



SECU



MISSION

OMB APPROVAL
OMB Number: 3235-0123
Expires: January 31, 2007
Estimated average burden hours per response . . . 12.00

SEC FILE NUMBER
8 - 65388

AC  
7/8

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 04/1/05 AND ENDING 3/31/06  
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER:  
**McNally Financial Services Corporation**

OFFICIAL USE ONLY
FIRM ID. NO.

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

1115 Tranquil Trail Drive

(No. and Street)

San Antonio  
(City)

Texas  
(State)

78232-5185  
(Zip Code)

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

David McNally

(210) 545-7080  
(Area Code - Telephone No.)

B. ACCOUNTANT IDENTIFICATION

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

**Helin, Donovan, Trubee & Wilkinson, LLP**

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

5918 W. Courtyard Drive Suite 400  
(Address)

Austin  
(City)

Texas  
(State)

78730  
(Zip Code)

CHECK ONE:

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

PROCESSED  
JUL 10 2006  
THOMSON FINANCIAL

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 (06-02)

Potential persons who are to respond to the collection of Information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

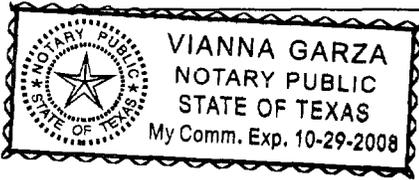
BB

AB  
7/8/06

OATH OR AFFIRMATION

I, David McNally, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of McNally Financial Services Corporation, as of March 31, 2006, 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:

NONE



Vianna Garza  
Notary Public

David McNally  
Signature

President  
Title

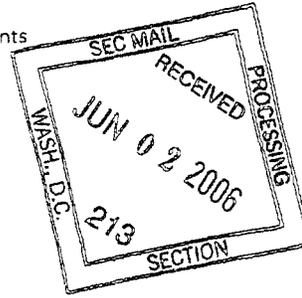
This report\*\* contains (check all applicable boxes):

- (a) Facing page.
- (b) Statement of Financial Condition.
- (c) Statement of Income (Loss).
- (d) Statement of 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.
- (o) Independent auditor's report on the internal control as required by SEC rule 17a-5.

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



Certified Public Accountants



**MCNALLY FINANCIAL SERVICES CORPORATION**

Financial Statements

March 31, 2006  
(With Independent Auditors' Report Thereon)

**MCNALLY FINANCIAL SERVICES CORPORATION**  
**Index to Financial Statements and Supplemental Schedule**  
**March 31, 2006**

---

INDEPENDENT AUDITORS' REPORT	1
------------------------------	---

---

FINANCIAL STATEMENTS	
Statement of Financial Condition	2
Statement of Operations	3
Statement of Changes in Stockholder's Equity	4
Statement of Cash Flows	5
Notes to the Financial Statements	6 - 8

---

SUPPLEMENTAL SCHEDULE	
I. Computation of net capital and aggregate indebtedness pursuant to Rule 15c3-1 of the Securities and Exchange Commission	9

---

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL	10 - 11
---	---------

---

**MCNALLY FINANCIAL SERVICES CORPORATION**  
**Statement of Financial Condition**  
**March 31, 2006**

**ASSETS**

Cash	\$ 25,221
Receivable from clearing broker-dealer	6,240
Receivable from customers	443
Employee advances	1,823
Clearing deposit	25,000
Securities owned, at market value	57,282
Fixed assets, net	<u>437</u>

**TOTAL ASSETS** **\$ 116,446**

**LIABILITIES AND STOCKHOLDER'S EQUITY**

**Liabilities**

Accrued expenses and other liabilities	\$ 14,456
Deferred tax liability, net	1,225
Franchise taxes payable	<u>256</u>

Total liabilities 15,937

**Stockholder's Equity**

Common stock, voting, 2,000 shares authorized, \$.01 par value, 1,000 shares issued and outstanding	10
Additional paid-in capital	104,411
Retained earnings	<u>(3,912)</u>

Total stockholder's equity 100,509

**TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY** **\$ 116,446**

See notes to financial statements and independent auditors' report.

**MCNALLY FINANCIAL SERVICES CORPORATION**

**Statement of Operations  
For the year ended March 31, 2006**

**REVENUES**

Securities commissions	\$	287,247
Insurance commissions		78,298
Trading profit		7,602
Interest and other income		<u>2,991</u>

Total revenues 376,138

**EXPENSES**

Commission expense		247,030
Payroll expenses		77,600
Professional fees		7,434
Regulatory fees		4,876
Advertising		1,441
Depreciation		357
Insurance		2,711
Other expenses		<u>31,385</u>

Total expenses 372,834

**INCOME BEFORE INCOME TAXES** 3,304

Current tax expense		18
Deferred tax expense		<u>566</u>

Net income tax expense 584

**NET INCOME** \$ 2,720

See notes to financial statements and independent auditors' report.

**MCNALLY FINANCIAL SERVICES CORPORATION**  
**Statement of Changes in Stockholder's Equity**  
**For the year ended March 31, 2006**

	Common Stock	Additional Paid-In Capital	Retained Earnings (Deficit)	Total
Balances at March 31, 2004	\$ 10	104,411	(6,632)	\$ 97,789
Net loss	-	-	2,720	2,720
Balances at March 31, 2005	\$ 10	104,411	(3,912)	\$ 100,509

See notes to financial statements and independent auditors' report.

MCNALLY FINANCIAL SERVICES CORPORATION

Statement of Cash Flows

For the year ended March 31, 2006

**Cash flows from operating activities:**

Net income	\$	2,720
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation expense		357
Deferred tax expense		566
Change in assets and liabilities		
Federal income tax receivable		5,021
Receivable from clearing broker-dealer		(2,922)
Other receivables		(2,266)
Securities owned, at market value		2,483
Other assets		934
Accrued expenses and other liabilities		(3,217)
<b>Net cash provided by operating activities</b>		<u>3,676</u>

**Cash flows from investing activities:**

Purchase of fixed assets		<u>(65)</u>
<b>Net cash used in investing activities</b>		<u>(65)</u>

**Cash flows from financing activities:**

		<u>-</u>
Net increase in cash		3,611
Cash at beginning of year		<u>21,610</u>

**CASH AT END OF YEAR** \$ 25,221

**Supplemental Disclosures of Cash Flow Information:**

Income tax refund received	\$	<u>5,021</u>
Interest paid	\$	<u>-</u>

See notes to financial statements and independent auditors' report.

# MCNALLY FINANCIAL SERVICES CORPORATION

## Notes to the Financial Statements

March 31, 2006

### **Note 1 - Nature of Business**

McNally Financial Services Corporation (Company) was incorporated in the State of Texas on April 11, 2002 and became a registered broker/dealer with the Securities and Exchange Commission (SEC) in September 2002 and is a member of the National Association of Security Dealers, Inc. (NASD). The Company operates under the provisions of Paragraph K(2)(ii) of Rule 15c3-3 of the SEC, and accordingly is exempt from the remaining provisions of that Rule. The Company's customers consist primarily of individuals located throughout the United States of America.

### **Note 2 - Significant Accounting Policies**

#### Basis of Accounting

These financial statements are presented on the accrual basis of accounting in accordance with generally accepted accounting principles whereby revenues are recognized in the period earned and expenses when incurred.

#### Cash equivalents

For purposes of the statements of cash flows, the Company considers short-term investments, which may be withdrawn at any time without penalty, and restricted cash, which will become available within one year from the date of the financial statements, to be cash equivalents.

#### 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.

#### Financial instruments and credit risk

Financial instruments that potentially subject the Company to credit risk include cash, receivables from clearing broker-dealers and securities owned. The Company's cash balances did not exceed federally insured limits of \$100,000 during the year. Receivables from clearing broker-dealers represent cash deposited and commissions receivable from these broker dealers and are insured by the Securities Investor Protection Corporation. Securities owned consist of investments in registered investment companies and are held for investment purposes. Securities that are marketable are stated at fair market value (as determined by quoted market prices) and securities not readily marketable are carried at fair value as determined by management of the Company. The increase or decrease in net unrealized appreciation or depreciation of securities is credited or charged to operations.

**MCNALLY FINANCIAL SERVICES CORPORATION**

**Notes to the Financial Statements**

March 31, 2006

**Note 2 - Significant Accounting Policies (Continued)**

Securities Transactions

Security transactions and the related commission revenues and expenses are recorded on a settlement date basis, generally the third business day following the transaction. If materially different, commission income and related expenses are recorded on a trade date basis.

Insurance Commissions

Insurance commissions are recorded when the insurance products are funded by the customer and the commission is earned.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. In addition, a valuation allowance is established to reduce any deferred tax asset in which the Company is not able to determine on a more likely than not basis that the deferred tax asset will be realized.

The Company is also subject to Texas Franchise tax at 4.5% of Federal taxable income.

**Note 3 - Net Capital Requirements**

The Company is subject to the SEC uniform net capital rule (Rule 15c3-1), which requires the maintenance of a minimum amount of net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1. Rule 15c3-1 also provides that equity capital may not be withdrawn or cash dividends paid if the resulting net capital ratio would exceed 10 to 1. At March 31, 2006, the Company had net capital and net capital requirements of \$89,214 and \$50,000, respectively. The Company's net capital ratio was .18 to 1 at March 31, 2006.

**MCNALLY FINANCIAL SERVICES CORPORATION**

**Notes to the Financial Statements**

March 31, 2006

**Note 4 - Income Taxes**

A reconciliation of the U.S. statutory income tax rate to the effective rate for the year ended March 31, 2006 is as follows:

Tax at Federal Statutory rate of 15%	\$	496
Other items		88
Income tax expense	\$	<u>584</u>

**Note 5 - Commitments and Contingencies**

Litigation

The Company is subject to various claims and legal actions arising in the ordinary course of business. At March 31, 2006, the Company was not involved in any litigation or active legal actions.

Clearing Agreement

Included in the Company's clearing agreement with its clearing broker-dealer, is an indemnification clause. This clause relates to instances where the Company's customers fail to settle security transactions. In the event this occurs, the Company will indemnify the clearing broker-dealer to the extent of the net loss on any unsettled trades. At March 31, 2006, management of the Company had not been notified by the clearing broker-dealer, nor were they otherwise aware, of any potential losses relating to this indemnification.

**Schedule I**  
**MCNALLY FINANCIAL SERVICES CORPORATION**  
**Computation of Net Capital and Aggregate Indebtedness**  
**Pursuant to Rule 15c3-1 of the Securities and Exchange Commission**  
**As of March 31, 2006**

Total stockholder's equity qualified for net capital	\$ 100,509
Deductions and/or charges	
Non-allowable assets:	
Fixed assets	437
Other assets	2,266
Total deductions and/or charges	<u>2,703</u>
Net capital before haircuts on securities	97,806
Haircuts on securities	<u>8,592</u>
Net capital	<u><u>\$ 89,214</u></u>
Aggregate indebtedness	
Accrued expense and other liabilities	\$ 14,456
Deferred tax liabilities	1,225
Franchise taxes payable	<u>256</u>
Total aggregate indebtedness	<u><u>\$ 15,937</u></u>
Computation of basic net capital requirement	
Minimum net capital required (greater of \$50,000 or 6 2/3% of aggregate indebtedness)	<u><u>\$ 50,000</u></u>
Net capital in excess of minimum requirement	<u><u>\$ 39,214</u></u>
Ratio of aggregate indebtedness to net capital	<u><u>0.18 to 1</u></u>
Reconciliation with company's computation (included in part II of Form X-17A-5 as of March 31, 2006)	
Net capital, as reported in Company's Part II (unaudited) FOCUS report	\$ 89,825
Audit adjustments	<u>(611)</u>
Net capital per above	<u><u>\$ 89,214</u></u>

See notes to financial statements and independent auditors' report.



Certified Public Accountants

**INDEPENDENT AUDITORS' REPORT**  
**ON INTERNAL CONTROL**

To the Stockholder of  
McNally Financial Services Corporation:

In planning and performing our audit of the financial statements and supplemental schedule of McNally Financial Services Corporation (the Company) for the year ended March 31, 2006, 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 preparation of financial statements in accordance with generally accepted accounting principles. Rule 17a-5(g) lists additional objectives of the practices and procedures listed in the preceding paragraph.

10

**Helin, Donovan, Trubee & Wilkinson, LLP**

5918 West Courtyard Drive Suite 400 Austin, TX 78730  
512.258.9670 phone 512.258.5895 fax 866.331.5336 toll free  
[www.helindonovan.com](http://www.helindonovan.com)





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 no matters involving internal control, including control activities 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 March 31, 2006 to meet the SEC's objectives.

This report is intended solely for use of the Managers, management, the SEC, the National Association of Securities Dealers, Inc. 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.

**Helin, Donovan, Trubee & Wilkinson, LLP**

*Helin, Donovan, Trubee + Wilkinson, LLP*

Austin, Texas  
May 19, 2006