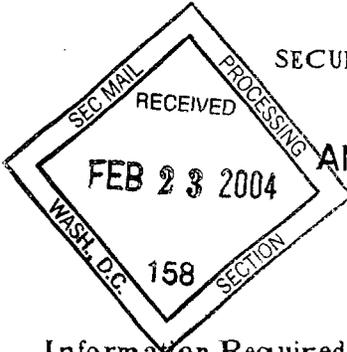


BB



SECURITY MISSION

OMB APPROVAL

OMB Number: 3235-0123

Expires: October 31, 2004

Estimated average burden hours per response: 12.00

SEC FILE NUMBER

8- 48058

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

FACING PAGE

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

REPORT FOR THE PERIOD BEGINNING 01/01/03 AND ENDING 12/31/03  
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER: Sterling Smith Corporation

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

OFFICIAL USE ONLY

FIRM I.D. NO.

4326A Scotland Street

(No. and Street)

Houston

Texas

77007

(City)

(State)

(Zip Code)

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

Sterling Smith

713-861-6500

(Area Code - Telephone Number)

B. ACCOUNTANT IDENTIFICATION

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

Easley, Endres, Parkhill & Brackendorff, PC

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

1333 West Loop South, Suite 1400

Houston

Texas

77027

(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 19 2004

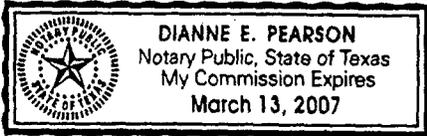
FOR OFFICIAL USE ONLY

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)

OATH OR AFFIRMATION

I, Sterling Smith, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of Sterling Smith Corporation, as of December 31, 2003, 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:



*Sterling R. Smith*  
Signature

President

Title

*Dianne E. Pearson* County of Harris  
Notary Public State of Texas

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 Proprietors' 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 15c3-3 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.

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

---

STERLING SMITH CORPORATION

FINANCIAL STATEMENTS AND SUPPLEMENTAL INFORMATION

DECEMBER 31, 2003

---

---

## CONTENTS

	<u>PAGE NUMBER</u>
INDEPENDENT AUDITORS' REPORT .....	3
FINANCIAL STATEMENTS	
STATEMENT OF FINANCIAL CONDITION .....	4
STATEMENT OF INCOME .....	5
STATEMENT OF STOCKHOLDER'S EQUITY .....	6
STATEMENT OF CASH FLOWS .....	7
NOTES TO FINANCIAL STATEMENTS .....	8-10
SUPPLEMENTAL INFORMATION	
INDEPENDENT AUDITORS' REPORT ON SUPPLEMENTAL INFORMATION REQUIRED BY RULE 17A-5 OF THE SECURITIES AND EXCHANGE COMMISSION .....	11
COMPUTATION OF NET CAPITAL .....	12
EXEMPTIVE PROVISION UNDER RULE 15C3-3 .....	12
INDEPENDENT AUDITORS' REPORT ON THE INTERNAL CONTROL STRUCTURE .....	13-14

---



INDEPENDENT AUDITORS' REPORT

February 2, 2004

Board of Directors  
STERLING SMITH CORPORATION  
Houston, Texas

We have audited the accompanying statement of financial condition of STERLING SMITH CORPORATION as of December 31, 2003 and the related statements of income, 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 STERLING SMITH CORPORATION 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 of America.

*Easley, Endres, Parkhill  
& Brackendorff, P.C.*

1333 West Loop South  
Suite 1400  
Houston, TX 77027  
Phone: 713.622.0016  
Fax: 713.622.5527

STERLING SMITH CORPORATION  
STATEMENT OF FINANCIAL CONDITION  
DECEMBER 31, 2003

ASSETS

Cash and cash equivalents	\$ 2,290,254
Accounts receivable, commissions	10,625
Securities, at market value	406,599
Investment in NASDAQ exchange	<u>29,122</u>
Total assets	<u>\$ 2,736,600</u>

LIABILITIES AND STOCKHOLDER'S EQUITY

Liabilities	
Accounts payable	<u>\$ 4,512</u>
Stockholder's equity	
Common stock with par value of \$.01 per share, 50,000,000 shares authorized, 100,000 issued and outstanding	1,000
Additional paid-in capital	212,000
Retained earnings	<u>2,519,088</u>
Total stockholder's equity	<u>2,732,088</u>
Total liabilities and stockholder's equity	<u>\$ 2,736,600</u>

The accompanying notes are an integral  
part of the financial statements.

STERLING SMITH CORPORATION  
STATEMENT OF INCOME  
FOR THE YEAR ENDED DECEMBER 31, 2003

REVENUES

Commissions	\$ 16,835
Gains on firm securities trading	4,665,968
Loan placement fees	75,000
Interest	<u>135,597</u>
Total revenues	<u>4,893,400</u>

EXPENSES

Commissions and associate fees	3,671,884
Office and other operating expenses	<u>399,652</u>
Total operating expenses	<u>4,071,536</u>

NET INCOME

\$ 821,864

The accompanying notes are an integral  
part of the financial statements.

STERLING SMITH CORPORATION  
STATEMENT OF STOCKHOLDER'S EQUITY  
FOR THE YEAR ENDED DECEMBER 31, 2003

	<u>Common Stock</u>	<u>Additional Paid in Capital</u>	<u>Retained Earnings</u>	<u>Total</u>
Balance, December 31, 2002	\$ 1,000	\$ 212,000	\$ 3,197,224	\$ 3,410,224
Dividends paid to stockholder			(1,500,000)	(1,500,000)
Net income			821,864	821,864
Balance, December 31, 2003	<u>\$ 1,000</u>	<u>\$ 212,000</u>	<u>\$ 2,519,088</u>	<u>\$ 2,732,088</u>

The accompanying notes are an integral  
part of the financial statements.

STERLING SMITH CORPORATION  
STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED DECEMBER 31, 2003

CASH FLOWS FROM OPERATING ACTIVITIES

Net income \$ 821,864

Adjustments to reconcile net income to net cash provided by operating activities:

Changes in working capital:

(Increase) decrease in cash related to changes in assets:

Accounts receivable and deposits	(3,411)
Trading securities	216,456

Increase (decrease) in cash related to changes in liabilities:

Accounts payable	3,044
------------------	-------

NET CASH PROVIDED BY OPERATING ACTIVITIES	1,037,953
---	-----------

CASH FLOWS FROM INVESTING ACTIVITIES	-0-
--------------------------------------	-----

CASH FLOWS FROM FINANCING ACTIVITIES

Notes payable repayments to stockholder	(214,142)
Dividends to stockholder	(1,500,000)

NET CASH USED IN FINANCING ACTIVITIES	(1,714,142)
---------------------------------------	-------------

NET DECREASE IN CASH AND CASH EQUIVALENTS	(676,189)
---	-----------

CASH AND CASH EQUIVALENTS, Beginning of year	2,966,443
--	-----------

CASH AND CASH EQUIVALENTS, End of year	\$ 2,290,254
--	--------------

INTEREST PAID	\$ -0-
---------------	--------

TAXES PAID	\$ -0-
------------	--------

The accompanying notes are an integral part of the financial statements.

STERLING SMITH CORPORATION  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2003

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

STERLING SMITH CORPORATION, a Texas corporation, (the "Company"), was formed on January 25, 1995. The Company was formed for the purpose of conducting business as a broker/dealer in securities.

The Company was approved by the Securities and Exchange Commission ("SEC") as a broker/dealer in securities under the Securities Exchange Act of 1934 on March 1, 1995. The Company was approved as a member of the National Association of Securities Dealers ("NASD") on March 13, 1995. The Company does not hold customer cash and/or securities and is exempt from the reserve requirements of Rule 15c3-3.

Cash and Cash Equivalents

For the purposes of the statement of cash flows, the Company considers cash and highly liquid investments with maturities of three months or less when purchased to be cash and cash equivalents.

Marketable Securities

Marketable securities owned and on deposit with the Company's clearing broker are recorded at market value based on quoted market prices as of the balance sheet date. The difference between cost and market value is included in income.

Revenue Recognition

The Company's revenues are earned primarily from the sale of trading securities to customers. Revenues are recognized as securities are sold, on a trade date basis. The Company's revenue from brokerage commissions is recorded on the settlement date. Revenue from advisory fees is recorded when received.

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 support and revenues and expenses during the reporting period. Actual results could differ from those estimates.

STERLING SMITH CORPORATION  
NOTES TO FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (*Continued*)

Income Taxes

The Company has elected to be taxed under the provisions of Subchapter S of the Internal Revenue Code. Under those provisions, the Company does not pay federal corporate income taxes on its taxable income. Instead, the stockholder is liable individually for federal income taxes arising from the Company's income. Accordingly, no provision has been made for federal income tax in the accompanying financial statements.

NOTE 2: FEES PAID TO AFFILIATE

The Company pays a monthly office service fee to an affiliated corporation commonly owned by the stockholder. The office service fees paid for the year ended December 31, 2003 were \$370,011.

NOTE 3: SECURITIES

The Company's marketable securities consist of the following:

U.S Treasury note, \$100,000 par value, 4.00%, due January 22, 2004*	\$ 99,950
GMAC bond, \$100,000 par value, 5.375%, due April 15, 2005	102,666
GMAC bond, \$200,000 par value, 5.25%, due November 15, 2004	<u>203,983</u>
	<u>\$ 406,599</u>

\* On deposit with the Company's clearing broker, which requires a \$100,000 minimum deposit.

As a member of the National Association of Securities Dealers (NASD), the Company invested in a private placement in the NASDAQ exchange in 2000. This investment is carried at cost.

NOTE 4: CONCENTRATIONS

The Company's business consists primarily of trading fixed income securities of non-U.S. issuers, which generally have higher yields than U.S. issuers. Management believes that current economic conditions are conducive for continued demand for these securities and the Company's services.

STERLING SMITH CORPORATION  
NOTES TO FINANCIAL STATEMENTS

NOTE 4:     CONCENTRATIONS (*Continued*)

The Company engages in trading and maintains securities in which counter-parties include other broker-dealers and financial institutions. In the event the counter-parties do not fulfill their obligations, the Company may be exposed to certain risks. It is the policy of the Company to consider the creditworthiness of each counter-party, as necessary.

NOTE 5:     NET CAPITAL REQUIREMENTS

The Company is subject to the Securities and Exchange Commission Uniform Net Capital Rule (SEC rule 15c3-1), which requires the maintenance of minimum net capital of \$100,000 (including subordinated indebtedness) and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1. The Company is currently in compliance with these requirements.

---

SUPPLEMENTAL  
INFORMATION

---

**EASLEY, ENDRES, PARKHILL  
& BRACKENDORFF, P.C.**  
CERTIFIED PUBLIC ACCOUNTANTS  
AND CONSULTANTS

INDEPENDENT AUDITORS' REPORT ON SUPPLEMENTAL INFORMATION REQUIRED  
BY RULE 17A-5 OF THE SECURITIES AND EXCHANGE COMMISSION

February 2, 2004

Board of Directors  
STERLING SMITH CORPORATION  
Houston, Texas

We have audited the accompanying financial statements of STERLING SMITH CORPORATION as of and for the year ended December 31, 2003, and have issued our report thereon dated February 2, 2004. Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The information contained in page 12 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.

*Easley, Endres, Parkhill  
& Brackendorff, P.C.*

STERLING SMITH CORPORATION  
COMPUTATION OF NET CAPITAL  
DECEMBER 31, 2003

Stockholder's equity	\$ 2,732,088
Deduct:	
Non-allowable NASDAQ private placement	(29,122)
Non-allowable cash accounts without PAIB agreements	<u>(622,731)</u>
Net capital before haircuts on marketable securities positions	2,080,235
Haircuts on marketable securities	<u>(38,637)</u>
Net capital pursuant to SEC Rule 15c3-1	<u>\$ 2,041,598</u>
Aggregate indebtedness	<u>\$ 4,512</u>
Percentage of aggregate indebtedness to net capital	<u>0.22%</u>

STATEMENT PURSUANT TO PARAGRAPH (d)(4) OF RULE 17a-5

There is no difference between this computation of net capital pursuant to Rule 15c3-1 and the corresponding computation prepared by Sterling Smith Corporation and included in the Company's unaudited Part II A Focus report filing as of December 31, 2003.

STATEMENT OF OMITTED SUPPLEMENTAL DATA

The Computation for Determination of Reserve Requirements Pursuant to Rule 15c3-3 and the Information Relating to Possession or Control Requirements Under Rule 15c3-3 have been omitted because Sterling Smith Corporation is exempt from the requirements of Rule 15c3-3 under condition (k)(2)(ii). The conditions of the exemption were being complied with as of December 31, 2003 and no facts came to our attention to indicate that the exemption had not been complied with during the fiscal year ended December 31, 2003.

See accompanying auditors' report.



INDEPENDENT AUDITORS' REPORT ON THE INTERNAL CONTROL STRUCTURE

February 2, 2004

Mr. Sterling Smith  
STERLING SMITH CORPORATION  
Houston, Texas

In planning and performing our audit of the financial statements and supplemental schedules of STERLING SMITH CORPORATION (the "Company") for the year ended December 31, 2003, we considered its internal control structure, including procedures 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 structure.

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 (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 Company does not carry securities accounts for customers or perform custodial functions relating to 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 an internal control structure 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 control structure policies and procedures 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 an internal control structure and the practices and procedures are to provide

1333 West Loop South  
Suite 1400  
Houston, TX 77027  
Phone: 713.622.0016  
Fax: 713.622.5527

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 U.S. 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 any internal control structure or the practices and procedures referred to above, errors or irregularities 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 the internal control structure would not necessarily disclose all matters in the internal control structure 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 structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation 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 the internal control structure, 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, 2003, to meet the SEC's objectives.

This report is intended solely for the use of the Board of Directors, management, the SEC, NASD, and other regulatory agencies that rely on rule 17a-5(g) under the securities Exchange Act of 1934 in their regulation for registered brokers and dealers, and should not be used for any other purpose.

*Fasley, Endres, Parkhill  
& Brackendorff, P.C.*