

FMSbonds, Inc.

STATEMENT OF FINANCIAL CONDITION

JUNE 30, 2009



**KAUFMAN
ROSSIN &
CO.** PROFESSIONAL
ASSOCIATION
CERTIFIED PUBLIC ACCOUNTANTS

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INDEPENDENT AUDITORS' REPORT

To the Stockholders
FMSbonds, Inc.
Boca Raton, Florida

We have audited the accompanying statement of financial condition of FMSbonds, Inc. as of June 30, 2009. This financial statement is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the statement of financial condition is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the statement of financial condition. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall statement of financial condition presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the statement of financial condition referred to above presents fairly, in all material respects, the financial position of FMSbonds, Inc. as of June 30, 2009, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, the Company adopted Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, during the year ended June 30, 2009.



Miami, Florida
August 26, 2009

**KAUFMAN
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FMSbonds, Inc.
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ASSETS

CASH, including \$101,831 segregated for exclusive benefit of customers	\$	3,189,931
RECEIVABLE FROM BROKERS AND DEALERS		2,926,225
RECEIVABLE FROM CUSTOMERS		8,024,968
SECURITIES OWNED, AT FAIR VALUE (NOTES 4, 6 AND 10)		120,819,752
BOND INTEREST AND REDEMPTIONS RECEIVABLE		1,769,211
SECURED DEMAND NOTES COLLATERALIZED BY MARKETABLE SECURITIES (NOTE 2)		8,350,000
PROPERTY AND EQUIPMENT (NOTE 3)		1,031,465
OTHER ASSETS (NOTE 5)		1,158,364
	\$	147,269,916

LIABILITIES AND STOCKHOLDERS' EQUITY

LIABILITIES

Collateral loan payable (Note 6)	\$	85,686,016
Payable to brokers and dealers		9,662,929
Payable to customers		155,520
Securities sold, but not yet purchased, at fair value (Notes 4 and 10)		1,942,645
Accounts payable and accrued liabilities (Note 8)		8,496,833
Stockholders' distribution payable		4,700,000
Total liabilities		110,643,943

LEASE COMMITMENTS AND CONTINGENCIES (NOTE 7)

SUBORDINATED LIABILITIES (NOTE 2)		8,350,000
STOCKHOLDERS' EQUITY		28,275,973
	\$	147,269,916

See accompanying notes.

FMSbonds, Inc.

NOTES TO STATEMENT OF FINANCIAL CONDITION

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business and Organization

FMSbonds, Inc. (the Company), is a broker and dealer specializing in municipal bonds. The Company acts primarily in a principal capacity, buying and selling for its own account and trading with customers and other dealers. To a lesser extent, the Company acts in an agency capacity, buying and selling equity securities and annuities for its customers and charging a commission.

Government and Other Regulation

The Company's business is subject to significant regulation by various governmental agencies and self-regulatory organizations. Such regulation includes, among other things, periodic examinations by these regulatory bodies to determine whether the Company is conducting and reporting its operations in accordance with the applicable requirements of these organizations.

Securities Transactions and Revenue Recognition

Securities transactions are reported on a trade date basis. The resulting difference between cost and market is included in trading profits in the statement of operations.

Interest income is recorded on an accrual basis.

Valuation of Investments in Securities at Fair Value - Definition and Hierarchy

The Company adopted Financial Accounting Standards Board Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("SFAS 157"), during the year ended December 31, 2008. In accordance with SFAS 157, fair value is defined as the price that the Company would receive to sell an investment or pay to transfer a liability in an orderly transaction with an independent counter-party in the principal market or in the absence of a principal market, the most advantageous market for the investment or liability. SFAS 157 establishes a three-tier hierarchy to distinguish between (1) inputs that reflect the assumptions market participants would use in pricing an asset or liability developed based on market data obtained from sources independent of the reporting entity (observable inputs); and (2) inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing an asset or liability developed based on the best information available in the circumstances (unobservable inputs); and to establish classification of fair value measurements for disclosure purposes.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

***Valuation of Investments in Securities at Fair Value -
Definition and Hierarchy (continued)***

Various inputs are used in determining the value of the Company's investments. The inputs are summarized in the three broad levels listed below.

Level 1 - quoted prices in active markets for identical investments

Level 2 - other significant observable inputs (including quoted prices for similar investments, interest rates, credit risk, etc.)

Level 3 - significant unobservable inputs (including the Company's own assumptions in determining the fair value of investments)

In applying the provisions of FAS 157 to the Company's portfolio activities during the year, the following valuation techniques have been employed:

Municipal Bonds and Certificates of Deposit. The fair value of municipal bonds and certificates of deposit is estimated using recently executed transactions, market price quotations and pricing models that factor in, where applicable, interest rates, bond or credit default swap spreads and volatility. These bonds and certificates of deposit are generally categorized in Level 2 of the fair value hierarchy.

Corporate Bonds. The fair value of corporate bonds is estimated using recently executed transactions, market price quotations (where observable), bond spreads or credit default swap spreads. The spread data used are for the same maturity as the bond. If the spread data does not reference the issuer, then data that references a comparable issuer is used. When observable price quotations are not available, fair value is determined based on cash flow models with yield curves, bond, or single-name credit default swap spreads and recovery rates based on collateral values as key inputs. Corporate bonds are generally categorized in Level 2 of the fair value hierarchy.

Property and Equipment

Property and equipment is recorded at cost. Expenditures for major betterments and additions are charged to the asset accounts while replacements, maintenance and repairs which do not improve or extend the lives of the respective assets are charged to expense currently.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Depreciation and Amortization

Depreciation and amortization of property and equipment is computed using the straight-line method at various rates based upon the estimated useful lives of the assets. The range of estimated useful lives is summarized as follows:

Furniture and fixtures	7 to 8 years
Office equipment	5 to 7 years
Leasehold improvements	7 years
Transportation equipment	5 years

Receivables

The Company does not provide a reserve for uncollected receivables as substantially all amounts are collateralized by securities awaiting delivery. Amounts are charged directly to expense when deemed uncollectible, and have historically been immaterial.

Income Taxes

The Company has elected, with the stockholders' consent, to be taxed under the S Corporation provisions of the Internal Revenue Code. Under these provisions, the taxable income of the Company is reflected by the stockholders on their personal income tax returns. Accordingly, no provision for income taxes is included in the accompanying financial statements.

The Company has elected to defer adoption of Financial Accounting Standards Board (FASB) Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," until the year ending June 30, 2010 in accordance with FASB Staff Position FIN 48-3. The Company has historically evaluated its potential income tax liability arising from uncertain tax positions pursuant to FASB statement No. 5 whereby loss contingencies are accrued if the loss is both probable and can be reasonably estimated. FSP FIN 48-3 deferred the mandatory adoption date of the Interpretation to the annual financial statements for fiscal years beginning after December 15, 2008 to allow the FASB to develop guidance on its application to pass-through entities, such as the Company.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statement. Actual results could differ from those estimates.

NOTE 2. SECURED DEMAND NOTES COLLATERALIZED BY MARKETABLE SECURITIES AND SUBORDINATED LIABILITIES

Secured demand notes collateralized by marketable securities consist of non-interest bearing loans to stockholders of \$8,350,000.

The subordinated liabilities may be repaid at the stated maturity dates only if, after giving effect to such repayment, the Company meets the regulatory net capital requirements governing repayment of such subordinated debt. These loans were made under agreements pursuant to the rules and regulations of the Securities and Exchange Commission, approved by the Financial Industry Regulatory Authority ("FINRA") and are subordinated to the claims of general creditors.

Effective December 30, 2008, an extension of maturity of \$3,315,000 of secured demand notes receivable and corresponding liabilities to stockholders was granted, with FINRA approval, with a new expiration date of December 31, 2011.

The maturities of the subordinated liabilities for the years subsequent to June 30, 2009 are as follows:

2011	\$ 5,035,000
2012	3,315,000
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	\$ 8,350,000

NOTE 3. PROPERTY AND EQUIPMENT

Property and equipment at June 30, 2009 consisted of the following:

Furniture and fixtures	\$ 599,654
Office equipment	932,492
Leasehold improvements	583,408
Transportation equipment	685,012
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	2,800,566
Less: accumulated depreciation and amortization	(1,769,101)
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	\$ 1,031,465

NOTE 4. FAIR VALUE MEASUREMENT

The Company's assets and liabilities recorded at fair value have been categorized based upon a fair value hierarchy in accordance with SFAS 157 and the Company's accounting policies as disclosed in Note 1. The following table presents information about the Company's assets and liabilities measured at fair value as of June 30, 2009:

ASSETS, at fair value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
<u>Securities Owned</u>				
Certificates of deposit	\$ -	\$ 1,065,359	\$ -	\$ 1,065,359
Corporate bonds	-	15,408,978	-	15,408,978
Municipal bonds	-	104,345,415	-	104,345,415
	\$ -	\$ 120,819,752	\$ -	\$ 120,819,752
<u>LIABILITIES, at fair value</u>				
<u>Securities Sold, But Not Yet Purchased</u>				
Certificates of deposit	\$ -	\$ 1,800,192	\$ -	\$ 1,800,192
Corporate bonds	-	141,459	-	141,459
Municipal bonds	-	994	-	994
	\$ -	\$ 1,942,645	\$ -	\$ 1,942,645

NOTE 5. OTHER ASSETS

Other assets at June 30, 2009 consisted of the following:

Prepays	\$ 54,588
Other receivables	71,393
Net cash value of life insurance policies	25,000
Deposits	311,265
Employee loans receivable	696,118
	\$ 1,158,364

NOTE 6. COLLATERAL LOAN PAYABLE

Collateral loan payable represents amounts due to the Company's clearing broker and is collateralized by securities owned or held as collateral by the Company and securities awaiting delivery on uncompleted transactions. Interest is payable monthly at the prevailing variable rate, which was 1.78% at June 30, 2009. All amounts due are payable on demand.

NOTE 7. LEASE COMMITMENTS AND CONTINGENCIES

Lease Commitments

The Company is obligated under various non-cancelable operating leases for certain equipment and office facilities.

As of June 30, 2009, the approximate future minimum annual rentals under the non-cancelable leases are as follows:

2010	\$ 140,000
2011	14,000
2012	10,000
2013	5,000
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	\$ 169,000

The Company has a month-to-month lease arrangement with its stockholders for an office facility in North Miami Beach, Florida.

Litigation Matters

The Company is involved in various legal proceedings arising in the ordinary course of business. These matters allege that the Company breached its fiduciary duties and negligently managed the claimants' accounts through unsuitable investments. The Company considers these allegations to be without merit and intends to vigorously contest these claims. While it is not feasible to predict or determine the outcome of these proceedings, in the opinion of management, based on a review with legal counsel, any losses which may result from such legal proceedings are not expected to have a material adverse effect on the Company's financial position or operating results.

NOTE 8. EMPLOYEE BENEFIT PLANS

The Company maintains a 401(k) plan covering substantially all employees. Employer contributions to the plan are at the discretion of management. At June 30, 2009, the Company had accrued \$140,907 for this plan. Additionally, the Company maintains a non-qualified Supplemental Employees' Retirement Plan (SERP). Contributions, the funding of which is at management's discretion, are calculated based on the qualifying employee's salary and years of employment. At June 30, 2009, the Company had accrued \$3,064,225 for the SERP. This amount is included in accounts payable and accrued liabilities in the accompanying statement of financial condition.

NOTE 9. NET CAPITAL REQUIREMENTS

As a registered broker-dealer, the Company is subject to the Uniform Net Capital Rule of the Securities and Exchange Commission, which requires that "Net Capital", as defined, shall be at least the greater of \$250,000 or 6-2/3% of "Aggregate Indebtedness", as defined. At June 30, 2009, the Company's "Net Capital" was \$24,018,672 which exceeded requirements by \$23,114,930. The ratio of "Aggregate Indebtedness" to "Net Capital" was 0.56 to 1 at June 30, 2009.

NOTE 10. CREDIT CONCENTRATIONS AND OFF-BALANCE-SHEET RISK

In the normal course of business, the Company enters into financial transactions in which there is a risk of loss due to changes in the market ("market risk") or failure of the other party to the transaction to perform ("credit risk"), as described below.

Securities Sold, But Not Yet Purchased

Securities sold, but not yet purchased, aggregate \$1,942,645 at June 30, 2009. Subsequent market fluctuations may require the Company to purchase these securities at prices which exceed the market value in the accompanying statement of financial condition. This short-sale liability is collateralized by securities owned.

Custody of Securities

Custodial functions for the Company's securities transactions are substantially provided by a New York City bank. At June 30, 2009, a majority of securities owned is held by this bank.

Deposits with Financial Institutions

The Company may, during the course of operations, maintain cash deposits in excess of federally insured limits.

NOTE 10. CREDIT CONCENTRATIONS AND OFF-BALANCE-SHEET RISK
(Continued)

Other Risk Concentrations

In the normal course of business, the Company's customer activities involve the execution, settlement, and financing of various customer securities transactions. These activities may expose the Company to off-balance-sheet risk in the event the customer or other broker is unable to fulfill its contracted obligations and the Company has to purchase or sell the financial instrument underlying the contract at a loss.

NOTE 11. SUBSEQUENT EVENTS

On June 30, 2009, the Company adopted FASB Statement No. 165, "Subsequent Events". The Statement establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Specifically, the Statement defines: (1) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, (2) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and (3) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. Management has reviewed events occurring through August 26, 2009, the date the financial statements were issued, and no subsequent events occurred requiring accrual or disclosure.