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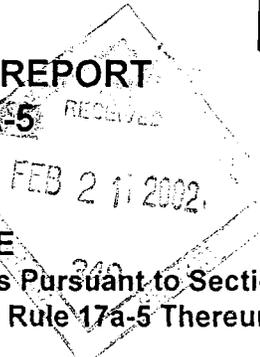
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OMB APPROVAL	
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**ANNUAL AUDITED REPORT
FORM X-17A-5
PART III**

SEC FILE NUMBER
8- 34876



FACING PAGE

Information Required of Brokers and Dealers Pursuant to Section 17 of the Securities Exchange Act of 1934 and Rule 17a-5 Thereunder

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REPORT FOR THE PERIOD BEGINNING 01/01/01 AND ENDING 12/31/01
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER: Grace Brothers Ltd.

OFFICIAL USE ONLY
FIRM ID. NO.

ADDRESS OF PRINCIPAL PLACE OF BUSINESS: (Do not use P.O. Box No.)

1560 Sherman Avenue Suite 900
(No. and Street)
Evanston Illinois 60201
(City) (State) (Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Jerald A. Trannel 630/588-7200
(Area Code - Telephone No.)

B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report*
Ernst & Young LLP

(Name - of individual, state last, first, middle name)

233 South Wacker Drive Chicago Illinois 60606
(Address) (City) (State) (Zip Code)

CHECK ONE:

- Certified Public Accountant
- Public Accountant
- Accountant not resident in United States or any of its possessions.

PROCESSED

APR 04 2002

THOMSON FINANCIAL

FOR OFFICIAL USE ONLY

*Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See section 240.17a-5(e)(2).

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OATH OR AFFIRMATION

I, David J. Allen, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statements and supporting schedules pertaining to the firm of Grace Brothers Ltd., as of December 31, 2001, are true and correct. I further swear (or affirm) that neither the company nor any partner, proprietor, principal officer or director has any proprietary interest in any account classified solely as that of a customer, except as follows:

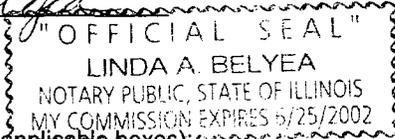
David J. Allen

Signature

Vice President of Spurgeon Corp., a
Title
General Partner of Grace Brothers Ltd.

Linda A. Belyea

Notary Public



This report** contains (check all applicable boxes):

- (a) Facing page.
- (b) Statement of Financial Condition.
- (c) Statement of Operations.
- (d) Statement of Cash Flows.
- (e) Statement of Changes in Stockholders' Equity or Partners' or Sole Proprietor's Capital.
- (f) Statement of Changes in Liabilities Subordinated to Claims or Creditors.
- (g) Computation of Net Capital.
- (h) Computation for Determination of Reserve Requirements Pursuant to Rule 15c3-3.
- (i) Information Relating to the Possession or control Requirements Under Rule 15c3-3.
- (j) A Reconciliation, including appropriate explanation, of the Computation of Net Capital Under Rule 15c3-1 and the Computation for Determination of the Reserve Requirements Under Exhibit A or Rule 15c3-3.
- (k) A Reconciliation between the audited and unaudited Statements of Financial Condition with respect to methods of consolidation.
- (l) An Oath or Affirmation.
- (m) A copy of the SIPC Supplemental Report.
- (n) A report describing any material inadequacies found to exist or found to have existed since the date of the previous audit.
- (o) Schedule of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges.
- (p) Statement of Secured Amount and Funds Held in Separate Accounts for Foreign Futures and Options Customers Pursuant to Commission Regulation 30.7.

**For conditions of confidential treatment of certain portions of this filing, see section 240.17a-5(e)(3).

Grace Brothers Ltd. and Subsidiaries

Consolidated Statement of Financial Condition

December 31, 2001

Assets

Cash and cash equivalents	\$ 1,302,748
Securities owned	248,294,977
Receivables from clearing broker	583,547
Due from affiliates	75,655,111
Accrued interest and dividends receivable	585,905
Other assets	107,181
Total assets	<u>\$326,529,469</u>

Liabilities, minority interest, and partners' capital

Securities sold, not yet purchased	\$ 65,222,872
Payables to clearing brokers	79,945,772
Accrued expenses and other liabilities	1,207,372
Total liabilities	<u>146,376,016</u>

Minority interest 135,263

Partners' capital	<u>180,018,190</u>
Total liabilities, minority interest, and partners' capital	<u>\$326,529,469</u>

See accompanying notes to financial statements.

Grace Brothers Ltd. and Subsidiaries
Consolidated Statement of Operations

Year ended December 31, 2001

Revenues	
Net trading and investment income	\$ 1,522,745
Interest and dividends	11,866,890
Total revenues	<u>13,389,635</u>
Interest expense	6,421,427
Net revenues	<u>6,968,208</u>
 Operating Expenses	
Compensation and benefits	2,059,157
General and administrative	1,749,644
Total expenses	<u>3,808,801</u>
Minority interest	392
Net income	<u><u>\$ 3,159,799</u></u>

See accompanying notes to financial statements.