

SECURITIES



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| OMB APPROVAL                                      |                    |
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**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 January 1, 2004 AND ENDING December 31, 2004  
MM/DD/YY MM/DD/YY

**A. REGISTRANT IDENTIFICATION**

NAME OF BROKER-DEALER:

Internet Securities

|                   |
|-------------------|
| OFFICIAL USE ONLY |
| FIRM ID. NO.      |

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

300 Frank H. Ogawa Plaza

Suite 210

PROCESSED

Oakland

(No. and Street)

CA

MAR 23 2005

94612

(City)

(State)

THOMSON FINANCIAL

(Zip Code)

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

Michael Beardsley

(510)444-5240

(Area Code - Telephone No.)

**B. ACCOUNTANT IDENTIFICATION**

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

Kevin G. Breard, CPA An Accountancy Corporation

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

9010 Corbin Avenue, Suite 7

Northridge

California

91324

(Address)

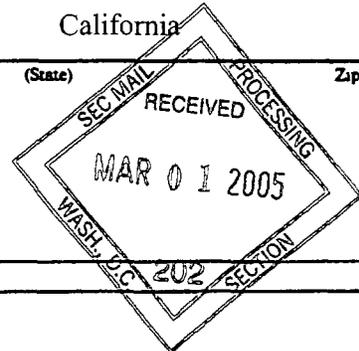
(City)

(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).

SEC 1410 (3-91)

Ad  
3-22-2005

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3/24/05  
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OATH OR AFFIRMATION

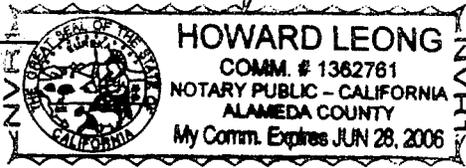
I, Michael Beardsley, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of Internet Securities, as of December 31, 2004, are true and correct. I further swear (or affirm) that neither the company nor any partner, proprietor, principal officer or director has any proprietary interest in any account classified solely as that of a customer, except as follows:

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

State of CALIFORNIA  
County of ALAMEDA  
Subscribed and sworn (or affirmed) to before me this 1 day of FEB, 2005

Michael W. Beardsley 2/1/05  
Signature  
president & CEO  
Title

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

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

KEVIN G. BREARD, C.P.A.  
AN ACCOUNTANCY CORPORATION

Independent Auditor's Report

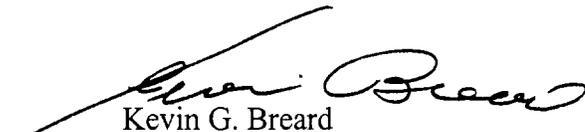
Board of Directors  
Internet Securities

I have audited the accompanying statement of financial condition of Internet Securities as of December 31, 2004 and the related statements of operations, changes in stockholder's equity, changes in liabilities subordinated to claims of general creditors, 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. My responsibility is to express an opinion on these statements based on my audit.

I conducted my audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that I 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. I believe that my audit provides a reasonable basis for my opinion.

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Internet Securities 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.

My examination was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The information contained on Schedules I-III is presented for purposes of additional analysis and is not required as part of the basic financial statements, but as supplementary information required by rule 17a-5 of the Securities and Exchange Act of 1934. Such information has been subject to the auditing procedures applied in the examination of the basic financial statements and, in my opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole and in conformity with the rules of the Securities and Exchange Commission.



Kevin G. Breard  
Certified Public Accountant

Northridge, California  
February 1, 2005

NORTHRIDGE OFFICE PLAZA  
9010 CORBIN AVENUE, SUITE 7  
NORTHRIDGE, CALIFORNIA 91324  
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B r e a r d C P A @ a o l . c o m

**Internet Securities**  
**Statement of Financial Condition**  
**December 31, 2004**

**Assets**

|   |                         |
|---|-------------------------|
| Cash and cash equivalents   | \$ 33,760               |
| Accounts receivable   | 827                     |
| Receivable from related party                                     | 7,877                   |
| Furniture & equipment, net of \$6,255 accumulated<br>depreciation | 298                     |
| Deposits  | 405                     |
| Deferred income taxes   | <u>23,653</u>           |
| <b>Total assets</b>   | <b><u>\$ 66,820</u></b> |

**Liabilities and Stockholder's Equity**

**Liabilities**

|                                       |               |
|---------------------------------------|---------------|
| Accounts payable and accrued expenses | \$ 23,734     |
| Subordinated debt                     | <u>17,746</u> |
| <b>Total liabilities</b>              | <b>41,480</b> |

**Stockholder's equity**

|   |                         |
|---|-------------------------|
| Common stock, no par value, 10 million shares authorized,<br>2.5 million shares issued, and outstanding | 2,500                   |
| Additional paid-in capital  | 197,332                 |
| Accumulated deficit   | <u>(174,492)</u>        |
| <b>Total stockholder's equity</b>   | <b><u>25,340</u></b>    |
| <b>Total liabilities and stockholder's equity</b>   | <b><u>\$ 66,820</u></b> |

*The accompanying notes are an integral part of these financial statements.*

**Internet Securities**  
**Statement of Operations**  
**For the year ended December 31, 2004**

**Revenue**

|                              |              |
|------------------------------|--------------|
| Consulting income            | \$ 4,079     |
| Interest and dividend income | 182          |
| Other income                 | <u>2,772</u> |
| <b>Total revenue</b>         | 7,033        |

**Expenses**

|                                |               |
|--------------------------------|---------------|
| Communications                 | 3,837         |
| Occupancy                      | 4,791         |
| Interest                       | 620           |
| Taxes, other than income taxes | 1,125         |
| Other operating expenses       | <u>18,458</u> |

**Total expenses** 28,831

**Income (loss) before taxes** (21,798)

**Income tax provision** 800

**Net income (loss)** \$ (22,598)

*The accompanying notes are an integral part of these financial statements.*

**Internet Securities**  
**Statement of Changes in Stockholder's Equity**  
**For the year ended December 31, 2004**

|                              | <u>Common<br/>Stock</u> | <u>Additional<br/>Paid-in<br/>Capital</u> | <u>Accumulated<br/>Deficit</u> | <u>Total</u>     |
|------------------------------|-------------------------|---|--------------------------------|------------------|
| Balance on January 1, 2004   | \$ 2,500                | \$ 197,332                                | \$ (151,894)                   | \$ 47,938        |
| Net income (loss)            | <u>—</u>                | <u>—</u>                                  | <u>(22,598)</u>                | <u>(22,598)</u>  |
| Balance on December 31, 2004 | <u>\$ 2,500</u>         | <u>\$ 197,332</u>                         | <u>\$ (174,492)</u>            | <u>\$ 25,340</u> |

*The accompanying notes are an integral part of these financial statements.*

**Internet Securities**  
**Statement of Changes in Liabilities Subordinated**  
**to the Claims of General Creditors**  
**For the Year Ended December 31, 2004**

|                              | <u>Subordinated<br/>debt</u> |
|------------------------------|------------------------------|
| Balance at January 1, 2004   | \$ 17,746                    |
| Additions (Reductions)       | <u>          —</u>           |
| Balance at December 31, 2004 | <u>\$ 17,746</u>             |

*The accompanying notes are an integral part of these financial statements.*

**Internet Securities**  
**Statement of Cash Flows**  
**For the year ended December 31, 2004**

**Cash flows from operating activities:**

|   |            |                 |
|---|------------|-----------------|
| Net income (loss)   |            | \$ (22,598)     |
| Adjustments to reconcile net income (loss) to net cash and cash equivalents provided by (used in) operating activities: |            |                 |
| Depreciation  | \$ 399     |                 |
| Amortization  | 4,270      |                 |
| Increase (decrease) in:   |            |                 |
| Accounts receivable   | (828)      |                 |
| (Decrease) increase in:   |            |                 |
| Accounts payable and accrued expenses   | <u>544</u> |                 |
| Total adjustments   |            | <u>4,385</u>    |
| Net cash and cash equivalents provided by (used in) operating activities  |            | <u>(18,213)</u> |

**Cash flows from investing activities:**

-

**Cash flows from financing activities:**

|  |  |                         |
|--|--|-------------------------|
| Advances and repayments to related party, net                            |  | <u>21,477</u>           |
| Net cash and cash equivalents provided by (used in) financing activities |  | <u>21,477</u>           |
| Net increase in cash and cash equivalents                                |  | 3,264                   |
| Cash and cash equivalents at beginning of year                           |  | <u>30,496</u>           |
| Cash and cash equivalents at end of year                                 |  | <u><u>\$ 33,760</u></u> |

**Supplemental disclosure of cash flow information:**

|                               |    |     |
|-------------------------------|----|-----|
| Cash paid during the year for |    |     |
| Income taxes                  | \$ | -   |
| Interest                      | \$ | 620 |

*The accompanying notes are an integral part of these financial statements.*

**Internet Securities**  
**Notes to Financial Statements**  
**For the year ended December 31, 2004**

**Note 1: GENERAL AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*General*

Internet Securities ( the "Company") was incorporated in the State of California on February 19, 1999. The Company is registered with the Securities and Exchange Commission as an introducing broker-dealer of securities that does not receive funds; and is a member of the National Association of Securities Dealers, Inc. (NASD) and the Securities Investor Protection Corporation (SIPC).

The Company is an online investment bank focused on the telecommunications industry. The Company offers consulting services in the areas of mergers and acquisitions, private equity underwriting, and equity research.

*Summary of Significant Accounting Policies*

The presentation 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

For purposes of statements of cash flows, the Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Intangible assets consist of fully amortized organization costs, start-up costs and trademark costs. Intangibles were amortized over their estimated useful lives using the straight-line method. Amortization expense for the year ended 2004 was \$4,270. As of December 31, 2004, intangible assets were fully amortized.

Consulting income consists of fees for trade show presentations for the year 2004. The income is recognized upon receipt, usually before the event. Other income consists of revenue earned by the Company for assisting clients with compliance associated with the hiring of a representative.

Rent expense for the year ended December 31, 2004 was \$4,791.

**Internet Securities**  
**Notes to Financial Statements**  
**For the year ended December 31, 2004**

**Note 2: FURNITURE AND EQUIPMENT**

The furniture and equipment are recorded at cost.

|                               |                | <u>Depreciable<br/>Life Years</u> |
|-------------------------------|----------------|-----------------------------------|
| Furniture & fixtures          | \$ 161         | 5                                 |
| Equipment                     | 141            | 5                                 |
| Computers                     | 5,083          | 5                                 |
| Software                      | <u>1,168</u>   | 3                                 |
|                               | 6,553          |                                   |
| Less accumulated depreciation | <u>(6,255)</u> |                                   |
| Furniture and equipment, net  | <u>\$ 298</u>  |                                   |

Depreciation expense for the year ended December 31, 2004 was \$399.

**Note 3: SUBORDINATED LOAN AGREEMENT**

The borrowings under subordination loan agreements at December 31, 2004 are listed as follows:

|  |           |
|--|-----------|
| Liabilities subordinated to the claims of general creditors: |           |
| No interest, due November 30, 2005                           | \$ 17,746 |

The subordinated borrowing is covered by agreements approved by the National Association of Security Dealers, Inc. and is thus available in computing net capital under the Securities and Exchange Commission's uniform net capital rule. To the extent that such borrowing is required for the Company's continued compliance with minimum net capital requirements, it may not be repaid.

**Note 4: RECENTLY ISSUED ACCOUNTING STANDARDS**

In January 2003, The Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 46, "*Consolidation of Variable Interest Entities*" (FIN 46"). This interpretation of Accounting Research Bulletin No. 51, requires companies to consolidate the operations of all variable interest entities ("VIE's") for which they are the primary beneficiary. The term "primary beneficiary" is defined as the entity that will absorb a majority of expected losses, receive a majority of the expected residual returns, or both. This interpretation was later revised by the issuance of Interpretation No. 46R ("FIN 46R"). The revision was issued to address certain implementation issues that had arisen since the issuance of the original interpretation and to provide companies with the ability to defer the adoption of FIN 46 to periods after March 15, 2004. The implementation of FIN No. 46 and FIN 46R, had no material impact on the Company's financial statements.

**Internet Securities**  
**Notes to Financial Statements**  
**For the year ended December 31, 2004**

**Note 4: RECENTLY ISSUED ACCOUNTING STANDARDS**  
**(Continued)**

On July 16, 2004, the FASB ratified the Emerging Issues Task Force ("EITF") consensus on Issue 02-14, "*Whether the Equity Method of Accounting Applies When an Investor Does Not Have an Investment in Voting Stock of an Investee but Exercises Significant Influence through Other Means*" ("EITF 02-14"). The consensus concludes that an investor should apply the equity method of accounting when it can exercise significant influence over an entity through a means other than holding voting rights. The consensus is effective for reporting periods beginning after September 15, 2004. The adoption of EITF 02-14 did not have a material impact on the Company's financial statements.

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123 (revised 2004), "*Share-Based Payment*" ("FASB 123R"), which addresses the accounting for employee stock options. FASB 123R requires that the cost of all employee stock options, as well as other equity-based compensation arrangements, be reflected in the financial statements based on the estimated fair value of the awards. Stock options are a valuable and important tool that have been used by many companies as a means to motivate employees and to promote business growth. The statement requires that the value of these arrangements be measured and recognized in the financial statements. FASB 123R becomes effective for reports filed after June 15, 2005. Early adoption of FASB 123R had no material effect on the Company's financial statements.

**Note 5: NET CAPITAL REQUIREMENTS**

The Company is subject to the uniform net capital rule (Rule 15c3-1) of the Securities and Exchange Commission, which requires both the maintenance of minimum net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1. Net capital and aggregate indebtedness change day to day, but on December 31, 2004, the Company's net capital of \$17,904 exceeded the minimum net capital requirement by \$12,904; and the Company's ratio of aggregate indebtedness (\$23,734) to net capital was 1.33 to 1, which is less than the 15 to 1 maximum ratio permissible for a Broker/Dealer.

**Internet Securities**  
**Notes to Financial Statements**  
**For the year ended December 31, 2004**

**Note 9: RECONCILIATION OF AUDITED NET CAPITAL TO UNAUDITED FOCUS**

There is a \$489 difference between the computation of net capital under net capital SEC rule 15c3-1 and the corresponding unaudited focus part IIA.

|                                    |               |                  |
|------------------------------------|---------------|------------------|
| Net capital per unaudited schedule |               | \$ 18,393        |
| Adjustments:                       |               |                  |
| Retained earnings                  | \$ (11,257)   |                  |
| Non-allowable assets               | <u>10,768</u> |                  |
| Total adjustments                  |               | <u>(489)</u>     |
| Net capital per audited statements |               | <u>\$ 17,904</u> |

**Internet Securities**  
**Schedule II - Computation for Determination of Reserve Requirements**  
**Pursuant to Rule 15c3-3**  
**As of December 31, 2004**

**Computation of net capital**

|   |                  |                 |
|---|------------------|-----------------|
| Stockholder's equity  |                  |                 |
| Common stock  | \$ 2,500         |                 |
| Additional paid-in capital  | 197,332          |                 |
| Retained earnings   | <u>(174,492)</u> |                 |
| Total stockholder's equity  |                  | \$ 25,340       |
| Add: Liabilities subordinated to the claims of general creditors  |                  |                 |
| Subordinated loan agreement                                       |                  | <u>17,746</u>   |
| Total stockholder's equity and allowable subordinated liabilities |                  | 43,086          |
| Less: Non-allowable assets  |                  |                 |
| Receivable from related party                                     | (827)            |                 |
| Furniture & equipment, net  | (298)            |                 |
| Deposits  | (405)            |                 |
| Deferred income taxes   | <u>(23,652)</u>  |                 |
| Total non-allowable assets  |                  | <u>(25,182)</u> |
| Net capital before haircuts                                       |                  | 17,904          |
| Total haircuts and undue concentration                            |                  | <u>—</u>        |
| <b>Net capital</b>  |                  | <b>17,904</b>   |

**Computation of net capital requirements**

|   |          |                |
|---|----------|----------------|
| Minimum net capital requirements            |          |                |
| 6 2/3 percent of net aggregate indebtedness | \$ 1,582 |                |
| Minimum dollar net capital required         | 5,000    |                |
| Net capital required (greater of above)     |          | <u>(5,000)</u> |

**Excess net capital** \$ 12,904

Ratio of aggregate indebtedness to net capital 1.33:1

There was an \$489 difference between net capital shown here and net capital as reported on the Company's unaudited Form X-17A-5 report dated December 31, 2004. See Note 6.

*See independent auditor's report.*

**Internet Securities**  
**Schedule II - Computation for Determination of Reserve Requirements**  
**Pursuant to Rule 15c3-3**  
**As of December 31, 2004**

A computation of reserve requirement is not applicable to Internet Securities as the Company qualifies for exemption under Rule 15c3-3 (k)(2)(i).

*See independent auditor's report.*

**Internet Securities**  
**Schedule III - Information Relating to Possession or Control**  
**Requirements Under Rule 15c3-3**  
**As of December 31, 2004**

Information relating to possession or control requirements is not applicable to Internet Securities as the Company qualifies for exemption under Rule 15c3-3 (k)(2)(i).

*See independent auditor's report.*

**Internet Securities**  
**Supplementary Accountant's Report**  
**on Internal Accounting Control**  
**Report Pursuant to 17a-5**  
**For the Year Ended December 31, 2004**

KEVIN G. BREARD, C.P.A.  
AN ACCOUNTANCY CORPORATION

Board of Directors  
Internet Securities

In planning and performing my audit of the financial statements and supplemental schedules of Internet Securities for the year ended December 31, 2004, I considered its internal control structure, for the purpose for safeguarding securities, in order to determine my auditing procedures for the purpose of expressing my 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, I have made a study of the practices and procedures followed by Internet Securities including tests of such practices and procedures that I considered relevant to 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 security accounts for customers or perform custodial functions relating to customer securities, I did not review the practices and procedures followed by the Company in any of the following:

1. Making the quarterly securities examinations, counts, verifications and comparisons
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 structure and the practices and procedures referred to in the preceding paragraph. In fulfilling this responsibility, estimates and judgements 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 Commission's above mentioned objectives. Two of the objectives of an internal control structure and the practices and procedures are to provide management with reasonable, but not absolute, assurance that assets for which the Company has responsibility are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit preparation of financial statements in conformity with generally accepted accounting principles. Rule 17-5(g) lists additional objectives of the practices and procedures listed in the preceding paragraph.

*i*

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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 they may become inadequate because of changes in conditions or that the effectiveness of their design and operation may deteriorate.

My consideration of the internal control structure would not necessarily disclose all matters in the 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 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 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, I noted no matters involving the internal control structure, including procedures for safeguarding securities, that I considered to be material weakness as defined above.

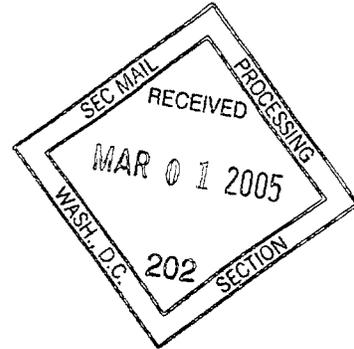
I understand that practices and procedures that accomplish the objectives referred to in the second paragraph of this report are considered by the Commission to be adequate for its purpose in accordance with the Securities Exchange Act of 1934 and related regulations, and that practices and procedures that do not accomplish such objectives in all material respects indicate material inadequacy for such purposes. Based on this understanding on my study, I believe that the Company's practices and procedures were adequate at December 31, 2004 to meet the Commission's objectives.

This report is intended solely for the use of management, the Securities and Exchange Commission, and other regulatory agencies which rely on Rule 17a-5(g) under the Securities Exchange Act of 1934 and should not be used for any other purpose.



Kevin G. Beard  
Certified Public Accountant

Northridge, California  
February 1, 2005



**Internet Securities**  
**Report Pursuant to Rule 17a-5 (d)**  
**Financial Statements**  
**For the Year Ended December 31, 2004**