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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 01/01/2008 AND ENDING 12/31/2008  
MM/DD/YY MM/DD/YY

**A. REGISTRANT IDENTIFICATION**

NAME OF BROKER-DEALER:

Potomac Capital Markets, LLC

OFFICIAL USE ONLY
FIRM ID. NO.

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

5 South Market Street, 4th Floor

(No. and Street)

Frederick

Maryland

21701

(City)

(State)

(Zip Code)

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

Christopher A. Weir

(301) 695-9229

(Area Code -- Telephone No.)

**B. ACCOUNTANT IDENTIFICATION**

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

Rothstein, Kass & Company, P.C.

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

4 Becker Farm Road

Roseland

NJ

SEC

07068

(Address)

(City)

(State)

Mail Processing  
Section

(Zip Code)

CHECK ONE:

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

FEB 26 2009

Washington, DC

101

FOR OFFICIAL USE ONLY

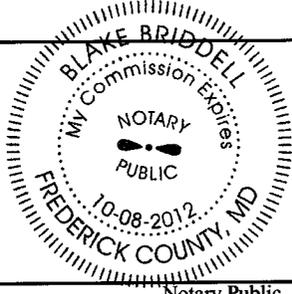
\*Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See section 240.17a-5(e)(2).

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, Christopher A. Weir, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of Potomac Capital Markets, LLC, as of December 31, 2008, 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:



Blake Briddell
2/24/09

[Handwritten Signature]

Signature

VICE PRESIDENT

Title

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.
(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 internal accounting control.
(p) Schedule of segregation requirements and funds in segregation--customers' regulated commodity futures account pursuant to Rule 171-5.

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

**POTOMAC CAPITAL MARKETS, LLC**  
**STATEMENT OF FINANCIAL CONDITION**  
**AND**  
**INDEPENDENT AUDITORS' REPORT**  
**DECEMBER 31, 2008**

**SEC**  
**Mail Processing**  
**Section**

**FEB 26 2009**

**Washington, DC**  
**101**

# POTOMAC CAPITAL MARKETS, LLC

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Certified  
Public  
Accountants

Rothstein, Kass & Company, P.C.  
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Beverly Hills  
Dallas  
Denver  
Grand Cayman  
Irvine  
New York  
Roseland  
San Francisco  
Walnut Creek

# Rothstein Kass

## INDEPENDENT AUDITORS' REPORT

To the Members of  
Potomac Capital Markets, LLC

We have audited the accompanying statement of financial condition of Potomac Capital Markets, LLC. (the "Company") as of December 31, 2008. This statement of financial condition is the responsibility of the Company's management. Our responsibility is to express an opinion on this statement of financial condition 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 statement of financial condition is 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 purposes of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall statement of financial condition presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the statement of financial condition referred to above presents fairly, in all material respects, the financial position of Potomac Capital Markets, LLC as of December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

*Rothstein, Kass & Company, P.C.*

Roseland, New Jersey  
February 24, 2009

# POTOMAC CAPITAL MARKETS, LLC

## STATEMENT OF FINANCIAL CONDITION

December 31, 2008

### ASSETS

Cash	\$	25,012
Due from parent		175,000
Investment, at fair value		<u>7,413</u>
	\$	<u>207,425</u>

### LIABILITIES AND MEMBERS' EQUITY

Accounts payable and accrued expenses	\$	965
Members' equity		<u>206,460</u>
	\$	<u>207,425</u>

# POTOMAC CAPITAL MARKETS, LLC

## NOTES TO FINANCIAL STATEMENTS

### 1. Nature of business and summary of significant accounting policies

#### *Nature of Business*

Potomac Capital Markets, LLC (the "Company") is a Maryland Limited Liability Company ("LLC") organized and registered as a minimum net capital broker-dealer. The Company is a member of the Securities and Exchange Commission ("SEC") and is a member of the Financial Industry Regulatory Authority ("FINRA"). The business activities of the Company as prescribed in the membership agreement are limited to private placements of securities.

As a minimum net capital broker-dealer, the Company does not hold customer securities or cash balances.

#### *Fees Receivable and Fees Revenue*

The Company carries its fees receivable at cost less an allowance for doubtful accounts. On a periodic basis, the Company evaluates its fees receivable and establishes an allowance for doubtful accounts, based on a history of past write-offs and collections and current credit conditions.

Fee revenues are recorded in accordance with the terms of individual agreements and, where applicable, recognized on a pro rata basis over those terms.

#### *Valuation of Investments in Securities and Securities at Fair Value - Definition and Hierarchy*

The Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements" ("SFAS No. 157"), effective January 1, 2008. Under SFAS No. 157, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the "exit price") in an orderly transaction between market participants at the measurement date.

In determining fair value, the Company uses various valuation approaches. SFAS No. 157 establishes a fair value hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are those that market participants would use in pricing the asset or liability based on market data obtained from sources independent of the Company. Unobservable inputs reflect the Company's assumptions about the inputs market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The fair value hierarchy is categorized into three levels based on the inputs as follows:

*Level 1* - Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Valuation adjustments and block discounts are not applied to Level 1 securities. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these securities does not entail a significant degree of judgment.

*Level 2* - Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

*Level 3* - Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

# POTOMAC CAPITAL MARKETS, LLC

## NOTES TO FINANCIAL STATEMENTS

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### 1. Nature of business and summary of significant accounting policies (continued)

#### *Valuation Techniques*

The Company values investments in securities and securities sold short that are freely tradable and are listed on a national securities exchange or reported on the NASDAQ national market at their last sales price as of the last business day of the year.

The Company values its investment, which is listed on a national securities exchange, at the last sales price for the year. Realized and unrealized gains and (losses) on investments of approximately (\$7,000) are included in the statement of operations.

#### *Income Taxes*

The Company has elected to be treated as a limited liability company under the applicable provisions of income tax laws. The Company is a limited liability company and, accordingly, no income taxes are incurred by the Company as all earnings and losses flow directly to the members.

The Company has adopted Financial Accounting Standards Board ("FASB") Staff Position ("FSP") No. FIN 48-3, which allows certain nonpublic entities to defer the effective date of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), until the annual financial statements for fiscal years beginning after December 15, 2008. The Company has elected to apply the deferral and will adopt the provisions of FIN 48 effective January 1, 2009. The Company's accounting policy for evaluating uncertain tax positions during financial statement periods subject to the deferral of FIN 48 is based on the recognition and disclosure criteria for loss contingencies under SFAS No. 5, "Accounting for Contingencies".

#### *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 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.

### 2. Net capital requirement

The Company is a member of the FINRA and is subject to the SEC Uniform Net Capital Rule 15c3-1. This Rule requires the maintenance of minimum net capital and that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1, and that equity capital may not be withdrawn or cash dividends paid if the resulting net capital ratio would exceed 10 to 1. At December 31, 2008, the Company's net capital was approximately \$30,000, which was approximately \$25,000 in excess of its minimum requirement of \$5,000.

### 3. Exemption from Rule 15c3-3

The Company is exempt from the SEC Rule 15c3-3 pursuant to the exemptive provision under sub-paragraph (k)(2)(i) and, therefore, is not required to maintain a "Special Reserve Bank Account for the Exclusive Benefit of Customers".

# POTOMAC CAPITAL MARKETS, LLC

## NOTES TO FINANCIAL STATEMENTS

### 4. Fair value measurements

The Company's assets and liabilities recorded at fair value have been categorized based upon a fair value hierarchy in accordance with SFAS No. 157. See Note 1 for a discussion of the Company's policies.

The following table presents information about the Company's assets measured at fair value as of December 31, 2008:

	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>	<u>Balance as of December 31, 2008</u>
<b>Assets</b>				
Securities owned, at fair value	\$ 7,413	\$ -	\$ -	\$ 7,413
	<u>\$ 7,413</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 7,413</u>

### 5. Related party transactions and commitments

#### *Service Agreement*

The Company is 99% owned by Potomac Investment Services, Inc., ("PIS") a Maryland C-type corporation. PIS provided employee, office space, communication systems, and administrative services in the amount of \$1,793,200 for the year ended December 31, 2008. There are no individuals which are employed directly by the Company. These services were provided under an Administration Services Agreement that provides for minimum charges for basic services and additional charges when additional services are provided; the agreement has a term of five years from March 2003 is renewable annually, and is cancelable with 30 days notice by either party at the end of the initial term.

#### *Due from Parent*

Amounts due from parent represent non-interest bearing advances from the Company to PIS which have no specific repayment terms or due dates. These amounts may be used to offset future expenses incurred under the Administration Services Agreement.

### 6. Concentrations of credit risk

The Company maintains its cash balances in various financial institutions, which at times, may exceed federally insured limits (\$250,000 at December 31, 2008). The Company has not experienced any losses in such accounts and believes it is not subject to any significant credit risk on cash.

# POTOMAC CAPITAL MARKETS, LLC

## NOTES TO FINANCIAL STATEMENTS

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### 7. Concentration of revenue

Fees earned from two customers accounted for approximately 73% of total fees in 2008. At December 31, 2008, there was no receivable balance due from any of these customers.