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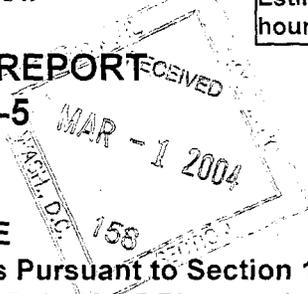


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Washington, D.C. 20549

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



SEC FILE NUMBER  
8- 47433

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 01/01/03 AND ENDING 12/31/03  
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER:  
Tejas Securities Group, Inc.

OFFICIAL USE ONLY  
FIRM ID. NO.

ADDRESS OF PRINCIPAL PLACE OF BUSINESS: (Do not use P.O. Box No.)  
2700 Via Fortuna, Suite 400

Austin TX 78746  
(City) (State) (Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT  
John Garber 512-306-8222  
(Area Code - Telephone No.)

B. ACCOUNTANT IDENTIFICATION

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

5 Times Square New York NY 10036  
(Address) (City) (State) (Zip Code)

CHECK ONE:

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

PROCESSED  
MAR 29 2004  
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).

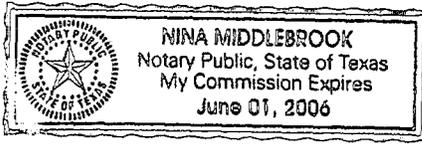
OATH OR AFFIRMATION

I, John Garber, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statements and supporting schedules pertaining to the firm of Tejas Securities Group, Inc, as of December 31, 20 03, 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:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

*John Garber*  
Signature  
Director of Finance  
Title

*Nina Middlebrook*  
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 Changes in Financial Condition.
- (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 or Rule 15c3-3.
- (k) A Reconciliation between the audited and unaudited Statements of Financial Condition with respect to methods of consolidation.
- (l) An Oath or Affirmation.
- (m) A copy of the SIPC Supplemental Report.
- (n) A report describing any material inadequacies found to exist or found to have existed since the date of the previous audit.

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

**TEJAS SECURITIES GROUP, INC.**  
(A Wholly Owned Subsidiary of Westech Capital Corp.)

Financial Statements, Schedules and Other Information

Years Ended December 31, 2003 and 2002

# TEJAS SECURITIES GROUP, INC.

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## Report of Independent Auditors

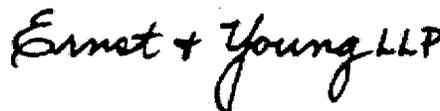
The Board of Directors and Shareholders  
Tejas Securities Group, Inc.

We have audited the accompanying statement of financial condition of Tejas Securities Group, Inc. (the "Corporation") (a wholly owned subsidiary of Westech Capital Corp.) as of December 31, 2003, and the related statement of operations, shareholders' 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 Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Tejas Securities Group, Inc. for the year ended December 31, 2002, were audited by other auditors whose report dated February 14, 2003, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States. 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 2003 financial statements referred to above present fairly, in all material respects, the financial position of Tejas Securities Group, Inc. at December 31, 2003, 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.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The information contained in Schedules 1 and 2 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.



January 30, 2004

**TEJAS SECURITIES GROUP, INC.**

Statements of Financial Condition

December 31, 2003 and 2002

Assets	<u>2003</u>	<u>2002</u>
Cash and cash equivalents	\$ 548,890	721,283
Receivables from employees and stockholders	99,197	87,841
Securities owned:		
Corporate equity securities	5,009,455	1,307,710
Corporate and municipal debt securities	592,327	4,677,595
	<u>5,601,782</u>	<u>5,985,305</u>
Other investment	1,155,000	1,250,000
Property and equipment:		
Property and equipment	379,830	420,683
Accumulated depreciation	(206,626)	(289,061)
Net property and equipment	<u>173,204</u>	<u>131,622</u>
Deferred tax asset	62,611	45,702
Other assets	171,543	274,519
	<u>\$ 7,812,227</u>	<u>8,496,272</u>
<b>Liabilities and Stockholder's Equity</b>		
Accounts payable, accrued expenses and other liabilities	\$ 2,245,455	2,182,212
Securities sold, not yet purchased	221,279	985,210
Payable to clearing organization	742,334	971,651
Federal income taxes payable to parent company	542,839	385,038
Total liabilities	<u>3,751,907</u>	<u>4,524,111</u>
Commitments and contingencies		
Stockholder's equity:		
Preferred stock, no par value, convertible, 1,000,000 shares authorized; none issued and outstanding	—	—
Common stock, no par value, 10,000,000 shares authorized; 5,828,888 shares issued and 5,799,055 outstanding	2,295,674	2,295,674
Additional paid-in capital	866,161	866,161
Retained earnings	905,818	817,659
Treasury stock, at cost, 29,833 shares	(7,333)	(7,333)
Total stockholder's equity	<u>4,060,320</u>	<u>3,972,161</u>
	<u>\$ 7,812,227</u>	<u>8,496,272</u>

See accompanying notes to financial statements.

**TEJAS SECURITIES GROUP, INC.**

Statements of Operations

For the Years Ended December 31, 2003 and 2002

	2003	2002
Revenue:		
Commissions from agency transactions	\$ 1,834,822	1,530,218
Commissions from principal transactions	27,425,651	17,937,058
Underwriting and investment banking income	72,799	335,663
Net dealer inventory and investment income (loss), net of trading interest expense of \$112,348 and \$51,484, respectively	(2,793,103)	1,296,933
Other income	41,754	84,452
Total revenue	26,581,923	21,184,324
Expenses:		
Commissions, employee compensation and benefits	19,026,049	15,617,467
Clearing and floor brokerage	589,913	412,657
Communications and occupancy	2,100,250	1,631,136
Professional fees	949,313	719,718
Interest, including \$65,219 to related party in 2002	992	67,268
Other	2,086,066	1,906,632
Total expenses	24,752,583	20,354,878
Income before income tax expense (benefit)	1,829,340	829,446
Income tax expense (benefit):		
Federal:		
Current	696,492	344,509
Deferred	(17,811)	(978)
State:		
Current	75,645	70,588
Deferred	902	(1,044)
	755,228	413,075
Net income	\$ 1,074,112	416,371

See accompanying notes to financial statements.

**TEJAS SECURITIES GROUP, INC.**

Statements of Stockholder's Equity

For the Years Ended December 31, 2003 and 2002

	Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Total
Balance at December 31, 2001	5,799,055	\$ 2,295,674	866,161	1,041,909	(7,333)	4,196,411
Dividends to parent company	—	—	—	(640,621)	—	(640,621)
Net income	—	—	—	416,371	—	416,371
Balance at December 31, 2002	5,799,055	2,295,674	866,161	817,659	(7,333)	3,972,161
Dividends to parent company	—	—	—	(985,953)	—	(985,953)
Net income	—	—	—	1,074,112	—	1,074,112
Balance at December 31, 2003	5,799,055	\$ 2,295,674	866,161	905,818	(7,333)	4,060,320

See accompanying notes to financial statements.

**TEJAS SECURITIES GROUP, INC.**

Statements of Cash Flows

For the Years Ended December 31, 2003 and 2002

	2003	2002
Cash flows from operating activities:		
Net income	\$ 1,074,112	416,371
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Deferred tax benefit	(16,909)	(2,022)
Depreciation and amortization expense	74,912	86,336
Loss on disposition of fixed assets	36,462	22,388
Changes in operating assets and liabilities		
Deposit with clearing organization	—	260,471
Receivable from/payable to clearing organization	(229,317)	2,876,989
Receivables from employees and stockholders	(11,356)	87,077
Securities owned	383,523	(2,973,638)
Other assets	102,976	39,841
Other investment	95,000	(1,250,000)
Accounts payable, accrued expenses and other liabilities	(19,104)	(742,346)
Securities sold, not yet purchased	(763,931)	652,629
Federal income taxes payable to parent company	157,801	(105,491)
Net cash provided by (used in) operating activities	884,169	(631,395)
Cash flows from investing activities:		
Purchase of furniture and equipment	(56,239)	(10,169)
Net cash used in investing activities	(56,239)	(10,169)
Cash flows from financing activities:		
Dividends to parent company	(985,953)	—
Payments on capital lease	(14,370)	—
Repayment of subordinated notes	—	(1,000,000)
Net change in receivable from/payable to parent company	—	1,844,041
Net cash provided by (used in) financing activities	(1,000,323)	844,041
Net increase (decrease) in cash and cash equivalents	(172,393)	202,477
Cash and cash equivalents at beginning of year	721,283	518,806
Cash and cash equivalents at end of year	\$ 548,890	721,283
Supplemental disclosures:		
Interest paid	\$ 992	67,268
Income taxes paid	\$ 571,121	480,500

Summary of non-cash transactions:

During 2003, the Corporation purchased fixed assets under capital lease with a value of \$96,716.

During 2002, the Corporation declared dividends to its parent company in amounts totaling \$640,621 in relation to its temporary funding arrangement with its parent company (Note 14).

During 2002, the Corporation transferred to Westech Capital Corp. (parent company), at cost, a promissory note from an officer totaling \$144,836 and increased its receivable from parent company by the corresponding amount (Note 14).

See accompanying notes to financial statements.

# TEJAS SECURITIES GROUP, INC.

## Notes to Financial Statements

December 31, 2003 and 2002

### (1) Organization and Basis of Presentation

Tejas Securities Group, Inc. (the "Corporation") (a wholly owned subsidiary of Westech Capital Corp.) is primarily engaged in securities brokerage, investment banking and trading activities. The Corporation's headquarters are located in Austin, Texas. The Corporation is registered as a broker and dealer in securities with the National Association of Securities Dealers, Inc. and clears its transactions on a fully disclosed basis through Correspondent Services Corporation.

On August 27, 1999, pursuant to an Agreement and Plan of Merger by and among the Corporation, Westech Capital Corp., a New York corporation ("Westech"), and Tejas Securities Group Holding Company, a Texas corporation ("Tejas Holding"), the Corporation acquired Westech through a reverse merger (the "Merger"). As a result of the Merger, Tejas Holding became a wholly owned subsidiary of Westech and the holder of approximately 81% of the outstanding common stock of the Corporation. On August 29, 2001, the minority interest shareholders exchanged their shares of the Corporation's common stock for restricted stock of Westech. As a result, Westech owns, directly or through Tejas Holding, 100% of the Corporation as of December 31, 2003.

The Corporation is authorized to issue 1,000,000 shares of convertible preferred stock. The convertible preferred shares may be issued from time to time and will have the designations, preferences, voting powers, relative, participating, optional or other special rights and privileges and the qualifications, limitations, and restrictions as determined by the Board of Directors.

### (2) Summary of Significant Accounting Policies

#### (a) Revenue Recognition

Agency commission revenue and related expense from customer security transactions is recorded on a trade date basis. Customer security transactions that are executed through the Corporation's proprietary trading account are recorded on a trade date basis as principal commission revenue. The related expense is also recorded on a trade date basis.

Net dealer inventory and investment income (loss) results from securities transactions entered into for the account of the Corporation. Net dealer inventory and investment income (loss) includes both realized and unrealized gains and losses, which are recorded on a trade date basis.

The Corporation does not carry or clear customer accounts, and all customer transactions are executed and cleared with other brokers on a fully disclosed basis. These brokers have agreed to maintain such records of the transactions effected and cleared in the customers' accounts as are customarily made and kept by a clearing broker pursuant to the requirements of Rules 17a-3 and 17a-4 of the Securities and Exchange Commission, and to perform all services customarily incident thereto.

#### (b) Investment Banking

Investment banking revenues include gains, losses, and fees, net of syndicate expenses, arising from securities offerings in which the Corporation acts as an underwriter or agent. Investment banking revenues also include fees earned from providing merger-and-acquisition and advisory services. Investment banking management fees are recorded on offering date, sales concessions on settlement date, and underwriting fees at the time the underwriting is completed and the income is reasonably determinable.

## TEJAS SECURITIES GROUP, INC.

### Notes to Financial Statements

December 31, 2003 and 2002

**(c) Cash and Cash Equivalents**

Cash and cash equivalents include cash and highly liquid investments with a maturity at date of purchase of ninety days or less.

**(d) Securities Owned and Securities Sold, Not Yet Purchased**

Long and short positions in securities are reported at fair value. Securities with readily determinable market values are based on quoted market prices. Securities with limited market activity for which quoted market values are not readily determinable are based on management's best estimate which may include dealer price quotations and price quotations for similar instruments traded. The difference between cost and fair value has been included in net dealer inventory and investment income (loss). These investments are subject to the risk of failure of the issuer and the risk of changes in market value based on the ability to trade such securities on the open market.

**(e) Property and Equipment**

Property and equipment are stated at cost. Depreciation is provided using the straight-line method over the estimated useful lives of the respective assets. Estimated useful lives for equipment approximate those used for Federal income tax purposes and range from 3 to 7 years. Leasehold improvements are amortized using the straight-line method over the shorter of the estimated useful lives of the improvements or the terms of the related leases.

The Corporation adopted SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, on January 1, 2002. The adoption of SFAS No. 144 did not affect the Corporation's financial statements. In accordance with SFAS No. 144, long-lived assets, such as property and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the statements of financial condition and reported at the lower of the carrying amount or fair value less costs to sell, and would be no longer depreciated.

**(f) Repurchase and Resale Agreements**

Repurchase and resale agreements are treated as financing transactions and are carried at the amounts at which the securities will be subsequently reacquired or resold as specified in the respective agreements. There were no repurchase or resale agreements outstanding at December 31, 2003 and 2002.

# TEJAS SECURITIES GROUP, INC.

## Notes to Financial Statements

December 31, 2003 and 2002

### **(g) Federal Income Taxes**

The results of operations for the Corporation are included in the consolidated federal income tax return of Westech. The Corporation is allocated its share of Westech's federal income tax accrual in accordance with an intercompany tax allocation policy which is based on a separate return method. Separate state tax returns are filed for the Corporation.

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

### **(h) 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.

### **(i) Reclassifications**

Certain reclassifications have been made to prior year balances to conform to current year presentation.

## **(3) Net Capital Requirements**

The Corporation, as a registered fully licensed broker and dealer in securities, is subject to the Securities and Exchange Commission Uniform Net Capital Rule (Rule 15c3-1). Under this rule, the Corporation is required to maintain a minimum "net capital" to satisfy rule 15c3-1. At December 31, 2003, the minimum "net capital" requirement for the Corporation was \$250,000. "Net capital" at December 31, 2003 aggregated \$924,132. The Corporation's ratio of aggregate indebtedness to net capital was 3.02 to 1 at December 31, 2003.

## **(4) Rule 15c3-3**

The Corporation is exempt from the Securities Exchange Commission Rule 15c3-3 under Subsection (K). Under this exemption, the "Computation for Determination of Reserve Requirements" and "Information Relating to Possession or Control Requirements" are not required. However, during 2001 and as a result of its examination process, the National Association of Securities Dealers, Inc. (NASD) raised certain issues related to the Corporation's exemptions under Rule 15c3-3. In October 2003, the NASD issued a Letter of Acceptance, Waiver and Consent (AWC) noting that the Corporation self-cleared a number of customer transactions, in apparent violation of Rule 15c3-3. The Corporation accepted the AWC and believes it is now in compliance with its exemption under Rule 15c3-3.

**TEJAS SECURITIES GROUP, INC.**

Notes to Financial Statements

December 31, 2003 and 2002

**(5) Receivables From and Payables To Clearing Organization**

At December 31, 2003 and 2002, the Corporation had net receivables from and payables to its clearing organization consisting of the following:

	2003	2002
Receivable:	\$	
Receivable from clearing organization	—	—
Fees and commissions receivable	—	—
	\$ —	—
Payable:		
Payable to clearing organization	\$ 742,334	971,651

**(6) Securities Owned and Securities Sold, Not Yet Purchased**

At December 31, 2003 and 2002, securities owned and sold, not yet purchased consisted of the following:

	2003		2002	
	Owned	Sold, not yet purchased	Owned	Sold, not yet purchased
State and municipal obligations	\$ 289,613	50,806	1,511,086	20,844
US Government bonds	—	—	275,550	608,864
Corporate bonds and notes	302,714	—	2,890,959	177,940
Equity securities	5,009,455	170,473	1,307,710	177,562
	\$ 5,601,782	221,279	5,985,305	985,210

At December 31, 2003 and 2002, the unrealized gain (loss) associated with securities owned and securities sold, not yet purchased, was \$206,943 and \$(788,379), respectively.

Approximately 78% of the value of securities owned as of December 31, 2003 related to a single security which was sold subsequent to year end at a gain.

# TEJAS SECURITIES GROUP, INC.

## Notes to Financial Statements

December 31, 2003 and 2002

### (7) Other Investment

In March 2002, Westech entered into a term loan agreement with a bank to borrow \$2,500,000 to satisfy its payable to the Corporation. The loan was due and payable on demand or by March 15, 2003 if no demand was made. As of March 15, 2003, Westech extended the maturity date of the loan to March 15, 2004. The Corporation has provided a certificate of deposit in a like amount as collateral for the loan. The balance as of December 31, 2003 and 2002 is included as other investment in the accompanying statements of financial condition. During 2002, Westech repaid \$1,100,000 of the loan from the bank through its own financing arrangements. The bank in turn released from collateralization \$1,100,000 of the certificate of deposit to the Corporation, of which \$1,000,000 was used to make payments on the Corporation's subordinated debt (Note 9) and the remaining \$100,000 was not redeemed and was included as other investment at December 31, 2002. In February 2003, the Corporation redeemed \$95,000 of the certificate of deposit.

In addition, the Corporation repaid \$250,000 of Westech's loan from the bank through the redemption of \$250,000 of the certificate of deposit during 2002. The Corporation's repayment of Westech's loan was accounted for as a dividend to parent company in the accompanying statements of stockholder's equity (Note 14). As of December 31, 2003 and 2002, the term loan agreement balance of Westech is \$1,150,000, which is collateralized with the certificate of deposit of the Corporation.

### (8) Accrued Commissions and Bonuses

Accrued commissions and bonuses are included in accounts payable, accrued expenses and other liabilities in the accompanying statements of financial condition.

As of December 31, 2003 and 2002, the Corporation has accrued approximately \$1,357,000 and \$1,243,000, respectively, in commissions and related payroll taxes payable.

The Corporation pays bonuses to its employees and officers at interim periods and year-end. Accrued bonuses as of December 31, 2003 and 2002 were \$365,000 and \$300,000, respectively. During 2003 and 2002, an officer of the Corporation received approximately \$289,000 and \$80,000, respectively, as part of his contractual compensation which was based on the Corporation's operating performance. Management of the Corporation reviews both contractual and discretionary bonus amounts, with discretionary bonus amounts approved by the Compensation Committee of Westech.

### (9) Subordinated Debt

The Corporation had \$1,000,000 in debt subordinated to claims of general creditors as of December 31, 2001. The subordinated debt accrued interest at 11.5 percent and was owed to a director of the Corporation. Interest was paid monthly. The maturity of the subordinated debt was November 1, 2002. On July 1, 2002, the Corporation repaid \$500,000 of the subordinated debt, and repaid the remaining \$500,000 on August 20, 2002. The Corporation paid \$65,219 in interest related to this debt for the year ended December 31, 2002.

**TEJAS SECURITIES GROUP, INC.**

Notes to Financial Statements

December 31, 2003 and 2002

**(10) Income Taxes**

Income tax expense for the years ended December 31, 2003 and 2002 differs from the amount computed by applying the U.S. Federal income tax rate of 34 percent to income before income tax expense (benefit) as a result of the following:

	<b>2003</b>	<b>2002</b>
Computed "expected" expense	\$ 621,976	282,012
Meals and entertainment	60,634	46,094
State income tax	76,547	69,544
Other	(3,929)	15,425
	\$ 755,228	413,075

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities at December 31, 2003 and 2002 are as follows:

	<b>2003</b>	<b>2002</b>
Deferred tax assets:		
Capital loss carryforwards	\$ 63,257	51,078
Accrued expenses	30,147	37,649
Other	25,720	13,596
Gross deferred tax assets	119,124	102,323
Valuation allowance	(48,902)	(48,902)
Net deferred tax assets	70,222	53,421
Deferred tax liabilities:		
Property and equipment	(7,611)	(7,719)
Total gross deferred tax liability	(7,611)	(7,719)
Net deferred tax asset	\$ 62,611	45,702

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods which the deferred tax assets are deductible, management believes it is more likely than not the Corporation will realize the benefits of these deductible differences net of the existing valuation allowances. For the year ended December 31, 2003, the Corporation did not recognize a change in valuation allowance for capital loss carryforwards. At December 31, 2003, the Corporation had capital loss carryforwards of approximately \$144,000. The capital loss carryforwards will expire in 2005.

# TEJAS SECURITIES GROUP, INC.

## Notes to Financial Statements

December 31, 2003 and 2002

### (11) Profit Sharing Plan

In January 1997, the Corporation instituted a profit sharing plan under section 401(k) of the Internal Revenue Code. The plan allows all employees who are over 21 years old to defer a predetermined portion of their compensation for federal income tax purposes. Contributions by the Corporation are discretionary. During 2003 and 2002, the Corporation contributed approximately \$167,000 and \$173,000, respectively, to the employee profit sharing plan.

### (12) Off Statement of Financial Condition Risk

The Corporation is responsible to its clearing organization for payment of all transactions executed both on its behalf and on behalf of its customers. Therefore, the Corporation is exposed to off statement of financial condition risk in the event a customer cannot fulfill its commitment and the clearing organization must purchase or sell a financial instrument at prevailing market prices. The Corporation and its clearing organization seek to control risk associated with customer transactions through daily monitoring to assure margin collateral is maintained under regulatory and internal guidelines.

The Corporation is exposed should Correspondent Services Corporation, the Corporation's clearing organization, be unable to fulfill its obligations for securities transactions.

The Corporation deposits its cash with financial institutions. Periodically such balances exceed applicable FDIC insurance limits.

### (13) Lease Commitments

The Corporation leases its office facilities and certain office equipment under operating and capital leases. The future minimum payments due under these leases as of December 31, 2003 are as follows:

	<u>Operating</u>	<u>Capital</u>
2004	\$ 1,463,000	35,000
2005	1,083,000	35,000
2006	890,000	15,000
2007	232,000	—
2008	33,000	—
Minimum Commitments	\$ <u>3,701,000</u>	85,000
Less Interest		<u>(3,000)</u>
Net Present Value of Capital Lease Obligations		<u>82,000</u>

Office equipment, under capital leases, with a recorded cost of \$96,716, net of depreciation of \$23,295 as of December 31, 2003, collateralizes the above capital lease obligations and is included in the statements of financial condition under the caption of "Property and Equipment." Depreciation expense for assets under capital lease was \$23,295 in 2003.

Rent expense amounted to approximately \$1,537,000 and \$1,452,000 for the years ended December 31, 2003 and 2002, respectively. Rent expense is reported net of sublease revenue which is disclosed below.

## TEJAS SECURITIES GROUP, INC.

### Notes to Financial Statements

December 31, 2003 and 2002

In June 2003, the Corporation subleased a portion of its Austin, Texas headquarters, furniture and equipment effective June 15, 2003 through February 2008. Under the terms of the sublease agreement, the future minimum payments to be received are approximately \$71,000 in 2004 through 2006, and approximately \$12,000 in 2007. During 2003, the Corporation received approximately \$35,000 in relation to this sublease agreement.

On December 22, 2000, the Corporation subleased a portion of its Austin, Texas headquarters, furniture and equipment effective January 1, 2001 through March 2003. The Corporation received approximately \$136,000 and \$660,000 during 2003 and 2002, respectively, in relation to these sublease agreements.

On September 30, 2002, the Corporation subleased a portion of its Atlanta, Georgia office space. Under the terms of the sublease agreement, the future minimum payments to be received are approximately \$84,000 in 2004 and approximately \$63,000 in 2005. The Corporation received approximately \$83,000 and \$10,000 during 2003 and 2002, respectively, in relation to this sublease agreement.

#### **(14) Related Party Transactions**

The Corporation makes advances to certain employees in months when their commission payout does not meet a predetermined amount. As of December 31, 2003 and 2002, approximately \$23,000 and \$63,000, respectively, had been advanced to employees and officers under this agreement. These receivables are to be repaid through reductions of future commissions or bonuses. During 2003, the Corporation forgave approximately \$63,000 in receivables from employees. During 2002, the Corporation forgave approximately \$17,000 in receivables from employees. The amounts forgiven are included in employee compensation and benefits expense in the accompanying statements of operations. During 2002, the Corporation transferred to Westech, at cost, a promissory note from an officer totaling \$144,836 and increased its receivable from parent company by the corresponding amount.

In November 2003, the Corporation received a \$60,000 note from an employee. The note accrues no interest and is due and payable on November 20, 2004. The balance of the note was \$50,000 as of December 31, 2003.

In April 2002, the Corporation received a \$25,000 note from an employee. The note accrues no interest and was due and payable on April 12, 2003. On April 12, 2003, the note began to accrue interest at the lesser of 5.55% per annum until paid. The balance of the note, plus accrued interest, was approximately \$26,000 as of December 31, 2003.

Notes receivables and related party receivables are included in receivables from employees and stockholders in the accompanying statements of financial condition.

Beginning in 2000, the Corporation began to provide or receive temporary funding to or from Westech. As of December 31, 2001, the Corporation had a receivable from parent company in the amount of \$2,339,826. In March 2002, the Corporation received \$2,500,000 in cash proceeds from Westech for settlement of the receivable in exchange for providing collateral on Westech debt (Note 7). Additional changes to the intercompany balance during 2002 were the result of principal and interest payments made by the Corporation in association with outstanding Westech debt (Note 15), payments made by the Corporation on behalf of Westech in association with routine Westech operating expenses, payments made by Westech to the Corporation to satisfy liability balances, and non-cash dividends declared by the Corporation to Westech in the amount of \$640,621. The Corporation declared dividends to Westech in the amount of \$985,953 during 2003.

## TEJAS SECURITIES GROUP, INC.

### Notes to Financial Statements

December 31, 2003 and 2002

The employees, officers and management of the Corporation may maintain personal accounts with the Corporation. When the Corporation executes securities transactions on behalf of its employees, officers and management, those transactions are executed at current market prices, plus execution costs. All officers of the Corporation, one of which is a majority owner of Westech, routinely conduct such transactions for their own accounts, and management of the Corporation deems the transactions to be arms length transactions. The majority owner of Westech also makes many of the proprietary trading decisions for the Corporation.

#### **(15) Commitments and Contingencies**

In October 2002, the Corporation's stock was pledged as collateral for a Westech loan agreement with a bank in the amount of \$500,050. The Corporation began making equal monthly installment payments on behalf of Westech in December 2002 which were accounted for as dividends to parent company in the accompanying consolidated statements of stockholder's equity (Note 14).

The Corporation is involved in various claims and legal actions that have arisen in the ordinary course of business. It is management's opinion that liabilities, if any, arising from these actions will not have a significant adverse effect on the financial condition or results of operations of the Corporation.

## TEJAS SECURITIES GROUP, INC.

## Computation of Net Capital Under Rule 15c3-1 of the Securities and Exchange Commission

December 31, 2003

Net capital:		
Total stockholders' equity	\$	4,060,320
Less:		
Nonallowable assets:		
Property and equipment, net		173,204
Receivable from employees and stockholders		99,197
Other investment		1,155,000
Deferred tax asset		62,611
Other assets		171,543
		<u>1,661,555</u>
Net capital before haircuts on securities		<u>2,398,765</u>
Haircuts on securities, including undue concentration		<u>1,474,633</u>
Net capital	\$	<u><u>924,132</u></u>
Aggregate indebtedness:		
Total liabilities	\$	3,751,906
Less:		
Payable to clearing organization		(742,334)
Securities sold, not yet purchased		(221,279)
Aggregate indebtedness	\$	<u><u>2,788,293</u></u>
Net capital requirement (greater of 6 2/3% of aggregate indebtedness or \$250,000)	\$	<u><u>250,000</u></u>
Net capital in excess of minimum requirement	\$	<u><u>674,132</u></u>
Ratio of aggregate indebtedness to net capital	\$	<u><u>3.02</u></u>

See accompanying independent auditors' report.

## TEJAS SECURITIES GROUP, INC.

## Computation for Determination of Reserve Requirements and Information Relating to Possession or Control Requirements Under Rule 15c3-3 of the Securities and Exchange Commission

December 31, 2003

The Corporation's management believes that it is exempt from the reserve requirements and the related computations for the determination thereof under Rule 15c3-3 under the Securities and Exchange Act of 1934 as the Corporation carries no margin accounts, promptly transmits all customer funds and delivers all securities received in connection with its activities as a broker or dealer, does not otherwise hold funds or securities for, or owe money or securities to customers and effectuates all financial transactions with customers through unaffiliated clearing organizations.

The Corporation did not hold funds or securities for, or owe money or securities to, customers as of December 31, 2003; all customer funds and securities are transmitted to a clearing broker. Therefore, possession or control requirements under Rule 15c3-3 do not apply.

The Corporation is exempt from the Securities Exchange Commission Rule 15c3-3 under Subsection (K). Under this exemption, the "Computation for Determination of Reserve Requirements" and "Information Relating to Possession or Control Requirements" are not required. However, during 2001 and as a result of its examination process, the National Association of Securities Dealers, Inc. (NASD) raised certain issues related to the Corporation's exemptions under Rule 15c3-3. In October 2003, the NASD issued a Letter of Acceptance, Waiver and Consent (AWC) noting that the Corporation self-cleared a number of customer transactions, in apparent violation of Rule 15c3-3. The Corporation accepted the AWC and believes it is now in compliance with its exemption under Rule 15c3-3.

See accompanying independent auditors' report.

## Independent Auditors' Report on Internal Control Required by SEC Rule 17a-5

Board of Directors  
Tejas Securities Group, Inc.

In planning and performing our audit of the consolidated financial statements and supplemental schedules of Tejas Securities Group, Inc. (the "Corporation") (a wholly owned subsidiary of Westech Capital Corporation) for the year ended December 31, 2003, we considered its internal control, including control activities for safeguarding securities, to determine our auditing procedures for the purpose of expressing our opinion on the consolidated 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 Corporation, including tests of compliance with such practices and procedures that we considered relevant to the criteria 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 for determining compliance with the exemptive provisions of rule 15c3-3. Because the Corporation 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 Corporation 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

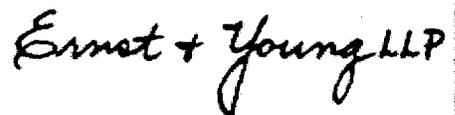
The management of the Corporation is responsible for establishing and maintaining internal control and the practices and procedures referred to in the preceding paragraph. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal 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 criteria. Two of the criteria of internal control and the practices and procedures are to provide management with reasonable but not absolute assurance that assets for which the Corporation 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 criteria of the practices and procedures listed in the preceding paragraph.

Because of inherent limitations in any 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 internal control may become inadequate because of changes in conditions or that the effectiveness of its 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 errors 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, and its operation that we consider to be material weaknesses as defined above.

We understand that practices and procedures that meet the criteria 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 meet such criteria in all material respects indicate a material inadequacy for such purposes. Based on this understanding and on our study, we believe that the Corporation's practices and procedures were adequate at December 31, 2003 to meet the SEC's criteria.

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.



January 30, 2004