

cm



UNITED STATES SECURITIES AND EXCHANGE COMMISSION Washington, D.C. 20549



SEC FILE NUMBER 8 - 28164

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

FV 8-30-02

REPORT FOR THE PERIOD BEGINNING 07/01/01 AND ENDING 06/30/02 MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER: Prospera Financial Services, Inc.

OFFICIAL USE ONLY FIRM ID. NO.

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

5429 LBJ Freeway, Suite 400 (No. and Street) Dallas Texas 75240 (City) (State) (Zip Code)

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

(Area Code - Telephone No.)

B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report*

Brad A. Kinder, CPA (Name - if individual, state last, first, middle name) 400 Parker Square, Suite 200K Flower Mound Texas 75028 (Address) (City) (State) (Zip Code)

CHECK ONE:

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

PROCESSED SEP 11 2002

FOR OFFICIAL USE ONLY THOMSON FINANCIAL

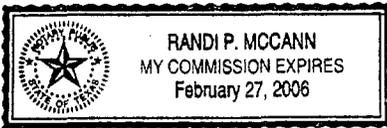
*Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See section 240.17a-5(e)(2).

Handwritten initials

OATH OR AFFIRMATION

I, David Stringer, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of Prospera Financial Services, Inc., as of June 30, 2002, 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



[Signature]
Signature
President
Title

Randi P. McCann 8/27/12
Notary Public

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

- (a) Facing page.
- (b) Statement of Financial Condition.
- (c) Statement of Income (Loss).
- (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 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 the internal control as required by SEC rule 17a-5.

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

CONTENTS

INDEPENDENT AUDITOR'S REPORT	1
------------------------------	---

FINANCIAL STATEMENTS

Statement of financial condition	2
Statement of income	3
Statement of changes in stockholders' equity	4
Statement of cash flows	5
Notes to financial statements	6 - 10

SUPPLEMENTARY SCHEDULE

1. Computation of net capital and aggregate indebtedness pursuant to Rule 15c3-1	11
---	----

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL	12 - 13
---	---------

BRAD A. KINDER, CPA

CERTIFIED PUBLIC ACCOUNTANT

400 PARKER SQUARE • SUITE 250-K • FLOWER MOUND, TX 75028
972-899-1170 • FAX 972-899-1172

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Prospera Financial Services, Inc.

We have audited the accompanying statement of financial condition of Prospera Financial Services, Inc. as of June 30, 2002, and the related statements of income, changes in stockholder's equity, and cash flows for the year then ended that you are filing pursuant to rule 17a-5 under the Securities Exchange Act of 1934. 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 Prospera Financial Services, Inc. as of June 30, 2002, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The information contained in Schedule I 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 under the Securities Exchange Act of 1934. Such information has been subjected to the 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.



BRAD A. KINDER, CPA

Flower Mound, Texas
July 23, 2002

PROSPERA FINANCIAL SERVICES, INC.
Statement of Financial Condition
June 30, 2002

ASSETS

Cash and cash equivalents	\$ 378,764
Commissions receivable	449,715
Receivable from related parties	30,220
Receivables - other	20,811
Marketable securities	1,800
Advances to employees	26,979
Clearing deposits	100,789
Non-marketable securities	172,300
Other assets	2,423

TOTAL ASSETS \$ 1,183,801

LIABILITIES AND STOCKHOLDER'S EQUITY

Liabilities

Accounts payable	\$ 113,602
Accrued expenses	472,144
Total Liabilities	<u>585,746</u>

Stockholder's Equity

Preferred stock, no par value, 1,000,000 shares authorized, none issued and outstanding	-
Common stock, no par value, 1,000,000 shares authorized, 120,000 shares issued, and 86,664 shares outstanding	38,272
Additional paid-in capital	379,339
Retained earnings	204,456
Treasury stock, 33,336 shares at cost	<u>(24,012)</u>
Total Stockholder's Equity	<u>598,055</u>

TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY \$ 1,183,801

PROSPERA FINANCIAL SERVICES, INC.

Statement of Income
Year Ended June 30, 2002

Revenue

Commissions	\$ 8,491,360
Management and advisory fees	1,333,040
Other	<u>502,829</u>
Total Revenue	<u>10,327,229</u>

Expenses

Compensation and related costs	7,217,166
Clearing costs	408,212
Communications	485,839
Errors and bad debts	16,392
Management fees to Parent	1,270,617
Occupancy and equipment	449,394
Promotional	123,890
Professional fees	137,078
Regulatory fees	98,164
Other expenses	<u>153,223</u>
Total Expenses	<u>10,359,975</u>
NET LOSS	<u><u>\$ (32,746)</u></u>

PROSPERA FINANCIAL SERVICES, INC.
Statement of Changes in Stockholder's Equity
Year Ended June 30, 2002

	<u>Preferred Shares</u>	<u>Common Shares</u>	<u>Treasury Shares</u>	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Treasury Stock</u>	<u>Total</u>
Balances at June 30, 2001	-	120,000	33,336	\$ 38,272	\$ 379,339	\$ 237,202	\$ (24,012)	\$ 630,801
Net loss	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(32,746)</u>	<u>-</u>	<u>(32,746)</u>
Balances at June 30, 2002	<u>-</u>	<u>120,000</u>	<u>33,336</u>	<u>\$ 38,272</u>	<u>\$ 379,339</u>	<u>\$ 204,456</u>	<u>\$ (24,012)</u>	<u>\$ 598,055</u>

PROSPERA FINANCIAL SERVICES, INC.
Statement of Cash Flows
For the Year Ended June 30, 2002

Cash Flows From Operating Activities:

Net loss	\$ (32,746)
Adjustments to reconcile net loss to net cash used in operating activities:	
Increase in commissions receivable	(122,601)
Increase in receivable from related parties	(28,327)
Increase in receivables - other	(20,811)
Increase in advances to employees	(9,904)
Decrease in prepaid expenses	62,156
Increase in clearing deposits	(20,775)
Increase in accounts payable	113,602
Decrease in accrued expenses	(60,502)
Decrease in income taxes payable	<u>(7,294)</u>
Net cash used in operating activities	<u>(127,202)</u>

Cash Flows From Investing Activities:

Purchase of marketable securities	<u>(1,800)</u>
Net decrease in cash and cash equivalents	(129,002)
Cash and cash equivalents at beginning of year	<u>507,766</u>
 CASH AND CASH EQUIVALENTS AT END OF YEAR	 <u><u>\$ 378,764</u></u>

Supplemental Disclosures of Cash Flow Information:

Cash paid during the year for:

Interest	<u><u>\$ -</u></u>
Income taxes	<u><u>\$ 7,294</u></u>

PROSPERA FINANCIAL SERVICES, INC.
Notes to Financial Statements

Note 1 - Nature of Business and Summary of Significant Accounting Policies

Nature of Business:

Prospera Financial Services, Inc. (Company) was organized in July 1982 as a Texas corporation. The Company is a wholly-owned subsidiary of Prospera Holdings, Inc. (Parent). The Company is a broker-dealer in securities registered with the Securities and Exchange Commission (SEC) under the exemptive provisions of SEC rule 15c3-3 (k)(2)(ii). These provisions provide that all the funds and securities belonging to Company's customers be handled by a clearing broker-dealer.

The majority of the Company's customers are individuals located throughout the United States, primarily in Texas.

Significant Accounting Policies:

Basis of Accounting

The Company operates under the provisions of Paragraph (k)(2)(ii) of Rule 15c3-3 of the SEC and, accordingly, is exempt from the remaining provisions of that Rule. Essentially, the requirements of Paragraph (k)(2)(ii) provide that the Company clear all transactions on behalf of customers on a fully disclosed basis with a clearing broker/dealer, and promptly transmit all customer funds and securities to the clearing broker/dealer. The clearing broker/dealer carries all of the accounts of the customers and maintains and preserves all related books and records as are customarily kept by a clearing broker/dealer.

Use of Estimates

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 statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash Equivalents

Money market funds are reflected as cash equivalents in the accompanying statement of financial condition and for purposes of the statement of cash flows.

Treasury Stock

Treasury stock is accounted for using the cost method.

PROSPERA FINANCIAL SERVICES, INC.
Notes to Financial Statements

Note 1 - Nature of Business and Summary of Significant Accounting Policies (continued)

Securities Transactions

Security transactions and the related commission revenues and expenses are recorded on the trade date.

Note 2 - Transactions with Clearing Broker/Dealers

The agreements with the clearing broker/dealers provide for clearing charges at a fixed rate multiplied by the number of tickets traded by the Company. The agreements also require the Company to maintain a minimum of \$100,000 as a deposit in accounts with the clearing broker/dealers.

Note 3 - Net Capital Requirements

The Company is subject to the SEC uniform net capital rule (Rule 15c3-1), which requires the maintenance of a minimum amount of net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1. Rule 15c3-1 also provides that equity capital may not be withdrawn or cash dividends paid if the resulting net capital ratio would exceed 10 to 1. At June 30, 2002, the Company had net capital and net capital requirements of \$297,989 and \$50,000, respectively. The Company's net capital ratio was 1.97 to 1.

Note 4 - Non-Marketable Securities

Non-marketable securities consist of a sports facilities municipal bond and four season ticket seat and option certificates at a total cost of \$11,000, 10,000 shares of common stock of the Nasdaq Stock Market, Inc. at a cost of \$130,000 and 2,300 warrants of the NASD to purchase shares of common stock of the Nasdaq Stock Market, Inc. at a cost of \$31,300. Each warrant entitles the Company to purchase four shares of common stock. The warrants are exercisable as follows.

<u>Shares subject to exercise</u>	<u>Exercisable On or After</u>	<u>Expiration</u>	<u>Exercise Price</u>
2,300	June 28, 2002	June 27, 2003	\$13
2,300	June 30, 2003	June 25, 2004	\$14
2,300	June 28, 2004	June 27, 2005	\$15
2,300	June 28, 2005	June 27, 2006	\$16

PROSPERA FINANCIAL SERVICES, INC.
Notes to Financial Statements

Note 5 - Commitments and Contingencies

Operating Leases

The Company leases office space, equipment and automobiles under noncancelable operating leases expiring in various years through February 2006. Future minimum lease commitments for each of the years ending June 30 are as follows:

2003	\$ 351,561
2004	317,137
2005	296,765
2006	56,667
Thereafter	<u>-</u>
	<u>\$ 1,022,130</u>

Rent expense for the year totaled \$188,513 and is reflected in the accompanying statement of income as occupancy and equipment costs.

Arbitrations

The Company has been named as a defendant in a number of actions relating to its activities as a broker-dealer in securities. Some of the actions seek damages of material or indeterminate amounts. While the ultimate outcome of the pending arbitrations involving the Company cannot be predicted with certainty, management, having reviewed these actions with its counsel, believes it has meritorious defenses to all such actions and intends to defend each of them vigorously.

Although there can be no assurance that such actions will not have a material adverse effect on the Company's financial position, results of operations or cash flows in any future period, in the opinion of management of the Company, based upon advice of counsel, the ultimate resolution of any such actions against the Company will not have a material adverse effect on its financial condition.

PROSPERA FINANCIAL SERVICES, INC.
Notes to Financial Statements

Note 6 - Profit Sharing Plan

Prospera Financial Services 401(k) Profit Sharing Plan (Plan) to which both the Company and eligible employees may contribute was established effective April 1, 2000. Participants from the previous plan dated January 1, 1994 became immediately eligible to participate in the Plan. The Plan is on a calendar year with employee entrance dates after the completion of 1,000 hours of service on January 1 and July 1. Company contributions are voluntary and at the discretion of the board of directors.

Employee salary deferral contributions and earnings on such contributions are 100% vested. Company matching and profit sharing contributions are subject to the following vesting schedule:

<u>Years of Service</u>	<u>Vested Portion</u>
Less than 2	0%
2 but less than 3	20%
3 but less than 4	40%
4 but less than 5	60%
5 but less than 6	80%
6 or more	100%

For the year ended June 30, 2002, the Company made contributions to the plan of \$33,777, and recognized \$4,204 in profit sharing plan expense.

Note 7 - Stock Appreciation Rights Plan

The Company has a Stock Appreciation Rights Plan which allows the Board to grant units to employees or independent contractors. The units, if granted, have a vesting schedule and if a Triggering Event, as defined, occurs the employees and/or independent contractors will be entitled to up to a maximum of 10% of the Net Proceeds, as defined, realized as a result of the Triggering Event.

Note 8 - Off-Balance-Sheet Risk and Concentration of Credit Risk

As discussed in Note 1, the Company's customers' securities transactions are introduced on a fully disclosed basis with its clearing broker/dealer. The clearing broker/dealer carries all of the accounts of the customers of the Company and is responsible for execution, collection and payment of funds, and receipt and delivery of securities relative to customer transactions. Off-balance-sheet risk exists with respect to these transactions due to the possibility that customers may be unable to fulfill their contractual commitments wherein the clearing broker/dealer may charge any losses it incurs to the Company. The Company seeks to minimize this risk through procedures designed to monitor the credit worthiness of its customers and that customer transactions are executed properly by the clearing broker/dealer.

PROSPERA FINANCIAL SERVICES, INC.
Notes to Financial Statements

Note 8 - Off-Balance-Sheet Risk and Concentration of Credit Risk (continued)

Cash held at two banks exceeded the federally insured limit by \$8,822 and \$64,875 at June 30, 2002; however, these at-risk amounts are subject to significant fluctuations on a daily basis throughout the year.

The Company has receivables due from one clearing broker/dealer of \$296,091, or approximately 25% of its total assets at June 30, 2002.

Note 9 - Related Party Transactions

Under an agreement (Agreement) with the Company's Parent, the Company incurs management fees to its Parent for management services, office space, office furniture, administrative assistance, telephone, computer equipment, and other necessary and reasonable business services and expenses. The amount of the fee is equal to the net profit of the Company, less such amount as may be necessary to maintain at least 150% of the net capital requirement of the Company. Under the Agreement, management fees not paid are forgiven, and do not accumulate or accrue. This Agreement was not consummated on terms equivalent to an arms length transaction. The Company incurred management fees to its Parent totaling \$1,270,618 for the year ended June 30, 2002. The management fees consisted of the following:

Cash paid to Parent	\$268,050
Management compensation and benefits paid on behalf of Parent	737,260
Office rent paid on behalf of Parent	<u>265,308</u>
Total	<u>\$1,270,618</u>

The Company's receivables from related parties totaled \$30,220 and are unsecured, non-interest bearing and due on demand.

The Company earned \$498,524 in insurance commissions from a related party, of which \$49,647 are due at June 30, 2002 and are included in commission receivable in the accompanying statement of financial condition.

Schedule I

PROSPERA FINANCIAL SERVICES, INC.
Computation of Net Capital and Aggregate
Indebtedness Pursuant to Rule 15c3-1
June 30, 2002

Total stockholder's equity qualified for net capital	\$ 598,055
Other deduction:	
Excess fidelity bond deductible	<u>44,000</u>
Total Capital	<u>554,055</u>
Deductions and/or charges	
Non-allowable assets:	
Receivable from related parties	30,220
Receivables - other	20,811
Advances to employees	26,979
Non-marketable securities	172,300
Other assets	<u>2,423</u>
Total deductions and/or charges	<u>252,733</u>
Net capital before haircuts on securities positions	<u>301,322</u>
Haircuts on securities:	
Cash equivalents	3,063
Marketable securities	<u>270</u>
Total haircuts on securities	<u>3,333</u>
Net Capital	<u><u>\$ 297,989</u></u>
Aggregate indebtedness	
Accounts payable	\$ 113,602
Accrued expenses	<u>472,144</u>
Total aggregate indebtedness	<u><u>\$ 585,746</u></u>
Computation of basic net capital requirement	
Minimum net capital required (greater of \$50,000 or	
6 2/3% of aggregate indebtedness)	<u>\$ 50,000</u>
Net capital in excess of minimum requirement	<u><u>\$ 247,989</u></u>
Ratio of aggregate indebtedness to net capital	<u><u>1.97 to 1</u></u>

Note: The above computation does not differ from the computation of net capital under Rule 15c3-1 as of June 30, 2002 as filed by Prospera Financial Services, Inc. on Form X-17A-5. Accordingly, no reconciliation is deemed necessary.

BRAD A. KINDER, CPA

CERTIFIED PUBLIC ACCOUNTANT

400 PARKER SQUARE • SUITE 250-K • FLOWER MOUND, TX 75028
972-899-1170 • FAX 972-899-1172

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL

Board of Directors
Prospera Financial Services, Inc.

In planning and performing our audit of the financial statements and supplemental schedule of Prospera Financial Services, Inc. (the Company) for the year ended June 30, 2002, we considered its internal control, including control activities for safeguarding securities, in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control.

Also as required by rule 17a-5(g)(1) of the Securities and Exchange Commission (SEC), we have made a study of the practices and procedures followed by the Company including tests of such practices and procedures that we considered relevant to the objectives stated in rule 17a-5(g) in making the periodic computations of aggregate indebtedness and net capital under rule 17a-3(a)(11) and 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 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.

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 SEC'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 accordance 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, including control activities for safeguarding securities that we consider to be material weaknesses as defined above.

We understand that practices and procedures that accomplish the objectives referred to in the second paragraph of this report are considered by the SEC 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 June 30, 2002 to meet the SEC's objectives.

This report is intended solely for use of the Board of Directors, management, the SEC, 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.



BRAD A. KINDER, CPA

Flower Mound, Texas
July 23, 2002