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

SEC FILE NUMBER

8. ~~0335~~

31155

## 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 01/01/04 AND ENDING 12/31/04  
MM/DD/YY MM/DD/YY

## A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER:

QA3 Financial Corp.

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

One Valmont Plaza, Fourth Floor

(No. and Street)

Omaha

NE

68154

(City)

(State)

(Zip Code)

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

Theodore A Lange

402-964-3835

(Area Code — Telephone No.)

## B. ACCOUNTANT IDENTIFICATION

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

Lutz &amp; Company PC

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

Miracle Hills Drive

Omaha

68154

(Address)

(City)

(State)

(Zip Code)

CHECK ONE:

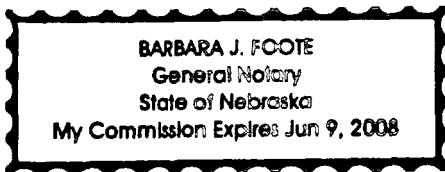
- ☒ Certified Public Accountant  
☐ Public Accountant  
☐ Accountant not resident in United States or any of its possessions.

FOR OFFICIAL USE ONLY

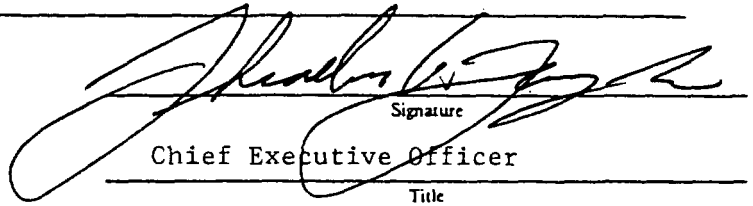
\*Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See section 240.17a-5(e)(2).

## OATH OR AFFIRMATION

I, Theodore A Lange, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of QA3 Financial Corp, as of December 31, ~~19~~xx2004, 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:



Barbara J. Foote  
Notary Public

  
Signature  
Chief Executive Officer  
Title

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

- ☒ (a) Facing page.
- ☒ (b) Statement of Financial Condition.
- ☒ (c) Statement of Income (Loss).
- ☒ (d) Statement of Changes in ~~Financial Condition~~ Cash Flow
- ☒ (e) Statement of Changes in Stockholders' Equity or Partners' or Sole Proprietor's Capital.
- ☐ (f) Statement of Changes in Liabilities Subordinated to Claims of Creditors.
- ☒ (g) Computation of Net Capital
- ☐ (h) Computation for Determination of Reserve Requirements Pursuant to Rule 15c3-3.
- ☐ (i) Information Relating to the Possession or control Requirements Under Rule 15c3-3.
- ☐ (j) A Reconciliation, including appropriate explanation, of the Computation of Net Capital Under Rule 15c3-1 and the Computation for Determination of the Reserve Requirements Under Exhibit A of Rule 15c3-3.
- ☐ (k) A Reconciliation between the audited and unaudited Statements of Financial Condition with respect to methods of consolidation.
- ☒ (l) An Oath or Affirmation.
- ☐ (m) A copy of the SIPC Supplemental Report.
- ☒ (n) A report describing any material inadequacies found to exist or found to have existed since the date of the previous audit.

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

**QA3 FINANCIAL CORP.**  
**(A WHOLLY OWNED SUBSIDIARY OF QA3, L.L.C.)**

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Note: The Company claims exemption to filing the Computation for Determination of Reserve Requirements and Information Relating to Possession or Control Requirements under Rule 15c3-3 of the Securities and Exchange Commission pursuant to SEC Rule 15c3-3(k)(2)(B).

11837 Miracle Hills Drive, Suite 100  
Omaha, Nebraska 68154-4418  
402.496.8800  
Fax: 402.496.2711  
www.lutzcpa.com

| SHAREHOLDERS      |                     |                    |
|-------------------|---------------------|--------------------|
| James D. Honz     | W. Reed Samson      | Steven P. Kenney   |
| Gary K. Witt      | Jeffrey L. Snyder   | William W. Kenedy  |
| Ronald J. Nebbia  | Patrick C. Knowles  | Stephen C. Irlbeck |
| Gregory J. Boulay | Sandra A. Lane      | Susan S. Krause    |
| Mark F. Duren     | Shawn A. Wederquist | Michael B. Mowat   |

## INDEPENDENT ACCOUNTANTS' AUDIT REPORT

Board of Directors and Stockholder  
QA3 Financial Corp.  
Omaha, Nebraska

We have audited the accompanying statement of financial condition of QA3 Financial Corp., an Iowa corporation and wholly owned subsidiary of QA3, L.L.C., as of December 31, 2004, and the related statements of earnings, changes in stockholder's equity and cash flows for the year then ended that you are filing pursuant to rule 17a-5 under the Securities Exchange Act of 1934. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of QA3 Financial Corp. as of December 31, 2004, 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.

*Lutz & Company, P.C.*

Omaha, Nebraska  
February 23, 2005

**QA3 FINANCIAL CORP.**  
(A WHOLLY OWNED SUBSIDIARY OF QA3, L.L.C.)

**STATEMENT OF FINANCIAL CONDITION**

**DECEMBER 31, 2004**

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**ASSETS**

|                                                                              |                     |
|------------------------------------------------------------------------------|---------------------|
| Cash and Cash Equivalents                                                    | \$ 605,843          |
| Receivables                                                                  |                     |
| Concessions                                                                  | 809,178             |
| Other                                                                        | 97,844              |
| Prepaid Expenses                                                             | 84,361              |
| Deposit with Clearing Organization                                           | 25,000              |
| Computer Software and Equipment, Net of Accumulated Depreciation of \$98,700 | 67,716              |
| <b>TOTAL ASSETS</b>                                                          | <b>\$ 1,689,942</b> |

---

**LIABILITIES**

|                                        |                  |
|----------------------------------------|------------------|
| Accounts Payable                       | \$ 42,704        |
| Fees Payable to Clearing Organization  | 15,682           |
| Commissions Payable                    | 968,673          |
| Deferred Revenue                       | 224,147          |
| Accrued Expenses and Other Liabilities | 35,821           |
| Income Taxes Payable                   | 3,368            |
| <b>Total Liabilities</b>               | <b>1,290,395</b> |

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**COMMITMENTS AND CONTINGENCIES** (Notes 3, 4 and 9)

**STOCKHOLDER'S EQUITY**

**COMMON STOCK**

|                                          |       |
|------------------------------------------|-------|
| \$1 Par Value, Authorized 100,000 Shares |       |
| Issued and Outstanding, 6,000 Shares     | 6,000 |

|                        |                  |
|------------------------|------------------|
| <b>PAID IN CAPITAL</b> | <b>1,898,405</b> |
|------------------------|------------------|

|                            |                    |
|----------------------------|--------------------|
| <b>ACCUMULATED DEFICIT</b> | <b>(1,504,858)</b> |
|----------------------------|--------------------|

|                                   |                |
|-----------------------------------|----------------|
| <b>Total Stockholder's Equity</b> | <b>399,547</b> |
|-----------------------------------|----------------|

---

|                                                   |                     |
|---------------------------------------------------|---------------------|
| <b>TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY</b> | <b>\$ 1,689,942</b> |
|---------------------------------------------------|---------------------|

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**QA3 FINANCIAL CORP.**  
(A WHOLLY OWNED SUBSIDIARY OF QA3, L.L.C.)

**STATEMENT OF EARNINGS**

**FOR THE YEAR ENDED DECEMBER 31, 2004**

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|                            |                     |
|----------------------------|---------------------|
| <b>CONCESSION REVENUES</b> | <b>\$28,557,018</b> |
|----------------------------|---------------------|

|                                                    |                   |
|----------------------------------------------------|-------------------|
| <b>COMMISSIONS ON CONCESSION REVENUES (Note 5)</b> | <b>26,196,264</b> |
|----------------------------------------------------|-------------------|

---

|                                |                  |
|--------------------------------|------------------|
| <b>NET CONCESSION REVENUES</b> | <b>2,360,754</b> |
|--------------------------------|------------------|

**OTHER REVENUES**

|                          |           |
|--------------------------|-----------|
| Other Operating Revenues | 1,596,289 |
|--------------------------|-----------|

|                 |        |
|-----------------|--------|
| Interest Income | 60,030 |
|-----------------|--------|

|                       |         |
|-----------------------|---------|
| Other Income (Note 5) | 156,973 |
|-----------------------|---------|

---

|                      |           |
|----------------------|-----------|
| Total Other Revenues | 1,813,292 |
|----------------------|-----------|

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|                     |                  |
|---------------------|------------------|
| <b>NET REVENUES</b> | <b>4,174,046</b> |
|---------------------|------------------|

**EXPENSES (Note 8)**

|                               |           |
|-------------------------------|-----------|
| Salaries and Related Expenses | 1,835,683 |
|-------------------------------|-----------|

|                |         |
|----------------|---------|
| Brokerage Fees | 282,574 |
|----------------|---------|

|                                   |        |
|-----------------------------------|--------|
| Communication and Data Processing | 80,921 |
|-----------------------------------|--------|

|              |        |
|--------------|--------|
| Depreciation | 19,763 |
|--------------|--------|

|                  |       |
|------------------|-------|
| Interest Expense | 5,363 |
|------------------|-------|

|               |        |
|---------------|--------|
| Miscellaneous | 64,801 |
|---------------|--------|

|           |         |
|-----------|---------|
| Occupancy | 337,517 |
|-----------|---------|

|                |         |
|----------------|---------|
| Office Expense | 217,725 |
|----------------|---------|

|                   |        |
|-------------------|--------|
| Professional Fees | 73,847 |
|-------------------|--------|

|            |         |
|------------|---------|
| Recruiting | 195,314 |
|------------|---------|

|                 |         |
|-----------------|---------|
| Regulatory Fees | 496,914 |
|-----------------|---------|

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|                |           |
|----------------|-----------|
| Total Expenses | 3,610,422 |
|----------------|-----------|

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|                                            |         |
|--------------------------------------------|---------|
| Earnings before Provision for Income Taxes | 563,624 |
|--------------------------------------------|---------|

|                                            |              |
|--------------------------------------------|--------------|
| <b>PROVISION FOR INCOME TAXES (Note 6)</b> | <b>3,368</b> |
|--------------------------------------------|--------------|

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|                     |                   |
|---------------------|-------------------|
| <b>NET EARNINGS</b> | <b>\$ 560,256</b> |
|---------------------|-------------------|

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See Notes to Financial Statements.

**QA3 FINANCIAL CORP.**  
(A WHOLLY OWNED SUBSIDIARY OF QA3, L.L.C.)

**STATEMENT OF CHANGES IN STOCKHOLDER'S EQUITY**

**FOR THE YEAR ENDED DECEMBER 31, 2004**

|                                    | <u>--Common Stock --</u> | <u>Par</u>   | <u>Paid In</u> | <u>Accumulated</u> | <u>Total</u>         |
|------------------------------------|--------------------------|--------------|----------------|--------------------|----------------------|
|                                    | <u>Shares</u>            | <u>Value</u> | <u>Capital</u> | <u>Deficit</u>     | <u>Stockholder's</u> |
|                                    |                          |              |                |                    | <u>Equity</u>        |
| <b>BALANCES, DECEMBER 31, 2003</b> | 6,000                    | \$6,000      | \$4,273,638    | \$(2,065,114)      | \$ 2,214,524         |
| Return of Capital (Note 8)         |                          |              | (2,375,233)    |                    | (2,375,233)          |
| Net Earnings                       |                          |              |                | 560,256            | 560,256              |
| <b>BALANCES, DECEMBER 31, 2004</b> | 6,000                    | \$6,000      | \$1,898,405    | \$(1,504,858)      | \$ 399,547           |

See Notes to Financial Statements.

**QA3 FINANCIAL CORP.****(A WHOLLY OWNED SUBSIDIARY OF QA3, L.L.C.)****STATEMENT OF CASH FLOWS****FOR THE YEAR ENDED DECEMBER 31, 2004**

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**CASH FLOWS FROM OPERATING ACTIVITIES**

|                                                                                       |            |
|---------------------------------------------------------------------------------------|------------|
| Net Earnings                                                                          | \$ 560,256 |
| Adjustments to Reconcile Net Earnings to Net Cash<br>Provided by Operating Activities |            |
| Depreciation                                                                          | 19,763     |
| Line of Credit Receivable Forgiven                                                    | 7,436      |
| Changes in Operating Assets and Liabilities                                           |            |
| Increase in Concessions Receivable                                                    | (319,936)  |
| Increase in Other Receivables                                                         | (46,496)   |
| Increase in Prepaid Expenses                                                          | (54,594)   |
| Decrease in Deposit with Clearing Organization                                        | 50,524     |
| Increase in Accounts Payable                                                          | 25,342     |
| Increase in Fees Payable to Clearing Organization                                     | 11,236     |
| Increase in Commissions Payable                                                       | 385,539    |
| Increase in Deferred Revenue                                                          | 159,666    |
| Increase in Accrued Expenses and Other Liabilities                                    | 9,740      |
| Increase in Income Taxes Payable                                                      | 3,368      |
| Net Cash Provided by Operating Activities                                             | 811,844    |

---

**CASH FLOWS FROM INVESTING ACTIVITIES**

|                                             |           |
|---------------------------------------------|-----------|
| Purchase of Computer Software and Equipment | (59,866)  |
| Net Increase in Affiliate Receivables       | (614,188) |
| Repayments on Line of Credit Receivable     | 24,997    |
| Net Cash Used in Investing Activities       | (649,057) |

---

|                                           |         |
|-------------------------------------------|---------|
| Net Increase in Cash and Cash Equivalents | 162,787 |
|-------------------------------------------|---------|

|                                              |         |
|----------------------------------------------|---------|
| Cash and Cash Equivalents, Beginning of Year | 443,056 |
|----------------------------------------------|---------|

---

|                                               |                   |
|-----------------------------------------------|-------------------|
| <b>Cash and Cash Equivalents, End of Year</b> | <b>\$ 605,843</b> |
|-----------------------------------------------|-------------------|

---

**SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION**

|                                                              |           |
|--------------------------------------------------------------|-----------|
| Interest Paid                                                | \$ 5,363  |
| Return of Capital Through Reduction in Affiliate Receivables | 2,375,233 |

# **QA3 FINANCIAL CORP.**

(A WHOLLY OWNED SUBSIDIARY OF QA3, L.L.C.)

## **NOTES TO FINANCIAL STATEMENTS**

**DECEMBER 31, 2004**

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### **1. Summary of Significant Accounting Policies**

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A summary of the significant accounting policies consistently applied in the preparation of the accompanying financial statements is set forth below.

**Organization and**

**Nature of Business**

QA3 Financial Corp. (the "Company") is a broker-dealer registered with the Securities and Exchange Commission (SEC) and is a member of the National Association of Securities Dealers (NASD). The Company is an Iowa corporation and a wholly owned subsidiary of QA3, L.L.C. ("Parent").

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Cash and Cash  
Equivalents**

The Company's policy is to invest excess cash in income-producing investments. Cash equivalents consist of temporary cash investments with maturities of three months or less. For purposes of the statement of cash flows, the Company includes these amounts in cash and cash equivalents.

**Concessions  
Receivable**

The Company's concessions receivable consists principally of concessions receivable from mutual fund companies, clearing organizations and others. Management believes all concessions receivable are collectible; accordingly, no allowance for doubtful accounts is required. If amounts become uncollectible, they will be charged to operations when that determination is made.

**Concentration of  
Credit Risk**

The Company has several financial instruments that potentially subject the Company to credit risk. The Company maintains bank accounts in which the balances sometimes exceed federally insured limits. The Company's concessions and other receivables are also subject to credit risk.

The Company is an introducing broker-dealer firm, which processes certain orders through mutual fund companies and clears stock related orders through clearing organizations. The Company may be exposed to risk in the event that a mutual fund company or clearing organization would not fulfill its obligations. It is the Company's policy to review, as necessary, the credit standing of the mutual fund companies and clearing organizations.

**QA3 FINANCIAL CORP.**  
(A WHOLLY OWNED SUBSIDIARY OF QA3, L.L.C.)

**NOTES TO FINANCIAL STATEMENTS**

**DECEMBER 31, 2004**

---

**1. Summary of Significant Accounting Policies - Continued**

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**Computer Software  
and Equipment**

Computer software and equipment are recorded at cost. Expenditures for additions and betterments are capitalized; expenditures for maintenance and repairs are charged to expense as incurred. The costs of assets disposed and the related accumulated depreciation are eliminated from the accounts in the year of disposal. Gains or losses from disposals are recognized in the year of disposal. Depreciation is computed using the straight-line method over the estimated useful life of computer software and equipment ranging from 3 to 5 years.

**Revenue Recognition** Concessions and the related commissions and brokerage fees expense are recorded on a trade-date basis as the security transactions occur at the mutual fund companies and clearing organizations.

**Income Taxes** Deferred income tax assets and liabilities are computed annually for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Income tax expense or benefit is the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

**2. Line of Credit Receivable**

---

In September 2000, the Company entered into a \$125,000 forgivable line of credit receivable agreement with Ares Capital Advisors ("Ares"), formerly known as Bunning Financial Services, in connection with the associates of Ares becoming registered representatives of the Company. In accordance with the agreement, the Company granted Ares the right to make interest free advances to its associates. The advances were forgiven at a rate of \$.10 for every dollar of gross dealer concessions and/or fee income that Ares processed through the Company. This agreement expired in January 2004 at which time the remaining balance converted into a note receivable accruing interest at 7% due June 2004. Over the life of the line of credit receivable, \$120,000 was advanced and \$95,003 was forgiven. The remaining balance was paid in full in June 2004.

**3. Employment Agreement**

---

The Company's Parent has entered into an employment agreement with the Company's president, who is also a minority stockholder of the Company's Parent, through May 31, 2009 with an automatic extension for two additional years unless the Company's Parent provides notice on or before April 1, 2009. This agreement provides for a monthly base salary based on certain performance factors and an annual incentive bonus based on net earnings before income taxes. The Company is responsible for its portion of the base salary and annual bonus as described in the agreement.

## **QA3 FINANCIAL CORP.**

**(A WHOLLY OWNED SUBSIDIARY OF QA3, L.L.C.)**

### **NOTES TO FINANCIAL STATEMENTS**

**DECEMBER 31, 2004**

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#### **4. Net Capital Requirements**

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The Company is subject to the Securities and Exchange Commission Uniform Net Capital Rule (SEC Rule 15c3-1), which requires the Company to maintain net capital of at least the greater of 6 2/3% of aggregate indebtedness or \$50,000. At December 31, 2004, the Company's net capital, as defined, was \$139,894, which was \$53,868 in excess of its required net capital of \$86,026.

#### **5. Insurance Proceeds**

---

The Company received \$250,000 of insurance proceeds related to the discovery of theft by an employee during the year ended December 31, 2004. The Company's investigation determined that this employee had defrauded the Company by diverting a total of \$436,913 of the Company's net concession revenues into her bank account since October 2002 of which \$221,506 related to the year ended December 31, 2004. The amounts diverted by the employee were charged to commissions expense and therefore, \$221,506 of insurance proceeds received were used to offset that portion of commissions expense relating to the year ended December 31, 2004. The remaining insurance proceeds of \$28,494 were recorded as other income.

#### **6. Income Taxes**

---

The provision for income taxes consists of current federal alternative minimum taxes of \$3,368 for the year ended December 31, 2004.

The Company has available at December 31, 2004, unused operating losses of approximately \$1,464,000, which may be applied against future taxable income expiring in various years from 2005 to 2023. A net deferred income tax asset in the amount of approximately \$590,000 attributable principally to net operating loss carryforwards has been offset by a valuation allowance in the same amount.

#### **7. 401(k) Savings Plan**

---

The Company is a member of the group contributory employee 401(k) savings plan of its former parent, Financial Continuum, L.L.C. ("FC"), which includes substantially all employees of the Company. The Company's Parent and FC are affiliated by common ownership. Contributions to the plan are discretionary. No contributions were made by the Company to the plan for the year ended December 31, 2004.

#### **8. Related Party Transactions**

---

The Company has an expense sharing agreement with its Parent for office space, employees and various operating expenses. Under this agreement, the Company is charged an allocation for its portion of the expenses, which amounted to \$2,391,567 for the year ended December 31, 2004.

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## **QA3 FINANCIAL CORP.**

**(A WHOLLY OWNED SUBSIDIARY OF QA3, L.L.C.)**

### **NOTES TO FINANCIAL STATEMENTS**

**DECEMBER 31, 2004**

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#### **8. Related Party Transactions - Continued**

---

The Company also made cash advances of \$5,449,414 to its Parent during the year ended December 31, 2004 for advisory and brokerage fees paid on behalf of its sister company, QA3 Financial, LLC, a company also wholly owned by its Parent.

At December 31, 2004, the Company's net affiliate receivable due from its Parent related to the transactions described above was \$2,375,233 and was accounted for as a return of capital.

#### **9. Subsequent Events**

---

On January 31, 2005, the majority stockholder of the Company's Parent entered into a \$3,000,000 installment loan agreement with a bank, payable in monthly installments of \$59,193, including interest at 6.75%, through February 2010. This loan is collateralized by the personal guarantee of this majority stockholder and the corporate guarantees of the Company's Parent and its sister companies, QA3 Financial, LLC and Quantum Insurance Design, L.L.C., both either wholly or majority owned subsidiaries of the Company's Parent. The Company has not guaranteed this loan, but anticipates that it will be required to make cash distributions in the future to cover a portion of the loan payments.

On February 16, 2005, the Company's former parent, Financial Continuum, L.L.C. (FC), filed for and was granted relief under Chapter 11 of the Bankruptcy Code by the United States Bankruptcy Court for the District of Nebraska. The Company's Parent and FC are affiliated by common ownership. The management of QA3 Financial Corp. does not expect this action to have any impact on the Company.

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## SUPPLEMENTAL INFORMATION

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11837 Miracle Hills Drive, Suite 100  
Omaha, Nebraska 68154-4418  
402.496.8800  
Fax: 402.496.2711  
www.lutzcpa.com

| SHAREHOLDERS      |                     |                    |
|-------------------|---------------------|--------------------|
| James D. Honz     | W. Reed Samson      | Steven P. Kenney   |
| Gary K. Witt      | Jeffrey L. Snyder   | William W. Kenedy  |
| Ronald J. Nebbia  | Patrick C. Knowles  | Stephen C. Irlbeck |
| Gregory J. Boulay | Sandra A. Lane      | Susan S. Krause    |
| Mark F. Duren     | Shawn A. Wederquist | Michael B. Mowat   |

## INDEPENDENT ACCOUNTANTS' AUDIT REPORT ON SUPPLEMENTAL INFORMATION

Board of Directors and Stockholder  
QA3 Financial Corp.  
Omaha, Nebraska

We have audited the accompanying financial statements of QA3 Financial Corp., a wholly owned subsidiary of QA3, L.L.C., as of and for the year ended December 31, 2004, and have issued our report thereon dated February 23, 2005. Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental information presented hereafter 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.

*Lutz & Company, P.C.*

Omaha, Nebraska  
February 23, 2005

**QA3 FINANCIAL CORP.**

(A WHOLLY OWNED SUBSIDIARY OF QA3, L.L.C.)

**COMPUTATION OF NET CAPITAL UNDER RULE 15c3-1 OF THE SECURITIES AND EXCHANGE COMMISSION****DECEMBER 31, 2004****NET CAPITAL****TOTAL STOCKHOLDER'S EQUITY** \$ 399,547**NONALLOWABLE ASSETS**

|                                      |                |
|--------------------------------------|----------------|
| Concessions Receivable               | 5,478          |
| Other Receivables                    | 97,844         |
| Prepaid Expenses                     | 84,361         |
| Computer Software and Equipment, Net | 67,716         |
| <b>Total Nonallowable Assets</b>     | <b>255,399</b> |

|                       |       |
|-----------------------|-------|
| Haircut on Securities | 4,254 |
|-----------------------|-------|

**NET CAPITAL** \$ 139,894**AGGREGATE INDEBTNESS**

|                                        |           |
|----------------------------------------|-----------|
| Accounts Payable                       | \$ 42,704 |
| Fees Payable to Clearing Organizations | 15,682    |
| Commissions Payable                    | 968,673   |
| Deferred Revenue                       | 224,147   |
| Accrued Expenses and Other Liabilities | 35,821    |
| Income Taxes Payable                   | 3,368     |

**AGGREGATE INDEBTEDNESS** \$1,290,395**CAPITAL REQUIREMENTS**

|                                                                 |            |
|-----------------------------------------------------------------|------------|
| Net Capital                                                     | \$ 139,894 |
| Greater of 6 2/3% of Aggregate Indebtedness or Minimum Required | 86,026     |

**NET CAPITAL EXCEEDING REQUIREMENTS** \$ 53,868**EXCESS NET CAPITAL AT 1000 PERCENT** \$ 10,854**RATIO OF AGGREGATE INDEBTEDNESS TO NET CAPITAL** 9.22 to 1

Note: There are no material differences to report between the computation of net capital under Rule 15c3-1 of the Securities and Exchange Commission and the net capital as reported in the Company's Part II (Unaudited) FOCUS report at December 31, 2004, as amended.

See Independent Accountants' Audit Report on Supplemental Information.

11837 Miracle Hills Drive, Suite 100  
Omaha, Nebraska 68154-4418  
402.496.8800  
Fax: 402.496.2711  
www.lutzcpa.com

| SHAREHOLDERS      |                     |                    |
|-------------------|---------------------|--------------------|
| James D. Honz     | W. Reed Samson      | Steven P. Kenney   |
| Gary K. Witt      | Jeffrey L. Snyder   | William W. Kenedy  |
| Ronald J. Nebbia  | Patrick C. Knowles  | Stephen C. Irlbeck |
| Gregory J. Boulay | Sandra A. Lane      | Susan S. Krause    |
| Mark F. Duren     | Shawn A. Wederquist | Michael B. Mowat   |

## INDEPENDENT ACCOUNTANTS' REPORT ON INTERNAL CONTROL

Board of Directors and Stockholder  
QA3 Financial Corp.  
Omaha, Nebraska

In planning and performing our audit of the financial statements and supplemental schedule of QA3 Financial Corp., an Iowa corporation and wholly owned subsidiary of QA3, L.L.C., for the year ended December 31, 2004, we considered its internal control, including control activities for safeguarding securities, in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control.

Also, as required by rule 17a-5(g)(1) of the Securities and Exchange Commission (SEC), we have made a study of the practices and procedures followed by the Company including tests of such practices and procedures that we considered relevant to the objectives stated in rule 17a-5(g) in making the periodic computations of aggregate indebtedness and net capital under rule 17a-3(a)(11) and for determining compliance with the exemptive provisions of rule 15c3-3. Because the Company does not carry securities accounts for customers or perform custodial functions relating to customer securities, we did not review the practices and procedures followed by the Company in any of the following:

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

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

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

Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of the specific internal control components does not reduce to a relatively low level the risk that error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted the following matter involving the control environment, accounting system and control activities and their operation that we consider to be a material weakness as defined above:

1. The Company's control activities for safeguarding cash were deficient during the first three quarters of the year. During the fourth quarter, the Company initiated the following new policies and procedures to strengthen the control of cash:
  - a. Commissions are to be balanced and reconciled on a daily basis.
  - b. Segregation of duties are to be maintained.
  - c. Commission Department employees should be cross-trained.
  - d. Additional staffing has been added to ensure transactions are recorded and commissions are reconciled in a timely and accurate manner.
  - e. Employee access to master file information is to be limited to supervisors only.
  - f. Analytical procedures have been enacted to determine reasonableness of commissions paid.

Additionally, the Company made a material audit adjustment as a result of the procedures we performed as part of our audit of the financial statements of QA3 Financial Corp. for the year ended December 31, 2004 relating to the following:

1. The recording of 12B-1, trailer and transfer concessions including the related receivables, payables, revenues and expenses.

The Company records these types of concessions on a cash basis due to the difficulty in identifying them in a timely enough manner to enable the Company to meet its interim regulatory reporting requirements. Currently, the Company's only method of identifying these types of concessions is to analyze subsequent activity. Therefore, as part of the audit process, these types of concessions were quantified based on subsequent cash receipts and recorded in the financial statements for the year ended December 31, 2004. The Company has amended its fourth quarter FOCUS report accordingly.

These conditions were considered in determining the nature, timing, and extent of the procedures to be performed in our audit of the financial statements of QA3 Financial Corp. for the year ended December 31, 2004, and this report does not affect our report thereon dated February 23, 2005.

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, except as noted in the above paragraph were adequate at December 31, 2004, to meet the SEC's objectives.

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

Lutz & Company, P.C.

Omaha, Nebraska  
February 23, 2005