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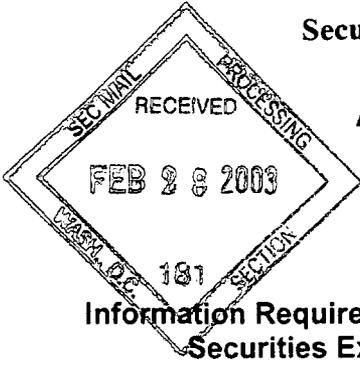


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Expires: September 30, 1998  
Estimated average burden hours per response...12.00

503/6/03



Annual Audited Report Form X-17A-5 Part III

SEC FILE Number  
8-24385-

31632

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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 1/1/02 AND ENDING 12/31/02  
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER:

Birchtree Financial Services, Inc.

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OFFICIAL USE ONLY

[Empty box]

Firm ID. NO.

ADDRESS OF PRINCIPAL PLACE OF BUSINESS: (Do not use P.O. Box)

4400 Blue Parkway

(No. and Street)

Kansas City

MO

64130

(City)

(State)

(Zip Code)

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

Kevin Harris

816/932-4937

(Area Code - Telephone No.)

B. ACCOUNTANT IDENTIFICATION

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

PricewaterhouseCoopers LLP

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

1055 Broadway, 10<sup>th</sup> Floor

Kansas City

MO

64105

(Address)

(City)

(State)

(Zip Code)

CHECK ONE:

Certified Public Accountant

Public Accountant

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

PROCESSED

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THOMSON FINANCIAL

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\* 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).

KJ

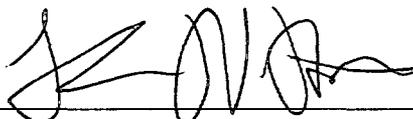
**Birchtree Financial  
Services, Inc.**

**Report and Financial Statements  
with Supplementary Schedule  
December 31, 2002**

Birchtree Financial Services, Inc.  
4400 Blue Parkway  
Kansas City, Missouri 64130

**OATH OF AFFIRMATION**

I, Kevin N. Harris, affirm that, to the best of my knowledge and belief, the accompanying financial statements and supporting schedule pertaining to the firm of Birchtree Financial Services, Inc. as of December 31, 2002, are true and correct. I further affirm that neither the company nor any principal officer or director has any proprietary interest in any account classified solely as that of a customer.

  
\_\_\_\_\_  
Signature

\_\_\_\_\_  
President  
Title

SWORN TO BEFORE ME THIS 27<sup>th</sup> DAY OF FEBRUARY 2003.

  
\_\_\_\_\_  
Notary Public

**MARGARET LISA BRUNKER**  
Notary Public - Notary Seal  
**STATE OF MISSOURI**  
Platte County  
My Commission Expires: Oct. 14, 2005

**Report of Independent Accountants**

To the Board of Directors and Stockholder of  
Birchtree Financial Services, Inc.

In our opinion, the accompanying balance sheet and the related statements of operations, of changes in stockholder's equity and of cash flows present fairly, in all material respects, the financial position of Birchtree Financial Services, Inc. (the "Company") at December 31, 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. 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 of these statements in accordance with auditing standards generally accepted in the United States of America, which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying supplementary information 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.

*PricewaterhouseCoopers LLP*

February 25, 2003

**BIRCHTREE FINANCIAL SERVICES, INC.**  
**Balance Sheet**  
**December 31, 2002**

**Assets**

Cash and cash equivalents	\$ 13,171,406
Deposit with and receivable from clearing broker	74,208
Commissions receivable	893
Insurance alliance receivable, net of allowance of \$600,000	400,000
Due from Parent	147,008
Goodwill	2,710,170
Deferred income taxes	53,959
Prepaid expenses and other assets	299,689
	<u>\$ 16,857,333</u>

**Liabilities and Stockholder's Equity**

Liabilities:

Deferred insurance alliance revenues	\$ 138,712
Commissions payable	350
Accounts payable and accrued expenses	75,071
Note payable	550,000
	<u>764,133</u>

Commitments and contingencies (See Note 7) -

Stockholder's equity:

Common stock, \$1 par value; 100,000 shares authorized; 1,000 shares issued and outstanding	1,000
Additional paid-in capital	8,634,325
Retained earnings	7,457,875
	<u>16,093,200</u>
	<u>\$ 16,857,333</u>

**BIRCHTREE FINANCIAL SERVICES, INC.**  
**Statement of Operations**  
**For the Year Ended December 31, 2002**

**Revenues**

Insurance alliance	\$ 5,053,256
Commissions	344,270
Other income	155,977
	<u>5,553,503</u>

**Expenses**

Provision for bad debts	1,900,000
Professional fees	246,597
Contract termination fees	1,984,400
Clearing fees	32,558
Commissions	94,652
General and administrative	795,643
	<u>5,053,850</u>

Income before income taxes	499,653
Income tax expense	194,365
Net income	<u>\$ 305,288</u>

See Notes to Financial Statements

**BIRCHTREE FINANCIAL SERVICES, INC.**  
**Statement of Changes in Stockholder's Equity**  
**For the Year Ended December 31, 2002**

	Class A Common <u>Stock</u>	Additional Paid-in <u>Capital</u>	Retained <u>Earnings</u>	<u>Total</u>
<b>Balances at January 1, 2002</b>	\$ 1,000	\$ 8,634,325	\$ 7,152,587	\$ 15,787,912
Net income	-	-	305,288	305,288
<b>Balances at December 31, 2002</b>	<u>\$ 1,000</u>	<u>\$ 8,634,325</u>	<u>\$ 7,457,875</u>	<u>\$ 16,093,200</u>

See Notes to Financial Statements

**BIRCHTREE FINANCIAL SERVICES, INC.**  
**Statement of Cash Flows**  
**For the Year Ended December 31, 2002**

**Cash flows from operating activities**

Net income	\$ 305,288
Adjustment to reconcile net income to net cash provided by operating activities:	
Provision for bad debts	1,900,000
Provision for deferred taxes	414,354
Changes in:	
Deposits with and receivable from clearing broker	(3,971)
Commissions receivable	25,466
Insurance alliance receivable	400,000
Advances to Parent, net	446,397
Prepaid expenses and other assets	257,096
Deferred insurance alliance revenues	(1,062,268)
Commissions payable	(19,683)
Accounts payable and accrued expenses	53,809
Note payable	550,000
Net cash provided by operating activities	3,266,488
Net increase in cash	3,266,488
Cash and cash equivalents at beginning of the year	9,904,918
Cash and cash equivalents at end of the year	\$ 13,171,406
 <b>Supplemental cash flow information:</b>	
Cash received for income taxes	\$ 17,218

**BIRCHTREE FINANCIAL SERVICES, INC.**  
**Notes to Financial Statements**  
**December 31, 2002**

**1. ORGANIZATION AND NATURE OF BUSINESS**

Birchtree Financial Services, Inc. (the "Company") is a wholly-owned subsidiary of RSM McGladrey, Inc. (the "Parent"). The Parent is an indirectly wholly-owned subsidiary of H&R Block, Inc. ("Block"). The Parent owns all outstanding Series A common shares of the Company.

The Company, located in Kansas City, Missouri, participates in an insurance alliance through which the Company and its Parent refer their financial advisory clients (through the Company's registered representatives) to independent insurance companies and independent, licensed insurance agents for certain life insurance products. (See Note 4). The Company also is a registered broker-dealer engaged in the general securities business, with registered representatives located throughout the United States. During 2002, the Company offered its services through Block company-owned and franchise offices. In December 2002, the Company completed the transfer of this portion of the business to a related party. (See Note 5).

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Management 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 and cash equivalents:* For purposes of the statement of cash flows, the Company defines cash equivalents as demand deposits, money market funds and any highly liquid debt instruments purchased with an original maturity of three months or less.

*Goodwill:* The Company adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" as of January 1, 2002. Goodwill is no longer being amortized but is subject to annual impairment testing.

While the Company's insurance alliance contracts do not stipulate mandatory future payments, the Company believes the insurance alliance will continue to provide substantial revenue in the future. The Company will closely monitor any resultant changes in the business and their impact on goodwill. No impairment was recorded as a result of the current year impairment testing.

*Revenue recognition:* Commission revenues and expenses are recorded on a trade date basis as securities transactions occur. Insurance alliance revenues consist of payments based on projected measurements, a portion of which is received upfront. Upfront payments were amortized over the amended first transaction period of the contract which was substantially expired in December 2002. The balance of the payments are performance based and are recognized as earned. (See Note 4).

*Income taxes:* The Company joins with Block in filing a consolidated federal income tax return. Currently payable and recoverable federal income taxes are calculated on the basis of the tax allocation method adopted by Block in its consolidated federal income tax return, which method charges income taxes payable and allocates recoverable income taxes to members of the consolidated group on the basis of each company's separate taxable income or loss. The Company records its currently payable or recoverable income taxes to the Due to/from Parent account. Deferred income tax assets and liabilities are provided based on enacted tax rates for the difference between the tax and financial reporting bases of assets and liabilities.

*Concentrations of credit risk:* Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of insurance alliance receivables. Insurance alliance receivables represent payments due on satisfaction of certain measurements. (See Note 4).

The Company maintains its cash accounts with two financial institutions. Each cash balance is insured by the FDIC up to \$100,000. The Company had cash on deposit at December 31, 2002 that exceeded the balance insured by the FDIC in the amount of \$8,340,303. The Company also maintains \$4,631,103 in money market funds that are not insured by the FDIC. (See Note 2).

### **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 shall not exceed 15 to 1. At December 31, 2002, the Company had net capital of \$12,363,651 which was \$12,312,709 in excess of its required net capital of \$50,942.

The aggregate indebtedness to net capital ratio was .06 to 1.

### **4. INSURANCE ALLIANCE**

In October 2000, the Company and its Parent entered into contracts with three unrelated insurance companies to refer their financial advisory clients (through the Company's registered representatives) to these companies and independent, licensed insurance agents for certain life insurance products. Both the Company and its Parent have specified obligations under the contracts, the breach of which by either party would allow for termination of the contracts. The Company has no reason to believe that the Parent will not fulfill its obligations under the contracts.

The Company received \$2.5 million from each insurance company in October 2000 for services to be performed by the Company through February 2002. In July 2002, the transaction period was extended to December 2002. These payments, net of direct expenses, were amortized over the amended transaction period. The Company receives additional payments on set measurement dates if certain criteria related to the number of referrals and staffed financial units are met. The amortization of the initial payments and the accrued revenue are included in Insurance alliance revenue on the Statement of Operations.

One of the insurance companies gave notice of their intention to withdraw from the alliance and the Company amended its agreement with this insurance carrier. Under the terms of the amended agreement, upon the addition of another carrier to replace the withdrawing carrier, the Company was required to pay the withdrawing carrier \$2.0 million less estimated recoveries and renewals on business previously placed with the carrier. Additionally, the Company executed a note due to the withdrawing carrier for \$550,000, due March 2004, bearing interest at 6.5% payable upon maturity. As a result, \$1,984,400 was recognized as Contract termination fees on the Statement of Operations.

In March 2002, the Company entered into a contract with a fourth unrelated insurance company to replace the withdrawing carrier. The contract is of similar substance and form to the initial contracts. The Company received \$1.7 million from the insurance company in March for services to be performed by the Company through December 2002. The Company accrued additional income for meeting certain criteria related to the number of referrals and staffed financial units being met.

In the year ended December 31, 2001, the Company recognized revenue and related receivables from the remaining two initial insurance companies resultant from additional contractual payments recorded for meeting the requirements of the contract terms. A portion of these amounts was written off during the current year in conjunction with allowing the fourth carrier into the alliance. The amount written off was \$1.9 million and is included in Provision for bad debts on the Statement of Operations.

The Parent incurred direct and incremental costs associated with initiating these contracts. These costs were transferred to the Company and are recorded in Prepaid expenses and other assets on the Balance Sheet. The costs are being amortized over the entire life of the contract.

##### **5. RELATED PARTY TRANSACTIONS**

*Due from Parent:* The Company's non-interest bearing receivable from its Parent primarily relates to funds advanced to its Parent, net of expenses related to the Insurance alliance contract and taxes payable. The receivable is anticipated to be realized through an offset of future tax liabilities.

*Transfer of registered representative contracts:* In October 2001, the Company began transferring its broker relationships with all Block affiliated representatives to a related party. Concurrently, the Company terminated its Independent Contractor Agreements with those representatives. The transfer was completed in December 2002. No consideration was received related to the transfer.

*Expense sharing agreement:* Effective May 1, 2002, the Company and the Parent entered into an agreement whereby the Parent has paid for operating expenses incurred by the company, except for expenses related to the Insurance alliance, including, but not limited to, occupancy, legal, office supplies and technology services. The Company's general and administrative duties were also performed by employees of the Parent. The Parent has recognized expenses related to the general accounting, human resources and legal services performed on behalf of the Company. The expense sharing agreement calls for a reimbursement of expenses as a percentage of net revenue. The net expense for 2002 was \$677,011 and was recognized in General and administrative expense on the Statement of Operations. Additionally, effective January 1, 2002, the Parent agreed to assume operating expenses related to the general securities business of the Company until the transfer of the registered representatives was completed on December 1, 2002.

Transactions with affiliates as disclosed above might not approximate terms that would otherwise be negotiated by the Company with unrelated third parties in arm's length transactions.

## 6. INCOME TAXES

The current and deferred components of the income tax expense for the year ended December 31, 2002 comprise the following:

Currently payable:	
Federal	\$ (197,934)
State, local	<u>(22,055)</u>
	<u>(219,989)</u>
Deferred:	
Federal	372,813
State, local	<u>41,541</u>
	<u>\$ 414,354</u>

The following table reconciles the U.S. federal income tax rate to the Company's effective tax rate for the year ended December 31, 2002:

Statutory rate	35.0%
Increases in income taxes resulting from:	
State income taxes net of Federal income tax benefit	<u>3.9%</u>
Effective rate	<u>38.9%</u>

Deferred tax assets of \$53,959 are generated from deferred revenue.

Management believes that it is more likely than not that the deferred tax assets will be realized in future periods, as such a valuation allowance has not been provided against the deferred tax assets.

#### **7. COMMITMENTS AND CONTINGENCIES**

The Company is a party to legal actions arising in the normal course of business. In the opinion of management based, in part, on discussions with outside legal counsel, resolution of such matters will not have a material adverse effect on the financial statements of the Company.

#### **8. CAPITAL STRUCTURE**

The various rights and privileges of the Company's stock issues are as follows:

Series A common shares are the only voting class of stock with the holders entitled to the net assets of the Company upon liquidation after the Series B common and preferred shares are redeemed.

Series B common shares are non-voting, subject to redemption and second preference on liquidation at par, and the holders are not entitled to dividends. As of and for the year ended December 31, 2002, there were no Series B common shares outstanding.

Preferred shares are non-voting, subject to redemption and first preference on liquidation at par. As of and for the year ended December 31, 2002, there were no preferred shares outstanding.

**BIRCHTREE FINANCIAL SERVICES, INC.**  
**Supplementary Information**  
**December 31, 2002**

1. Computation of net capital under Rule 15c3-1

Total stockholder's equity	\$ 16,093,200
Nonallowable assets	(3,635,927)
Haircuts on money market funds	<u>(93,622)</u>
Net capital	12,363,651
Minimum net capital required, the greater of \$50,000 or 6 2/3% of aggregate indebtedness	<u>50,942</u>
Excess net capital	<u>\$ 12,312,709</u>
Aggregate indebtedness	<u>\$ 764,133</u>
Ratio of aggregate indebtedness to net capital	<u>.06 to 1</u>

NOTE: Net capital as computed above does not differ materially from that reported by the Company in Part IIA of the unaudited FOCUS Report on Form X-17a-5 at December 31, 2002.

2. Computation for determination of reserve requirements under Rule 15c3-3

The Company operates under the exemptive provisions of paragraph (k)(2)(B) of SEC Rule 15c3-3.

3. Information relating to the possession or control requirements under Rule 15c3-3

The Company has complied with the exemptive requirements of Rule 15c3-3 and did not maintain possession or control of any customer funds or securities as of December 31, 2002.

To the Board of Directors and Stockholder of  
Birchtree Financial Services, Inc.

In planning and performing our audit of the financial statements and supplemental schedule of Birchtree Financial Services, Inc. (the "Company") for the year ended December 31, 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 the internal control.

Also, as required by Rule 17a-5(g)(1) of the Securities and Exchange Commission (the "SEC"), we have made a study of the practices and procedures followed by the Company, including tests of compliance with such practices and procedures, that we considered relevant to the objectives stated in Rule 17a-5(g) in the following:

1. Making the periodic computations of aggregate indebtedness and net capital under Rule 17a-3(a)(11); and
2. 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, and the recordation of differences required by Rule 17a-13;
2. 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; and
3. Obtaining and maintaining physical possession or control of all fully paid and excess margin securities of customers as required by Rule 15c3-3;

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 control 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 the 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, errors or fraud may occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that controls 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 one or more 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 procedures 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 December 31, 2002 to meet the SEC's objectives.

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

*PricewaterhouseCoopers LLP*

February 25, 2003