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

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| OMB APPROVAL | |
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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 July 1, 2006 (MM/DD/YY) AND ENDING June 30, 2007 (MM/DD/YY)

## A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER: Financial Security Management, Inc.

OFFICIAL USE ONLY
FIRM I.D. NO.

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

575 Lynnhaven Parkway Suite 310
(No. and Street)

Virginia Beach (City) VA (State) 23452 (Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT
Fern Vazquez 757-431-1414
(Area Code – Telephone Number)

## B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report*

Witt Mares, PLC
(Name – *if individual, state last, first, middle name*)

150 West Main Street Suite1150 (Address) Norfolk (City) VA (State) 23510 (Zip Code)

**CHECK ONE:**

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

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**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.**

# OATH OR AFFIRMATION

I, Reginald C. Corinaldi, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of Financial Security Management, Inc., as of June 30, 2007, 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:

FERN E. VAZQUEZ
MY COMMISSION EXPIRES
COMMONWEALTH OF VIRGINIA COMMISSION # 193308
10-31-2009
NOTARY PUBLIC

Fern E Vazquez

Notary Public

Signature

President

Title

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

- [x] (a) Facing Page.
- [x] (b) Statement of Financial Condition.
- [x] (c) Statement of Income (Loss).
- [ ] (d) Statement of Changes in Financial Condition.
- [x] (e) Statement of Changes in Stockholders' Equity or Partners' or Sole Proprietors' Capital.
- [ ] (f) Statement of Changes in Liabilities Subordinated to Claims of Creditors.
- [x] (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.
- [x] (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).*

# *Financial Security Management, Inc.*

***(a wholly owned subsidiary)***

FINANCIAL REPORT

JUNE 30, 2007

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WITT MARES

THE POWER TO MAKE A DIFFERENCE. THE PEOPLE TO MAKE IT COUNT.™

# INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Financial Security Management, Inc.
Virginia Beach, Virginia

We have audited the accompanying statement of financial condition of Financial Security Management, Inc. (a wholly owned subsidiary) as of June 30, 2007, and the related statements of income, changes in stockholders' 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 generally accepted auditing standards of 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 Financial Security Management, Inc., at June 30, 2007, 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.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The information contained in Schedules I, II, III, and IV 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.

Witt Mares, PLC

Norfolk, Virginia
August 10, 2007

# FINANCIAL STATEMENTS

# FINANCIAL SECURITY MANAGEMENT, INC.

Statement of Financial Condition

June 30, 2007

## ASSETS

| | | |
|---|---|---|
| Cash and cash equivalents | $ | 215,248 |
| Investments | | 22,256 |
| Commissions receivable | | 111,061 |
| Accounts receivable - related party | | 25,000 |
| Prepaid expenses | | 29,319 |
| Property and equipment, net | | 27,809 |
| Licensing costs, net | | 2,145 |
| Total assets | $ | 432,838 |

## LIABILITIES AND STOCKHOLDERS' EQUITY

| | | |
|---|---|---|
| **LIABILITIES** | | |
| Accrued expenses | $ | 298 |
| Commissions payable | | 73,848 |
| Deferred income taxes | | 15,246 |
| Total liabilities | | 89,392 |
| **STOCKHOLDERS' EQUITY** | | |
| Common stock - No par value, 5,000 shares authorized, 1,500 shares issued and outstanding | | 15,000 |
| Additional paid-in capital | | 91,667 |
| Retained earnings | | 236,779 |
| Total stockholders' equity | | 343,446 |
| Total liabilities and stockholders' equity | $ | 432,838 |

See accompanying notes.

# FINANCIAL SECURITY MANAGEMENT, INC.

Statement of Income

Year Ended June 30, 2007

| | |
|---|---|
| **COMMISSION INCOME** | $ 2,203,133 |
| **EXPENSES** | |
| Commissions | 1,540,071 |
| Management fees | 547,744 |
| Professional fees | 26,670 |
| Taxes and licenses | 29,122 |
| Office expense | 20,255 |
| Depreciation | 5,250 |
| Amortization | 446 |
| Education | 2,313 |
| Total expenses | 2,171,871 |
| Gross profit | 31,262 |
| **OTHER INCOME** | |
| Interest income | 10,595 |
| Unrealized gain on investments | 1,735 |
| Other income | 12,330 |
| Net income before income taxes | 43,592 |
| **PROVISION FOR INCOME TAXES** | 8,339 |
| **NET INCOME** | $ 35,253 |

See accompanying notes.

# FINANCIAL SECURITY MANAGEMENT, INC.

Statement of Changes in Stockholders' Equity

Year Ended June 30, 2007

| | Shares | Common Stock | Additional Paid-In Capital | Retained Earnings |
|---|---|---|---|---|
| Retained earnings, beginning of year | 1,501 | $ 15,000 | $ 91,667 | $ 201,526 |
| Net income | - | - | - | 35,253 |
| Retained earnings, end of year | 1,501 | $ 15,000 | $ 91,667 | $ 236,779 |

See accompanying notes.

# FINANCIAL SECURITY MANAGEMENT, INC.

Statement of Cash Flows

Year Ended June 30, 2007

| | |
|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | |
| Net income | $ 35,253 |
| Adjustments to reconcile net income to net cash provided by operating activities: | |
| Depreciation | 5,250 |
| Amortization | 446 |
| Changes in assets and liabilities: | |
| Deferred income taxes | 7,230 |
| Investments | (2,238) |
| Commissions receivable | (78,536) |
| Prepaid expenses | (215) |
| Accrued expenses | (9,658) |
| Commissions payable | 51,765 |
| Net cash provided by operating activities | 9,297 |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | |
| Purchase of computer software | (12,513) |
| Purchase of property and equipment | (4,222) |
| Net cash used in investing activities | (16,735) |
| Net decrease in cash and cash equivalents | (7,438) |
| **CASH AND CASH EQUIVALENTS** | |
| Beginning | 222,686 |
| Ending | $ 215,248 |
| **SUPPLEMENTAL CASH FLOW DISCLOSURES** | |
| Cash paid during the year for: | |
| Income taxes | $ 511 |

See accompanying notes.

## NOTE 1. NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

*Nature of Business*

Financial Security Management, Inc. (the "Company") is a limited broker/dealer dealing solely in mutual funds and variable annuities, and is located in the Commonwealth of Virginia. It is a wholly owned subsidiary of Financial Security Companies, LLC. (FSC)

*Use of Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

*Cash and Cash Equivalents*

For purposes of the statement of cash flows, all highly liquid investments purchased with maturities of three months or less are considered to be cash equivalents.

*Property and Equipment*

Property and equipment are stated at cost less accumulated depreciation and are depreciated over their estimated useful lives using the straight-line method for financial reporting purposes.

*Affiliates and Ownership*

On August 18, 2003, the Company's stockholders formed Financial Security Companies, LLC, a Virginia limited liability company. FSC wholly owns Financial Security Management, Inc., and also wholly owns Financial Security Group, Inc. (FSG) and Financial Security Advisory, Inc. (FSA). The Company's former stockholders are now stockholders of FSC. These financial statements do not include accounts and transactions of these affiliates.

*Recognition of Revenue and Expenses*

The Company reports its commission income and expense on a settlement date basis.

*Licensing Costs*

Licensing costs are amortized over fifteen years using the straight-line method.

(Continued)

## NOTE 1. NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Concluded)

***Investments***

The Company's investments consist of trading securities that are primarily money market mutual funds. Securities that are held for short-term resale are classified as trading account securities and recorded at their fair market values based on stock market quotes. Realized and unrealized gains and losses on trading account securities are included in other income.

***Intangibles***

Intangibles are amortized over three years using the straight-line method.

***Income Taxes***

The Company uses the liability method of accounting for income taxes. Accordingly, deferred tax assets and liabilities are determined based on the difference between the basis of assets and liabilities for financial statement and income tax purposes, using enacted tax rates in effect for the year in which the differences are expected to reverse. Differences relate to the use of accrual basis accounting for financial statement purposes and cash basis accounting for income tax purposes. The deferred tax assets and liabilities represent the future tax consequences of those differences which will either be taxable or deductible when the assets and liabilities are recovered or settled. Income tax expense is the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

## NOTE 2. INCOME TAXES

Income taxes are reconciled to the Company's actual income tax expense as follows:

| | | |
|---|---|---|
| Current: | | |
| Federal | $ | 770 |
| State | | 339 |
| Deferred: | | |
| Federal | | 5,071 |
| State | | 2,159 |
| Provision for income taxes | $ | 8,339 |

(Continued)

**NOTE 2. INCOME TAXES** (Concluded)

The Company's total deferred tax assets and deferred tax liabilities are as follows:

| | |
|---|---|
| Total deferred tax assets | $ - |
| Less Valuation Allowance | - |
| | - |
| Total deferred tax liabilities | (15,246) |
| Net deferred tax asset (liability) | $ (15,246) |

These amounts have been presented in the Company's financial statements as follows:

| | |
|---|---|
| Deferred income taxes, current | $ (12,570) |
| Deferred income taxes, noncurrent | (2,676) |
| Net deferred tax asset (liability) | $ (15,246) |

**NOTE 3. PROPERTY AND EQUIPMENT**

Property and equipment as of June 30, 2007 consists of the following:

| | |
|---|---|
| Computer equipment | $ 26,993 |
| Computer software | 19,308 |
| Less: accumulated depreciation | 18,492 |
| Net property | $ 27,809 |

**NOTE 4. LIABILTIES SUBORDINATED TO CLAIMS OF GENERAL CREDITORS**

The Company has no subordination agreements.

**NOTE 5. RELATED PARTY TRANSACTIONS**

FSG provides office space, supplies and administrative support to the Company. The Company paid total discretionary fees of $547,744 to FSG for the year ended June 30, 2007. As of June 30, 2007, FSG owed the Company $25,000, which constituted an intercompany loan.

An immediate family member of a Company principal is developing internal software for the entity. For the fiscal year ended June 30, 2007, the Company paid $13,813 to the family member. No outstanding balances were due at year-end.

## NOTE 6. NET CAPITAL REQUIREMENTS

The Company is subject to the Securities and Exchange Commission Uniform Net Capital Rule (rule 15c3-1), which requires 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. The rule of the "applicable" exchange 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 June 30, 2007, the Company had net capital of $270,899, which was $265,899 in excess of its required net capital of $5,000. The Company's net capital ratio was .27 to 1 at June 30, 2007.

## NOTE 7. CONCENTRATIONS

Financial Security Management, Inc. maintains its bank accounts in one financial institution located in Virginia Beach, Virginia. The balance in those accounts is insured by the Federal Deposit Insurance Corporation up to $100,000. The uninsured cash balances totaled $147,688 as of June 30, 2007.

SUPPLEMENTARY INFORMATION
PURSUANT TO RULE 17a-5 OF THE
SECURITIES AND EXCHANGE ACT OF 1934

**FINANCIAL SECURITY MANAGEMENT, INC.**

Schedule I

Computation of Net Capital Under Rule 15c3-1

of the Securities and Exchange Commission

June 30, 2007

| | | |
|---|---|---|
| **NET CAPITAL** | | |
| Stockholders' equity | $ | 343,446 |
| Deferred income taxes | | 15,246 |
| Total capital and allowable subordinated liabilities | | 358,692 |
| | | |
| Deduct non-allowable assets: | | |
| Accounts receivable - related party | | 25,000 |
| Prepaid expenses and other assets | | 57,128 |
| Licensing costs, net | | 2,145 |
| Haircuts on security positions | | 3,520 |
| | | 87,793 |
| Net capital | $ | 270,899 |
| | | |
| **AGGREGATE INDEBTEDNESS** | | |
| Items included in statement of financial condition: | | |
| Commissions payable | $ | 73,848 |
| Total aggregate indebtedness | $ | 73,848 |
| | | |
| **COMPUTATION OF BASIC NET CAPITAL REQUIREMENT** | | |
| Minimum net capital required | $ | 5,000 |
| Excess net capital | $ | 265,899 |
| Ratio: Aggregate indebtedness to net capital | | .27 to 1 |
| | | |
| **RECONCILIATION WITH COMPANY'S COMPUTATION** | | |
| Net capital, as reported in Company's Part II (unaudited) FOCUS report as of June 30, 2007 | $ | 259,418 |
| Allowable credits - deferred income taxes | | 15,246 |
| Audit adjustments to the following accounts: | | |
| Accounts payable, accrued liabilities, expenses and other | | (3,765) |
| Net capital per above | $ | 270,899 |

# FINANCIAL SECURITY MANAGEMENT, INC.

Schedule II

Computation for Determination of Reserve Requirements

Under Rule 15c3-3 of the Securities and Exchange Commission

June 30, 2007

Financial Security Management, Inc. is a limited broker dealer, exclusively dealing in the purchase, sale, and redemption of mutual funds and variable annuities. All funds received in the connection with the activity of the firm are promptly transmitted, and are not held in the custody of the firm.

All of the transactions of the Company are in accordance with the provisions of exemption K(1) under SEC Rule 15c3-3. The Company was in compliance with this exemption.

**FINANCIAL SECURITY MANAGEMENT, INC.**

Schedule III

Information Relating to Possession or Control Requirements

Under Rule 15c3-3 of the Securities and Exchange Commission

June 30, 2007

Financial Security Management, Inc. is a limited broker dealer, exclusively dealing in the purchase, sale, and redemption of mutual funds and variable annuities. All funds received in the connection with the activity of the firm are promptly transmitted, and are not held in the custody of the firm.

All of the transactions of the Company are in accordance with the provisions of exemption K(1) under SEC Rule 15c3-3. The Company was in compliance with this exemption.

**FINANCIAL SECURITY MANAGEMENT, INC.**

Schedule IV

Schedule of Segregation Requirements and Funds in Segregation for Customers' Regulated Commodity Futures and Options Accounts

June 30, 2007

Financial Security Management, Inc. is a limited broker dealer, exclusively dealing in the purchase, sale, and redemption of mutual funds and variable annuities. All funds received in the connection with the activity of the firm are promptly transmitted, and are not held in the custody of the firm.

All of the transactions of the Company are in accordance with the provisions of exemption K(1) under SEC Rule 15c3-3. The Company was in compliance with this exemption.

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# INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL REQUIRED BY SEC RULE 17a-5 FOR A BROKER-DEALER CLAIIMING EXEMPTION FROM SEC RULE 15c3-3

To the Board of Directors
Financial Security Management, Inc.
Virginia Beach, Virginia

In planning and performing our audit of the financial statements and supplemental schedules of Financial Security Management, Inc. (the Company), as of and for the year ended June 30, 2007, in accordance with auditing standards generally accepted in the United States of America, we considered the Company's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's 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 consideration of control activities for safeguarding securities. This study included tests of such practices and procedures that we considered relevant to the objectives stated in rule 17a-5(g) in making the periodic computations of aggregate indebtedness (or aggregate debits) and net capital under rule 17a-3(a)(11) and for determining compliance with the exemptive provision 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. 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 generally accepted accounting principles. Rule 17a-5(g) lists additional objectives of the practices and procedures listed in the preceding paragraph.

Because of inherent limitations in 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.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control was for the limited purpose described in the first and second paragraphs and would not necessarily identify all deficiencies in internal control that might be material weaknesses. We did not identify any deficiencies in internal control and 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 June 30, 2007, to meet the SEC's objectives.

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

Witt Mares, PLC

Norfolk, Virginia
August 10, 2007

END