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

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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 10/01/2004 AND ENDING 09/30/2005  
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER: First Southwest Company

OFFICIAL USE ONLY  
 FIRM ID. NO.

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

325 North St. Paul Street, Suite 800  
(No. and Street)

Dallas Texas  
(City) (State)

75201  
(Zip Code)

**PROCESSED**  
**SEP 22 2006**  
**THOMSON FINANCIAL**

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

David A. Commons (214) 953 - 4000  
(Area Code - Telephone No.)

B. ACCOUNTANT IDENTIFICATION

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

KPMG LLP

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

301 Commerce St., 2500 City Center Tower II, Ft. Worth, Texas 76102  
(Address) (City) (State) (Zip Code)

CHECK ONE:

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

SECURITIES AND EXCHANGE COMMISSION  
**RECEIVED**  
**JUL 28 2006**

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 BRANCH OF REGISTRATIONS AND EXAMINATIONS

\*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)

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 Mr



KPMG LLP  
2500 D R Horton Tower  
301 Commerce Street  
Fort Worth, TX 76102

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## INDEPENDENT AUDITORS' REPORT

The Board of Directors  
First Southwest Company:

We have audited the accompanying consolidated statements of financial condition of First Southwest Company (a wholly owned subsidiary of First Southwest Holdings, Inc.) and subsidiaries as of September 30, 2005 and 2004, and the related consolidated statements of income, changes in stockholder's equity, and cash flows for the years then ended, that you are filing pursuant to Rule 17a-5 under the Securities Exchange Act of 1934. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. 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 audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of First Southwest Company and subsidiaries as of September 30, 2005 and 2004, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The information contained in Schedules I, II and III is presented for purposes of additional analysis and is not a required part of the basic consolidated 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 audits of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

KPMG LLP

October 25, 2005

**FIRST SOUTHWEST COMPANY AND SUBSIDIARIES**

**Consolidated Statements of Financial Condition**

**September 30, 2005 and 2004**

	2005	2004
<b>Assets</b>		
Cash and cash equivalents	\$ 29,474,049	6,033,987
Cash and securities segregated for regulatory purposes	5,000,000	56,000,000
Receivable from brokers, dealers, and clearing organizations	136,042,641	299,315,164
Receivable from customers - secured	118,723,468	83,789,715
Securities:		
Marketable	32,453,478	29,342,759
Not readily marketable	42,612	24,604
Furniture, equipment, and leaseholds, net	3,611,335	3,620,414
Goodwill, net	3,527,657	3,527,657
Other assets and deferred charges, net	11,321,312	9,378,448
Deferred income taxes, net	912,049	1,075,685
	\$ 341,108,601	492,108,433
<b>Liabilities and Stockholder's Equity</b>		
<b>Liabilities:</b>		
Drafts payable	\$ 11,142,128	7,831,740
Notes payable	—	11,998,860
Payable to brokers, dealers, and clearing organizations	140,227,346	296,171,343
Payable to customers	82,521,678	90,718,536
Other liabilities and deferred credits	41,905,762	32,552,182
	275,796,914	439,272,661
<b>Commitments and contingent liabilities</b>		
<b>Stockholder's equity:</b>		
Common stock at \$.01 par value. Authorized, issued and outstanding 500 shares	5	5
Additional paid-in capital	26,376,238	25,712,034
Retained earnings	38,935,444	27,123,733
	65,311,687	52,835,772
<b>Total stockholder's equity</b>	<b>\$ 341,108,601</b>	<b>492,108,433</b>

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



**FIRST SOUTHWEST COMPANY AND SUBSIDIARIES**

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

September 30, 2005



KPMG LLP  
2500 D R Horton Tower  
301 Commerce Street  
Fort Worth, TX 76102

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

The Board of Directors  
First Southwest Company:

In planning and performing our audit of the consolidated financial statements of First Southwest Company (the Company) (a wholly owned subsidiary of First Southwest Holdings, Inc.) and subsidiaries, for the year ended September 30, 2005, 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 consolidated financial statements and not to provide assurance on the 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 compliance with such practices and procedures that we considered relevant to the objectives stated in rule 17a-5(g), in the following:

1. Making the periodic computations of aggregate indebtedness (or aggregate debits) and net capital under rule 17a-3(a)(11) and the reserve required by rule 15c3-3(e)
2. Making the quarterly securities examinations, counts, verifications and comparisons, and the 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
4. Obtaining and maintaining physical possession or control of all fully paid and excess margin securities of customers as required by rule 15c3-3

The management of the Company is responsible for establishing and maintaining an 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 conformity 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 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 September 30, 2005, 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, 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.

KPMG LLP

October 25, 2005