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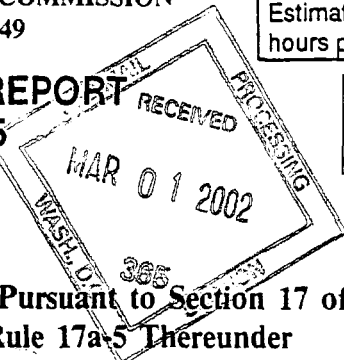
Washington, D.C. 20549

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OMB APPROVAL	
OMB Number:	3235-0123
Expires:	January 31, 1993
Estimated average burden hours per response	12.00

SEC FILE NUMBER
8. 15433

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



FACING PAGE

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

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:  
KMS FINANCIAL SERVICES, INC.

OFFICIAL USE ONLY
FIRM ID. NO.

ADDRESS OF PRINCIPAL PLACE OF BUSINESS: (Do not use P.O. Box No.)  
2200 SIXTH AVENUE, SUITE 1125  
(No. and Street)

SEATTLE WASHINGTON 98121  
(City) (State) (Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT  
KEN PAULSEN (206) 441-2885  
(Area Code — Telephone No.)

**B. ACCOUNTANT IDENTIFICATION**

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report\*

HAGELIN & ASSOCIATES

(Name — if individual, state last, first, middle name)

2200 SIXTH AVENUE, SUITE 430 SEATTLE WASHINGTON 98121  
(Address) (City) (State) (Zip Code)

CHECK ONE:

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

**PROCESSED**  
P MAR 15 2002

FOR OFFICIAL USE ONLY
THOMSON FINANCIAL

\*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).

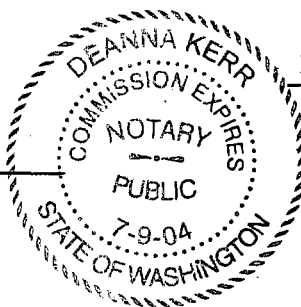
VF 3-13-02

## OATH OR AFFIRMATION

I, MARK HAMBY, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of KMS FINANCIAL SERVICES, INC., as of DECEMBER 31, ~~19~~ 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:

NONE

Deanna Kerr  
Notary Public



Mark Hamby  
Signature  
PRESIDENT, CEO  
Title

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

- (a) Facing page.
- (b) Statement of Financial Condition.
- (c) Statement of Income (Loss).
- (d) Statement of ~~Changes in Financial Condition~~ 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 of 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 of 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) Independent auditor's report on internal control

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

**HAGELIN & ASSOCIATES**  
CERTIFIED PUBLIC ACCOUNTANTS  
2200 Sixth Avenue, Suite 430  
Seattle, WA 98121-1845

(206) 441-7100  
FAX (206) 441-5804  
Email [hagelinpa@juno.com](mailto:hagelinpa@juno.com)

INDEPENDENT AUDITOR'S REPORT

Board of Directors  
KMS Financial Services, Inc.

We have audited the accompanying statement of financial condition of KMS Financial Services, Inc. as of December 31, 2001, and the related statements of income, stockholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of KMS Financial Services, Inc. as of December 31, 2001, and the results of its operations and its cash flows for the year then ended in conformity with United States of America generally accepted accounting principles.

*Hagelin & Associates*

Seattle, Washington

February 11, 2002

KMS FINANCIAL SERVICES, INC.  
STATEMENT OF FINANCIAL CONDITION  
December 31, 2001

ASSETS

Cash and cash equivalents	\$3,831,011
Commissions receivable, net of allowance for doubtful accounts	1,471,385
Investments in common stocks and U.S. Treasury Notes, at market value	960,583
Prepaid expenses and other receivables	5,401
Advances to registered representatives	20,718
Deposit with clearing organization	100,000
Office equipment and fine art at cost, net of accumulated depreciation of \$510,635	263,616
Deferred Federal income tax asset	99,000
	<u>\$6,751,714</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

Accounts payable	\$ 231,146
Commissions payable	1,243,898
Payable to customers	205,409
Profit sharing contribution payable	455,258
Accrued expenses	26,216
Federal and state income taxes currently payable	14,690
Note payable to stockholder	850,000
Supplemental retirement payable	669,109
	<u>3,695,726</u>
Commitments and contingent liabilities	
Stockholders' equity:	
Common stock - no par value:	
Authorized - 50,000 shares, issued and outstanding - 13,377 shares	260,374
Retained earnings	2,795,614
	<u>3,055,988</u>
	<u>\$6,751,714</u>

See notes to financial statements.

KMS FINANCIAL SERVICES, INC.  
STATEMENT OF INCOME  
For the year ended December 31, 2001

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REVENUES

Commissions	\$26,152,317
Interest income	218,574
Other income	2,557,867
Total revenues	28,928,758

EXPENSES

Commission expense	23,554,556
Salaries	2,153,323
Supplemental executive retirement	74,869
Payroll taxes	133,441
Employee benefits	88,017
Profit sharing plan expense	464,349
Rent	127,128
Promotion, entertainment and sales expense	41,242
Office expenses	148,044
Telephone	14,494
Settlement expenses	158,341
Research and sundry	195,056
Data processing	35,064
Repairs and maintenance	26,050
Professional fees	46,545
Business taxes	90,793
Registration fees and expenses	52,480
Insurance	76,954
Interest	65,359
Dues and subscriptions	9,790
Miscellaneous	25,234
Depreciation and amortization	119,563
Total expenses	27,700,692

INCOME BEFORE INCOME TAXES 1,228,066

PROVISION FOR INCOME TAXES 439,392

NET INCOME \$ 788,674

See notes to financial statements.

KMS FINANCIAL SERVICES, INC.  
STATEMENT OF STOCKHOLDERS' EQUITY  
For the year ended December 31, 2001

	<u>Common Stock</u>		<u>Retained</u>
	<u>Shares</u>	<u>Dollars</u>	<u>Earnings</u>
Balance - January 1, 2001	13,377	\$260,374	\$2,006,940
Net income for the year	_____	_____	<u>788,674</u>
Balance - December 31, 2001	<u>13,377</u>	<u>\$260,374</u>	<u>\$2,795,614</u>

See notes to financial statements.

KMS FINANCIAL SERVICES, INC.  
STATEMENT OF CASH FLOWS  
For the year ended December 31, 2001  
Increase (Decrease) in Cash and Cash Equivalents

CASH FLOWS FROM OPERATING ACTIVITIES	
Net income	\$ 788,674
Adjustment to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	119,563
Loss on disposition of office equipment	5,946
 (Increase) decrease in:	
Commissions receivable	57,346
Investments	82,336
Prepaid expenses and other receivables	85,026
Advances to registered representatives	(7,077)
Deposits	25,000
Deferred Federal income tax asset	(17,000)
 Increase (decrease) in:	
Accounts payable	49,406
Commissions payable	22,985
Payable to customers	173,869
Accrued expenses	107,617
Federal and state income taxes payable	(135,723)
Supplemental retirement payable	14,868
NET CASH FLOWS FROM OPERATING ACTIVITIES	<u>1,372,836</u>
 CASH FLOWS FROM INVESTING ACTIVITIES	
Purchase of office equipment and fine art	(67,157)
NET CASH FLOWS (USED IN) INVESTING ACTIVITIES	<u>(67,157)</u>
 CASH FLOWS FROM FINANCING ACTIVITIES	
Principal payments of Note payable to stockholder	(100,000)
NET CASH FLOWS (USED IN) FINANCING ACTIVITIES	<u>(100,000)</u>
 NET INCREASE IN CASH AND CASH EQUIVALENTS	 1,205,679
 CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	 <u>2,625,332</u>
 CASH AND CASH EQUIVALENTS AT END OF YEAR	 <u>\$3,831,011</u>

See notes to financial statements.

KMS FINANCIAL SERVICES, INC.  
NOTES TO FINANCIAL STATEMENTS

1. THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

THE COMPANY - The Company is a NASD Registered Broker and Dealer selling securities and insurance products through registered representatives in the Western United States. Commissions revenues are generated predominantly from the sale of mutual fund shares, general securities and variable annuities.

INCOME RECOGNITION - Securities transactions and the commission revenue and expense are recorded in the accounts on a trade date basis.

INCOME TAXES - Deferred Federal income taxes are provided when income, related to carrying investments at market value, and expenses, principally supplemental executive retirement program expenses accrued for financial statement purposes not deductible for tax purposes until paid, are recognized in different years for tax and financial statement purposes. No valuation allowances have been recorded to offset deferred tax assets recorded by the Company.

FIXED ASSETS AND DEPRECIATION - Office equipment and fine art are stated at cost. Office equipment is depreciated over its estimated economic life, ranging from five to seven years and is computed on the straight-line and accelerated methods. Fine art is depreciated on the straight-line method over its estimated economic lives of twenty to fifty years.

INVESTMENTS - Investments in common stocks and U.S. Treasury Notes are carried at fair market value based upon quoted market prices.

ESTIMATES AND ASSUMPTIONS - Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses.

FAIR VALUE OF FINANCIAL INSTRUMENTS - The carrying value of cash, receivables and accounts payable approximate fair value due to the short maturity of these instruments. None of the financial instruments are held for trading purposes.



KMS FINANCIAL SERVICES, INC.  
NOTES TO FINANCIAL STATEMENTS  
(continued)

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2. CASH AND CASH EQUIVALENTS

The Company considers cash and cash equivalents to include cash and those short-term, highly liquid investments with original maturities of three months or less.

Cash and cash equivalents at December 31, 2001 consist of the following:

General funds	\$ 231,046
Cash segregated in compliance with Federal and other regulations	213,173
Cash segregated in compliance with agreements with registered representatives (Note 5)	178,525
Investments in money market funds	<u>3,208,267</u>
	<u>\$3,831,011</u>

Supplemental disclosures for the statement of cash flows include cash paid during the year for:

Interest	\$ 65,359
Income taxes (Note 7)	\$592,115

3. NET CAPITAL REQUIREMENTS

The Company is subject to the Securities and Exchange Commission Uniform Net Capital Rule (Rule 15c3-1), which requires the maintenance of minimum net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1.

At December 31, 2001, the Company had net capital of \$2,464,590 and net capital required under the Rule was \$250,000. The Company's net capital ratio was 1.50 to 1.

The net capital rules may effectively restrict the payment of cash dividends.

4. SUPPLEMENTAL EXECUTIVE RETIREMENT PROGRAM

The Company maintains a supplemental executive retirement program covering an employee that provided for monthly benefits of \$5,000 commencing in 1998. The Company's policy is to not fund the liability. The unfunded accumulated benefit obligation is reflected in the accompanying financial statements as supplemental retirement payable.

KMS FINANCIAL SERVICES, INC.  
NOTES TO FINANCIAL STATEMENTS  
(continued)

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5. COMMITMENTS

The Company leases office premises under noncancelable operating leases. The following is a schedule by years of future minimum rental payments required under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of December 31, 2000:

<u>Year ending December 31,</u>	
2002	\$126,480
2003	126,480
2004	<u>129,120</u>
Total minimum payments required	<u>\$382,080</u>

The Company's rental expense, under operating leases, was \$127,128 during 2001.

The Company has received payments from registered representatives, and maintains the funds to supplement professional liability insurance programs as necessary. The Company, and appointed registered representatives are responsible for administration of funds.

The Company is obligated to purchase, from certain stockholder's estates, the estate's common stock at a purchase price per share determined by formula. Additionally, the Company is obligated to purchase shares from certain terminated employees.

The Company maintains life insurance on certain stockholders. Proceeds from these life insurance policies are to be used to redeem common stock from the estate, with balances generally payable over five years at prime rates less one percent.

6. NOTE PAYABLE TO STOCKHOLDER

A note payable to a stockholder from the redemption of a portion of the stockholder's common stock, calls for quarterly principal payments of \$25,000 plus interest at a bank's prime lending rate less one percent (6.5% at December 31), through June 2010.

The note payable contains certain covenants, the most restrictive of which provide that the note payable is currently due on certain triggering events including:

1. Substantially altering the existing Company management;
2. Substantially altering the existing capital or debt structure; or
3. Substantially altering the existing Company ownership.

KMS FINANCIAL SERVICES, INC.  
NOTES TO FINANCIAL STATEMENTS  
(continued)

6. NOTE PAYABLE TO STOCKHOLDER (continued)

Maturities of the note payable to stockholder are as follows:

<u>Year ending December 31,</u>	<u>Amount</u>
2002	\$100,000
2003	100,000
2004	100,000
2005	100,000
2006	100,000
Thereafter	<u>350,000</u>
	<u>\$850,000</u>

7. INCOME TAXES

The Company's provision for income taxes consist of the following components:

Currently payable	\$456,392
Deferred (benefit)	<u>(17,000)</u>
	<u>\$439,392</u>

The Company's deferred Federal tax asset represents the tax effects of deductible temporary differences in reporting compensation and retirement benefits under terms of the supplemental executive retirement program covering an officer.

The Company's deferred Federal income tax payable represent the tax effects of taxable temporary differences in carrying investments in common stocks and U.S. Treasury Notes at fair market value for financial presentation purposes. The net deferred Federal income tax asset includes the asset, net of the payable.

The Company's provision for income taxes differs from applying the statutory U.S. Federal income tax rate to income before income taxes. The primary difference results from providing for state income taxes.

8. EMPLOYEE PENSION AND PROFIT SHARING PLAN

The Company's employees are participants in a pension and profit sharing plan adopted on January 1, 1980. The plans cover substantially all of the Company's employees.

The plans call for minimum contributions, together with additional discretionary contributions determined by the Board of Directors. Contributions cannot exceed twenty five percent of compensation. Contributions of \$464,348 (including \$193,917 of required minimum contributions) were authorized by the Board of Directors for 2001. The Company is obligated for contributions to the pension plan of ten percent of eligible compensation, as defined, on an annual basis. The Company funds plan contributions as incurred.

KMS FINANCIAL SERVICES, INC.  
NOTES TO FINANCIAL STATEMENTS  
(continued)

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9. CONTINGENT LIABILITIES

The Corporation maintains its cash accounts in one commercial bank located in Seattle, Washington. The total cash balances are secured by the Federal Deposit Insurance Corporation up to \$100,000. Additionally, investments in money market funds are not secured.

10. NONRECURRING ITEM

The Corporation received insurance proceeds approximating \$677,000 from claims under the Corporation's errors and omissions policies. This recovery was partial reimbursement for claim payments made in the prior year. This recovery is included in the accompanying financial statements with other income.

**HAGELIN & ASSOCIATES**  
CERTIFIED PUBLIC ACCOUNTANTS  
2200 Sixth Avenue, Suite 430  
Seattle, WA 98121-1845

(206) 441-7100  
FAX (206) 441-5804  
Email [hagelincpa@juno.com](mailto:hagelincpa@juno.com)

INDEPENDENT AUDITOR'S REPORT ON  
SUPPLEMENTARY INFORMATION REQUIRED BY RULE 17a-5 OF THE  
SECURITIES AND EXCHANGE COMMISSION

Board of Directors  
KMS Financial Services, Inc.

We have audited the accompanying financial statements of KMS Financial Services, Inc. as of and for the year ended December 31, 2001, and have issued our report thereon dated February 11, 2002. Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The information contained in pages 15 - 25 is presented for purposes of additional analysis and is not a required part of the basic financial statements, but is supplementary information required by Rule 17a-5 of the Securities and Exchange Commission. Such information has been subjected to the United States of America auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*Hagelin & Associates*

Seattle, Washington

February 11, 2002

**FORM  
X-17A-5**

**FOCUS REPORT**

(Financial and Operational Combined Uniform Single Report)

**PART IIA** 12

OMB APPROVAL  
OMB # 3235-0123  
Expires May 31, 1987

*(Please read instructions before preparing Form.)*

This report is being filed pursuant to (Check Applicable Block(s):

- 1) Rule 17a-5(a) 16      2) Rule 17a-5(b) 17      3) Rule 17a-11 18  
 4) Special request by designated examining authority 19      5) Other  26 Rule 17-a-5(d)

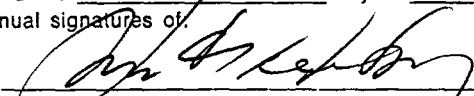
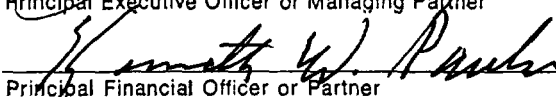
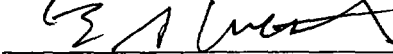
NAME OF BROKER-DEALER	SEC FILE NO.
KMS FINANCIAL SERVICES, INC. <span style="float: right; border: 1px solid black; padding: 0 5px;">13</span>	8-15433 <span style="float: right; border: 1px solid black; padding: 0 5px;">14</span>
ADDRESS OF PRINCIPAL PLACE OF BUSINESS (Do Not Use P.O. Box No.)	FIRM ID. NO.
2200 SIXTH AVENUE, SUITE 1125 <span style="float: right; border: 1px solid black; padding: 0 5px;">20</span>	01-03866 <span style="float: right; border: 1px solid black; padding: 0 5px;">15</span>
(No. and Street)	FOR PERIOD BEGINNING (MM/DD/YY)
SEATTLE <span style="float: right; border: 1px solid black; padding: 0 5px;">21</span>	01/01/01 <span style="float: right; border: 1px solid black; padding: 0 5px;">24</span>
WASHINGTON <span style="float: right; border: 1px solid black; padding: 0 5px;">22</span>	AND ENDING (MM/DD/YY)
98121 <span style="float: right; border: 1px solid black; padding: 0 5px;">23</span>	12/31/01 <span style="float: right; border: 1px solid black; padding: 0 5px;">25</span>
(City) (State) (Zip Code)	
NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT	(Area Code)—Telephone No.
KEN PAULSEN <span style="float: right; border: 1px solid black; padding: 0 5px;">30</span>	(206) 441-2885 <span style="float: right; border: 1px solid black; padding: 0 5px;">31</span>
NAME(S) OF SUBSIDIARIES OR AFFILIATES CONSOLIDATED IN THIS REPORT:	OFFICIAL USE
<span style="float: right; border: 1px solid black; padding: 0 5px;">32</span>	<span style="float: right; border: 1px solid black; padding: 0 5px;">33</span>
<span style="float: right; border: 1px solid black; padding: 0 5px;">34</span>	<span style="float: right; border: 1px solid black; padding: 0 5px;">35</span>
<span style="float: right; border: 1px solid black; padding: 0 5px;">36</span>	<span style="float: right; border: 1px solid black; padding: 0 5px;">37</span>
<span style="float: right; border: 1px solid black; padding: 0 5px;">38</span>	<span style="float: right; border: 1px solid black; padding: 0 5px;">39</span>

DOES RESPONDENT CARRY ITS OWN CUSTOMER ACCOUNTS?      YES 40      NO  41  
 CHECK HERE IF RESPONDENT IS FILING AN AUDITED REPORT XX 42

**EXECUTION:**

The registrant/broker or dealer submitting this Form and its attachments and the person(s) by whom it is executed represent hereby that all information contained therein is true, correct and complete. It is understood that all required items, statements, and schedules are considered integral parts of this Form and that the submission of any amendment represents that all unamended items, statements and schedules remain true, correct and complete as previously submitted.

Dated the 26TH day of FEBRUARY ~~XX~~ 2002  
 Manual signatures of:

- 1)   
Principal Executive Officer or Managing Partner
- 2)   
Principal Financial Officer or Partner
- 3)   
Principal Operations Officer or Partner

**ATTENTION**—Intentional misstatements or omissions of facts constitute Federal Criminal Violations. (See 18 U.S.C. 1001 and 15 U.S.C. 78:f(a))

TO BE COMPLETED WITH THE ANNUAL AUDIT REPORT ONLY:

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report

Name (If individual, state last, first, middle name)

HAGELIN & ASSOCIATES

70

ADDRESS	Number and Street	City	State	Zip Code
	2200 SIXTH AVENUE, SUITE 430,	SEATTLE, WASHINGTON		98121

71

72

73

74

Check One

Certified Public Accountant

75

FOR SEC USE

Public Accountant

76

Accountant not resident in United States or any of its possessions

77

DO NOT WRITE UNDER THIS LINE ... FOR SEC USE ONLY

WORK LOCATION	REPORT DATE MM/DD/YY	DOC. SEQ. NO.	CARD				
50	51	52	53				

**FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT  
PART IIA**

BROKER OR DEALER **KMS FINANCIAL SERVICES, INC.**

**N 3**

100

**STATEMENT OF FINANCIAL CONDITION FOR NONCARRYING, NONCLEARING AND  
CERTAIN OTHER BROKERS OR DEALERS**

as of (MM/DD/YY) 12/31/01 99  
 SEC FILE NO. 8-15433 98  
 Consolidated  198  
 Unconsolidated  199

**ASSETS**

Allowable

Non-Allowable

Total

1. Cash .....	\$ 231,046	200	\$ 231,046	750
2. Receivables from brokers or dealers:				
A. Clearance account .....		295		
B. Other .....	1,471,385	300	1,471,385	810
3. Receivables from non-customers .....	213,173	355	213,173	830
4. Securities and spot commodities owned, at market value:				
A. Exempted securities .....		418		
B. Debt securities .....	3,934,105	419		
C. Options .....		420		
D. Other securities .....	413,270	424		
E. Spot commodities .....		430	4,347,375	850
5. Securities and/or other investments not readily marketable:				
A. At cost $\nabla$ \$ .....		130		
B. At estimated fair value .....		440	610	860
6. Securities borrowed under subordination agree- ments and partners' individual and capital securities accounts, at market value:		460	630	880
A. Exempted securities \$ .....		150		
B. Other securities \$ .....		160		
7. Secured demand notes: .....		470	640	890
market value of collateral:				
A. Exempted securities \$ .....		170		
B. Other securities \$ .....		180		
8. Memberships in exchanges:				
A. Owned, at market \$ .....		190		
B. Owned, at cost .....			650	
C. Contributed for use of the company, at market value .....			660	900
9. Investment in and receivables from affiliates, subsidiaries and associated partnerships .....		480	670	910
10. Property, furniture, equipment, leasehold improvements and rights under lease agreements, at cost-net of accumulated depreciation and amortization .....		490	263,616	680
11. Other assets .....	100,000	535	125,119	735
12. TOTAL ASSETS .....	\$ 6,362,979	540	\$ 388,735	740
			\$ 6,751,714	940



**FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT  
PART IIA**

BROKER OR DEALER **KMS FINANCIAL SERVICES, INC.**

as of 12/31/01

**STATEMENT OF FINANCIAL CONDITION FOR NONCARRYING, NONCLEARING  
AND CERTAIN OTHER BROKERS OR DEALERS**

**LIABILITIES AND OWNERSHIP EQUITY**

<u>Liabilities</u>	<u>A.I. Liabilities</u>	<u>Non-A.I. Liabilities</u>	<u>Total</u>
13. Bank loans payable.....	\$ 1045	\$ 1255	\$ 1470
14. Payable to brokers or dealers:			
A. Clearance account.....	1114	1315	1560
B. Other.....	1,243,898	1305	1,243,898
15. Payable to non-customers.....	205,409	1355	205,409
16. Securities sold not yet purchased, at market value.....		1360	1620
17. Accounts payable, accrued liabilities, expenses and other.....	1,396,419	1385	1,396,419
18. Notes and mortgages payable:			
A. Unsecured.....	850,000		850,000
B. Secured.....	1211	1390	1700
19. Liabilities subordinated to claims of general creditors:			
A. Cash borrowings:			
1. from outsiders \$.....	970		
2. Includes equity subordination (15c3-1 (d)) of .... \$.....	980		
B. Securities borrowings, at market value:...			
from outsiders \$.....	990		
C. Pursuant to secured demand note collateral agreements:.....			
1. from outsider: \$.....	1000		
2. Includes equity subordination (15c3-1 (d)) of .... \$.....	1010		
D. Exchange memberships contributed for use of company, at market value.....			
E. Accounts and other borrowings not qualified for net capital purposes.....	1220	1440	1750
20. TOTAL LIABILITIES.....	\$ 3,695,726	\$ 1450	\$ 3,695,726

**Ownership Equity**

21. Sole proprietorship.....		\$ 1770
22. Partnership (limited partners.....)	\$ 1020	\$ 1780
23. Corporation:		
A. Preferred stock.....		1791
B. Common stock.....		260,374
C. Additional paid-in capital.....		1793
D. Retained earnings.....		2,795,614
E. Total.....		3,055,988
F. Less capital stock in treasury.....		(1796)
24. TOTAL OWNERSHIP EQUITY.....		\$ 3,055,988
25. TOTAL LIABILITIES AND OWNERSHIP EQUITY.....		\$ 6,751,714

**FINANCIAL AND OPERATION COMBINED UNIFORM SINGLE REPORT  
PART IIA**

**BROKER OR DEALER** KMS FINANCIAL SERVICES, INC.

as of 12/31/01

**COMPUTATION OF NET CAPITAL**

1. Total ownership equity from Statement of Financial Condition .....	\$	3,055,988		3480
2. Deduct ownership equity not allowable for Net Capital .....	19	(		3490
3. Total ownership equity qualified for Net Capital .....		3,055,988		3500
4. Add:				
A. Liabilities subordinated to claims of general creditors allowable in computation of net capital .....				3520
B. Other (deductions) or allowable credits (List) .....				3525
5. Total capital and allowable subordinated liabilities .....	\$	3,055,988		3530
6. Deductions and/or charges:				
A. Total nonallowable assets from Statement of Financial Condition (Notes B and C) .....	17	\$ 388,735		3540
B. Secured demand note deficiency .....				3590
C. Commodity futures contracts and spot commodities- proprietary capital charges .....				3600
D. Other deductions and/or charges .....				3610
7. Other additions and/or allowable credits (List) .....			( 388,735 )	3620
8. Net capital before haircuts on securities positions .....	20	\$	2,667,253	3640
9. Haircuts on securities (computed, where applicable, pursuant to 15c3-1 (f)):				
A. Contractual securities commitments .....		\$		3660
B. Subordinated securities borrowings .....				3670
C. Trading and investment securities:				
1. Exempted securities .....	18			3735
2. Debt securities .....		78,682		3733
3. Options .....				3730
4. Other securities .....		123,981		3734
D. Undue Concentration .....				3650
E. Other (List) .....				3736
10. Net Capital .....			( 202,663 )	3740
	\$	2,464,590		3750

OMIT PENNIES

**FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT  
PART IIA**

BROKER OR DEALER **KMS FINANCIAL SERVICES, INC.**

as of 12/31/01

**COMPUTATION OF BASIC NET CAPITAL REQUIREMENT**

**Part A**

11. Minimum net capital required (6-2/3% of line 19) .....	\$	246,382	3756
12. Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A) .....	\$	250,000	3758
13. Net capital requirement (greater of line 11 or 12) .....	\$	250,000	3760
14. Excess net capital (line 10 less 13) .....	\$	2,214,590	3770
15. Excess net capital at 1000% (line 10 less 10% of line 19) .....	▼ \$	2,095,017	3780

**COMPUTATION OF AGGREGATE INDEBTEDNESS**

16. Total A.I. liabilities from Statement of Financial Condition .....	\$	3,695,726	3790
17. Add:			
A. Drafts for immediate credit .....	▼ \$	3800	
B. Market value of securities borrowed for which no equivalent value is paid or credited .....	\$	3810	
C. Other unrecorded amounts (List) .....	\$	3820	3830
19. Total aggregate indebtedness .....	\$	3,695,726	3840
20. Percentage of aggregate indebtedness to net capital (line 19 ÷ by line 10) .....	%	1.50 TO 1	3850
21. Percentage of debt to debt-equity total computed in accordance with Rule 15c3-1 (d) .....	%	N/A	3860

**COMPUTATION OF ALTERNATE NET CAPITAL REQUIREMENT**

**Part B**

22. 2% of combined aggregate debit items as shown in Formula for Reserve Requirements pursuant to Rule 15c3-3 prepared as of the date of the net capital computation including both brokers or dealers and consolidated subsidiaries' debits .....	\$	N/A	3870
23. Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A) .....	▼ \$		3880
24. Net capital requirement (greater of line 22 or 23) .....	\$		3760
25. Excess net capital (line 10 less 24) .....	\$		3910
26. Net capital in excess of the greater of:			
A. 5% of combined aggregate debit items or \$120,000 .....	\$		3920

**NOTES:**

- (A) The minimum net capital requirement should be computed by adding the minimum dollar net capital requirement of the reporting broker dealer and, for each subsidiary to be consolidated, the greater of:
1. Minimum dollar net capital requirement, or
  2. 6-2/3% of aggregate indebtedness or 4% of aggregate debits if alternative method is used.
- (B) Do not deduct the value of securities borrowed under subordination agreements or secured demand note covered by subordination agreements not in satisfactory form and the market values of memberships in exchanges contributed for use of company (contra to item 1740) and partners' securities which were included in non-allowable assets.
- (C) For reports filed pursuant to paragraph (d) of Rule 17a-5, respondent should provide a list of material non-allowable assets.

**FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT  
PART IIA**

**BROKER OR DEALER** KMS FINANCIAL SERVICES, INC.

For the period (MMDDYY) from 01/01/01 3932 to 12/31/01 3933  
Number of months included in this statement 12 3931

**STATEMENT OF INCOME (LOSS)**

**REVENUE**

1. Commissions:		
a. Commissions on transactions in exchange listed equity securities executed on an exchange	\$ 1,844,145	3935
b. Commissions on listed option transactions		3938
c. All other securities commissions	4,898,032	3939
d. Total securities commissions		3940
2. Gains or losses on firm securities trading accounts		
a. From market making in options on a national securities exchange		3945
b. From all other trading		3949
c. Total gain (loss)		3950
3. Gains or losses on firm securities investment accounts	(10,829)	3952
4. Profit (loss) from underwriting and selling groups		3955
5. Revenue from sale of investment company shares	15,308,085	3970
6. Commodities revenue		3990
7. Fees for account supervision, investment advisory and administrative services	5,188,632	3975
8. Other revenue	1,700,693	3995
9. Total revenue	\$ 28,928,758	4030

**EXPENSES**

10. Salaries and other employment costs for general partners and voting stockholder officers	\$ 1,787,785	4120
11. Other employee compensation and benefits	1,044,125	4115
12. Commissions paid to other broker-dealers		4140
13. Interest expense	65,359	4075
a. Includes interest on accounts subject to subordination agreements	-0- 4070	
14. Regulatory fees and expenses	52,330	4195
15. Other expenses	24,774,485	4100
16. Total expenses	\$ 27,724,084	4200

**NET INCOME**

17. Net income (loss) before Federal income taxes and items below (Item 9 less Item 16)	\$ 1,204,674	4210
18. Provision for Federal income taxes (for parent only)	416,000	4220
19. Equity in earnings (losses) of unconsolidated subsidiaries not included above		4222
a. After Federal income taxes of	4238	
20. Extraordinary gains (losses)		4224
a. After Federal income taxes of	4239	
21. Cumulative effect of changes in accounting principles		4225
22. Net income (loss) after Federal income taxes and extraordinary items	\$ 788,674	4230

**MONTHLY INCOME**

23. Income (current month only) before provision for Federal income taxes and extraordinary items	\$	N/A	4211
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**FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT  
PART IIA**

**BROKER OR DEALER** KMS FINANCIAL SERVICES, INC.

For the period (MMDDYY) from 01/01/01 to 12/31/01

**STATEMENT OF CHANGES IN OWNERSHIP EQUITY  
(SOLE PROPRIETORSHIP, PARTNERSHIP OR CORPORATION)**

1. Balance, beginning of period.....	\$	2,267,314	4240
A. Net income (loss).....		788,674	4250
B. Additions (Includes non-conforming capital of.....)	\$	4262	4260
C. Deductions (Includes non-conforming capital of.....)	\$	4272	4270
2. Balance, end of period (From item 1800).....	\$	3,055,988	4290

**STATEMENT OF CHANGES IN LIABILITIES SUBORDINATED  
TO CLAIMS OF GENERAL CREDITORS**

3. Balance, beginning of period.....	\$	N/A	4300
A. Increases.....			4310
B. Decreases.....			4320
4. Balance, end of period (From item 3520).....	\$	N/A	4330

OMIT PENNIES

**FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT  
PART IIA**

**BROKER OR DEALER**    **KMS FINANCIAL SERVICES, INC.**

as of 12/31/01

**Exemptive Provision Under Rule 15c3-3**

25. Identify below the section upon which an exemption from Rule 15c3-3 is claimed:

- A. (k) (1) – \$2,500 capital category as per Rule 15c3-1..... 4550
- C. (k) (2) (B) – All customer transactions cleared through another broker-dealer on a fully disclosed basis  
 Name of clearing firm <sup>30</sup> DONALDSON, LUFKIN & JENRETE 4335 X 4570
- D. (k) (3) – Exempted by order of the Commission (include copy of letter)..... 4580
- CLEARING FIRM SEC#: 8-17574**

**Ownership Equity and Subordinated Liabilities maturing or proposed to be withdrawn within the next six months and accruals, (as defined below), which have not been deducted in the computation of Net Capital.**

Type of Proposed Withdrawal or Accrual (See below for code)	Name of Lender or Contributor	Insider or Outsider? (In or Out)	Amount to be withdrawn (cash amount and/or Net Capital Value of Securities)	(MMDDYY) Withdrawal or Maturity Date	Expect to Renew (yes or no)
▼ <sup>31</sup> 4600	4601	4602	\$ 4603	4604	4605
▼ <sup>32</sup> 4610	4611	4612	4613	4614	4615
▼ <sup>33</sup> 4620	4621	4622	4623	4624	4625
▼ <sup>34</sup> 4630	4631	4632	4633	4634	4635
▼ <sup>35</sup> 4640	4641	4642	4643	4644	4645
			Total \$ <sup>36</sup> <u>N/A</u> 4699		

OMIT PENNIES

**Instructions:** Detail Listing must include the total of items maturing during the six month period following the report date, regardless of whether or not the capital contribution is expected to be renewed. The schedule must also include proposed capital withdrawals scheduled within the six month period following the report date including the proposed redemption of stock and anticipated accruals which would cause a reduction of Net Capital. These anticipated accruals would include amounts of bonuses, partners' drawing accounts, taxes, and interest on capital, voluntary contributions to pension or profit sharing plans, etc., which have not been deducted in the computation of Net Capital, but which you anticipate will be paid within the next six months.

<b>WITHDRAWAL CODE:</b>	<b>DESCRIPTION</b>
1.	Equity Capital
2.	Subordinated Liabilities
3.	Accruals

KMS FINANCIAL SERVICES, INC.  
 COMPUTATION OF NET CAPITAL UNDER RULE 15c3-1 OF THE  
 SECURITIES AND EXCHANGE COMMISSION  
 December 31, 2001

NET CAPITAL

Total stockholder's equity qualified for net capital	\$3,055,988
Deductions and/or charges:	
A. Non-allowable assets	
Property, furniture, equipment and leasehold improvements (net of accumulated depreciation)	\$263,616
Other receivables and prepaid expenses	104,401
Advances to registered representatives	<u>20,718</u>
	388,735
Net capital before haircuts on securities positions	<u>2,667,253</u>
Haircuts on securities (computed, where applicable, pursuant to Rule 15c3-1(f)):	
C. Trading and investment securities	
2. Debt securities	78,682
4. Other securities	<u>123,981</u>
Net capital	<u><u>\$2,464,590</u></u>

AGGREGATE INDEBTEDNESS

Items included in statement of financial condition	
Payable to brokers or dealers	\$ 205,409
Accounts payable	231,146
Accrued expenses and other liabilities	496,164
Commissions payable	1,243,898
Note payable to stockholder	850,000
Deferred retirement payable	669,109
Total aggregate indebtedness	<u><u>\$3,695,726</u></u>

COMPUTATION OF BASIS NET CAPITAL REQUIREMENT

Minimum net capital required	<u>\$246,382</u>
Minimum dollar net capital required of reporting broker or dealer	<u>\$250,000</u>
Excess net capital	<u>\$2,214,590</u>
Excess net capital at 1000%	<u>\$2,095,017</u>
Ratio: Aggregate indebtedness to net capital	<u>1.50 to 1</u>

KMS FINANCIAL SERVICES, INC.  
COMPUTATION OF NET CAPITAL UNDER RULE 15c3-1 OF THE  
SECURITIES AND EXCHANGE COMMISSION

(Continued)

December 31, 2001

RECONCILIATION WITH COMPANY'S COMPUTATION

(included in Part IIA of Form X-17A-5 as  
of December 31, 2000)

Net capital, as reported in Company's Part IIA (Unaudited) FOCUS report	\$2,399,012
Audit adjustments increasing allowable assets	
Commissions receivable	289,242
Audit adjustments increasing A.I. Liabilities	
Trade accounts payable	(15,209)
Federal income taxes currently payable	(14,690)
Commissions payable	(251,283)
Audit adjustments decreasing Haircuts on securities	57,518
Net capital as computed per this schedule	<u>\$2,464,590</u>



**HAGELIN & ASSOCIATES**  
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INDEPENDENT AUDITOR'S REPORT ON INTERNAL  
CONTROL REQUIRED BY RULE 17a-5 OF THE  
SECURITIES AND EXCHANGE COMMISSION

Board of Directors  
KMS Financial Services, Inc.

We have audited the financial statements of KMS Financial Services, Inc. as of and for the year ended December 31, 2001, and have issued our report thereon dated February 11, 2002. In planning and performing our audit of the financial statements and supplemental schedules of KMS Financial Services, Inc. for the year ended December 31, 2001, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control.

Also, as required by Rule 17a-5(g)(1) of the Securities and Exchange Commission, we have made a study of the practices and procedures (including tests of compliance with such practices and procedures) followed by KMS Financial Services, Inc. that we considered relevant to the objectives stated in Rule 17a-5(g) in making the periodic computations of aggregate indebtedness (or aggregate debits) and net capital under Rule 17a-3(a)(11) and the procedures for determining compliance with the exemptive provisions of Rule 15c3-3.

Because the Company does not carry securities accounts for customers or perform custodial functions relating to customer securities, we did not review the practices and procedures followed by the Company in any of the following:

1. Making the quarterly securities examinations, counts, verifications and comparisons.
2. Recordation of differences required by Rule 17a-13.
3. Complying with the requirements for prompt payment for securities under Section 8 of Federal Reserve Regulation T of the Board of Governors of the Federal Reserve System.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL  
CONTROL REQUIRED BY RULE 17a-5 OF THE  
SECURITIES AND EXCHANGE COMMISSION

(Continued)

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The management of the Company is responsible for establishing and maintaining internal control and the practices and procedures referred to in the preceding paragraph. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of controls and of the practices and procedures referred to in the preceding paragraph and to assess whether those practices and procedures can be expected to achieve the Commission's above-mentioned objectives. Two of the objectives of internal control and the practices and procedures are to provide management with reasonable, but not absolute assurance that assets for which the Company has responsibility are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit preparation of financial statements in conformity with generally accepted accounting principles. Rule 17a-5(g) lists additional objectives of the practices and procedures listed in the preceding paragraph.

Because of inherent limitations in internal control or the practices and procedures referred to above, error or fraud may occur and not be detected. Also, projection of any evaluation of them to future periods is subject to the risk that they may become inadequate because of changes in conditions or that the effectiveness of their design and operation may deteriorate.

Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of the specific internal control components does not reduce to a relatively low level the risk that error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving internal control that we consider to be material weaknesses as defined above.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL  
CONTROL REQUIRED BY RULE 17a-5 OF THE  
SECURITIES AND EXCHANGE COMMISSION

(Continued)

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We understand that practices and procedures that accomplish the objectives referred to in the second paragraph of this report are considered by the Commission to be adequate for its purposes in accordance with the Securities Exchange Act of 1934 and related regulations, and that practices and procedures that do not accomplish such objectives in all material respects indicate a material inadequacy for such purposes. Based on this understanding and on our study, we believe that the Company's practices and procedures were adequate at December 31, 2001, to meet the Commission's objectives.

This report is intended solely for the information and use of the Board of Directors, management, the Securities and Exchange Commission, the National Association of Securities Dealers, Inc. and other regulatory agencies that rely on Rule 17a-5(g) under the Securities Exchange Act of 1934 in their regulation of registered brokers and dealers, and is not intended to be and should not be used by anyone other than these specified parties.

*Hagelin & Associates*

Seattle, Washington

February 11, 2002

**KMS FINANCIAL SERVICES, INC.**

**Audited Financial Statements**

**Financial and Operational Combined Uniform**

**Single Report – Parts III and IIA**

**Independent Auditor's Report on Internal Control**

**December 31, 2001**

**HAGELIN & ASSOCIATES**  
CERTIFIED PUBLIC ACCOUNTANTS

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