions tends to strengthen the control environment.

It should be noted that many of the BNE controls with respect to portfolio transactions and fund accounting described in this report are manual; BNE is in the process of implementing an automated fund accounting system. Implementation is expected to be completed during 1986, at which point some of the manual controls identified in this report may be superseded by application controls designed to achieve the same objective.

C.2. CASH FUNDS

CONTROL OBJECTIVES AND PROCEDURES

C.2.a. CASH FUNDS
SHAREHOLDER TRANSACTIONS

E.F. HUTTON & COMPANY INC.

CASH FUNDS

SHAREHOLDER TRANSACTIONS

PURCHASES

Control Objective

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that:

1. Capital stock purchase transactions are properly authorized.

Control design is considered adequate.

(a) Purchases through E.F. Hutton

- 1.(a)(1) In order to process a trade, a purchaser must have an account with E.F. Hutton. Standard forms and procedures exist to establish an account. EDP controls provide that the initial purchase automatically generates the mailing of a prospectus.
- (2) EDP controls provide that proceeds of a customer securities transaction will be used to purchase cash fund shares on settlement date, based upon instructions on the order entry ticket for the transaction.
- (3) All purchases are confirmed by E.F. Hutton through the customer's monthly statement.
- (4) Responsibility for customer authorization is fixed with the Account Executive.

(b) BNE wire purchases

- 1.(b)(1) A valid E.F. Hutton account number and payment must be furnished with the order; BNE will contact E.F. Hutton by telephone to verify account numbers if purchaser is not on BNE records.
- (2) All purchases are confirmed by E.F. Hutton through the customer's monthly statement.

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
(c) Automatic investment	1.(c)(1) An AMA/ARA Account application must be processed prior to participation in the program. (2) EDP controls in the E.F. Hutton systems provide that transactions are initiated in accordance with AMA/ARA account procedures. (3) All automatic purchases are confirmed by E. F. Hutton through customer monthly statement.	Control design is considered adequate.
2. <u>Minimum purchase dollar amounts are complied with as set forth in each prospectus.</u>	2.(a) Edit and validation routines in the E.F. Hutton Order Entry system test for adherence to dollar minimums. (b) Individual transactions are subject to manual review by BNE clerical personnel for adherence to dollar minimums.	3-1 Control design is considered adequate; however controls would be enhanced by periodically reviewing the job control log to check that the job effecting cut-off is run at the appropriate time.
3. <u>Purchase orders are not accepted after cut-off times specified in each prospectus.</u>	3.(a) EDP operating procedures require that the E.F. Hutton Order Entry system cut off purchase orders at 2:00 PM. Cash fund transactions will not be accepted after this cut-off. Wire order entry personnel are responsible for time and date stamping of all orders at the branch offices. (b) Staff responsible for processing orders are advised of cut-off times by memoranda and are responsible for adherence thereto.	
(a) Purchases through E.F. Hutton		
(b) BNE wire purchases		

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
4. <u>Purchase orders received by E. F. Hutton are promptly and accurately transmitted to BNE.</u>	4.(a) Application controls are established to determine that all orders flow into the pending file and are maintained there until transmission to BNE. (b) Data transmission controls (including monitoring of totals) are established to provide that data received by BNE are complete. (c) Periodic running of the "break list" by E. F. Hutton identifies any discrepancies between shareholder positions reflected by BNE and E.F. Hutton.	Control design is considered adequate.
5. <u>Payment for purchases is properly credited to the funds accounts.</u>	5.(a) BNE effects a single net daily settlement with E.F. Hutton, reflecting all shareholder activity received from E.F. Hutton for the four cash funds. A "daily reconciliation" worksheet, which summarizes total activity for each of the four funds by eight transaction types, is agreed upon by both parties prior to the wire transfer being effected. (b) Direct purchases from shareholders are accepted upon the receipt of payment by Federal Funds wire.	Control design is considered adequate.
(a) Purchases through E.F. Hutton.		
(b) BNE wire purchases		
6. <u>AMA/ARA account purchases are executed in accordance with prospectus disclosure.</u>	6.(a) The E.F. Hutton EDP application which performs "good funds analysis" is designed to identify "Free Credit Balances" which are available to a participant on demand and which may be transferred from a participant's securities account without giving rise to interest charges. (b) The EDP application which performs the "sweep" is designed to be consistent with prospectus disclosures.	Control design is considered adequate.
(a) Free credit balances are defined in a manner consistent with each prospectus.		
(b) Free credit balances are invested upon exceeding the minimum level specified in each prospectus.		

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
7. <u>Purchases are accurately reflected in shareholder accounts on a timely basis.</u>	7.(a) Periodic running of the "break list" by E.F. Hutton identifies any discrepancies between shareholder positions reflected by BNE and E.F. Hutton. (b) Shareholder transactions are confirmed through monthly statement to customer and Account Executive by E.F. Hutton.	Control design is considered adequate.
8. <u>The Fund shares are legally registered for sale in the states in which sales are made, and the registration fees are properly computed and paid.</u>	8. HAM relies on the funds' outside legal counsel to register shares of the funds in states in which shares are sold and that registration fees are properly computed and filing requirements are met.	Control design is considered adequate.
9. <u>Additional shares are registered in each state and become effective with sufficient time to preclude sales in excess of shares registered.</u>	9.(a) HAM has its outside legal counsel prepare compliance calendars or otherwise advise it of dates by which additional shares should be registered in each state. HAM receives totals of shares sold in each state on a monthly basis and submits such information to the funds' outside legal counsel. (b) Outside legal counsel has been engaged to compare shares sold to shares registered and coordinates with the operations department personnel at HAM to register shares with sufficient time to preclude excess sales. (c) HAM has instructed outside counsel to the funds to register shares when they estimate that approximately three to six months of sales, based on a historical average, may occur prior to exceeding the current registered amount.	9-1 HAM should assign an officer or employee the responsibility to monitor reports prepared by outside counsel for consistency with fund share sales data.

E.F. HUTTON & COMPANY INC.

CASH FUNDS

SHAREHOLDER TRANSACTIONS

REDEMPTIONS

Control Objective

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that:

1. Capital stock redemption transactions are properly authorized.

Control design is considered adequate.

(a) Redemptions through E.F. Hutton

- 1.(a)(1) Responsibility for authorization of redemption requests from shareholders is fixed with the Account Executive.
- (2) EDP controls provide that cash fund shares will be redeemed to pay for customer securities purchases on settlement date, unless instructions to the contrary are indicated on the securities order ticket.
- (3) All redemptions are confirmed through monthly E.F. Hutton customer statement.

(b) BNE wire redemptions

- 1.(b)(1) BNE requires a completed expedited wire transaction application with guaranteed signature of shareholder.
- (2) BNE personnel verify telephone requests for wire redemptions by having caller repeat certain account information contained in the initial application.
- (3) Telephone conversations are recorded and tapes are periodically reviewed by supervisory personnel.

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
(c) BNE check redemptions	1.(c)(1) BNE requires a completed signature card (authorized by an E.F. Hutton stamp) and verifies signatures on all checks. (2) Shareholders receive paid checks at end of month.	
(d) Automatic redemptions	1.(d)(1) AMA/ARA account application must be processed prior to participation in the program. (2) EDP controls at E.F. Hutton provide that redemption transactions are initiated in accordance with each prospectus. (3) All automatic redemptions are confirmed by E.F. Hutton through monthly AMA/ARA account statement.	
2. <u>Redemptions requests are in "good order" as specified in each prospectus.</u>		Control design is considered adequate.
(a) Redemptions through E.F. Hutton	2.(a) Edit and validation routines at E.F. Hutton and BNE test for adequacy of shares owned, validity of account number and other attributes.	
(b) BNE wire redemptions	(b) BNE personnel are responsible for manual verification that shareholder application authorizing wire redemption is on file and that shares owned are adequate.	
(c) BNE check redemptions	(c) BNE edit routines test for minimum amount and adequacy of shares owned. Manual review tests for signature validity, currentness of dating of check and absence of any "stop check" orders.	
3. <u>Redemption orders received by E.F. Hutton are promptly and accurately transmitted to BNE.</u>		Control design is considered adequate.
	3.(a) Application controls at E.F. Hutton are established to determine that all orders flow into the pending file and are maintained there until transmission to BNE.	
	(b) Data transmission controls (including monitoring of totals) are established to provide that data received by BNE are complete.	
	(c) Periodic running of "break list" by E.F. Hutton identifies any discrepancies between shareholder positions reflected by BNE and E.F. Hutton.	

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
4. <u>Redemption orders are cut off in accordance with prospectus disclosures.</u>	<p>4.(a) Established EDP operating procedures require that the order entry system cut off redemption orders at 2:00 PM. Cash Fund transactions will not be effected after this cut-off. Wire order entry personnel are responsible for dating and time stamping orders.</p> <p>(b) BNE clerks processing redemption orders are advised in writing of applicable cut-off times and are responsible for adherence thereto.</p>	Control design is considered adequate.
5. <u>Redemption proceeds are promptly paid to redeeming shareholders.</u>	<p>5.(a) Redemption proceeds are sent to bank account specified by shareholder and will appear on the shareholder's monthly statement.</p> <p>(b) Redemption proceeds are credited to the shareholder's account with E.F. Hutton, and will appear on the monthly statement sent to the shareholder and Account Executive.</p>	5-1 See Recommendation No. 3 in the Letter in this Report.
6. <u>AMA/ARA Account automatic redemptions are executed in accordance with prospectus disclosures.</u>	<p>6.(a) The E.F. Hutton FDP application which performs "good funds analysis" is designed to identify "Free Credit Balances" which are available to a participant on demand and which may be transferred from a participant's securities account without giving rise to interest charges.</p> <p>(b) The E.F. Hutton EDP application which perform the "sweep" is designed to be consistent with prospectus disclosure.</p>	Control design is considered adequate.
7. <u>Redemptions are accurately recorded in shareholders accounts on a timely basis.</u>	7.(a) Periodic running of the "break list" by E. F. Hutton identifies any discrepancies between shareholder positions identified by BNE and E.F. Hutton.	Control design is considered adequate.

Control Objective

Control Procedures

Comments/Recommendations

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| 8. <u>Redemption proceeds wired by BNE are sent only to the authorized bank account of the shareholder.</u> | (b) Shareholder transactions are confirmed through statements sent by E.F. Hutton.

8. The initial application creates a recurring payment authorization which is sent to the wire room. Requests by BNE Operations for redemptions must be based on the recurring authorization, and accordingly will be wired only to bank account specified in the authorization. | Control design is considered adequate. |
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E.F. HUTTON & COMPANY INC.

CASH FUNDS

SHAREHOLDER TRANSACTIONS

TRANSFERS AND SHAREHOLDER ACCOUNT MAINTENANCE

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>Transfers of shareholder accounts and other registration changes are properly authorized and processed on a timely basis.</u>	1.(a) Instructions are communicated by shareholders to Account Executives. Changes in address generate confirmations by E.F. Hutton which are mailed directly to the shareholder's old and new address. Other changes are reflected in the next customer statement. (b) Changes in authorized check signatures (or initiation of check redemption privileges) require signature of shareholder, authorized by Account Executives.	Control design is considered adequate.
2. <u>Shareholder transactions are appropriately confirmed through AMA/ARA or conventional brokerage account statements.</u>	2.(a) EDP application controls are designed to check that all shareholder account activity recorded by E.F. Hutton is reported on statements. (b) Periodic running of the "break list" by E.F. Hutton identifies discrepancies between E.F. Hutton and BNE records.	Control design is considered adequate.

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
3. <u>Adjustments and corrections of orders are appropriately authorized.</u>	3.(a) Trade corrections require the cancellation of the original order and the re-submission of a revised order in accordance with normal trade procedures. (b) "Kickouts" of invalid transactions by BNE are telefaxed to E.F. Hutton for follow-up.	Control design is considered adequate.
4. <u>Capital share transactions can be processed at prices other than \$1.00 per share, in the event that such pricing should become necessary.</u>	4. E.F. Hutton and BNE maintain separate share and dollar records in order to permit processing of transactions at prices other than \$1.00 per share.	Control design is considered adequate.

E.F. HUTTON & COMPANY INC.

CASH FUNDS

SHAREHOLDER TRANSACTIONS

DIVIDENDS FROM INVESTMENT INCOME AND
CAPITAL GAINS DISTRIBUTIONS

Control Objective

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that:

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| 1. <u>Aggregate income available for dividends to shareholders is properly determined.</u> | 1.(a) | The NAV worksheet, which sets forth the computation of daily net income, is manually prepared by the Fund Accountant from the general ledger and is reviewed and approved by the BNF fund accounting supervisor. | Control design is considered adequate. |
| 2. <u>Shareholders entitled to dividends on record date are properly determined.</u> | | | Control design is considered adequate. |
| (a) Purchasing shareholders are entitled to dividends beginning on the next business day after the transaction; those shareholders for which wires are received before noon are entitled to dividends on the same day. | 2.(a) | The daily dividend computation is based upon the current day's NAV worksheet. Shares outstanding therefore reflect the prior day's purchases and redemptions and any morning wire transactions which create a same-day change in dividend status. | |
| (b) Redeeming shareholders are entitled to dividends up to and including the day of the transaction; those requesting same day wire redemptions are not entitled to that day's dividend. | (b) | See above. | |

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
3. <u>Dividends per share are properly computed and applied to individual shareholder dividends payable accounts.</u>	3.(a) The Dividend Rate Sheet is manually prepared by the Fund Accountant from the NAV worksheet, checked by a second fund accountant and custody supervisor, and is subject to two reviews by different departments at BNE (Accounting Control and Operations). (b) EDP application controls at BNE provide that the day's dividend is posted to each shareholder's account. (c) The Daily Interest Summary Report is checked to the Dividend Rate Sheet by Accounting Control.	Control design is considered adequate.
4. <u>Dividend payments and reinvestments are properly processed.</u>	4.(a) The master file maintained by BNE includes information regarding dividend options, which is based on data transmissions from E.F. Hutton. (b)(1) The BNE processing cycle for dividend payouts balances the total distribution to amounts paid in cash and amounts reinvested. (b)(2) E.F. Hutton balances cash dividends received from BNE to aggregate amounts credited to shareholder accounts. Dividend payments and reinvestments are reported to shareholders on monthly E.F. Hutton customer statements.	Control design is considered adequate.
5. <u>Accurate reporting of dividend and capital gain information to shareholders and the Internal Revenue Service.</u>	5. All transactions are reflected in the customer account; Form 1099 is automatically generated by E.F. Hutton's tax reporting system for reportable customer account activity.	Control design is considered adequate.

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
6. <u>Dividend accruals, payments and reinvestments are properly posted to each fund's accounting records.</u>	<p>6.(a) Dividend Rate Sheet is proved to the Daily Interest Summary Report by BNE. The rate sheet is derived from the NAV worksheet which reflects the recording of dividend information in each fund's general ledger.</p> <p>(b) Dividend payouts relating to shareholders redeeming their accounts during the month are reported by BNE Operations and are subject to balancing controls over the Daily Interest Summary Report.</p>	Control design is considered adequate.

C.2.b. CASH FUNDS
PORTFOLIO TRANSACTIONS

E.F. HUTTON & COMPANY INC.

CASH FUNDS

PORTFOLIO TRANSACTIONS

TRADE INITIATION AND RECORDING

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>Portfolio transactions are authorized by appropriate personnel.</u>	1. HAM designated individuals are authorized to initiate portfolio transactions; a listing of such individuals is approved by the Board of Directors on a periodic basis. Each fund's custodian contract specifies that BNE may act only on the written authorization of such individuals; BNE personnel are apprised in writing of authorized individuals by HAM officials.	Control design is considered adequate.
2. <u>Details of executed and cancelled transactions are accurately recorded by traders.</u>	2. Portfolio managers and traders complete trade tickets which include all relevant information. All trades are verbally confirmed with contra-party. Trade tickets document the names of individuals at the contra-party with whom the trade was made and with whom it was confirmed.	2-1 Control design is considered adequate; however, interest purchased on variable rate securities should be recomputed by HAM to check that amounts paid are accurately determined.
3. <u>Transactions are communicated accurately and completely to the recordkeeping agent by the investment adviser.</u>	3.(a) All tickets are telefaxed to BNE custody promptly after completion. The number of trades reported for each fund is agreed upon by portfolio managers and BNE. (b) Portfolio managers and BNE agree projected cash balances at no later than 1:30 p.m. in order to determine that net money on purchase and sales are accurately recorded.	Control design is considered adequate.

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
4. <u>The recordkeeping agent accurately records all portfolio transactions no later than the business day after trade date.</u>	4.(a) Trades settled during the day are compared against trade tickets by BNE Fund Accounting supervisor. (b) The HAM Compliance Department compares transactions reflected on reports from BNE to original trade tickets.	Control design is considered adequate.
5. <u>Transactions are in accordance with applicable prospectus requirements, including:</u>	5.(a) Portfolio managers have advised us that they are informed of applicable prospectus restrictions and requirements. (b) Every transaction is checked by Compliance Department against tailored checklist of more important applicable requirements. (c) Compliance Officer is required to periodically report to the Board of Directors as to any instances of noncompliance.	5-1 Summary listings of applicable requirements should be developed and updated for use by portfolio managers on all funds. 5-2 The Compliance Department's checklists should include all applicable prospectus, 1940 Act, IRS and SEC requirements. 5-3 All questions regarding compliance should initially be directed to and coordinated by the HAM Compliance Officer.
6. <u>Portfolio transactions are in compliance with rules and regulations under the 1940 Act and with restrictions and limitations included in state Blue-Sky laws, including:</u>	6.(a) See procedures listed with respect to 5. above. (b) HAM relies on the funds' outside legal counsel to ascertain that restrictions and limitations included in the various states securities laws are included as restrictions and limitations in the funds' objectives and policies, which are monitored as noted in 5. above.	6-1 See recommendations in 5. above.

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
7. <u>Prospectus restrictions relating to repurchase agreements are adhered to, including:</u>	<p>7.(a)(1) The Boards of Directors have adopted written procedures covering repurchase agreements.</p> <p>(2) HAM monitors creditworthiness of contra-parties and has advised that it conducts transactions only with primary dealers. The listing of approved dealers is reviewed by the Board of Directors annually.</p>	7-1 HAM should continue efforts to have all dealers sign a recently revised repo agreement and check that agreements properly perfect a security interest in collateral received.
(a) Creditworthiness of contra-parties		7-2 HAM should consider establishing limits for outstanding repurchase agreements with individual contra-parties.
(b) Possession of collateral and adequacy of market value.	<p>(b)(1) Written agreements are maintained with all contra-parties.</p> <p>(2) The fund custodian has procedures to effect payment only against receipt of securities; the custodian communicates information about failed collateral to HAM Compliance Department.</p> <p>(3) Portfolio managers are instructed to determine the adequacy of collateral upon entering into the transaction.</p>	7-3 See Recommendation No. 10 in the Letter in this Report.
8. <u>With respect to reverse repurchase agreements:</u>		
(a) Agreements are entered into only when repurchase agreements are available at a more favorable rate.	8.(a) Portfolio managers are responsible for entering into reverse repurchase agreements only when a more favorable rate will be obtained on a repurchase agreement.	8-1 See recommendation 7-1 above.
(b) Collateral delivered by the fund is not excessive.	(b) The fund custodian in accordance with its contract delivers securities only against payment.	8-2 HAM should improve procedures to check that the market value of collateral delivered under reverse repurchase agreements is not excessive.
(c) Agreements are entered into only with credit-worthy parties.	(c) See 7.(b) above.	
(d) Sufficient cash or other liquid assets are maintained in a segregated account to cover the amount of the obligation.	(d) Portfolio managers identify collateral, instruct the custodian to segregate it and determine that the initial market value segregated is in excess of the related liability.	

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
9. <u>With respect to when issued and delayed delivery securities transactions:</u>		
(a) Such transactions are appropriately identified and reported to the custodian.	9.(a) Portfolio managers identify such transactions on the trade authorization sent to the custodian.	9-1 HAM should improve procedures to determine the adequacy of the value of segregated assets underlying such liabilities throughout the period such commitments are outstanding.
(b) Sufficient cash and other liquid assets are maintained in a segregated account to cover the related liability.	(b) See 8.(d) above.	
10. <u>Sufficient collateral is held by the funds for loans of portfolio securities.</u>	10.(a) Fund portfolio managers have stated that, as a matter of internal policy, portfolio lending is not done. Responsibility for adherence to that policy is vested in portfolio managers under the general direction of HAM management.	Control design is considered adequate.

E.F. HUTTON & COMPANY INC.

CASH FUNDS

PORTFOLIO TRANSACTIONS

TRADE SETTLEMENT

Control Objective

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that:

- | | | |
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| 1. <u>Deliveries and receipts of securities, including those effected through book entry procedures, and related cash movements are based upon appropriate authorization.</u> | 1.(a) With respect to Fed book entry settlements, manual buy/sell sheets authorizing settlements are prepared at BNE by Fund Accountants based on trade authorizations, and are approved by a supervisor. All Fed book entry activity is matched to the buy/sell sheets.

(b) With respect to physical settlements, the sub-custodian receives authorization from BNE via CRT. All activity processed by the sub-custodian is agreed to trade authorization by the Fund Accountant and supervisor. | Control design is considered adequate. |
| 2. <u>Securities are delivered only against receipt of payment, and payment is made only on delivery.</u> | 2.(a) Custodian and subcustodian agreements require that deliveries be made only against payments and payments only against receipt. BNE advised that cage personnel are appropriately instructed.

(b) Review of cash and securities movements by BNE Fund Accounting identifies discrepancies; the daily cash reconciliation would also identify discrepancies. | Control design is considered adequate. |
| 3. <u>Differences on settlement are promptly identified and resolved.</u> | 3. Cage personnel are instructed to agree settlements to the related authorizations and to report discrepancies to BNE Fund Accountants immediately. Daily cash reconciliation procedures would detect any differences not identified by cage personnel. BNE advised that Fund Accountants are instructed to follow up by telephone with the portfolio managers, as necessary. | Control design is considered adequate. |

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
4. <u>Fails are promptly investigated and resolved.</u>	4. Fails are reported by telephone to the portfolio managers for follow-up.	Control design is considered adequate.
5. <u>The funds do not suffer economic loss or loss of cash availability for investment as a result of failed securities transactions.</u>	<p>5.(a) The custodian identifies book credit balances resulting from failed purchase transactions and gives the fund a credit on the custodian fee as a percentage of the 90-day Treasury bill rate. (MCRM only.) On all funds, trades receive interest as if the fund received the security on settlement date.</p> <p>(b) For overdrafts arising from failed sale transactions, the custodian advances the cash to the fund at no charge and investigates the error to determine responsibility for the fail. HAM is responsible for following up with receiving broker to check that custodian is compensated for overdrafts caused by receiving broker error.</p>	Control design is considered adequate.

E.F. HUTTON & COMPANY INC.

CASH FUNDS

PORTFOLIO TRANSACTIONS

SAFEKEEPING

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>Securities are held by an independent custodian; personnel responsible for custody of securities are independent of accounting functions or other incompatible duties.</u>	1.(a) The current agreement with the custodian and the custodian's agreement with the subcustodian appropriately fix responsibility for safekeeping of assets. (b) The recordkeeping function is organizationally separate from areas responsible for custody.	Control design is considered adequate.
2. <u>Assets held by the custodian are properly segregated. Securities are periodically counted or compared to amounts in a central depository account.</u>	2. Physical segregation is the responsibility of the sub-custodian with respect to non-book entry securities.	Control design is considered adequate.
3. <u>Securities are promptly registered in the name of the fund or an appropriate nominee.</u>	3. Securities are registered in the name of the fund's nominee in the absence of contrary instructions.	Control design is considered adequate.
4. <u>Securities reflected in the funds' accounting records are held by or in the control of the funds' custodian.</u>	4. Statements of holdings are periodically reconciled to the accounting records by BNE Accounting Control personnel.	4-1 Control design is considered adequate; however, HAM personnel should review BNE reconciliations of holdings on a monthly basis.

E.F. HUTTON & COMPANY INC.

CASH FUNDS

PORTFOLIO TRANSACTIONS

INCOME RECORDING AND COLLECTION

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>Interest income (including amortization of discount) is properly calculated.</u>	1. The BNE Fund Accountant recomputes daily interest income on a proof sheet, using "interest cards" as the source document. The interest cards constitute each fund's investment ledger. The proof is reviewed bi-weekly by Fund Accounting Supervisor.	Control design is considered adequate.
2. <u>Interest rate changes on variable rate instruments are promptly identified and reflected in the computation of interest income.</u>	2. Fund Accountant notes frequency of interest rate changes on "interest cards", and will follow-up if the investment adviser does not furnish the information regarding updated interest rates.	Control design is considered adequate.
3. <u>Non-tax exempt income is appropriately identified and reported. (Applies to Municipal Cash Reserve Management Fund only.)</u>	3. BNE has manual procedures to identify and accumulate non tax-exempt interest for this fund. BNE personnel review year to date journals to accumulate such information.	Control design is considered adequate.
4. <u>Appropriate follow-up procedures exist with respect to past-due receivables and with respect to discrepancies between amounts accrued and amounts received.</u>	4. BNE has manual procedures to identify past due interest and proofs of claim are filed with respect to all outstanding amounts.	4-1 Control design is considered adequate; however, designated HAM personnel should review reports of past-due income receivable on a monthly basis.
5. <u>Realized gain and losses are appropriately computed and classified.</u>	5. Amount appears on trade ticket received from HAM and is compared to number calculated by BNE Fund Accountant. Gains/losses subject to long-term treatment are identified by the Fund Accountant for reporting purposes.	Control design is considered adequate.

C.2.c. CASH FUNDS
CASH/ACCOUNTS PAYABLE/EXPENSES

E.F. HUTTON & COMPANY INC.
CASH FUNDS
CASH/ACCOUNTS PAYABLE/EXPENSES
CASH

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>Cash disbursements and receipts are subject to appropriate authorization and review.</u>	1.(a) The custodian agreement with BNE specifies levels of authorization required for various cash activities. BNE maintains listings of individuals empowered to authorize cash transactions. (b) Cash activity relating to securities settlements, shareholder transactions and fund expenses are subject to the controls described in the related sections of this analysis.	Control design is considered adequate.
2. <u>Recorded cash disbursements/receipts represent aggregate payments and collections during the period and are properly applied in reduction of payable/ receivable balances or other appropriate accounts.</u>	2.(a) BNE bank account reconciliation procedures (see 3. below) provide for recording all cash receipts and disbursements. (b) Procedures surrounding cash activity relating to securities settlements, shareholder transactions and fund expenses (see related sections of this analysis) provide for recording and proper application that associated cash is properly recorded and applied.	Control design is considered adequate.
3. <u>Bank reconciliation and related procedures are adequate to assure that activity and balances reflected in bank statements have been properly recorded.</u>	3. Wires or bank advices relating to transactions are individually compared to the recording of the related transactions. The remaining cash balance at the end of day is generally reflected as a deposit in savings account, leaving a zero cash balance. Both the savings account and cash balances are reconciled by Accounting Control to the respective bank statements on a next-day basis; reconciliations are reviewed by the Accounting Control Supervisor and furnished to the Fund Accountant.	Control design is considered adequate.

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
<p>4. <u>Cash transactions and requirements are properly monitored to provide assurance that cash obligations can be met and portfolio managers are aware of cash available for investment.</u></p>	<p>4.(a) Projected maturities of investments are confirmed with portfolio managers at the close of business on the day before maturity.</p> <p>(b) Cash flow projections are furnished by BNE to portfolio managers by telefax by 9:30 AM and are continuously updated throughout the day until the final cash worksheet is prepared no later than 1:30 PM. Updated and final cash availability is reported to and agreed upon with portfolio managers by telephone.</p>	<p>Control design is considered adequate.</p>

E.F. HUTTON & COMPANY INC.

CASH FUNDS

CASH/ACCOUNTS PAYABLE

ACCOUNTS PAYABLE AND EXPENSES

Control Objective

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that:

- | | | | |
|--|----|---|---|
| 1. <u>Expenses are properly authorized and borne by the fund in accordance with current agreements and prospectus disclosures.</u> | 1. | Fund management at HAM review expense invoices and other charges prior to approval and transmittal to BNE for payment and recording. Fund management approve expenses. | Control design is considered adequate. |
| 2. <u>Expenses are properly accrued for in the computation of net asset value.</u> | 2. | Fund management at HAM (in consultation with the independent accountants) develop expense estimates and instructions which are updated on a quarterly basis. BNE Fund Accountants record expenses based upon instructions from HAM. | 2-1 HAM Finance Department personnel should monitor the accuracy of expense accruals on at least a monthly basis.

2-2 Consideration of the requirements of Rule 2a-4, including an analysis of the impact on capital share activity, should be documented by the HAM Finance Department personnel for the adjustment of expense accruals and rates. Formal, written documentation for expense adjustments should be provided to BNE. |

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
3. <u>Investment advisory fees are properly calculated and recorded in accordance with current advisory agreement and prospectus disclosure.</u>	3.(a) Fund management at HAM provide BNE with current advisory fee rates as specified in current advisory agreements and prospectuses. BNE Fund Accountants compute advisory fees based on this information. (b) When paid at month-end, the fee for the month is recalculated and checked against the daily accruals. (c) HAM Finance Department personnel review fund advisory fees for reasonableness on a monthly basis.	3-1 Control design is considered adequate; but HAM Finance Department personnel should check BNE's calculations of advisory fees on a quarterly basis and as of the effective dates of any rate changes.
4. <u>Distribution fees are properly calculated and recorded in accordance with the Distribution Plan and prospectus disclosure.</u>	4. Plan of distribution fees are computed based on average net assets. The computation is prepared on a daily basis and is reviewed by both BNE Operations and BNE Accounting Control.	4-1 See 3-1 above.

C.2.d. CASH FUNDS
FUND ACCOUNTING AND CALCULATION
OF NET ASSET VALUE

E.F. HUTTON & COMPANY INC.
CASH FUNDS
FUND ACCOUNTING AND CALCULATION
OF NET ASSET VALUE

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>Journal entries and other accounting input and appropriately reviewed and approved.</u>	1. Miscellaneous journal entries require manually prepared support which is subject to review by fund accounting supervisors.	Control design is considered adequate.
2. <u>All assets and liabilities of the fund are reflected in the computation of net asset value on a timely basis.</u>	2.	2-1 Control design is considered adequate; however, consideration of the requirements of Rule 2a-4, including an analysis of the impact on capital share activity, should be documented by the HAM Finance Department personnel. Formal written documentation for adjustments should be provided to BNE.
(a) Agreement of net asset value computations to underlying ledger balances	(a) Net asset value worksheets are prepared directly from the general ledger.	
(b) Agreement of subsidiary ledgers and journals to related general ledger accounts	(b) The general ledger is balanced to supporting ledgers and journals on a daily basis by the BNE Fund Accountant.	2-2 Control design is considered adequate; however, comparisons prepared by BNE of market value to amortized cost should be reviewed by HAM on at least a quarterly basis.
(c) Inclusion of all securities positions in the net asset value computation	(c) Procedures described in the Trade Initiation and Recording section provide for recording transactions.	
3. <u>Procedures are adequate to determine that the use of the amortized cost method is appropriate and to quantify the extent of deviation from market value.</u>	3. The HAM Compliance Department checks investments made by the funds for compliance with Rule 2a-7 of the 1940 Act and certain related procedures adopted by the Board of Directors. BNE performs a periodic comparison of market value to amortized cost.	Control design is considered adequate.

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
4. <u>Fund accounting records are maintained in accordance with Rules 31a-1, 31a-2, and 31a-3 under the 1940 Act.</u>	4.(a) The custodian contract assigns recordkeeping responsibility to BNE, including responsibility for compliance with Rule 31a-1. (b) BNE records appear suitably designed to facilitate compliance.	Control design is considered adequate.
5. <u>The net asset value per share computation is properly reviewed and approved.</u>	5. The NAV worksheet prepared by the BNE Fund Accountant must be reviewed and approved by a Supervisor.	5-1 Control design is considered adequate with respect to procedures performed by BNE; however, HAM should review the calculation of net asset value for each of the funds on a monthly basis.
6. <u>State expense limitations are properly monitored and reimbursements are made, if applicable.</u>	6.(a) State expense limitations are reviewed by the manager of the HAM Finance Department and the funds' independent accountants on a semi-annual basis. (b) HAM requests BNE to monitor such limitations on a daily basis and advise HAM of situations where limitations are exceeded.	6-1 State expense limitations should be reviewed on a monthly basis by the HAM Finance Department.

C.2.e. CASH FUNDS
FINANCIAL REPORTING

E.F. HUTTON & COMPANY INC.

CASH FUNDS

FINANCIAL REPORTING

Control Objectives

Control Procedures

Comments/Recommendations

A. Annual and semi-annual reports to shareholders

What procedures are designed to provide reasonable assurance that:

1. The financial statements included in the annual and semi-annual reports to shareholders are prepared on the basis of appropriate supporting data and final trial balances.

- 1.(a) The funds have third-party recordkeeping agents whose procedures include controls designed to check that general ledger transactions are properly accumulated, classified and summarized in the accounts and that closing entries are reviewed and approved by authorized personnel.
- (b) HAM relies upon its independent accountants to prepare the draft annual and semi-annual financial statements and agree or reconcile them to the balances on the funds' general ledgers.
- (c) The annual financial statements are subject to an examination in accordance with generally accepted auditing standards and the semi-annual financial statements are subject to an informal review by the independent accountants.
- (d) The manager of the Finance Department of HAM reads the draft financial statements and coordinates with the independent accountants on any issues coming to his attention.

- 1-1 HAM should establish procedures whereby the Finance Department prepares annual and semi-annual financial statements.

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
2. <u>Proposed adjustments by the independent accountants are reviewed and approved or waived by an appropriate official of HAM.</u>	2.(a) Established procedures require that the independent accountants review with the manager of the HAM Finance Department the proposed adjustments developed during the annual examination and the interim review. (b) The manager of finance is responsible for authorizing the recording or waiving of such adjustments. (c) The recording of any adjustments in the accounting records is the responsibility of the recordkeeping agent and this is checked by the independent accountants. (d) Both the finance manager and independent accountants determine that any agreed upon adjustments have been reflected in the financial statements of the fund prior to approving the final draft for printing.	Control design is considered adequate.
3. <u>The annual and semi-annual financial statements included in the respective reports to shareholders are fairly presented in accordance with generally accepted accounting principles.</u>	3.(a) HAM Finance Department informally compares the disclosures therein to the financial statements of the prior year. Matters arising during the year which would impact financial accounting policies or disclosure are addressed as they arise and are considered in the preparation of the annual and semi-annual financial statements. (b) HAM relies on the fund's independent accountants to determine that the financial statements are fairly presented in accordance with generally accepted accounting principles, disclosures made therein comply with such principles, and that the accounting policies disclosed therein are the policies followed by each fund during the period reported on.	3-1 HAM should establish formal procedures to review the financial statements for fair presentation in accordance with generally accepted accounting principles and should consider the development and use of an appropriate checklist.

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
4. <u>The financial statements included in the semi-annual and annual reports include all the disclosures required by Regulation S-X for regulated investment companies.</u>	4. HAM relies on the funds' independent accountants to determine that all disclosures required by Regulation S-X are included in the financial statements of the funds.	4-1 HAM Finance Department should perform a review for compliance with the applicable requirements of Regulation S-X and with Section 30(d) and Rule 30d of the 1940 Act to check that all disclosures required by federal securities laws are included. A comprehensive checklist should be developed for this purpose and completed and initialed by the HAM Finance Manager for each fund. 4-2 Procedures to update the checklist referred to in 4-1 for changes in regulations should be established.
5. <u>The financial information in management's discussion and the other financial information included in the annual report is consistent with the financial statements and is materially correct.</u>	5.(a) The other financial information included in the annual report is prepared from data supplied by the recordkeeping agent or from information disclosed in the financial statements. (b) HAM Finance Department is responsible for checking the other financial information included in the annual and semi-annual reports. (c) HAM requests the funds' independent accountants to review the other data included in the annual report and check to the extent possible that it is consistent with the audited financial statements.	Control design is considered adequate.
6. <u>The annual and semi-annual reports, including the financial statements, are reviewed and approved by the appropriate levels of management before issuance.</u>	6.(a) The manager of the HAM Finance Department is responsible for the final review and approval of the annual and semi-annual financial statements and other financial information included in the annual and semi-annual reports. (b) The Chief Administrator of the funds also reviews all the information included in the annual report other than the financial statements.	Control design is considered adequate.

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
7. <u>The annual and semi-annual reports are mailed to shareholders and are sent to the Securities and Exchange Commission on a timely basis.</u>	<p>7.(a) Outside legal counsel advises HAM through the compliance calendars of the filing and mailing due dates for annual and semi-annual reports.</p> <p>(b) The manager of finance or operations manager at HAM is responsible for coordinating the preparation of the financial statements and the reports in order to effect timely printing, mailing and filing.</p> <p>(c) The Chief Administrator monitors the status of the preparation of such reports with the Finance Department manager on an informal basis.</p> <p>(d) The manager of finance or the operations officer at HAM is responsible for checking that reports are printed and sent to the Hutton department responsible for timely mailing to shareholders. HAM also follows up and receives verbal representation from such department that such reports have been mailed on time.</p> <p>(e) Outside legal counsel is responsible for sending reports to the Securities and Exchange Commission on a timely basis and sends a copy of the transmittal letter or verbally confirms that such reports have been sent.</p>	Control design is considered adequate.

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
<p>B. <u>Annual and semi-annual Report on Form N-SAR</u></p> <p>What procedures are designed to provide reasonable assurance that:</p>	<p>1. (a) HAM is notified of the N-SAR filing requirements by outside legal counsel to the funds.</p> <p>(b) HAM relies on outside legal counsel to request the information required by them to prepare Form N-SAR. Outside legal counsel makes a written request of the Chief Administrator and others within HAM for the information needed.</p> <p>(c) The Chief Administrator delegates the gathering of the information and coordination with outside legal counsel to the manager of the Finance Department or the compliance officer. The designated manager separates the requirements, obtains the information required from the recordkeeping agent and the applicable departments within HAM, and furnishes such information to outside legal counsel.</p> <p>(d) The funds' N-SARs are reviewed by the manager of finance who is responsible for checking the financial information included therein and copies of the N-SARs are sent to the independent accountants to check the other financial information included therein.</p>	<p>Control design is considered adequate.</p>
<p>2. <u>The Form N-SAR is reviewed and approved by the appropriate levels of management prior to filing.</u></p>	<p>2. Once the finance manager approves the N-SAR it is received by the Chief Administrator and sent to outside legal counsel who is responsible for filing with the SEC.</p>	<p>Control design is considered adequate.</p>

<u>Control Objective</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
C. <u>Registration Statement - Form N-1A</u>		
What procedures are designed to provide reasonable assurance that:		
1. <u>The financial information included in Form N-1A is consistent with the annual financial statements and/or the books and records of the fund.</u>	1. See the procedures for the preparation of financial information in Form N-1A under the section of this report entitled "Compliance with the Securities Act of 1933."	Control design is considered adequate.

D. VARIABLE INVESTMENT PROGRAM

D.1. VARIABLE INVESTMENT PROGRAM

OVERVIEW

E.F. HUTTON & COMPANY INC.

HUTTON VIP SEPARATE ACCOUNT
AND HUTTON VIP FUND

OVERVIEW

INVESTMENT PRODUCTS:

Hutton VIP Separate Account Of

E.F. Hutton Life Insurance Company ("Separate Account")
Hutton VIP Fund ("VIP Fund")

The Separate Account is a unit investment trust registered with the SEC as an investment company under the 1940 Act which issues variable annuity contracts of E.F.Hutton Life Insurance Company which are registered as securities under the 1933 Act. All assets of the Separate Account, which has three subaccounts ("variable accounts"), are invested ("poured over") in shares of the VIP Fund, a management investment company organized in series form (three operational series at the time of the review) which is also registered under the 1940 Act. The shares of the respective series of VIP Fund are registered under the 1933 Act and are sold exclusively to the Separate Account. The variable annuity contracts are sold exclusively by licensed insurance agents of E.F. Hutton Life Insurance Company who are registered representatives of E.F. Hutton & Company Inc.

The Variable Accounts of the Separate Account invest in the following Hutton VIP Fund series:

Money Market Series (Variable Account I) - invests in a variety of money market instruments.

Equity Series (Variable Account II) - invests in common stock or securities convertible into or exchangeable for common stocks.

Bond and Income Series (Variable Account III) - invests in bonds and other income producing securities.

CONTROL SYSTEM - KEY PARTICIPANTS:

Separate Account:

E.F. Hutton & Company Inc. ("E.F. Hutton") is the distributor of the Separate Account contracts.

E.F. Hutton Life Insurance Company ("Hutton Life") is the sponsor and the custodian of the securities of the Separate Account. Hutton Life is responsible for matters relating to external and internal financial reporting. Operating expenses of the Separate Account are paid by Hutton Life. Hutton Life is reimbursed by the Separate Account for operating expenses up to the prescribed limitation. Officers of Hutton Life are responsible for approving all operating expenses of the Separate Account. Additionally, Hutton Life is responsible for monitoring compliance with expense limitation requirements. Other expenses of the Separate Account, such as mortality, expense and contract maintenance charges are processed by the DST Annuity System.

Investors Fiduciary Trust Company ("IFTC") is the record-keeping agent for the Separate Account. IFTC performs the daily accounting and the calculation of accumulation unit values for each variable account of the Separate Account. IFTC has a service agreement with DST Systems, Inc. ("DST") whereby DST provides data processing services to Hutton Life. All contractowner's records are maintained on the DST Annuity System.

Hutton VIP Fund:

Hutton Asset Management Division of E.F. Hutton ("HAM") serves as the investment advisor to the VIP Fund. HAM portfolio managers are responsible for all investment decisions for the VIP Fund Series. The HAM Compliance Department is responsible for monitoring the VIP Fund's investment compliance with the applicable prospectus and regulated investment company requirements.

Hutton Life is responsible for matters relating to external and internal financial reporting.

IFTC is the transfer agent, dividend disbursement agent and recordkeeping agent for the VIP Fund. IFTC, as record-keeping agent, performs the daily accounting and the calculation of net asset value per share for each series. HAM portfolio management informs IFTC of executed securities transactions, and Hutton Life provides IFTC with relevant information and authorizations regarding VIP Fund expenses, periodic dividends and distributions and other matters.

First Interstate Bank of California ("FIB") serves as the custodian to the VIP Fund pursuant to a custodian agreement. FIB maintains all securities positions either independently or through a subcustodian agreement with Chase Manhattan Bank, N.A. ("Chase Manhattan"). Additionally, FIB maintains bank accounts, disburses checks for the payment of fund expenses and performs other custodial functions for the series, including the collection of investment income.

CONTROL SYSTEM - KEY TRANSACTION CYCLES:

Contractowner transactions

Separate Account

As previously mentioned, variable annuity contracts of Hutton Life may be purchased only through licensed insurance agents of Hutton Life who are registered representatives of E.F. Hutton. Initial premium payments are transmitted by the agents ("Account Executives") either by wire or mail to the Annuity Receipt Processing Department of Hutton Life ("ARP") at its Annuity Service Office. Initial premium payments may be in the form of contractowner checks, E.F. Hutton branch checks or debit advices to the prospective contractowner's brokerage account.

All initial premium payments require a completed application in "good form." Contracts become effective upon entry of purchase information by Hutton Life's Annuity Department ("AD") into the DST Annuity System. This occurs for wire orders on the day after the date of receipt of the initial payment by Hutton Life at its Annuity Service Office. For mail orders, contracts become effective on the second day after date of receipt. Subsequent premium payments can be made either directly to Hutton Life or to the Account Executive. Subsequent premium payments are priced at the accumulation unit value next determined following receipt of the premium payment at Hutton Life's Annuity Service Office.

Contractowners may redeem units by submitting prescribed request forms to AD which designates the requested action (e.g. full or partial withdrawal). All redemption and withdrawals are reviewed by AD supervisors. Preparation and

mailing of checks for redemption and withdrawals are performed by Hutton Life's Accounting Department. Death claim benefits are payable only upon receipt of proof of death by Hutton Life's Claims Department. All death claim benefits are reviewed by Hutton Life's Actuarial Department and Claims Department supervisors. Accounting Department prepares death claim benefit payments. Such payments are mailed by the Claims Department.

Transfers, which represent exchanges from one variable account to another, are processed only upon receipt by AD of written request from the contractowners. Transfers are priced as a redemption from the existing variable account and a purchase in the requested variable account at the unit value next determined after receipt of the request. Account maintenance changes, except assignments and changes in beneficiaries, are made by AD upon receipt of written notice from the contractowner. Assignments and changes in beneficiaries are processed by Hutton Life's Title Processing Department upon receipt of written notice from the contractowner.

Hutton VIP Fund

As previously mentioned, the Hutton VIP Fund has one shareholder, the Separate Account. Based upon the purchases, redemptions/withdrawals, death benefits and exchanges of units in the Separate Account, a net purchase or redemption of capital shares in the underlying VIP Fund series is made. IFTC records transactions in the series' capital shares based upon information produced for the Separate Account by the DST Annuity System.

Portfolio transactions

Portfolio transactions of the Separate Account are limited to purchases or redemptions of VIP Fund shares. The portfolio of the Separate Account (e.g., shares of the VIP Fund) are maintained in book entry form.

For the VIP Fund, portfolio transactions are under the control of the Investment Advisor, HAM. Daily, IFTC advises HAM portfolio management of cash available for investment; portfolio managers also maintain records of cash availability. HAM portfolio managers and traders telecopy authorized trade tickets to IFTC for executed portfolio transactions for recording in the funds' records. IFTC telecopies such trade tickets to FIB to authorize the receipt and delivery of securities. FIB effects book entry securities transactions and provides instructions to Chase Manhattan for trade settlements. IFTC follows up with HAM portfolio management and FIB to resolve any failed transaction settlements.

Calculation of accumulation unit values and net asset values per share

The calculation of accumulation unit values for the Separate Account are calculated manually by IFTC daily and entered into the Annuity System. The net asset values per share for the VIP Fund are calculated systematically by the DST Portfolio Accounting System and reviewed by IFTC personnel daily. An independent "third party" review of the DST Annuity System is performed annually. No material weaknesses were disclosed as a result of the 1985 "third party" review.

Financial reporting

Financial reporting to contractowners and the SEC is the responsibility of Hutton Life. In addressing the financial reporting requirements, Hutton Life is assisted by the outside legal counsel and the independent accountants of the Separate Account and VIP Fund.

CONTROL SYSTEM - PRINCIPAL CONTROLS:

The principal controls surrounding the operations of the Separate Account and the VIP Fund can be categorized into data processing controls and manual controls. A brief overview of the principal controls by category follow:

Data processing controls - The primary data processing systems used by the Separate Account and the VIP Fund are the Annuity System and the Portfolio Accounting System which are maintained at DST. The systems contain application processing controls, such as password and terminal restrictions and edit, validation and reasonableness tests. Additionally the systems produce exception reports for users. These processing controls enhance the control environment surrounding Separate Account and VIP Fund transaction processing. Of particular relevance to this review, both systems are subject to a "third party" review annually. Additionally, the general ("environmental") controls surrounding DST are reviewed annually. The results of the reviews conducted during 1985 disclosed no material weaknesses.

Manual controls - Hutton Life and the agents of the Separate Account and the VIP Fund have manual controls which complement the data processing controls previously mentioned. In

particular, these controls include balancing procedures, access restrictions, physical security and segregation of duties. Additionally, supervisory involvement is prevalent through the operations of the Separate Account and the VIP Fund.

The above E.F. Hutton and Hutton Life departments and agents serve to form a broad control environment for the Separate Account and VIP Fund. The involvement of these various groups provides a complex control environment but also provides a measure of control through the interaction of the personnel involved.

D.2. VARIABLE INVESTMENT PROGRAM
CONTROL OBJECTIVES AND PROCEDURES

D.2. a. VIP SEPARATE ACCOUNT
CONTROL OBJECTIVES AND PROCEDURES

D.2. a.1) SEPARATE ACCOUNT
CONTRACTOWNER TRANSACTIONS

E.F. HUTTON & COMPANY INC.

HUTTON VIP SEPARATE ACCOUNT

CONTRACTOWNER TRANSACTIONS

PURCHASES

Control Objectives

What procedures are designed to provide reasonable assurance that:

1. Initial orders (wire or mail) are priced not later than two business days after receipt in good form at Hutton Life's Annuity Service Office.

Control Procedures

- 1.(a) Purchase orders, applications and checks or wire orders are time and date stamped upon receipt. During processing, AD reviews date stamp to check timeliness of order processing.
- (b) Checks received are restrictively endorsed by ARP and deposited daily into an E.F. Hutton bank account.
- (c) AD balances daily the number of applications/orders processed and total premiums with ARP records generated by Hutton Life's VT10 system. Any out-of-balance situations are investigated.
- (d) ARP reconciles VT10 system premiums to the checks deposited on the date of receipt.
- (e) Accounting Department reconciles VT10 system premiums to cash transferred from E.F.Hutton for wire and mail orders.

Comments/Recommendations

- 1-1 Controls would be strengthened if (1) applications and written requests were separated from the accompanying checks by the Work Distribution Center and forwarded directly to AD, (2) the checks continued to be sent to ARP and (3) the daily reconciliation between AD and ARP continued to be performed.
- 1-2 See Recommendation No. 4 in the Letter in this report.
- 1-3 See Recommendation No. 8 in the Letter in this report.

Control Objectives

Control Procedures

Comments/Recommendations

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| <p>2. <u>Initial premium payments (wire or mail) are accurately processed as to contractowner information (name, address and annuitant) and fund series designation.</u></p> | <p>1.(f) Contracts become effective upon entry of purchase information by AD into the DST Annuity System which occurs for wire orders on the receipt day +1 and for mail orders on the receipt day +2. AD balances the number of applications/orders processed and total premiums to the DST Annuity System. Out-of-balance situations are investigated.</p> <p>(g) A "hold" suspense file is prepared and reviewed daily for all initial premium payments which have incomplete applications.</p> <p>(h) Incomplete applications are resolved through direct communication with the Account Executive.</p> <p>2.(a) Initial premium payments are edited and balanced by fund series through the VT10 system.</p> <p>(b) Upon entry of information into the DST Annuity System, confirmations are produced from the System and matched to the application by a subgroup within AD who is independent of the processor of the application. Confirmations are sent to the contractowners and Account Executives.</p> <p>(c) AD assembles policies and mails the policies to the Account Executive for delivery to the contractowners.</p> | <p>Control design is considered adequate; however, as previously noted, the procedures for the processing of check receipts should be modified.</p> |
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Control Objectives

Control Procedures

Comments/Recommendations

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| 3. <u>Subsequent premium payments (wire or mail) are priced at the accumulation unit value next determined following receipt of the premium payment at Hutton Life's Annuity Service Office.</u> | 2.(d) Procedures provide for the initial purchase payment to be accompanied or followed by an executed application for the contract. Item #7 on the contract requires the applicant to designate how each payment should be allocated among the fixed account and/or the three variable accounts. Designation in Item #7 is reviewed by AD.

3.(a) Purchase orders, remittance advices and checks or wire orders are time and date stamped upon receipt. During processing, AD reviews the date stamp to check timeliness of order processing.

(b) Checks received are restrictively endorsed by ARP and deposited daily into an E.F.Hutton bank account. ARP reconciles the information prepared by AD to the checks deposited on the date of receipt.

(c) Daily, AD balances the number of purchase orders and total premiums from the DST Annuity System with ARP records.

(d) Accounting department reconciles AD/ARP reconciliation information to the cash transferred from E.F. Hutton. | Control design is considered adequate; however, as previously noted, the procedures for the processing of check receipts should be modified. |
| 4. <u>Subsequent premium payments (wire or mail) are accurately processed to contractowner's account and fund series designation.</u> | 4.(a) Subsequent premium payments are edited and balanced by fund series by AD through the DST Annuity System.

(b) Confirmations are prepared using the DST Annuity System, matched by AD to remittance advices and mailed to the contractowners and the Account Executives. | Control design is considered adequate. |

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
5. <u>Monies received by Hutton Life for the purchase of variable annuity contracts (less applicable pro rata account maintenance charge) are transmitted intact and on a timely basis to the custodian of the VIP Fund.</u>	5.(a) Daily, the Accounting Department reconciles total premium payments by fund series processed by the DST Annuity System to net monies transferred to VIP Fund's First Interstate Bank custodian accounts. (b) IFTC accounting personnel reconcile all Separate Account cash activity daily, including amounts received for the purchase of annuity contracts as recorded on the DST Annuity System. (c) IFTC accounting personnel reconcile each VIP Fund custody cash bank account daily, including the monies received for annuity contract purchases.	Control design is considered adequate.
6. <u>Purchase orders comply with minimum and maximum purchase dollar amounts as set forth in the prospectus.</u>	6.(a) AD reviews applications to check that minimum and maximum purchase requirements are met. (b) Requests are made by wire to Account Executives to resolve instances of noncompliance.	Control design is considered adequate.
7. <u>Orders are accepted only in states in which the Separate Account is registered under applicable state insurance and securities laws and only from registered agents licensed in the respective states.</u>	7.(a) Hutton Life maintains a current database of registered agents. AD matches information on applications with the file to determine whether the agent licensing requirements and state approvals have been met. Any discrepancies that result are recorded on a "hold" suspense file for follow-up. (b) The "hold" suspense file is prepared and reviewed daily for all initial premium payments which require follow-up.	Control design is considered adequate.

E.F. HUTTON & COMPANY INC.

HUTTON VIP SEPARATE ACCOUNT

CONTRACTOWNER TRANSACTIONS

REDEMPTIONS AND WITHDRAWALS

Control Objectives

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that:

1. Redemptions and withdrawals (death benefits, annuitization and other redemptions and withdrawals) are effected at the accumulation unit value next determined after receipt of appropriate information in "good form."

- 1.(a) Hutton Life requires that the contractowner(s) complete and submit various forms for the order to be processed, including in particular, Form 7616/1283 "Annuity Owner Service Request" which designates what action, full or partial withdrawal/termination, the contractowner requests.
- (b) An executed request form accompanied by the appropriate tax forms (e.g., W-9, Section 1035 (a) exchange forms, etc.), if necessary, and/or contract are required to process a redemption/withdrawal.
- (c) The application of the accumulation unit value is performed systematically and consistently for all redemptions and withdrawals by the DST Annuity System.
- (d) The System will cause all redemption/withdrawal transactions to be effected within the required time frame, if necessary information is entered properly by AD.
- (e) Transactions are confirmed to the contractowner/beneficiary and the Account Executive.

Control design is considered adequate.

Control Objectives

Control Procedures

Comments/Recommendations

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| 2. <u>Redemptions and withdrawals are accurately recorded in the contractowner's account.</u> | 1.(f) A manual "pending" file is maintained for all redemption and withdrawal requests not processed because of incomplete information. AD supervisors review the file daily to resolve any pending requests. | |
| (a) <u>Death Benefits</u> | 2.(a) (1) Death benefits are payable only upon receipt of proof of death by the Claims Department.

(2) All death claim benefits are reviewed by the Actuarial Department and Claims Department supervisors for propriety.

(3) Levels of approval exist for check requests depending upon the dollar amount of payment for death benefits.

(4) Upon approval by Claims Department supervisors, check requests are forwarded to the Accounting Department for preparation of checks. Checks are returned to Claims Department for mailing.

(5) Edit and validation checks exist in the DST Annuity System. Exceptions are investigated by AD personnel.

(6) The Accounting Department reconciles daily redemptions and withdrawals from the DST Annuity System to redemptions from the VIP Fund and Separate Account. | 2-1 Death claim benefit payment checks on variable annuity contracts should be prepared and mailed by a department other than the Claims Department. |

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
(b) <u>Annuitization and other redemptions and withdrawals</u>	<p>2.(b) (1) A signature guarantee is required for all redemptions or withdrawals if the amount exceeds \$10,000.</p> <p>(2) For full withdrawals and annuitization, the actual contract or an affidavit of loss must be signed by the contractowner and be presented to Hutton Life.</p> <p>(3) AD prepares an accounting worksheet listing all redemptions and withdrawals which must be approved by AD supervisors prior to processing on the DST Annuity System. During this process AD supervisors review for compliance with signature guarantee and other contract requirements.</p> <p>(4) Confirmations generated by the DST Annuity System are matched to the accounting worksheet.</p> <p>(5) Edit and validation checks exist in the DST Annuity System. Exceptions are investigated by AD personnel.</p> <p>(6) Daily, the Accounting Department reconciles redemptions and withdrawals from the DST Annuity System to redemptions from the VIP Fund and Separate Account.</p>	<p>2-2 Hutton Life should develop a plan to limit access by AD personnel to variable annuity master file information maintained on the DST Annuity System.</p>
3. <u>The correct contingent deferred sales charge is imposed on redemptions and withdrawals.</u>	3. Contingent sales charges are calculated manually by AD on a "disbursement request worksheet" which is reviewed by AD supervisors before processing.	Control design is considered adequate; however, Hutton Life officials advised during the period January 29, 1985 through September 30, 1985, the contingent deferred sales charge was incorrectly calculated on withdrawals from variable accounts for 24 contracts. They also advised that by April 11, 1986, all affected contractowners were reimbursed.

E.F. HUTTON & COMPANY INC.

HUTTON VIP SEPARATE ACCOUNT

CONTRACTOWNER TRANSACTIONS

TRANSFERS AND ACCOUNT MAINTENANCE

Control Objectives

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that:

1. Contractowner transfer requests (wire or mail) are processed on a timely basis.

- 1.(a) Transfers are input via a special transaction code and result in redemptions from an existing account and purchases in the requested account. Application of the accumulation unit value is performed by the DST Annuity System.

1-1 Control design is considered adequate; however, see Recommendation No. 5 in the Letter in this report.

- (b) Transfers are confirmed to the contractowners and Account Executives.

2. All transfers are accurately recorded in the contractowner accounts.

- 2.(a) Transfer requests are recorded by AD in a manual transfer log. Confirmations prepared by the DST Annuity System are agreed by AD to the transfer log to check the processing of the transfer.

Control design is considered adequate.

- (b) Edit and validation checks are performed by the DST Annuity System. Exceptions are investigated by AD personnel.

- (c) Daily, the Accounting Department reconciles aggregate transfers recorded in the DST Annuity System to aggregate transfers reflected in the VIP Fund and Separate Account.

- (d) IFTC accounting personnel reconcile all Separate Account cash activity daily, including aggregate transfers of annuity contracts as recorded on the DST Annuity System.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
3. <u>No contingent deferred sales charge is imposed on transfers among series.</u>	<p>(e) IFTC accounting personnel reconcile each VIP Fund custody cash bank account daily, including aggregate transfers reflected in the VIP fund.</p> <p>3.(a) The special transaction code used to input transfers, prevents the assessment of the contingent deferred sales charge.</p>	Control design is considered adequate.
4. <u>Adequate records are maintained on contractowner accounts.</u>	<p>(b) Transfers are confirmed to the contractowners and the Account Executives.</p> <p>4.(a) Hutton Life maintains contractowner accounts through use of the DST Annuity System.</p> <p>(b) Daily, transaction logs for purchases, transfers and redemptions and withdrawals are generated by the DST Annuity System. These logs are reconciled by Hutton Life's Accounting Department to the manual records prepared by AD for the Separate Account.</p>	4-1 Hutton Life should establish procedures for the review of exception processing reports by supervisory personnel.
5. <u>Maintenance changes to shareholder accounts are properly authorized.</u>	<p>(c) Quarterly statements are provided to contractowners.</p> <p>5.(a) Standard request forms signed by the contractowner are submitted for maintenance changes.</p> <p>(b) Request forms are received by AD or Title Processing Department. Supervisors review maintenance changes before processing.</p>	<p>5-1 See recommendation 2-2 in the Contractowner Transactions - Redemptions and Withdrawals section. Such a plan should include Title Processing Department personnel.</p> <p>5-2 A plan should be developed to confirm to contractowners, changes in addresses to both the old and new addresses.</p>

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
6. <u>Maintenance changes to contract-owner accounts are processed on a timely basis.</u>	5.(c) Confirmations are sent to the contractowners and Account Executives for any changes which are of a financial nature. 6. AD and Title Processing Department supervisors monitor workflow to check reasonableness of timely processing of maintenance changes.	Control design is considered adequate.
7. <u>Fees and expenses borne by the Separate Account are monitored for compliance with prospectus disclosures.</u>	7.(a) All disbursements for fees and expenses of the Separate Account must be approved by a Hutton Life officer prior to payment. (b) Disbursements for fees and expenses are paid by Hutton Life. Hutton Life is subsequently reimbursed by the Separate Account.	Control design is considered adequate.

D.2. a.2) VIP SEPARATE ACCOUNT

CALCULATION OF ACCUMULATION UNIT VALUES (AUVs)

E.F. HUTTON & COMPANY INC.

HUTTON VIP SEPARATE ACCOUNT

CALCULATION OF ACCUMULATION UNIT VALUES (AUVs)

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>The accumulation unit value computation is properly reviewed and approved.</u>	1. IFTC accounting personnel calculate the AUV daily in accordance with the formula specified in the Separate Account prospectus. The calculation is reviewed by a second IFTC accountant and entered into the DST Annuity System by IFTC for contract pricing.	1-1 Accumulation unit values should be monitored for unusual fluctuations daily by the Hutton Life Accounting Department personnel.
2. <u>Mortality and expense risk charges are properly computed and charged to the Separate Account.</u>	2. The computation of mortality and expense risk charges and allocation to the Separate Account are performed systematically by the DST Annuity System.	Control design is considered adequate.
3. <u>Operating expenses are properly computed, charged to and paid for by the Separate Account.</u>	3.(a) Operating expenses of the Separate Account are approved by officers of Hutton Life prior to payment. (b) Operating expenses are paid by Hutton Life which is reimbursed through redemption of accumulation units. (c) Copies of the approved invoices together with a copy of the check issued for payment are maintained by the Accounting Department of Hutton Life.	Control design is considered adequate.
4. <u>The expense limitation is properly computed and expenses incurred are monitored to preclude exceeding that limitation.</u>	4. The expenses of the Separate Account are accrued by IFTC and reviewed monthly by the Hutton Life Accounting Department. The review performed by the Accounting Department includes reviewing actual expenses incurred to determine that the accrual at the maximum level continues to be appropriate.	Control design is considered adequate.

Control Objectives

Control Procedures

Comments/Recommendations

5. Annual contract maintenance charge is properly computed and charged.

5.(a) The annual contract maintenance charge (at the time of the review \$30) is charged on a pro rata basis for contracts created during the calendar year and applied prospectively in full for each contract existing on December 31. The charge is made systematically by the DST Annuity System.

(b) In order to pay the charge, sufficient accumulation units are redeemed (i.e., sold) with proceeds payable to Hutton Life.

(c) Processing and valuation are accomplished systematically through the DST Annuity System and tested in the same manner as any other withdrawal/redemption and reported to contractowners and the Account Executives.

6. Contingent deferred sales charge is properly computed and charged on any full or partial withdrawal/redemption.

6. All withdrawals and redemptions are processed by AD. AD determines if the contingent deferred sales charge is applicable. If applicable, AD personnel compute the contingent deferred sales charge on a "disbursement request worksheet" which is reviewed and approved by an AD supervisor before processing.

Control design is considered adequate.

Control design is considered adequate; however, Hutton Life officials advised during the period January 29, 1985 through September 30, 1985, the contingent deferred sales charge was incorrectly calculated on withdrawals from variable accounts for 24 contracts. They also advised that by April 11, 1986, all affected contractowners were reimbursed.

D.2. a.3) VIP SEPARATE ACCOUNT
FINANCIAL REPORTING

E.F. HUTTON & COMPANY INC.

HUTTON VIP SEPARATE ACCOUNT

FINANCIAL REPORTING

Control Objectives

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that:

1. Post-effective amendments to the registration statement of the Separate Account which meet the applicable requirements of the federal securities laws are filed promptly and made effective in accordance with Section 24.
2. Prospective contractowners are provided a copy of the currently effective prospectus of the Separate Account.

1. Officers of Hutton Life, with assistance provided by outside legal counsel and the independent accountants for the Separate Account, prepare at least annually post-effective amendments to the registration statement which are filed with the SEC by such counsel. These filings follow an annual regulatory compliance calendar for the Separate Account which lists target dates for required or appropriate regulatory actions. The calendar is prepared by an officer of Hutton Life and reviewed by legal counsel for the Separate Account. Responsibility at Hutton Life is vested primarily in one officer.
- 2.(a) Every individual prospective applicant/owner and joint applicant/owner and proposed annuitant and joint annuitant, if other than the owner, must execute an application for the variable annuity contract which includes a signed acknowledgement that "Receipt is acknowledged of the current prospectus for E.F. Hutton Life Insurance Company Individual Flexible Premium Deferred Annuity and Variable Accumulation Contract." The contract will not be issued by AD without receipt by Hutton Life of a properly executed application.

- 1-1 Hutton Life should adopt a plan to consolidate and enhance procedural manuals which clearly and currently document the flow of transactions and external filing requirements for the Separate Account.
- 2-1 Procedures should be reviewed to check that current prospectuses are provided to purchasers of Hutton Life's variable annuity contracts.

Control Objectives

Control Procedures

Comments/Recommendations

(b) Instructions for sale provided to the registered representative/agent (Form 8026/1083-85), "How to Sell VIP" instruct the agent to provide the current prospectuses for both the Separate Account and the VIP Fund.

3. Existing contractowners are provided a copy of the currently effective prospectus of the Separate Account.

3. Hutton Life mails a copy of the current prospectus for the Separate Account and the VIP Fund to every existing contractholder whenever post-effective amendments to the registration statements become effective, at least annually.

Control design is considered adequate.

4. Contractowners are provided a periodic statement of account stating their current interest(s) in the Separate Account.

4. Quarterly, every existing contractowner and Account Executive is mailed a statement of account in confirmation format which states the current value(s) of the contract(s). The statement is generated by the DST Annuity System and processed by AD which oversees the mailing of the statements to contractowners.

Control design is considered adequate.

5. Contractowners are provided a semi-annual financial/performance report.

5. Every existing contractowner is mailed a semiannual report of the VIP Fund. Through discussions with outside legal counsel for the Separate Account, Hutton Life has determined that semiannual reports on the Separate Account are not required by Rule 30d-2. Accordingly, no semiannual reports on the Separate Account have been provided to contractowners.

Control design is considered adequate.

6. Contractowners are provided an annual financial/performance report (including financial statements with a report of independent accountants).

6. Every existing contractowner is mailed an annual report of the Separate Account which includes financial statements with a report of independent accountants.

Control design is considered adequate; however, the report of Independent Accountants does not fully comply with Rule 30(e).

Control Objectives

Control Procedures

Comments/Recommendations

7. The financial statements included in the annual and semi-annual reports include all disclosures required by Section 30 and Regulation S-X.

7. Hutton Life consults with its independent accountants for the Annual Report to determine that all disclosures required by Section 30 and Regulation S-X are included in the financial statements of the VIP Separate Account.

See Recommendation No. 12 in the Letter in this report.

D.2. a.4) VIP SEPARATE ACCOUNT
COMPLIANCE AND OTHER SEC REQUIREMENTS

E.F. HUTTON & COMPANY INC.
HUTTON VIP SEPARATE ACCOUNT
COMPLIANCE AND OTHER SEC REQUIREMENTS

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>Proxy statements and/or other disclosure notices regarding voting rights are provided to contract-owners and filed with the SEC on a timely basis and in accordance with applicable disclosure requirements of Section 20.</u>	1. Hutton Life prepares a voting list from the DST Annuity System containing names, addresses and other voting information of all existing contractowners as of the record date. The proxy statement of the VIP Fund together with a voting instruction/proxy card is mailed from the DST Annuity System Service Center to every contractowner of the Separate Account.	Control design is considered adequate.
2. <u>Accurate confirmations of purchase and/or redemption/withdrawal transactions are provided to contract-owners on a timely basis.</u>	2.(a) Every purchase, redemption or transfer transaction which causes a change in the AUs credited to a contractowner's account is recorded on the DST Annuity System. (b) On the day after the transaction is recorded onto the DST Annuity System, the DST Annuity generates a confirmation which is mailed by Hutton Life to the affected contractowner and Account Executive.	Control design is considered adequate.

Control Objectives

Control Procedures

Comments/Recommendations

3. Books and records are prepared and maintained in accordance with Rules 31a-1, 31a-2 and 31a-3.

3.(a) Pursuant to contracts entered into in August 1983 between Hutton Life on behalf of the Separate Account and DST and IFTC, IFTC has, as recordkeeping agent for Hutton Life, agreed to prepare and maintain the required accounting and related records. IFTC has also agreed to prepare and maintain all the books and records required by Section 31 and the rules thereunder.

(b) The IFTC accounting manual covers these rules. The records prepared and maintained by IFTC are designed to facilitate compliance.

Control design is considered adequate.

D.2. b.1) VIP FUND
PORTFOLIO TRANSACTIONS

E.F. HUTTON & COMPANY INC.
HUTTON VIP FUND
PORTFOLIO TRANSACTIONS
TRADE INITIATION AND RECORDING

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>Portfolio transactions are authorized by appropriate personnel.</u>	1. Hutton Asset Management (HAM) makes all investment decisions for the VIP Fund. HAM portfolio managers and traders in New York execute trades and document details of transactions on trade tickets which are approved in writing by the responsible portfolio manager. In the absence of the portfolio manager, a designated officer of HAM will approve the transaction. Employees of IFTC have been instructed not to accept trade tickets which are not properly authorized.	Control design is considered adequate.
2. <u>Details of executed and cancelled transactions are accurately recorded by traders.</u>	2.(a) Portfolio managers and traders confirm details of transactions with contra parties by phone or through the Depository Trust Company ID System prior to execution. (b) Portfolio managers and traders maintain their own records of securities positions and periodically agree amounts to reports received from IFTC.	Control design is considered adequate.
3. <u>All transactions executed are accurately and completely communicated to the recordkeeping agent by the investment adviser.</u>	3.(a) HAM telecopies the trade tickets to IFTC for recording of securities transactions. Trade tickets for money market instruments are telecopied on trade date; all others on day following trade date. (b) For all securities except U.S. Government securities, control totals of the number or amount of trades for the day are used by HAM and IFTC. U.S. Government securities transactions are confirmed individually. (c) HAM personnel compare trade tickets to transactions recorded by IFTC on the day following trade date for money market instruments and on the second day following trade date for all other securities.	3-1 Control design is considered adequate; however, HAM should develop and implement procedures to identify and report to IFTC any securities tendered so that they may be recorded on the appropriate dates.

Control Objectives

Control Procedures

Comments/Recommendations

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| 4. <u>The recordkeeping agent accurately records all portfolio transactions no later than the business day following trade date.</u> | 4.(a) IFTC accountants enter portfolio transactions into the Portfolio Accounting System based on trade tickets received from HAM. The system requires the entry of a security CUSIP number and all key fields for each transaction and performs extensions and other calculations. Transactions are recorded in investment related files in an "on-line, real-time" mode.

(b) Debt maturities are identified by the system on pending files which are reviewed by IFTC accountants and manually accepted for recording on maturity dates.

(c) IFTC accountants batch purchase and sale trade tickets received from HAM each day and agree the control totals (including maturities noted at 4(b)) to net postings in general ledger investment accounts.

(d) See HAM procedures at 2.(b) above. | 4-1 See recommendation to strengthen controls at 3-1 above. |
| 5. <u>Investment restrictions set forth in prospectuses are complied with including those with respect to:</u>

. Types of investments
. Industry limitations
. Individual issuers | 5.(a) Portfolio managers have stated that they are knowledgeable of prospectus policies and restrictions as well as current portfolio positions. Portfolio managers approve all portfolio trades.

(b) For certain funds, portfolio summary sheets are prepared which indicate prospectus investment restrictions.

(c) Every portfolio transaction is checked to a tailored compliance checklist of significant prospectus investment restrictions by the HAM Compliance Department.

(d) The Compliance Officer is required to periodically report to the Board of Directors the status of compliance with prospectus policies and restrictions. | 5-1 Summary listings of applicable requirements should be updated or developed, where applicable, for use by portfolio managers.

5-2 Compliance Department checklists should include all applicable prospectus, 1940 Act, SEC and significant IRS requirements.

5-3 All portfolio management questions regarding compliance should initially be directed to and coordinated by the HAM Compliance Officer. |

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
6. <u>Portfolio transactions are in compliance with rules and regulations under the 1940 Act, including:</u>	6.(a) See procedures described at 5. above. (b) Information regarding compliance is prepared by the Compliance Officer.	6-1 See recommendations under 5. above.
. Portfolio diversification . Transactions with affiliated persons		
7. <u>Prospectus restrictions relating to repurchase agreements are adhered to, including:</u>	7.(a) 1. The Board of Directors has adopted written procedures regarding repurchase agreements. 2. HAM monitors the creditworthiness of contra parties and presently conducts transactions only with primary dealers. The listing of approved dealers is reviewed by the Board of Directors annually. 3. HAM advises that the funds deal only with primary repo dealers. (b) 1. The funds have written agreements with all of their contra parties. (b) 2. Sub-custodian procedures provide for amounts to be paid only against receipt of collateral. 3. Portfolio managers and traders ascertain the adequacy of collateral upon entering into the transaction.	7-1 HAM should continue efforts to have all dealers sign a recently revised repo agreement and ensure all agreements properly perfect a security interest in collateral received. 7-2 HAM should consider establishing limits for outstanding repurchase agreements with individual contra parties. 7-3 See Recommendation No. 10 in the Letter in this report.
(a) Creditworthiness of contra parties		
(b) Possession of collateral and adequacy of market value		
8. <u>With respect to reverse repurchase agreements:</u>	8.(a) See procedures described at 7.(a) above. (b) The custodian and sub-custodian deliver securities only against payment in accordance with their contracts.	8-1 See recommendation 7-1 above. 8-2 HAM should establish procedures to check that the market value of collateral delivered for reverse repurchase agreements is not excessive.
(a) Agreements are entered into only with creditworthy parties.		
(b) Collateral delivered by the funds is not excessive.		

Control Objectives

Control Procedures

Comments/Recommendations

(c) Agreements are entered into only when investments with a more favorable interest rate are available.

(d) Sufficient cash or liquid assets are maintained in a segregated account to cover the amount of obligations.

(c) Portfolio managers are charged with responsibility to enter into reverse repos only when proceeds may be invested at a higher rate.

(d) Portfolio managers and traders identify collateral to be held in a segregated account by the custodian and ascertain that the initial market value segregated is in excess of the related liability.

Control design is considered adequate.

Control design is considered adequate.

9. With respect to when-issued and delayed delivery securities:

(a) Transactions are appropriately identified and reported to IFTC.

(b) Sufficient cash and liquid assets are maintained in a segregated account to cover the related liability.

9.(a) Portfolio managers and traders identify such transactions on trade tickets telecopied to IFTC.

(b) Portfolio managers and traders identify collateral to be held in a segregated account by the custodian and check that the value of such assets is sufficient.

9-1 HAM should establish procedures to determine the adequacy of the value of segregated assets underlying such liabilities throughout the period such commitments are outstanding.

Control design is considered adequate.

E.F. HUTTON & COMPANY INC.

HUTTON VIP FUND

PORTFOLIO TRANSACTIONS

TRADE SETTLEMENT

Control Objectives

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that:

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| <p>1. <u>Deliveries and receipts of securities, including those effected through book entry procedures, and related cash movements are based upon appropriate authorization.</u></p> | <p>1.(a) IFTC telecopies trade tickets received from HAM to First Interstate which serve as authorizations to receive and deliver securities for payment.</p> <p>(b) First Interstate receives or delivers securities or provides settlement instructions to Chase Manhattan, the sub-custodian, based on the HAM trade tickets received through IFTC. First Interstate and sub-custodian personnel are instructed to agree securities settling to appropriate authorizations and to report any discrepancies to IFTC for follow-up.</p> <p>(c) IFTC accountants agree actual movements of cash and securities reflected on daily First Interstate cash and activity statements to pending securities settlements and money market transactions recorded on the Portfolio Accounting System.</p> | | |
| <p>2. <u>Securities are delivered only upon receipt of payment, and payment is made only upon receipt of securities.</u></p> | <p>2.(a) First Interstate has established procedures to receive and deliver cash and securities only in exchange for amounts authorized by HAM.</p> <p>(b) The sub-custodian has established procedures to receive and deliver cash and securities only in exchange for amounts authorized by First Interstate.</p> <p>(c) See description of procedures at 1(b) above.</p> | | <p>Control design is considered adequate.</p> |
| <p>3. <u>Differences on transaction settlements are promptly identified and resolved.</u></p> | <p>3.(a) The Portfolio Accounting System automatically creates a pending settlement record for each securities transaction recorded, except for transactions with same day settlement, such as money market transactions.</p> | | <p>Control design is considered adequate.</p> |

Control Objectives

Control Procedures

Comments/Recommendations

- (b) IFTC accountants agree actual settlements reflected on daily bank statements to pending settlement records and follow-up on differences noted. Settlement records for the series must be cleared manually on the system.
- (c) In recording cash transactions and reversing receivables and payables for securities transactions, IFTC accountants identify settlement differences. IFTC accountants and supervisors are responsible to resolve differences with First Interstate and HAM.

4. Fails are promptly investigated and resolved.

- 4.(a) Fails are identified by IFTC and custodian procedures described at 1. and 3. above. IFTC accountants and supervisors are responsible to contact HAM portfolio managers or traders and First Interstate to resolve fails.
- (b) Upon notification of fails from IFTC or brokers, HAM portfolio traders investigate fails and follow up until resolved.

Control design is considered adequate.

D.2. b.2) VIP FUND

CASH/ACCOUNTS PAYABLE/EXPENSES

E.F. HUTTON & COMPANY INC.
HUTTON VIP FUND
CASH/ACCOUNTS PAYABLE/EXPENSES
CASH

Control Objectives

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that:

A. Cash

1. Cash disbursements and receipts are subject to appropriate authorization and review.

2. Recorded cash disbursements/receipts represent aggregate payments and collections during the period and are properly applied in reduction of payable/receivable balances or other appropriate accounts.

- 1.(a) The custodian agreements with First Interstate specify the levels of authorization required for various cash activities. First Interstate maintains listings of authorized signatories.
- (b) Cash disbursements and receipts in connection with securities transactions are authorized as described at 1. under the Trade Initiation and Recording section.
- (c) Cash disbursements for expenses are made by First Interstate after receiving written authorization from Hutton Life.
- (d) First Interstate has established procedures to control transfers of monies into or out of the series custody bank accounts. Such control procedures include the requirement that all transfers be approved by authorized signers.

- 2.(a) IFTC bank account reconciliation procedures (see description at 3. below) require that all cash receipts and disbursements are accounted for and recorded.
- (b) IFTC procedures for reviewing and recording trade settlements (see description at 3. under Trade Settlement section above) require that associated cash is recorded and applied to trade payable/receivable balances.
- (c) IFTC procedures for recording receipt of interest and dividends (see description at 3. under Income Recording and Collection section above) require that such amounts are recorded and applied to the appropriate receivable balances.

Control design is considered adequate.

Control design is considered adequate.

Control Objectives	Control Procedures	Comments/Recommendations
<p>3. <u>Bank reconciliations and related procedures are adequate to assure that activity and balances reflected in bank statements have been properly recorded.</u></p>	<p>(d) Procedures for the authorization of disbursements for expenses (see description at 1. under Accounts Payable and Expenses section) provide for the proper recording of such amounts. Authorizations prepared by Hutton Life personnel indicate the applicable series.</p> <p>3.(a) IFTC has established procedures for accountants to reconcile bank statements for each fund daily. Accountants are required to account for all cash activity, as described at 2. above, and reconcile ending bank balances to general ledgers. Bank reconciliations are approved by supervisory personnel.</p> <p>(b) Hutton Life personnel reconcile cash balances reported by First Interstate to those recorded by IFTC for the series.</p>	<p>Control design is considered adequate.</p>
<p>4. <u>Cash transactions and requirements are properly monitored to provide assurance that cash obligations can be met and portfolio managers are aware of cash available for investment.</u></p>	<p>4.(a) IFTC prepares a daily cash availability worksheet for each fund. All activity affecting cash balances is considered, including contract owner transactions and securities trade settlements and maturities. Every morning IFTC reports each fund's cash available for investment to HAM portfolio management.</p> <p>(b) Cash flow projections are furnished to HAM short-term portfolio managers continuously throughout the day until the final cash worksheet is prepared no later than 12:30 p.m. New York City time.</p> <p>(c) HAM portfolio managers and traders maintain their own records of cash available for investment and compare their balances to those reported by IFTC for reasonableness.</p> <p>(d) Actual cash transactions are authorized and reviewed by procedures described at 1. and 2. above.</p>	<p>Control design is considered adequate.</p>

E.F. HUTTON & COMPANY INC.

HUTTON VIP FUND

CASH/ACCOUNTS PAYABLE/EXPENSES

ACCOUNTS PAYABLE AND EXPENSES

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>Expenses are properly authorized and borne by each series in accordance with current agreements and the prospectus.</u>	1. Hutton Life reviews and approves expense invoices and other charges for the series. Personnel responsible for reviewing and/or approving expenses have informed us that they are knowledgeable of prospectus and service agreement requirements.	Control design is considered adequate.
2. <u>General expenses are properly allocated among the series.</u>	2.(a) Hutton Life identifies expenses relating to individual series and general expenses to be allocated among the series, such as directors' fees, accounting and legal expenses. Hutton Life determines the allocation of general expenses in accordance with prospectus guidelines. (b) IFTC records the allocation of general expenses to the series as authorized by Hutton Life.	Control design is considered adequate.
3. <u>Expenses are properly accrued for in the daily calculation of net asset value per share.</u>	3.(a) Hutton Life develops an expense budget and accrual rates for each series and provides IFTC with authorizations indicating the amount of expense to be accrued daily. Since the expenses of the VIP Separate Account and VIP Fund have exceeded their combined expense limitation guaranteed by Hutton Life, Hutton Life has instructed IFTC to accrue expenses for the VIP Fund only up to its share of the limitation. (b) Hutton Life reviews actual and budgeted expenses monthly to ascertain whether it is still appropriate to accrue expenses up to the expense limitation. (c) IFTC reviews the reasonableness of daily expense accruals as part of the daily analysis of the change in net asset value per share or yield (see description at 5. below).	Control design is considered adequate.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
4. <u>Expense limitations pursuant to state securities regulations are monitored and complied with appropriately.</u>	4.(a) See Hutton Life procedures described at 3(a) and (b) above. (b) IFTC personnel monitor compliance with applicable expense limitations, as required, to properly reflect net asset value per share.	Control design is considered adequate.
5. <u>Investment advisory fees are properly calculated and recorded in accordance with current advisory agreements and prospectus disclosure.</u>	5.(a) Hutton Life is responsible for providing IFTC with current advisory fee rates as specified in current advisory agreements and prospectuses. (b) IFTC fund accounting personnel enter current advisory fee rates into the Portfolio Accounting System, except for The Money Market Series, since the investment adviser voluntarily agreed to waive such fees. The system automatically calculates the advisory fees based on daily net assets and accrues such amounts. (c) Hutton Life personnel review fund advisory fees for reasonableness on a monthly basis. (d) See description of IFTC NAV calculation review procedures at 5.(b) under Fund Accounting and Calculation of Net Asset Value Per Share section below.	5-1 Control design is considered adequate; however, Hutton Life personnel should check IFTC's calculations of advisory fees on a quarterly basis and as of the effective dates of any rate changes.

D.2. b.3) VIP FUND
FUND ACCOUNTING AND CALCULATION OF
NET ASSET VALUE PER SHARE

E.F. HUTTON & COMPANY INC.

HUTTON VIP FUND

FUND ACCOUNTING AND CALCULATION OF
NET ASSET VALUE PER SHARE

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>Journal entries and other accounting input are appropriately reviewed and approved.</u>	<p>1.(a) Investment transactions are authorized and recorded transactions are reviewed by IFTC and HAM personnel as described under Trade Initiation and Recording.</p> <p>(b) The Portfolio Accounting System automatically sets up journal entries to record trade settlements, maturities, dividends, etc.; however, IFTC accountants must enter an "acceptance" into the system prior to actual recording. Accrual of interest is automatically recorded by the system.</p> <p>(c) IFTC has established procedures for fund administrators to file manually prepared support for all miscellaneous journal entries in posting books which are reviewed by supervisors.</p>	Control design is considered adequate.
2. <u>All assets and liabilities of the series are reflected in the computation of net asset value on a timely basis.</u>	<p>2.(a) The computation of net asset value is performed by the system for each series at the end of the day. IFTC fund administrators are instructed to check all portfolio trades, journal entries and other system updates are entered prior to the pricing of the portfolio (see 3. below) and calculation of NAV.</p> <p>(b) Since the DST Portfolio Accounting System calculates net asset value per share, the current general ledger balances are used in the computations.</p> <p>(c) Transactions recorded by IFTC are recorded in an "on-line, real-time" mode by the system and investment related files are updated at the same time. This helps to check subsidiary ledgers and journals are in agreement with general ledger accounts.</p>	2-1 Control design is considered adequate; however, see recommendations at 3. below.
o Assets and liabilities used in net asset value computations agree with underlying ledger balances.		
o Subsidiary ledgers and journals are in agreement with related general ledger accounts.		
o Inclusion of all securities positions in the net asset value computation.		

Control Objectives

Control Procedures

Comments/Recommendations

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| <p>3. <u>Securities are properly valued.</u></p> <ul style="list-style-type: none">o Valuations are in accordance with policies set forth in prospectuses.o Significant or unusual changes in market prices are investigated. | <ul style="list-style-type: none">(d) The system highlights out-of-balance conditions (including differences between subsidiary and general ledgers) on various reports. IFTC accountants investigate such conditions.(e) Procedures described under the Trade Initiation and Recording section and those above provide for all securities positions to be recorded and investment subsidiary ledgers to be in agreement with the general ledger. <p>3.(a) HAM is responsible for advising IFTC of fund securities pricing policies as set forth in prospectus and any changes thereto.</p> <p>(b) IFTC obtains market prices for securities, as specified in prospectuses, through system interface with an outside pricing service (Quotron), except for corporate bond and U.S. Government securities where prices are supplied by HAM.</p> <p>(c) Market prices for corporate bonds and U.S. Government securities are obtained by HAM portfolio management from brokers and market makers for use by IFTC.</p> <p>(d) IFTC accountants review market prices for reasonableness by reviewing a pricing stratification report which indicates significant changes in prices and omitted prices. Accountants are instructed to investigate significant changes and omitted prices immediately which are also reviewed by supervisors. The change in each series total portfolio market value is also reviewed for reasonableness as part of the daily analysis of the change in net asset value per share.</p> <p>(e) The HAM long-term taxable bond portfolio management group reviews IFTC securities valuations for reasonableness.</p> | | <p>3-1 Adjustments to securities valuations and any pricing errors should be evaluated by HAM Finance Department personnel, giving consideration to the requirements of Rule 2a-4. The disposition should be documented in writing by Compliance Department personnel and approved by management.</p> <p>3-2 HAM should establish procedures to check securities prices obtained by IFTC to an independent source on a test basis.</p> <p>3-3 For The Equity Series, the HAM portfolio managers or traders should adhere to established procedures and review securities valuations performed by IFTC.</p> |
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Control Objectives

Control Procedures

Comments/Recommendations

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| 4. <u>Capital share transactions are properly recorded and the correct number of outstanding shares is used in the calculation of net asset value per share.</u> | 4.(a) IFTC accountants record the net purchase or redemption of capital stock (in dollars) by the VIP Separate Account (sole shareholder) daily on the Portfolio Accounting System for each series. Shareholder activity is obtained from reports generated by the DST Annuity System based on annuity contract transactions entered by Hutton Life. The quantity of capital shares purchased or redeemed is computed by IFTC based on the series' net asset value per share for the applicable trade date.

(b) IFTC accountants reconcile the capital stock transactions to the monies received by the custodian for such transactions daily.

(c) IFTC accountants agree outstanding shares recorded for each series to the corresponding Separate Account memo account for shares owned. | Control design is considered adequate. |
| 5. <u>The net asset value per share computation is properly reviewed and approved.</u> | 5.(a) IFTC accountants investigate significant changes in securities prices as described at 3.(d) above. Supervisors review dispositions.

(b) IFTC requires that an analysis of the change in net asset value per share, or yield for The Money Market Series, be prepared each day and approved by supervisors prior to the issuance of series prices. These analyses are performed by completion of the standard IFTC Net Asset Rollforward schedules for equity or bond funds and money market funds. The Rollforward schedules isolate the components of the change in net assets from the beginning to the end of the day. | 5-1 Control design is considered adequate with respect to procedures performed by IFTC; however, Hutton Life should review the Net Asset Rollforward schedules and calculations of net asset value per share for each series on a monthly basis. |
| 6. <u>For the Money Market Series which uses the amortized cost method to value securities and compute net asset value, procedures are adequate to determine the extent of deviation from market value and that such valuations are appropriate.</u> | 6.(a) The HAM Compliance Department checks investments made by money market funds for compliance with Rule 2a-7 of the 1940 Act and certain procedures adopted by the Board of Directors. | 6-1 See Recommendation No. 11 in the Letter in this report. |

Control Objectives

Control Procedures

Comments/Recommendations

7. Books and records are maintained in accordance with Rules 31a-1, 31a-2 and 31a-3 under the 1940 Act.

- 7.(a) The VIP Fund's recordkeeping agreement affixes responsibility with IFTC for the proper maintenance of accounting and related records. The recordkeeping agreement also provides for the VIP Fund's ownership of and accessibility to such records.
- (b) The IFTC accounting manual includes these rules and the records appear suitably designed to facilitate compliance.

Control design is considered adequate.

D.2. b.4) VIP FUND
FINANCIAL REPORTING

E.F. HUTTON & COMPANY INC.

HUTTON VIP FUND

FINANCIAL REPORTING

Control Objectives

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that:

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| <p>1. <u>Post-effective amendments to the registration statement of Hutton VIP Fund which meet the applicable requirements of the federal securities laws are filed promptly.</u></p> | <p>1. Officers of Hutton Life and the VIP Fund with assistance provided by counsel for the VIP Fund prepare at least annually post-effective amendments to the registration statement which are reviewed by the independent accountants, are filed with the SEC by such legal counsel. These filings follow an annual regulatory compliance calendar for the Hutton VIP Fund which lists target dates for all required or appropriate regulatory actions. The calendar is prepared by an officer of Hutton Life and the VIP Fund and reviewed by counsel for the VIP Fund.</p> | <p>1-1 Hutton Life should adopt a plan to consolidate and enhance procedural manuals which clearly and currently document the flow of transactions and external filing requirements for the VIP Fund.</p> |
| <p>2. <u>Periodic disclosure filings, including Form N-SAR, which meet the applicable requirements of the federal securities law are filed promptly.</u></p> | <p>2. Officers of Hutton Life and the VIP Fund with assistance provided by outside legal counsel prepare at least annually, post-effective amendments to the registration statements which are reviewed by the independent accountant for the VIP Fund and filed with the SEC by outside legal counsel. These reviews and filings follow an annual regulatory compliance calendar for the Separate Account and Fund which lists target dates for all required or appropriate regulatory actions. The calendar is prepared by a Hutton Life officer and reviewed by such counsel. That Hutton Life officer, with the assistance of such counsel, assumes primary responsibility for meeting the targets stated on the calendar.</p> | <p>Control design is considered adequate.</p> |

Control Objectives

Control Procedures

Comments/Recommendations

3. Copies of periodic reports to contractowners are filed with the SEC promptly.

3. Through coordination between an officer of Hutton Life and the VIP Fund and outside legal counsel, all required filings are submitted by outside legal counsel to the SEC. Outside counsel and Hutton Life maintain files of all such filings.

Control design is considered adequate.

4. Prospective contractowners are sent a copy of the currently effective prospectus of the Hutton VIP Fund.

4.(a) Every individual prospective applicant/owner and joint applicant/owner and proposed annuitant and joint annuitant if other than the owner must execute an application for the variable annuity contract which includes a signed acknowledgement that "Receipt is acknowledged of the current prospectus for E.F. Hutton Life Insurance Company Individual Flexible Premium Deferred Annuity and Variable Accumulation Contract." The contract will not be issued by AD without receipt by Hutton Life of a properly executed application.

4-1 Procedures should be reviewed to check that current prospectuses are provided to purchasers of Hutton Life's variable annuity contracts.

(b) Instructions for sale provided to the registered representative/agent (Form 8026/1083-85), "How to Sell VIP," instruct the agent to provide the current prospectuses for both the VIP Separate Account and the VIP Fund.

5. Subsequent purchasers/existing contractowners are sent a copy of the currently effective prospectus of the Hutton VIP Fund.

5. Hutton Life mails a copy of the current prospectus for the VIP Fund to every existing contractholder whenever the post-effective amendment to the registration statements becomes effective, i.e., at least annually.

Control design is considered adequate.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
6. <u>Contractowners are sent a semi-annual financial/performance report.</u>	6. Every existing contractowner is mailed a semiannual report of the VIP Fund.	Control design is considered adequate.
7. <u>Contractowners are sent an annual financial/performance report (including financial statements with a report of independent accountants).</u>	7. Every existing contractowner is mailed an annual report of the VIP Fund which includes financial statements with a report of independent accountants.	Control design is considered adequate; however, the report of Independent Accountants does not fully comply with Rule 30(e).
8. <u>The financial statements included in the annual and semi-annual reports include all disclosures required by Section 30 and Regulation S-X.</u>	8. Hutton Life consults with its independent accountants for the Annual Report to determine that all disclosures required by Section 30 and Regulation S-X are included in the financial statements of the VIP Fund.	8-1 See Recommendation No. 12 in the Letter in this report..

D.2. b.5) VIP FUND
COMPLIANCE AND OTHER SEC REQUIREMENTS

E.F. HUTTON & COMPANY INC.

HUTTON VIP FUND

COMPLIANCE AND OTHER SEC REQUIREMENTS

Control Objectives

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that:

1. Annual reports, including audited financial statements, are provided to shareholders and filed with regulatory authorities on a timely basis in accordance with Section 30 and Rules 30a-1 and 30b-1.

2. Proxy statements and/or other disclosure notices regarding voting rights are provided to shareholders and filed with the SEC on a timely basis and in accordance with applicable disclosure requirements of Section 20.

- 1.(a) Outside legal counsel for the VIP Fund is assigned responsibility by Hutton Life for filing reports with the SEC on time.
 - (b) Officers of Hutton Life and VIP Fund together with such counsel and the independent accountants for the VIP Fund revise and update existing disclosure materials and with the assistance of such counsel, file with the SEC.
 - (c) Through coordination between a Hutton Life officer and such counsel, required filings are submitted by such counsel to the SEC. Such counsel and Hutton Life maintain files of such filings.
2. Hutton Life prepares a voting list from the DST Annuity System containing names, addresses and other voting information of all existing contractowners as of the record date. The proxy statement of the VIP Fund together with a voting instruction/proxy card is mailed from the DST Annuity Service Center to every contractowner of the Separate Account. The proxy card which states that it must be signed by the contractowner to be valid acknowledges receipt of Notice of the Annual Meeting and the Proxy Statement of the VIP Fund.

Control design is considered adequate.

Control design is considered adequate.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
3. <u>Confirmations of purchase and/or redemption/withdrawal transactions are provided to shareholders on a timely basis.</u>	3. Hutton Life, on behalf of the Separate Account, receives a daily detailed listing of every share transaction for the VIP Fund.	Control design is considered adequate.
4. <u>Books and records are prepared and maintained as required by Section 31 and Rules 31a-1, 31a-2 and 31a-3.</u>	4.(a) Pursuant to their contracts with the Fund, the custodian (FIB) and the recordkeeping agent (IFTC) have undertaken to prepare and maintain, to the extent applicable to the activities of each, the books and records required by Section 31 and the rules thereunder. (b) The IFTC accounting manual covers these rules. The records prepared and maintained by IFTC are designed to facilitate compliance.	Control design is considered adequate.
5. <u>Net asset values of each series are properly computed on a current basis, including in particular, as applicable, compliance with Rules 2a-4, 2a-7 and 22c-1.</u>	5. Pursuant to its recordkeeping agency agreement with the VIP Fund, IFTC is responsible for computing the net asset values on a daily basis. See description of procedures under the Fund Accounting and Calculation of Net Asset Value Per Share section.	Control design is considered adequate.
6. <u>Operating expenses are properly, approved, computed, charged to and paid for by the appropriate series and in accordance with prospectus disclosures and statement of additional information.</u>	6.(a) IFTC, in computing the daily net asset value for each series accrues for ongoing operating expenses, primarily the investment advisory fees. (b) Officers of the VIP Fund review and approve payments and authorize the custodian to make payments. (c) Allocations of charges and/or payments are made by IFTC, as instructed by the funds officers. (d) The Accounting Department at Hutton Life compares monthly the actual expenses paid to amounts accrued by IFTC to determine compliance with expenses limitations.	Control design is considered adequate.

Control Objectives

Control Procedures

Comments/Recommendations

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| 7. <u>The Board of Directors is properly constituted in accordance with Section 10.</u> | 7. Outside legal counsel for the VIP Fund is requested by Hutton Life to monitor this requirement. Also all contractowners of VIP Separate Account are sent a Proxy Statement of the fund which discloses whether any director/ nominee is an "interested person" of the fund and whether the fund has the requisite percentage of disinterested directors. | Control design is considered adequate. |
| 8. <u>The acquisition of securities during the existence of an underwriting syndicate is in accordance with Rule 10f-3.</u> | 8. The Board of Directors receives a compliance memorandum setting forth the requirements of Rule 10f-3 and a report of all portfolio transactions executed by HAM on behalf of the fund, including a listing from the HAM portfolio manager of any transactions during the period reported which may be subject to Rule 10f-3. The fund's president reports quarterly to the Board of Directors on compliance with the requirements in a compliance memorandum and the Board reviews the applicable procedures at least annually. | Control design is considered adequate. |
| 9. <u>The acquisition of securities issued by persons engaged in securities related businesses is in accordance with Rule 12d3-1.</u> | 9. The Board of Directors is sent a compliance memorandum setting forth the requirements of Section 12(d)(3) and Rule 12(d)3-1. The Board is sent a periodic report of all portfolio transactions executed by HAM on behalf of the fund, including a report of any which may be subject to the rule and stating whether such were in compliance with the rule. | Control design is considered adequate. |

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
10. <u>The investment advisory contract for the fund has been properly and timely approved in accordance with Section 15.</u>	10. The investment advisory contract is presented to contractholders for their approval at the annual meeting of the fund and is also voted upon by the directors as required by Section 15.	Control design is considered adequate.
11. <u>The principal underwriting contract for the fund has been properly and timely approved in accordance with Section 15.</u>	11. The contract is reapproved by the Board of Directors as required by Section 15.	Control design is considered adequate.
12. <u>Transactions between the fund and certain affiliated persons have been executed in accordance with Section 17 and Rule 17a-6 and/or 17a-7.</u>	<p>12.(a) The Board of Directors are sent a compliance memorandum prepared by HAM setting forth the procedures adopted pursuant to Rule 17a-7 so that purchase and sale transactions between the Fund and certain persons are in accordance with the Rule.</p> <p>(b) Procedures require that the HAM trader(s) provide a report to the fund president monthly of all purchases or sales subject to the rule. The president reports quarterly to the Board. The Board reviews the procedures annually.</p>	Control design is considered adequate.
13. <u>Transactions between the fund and its affiliated broker-dealer have been effected in accordance with Section 17(e) and Rule 17e-1.</u>	13. The Board is sent a compliance memorandum setting forth the procedures adopted pursuant to Rule 17e-1 regarding determining the fairness and reasonableness of commissions paid to an affiliated broker. HAM manager(s) report to the fund's president quarterly, any transactions subject to the rule and the president presents such transactions in reports to the Board quarterly. The Board is supplied a report of all portfolio transactions for the fund. The Board reviews the 17e-1 procedures annually.	Control design is considered adequate.

Control Objectives	Control Procedures	Comments/Recommendations
14. <u>The Fund's custodian arrangements are in accordance with Section 17(f) and Rules 17f-3, 17f-4 and 17f-5.</u>	<p>14.(a) The Fund has an effective custodian contract with FIB dated April 30, 1985.</p> <p>(b) An officer of the VIP Fund and Hutton Life with assistance from the outside legal counsel for the VIP Fund, determine annually that FIB meets the requirements of Sections 17 and 26(a).</p> <p>(c) The custodian contract provides for participation in a securities depository pursuant to Rule 17f-4.</p> <p>(d) The Fund does not maintain custody of its assets outside the U.S. as all assets are required to be maintained by FIB, the sub-custodian (Chase Manhattan) or pursuant to Rule 17f-4.</p> <p>(e) The custodian contract does authorize demand deposit accounts for each series of the Fund, but does not specifically provide for monies to be swept by the custodian into an uninsured master trust account.</p>	14-1 See Recommendation No. 13 in the Letter in this report.
15. <u>The fund is in compliance with the bonding requirements of Section 17(g) and Rule 17g-1.</u>	15. The Board of Directors annually consider and approve a fidelity bond in the appropriate form and amount as required by Section 17(g) and Rule 17(g)-1. In considering and approving the annual review, the Board of Directors determines the adequacy of the fidelity bond.	Control design is considered adequate.
16. <u>The fund has a code of ethics in compliance with Section 17(j) and Rule 17j-1.</u>	16. The Board of Directors has adopted for the fund a code of ethics as has the Investment Adviser. The code provides for quarterly reporting by HAM, the fund directors and the fund officers which are reviewed by the president and presented to the Board of Directors at its meetings.	Control design is considered adequate.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
17. <u>The fund is in accordance with the capital structure and senior security provisions of Section 18 and Rule 18f-2.</u>	17.(a) Outside legal counsel for the VIP Fund is assigned responsibility by Hutton Life for monitoring these requirements. (b) Every contractowner receives annually a Proxy Statement and voting card for the VIP Fund which is mailed from the DST Annuity Service Center. (c) The Fund's procedures, set forth in its contracts with FIB and IFTC, require accounting of transactions on an individual series basis and the allocation of operating expenses to the particular series involved. Each series separately maintains records and separately computes net asset values. (d) All payments of expenses are authorized by a fund officer who is responsible for appropriate allocation of expenses affecting the fund as a whole; for example, allocated pro rata based on net assets. (e) The Investment Advisory Agreement is separately voted on at the fund's annual meeting by each contractowner.	Control design is considered adequate.
18. <u>The fund is in accordance with the capital gain payment provisions of Section 19 and Rules 19a-1 and 19g-1.</u>	18. The Board of Directors approve the declaration and payment of dividends and/or capital gains for each series separately. IFTC maintains a record of all such dividend and capital gains payments which are not paid in cash to the sole shareholder, but automatically re-invested in additional shares of each series. Hutton Life is notified by IFTC of all transactions affecting the VIP Fund.	Control design is considered adequate.

E.F. HUTTON & COMPANY INC.

HUTTON VIP FUND

PORTFOLIO TRANSACTIONS

SAFEKEEPING

Control Objectives

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that:

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| 1. <u>Securities are held by an independent custodian; personnel responsible for custody of securities are independent of accounting functions or other incompatible duties.</u> | 1. All securities are held under a VIP Fund custody agreement with First Interstate, an independent bank. Physical securities and book entry positions in central depositories (Depository Trust Company and Federal Reserve) are maintained by both First Interstate and Chase Manhattan (under a sub-custodian agreement with First Interstate). First Interstate and Chase Manhattan personnel responsible for custody of securities have no fund accounting responsibilities. | Control design is considered adequate. |
| 2. <u>Assets held are properly segregated. Securities are periodically counted or compared to amounts held in a central depository account.</u> | 2. Securities positions are maintained by the custodian and sub-custodian in separate accounts for the fund. Physical securities are segregated for the fund. The custodian and sub-custodian have established procedures to periodically count securities held physically and to reconcile positions maintained by book entry. | Control design is considered adequate. |
| 3. <u>Securities are appropriately registered in the name of the fund or appropriate nominee.</u> | 3. Securities are usually maintained by book entry in Central Depositories (DTC and Federal Reserve), if eligible. Other securities are usually registered in a custodian or sub-custodian nominee name. | Control design is considered adequate. |
| 4. <u>Statements of holdings are periodically reconciled to the accounting records.</u> | 4. (a) IFTC has established procedures to reconcile statements of holdings prepared by First Interstate to the fund accounting records each month. Reconciliations are performed for each fund and all positions recorded on the fund's records are reconciled. Reconciliations are reviewed and approved by IFTC supervisors.

(b) Hutton Life personnel reconcile securities balances reported by First Interstate to those recorded by IFTC for the series. | Control design is considered adequate. |

E.F. HUTTON & COMPANY INC.

HUTTON VIP FUND

PORTFOLIO TRANSACTIONS

CREDIT ON FAILED SECURITIES TRANSACTIONS
AND UNCOLLECTED INCOME

Control Objectives

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that the funds do not suffer economic loss or loss of cash availability for investment from:

1. Failed securities transactions.

1.(a) The daily cash availability amounts reported by IFTC include all trades that should settle for the day.

(b) The HAM short-term portfolio manager attempts to invest all available cash reported at least on an overnight basis. The custodian has the responsibility of identifying additional cash credit balances resulting from failed securities purchase transactions and gives the series credit on their custodian fees. (At the time of the review it is not certain whether credits may be carried over to the next year.)

1-1 Hutton Life should review procedures with First Interstate to ascertain that all fail cash credit balances are identified on a timely basis and earn the appropriate fail rate.

2. Uncollected or partially collected income as of day following payable date.

2.(a) For interest on corporate bonds and federal funds instruments, the custodian generally gives cash availability to the series on the day following payable date although funds earn interest at FIB as of payable date. Cash availability for interest on other securities and for dividends is given on the second day following receipt although funds earn interest at FIB as of payable date.

2-1 See recommendation for the follow-up of past due interest income for the control objective 3. under the Income Recording and Collection section.

Control Objectives

Control Procedures

Comments/Recommendations

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| | (b) Amounts not received on payment dates are automatically moved by the system to past due receivable general ledger accounts and are recorded on past due income reports. | |
| | (c) IFTC has established procedures for accountants to investigate and resolve discrepancies and amounts not received with First Interstate. | |
| | (d) The HAM equity group receives IFTC reports on dividends receivable and follows up with IFTC on past due amounts. | |
| 4. <u>Bond discounts and premiums are properly amortized.</u> | 4.(a) The Portfolio Accounting System automatically calculates and records the amortization of discounts and premiums on bonds to maturity based on data entered for securities acquisitions. | 4-1 Control design is considered adequate for financial reporting purposes; however, see recommendations 1-1 and 1-3 under Compliance with Federal and State Income Tax Regulations. |
| | (b) Information regarding original issue discount, market discount and other items requiring special tax treatment is manually accumulated by IFTC personnel under the supervision of a VIP Fund officer. | |
| 5. <u>Realized gains and losses are properly computed and classified.</u> | 5.(a) When securities dispositions are recorded by IFTC accountants, the Portfolio Accounting System automatically selects the securities lots sold based on a programmed method, unless specifically identified by the portfolio manager. The system also calculates the realized gain or loss and classification as less than 3 months, 3-6 months or over 6 months. | Control design is considered adequate. |
| | (b) IFTC accountants review the reasonableness of recorded gains and losses determined by the system daily as part of the review of net asset value per share. | |

Control Objectives

Control Procedures

Comments/Recommendations

E.F. HUTTON & COMPANY INC.

HUTTON VIP FUND

PORTFOLIO TRANSACTIONS

INCOME RECORDING AND COLLECTION

Control Objectives

Control Procedures

Comments/Recommendations

What procedures are designed to provide reasonable assurance that:

1. Dividend declarations and other corporate actions are properly monitored and recorded.

1.(a) The DST Portfolio Accounting System automatically identifies (through an interface with outside services) cash dividends and corporate actions (e.g., stock splits and stock dividends) and sets up entries to record such items. IFTC accountants review dividends and corporate actions identified by the system and "accept" entries for recording. IFTC accountants review The Wall Street Journal and Standard & Poor's dividend reports to identify any dividends or corporate actions not reported by the outside service.

Control design is considered adequate.

(b) IFTC accountants are instructed to consult supervisors for recording of securities cost adjustments for corporate actions.

(c) IFTC accountants review significant securities market price fluctuations to identify dividends and corporate actions as part of their daily review of securities valuations.

(d) Designated HAM trader assistants review dividends recorded by IFTC for the series.

2. Interest income is properly accrued on a daily basis.

2.(a) The Portfolio Accounting System automatically accrues interest income on debt instruments based on data entered when recording securities purchases.

Control design is considered adequate.

(b) Interest accruals in the aggregate are reviewed as part of the daily analysis of the change in net asset value per share or yield.

3. Appropriate follow-up procedures exist with respect to past-due receivables and with respect to discrepancies between amounts accrued and amounts received.

3.(a) IFTC accountants record the receipt of interest and dividends as shown on daily bank statements. Differences between amounts accrued and received are identified by IFTC accountants in reversing receivables.

3-1 Control design is considered adequate; however, control could be enhanced by having designated HAM personnel review IFTC reports of past due interest income on a monthly basis.

E. UNIT INVESTMENT TRUSTS

E.1. UNIT INVESTMENT TRUSTS

OVERVIEW

E.F. HUTTON & COMPANY INC.

UNIT INVESTMENT TRUST

OVERVIEW

INVESTMENT PRODUCTS:

E.F. Hutton & Company Inc. has sponsored over 300 unit investment trusts (UITs). The following December, 1985 information was provided:

	<u>Number of Series</u>	<u>Total Assets (\$ Millions)</u>
Tax exempt	224	\$2,688
Equities, corporate debt and U.S. Governments series	74	1,495
Put series	<u>14</u>	<u>251</u>
	<u>312</u>	<u>\$4,434</u>

The UITs are grouped in accordance with the nature of the securities in which they invest. The "put series" trusts provide that the seller of the securities agrees to repurchase the securities from the trusts in an amount which will protect the trusts against loss of principal and provide liquidity to satisfy redemptions, if needed. These trusts were invested either in tax exempt securities or preferred stocks at the time of the review.

CONTROL SYSTEM - KEY PARTICIPANTS:

The four organization charts which follow illustrate the process of the formation of the UITs and indicate the organizational units involved in that process. As can be seen in Charts 2-4, the tax exempt series of UITs is formed by E.F. Hutton's Public Finance group located in New York. The equities, corporate debt and U.S. Government series is formed by the Hutton Asset Management division in New York.

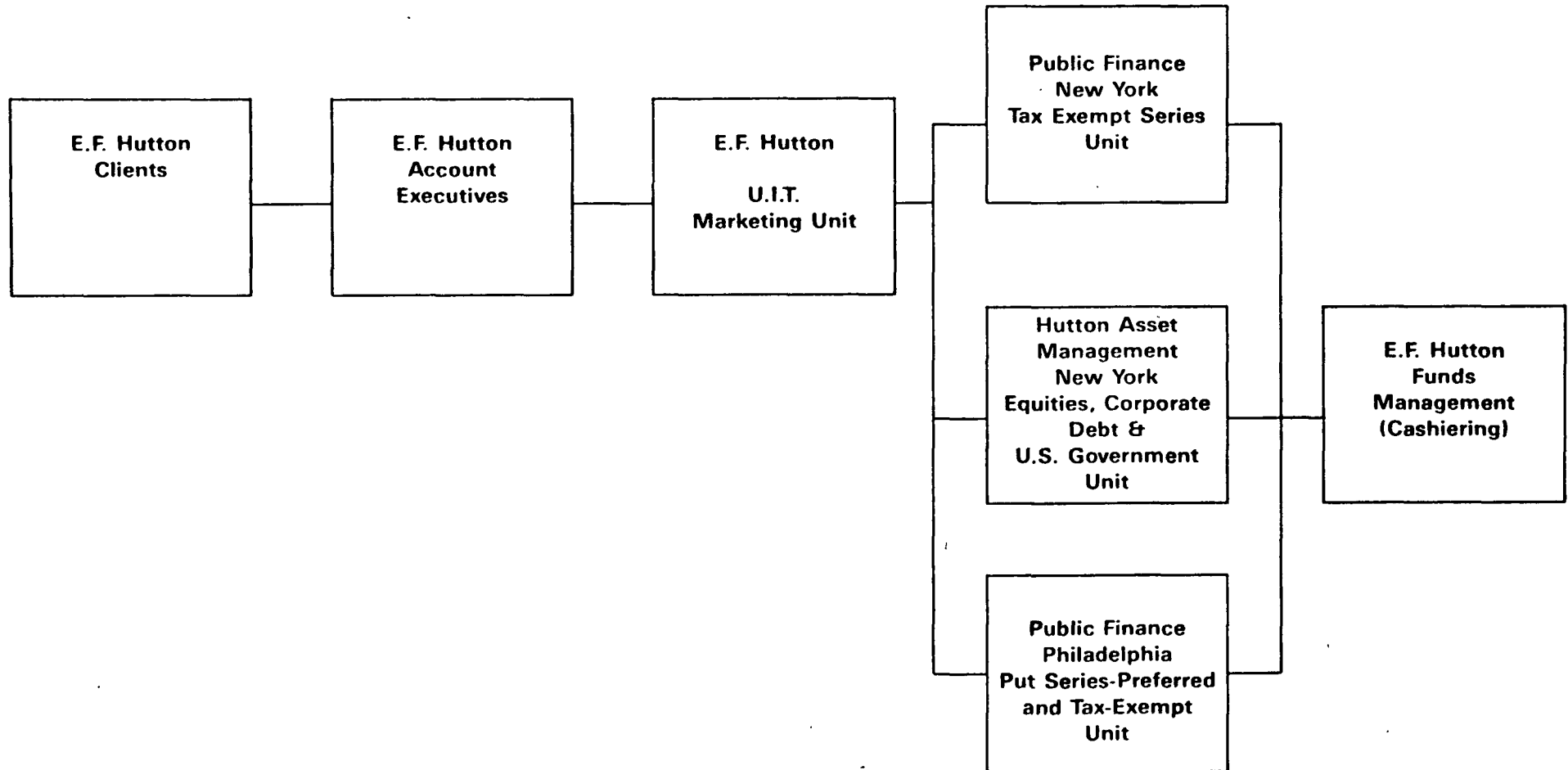
And, the "put series" is formed by E.F. Hutton Public Finance operations located in Philadelphia. The E.F. Hutton UIT Marketing unit determines that there is a market for the UIT product, initiates the creation of UITs other than the put series, distributes the UITs and maintains the secondary market for them.

CONTROL SYSTEMS - PRINCIPAL CONTROLS:

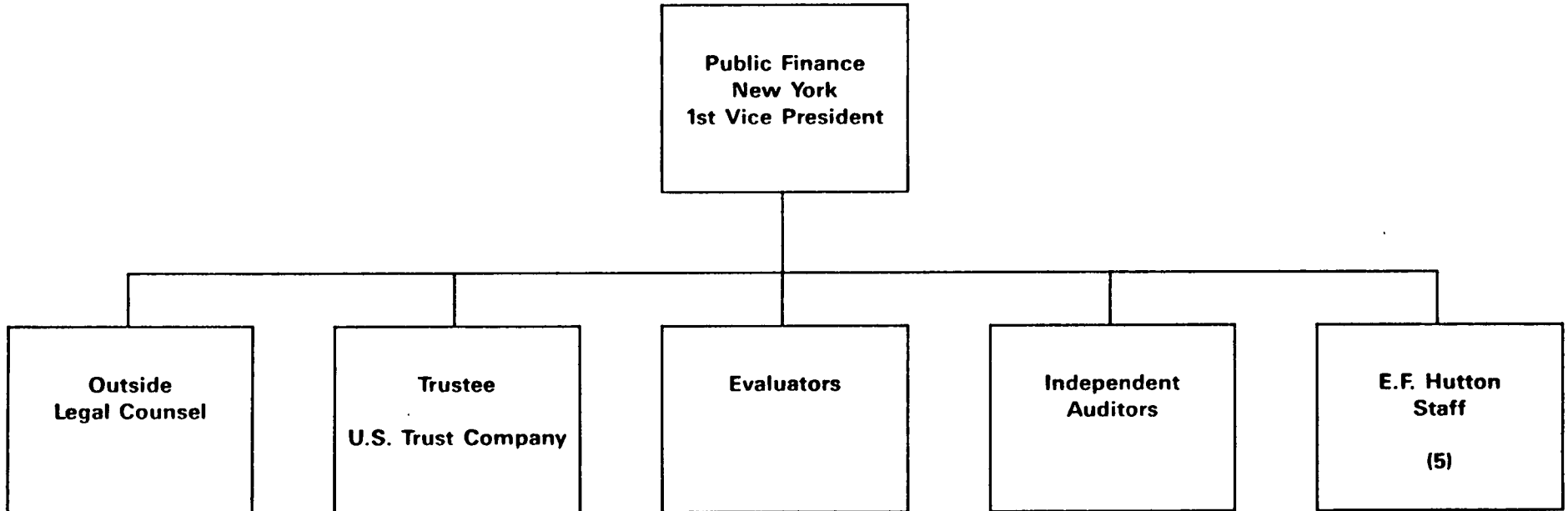
UITs are different from the other investment companies sponsored by E.F. Hutton in that Hutton's activities are concentrated in the formation of the trusts and the selection of securities to be placed in the trusts. In accordance with their trust indenture agreements the trusts are formed and the assets are turned over to an independent trustee in exchange for units of ownership on the date of deposit. Thereafter, the trustee administers the affairs of the UIT and E.F. Hutton may perform portfolio supervisory and/or administrative services pursuant to the trust indenture agreement.

Hutton is aided in its formation of the trusts by its outside legal counsel. The trusts are audited on the day of deposit by the independent accountants of E.F. Hutton, and an independent evaluator evaluates the portfolio securities to determine the offering price of the units. The independent evaluator also provides prices subsequent to the day of deposit for the purpose of establishing values in the secondary market and for redeeming units.

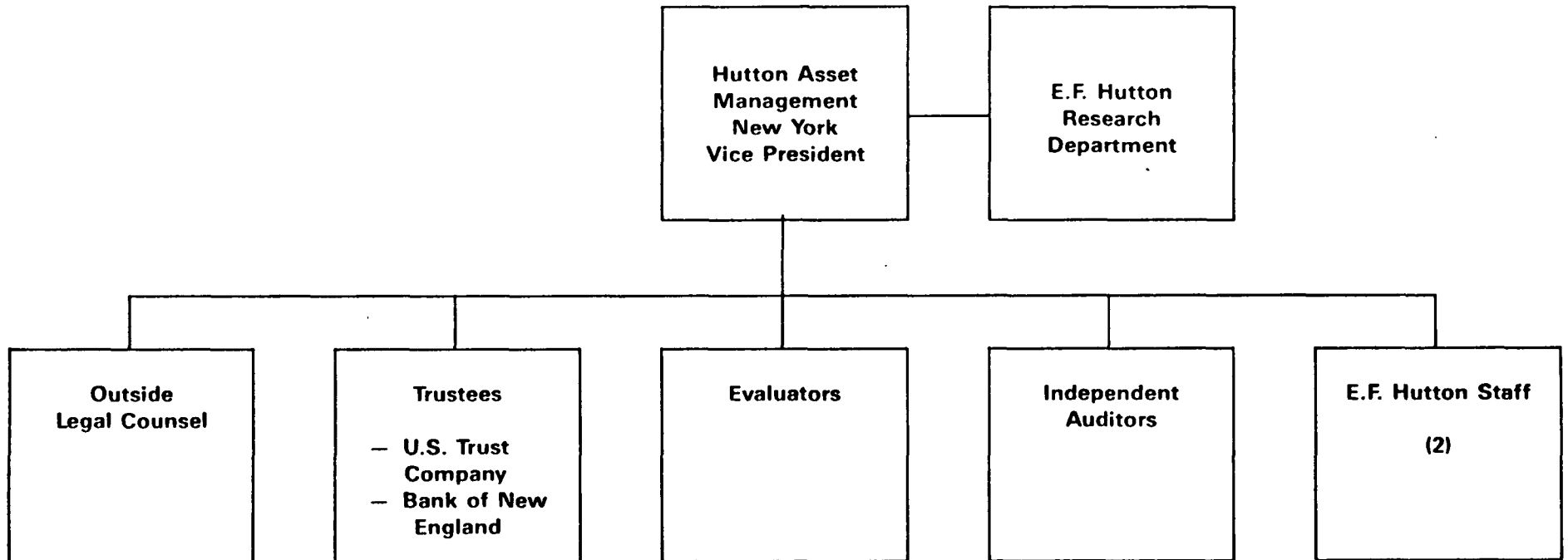
**E.F. HUTTON & COMPANY INC.
UNIT INVESTMENT TRUSTS
ORGANIZATION**



**E.F. HUTTON & COMPANY INC.
UNIT INVESTMENT TRUSTS
TAX-EXEMPT TRUSTS ADMINISTRATION**

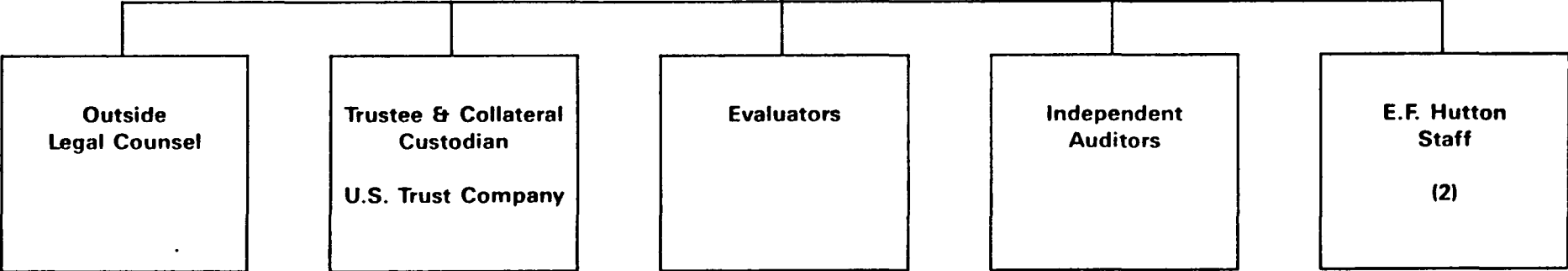


**E.F. HUTTON & COMPANY INC.
UNIT INVESTMENT TRUSTS
EQUITIES, CORPORATE DEBT AND U.S. GOVERNMENT TRUSTS ADMINISTRATION**



**E.F. HUTTON & COMPANY INC.
UNIT INVESTMENT TRUSTS
PUT SERIES ADMINISTRATION**

Public Finance
Philadelphia
1st Vice-President
Put Series –
Preferred Stocks
Or Tax Exempts



E.2. UNIT INVESTMENT TRUSTS
CONTROL OBJECTIVES AND PROCEDURES

E.F. HUTTON & COMPANY INC.

UNIT INVESTMENT TRUST ADMINISTRATION

ANALYSIS OF CONTROL OBJECTIVES AND PROCEDURES

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
What procedures are designed to provide reasonable assurance that:		
1. <u>Transactions are initiated by authorized individuals and are approved by appropriate levels of E.F. Hutton management.</u>	1.(a) The UIT Marketing unit's officer in charge (OIC) initiates the creation of UITs other than "put" series. (b) The "put" series OIC of administration initiates the creation of these UITs after a source of securities is identified and has agreed to participate. (c) The OIC of administration for the tax-exempt series and the OIC of administration, equities, corporate debt and U.S. Governments assemble and administer the series initiated by the OIC of the UIT marketing unit. (d) The OIC of the UIT Marketing unit administers the distribution of the "put" series. (e) E.F. Hutton Fund Management (cashiering) agree and arrange letters of credit financing for the deposit.	Control design is considered adequate.
2. <u>The trustee selected qualifies under section 26 of the 1940 Act.</u>		
(a) <u>at the date of deposit</u>	2.(a) Trustees (U.S. Trust Company of New York and Bank of New England) meet the requirements of Section 26 of the 1940 Act at date of deposit.	Control design is considered adequate.
(b) <u>throughout the UITs life cycle.</u>	(b) The financial statements of each trust are examined by independent auditors in connection with an annual updating of the trusts' registration statements.	

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
3. <u>Investment securities positions are accurately recorded and valued; adequate records are maintained and appropriate reports are issued.</u>	3.(a) 1. E.F. Hutton's administrative staffs for the trusts and the independent evaluator value portfolio securities at the date of deposit. Such evaluation is subject to audit by independent auditors for the trusts. 2. Descriptions of the portfolio securities descriptions and insurance covering payment of interest and principal on portfolio securities, if applicable, are agreed to prospectus for the municipal securities in the trusts by the applicable Hutton administrative staff. The portfolio securities are subject to audit by the independent auditors of the trust at date of deposit. 3. Securities gains/losses of E.F. Hutton on the delivery of the portfolio to the UIT are calculated by the applicable E.F. Hutton administrative staffs noted in the exhibit and disclosed in the prospectus. 4. The prospectus diversification requirements are reviewed at the date of deposit by the E.F. Hutton administrative staffs noted in the exhibit, outside legal counsel, the independent auditors, and the trustee.	Control design is considered adequate.
(a) <u>at the date of deposit</u>		
(b) <u>after the date of deposit</u>	(b) After the date of deposit, the evaluators provide daily valuation reports on trust holdings to the Trustees. The trustees review the portfolio and receive portfolio supervisory services from the E.F. Hutton administrative staffs responsible for UITs. Should action to change the portfolio be advisable, the trustee executes the trades.	Control design is considered adequate.
4. <u>Unitholders' positions are accurately recorded; adequate records are maintained and appropriate reports are issued.</u>	4. The trustees maintain the unitholders records and E.F. Hutton maintains within its customer accounts system information for those unitholders who are E.F. Hutton customers and leave their securities in safekeeping with E.F. Hutton.	Control design is considered adequate.
5. <u>E.F. Hutton expenses of providing portfolio supervisory and administrative services are promptly and accurately recorded; adequate records are maintained and appropriate reports are issued.</u>	5. The OIC administration for the tax-exempt series develops expense data with the assistance of the Public Finance division's controller. No other procedures were noted.	Institute formal accounting procedures to support the allocation of expenses of E.F. Hutton for portfolio supervisory and administrative services rendered to the UITs.

<u>Control Objectives</u>	<u>Control Procedures</u>	<u>Comments/Recommendations</u>
6. <u>Transactions are properly accumulated, classified and summarized to enable financial reporting to unitholders.</u>	6. The Trustee is responsible for providing unitholders with an annual accounting and tax information.	Control design is considered adequate.
7. <u>SEC annual report and registration statement filings are prepared and filed timely.</u>	<p>7.(a) The various E.F. Hutton administrative staffs working with outside legal counsel for the trusts prepare and submit the SEC annual filing on Form N-SAR within 60 days of December 31.</p> <p>(b) The UIT Marketing unit tracks secondary market activity to determine the need to maintain effective registration statements for each trust.</p> <p>(c) Outside legal counsel establishes and carries out the registration statement updating process with the E.F. Hutton administrative staffs and the independent auditors for the trusts.</p>	Control design is considered adequate.
8. <u>Subchapter M tax compliance is prepared and monitored on a timely basis.</u>	8. For equities, corporate debt and U.S. Government UITs filing with the Internal Revenue Service as regulated investment companies, the Hutton Asset Management administrative staff performs the Subchapter M diversification compliance tests.	Control design is considered adequate.
9. <u>Federal income tax returns are prepared and filed timely.</u>	9. The trustees or the independent auditors prepare the federal income tax returns.	Control design is considered adequate.